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Investment Insights Monthly

From the Desk of Bill Hornbarger, Chief Investment Officer — June 2024

In Between Days

If you happen to be a new wave music fan and know the English band The Cure, you might be familiar with their iconic single "In Between Days." According to the lyricist (and lead singer), the song is about trios—"days, people, places, ages…"—but the title has so many possibilities. And as we sit here in June, it feels like we are "in between days" on a number of topics. Spring is turning to summer, "politics as usual" is transitioning into what promises to be a contentious election year, are we headed for a soft landing or something harder, and the continuing evolution of U.S. Federal Reserve (Fed) expectations.

Soft Landing?

Those calling for a recession generally point to three indicators that historically have been fairly accurate in forecasting a hard landing. Those three, in no particular order, are the inverted yield curve, and extended periods of weakness for both the index of leading economic indicators and the Institute for Supply Management Manufacturing (ISM) Survey. In more recent months, all three indicators have shown some signs of improvement, with the yield curve less inverted, and both leading indicators and the ISM index posting a positive month in 2024 and generally showing signs of improvement.

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The U.S. economy is/has been stronger than some investors think. In May, the economy added 272,000 new jobs and has averaged almost 250,000 per month this year, and wage growth was up a strong 0.4% in May. Bears will point to the increase in the unemployment rate to 4%; however, this rate is still low historically, is calculated from the more volatile household survey and misses several groups that don't respond to surveys via phone. The U.S. consumer has also been remarkably resilient in the face of higher inflation and tighter monetary policy. In our opinion, a major reason that consumers have been less sensitive to higher interest rates is the plethora of households with low mortgage rates, courtesy of years of zero and near-zero interest-rate policy.

At this point, the Fed can lay claim to something that looks like a soft landing. The Fed raised interest rates 550 basis points, and the economy has continued to grow, while stocks hit record highs, home prices remained strong and inflation moderated (while still above the Fed's target). The International Monetary Fund is predicting the U.S. economy will expand this year at more than twice the rate of other major developed countries, with a forecast of 2.7%.

We are still of the opinion that the U.S. economy will avoid a recession. That view is based not only on what we see in the economy, but also on market activity, specifically narrow credit spreads and the fact that more defensive areas of the market continue to show few signs of market leadership as they would if economic concerns were greater. The most obvious risk to this outlook is the "higher for longer" monetary policy scenario.

Monetary Policy Expectations

Expectations around monetary policy continue to evolve, with expected rate cuts now fewer and later than previously forecast. Coming into the year, the markets were priced for six to seven interest rate cuts this calendar year. In current trading, the futures markets are now pricing in one to two potential decreases, with the greatest odds at the December meeting. Some market participants are even calling for additional rate increases, and Fed speakers have been very transparent on the desire to see inflation clearly trending toward the 2% target (as measured by core personal consumption expenditures) before entertaining rate cuts.

This tightening cycle has been the most aggressive of the past four decades. Over that same 40-year timeframe, the median length of time from the last increase to the first interest-rate cut has been eight months, with a fair amount of variability. In 1984, the Fed lowered rates within a month of the last increase, and in the 2006 cycle, 15 months lapsed. The Fed last raised rates on July 26, 2023 (11 months ago) and remains within the band of time that one historically would expect rate cuts. We are still in the camp that the next Fed move will be a rate cut, with the timing contingent on the incoming inflation data and the best clue as to when it will happen in the rhetoric from Fed speakers.

