Market commentary notes

Monthly call notes
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Wealth Management

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Key issues summary:

The Fed—We have additional information that supports prior information— The FOMC met a couple of weeks ago and made no changes to interest rates or to their purchases of longer-term bonds. Fed purchases of longer-term bonds are intended to keep those interest rates down, although it is disputable as to how effective that actually is in a normal economic environment.

Since the last FOMC meeting in mid-June, we've had additional economic data come in: The CPI price index moderated a little for the month, with no increase. Since the start of the year, the overall urban CPI showed YoY inflation of between 3.4% and 3.1%, now at 3.2%. There's no evidence of an actual trend in any direction. The core CPI (excluding food and energy) has been trending downward. Back in January the trailing 12-month core CPI rate was 3.9%. In May it was 3.4%. Although, it has been trending down it's still well over the Fed's 2% target. The PCE index, which the Fed appears to pay more attention to, came in at +2.6% YoY. Since the beginning of the year, it has been between 2.7% and 2.5% so no downward trend. Core PCE has also been between 2.8% and, more recently, 2.6%—so at most, slight evidence of trending downward. The Fed has made clear that they want to see a downward trend before making changes. [https://www.bea.gov/news/2024/personal-income-and-outlays-may-2024, June 29, 2024] In addition, personal incomes were up 0.5% or $114 billion in May. That suggests that consumer demand is likely to stay healthy this year. Notably, 2024 FOMC median dot plot shows 25bp of cuts vs. 75bp prior. More specifically looking at 2024, four officials are penciling in zero cuts, seven are forecasting a single cut, and eight are projecting two cuts. [Factset Street Account, June 12, 2024].

However, beyond the U.S. Fed and our policy, there's a whole investment world out there and we ignore that at our peril. What are other central banks doing in 2024 and how might that affect investment opportunities?

Different countries face different issues right now, leading to different trade-offs and policy strategies. For instance, the EU appears to have skirted recession in 2023, with modest recovery/improvement so far in 2024. The ECB has an incentive to help improve growth. On top of that, EU's inflation indicators are around 2.3%, below those of the US. Current rates in EU are 4%—meaning a real rate of 1.7%, which is "high-ish" for the Euro economies. So, EU has more of an incentive to cut rates, faster, than does the US. That, in turn could lead the Euro to depreciate compared to the USD, which is a twin-edged sword. It might help Euro exports and tourism, but could add inflationary pressure. [https://corporate.vanguard.com/content/corporatesite/us/en/corp/vemo/higher-rates-stay-though-policy-divergence-wont.html, June 29, 2024].

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What does that mean from an investments standpoint? Europe is looking a bit more attractive than it did a year ago. In particular, vehicles that focus on European exporters but do it in USD terms might benefit doubly if these guesses on policy prove correct.

The story for BOE (England) is similar but more so. BOE rates are higher, around 5.25%. Inflation seems to be in the low 2's, down from 4% at the beginning of the year, and manufacturing is picking up out of the doldrums. A real interest rate of 3% is arguably way too high for a healthy UK economy so we could see significant moves downward, with the same investment implications as what I described for EU.

Japan, on the other hand, is seeing flat or even rising inflation rates of around 2.5 to 2.8%. The yen is depreciating, but real GDP growth is weak and occasionally negative. On top of that, Japan is running a balance of trade deficit. So, they have very split incentives: The inflation rate would argue for higher interest rates but the weak GDP and trade numbers would argue for lower rates. It looks like overall, the chances are greater that the BOJ will modestly raise interest rates, while the rest of the world is moving the other way. That signals to me an investment strategy of "keep away". Their economy is so divided right now in terms of its needs that it's hard to see an upward trend developing in the short term.

Bank of Canada reduced rates by a quarter point in June to 4.75%. Typically, BoC has to shadow US policy since the economies are tied together so closely. This move will likely cause the C$ to feel some downward pressure, which is good for exports and particularly for profits in the extractive industries. That may be a positive for the Canadian economy, but from a US investor's standpoint, there isn't much incentive so far to get involved. By the way, Canadian inflation has stayed all year in the high 2's and the housing market is out of control in major cities so the BoC likely has to be very cautious reducing rates right now.

Earnings—May brought us new payrolls well ahead of expectations at 272,000. Professional services, education and leisure were major sources of new jobs. Weekly average hours worked didn't change. [https://www.bls.gov/ces/, June 29, 2024].

