Transition Insights

Welcome to Transition Insights!

As we enter the second half of 2024, now is the perfect time to review the last quarter.

Overall, bulls continued to run during the second quarter of 2024 as several major stock indexes broke out of recent trading ranges to the upside.

Tallying the quarter, the S&P 500 increased by approximately 3.90%, the Nasdaq Composite rose by close to 8.1%, and the Dow Jones Industrial Average decreased by nearly 1.7%.

Economy

Rewind to the beginning of the year, and the talk of the town was as many as six rate cuts to come this year. Remember that? Well, courtesy of sticky inflation (which has recently shown early signs of potentially softening), the narrative has changed significantly since then.

Current expectations are for one rate cut in 2024, with the Fed's ability to cut near the presidential election in question.

Inflation

The year-over-year Consumer Price Index inflation rate declined in Q2, with the last CPI reading of the quarter showing consumer pricing cooling slightly month-over-month in May and year-over-year inflation running at 3.3%. It is too early to say if the trend will continue, as many market bulls desire.

Core CPI (which removes more volatile food and energy from the metric) dropped to a three-year low of 3.4% in May, potentially bolstering the case for rate cuts down the line. This metric illustrates just how much the necessities of food and energy contribute to the inflationary pressures here in America.
U.S. equities loved seeing inflation metrics tick lower throughout the second quarter, and the S&P 500 continued to make fresh all-time highs.

Labor Market

Labor markets remained mostly steady to higher throughout Q2, with payroll gains (206,000 in June, 272,000 in May, 175,000 in April) in each month and June and May data beating analyst consensus expectations.

For June, the unemployment rate rose to 4.1%, higher than the estimated 4.0% and the highest level since November 2021. The unemployment rate has inched higher each month for the past three months, potential signs that the Fed’s rate hike crusade has dampened the U.S. economy. You wouldn’t know it by looking at the S&P 500!

Quarterly Fed Expectations

The second quarter featured two Federal Reserve (Fed) policy meetings. The Fed left rates unchanged both times, in line with market expectations. The result is a current target overnight lending rate of 5 - 5.25%.

More importantly, the Fed has set expectations that it will cut rates only once in 2024.

In the third quarter, there will be two Fed meetings: July 31st and September 18th. As of early July, markets were pricing a 93.3**%** probability of no rate cut in July and a 70.8% probability of a 25-basis-point cut in September, per the CME FedWatch Tool.

Pre-Election Rate Cut Debate

Even with a 70.8% probability of a Fed rate cut at the September meeting, much controversy surrounds such a cut, as some market participants argue that a cut could bolster the economy and show potential favoritism to the incumbent. This will likely remain a topic of discussion as the time remaining until Election Day ticks down.

Treasuries

Courtesy of slowing inflation data and Fed rate cut expectations, Treasury yields fell in the second quarter by more than 30 basis points from their April peak, ending the quarter near 4.37%.

As a result, holders of bonds have seen some well-deserved price appreciation since April. The Morningstar Core Bond Index gained 0.17% for Q2, and high-yield bonds tacked on 1.07% for the quarter, with the longer end of the curve lagging the shorter-term counterparts.

Generational Opportunity in Bonds?

It has been a rough patch for bond investors, to say the least, but there is hope!

Is it so bad that it is good? Some experts say yes. It has been 46 months since the bond market made an all-time high.

Looking at the Bloomberg US Aggregate Bond Index's largest drawdown periods from 1976-2024, we can see that this drawdown has reached extreme levels. Should inflation continue to decelerate or decrease, it could be a time when smart money looks to bonds, given the value proposition.

Not as trendy as AI-fueled stocks, bonds do stand the test of time, and there is ample math that supports these fixed-income assets. Some food for thought entering the third quarter!

Forgotten Yield Curve Inversion

The longest yield curve inversion in U.S. history passed the two-year mark on July 7th. Seemingly forgotten as of late, the abnormal phenomenon has historically portended economic contraction or recession, but those who have banked on that thus far have missed a large rally in equities.

It is election season, so anything is possible moving forward.

Wall Street Wisdom Debunked

The classic Wall Street adage of "Sell in May and Go Away" did not transpire in the second quarter — for the second year in a row!

That's right. Despite the higher interest rate environment, an inverted yield curve, and seasonality, the S&P 500 was positive for two out of three months in the second quarter. After declining by 4.16% in April, the S&P 500 added 4.80% in May and 3.47% in June, a solid quarter for the broad market average.

