SUMMER 2024 MARKET OUTLOOK

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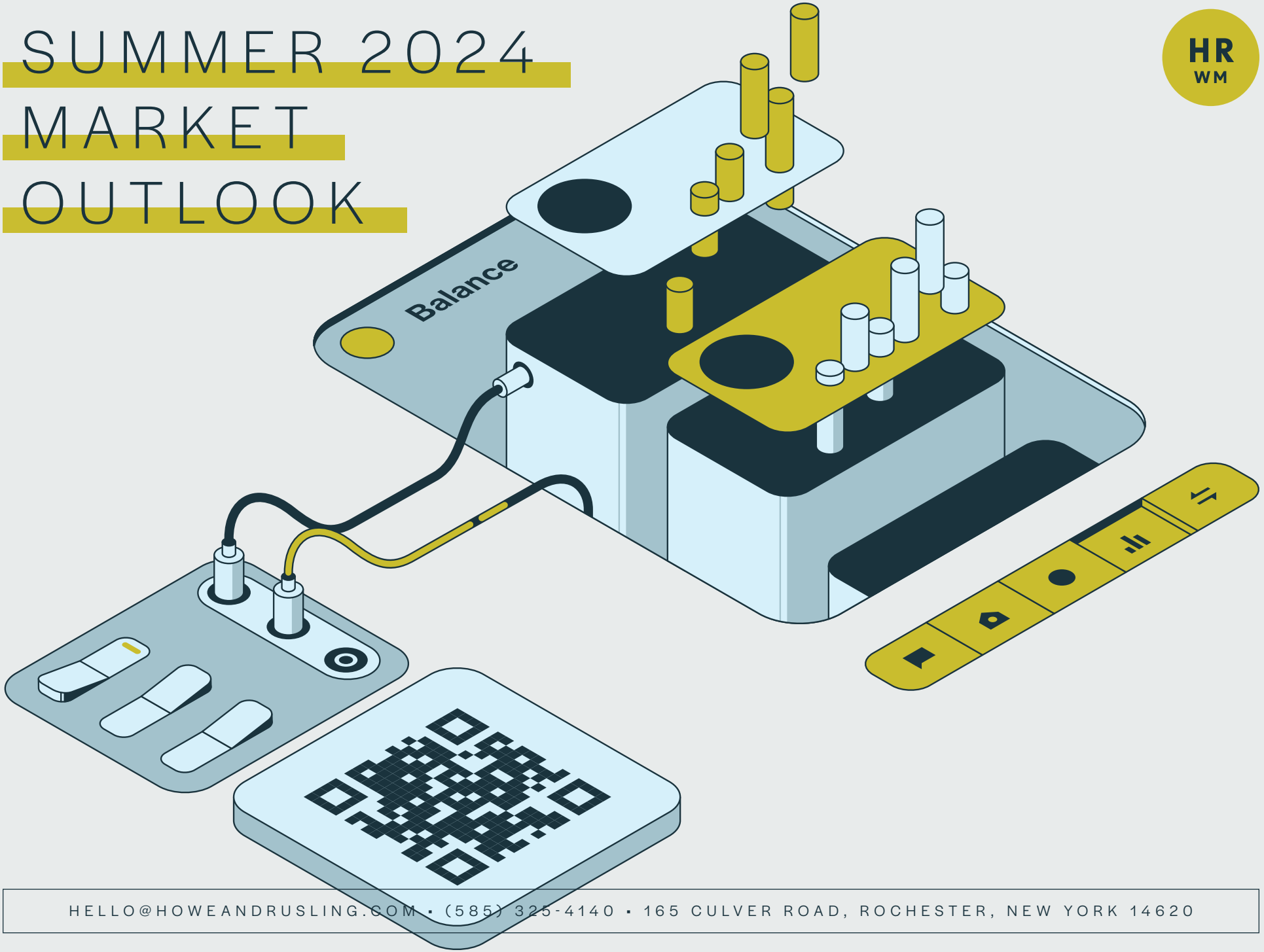

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On Our Minds

In our 2024 outlook that we distributed in January, we wrote about what we thought would be the most important factors that would impact investments in 2024, including:

(1) Will inflation continue to fall as expected towards the Fed's 2% target?

