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Economic & Market Update

August 2024 Outlook

Global Economy

- The U.S. economy grew at a rate generally around its long-term trend of 2.0% in the first half of 2024, as ample jobs and wage growth fueled consumer spending. With the labor market slowing somewhat at the beginning of the third quarter and the savings rate having fallen to a rather low level of roughly 3.5%, there should be some slowing of consumer spending over the coming months, but a better balance seems to be developing between spending on goods and spending on services. The willingness to spend within the recently retired population cohort should continue to be a more secular driver of consumer spending that can partially offset cyclical slowdowns.
- Capital spending by businesses can likely counter any consumer slowdown. The increase in corporate profit growth should continue to fund investment in equipment and intellectual property that can drive productivity growth in a still somewhat labor-constrained economy. Government spending in a presidential election year is also expected to be additive to gross domestic product (GDP) in the second half of 2024, while a rising trade deficit and a challenging housing market will likely be slight detractors to economic growth.
- With shelter and wages still the most prominent factors limiting the disinflationary trend, the growing supply in both existing and new home inventory should reduce price pressure in house prices and rents, while wage growth should slow as the labor market gradually loosens. This combination should allow the inflation rate to move closer to the Federal Reserve's (Fed's) 2% target as we approach year-end.
- The European economy is expected to grow more slowly than the United States but is still expected to grow despite the decline being seen in Germany, the bloc's largest economy. Continued services spending on tourism in the southern-tier countries and the impact of the Olympic games on the French economy will be positive drivers. Prospective monetary policy relief will be helpful, although fiscal policy support will be restrained by growing budget deficits that may lead to slower government spending and perhaps tax increases in some economies.
- GDP growth in Japan appears to be increasing, with the coming months expected to provide a better indication of whether the Japanese economy could be driven by improving domestic demand as the tailwind of a sharp currency decline has been effectively removed. The recently completed union wage negotiations should boost consumption, although there needs to be an adjustment in the excess savings mentality of Japanese citizens after decades of deflation and anemic spending growth.
- Increased support from both monetary and fiscal policymakers has helped boost Chinese economic growth somewhat, although the secular headwinds of continued trade wars, poor demographics, and a recession in the property sector will prove challenging.

Monetary Policy

- With some recent and prospective relief in the sticky services price components of the inflation indicators, the Fed is poised to ease at the September Federal Open Market Committee meeting. The Fed will be careful about indicating that this will be the first in a series of future rate decreases, as it will be in the rather unusual position of easing into an environment of continued economic growth. Further expected progress on reducing the inflation rate should lead to at least one more rate decrease, likely during the December meeting. The Fed may also be wary of easing closer to the presidential election.
- Due to slower economic growth and better progress in bringing inflation closer to targets, the European Central Bank (ECB), Bank of England, and several smaller central banks on the continent have already begun the easing cycle. As expected, the ECB deferred any further easing moves at its July meeting and was careful to convey it is not precommitted to a particular path and will remain data-dependent. But with growing risks of an economic slowdown and a receding German economy, the ECB should decrease rates again at its September meeting.
- The Bank of Japan (BOJ) had resisted the tightening trend begun among other developed market central banks two years ago, as it was looking to encourage higher inflation after decades of slow growth and entrenched deflationary forces. With greater confidence that steady and more balanced economic growth can be achieved, the BOJ recently began to incrementally tighten rate policy. With the requisite caveats of remaining data-dependent, the central bank should continue to incrementally tighten through both rate increases and a distinct slowdown in balance sheet expansion.
- To expand domestic demand and help the government achieve its targeted growth goals, the People's Bank of China is expected to continue cutting its key short-term interest rates, although it will be careful to prevent any sharp decrease in its currency that could lead to heightened capital flight.

Bond Markets

- With the Fed about to embark on what should be a gradual rate-cutting campaign, short-term rates should decline throughout the rest of the year. Intermediate- to longer-term Treasury yields may be stickier around current levels as the yield curve finally returns to its more logical upward slope. Continued economic growth and greater supply to fund a growing deficit will place further upward pressure on intermediate maturity rates.
- The municipal bond market is largely impacted by the same dynamics, which influence yields in the taxable space. Additional factors are credit quality and supply and demand. The outlook for continued economic growth should preclude any significant credit deterioration, while slower incremental supply growth compared to Treasurys has rendered certain state issues rather expensive given the growing demand for shelter in high-tax states.
- High-yield bonds continue to appear expensive given the continued narrowing of interest rate spreads to historical lows. With no recession forecast over the near-term horizon, the biggest risk to the asset class remains refinancing risk, as quite a few issuers will be burdened with incrementally higher interest costs over the coming years.

Equity Markets

- A rather solid second quarter earnings season for U.S. equities has reduced apprehension about current valuation levels and has added to the breadth of the advance, with the more cyclical sectors participating as well as an impressive advance in the small- and mid-cap space. With monetary policy expected to provide less of a headwind on valuation and earnings growth rates continuing to improve, the rest of the equity market should continue to "catch up" somewhat to the impressive year-to-date performance of the top companies.

- An earlier start to monetary ease and avoidance so far of economic recession has helped improve the relative performance of European equities whose valuations remain notably cheaper than those seen in the United States. As earnings in these markets tend to be more tied to the global economy than any specific domestic economy, continued growth in the United States should be the primary driver of revenue growth and profit margins, although slower growth in China will be an important offsetting dynamic, particularly among German equities.
- Incremental monetary tightening in Japan has reversed the Japanese yen depreciation, which had been a large driver of Japanese equity performance. It appears the Japanese equity market can withstand a certain amount of currency appreciation as better domestic and international growth dynamics continue to drive earnings.
- The Chinese equity market appears to be relying on government policy support more than most markets, as equity sentiment continues to be weighed down by trade wars, a property recession, and poor demographics. Recent policy support can be a catalyst for a cyclical rebound over the coming months.

Commodities and Currencies

- Stable energy prices in a rather balanced market between supply and demand should further ease inflationary concerns. Lower prices over recent weeks despite growing geopolitical risk can be viewed as an indication that ample supply may exert incremental downward pressure over the remainder of the summer.
- Slower global economic growth, with particular weakness out of China, has placed pressure on industrial commodity prices, as producers reacted to take advantage of the hike in prices that occurred during the spring months. It is difficult to discern a catalyst for higher prices in this currently well-supplied market.
- The global trend toward greater monetary ease and growing fiscal deficits should continue to be favorable for gold and other precious metals, as short-term rates should soon be less competitive with these non-yielding assets.
- Anticipation of Fed easing has begun to pressure the U.S. dollar, although any further depreciation this year should be rather limited due to strong relative economic growth and higher interest rates available in the United States.

What This Means for Investors

- This environment of cooling global economic growth, which has led to lower inflation without recessions, has been conducive to the performance of most risk assets, particularly equities. Seeing the rest of the U.S. equity market and international markets catch up to the performance of the large industry leaders will be a strong sign of confidence for continued equity market advances. The obvious sources of risk to further advances are geopolitical factors and the U.S. presidential election. Markets will likely react only to the more discernible and tangible implications of both political landscapes. We continue to focus investors on the favorable economic and earnings fundamentals as we position portfolios accordingly.

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