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Economic & Market Update

June 2024 Outlook

Global Economy

- At face value, U.S. economic growth slowed in the first quarter of the year to a level below its long-term trend of approximately 2.0%. However, weakness in trade and a decline in inventories led to much of the slowdown. Consumer spending growth appears to be slowing somewhat in the second quarter, but persistent strength in the labor market and continued demand for services should prevent any meaningful declines. Businesses appear to be growing slightly more confident that the economy will avoid recession and should continue to invest accordingly, with an emphasis on productivity-enhancing technology spending in their capital budgets. Government fiscal spending in an election year should also be supportive in helping to keep economic growth comfortably positive through the remainder of the year.
- While goods price inflation has been virtually eliminated as greater supply has caught up to slowing demand, services inflation has remained frustratingly sticky as consumer spending has clearly pivoted toward experiences. Shelter inflation has been particularly stubborn, although the recent decline in observed rents should soon be reflected in the Consumer Price Index reports published over the coming months. After some stagnation in the progress of reducing overall inflation in the economy, we expect a resumption of the gradual decline in the inflation rate over the coming months.
- After a long period of stagnation, European economies are showing signs of recovery, as a pickup in domestic demand is supplementing growth in exports driven by weaker currencies and strong demand from the United States. With inflation moving closer to central bank targets, monetary policy may be an additional catalyst supporting the recovery over the second half of the year.
- After a decline in gross domestic product (GDP) during the first quarter, the Japanese economy should return to positive growth in the second quarter, as the recently completed annual spring union wage negotiations should help drive domestic spending. Exports should continue to be supported by the weak Japanese yen.
- China appears to be experiencing a near-term economic rebound driven by government policy initiatives, but structural headwinds around demographics, trade wars, and the property crisis will likely prevent achievement of the government's 5% 2024 GDP growth target. Government backing of state-owned enterprises over independent entrepreneurial businesses may have a continued negative impact on productivity in the economy.

Monetary Policy

- The Federal Reserve (Fed) will be looking for a few more months of below 3% year-over-year core personal consumption expenditures inflation readings to begin its monetary easing process. Expectations for slower economic growth should allow for enough of a decrease in this key inflationary indicator for the Fed to implement the first federal funds rate cut of 25 basis points at the September Federal Open Market Committee meeting.
- The European Central Bank (ECB) is highly likely to implement its first rate cut at this month's meeting, joining both the Swiss National Bank and Sweden's Riksbank at the beginning of an easing cycle. However, some recent inconsistency in the improvement of inflationary indicators, combined with the recent improvement in economic growth in the eurozone, should lead the ECB to caution against the expectation of consecutive rate cuts at subsequent meetings.
- The Bank of England also appears poised to begin easing monetary policy this summer. The recent vote to maintain rates at current levels was not unanimous, with the head of the central bank pointing out the different economic situation in the United Kingdom compared to the United States as rationale for an earlier rate cut than is expected from the Fed.
- The inflationary impact of union-negotiated wage increases should lead the Bank of Japan to tighten policy again during its September meeting, but with GDP growth still expected to be rather anemic throughout the rest of the year, the Japanese central bank will likely be hesitant to aggressively normalize the very low current rate levels.
- The People's Bank of China is providing mild incremental support to the economy in the form of policy rate cuts and declines in bank-required reserve ratios. As the government appears to prefer a rather strong currency and is wary of capital flight out of the country, we don't expect more aggressive ease from the central bank.

Bond Markets

- Yields on U.S. Treasuries appear to have settled into a trading range supported on the upside by slowing economic growth but limited on the downside by the impact of bond issuance to finance the growing level of government debt.
- With the current yield on the 10-year U.S. Treasury near our year-end target, we expect some progress over the remainder of the year in resolving the inverted yield curve challenge. Shorter-term rates should begin to decline as the Fed moves closer to implementing rate cuts. However, this process of moving back to a more normal, upward sloping curve may take several more quarters in a nonrecessionary economic environment.
- Continued economic growth and the lack of any meaningful increase in default rates have allowed interest rate spreads on high-yield bonds to remain near historic lows. While it does not appear that a recession will apply much pressure on the asset class over the coming months, concerns around refinancing risk as maturing debt will need to be reissued at much higher rates suggest a more cautious approach in investing in the below-investment-grade-debt space.

Equity Markets

- Earnings growth appears to have taken the baton from valuation multiple expansion as the primary driver of U.S. equity markets. As the rebound from the mild April pullback has still been dominated by the top mega cap companies in the S&P 500 Index, we expect greater breadth of participation across the market capitalization spectrum extending into the small- and mid-cap space where valuations are much more attractive.
- Valuations are also relatively attractive in the European equity markets although expected earnings growth is lower compared

to earnings growth in the United States. An earlier start to the monetary easing cycle should help European equities perform in line with those in the United States.

- Japanese equities will likely need to show they can perform in a more stable currency environment, as much of the year-to-date appreciation in local market prices has been lost to U.S. investors due to depreciation of the Japanese yen. An expected pickup in domestic demand could allow for broader participation in the equity market advance beyond the large exporters.
- Momentum has waned recently in the Chinese equity market, as investors have focused on the longer-term headwinds impacting the country's key export and manufacturing industries. With monetary policy support expected to be uncertain, investors will likely be looking to greater government fiscal spending to revive interest in this market.

Commodities and Currencies

- A general balance between supply and demand has kept oil prices rather contained over the past few months after the spike higher in the early part of the year. Non-OPEC production and some violation of assigned quotas among OPEC nations have kept supply ample in a global economic environment in which demand has been stable. Difficult-to-anticipate geopolitical risks to supply appear to be the only factor that could cause appreciation above current levels.
- Speculation around limited supply has led to a spike higher in many industrial metals over the last few months. We expect supply to soon react to these higher price levels, which should lead to notably reduced bullishness in the space.
- The recent move higher in gold prices is likely in anticipation of a broad easing of monetary policies around the globe. To the extent the Fed delays the timing and magnitude of rate decreases, gold may be vulnerable to a near-term pullback or correction from these rather lofty levels.
- After notable appreciation over the first four months of the year, the U.S. dollar is likely to settle into a trading range over the summer months in anticipation of the first Fed easing move. With other central banks having already begun to ease and U.S. economic growth and interest rates relatively higher compared to most other countries, downside risk to the greenback appears limited.

What This Means for Investors

- Global economic growth, driven by the United States, should remain comfortably positive through the end of the year. With supply having caught up to demand in the goods space, services inflation will need to come down to prevent monetary policy from being too restrictive to economic growth. With U.S. equities near record highs, we'll be looking for a broadening of participation to confirm the health of this bull market.

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