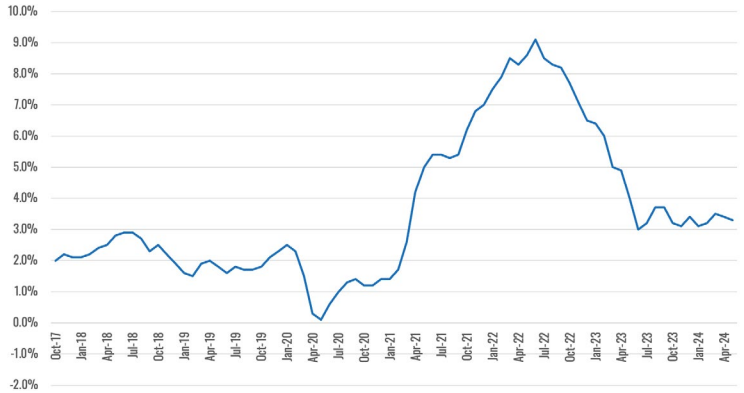
(2) Will there be a recession?

At the halfway point of 2024, we update our inflation and economic outlook based on new information and assumptions.

INFLATION DATA

Inflation was considerably higher than expected during the first quarter of 2024. Although inflation decelerated sequentially in April and May, the worse-than-expected inflation data in the first quarter has kept the year-over-year rate of inflation above 3%, with little downward progress since last June. Consequently, the Federal Reserve changed its communication during Q2 2024, indicating that inflation has not declined as they expected and that they would need to see several months of better inflation data to give them confidence to begin an interest rate easing cycle.

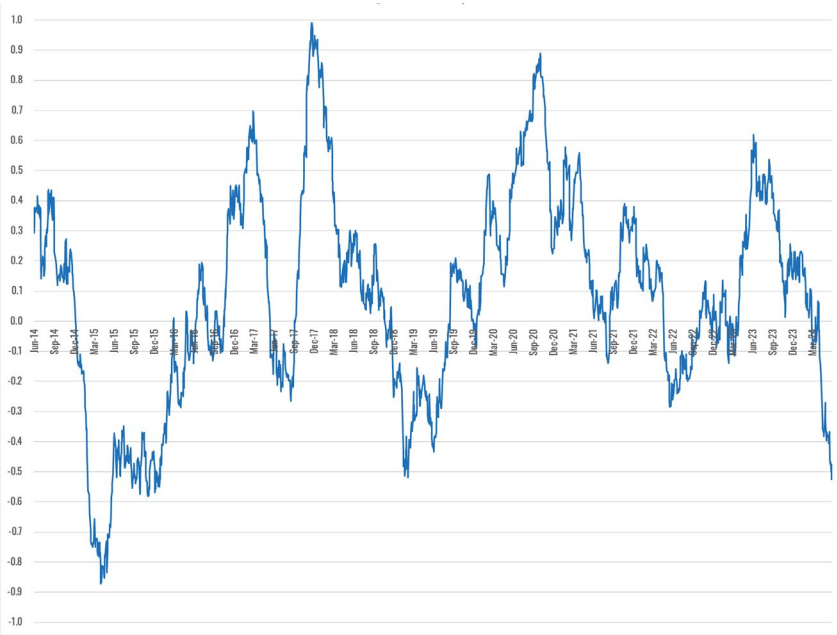
CPI YEAR OVER YEAR CHANGE



Source: U.S. Bureau of Labor Statistics, Bloomberg

The economy continued to grow in the first half of 2024 but reported GDP growth decelerated to less than 2% in Q1 and recently, most economic data has surprised negatively. The Bloomberg Economic Surprise Index graphed below shows the magnitude of the surprise of the trailing six months of economic data releases compared to economists' aggregate forecast. The data are normalized such that the maximum positive reading is +1 and the maximum negative reading is -1.

