June 2024 Capital Markets Commentary

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"Whenever you find yourself on the side of the majority, it is time to pause and reflect."

Mark Twain

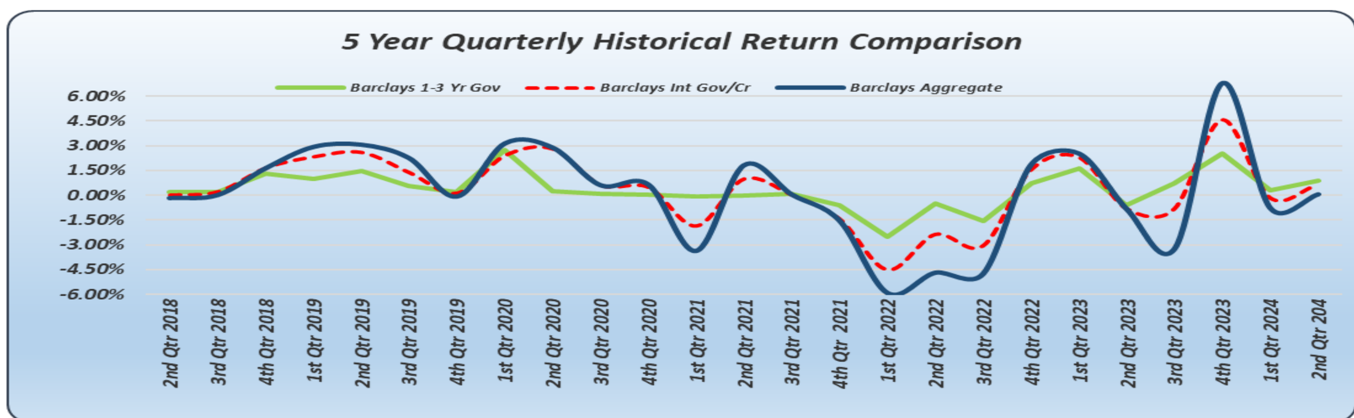
Fixed Income

The Fixed Income markets ended the 2nd quarter rather meekly. After a weak 1st quarter quarter return of -0.77% and a 1-year return of +2.63 on the Bloomberg Aggregate Index, the fixed income markets were relatively flat as June ended. The upward pressure on yields to start the year, have finally given way to indications that the Fed will probably start to lower rates, as we move into the last half of the year. This was reinforced by the FOMC's decision to leave Fed Funds unchanged again through June. However, inflation numbers have improved, but are still higher than the Fed's target, along with an economy that continues to move forward, but more slowly now.

In the second quarter of 2024, spreads in high grade fixed income sectors have been tightening but yields still remain high and attractive. Riskier fixed-income categories, such as leveraged loans and emerging market debt, gained, while US Treasuries and mortgage-backed securities lost value.

The FOMC met during the quarter, as scheduled, (and again in July, I am a little late with the quarterly commentary) and just like the previous meetings, left the target Fed Funds in a range of 5.25% to 5.50%. Inflation is still higher than the Fed would like, but most Fed governors are leaning towards cutting rates, and the recent minutes now show that the Fed could and will possibly lower rates in the 4th quarter.

As we can see, returns were negative on the long and intermediate parts of the curve during the quarter. The Barclays U.S. Aggregate posted a +0.07% return for the quarter. The Barclays Intermediate Index was at +0.64%. On the short end of the yield curve, we saw positive a return, with the 1-3 Year Government Index at +0.91%. And, at the truly short end of the curve, the 1 Year T-Bill returned +1.09% for the quarter. The 10-year Treasury yield ended the quarter at 4.36%. The 5-year Treasury yield ended at 4.33%, and the 2-year Treasury yield ended at 4.71%. (As of August 12th, yields are lower by approximately 40 to 50 basis Points)



Fixed Income Markets - Looking Ahead

At the July meeting, just like in June, there was no rate movement from the Fed. (Why? There is still a reason.)

Inflation has slowed to levels that should allow the Federal Reserve to cut interest rates, which improves the total-return prospects for bonds through the end of the year. Although the fixed income markets are looking for large downward rate cuts,(which is priced into the market currently), we do not foresee significant Fed easing in 2024, (more like 25 to 50 basis points on the high side). However, investors shouldn't miss the opportunity to lock in attractive yields and potentially benefit from the price appreciation that would occur when rates eventually decline in 2024 and decline further in 2025.

