Capital Markets Outlook
2Q 2024

Blake Gaulden, CFA, CFP®
Chief Investment Officer

Home Office
1447 York Rd
Suite 801
Lutherville, MD
21093
410.825.0781

Sykesville Office
7520 Main St
Suite 102
Sykesville, MD
21784
410.730.9786

Richmond Office
6641 W Broad St
Ste 403
Richmond, VA
23230
804.253.1437

Vienna Office
8219 Leesburg Pike
Vienna, VA
22182
703.287.1559

York Office
2449 W Philadelphia St
York, PA 17404
410.372.3232

Rockville Office
5410 Edson Lane
Suite 320
Rockville, MD
20852
301.296.6278

Chesapeake Office
649 Cedar Road
Suite 201
Chesapeake, VA
23322
757.777.3172

Summary

Outlook

- Job gains and easing inflation should allow the US economy to continue on its path to a soft-landing.
- The Fed will likely begin rate cuts later this year. How the economy responds will play a large role in market performance.
- Fixed income yields remain high, offering favorable future return opportunities.
- Slowing economic activity and the end of the Fed tightening cycle favor high-quality stocks and bonds.

Key Risks

- A soft economic landing is possible, but the range of potential outcomes is wide.
- Much of the economic recovery hinges on reducing inflation. If the Fed believes it necessary to delay rate cuts significantly, it could disrupt financial markets.

Review

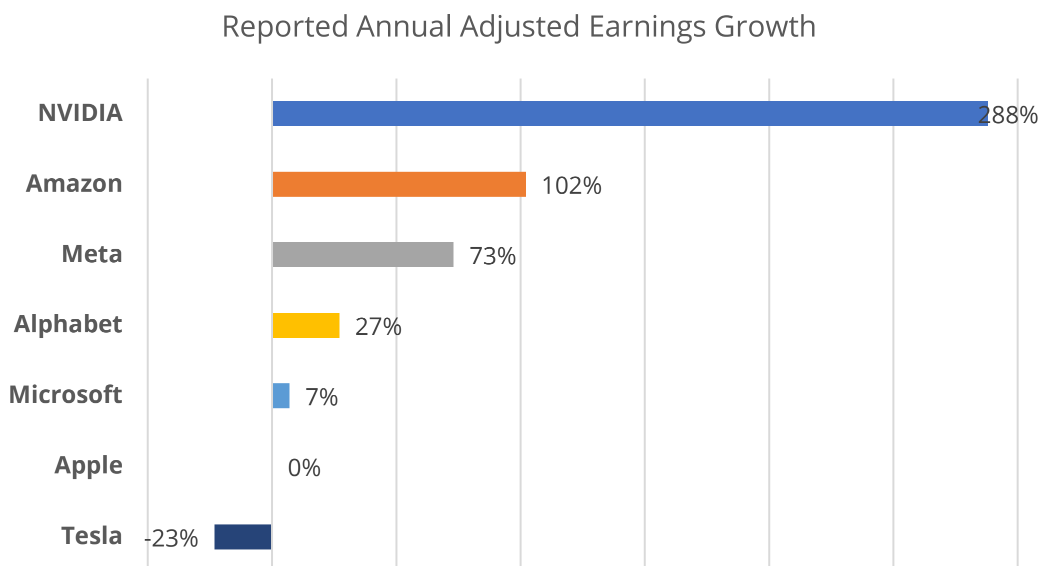
The US economy continued to expand in the first quarter, led by a robust labor market. A growing labor force leads to more capacity for productivity and consumption. The supply-side boost from a strong labor force has also contributed to disinflation, though that process did slow to a degree in the first quarter. The Fed is expecting to cut rates up to three times this year and reduced the number of expected cuts from four to three. The news of a more gradual rate cut cycle caused long-term interest rates to rise but stocks were unphased, setting new all-time highs.

	YTD	6 Months	1 Year
Large Cap	10.4%	23.2%	29.6%
Mid Cap	9.9%	22.7%	23.2%
Small Cap	2.4%	17.8%	15.9%
International	6.0%	17.3%	15.2%
Emerging Markets	2.2%	10.3%	6.9%
High Yield Bond	1.6%	8.9%	9.6%
1-3 Year Treasuries	0.3%	2.8%	2.8%
7-10 Year Treasuries	-1.3%	5.0%	-1.6%
20+ Year Treasuries	-3.7%	8.7%	-7.8%
Aggregate Bond	-0.7%	6.0%	1.6%
TIPs	-0.1%	4.4%	0.1%