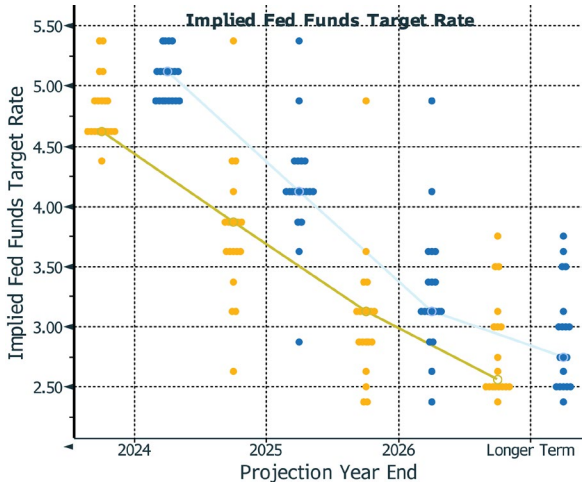
BLOOMBERG ECONOMIC SURPRISE INDEX



Source: Bloomberg

In our opinion, recent data indicate that economic conditions are weakening. We believe data on inflation during the summer months will be very important for equities. Recent communication from the Federal Reserve makes it clear that they want to see several consecutive months of slowing inflation data before beginning an interest rate easing cycle. A higher-than-expected inflation report during the summer could jeopardize investors' current expectation for a Fed rate cut in September based on better inflation data. A scenario in which economic data continues to weaken along with higher-than-expected inflation reports would likely reintroduce concerns about a recession, and the Fed would have a very difficult decision to make. Our current assumption is that inflation data will show improvement this summer, allowing the Fed to cut rates this fall. However, considering this is clearly a consensus opinion, the downside in equities would likely be material if inflation runs hot and consensus is wrong. As a result, our equity portfolios are positioned in high quality companies, and we are underweighting most highly cyclical sectors.

MARCH AND JUNE 2024 DOT PLOTS FOMC PARTICIPANTS' YEAR-END FORECASTS



Note: Each dot represents one FOMC member's forecast.
Blue dots – June 2024 & Orange dots– March 2024. Source: Bloomberg

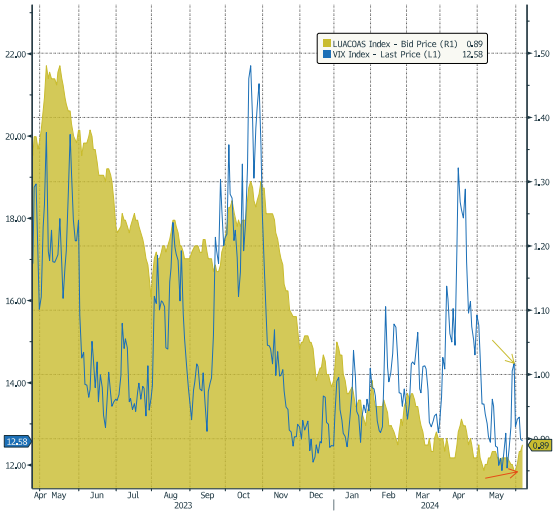
The Federal Reserve has maintained the fed funds target rate at 5.25%-5.50% since last July. While higher-than-expected inflation was observed in the first quarter, cooler-than-expected data in April and May have revived hopes for a potential rate cut in September.

Despite inflationary pressures, the labor market and economic activity have remained robust in the first half of 2024. FOMC officials also provide a dot for the longer run, which represents the so-called "neutral rate of interest," or the point where rates are neither stimulating nor restricting economic growth. This strength has led some economists and FOMC officials to reconsider whether the neutral rate might be higher than previously anticipated. Inflation is cooling partly due to consumer resistance to rapid price increases.

The June dot plot projections were higher than those in March, with the median end-2024 projection rising from 5.125% to 5.375% following the inflation spike in the first quarter. However, with cooler inflation readings in April and May, there is cautious optimism. If progress toward the 2% inflation target continues, many FOMC officials believe that easing may be appropriate by the end of the year.

CREDIT MARKET OUTLOOK

INVESTMENT GRADE CREDIT SPREADS AND VIX INDEX



Source: Bloomberg, as of 07/06/2024

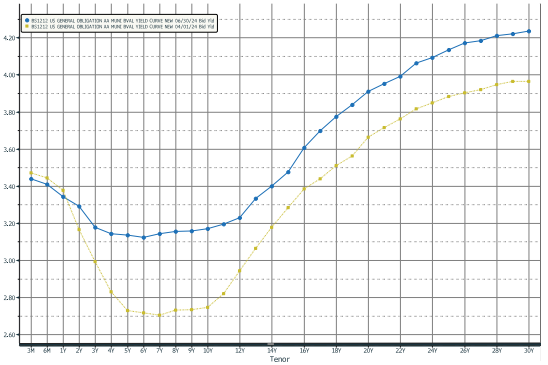
Following a record-breaking first quarter in 2023, the investment grade corporate bond market witnessed the second highest volume of new debt issuance in the first half of a year, with $867 billion issued, trailing only the $1 trillion issued during the Covid-era in 2020.