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June—"Sell in May and go away", not so far – May's momentum seems to be continuing into June. The S&P 500 was up 3.6%, while Mid- and Small-Caps dipped a little at -1.6% and -2.3%, respectively. The All-Country stock index was flat, while emerging markets were up 3.9%.

On the bond side, Intermediate bonds were up 0.9%, making them about flat for the YTD. High yield corporates were up by a similar amount and up 2.6% YTD. So far, short term Treasuries are still the winner YTD.

Global stock indexes

Total Index	June %	YTD %	1 yr %	2023 Est PE Trailing/ Projected
S&P 500	3.59	15.29	24.56	23.27/21.76
S&P Mid Cap	-1.58	6.17	13.57	18.25/16.49
S&P Small Cap	-2.28	-0.72	8.66	26.69/16.44
FTSE All REIT	2.21	-2.09	5.78	
MSCI All Country xU.S.	-0.10	5.69	11.62	
MSCI Emerg Mkt	3.94	7.49	12.55	

Source: Morningstar as of June 30, 2024. Estimated PE's are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 29, 2023. Projected PEs are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	June %	YTD %	1 yr %
Bloom Agg Intermed	0.92	0.04	3.55
ICE BofA U.S. Convertibles	1.22	2.26	6.17
S&P GSCI	1.43	11.08	15.01
Bloom U.S. Corp HY	0.94	2.58	10.44

Source: Morningstar as of June 30, 2024.

Sector performance—In June, the worst sector performers were Utilities, Materials and Industrials. The best were: Info Tech, Consumer Discretionary and Communications. YTD, the top sectors were: Info Tech, Communications and Financials. The worst were real estate, materials and consumer discretionary. [https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, June 29, 2024]. [https://digital.fidelity.com/prgw/digital/research/sector, June 29, 2024].

Commodities

Commodity and food price changes, current month and YoY

Total Index	June%	YoY %
Copper	-8.3%	19.0%
Lumber	-14.5%	-17.3%
Cotton	-22.2%	-22.2%
Sugar	11.8%	-11.3%
Coffee	-2.7%	37.3%
Wheat	-17.2%	-14.1%
Corn	-7.6%	-19.6%
Oil	2.9%	16.5%
NatGas	-2.4%	-3.3%

Source: https://tradingeconomics.com/commodities, June 29, 2024.

Seven of these nine major commodities saw prices decline in June. For these nine, the average one-year price change was a decline of 1.7% after a similar rise last month.

Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 34 of the 48 saw price declines in June, compared to 19 last month. Eighteen saw lower prices than a year ago, which has been about the same for three months in a row. This reinforces my impression that longer-term price declines are tapering off. Short-term fluctuation in commodity prices seem to be continuing with more summer declines. This may be what led to the better inflation print last month, but I'm not sure that it will carry forward.

U.S. economy

The U.S. economy at a crossroads ...

GDP estimates

[https://www.bea.gov/news/2024/gross-domestic-product-state-and-personal-income-state-1st-quarter-2024, June 29, 2024] [https://www.atlantafed.org/cqer/research/gdpnow, June 3, 2024] The third GDP estimate for the first quarter was published last week. The annualized real GDP growth rate was 1.4%, up slightly from the previous estimate. Real GDP had increased in 39 states. Maybe surprisingly, construction was the largest contributor to business growth. Also, personal incomes had increased in all 50 states and in D.C. The total quarterly increase in personal incomes was just under $400 billion, which corresponds to a 7.0% annual growth rate.

Looking at the quarter that we just finished, GDP Now from the Atlanta Fed estimates real GDP growth of 1.7%. However, that number has fluctuated over the last quarter between 3.3% and 1.4%. We'll see in three weeks what the advance estimate looks like. My guess is that it will be 1.8% or higher. [https://www.atlantafed.org/cqer/research/gdpnow , July 1, 2024].

U.S. PMI statistics

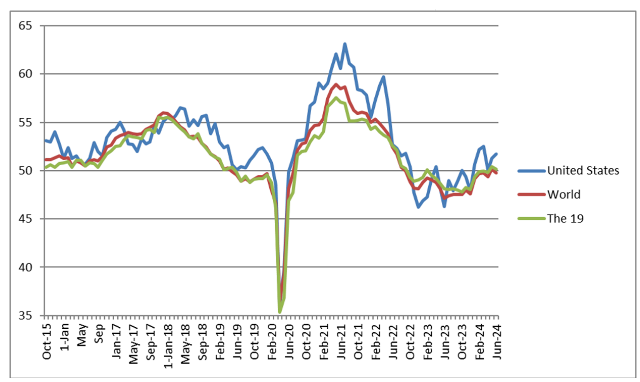
The June PMI Manufacturing number rose a bit more to 51.7. The Services PMI came in at a very strong 55.1. A couple of months ago it was 51.3. Together, these indicate a significant uptick in economic activity. [Trading Economics, PMI statistics, June 29, 2024]. [Trading Economics, https://tradingeconomics.com/country-list/services-pmi, June 29, 2024].