The Fed's top priority of inflation reduction and containment remains. And, while progress has been achieved, the Fed's desired target of 2% remains a goal. Currently it seems that the base case is that the Fed will cut rates in 2024 based on current economic data and inflation. Further declines in 2025 will still be data dependent.

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Equity

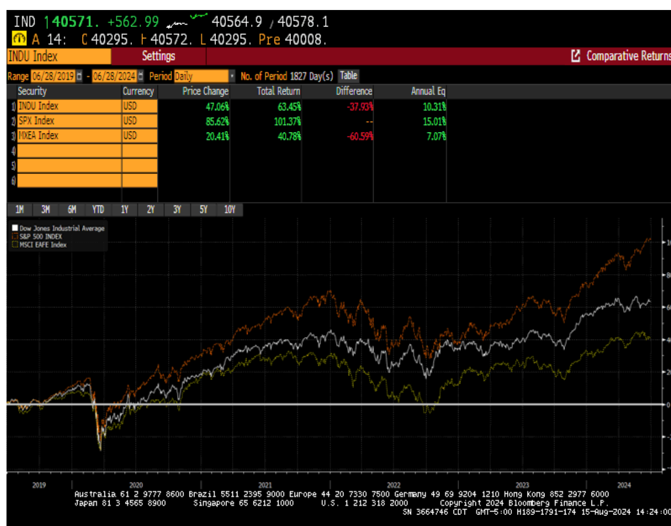
The equity market, as measured by the S & P 500 Index, wrapped up strong in the second quarter of 2024, hitting record highs signaling a robust equity market. This was followed by decelerating growth in non-farm payrolls and unemployment reaching a 2 ½ year peak at 4.1%, leading to heightened expectations for interest rate cuts in the 3rd and or 4th quarter. Despite inflation reducing faster than expected towards 3%, moving closer to the Fed's 2% target, the second quarter of 2024 saw no rate cuts in the first half of the year. The market has gained in six of the last seven quarters.

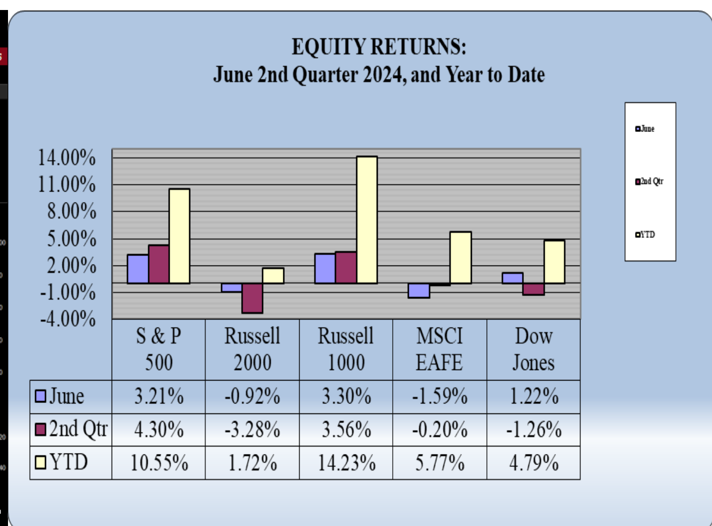
Reinforced by the combination of a slowing but solid economy, better-than-expected corporate earnings, reduced inflation, and a policy shift by the Federal Reserve, stocks rallied +4% in 2nd quarter of 2024, and had Y-T-D performance numbers of +15.3%.

Equity markets had continued positive returns in the 2nd quarter, with the S&P 500 up over 4% and nearly 30% from October's low. Improving economic tenets such as moderating inflation, a resilient labor market, and stronger than anticipated GDP growth moved risk assets higher, with recession fears fading into the background.

While the stock market saw intermittent selloffs during the quarter, it continued marching higher as corporate earnings held out hopes that the economy can still avoid a recession. As mentioned above, the S&P 500 index rose 15.3% during the first six months of the year, its best 6-month performance since 2023. The Nasdaq Composite also gained during the 2nd quarter, earning over 8%.

Only two indexes were positive for the quarter. On the U.S. side, the S&P 500 ended with positive +4.3% return for the quarter, and the Russell 1000 index returned +3.6%. However, the Russell 2000 index returned -3.3%, and the Dow returned -1.26%. The International markets also closed with negative returns, posting a -0.20% for the quarter.