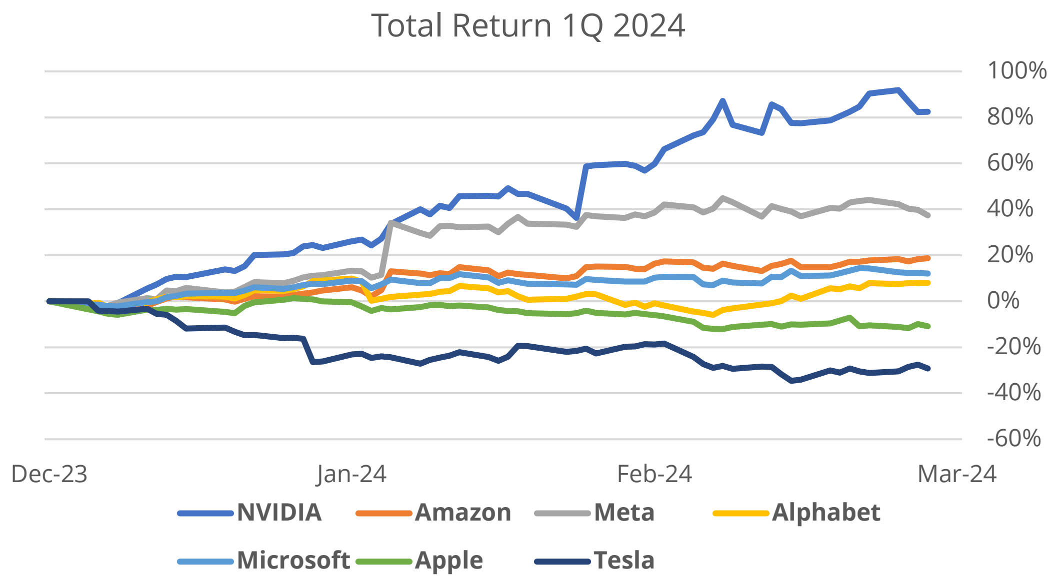
Source: YCharts. S&P 500 Index, S&P MidCap 400 Index, S&P SmallCap 600 Index, MSCI EAFE Index, MSCI Emerging Markets Index, ICE Us Treasury 1-3 Year Bond Index, ICE US Treasury 7-10 Year Bond Index, ICE US Treasury 20+ Year Bond Index, Bloomberg US Aggregate Bond Index, Bloomberg US Treasury Inflation-Linked Bond Index[1]

Outlook

The market's resilience shows a potential turning point for investors. Inflation, growth, and interest rates have been the dominant forces in market returns. However, corporate profits may be regaining prominence. Many analysts look at the Magnificent Seven mega cap stocks that have been driving broad market returns. In the first quarter of 2024, those stocks' returns were correlated to their earnings growth.

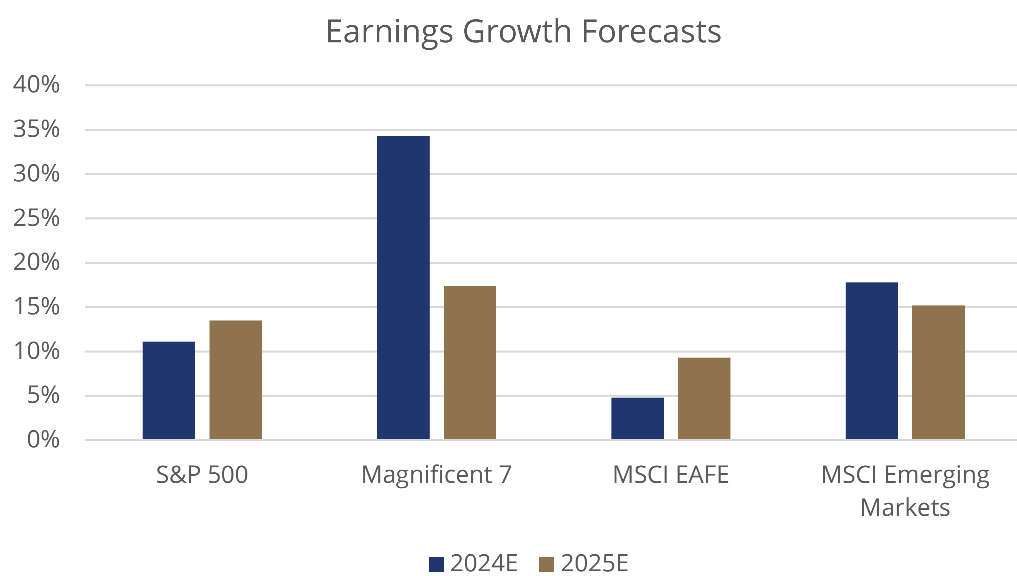


Source: YCharts. Based on reported adjusted earnings for the most recent fiscal year. Fiscal year for Amazon, Meta Platforms, Alphabet Inc. and Tesla ended December 31, 2023. Microsoft's most recent fiscal year ended June 30, 2023. Apple's fiscal year ended September 30, 2023. NVIDIA's fiscal year ended January 31, 2024.



