Economic Overview

Steve Scranton, CFA, SVP, Economist

Although we will not have full data on 2nd quarter economic growth until the end of July, the data through May shows an economy that is still growing. Although 1st quarter growth slowed from the 4th quarter pace, growth in the 2nd quarter appears to have recovered slightly from the 1st quarter.

- The New York Federal Reserve's real-time model (Nowcast) is currently estimating the economy increased from 1.4% in the 1st quarter to 1.9% in the 2nd quarter.
- The Atlanta Federal Reserve's real-time model (GDPNow) is currently estimating 2nd quarter GDP growth of 1.7%.
- The median forecast from economists surveyed by Bloomberg is currently at 2.1%.

Jobs creation continues to be a major source of strength for the economy. The nation added another 272,000 jobs in May. The nation has averaged 248,000 jobs per month this year.

- As I have said in the past, jobs create income which supports spending. Based on the personal income data from the Bureau of Economic Analysis, the nation added $177.1 billion in new income from the end of March to the end of May. When factoring out inflation and taxes, real disposable personal income rose $145.9 billion. That income growth supported spending in the quarter.

Unfortunately, even though income grew, borrowing continued to grow as well. The outstanding balance on credit cards and other revolving plans continues to hit record levels. Total balances grew $4.4 billion from the end of March to the end of May and are $71.6 billion higher from a year ago.

From a business spending perspective, two industries continued to benefit from stimulus bills passed over the past three years. Construction and manufacturing continue to receive funds from the CHIPS, IRA and Infrastructure acts as projects related to those funds are multi-year projects.

- Strength in the construction sector was seen for communication, power, sewage & disposal, and manufacturing. Manufacturing strength was centered around technology (chips facilities and server farms) and "green" facilities (electric vehicle batteries and parts).

Overall, businesses continue to invest in technology to improve productivity, as labor shortages and rising costs for employees have motivated businesses to focus on alternative solutions.

This economy continues to show characteristics of an economy experiencing a rolling recession versus a traditional recession. The net result is positive overall growth with weakness in specific industries.

- The residential housing market experienced its own micro recession in 2022 due to the rapid increases in mortgage rates and lack of inventory.
- Most of the manufacturing sector — except for those listed above — experienced their own micro recession in 2023 as almost all the manufacturing activity indices contracted through the year.
- At this point in 2024, the commercial real estate sector appears to be the sector experiencing its own micro recession.

Although the economy did not experience homogeneous growth, it continued to grow in the 2nd quarter. The Economic Outlook section of this newsletter discusses what to consider for the rest of the year.

Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

Markets remain beholden to economic data and central banks with respect to interest rates. Overall, this was another mostly positive quarter but not without some volatility. Equities continued to trend higher, although heavily influenced by a small number of stocks. Bonds, however, have provided varied results depending on the length of maturity.

Resilient US economic data has seemingly delayed the Federal Reserve from cutting interest rates in the near term. April experienced a marked shift in rate expectations as yields increased, which weighed on equities in the month. Change in comments and tone from Federal Reserve members eased some concerns, and equities continued their path higher in May and June while yields ended essentially unchanged.

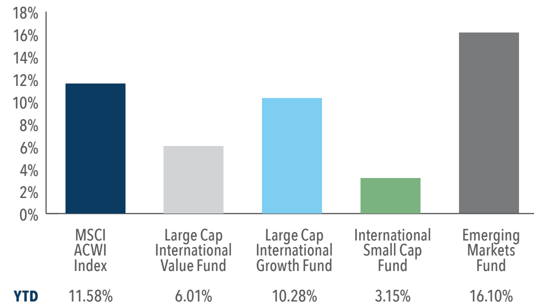
US large cap stocks finished higher in the quarter, remaining dominant over mid and small cap companies, which both suffered declines. A strong US dollar has dampened developed international equity returns. Developed international equities gained but underperformed US equities. Emerging markets led all equities in the quarter, helped by even stronger returns out of China and India.

There continued to be some volatility within fixed income markets during the quarter as expectations shifted with each new economic data reading and where Fed comments took them. Returns varied across the curve with shorter dated maturities ending the quarter with higher gains compared to slight gains of longer dated maturities, which are more interest rate sensitive. Credit quality also made some difference, with risk-taking benefiting, as high yield bonds gained more than government bonds. Investment-grade corporate bonds finished somewhere in between. Treasury Inflation-Protected Securities (TIPS) bonds outperformed all.