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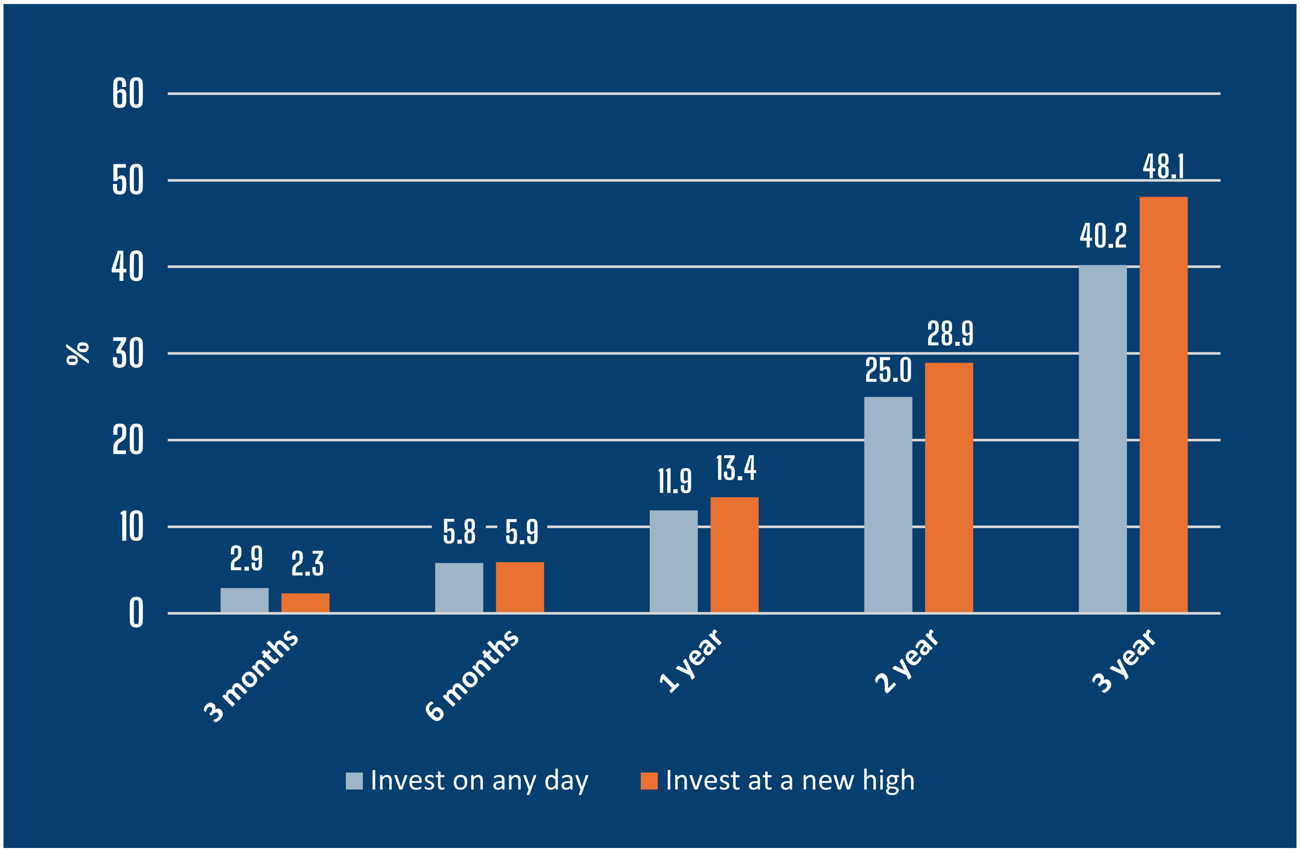
Sometimes a Picture Is Worth a Thousand Words

This chart from financial writer Mike Zaccardi recently caught my eye. The S&P 500 and the NASDAQ both have achieved multiple new highs this year (30 for the S&P 500 as we write this), a development that often can increase investor anxiety. In our opinion, the best way to interpret it is to stay invested. Stocks rise over time, and the periodic corrections and bear markets (impossible to time) are the "cost" of earning higher returns versus other asset classes.