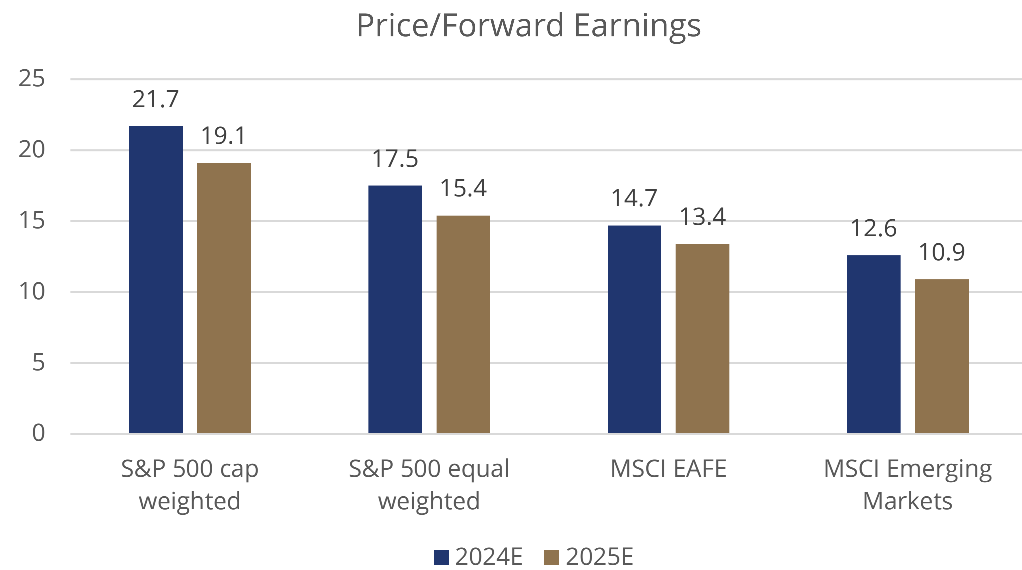
Source: YCharts

If the trend of corporate profits driving returns continues, it could bode well for the broader market. Consensus earnings forecasts point to further growth.



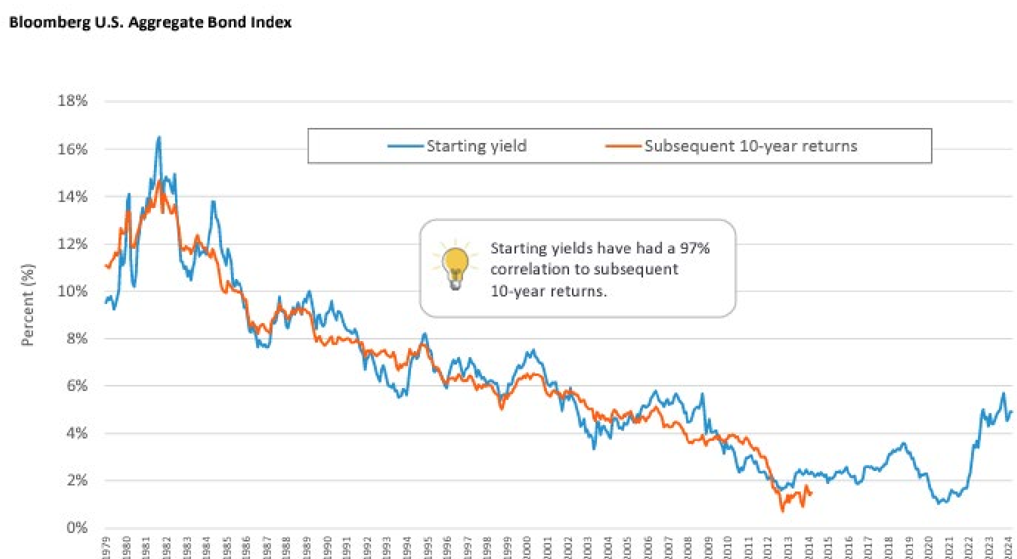
Source: AllianceBernstein, Bloomberg, FactSet, MSCI, S&P, Thomson Reuters I/B/E/S. As of March 31, 2024.

Additionally, valuations are not as extreme as they may seem. Some Mega Cap companies such as those in the Magnificent 7 have stretched S&P 500 P/E ratios but looking at the equal weighted index paints a different picture.