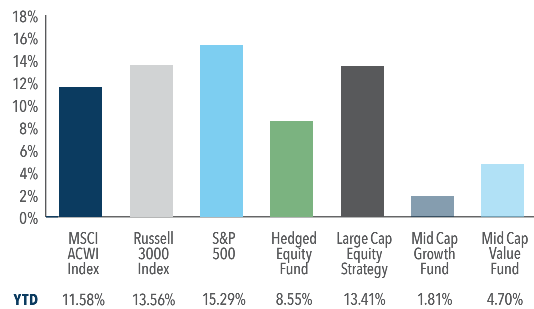
Alternative strategies provided further diversification amidst the market volatility in the quarter. Broad commodities added to their year-to-date gains. Both gold and oil prices increased further, driven by geopolitical concerns and demand prospects. Managed futures trend-following strategies struggled a bit with choppy markets and trend reversals, resulting in slight losses over the quarter. Losses in real estate grew slightly more pressured by rates. Global macro strategies saw gains in-line with short-term bonds as the strategy carries very little interest rate risk and is helped by the higher short-term rates.

The winds of changing expectations can be tough to navigate and subject investors to market volatility in the short term. Staying invested with a long-term perspective, while maintaining a diversified portfolio, can help investors to be better positioned, sticking to an investment plan over the long run.

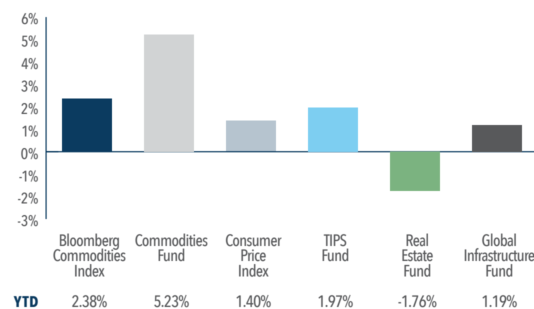
INTERNATIONAL DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



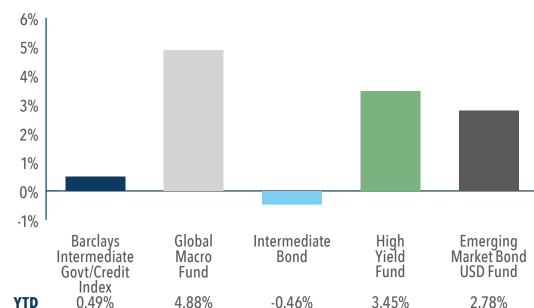
DOMESTIC DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



REAL RETURN (INFLATION PROTECTION) DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



INCOME DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

After a strong 1st quarter, the 2nd quarter presented some high and low notes. The 2nd quarter's best-performing index was again the technology-laden NASDAQ Composite, up 8.5%, followed by the S&P 500, up 4.3%. Disappointingly, the small cap-oriented Russell 2000 was down 3.3% and the Dow Jones Industrial Average (Dow) fell by 1.3%.

For the 1st half, all of the indices delivered gains. The NASDAQ led, with an impressive 18.6% gain, followed by the S&P 500, up 15.3%. The Dow and Russell 2000 were far behind, up 4.8% and 1.7%, respectively. There was much disparity between the indices' performance results — for the quarter and the half.

This year feels a bit like déjà vu in relation to last year, with performance leadership again quite narrow. Technology-related (and specifically, artificial intelligence (AI) related) "growth" companies continue to be substantial drivers. As such, the tech-heavy NASDAQ's returns speak for themselves. But when looking at a more diversified index, just seven companies contributed approximately 60% of the S&P 500's 15.3% gain for the 1st half. Aside from Eli Lilly (LLY, a market leader in the fast-growing GLP-1 anti-obesity market), the other companies are mega cap growth companies and leaders in AI proliferation (Alphabet--GOOGL, amazon.com--AMZN, Broadcom--AVGO, Meta Platforms--META, Microsoft—MSFT, and NVIDIA—NVDA). When looking at overall performance for the S&P 500's companies, only 22% outperformed the index during the 1st half. Market leadership was very narrow.

Unsurprisingly, growth continues to outperform value. During the 2nd quarter, growth gained 9.6%, while value lost 2.1%. For the 1st half, growth gained a spectacular 23.6% versus a modest 5.8% for value. At the sector level, it comes as little surprise that the communication services and information technology sectors (where most AI-related tech companies live).provided performance leadership for both the 2nd quarter and first half.

Things to watch into the 3rd quarter: an elevated valuation level for the market (meaning good news is well priced in), optimistic expectations for earnings growth, a potentially turbulent presidential election cycle, expectations for continued economic and labor market stability, and hope that inflation will moderate sufficiently to entice the Federal Reserve to start its interest rate reduction cycle.