Average Cumulative S&P 500 Total Returns
1/1/88 - 12/31/23



Source: Mike Zaccardi, CFA, CMT

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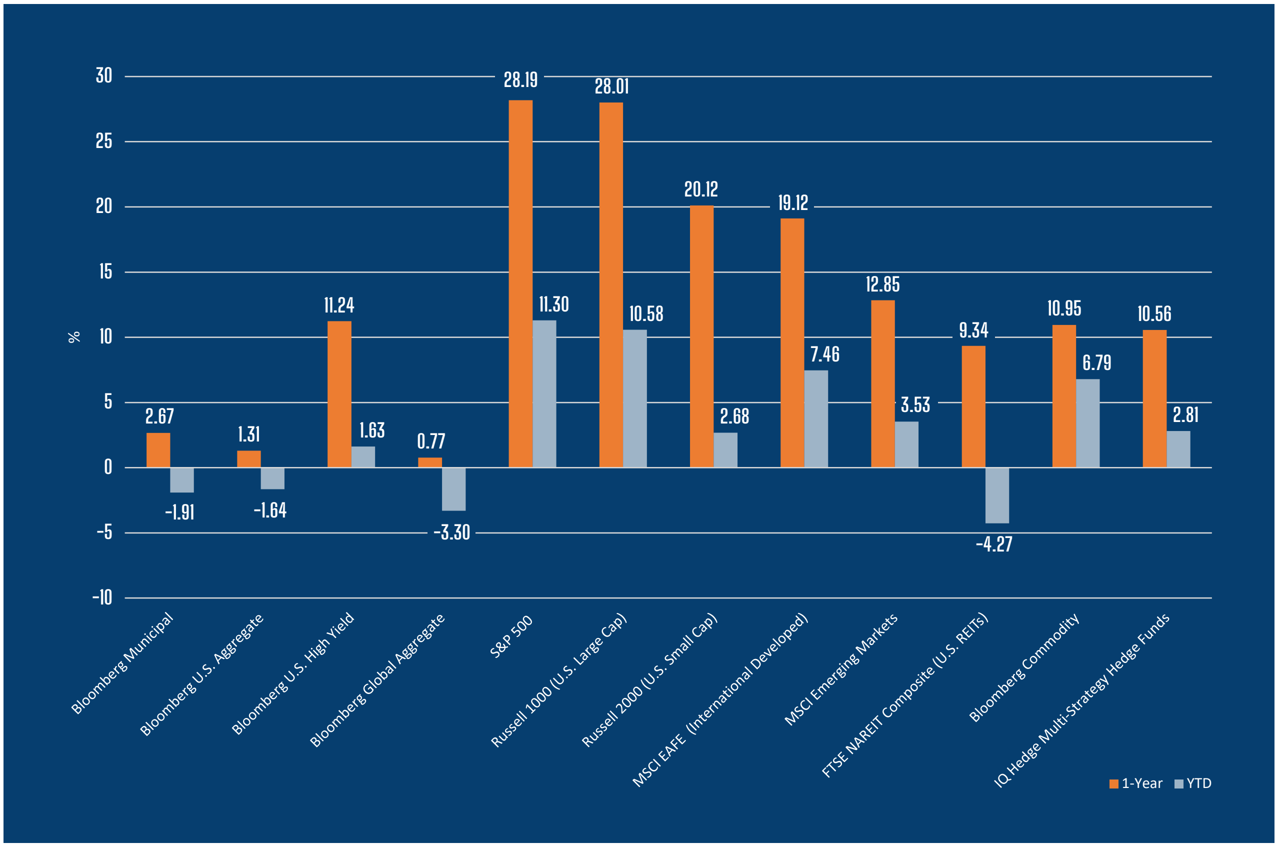
Asset Class Returns

Comparing Recent 1-Year and Year-to-Date Total Returns



As of May 31, 2024
Source: Conway Investment Research

Fixed Income

- Treasury and other sovereign debt yields fell across the board in May, resulting in gains for core fixed income. Municipal technical factors were weak, causing a modest decline.
- Credit spreads generally tightened further last month, leading to gains in investment grade, high yield and loans.
- Bonds outside the U.S. benefited from similar trends of spread tightening and falling yields. They also got a boost from U.S. dollar weakness.

Equities

- U.S. equities posted positive returns in May led by strength in growth/tech stocks and small caps.
- Small caps beat large caps by a slight margin, and growth outperformed value.
- U.S. equities have posted very solid year-to-date gains through the end of May, although market breadth remains fairly narrow.
- Non-U.S. equities lagged U.S. equities last month, and emerging markets really lagged developed markets.
- Similar to the U.S., small caps beat large caps outside the U.S., but value outperformed growth.
- Latin America drove the emerging-market weakness.
- U.S. dollar weakness provided a tailwind for non-U.S. equities.

Alternatives

- Real Estate Investment Trusts (REITs) posted strong gains for the month, helped by lower rates.