Credit spreads remain at very low levels, indicating that investors are demanding a relatively low risk premium for high-grade companies seeking capital.

Despite rising market volatility, as indicated by the VIX, credit spreads did not widen significantly, diverging from their typical historical relationship, and indicating investor confidence in high-grade companies despite broader market uncertainties.

MUNI MARKET OUTLOOK

MUNI YIELD CURVE



Source: Bloomberg, as of 07/02/2024

Yields in the municipal bond market increased in the second quarter of 2024 amid strong new issuance.

Each month in the first half of 2024 saw higher-than-average new issuance volumes, with June experiencing the strongest demand as redemptions (maturities and coupon payments) surged.

The yield curve flattened, with intermediate maturities experiencing the most significant increases.

We continue to find nominal yields and taxable equivalent yields appealing, and the ratios to Treasury yields are becoming increasingly attractive.

EQUITIES

COMPOSITION OF YTD 2024 STOCK RETURNS:

MOMENTUM LEADERSHIP CONTINUES, CYCLICALS DETERIORATE IN Q2

2023 equity returns were disproportionately driven by a small number of the biggest technology companies due to excitement about artificial intelligence technology. Year-to-date through Q2, AI excitement continues to feature prominently, and the strongest returns have generally been in large cap technology stocks and other perceived artificial intelligence beneficiaries.

As economic data began to surprise more negatively in Q2 2024, the performance of cyclical sectors such as materials, energy, industrials and financials deteriorated.

SECTOR	1H 2024 RETURN	Q2 2024 RETURN	Q1 2024 RETURN
Technology	28.2%	13.8%	12.7%
Communications Services	26.7%	9.4%	15.8%
Energy	10.9%	-2.4%	13.7%
Financials	10.2%	-2.0%	12.4%
Utilities	9.4%	4.7%	4.6%
Consumer Staples	9.0%	1.4%	7.5%
Health Care	7.8%	-1.0%	8.9%
Industrials	7.8%	-2.9%	11.0%
Consumer Discretionary	5.7%	0.6%	5.0%
Material	4.0%	-4.5%	8.9%
Real Estate	-2.4%	-1.9%	-0.5%

Source: S&P, Bloomberg

Growth stocks continued to outperform value stocks, largely due to excitement about artificial intelligence.

STYLE	1H 2024 RETURN	Q2 2024 RETURN	Q1 2024 RETURN
Growth	20.7%	8.3%	11.4%
Value	6.6%	-2.2%	9.0%

Source: Russell, Bloomberg

Large cap stocks continued to outperform small cap stocks, largely due to excitement about artificial intelligence that predominantly benefits large cap technology stocks.

SIZE	1H 2024 RETURN	Q2 2024 RETURN	Q1 2024 RETURN
Large Cap	16.4%	5.2%	10.6%
Small Cap	2.0%	-3.5%	5.7%

Source: MSCI, Bloomberg

The returns referenced are total returns, including gross dividends, and do not account for any fees, taxes, or other expenses that may impact investor results.

EQUITY VALUATION

The valuation of the S&P 500 increased further and has seldom been higher in history. High valuations on several mega cap technology and communications companies have driven the valuation of the broad stock indexes up, but the valuation of equally weighted equity benchmarks is also high compared to history.