Fixed Income

Callen Young, VP, Portfolio Manager

The 2nd quarter was really a tale of two halves for the bond market. Initially, there was a steady rise in overall yields, continuing the 1st quarter's reversal of the bond market's 2023 end-of-year rally. The five-year Treasury yield increased from 3.85% at the beginning of the year to 4.72% by the end of April, driven by fears of prolonged restrictive policy by the Federal Reserve, strong early-year job numbers, low jobless claims, and higher-than-expected inflation data.

However, towards the end of April, more bond-favorable economic data started to emerge, including softer job numbers, higher initial jobless claims, and better inflation figures. And on the inflation front, May's inflation data may prove to be an inflection point for the bond market, CPI showed a 0% monthly growth during the month, while PPI had a deflationary -0.2% print. The Fed's preferred measure of inflation, core PCE, rose just 0.1% in May leading to a 2.6% year-over-year rate. This was the lowest core PCE reading since March of 2021. By the end of the quarter, the five-year Treasury yield had fallen back to 4.37%.

Also, municipal bonds gave back some of their relatively strong 1st quarter performance during the 2nd quarter, with yields increasing more than US Treasuries. Some of the move can be attributed to an evolving mix of supply and demand in the muni market, as supply is running about 30% above last year's levels, while demand may be dampened by expectations that both Presidential candidates favor extending corporate and individual tax cuts that are set to expire after 2025.

As we enter the 3rd quarter, the bond market will continue to be hyper-focused on inflation and Federal Reserve policy. We expect that politics and the upcoming US election to begin playing more of a role in bond market movement, especially as more clarity on the candidates' policy positions is gleaned. The labor market will also be scrutinized, as the US has continued to add jobs at a steady pace, but the unemployment rate has quietly risen from a multi-decade low of 3.4% last year to 4.0% at the end of the 2nd quarter.

Investors are still convinced that the Federal Reserve will institute rate cuts beginning this year. Futures market pricing shows a 60% chance of the first cut in September, with about 73% chance of another after that. We expect the Fed to cut rates just once, sometime in the 4th quarter. With that expectation helping guide us, we think that current yields will look attractive over coming quarters and continue to favor an opportunistic extension of duration.

Second Quarter 2024 – Wealth Management Insights

International

Matthew Clarke, CIMA®, VP, Senior Client Portfolio Manager

Halfway through the year, and for the most part the global markets are still moving in a favorable direction – largely on the same two macro themes: easing inflationary pressures and the evolving story about artificial intelligence (AI). With AI firmly in the foreground, **emerging markets outpaced their developed peers and even the S&P 500**, which hit new highs through the quarter. The MSCI emerging markets index returned 5.03%, while the MSCI EAFE (developed international) closed out the quarter lower by -0.20%.

Emerging markets strength was fueled by gains out of Taiwan. The MSCI Taiwan index climbed 16.78% as everything artificial intelligence (AI) continued to support demand for AI related chips and server hardware. India and China were both major contributors as well. The MSCI India index managed to return 10.34% in the quarter despite election volatility. Stocks there were buoyed by individual investors as younger participants shift from saving to investing. The MSCI China index returned 6.88% helped along by government intervention to support their struggling real estate sector. Though not weighted heavily in the global markets, **the best performing emerging country was Turkey** which climbed 23.24% buoyed by optimism that they'll continue to fight inflation in a more conventional way.

There was mixed leadership within the developed international space. Eurozone shares moved mostly lower on the announcement of parliamentary elections in France and as expectations for deeper cuts began to dry up. The MSCI UK index managed to climb 3.59% as UK's economic picture continued to improve. In terms of monetary policy, **it's also worth acknowledging that both the European Central Bank (ECB) and the Bank of Canada (BOC) cut rates in June.** This follows the Swiss National Bank (SNB) in March (and again in June) and Sweden in May, which now means that approximately half of the G10 countries have shifted in an accommodative direction. **Japan continues to be a global outlier** after having hiked their prime rate back in March for the first time in 17 years. Notably, the Bank of Japan's (BOJ) Governor Kazuo Ueda recently suggested that they could hike rates again in July – depending on economic data.

In terms of global bonds, we saw investment grade (IG) corporate bonds in both the US and Europe deliver both positive absolute and relative returns versus government bonds. High yield bonds (lower credit ratings and higher risk) moved in tandem and provided stronger returns than both government and IG corporates.

Looking at the second half of the year, it will be hard to ignore the upcoming US presidential election and the potential impact it may have on US relations with China. **With this, we expect near-term market volatility** as market participants consider who will reside in the White House and how policies may change.

Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.

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