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. The June numbers (not all of which have been updated from May) indicate that manufacturing expanded in 21 of our 38 countries. It was 22 last month and 19 before that. Germany, France and Italy were all in the mid-40's so while there's been a bit of an improvement recently, it is slow and modest. The GDP-weighted average manufacturing PMI dipped slightly to 49.8 which still qualifies as close to the highest reading since September 2022. EU's Services PMI stayed solid at 52.6 and Germany, Italy, Spain all were in the mid-50's. [https://tradingeconomics.com/country-list/services-pmi, June 29, 2024].

Here's our updated graph of Manufacturing PMIs



Source: Author's calculations based on published PMI statistics, as of June 29, 2024.

Table summary

Region	Manu PMI	Last Month	12 mo. Ago
U.S.	51.7	51.3	46.3
19 majors	50.1	50.4	48.1
38 world	49.8	50.1	47.1
EU	45.6	47.3	43.4
China	51.7	51.7	50.5

Source: Author's calculations based on published PMI statistics, June 29, 2024.

What might we conclude from these figures? First that the US is still leading the world in terms of growth and it has moved from modest to moderate. Europe is still lagging, although there are signs of improvement. Japan is hard to call. Services seem okay but manufacturing remains weak, as does consumer spending.

We should run all of the economic data through a filter of "what does it mean for the central bank?" We went over some of this previously. To summarize, the US Fed seems inclined toward lowering rates maybe once or twice this year. However, the pressure on them to do anything at all is pretty weak as there isn't any evidence that the economy is weakening in undesirable ways. The same isn't true in EU. There, inflation has come down, opening an opportunity for the ECB to reduce rates. At the same time, growth recovery is weak at best, motivating the ECB to reduce. Odds are that they will reduce more and faster than the US. That, in turn, might create an opportunity for EU exporters, but otherwise there's not much clear opportunity in Europe yet.

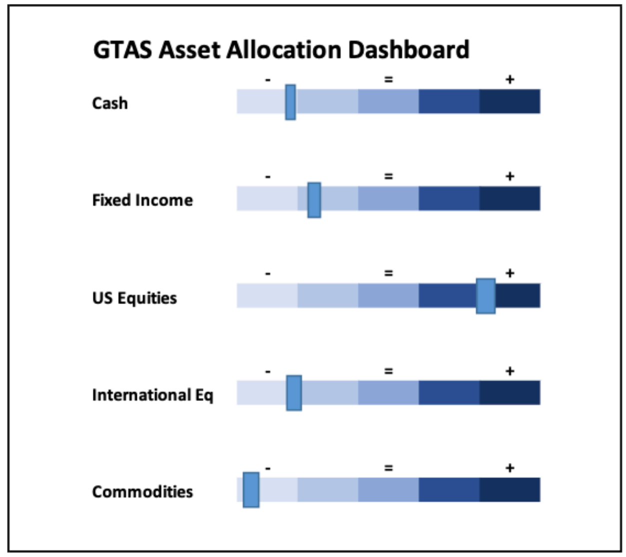
Investment strategy

Our investment strategy is still driven to a great extent by the Fed, the Fed's actions and speculation about the Fed's actions to come. There's no escaping that currently the US focus is on whether and how much the Fed will ease rates, as well as whether we will find ourselves in a recession. So far the signs appear to lean towards, "a little" and "no."

Globally, we may see Europe reducing rates faster and further than the US Fed. Japan is a difficult call because they have incentives in both directions. Given that, staying domestic makes sense from an investment standpoint. To the extent that we dip a toe into international equities, the prudent thing right now seems to be to use ETFs that hedge back to the US dollar.

On the bond front, it's a harder call. We're still staying largely shorter maturities and that has worked so far this year. The yield curve started this week by selling off (rates rising) fairly significantly. That said, at some point looking in rates for longer may make sense.

GTAS Allocation chart



(+/=/-) represents our group's views over a 6- to 18-month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed — Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY — Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT — FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles — ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality (e.g., it includes investment-grade, speculative-grade, and non-rated issues). The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. — MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt — MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

S&P 500 — S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI — S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap — S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap — S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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