S&P 500 12 MONTHS FORWARD PE MULTIPLE

Source: Bloomberg

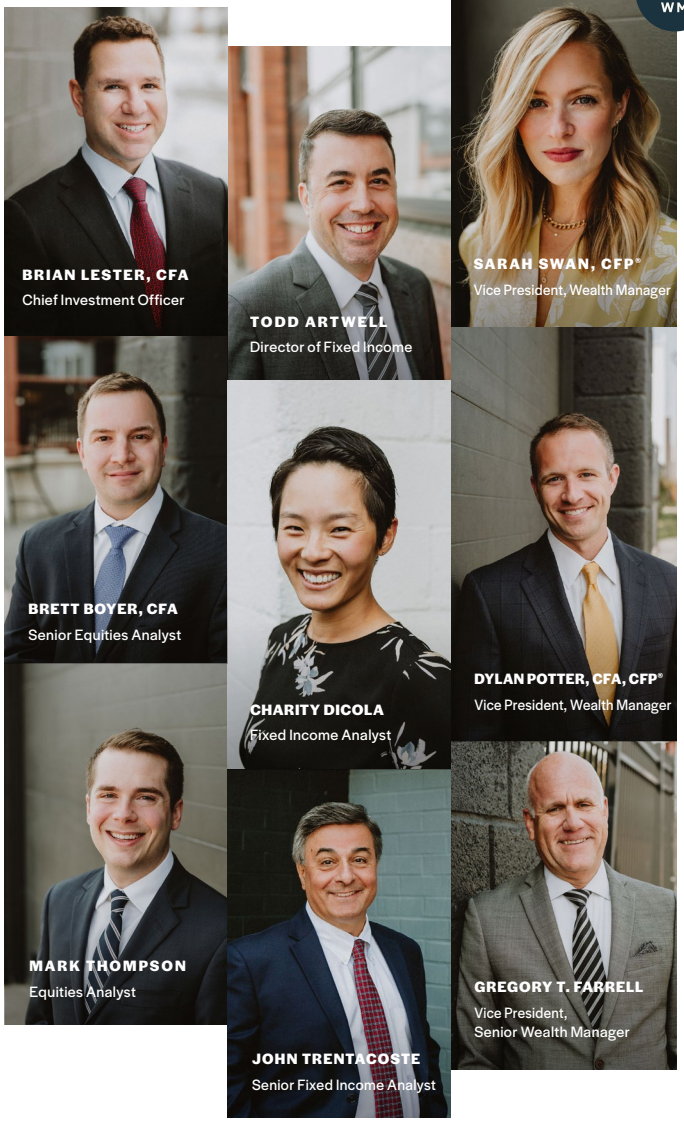
Our Outlook

We expect the Federal Reserve to hold interest rates at the current level through this summer and we believe they will only cut if we get several months of data that shows inflation is falling, or if the economic outlook weakens materially. At the start of the year, investors had become convinced that the Fed would not be forced to make a difficult trade-off decision between inflation and growth. Higher-than-expected inflation data during Q1 and weaker than expected economic data to close out Q2 has created a more challenging environment for the Federal Reserve. Excitement about Artificial Intelligence has continued to propel gains in the very largest technology companies and those stocks accounted for nearly all the Q2 gains in the S&P 500 index, which is weighted based on the market value of companies. The equally weighted S&P 500 index declined 3% during Q2.

The valuation of broad stock market indexes, such as the S&P 500, are very high compared to history as the consensus opinion is the next Fed move will be a cut, economic conditions won't deteriorate significantly further, and geopolitical risks won't worsen. With this backdrop, we are investing in companies that we believe are high quality, we have reduced our weighting in some highly cyclical companies, and we remain disciplined on valuations.

The fixed income market is poised to navigate a complex landscape influenced by evolving economic conditions and monetary policies. Inflationary pressures have shown signs of moderating, leading to expectations of a more measured approach from central banks regarding interest rate adjustments. This environment may provide some stability to bond prices, especially in high-quality segments. Investment-grade corporate bonds and municipals are likely to remain attractive due to their relative safety and favorable yield spreads. We anticipate continued opportunities in these areas, particularly as investors seek refuge from potential market volatility. We will maintain a diversified approach, emphasizing quality and liquidity, while closely monitoring macroeconomic indicators and policy shifts. We plan to stay agile and adaptive with the goal of trying to capitalize on favorable market conditions and manage risks effectively.

Due to the stock market's relative outperformance compared to the bond market year-to-date, the allocation of equities versus bonds is now close to neutral in most Howe & Rusling portfolios. We are vigilantly monitoring inflation and economic data and will adjust allocations as we deem necessary.



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QUESTIONS? LET'S CHAT

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