	S & P 500	Russell 2000	Russell 1000	MSCI EAFE	Dow Jones
June	3.21%	-0.92%	3.30%	-1.59%	1.22%
2nd Qtr	4.30%	-3.28%	3.56%	-0.20%	-1.26%
YTD	10.55%	1.72%	14.23%	5.77%	4.79%

Equity Markets - Looking Ahead

2024 – 2nd half of 2024 . How does it play out?

As we enter the second half of 2024, conditions remain good for U.S. equities. U.S. corporate earnings are widely expected to continue, potentially improving as we move through the last half of the year as inflation and possibly, interest rates come down—this, despite lingering economic worries.

Historically, stock markets have experienced volatility in the few months prior to U.S. Election Day, which is slated for Nov. 5 in 2024. However, markets typically recover in the weeks following the election.

In this election cycle, expectations are that Congress remains divided, which means no regulation or legislation is likely, regardless of which party wins. Markets tend to prefer this environment of political gridlock, as it means a more transparent operating environment for companies to run their businesses. Over the long run, markets tend to follow the fundamentals — including inflation, interest rates and economic growth — more so than politics and elections.

As we move forward, there are risks for markets and investors. Inflation is falling but remains above Fed targets. The timing and amount of future interest rate cuts by the U.S. Federal Reserve is positive, but the lens which we look through is still murky. Anything can happen.

The Economy

The Economy

As expected, the Federal Reserve again left interest rates unchanged at its June, (and now July meeting). The top end of the federal funds rate has remained at 5.50% since July 2023. The FOMC has been on pause since raising rates by 5.25% total over an almost two-year period beginning in March 2022. As the Fed gains more conviction that inflation is on a sustainable downward path, they will begin to lower interest rates. The FOMC's most recent Summary of Economic Projections (SEP) showed that the median participant expects they will lower rates to around 5.0% in 2024 and to 4.0% in 2025. However, although the Fed members note that recent numbers suggest policy is taming inflation, they still to want to see indications that lower inflation is both continuing and enduring before embarking on a series of rate cuts to prevent their monetary policy from becoming restrictive.

Consumer spending has slowed (although slower inflation has played a role), with retail sales (expressed in nominal, not real, terms) down slightly as the quarter ended. Even adjusting for inflation, May personal consumption expenditures (a broader measure of consumer spending than retail sales) rose by a modest 0.3 percent – after declining in April. With consumer spending roughly two-thirds of all spending in the economy, a slowdown is sure to bring growth in core GDP down.

Housing was the weakest sector during the quarter. A lack of supply in the post-Covid period came from the large share of mortgages at or near record low interest rates, and they will be slow to transact. A lack of supply has led to record house prices – and when combined with higher mortgage rates this year, has caused home sales to drop. New home sales for May fell by 11.3 percent to an annualized pace of 619,000 – the second lowest figure since November 2022. Existing home sales have declined every month since early in the year. Additionally, the supply situation is unlikely to improve in the near term, with housing starts in May down to the lowest level since June 2020 – just as the economy was beginning to pull out of the Covid recession.

The Economy - Looking Ahead

Economic Growth? Jobs? Inflation? Recession? Global problems? Same old, Same old!

The Fed has kept interest rates unchanged for the past eleven months while they have tried to balance their mandate of maximum employment and stable prices. According to some data, market pricing for expected rate cuts in 2024 reached as high as 150 basis points earlier this year before declining to about 50 basis points as the current espectation. Currently as economic and inflation data have exceeded expectations, especially earlier in the year, many market participants are worried. Investors(mostly Fixed Income) who are upset that the Fed hasn't cut rates yet should be careful what they hope for. Both equity markets and fixed income markets have rallied over the last several months as corporate earnings and economic growth have done extremely well. If the Fed starts moving interest rates substantially lower, it will likely be because the labor market and economy have hit a wall. This might not bode well for the financial markets. But, most folks seem to be convinced that inflation is on the right trajectory

What has remained very strong, is the jobs front, defying continual expectations every month. Economists keep calling for more of a slowdown than actually happens, and so, job growth remains strong. There have been some interesting dynamicson the job front where, for example, immigration has played a big role in supporting job growth in this country. There are other factors that are feeding through, and strong jobs mean that consumers like to keep spending, which keeps the economy moving forward. So, despite the fact that we had significant interest-rate increases starting in 2022, the economy is doing well, and currently, there's no sign of a recession.

The economy seems to be in good shape for now. However, at some point things will slow down and there will probably be a recession. But, at this point a recession in 2024 has a low probability, but if a recession occurs in last few months of 2024, it will likely be due to some external shock or unforeseen event.

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