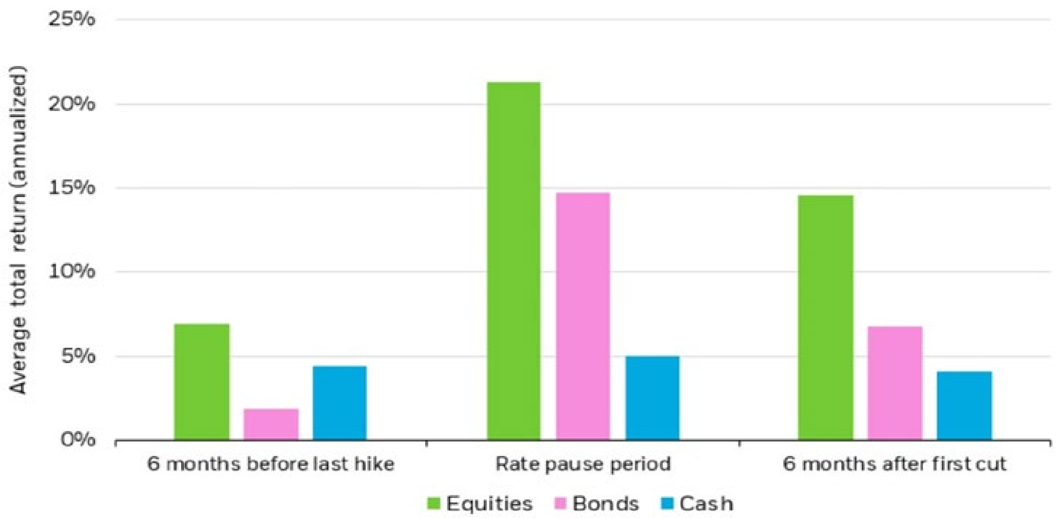
Source: AllianceBernstein, FactSet, MSCI, S&P.

There are also opportunities in bonds. The starting yield of US core bonds is very highly correlated with subsequent 10-year returns. Interest rate policy has lifted yields to levels no seen in 15+ years which suggests the potential for solid returns in fixed income.



Source: Lincoln Financial Market Intel Exchange. Research affiliates based on data from Bloomberg and FactSet as of March 31, 2024. Proxy: Bloomberg U.S. Aggregate Bond Index.

The positive case for stocks and bonds is further demonstrated in data from past Fed rate hike cycles. The below chart shows returns for stocks, bonds, and cash six months before the last rate hike, during the pause period, and six months after the last rate hike. During the first rate pause and first cut periods, stocks and bonds have outperformed cash.



Source: Lincoln Financial Market Intel Exchange. BlackRock, Bloomberg, as of November 16, 2023. Total return analysis produced by iShares Investment Strategy. Historicalanalysis calculates average performance of the S&P 500 Index (equities), the Bloomberg U.S. Aggregate Bond Index (bonds), and the Bloomberg U.S. Treasury Bills: 1-3 Months TR Index (cash) in the 6 months leading up to the last Fed rate hike, between the last rate hike and first cut, and the 6 months after the first cut. The dates used for the last rate hike of a cycle are: 2/1/1995, 3/25/1997, 5/16/2000, 6/29/2006, 12/19/2018. Dates used for the first-rate cut are: 7/6/1995, 9/29/1998, 1/3/2001, 9/18/2007, 8/1/2019. Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

Conclusion

There are many positive trends for both stocks and bonds, but investors should be prepared for a range of outcomes. Improving economic data has reduced the probability of a recession. Most analysts believe there will either be a mild recession or no recession at all in the near term. A strong labor market, positive corporate profit outlook, and elevated yields point to the potential for continued strength in capital markets.

We will continue to monitor trends that we believe could impact your portfolios, such as the pace of the recovery, earnings growth, valuation, and inflation. Our goal is always to be efficient and selective in portfolio construction to best position clients for success.

If you have any questions, please don't hesitate to reach out to your Academy Financial advisor.

[1]The S&P 500 index covers the 500 largest companies that are in the United States. These companies can vary across various sectors. The S&P MidCap 400 Index, more commonly known as the S&P 400, is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence. The S&P SmallCap 600 Index is a stock market index established by Standard & Poor's. It covers roughly the small-cap range of US stocks, using a capitalization-weighted index. The MSCI EAFE Index tracks large cap and mid cap companies in developed countries around the world. The index primarily covers the Europe, Australasia, and the Far East regions. The MSCI Emerging Markets Index represents securities that are headquartered in emerging markets. An emerging market is considered a country that has not yet become developed because of economic characteristics. The ICE U.S. Treasury 1-3 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than one year and less than or equal to three years. The ICE U.S. Treasury 7-10 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than seven years and less than or equal to ten years. The ICE U.S. Treasury 20+ Year Bond Index is part of a series of indices intended to the assess U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than twenty years. The Bloomberg USAgg Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The Bloomberg US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.*