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May 31, 2024	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.49%	0.92%	2.26%	5.51%	2.97%	2.13%	1.45%
Bloomberg Municipal	-0.29%	-1.53%	-1.91%	2.67%	-1.29%	0.93%	2.25%
Bloomberg US Govt/Credit Intermediate	0.73%	0.39%	0.81%	3.86%	0.31%	1.25%	1.29%
Bloomberg U.S. Aggregate	1.70%	-0.87%	-1.64%	1.31%	-3.10%	-0.17%	1.26%
Bloomberg U.S. High Yield	1.10%	0.15%	1.63%	11.24%	1.78%	4.19%	4.30%
Bloomberg Global Aggregate	1.31%	-1.25%	-3.30%	0.77%	-5.82%	-1.62%	-0.37%
U.S. Equity Indices							
DJ Industrial Average	2.58%	-2.47%	3.52%	19.97%	6.00%	11.62%	11.25%
S&P 500	4.96%	0.67%	11.30%	28.19%	9.57%	15.80%	12.69%
NASDAQ Composite (Price)	6.88%	2.17%	11.48%	29.37%	6.77%	17.56%	14.71%
Russell 1000	4.71%	0.25%	10.58%	28.01%	8.46%	15.42%	12.40%
Russell 1000 Growth	5.99%	1.49%	13.08%	33.60%	11.12%	19.37%	15.80%
Russell 1000 Value	3.17%	-1.24%	7.64%	21.71%	5.45%	10.74%	8.61%
Russell Mid Cap	2.85%	-2.70%	5.66%	23.11%	3.10%	11.07%	9.47%
Russell 2500	4.16%	-2.82%	3.91%	21.70%	0.60%	10.14%	8.66%
Russell 2000	5.02%	-2.37%	2.68%	20.12%	-1.65%	8.61%	7.66%
Russell 2000 Growth	5.36%	-2.76%	4.62%	18.38%	-3.34%	7.79%	8.06%
Russell 2000 Value	4.68%	-1.99%	0.85%	21.76%	-0.17%	8.77%	6.87%
Non-U.S. Equity Indices							
MSCI World	4.53%	0.70%	9.77%	25.51%	7.18%	13.31%	9.71%
MSCI ACWI	4.12%	0.73%	9.11%	24.13%	5.62%	12.21%	8.95%
MSCI ACWI Ex-U.S.	3.00%	1.23%	6.10%	17.33%	0.79%	7.32%	4.52%
MSCI EAFE	4.00%	1.45%	7.46%	19.12%	3.60%	8.57%	5.11%
MSCI EAFE Growth	3.88%	-0.15%	6.94%	14.12%	0.57%	8.25%	5.92%
MSCI EAFE Value	4.13%	3.19%	8.05%	24.46%	6.49%	8.48%	4.06%
MSCI Europe	5.03%	3.21%	8.78%	20.46%	4.87%	9.68%	5.01%
MSCI Japan	1.35%	-3.57%	7.20%	19.03%	2.82%	7.95%	6.53%
MSCI AC Asia	1.50%	0.34%	6.07%	14.37%	-3.41%	5.62%	5.17%
MSCI EAFE Small Cap	4.43%	1.41%	3.96%	14.91%	-2.44%	6.16%	5.18%
MSCI ACWI Ex-U.S. Small Cap	3.32%	1.88%	4.13%	16.88%	-0.82%	7.75%	5.20%
MSCI Emerging Markets	0.59%	1.07%	3.53%	12.85%	-5.85%	3.94%	3.05%
MSCI EM Asia	1.44%	2.39%	5.90%	13.03%	-6.58%	5.22%	4.67%
MSCI China	2.42%	9.18%	6.78%	4.45%	-16.98%	-2.25%	2.08%
MSCI EM Eastern Europe	3.61%	5.88%	7.71%	43.33%	-33.43%	-18.42%	-8.32%
MSCI EM Latin America	-3.09%	-6.46%	-10.11%	13.17%	4.55%	3.07%	1.11%
MSCI EM Small Cap	0.69%	2.72%	3.87%	22.14%	2.78%	10.65%	5.41%
MSCI Frontier Markets	3.89%	0.82%	6.19%	15.41%	-1.94%	3.03%	1.06%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	1.26%	0.20%	2.81%	10.56%	1.29%	3.32%	2.60%
Real Assets Indices							
FTSE NAREIT Composite	5.20%	-3.04%	-4.27%	9.34%	-1.71%	2.95%	5.75%
Alerian MLP	0.17%	-1.05%	12.69%	35.39%	23.02%	11.78%	2.17%
Bloomberg Commodity	1.76%	4.49%	6.79%	10.95%	6.85%	8.15%	-1.08%
S&P Global Infrastructure	6.34%	5.76%	7.17%	13.59%	6.02%	6.07%	5.28%
Other							
CBOE Market Volitility (VIX)	-17.44%	-0.69%	3.78%	-27.98%	-8.31%	-7.14%	1.26%

Source: Morningstar

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