Tech and artificial intelligence (AI) continue to outperform the broader market, and AI-fueled gains were a prevailing narrative once again in the second quarter.

Technology Strength, Materials & Industrials Lag in Q2

On the subject of AI and tech, below is the overall performance of the technology sector in the second quarter, along with other popular stock sectors and how they fared in Q2 2024.

- Technology: +11.40% in Q2 2024.
- Basic Materials: -5.88% in Q2 2024.
- Communication Services: +9.16% in Q2 2024.
- Consumer Cyclical: -1.20% in Q2 2024.
- Utilities: +4.48% in Q2 2024.
- Industrials: -3.41% in Q2 2024.

Dividend Stocks Lag in Q3: Turning Point Ahead?

With the ten-year yield near 4.268% and, of course, the two-year yield higher at around 4.624%, it is not rocket science why blue-chip dividend-paying stocks have lagged as their trendier tech and AI counterparts have caught massive inflows of investor cash.

But those who have been around the markets for a while know that trends can be temporary, and U.S. giants like Coca-Cola, Disney, and 3M, for example, have stood the test of time and will not be going anywhere anytime soon.

Should interest rates decline, as many expect, dividend-paying stocks could once again come back into favor. We see that defensive sectors like utilities did well in the second quarter — perhaps a sign of things to come.

More food for thought for those seeking further portfolio diversification heading into Q3.

From Q2 to Q3: A Summary

Of course, much attention will continue to be paid to inflation data and Fedspeak. The Fed has broadcast its intentions for one rate cut in 2024, with the CME FedWatch Tool showing current expectations for one in September. The presidential election later this year adds an element of uncertainty to trying to "time" an interest rate cut.

But, putting those two things aside, portfolio diversification and a long-term focus have been the ticket for ages. Some active participants may seek to look outside of tech and AI in Q3 to reduce portfolio volatility, be first in line to some dividend-paying blue chips, and perhaps find happiness in the beaten-up bonds/fixed-income products.

Diversification is the ticket to being a successful long-term investor; timing the market is very difficult, and diversification is much easier. Moreover, remaining focused on the long term allows an investor to avoid getting caught up in quickly changing narratives that could trigger emotional decisions.

With that overview noted**,** if Q2 market developments are on your mind, feel free to give us a call!

Embracing the Unknown: Why Investors Shouldn't Look Too Far Ahead

If you've ever been caught in a rainstorm during a round of golf, wishing you packed sunscreen on a day that was supposed to be cloudy, or simply taking the weather forecast with a grain of salt, you probably understand that forecasting is not an exact science. That grain-of-salt attitude should also be applied when trying to predict the stock markets—particularly when focusing on the long term, which is more difficult than trying to predict the short term. Why? Because there is much more time for the different variables that affect the market to change or make themselves known.

The Illusion of Control

It is a scientific fact that humans fear the unknown. It follows, then, that the markets also hate the uncertainty that comes from the unknown. To gain "control," investors will read different analyst opinions about the future of the overall market, as well as specific areas of the market. It's natural to feel more in control if you feel at least some certainty about things. But investing involves risk because the future is so uncertain. The key, then, is to intently focus much more on the now than on the then.

Looking Too Far Ahead

"You've got to be very careful if you don't know where you are going, because you might not get there." — Yogi Berra (oft-quoted New York Yankees catcher)

Looking too far into the future has gotten some investors into trouble in the not-too-distant past. A good example is the 2016 presidential election. Analysts and investors alike made predictions at the beginning of 2016. Generally, it was anticipated that if Donald Trump—known for his unpredictable nature and his antitrade rhetoric—won, we would see a drop in the markets of 8 percent to 10 percent. On the other hand, a Hillary Clinton victory (which was widely expected) was already priced into the market, so most thought the markets would move sideways. What actually happened? The markets rallied and have mostly continued to do so throughout his presidency.

The Road Less Traveled

"Two roads diverged in a wood and I—I took the one less traveled by, and that has made all the difference." — Robert Frost ("The Road Not Taken")

A lot of investors look too far into the future. Instead, we would be wise to consider the road less traveled. In other words, evaluate current factors on a shorter-term basis. Forecasting in the short term is more precise than doing so for the long term; moreover, it is more of an evaluation than a forecast as you look at current data and compare it with historical levels. For instance, you could compare current Shiller P/E ratios with historical ones to evaluate valuation risk in the market.

Follow the Trends

"No, I don't know where I'm goin'. But I sure know where I've been." — "Here I Go Again" (a song by Whitesnake)

The economy is usually either growing or slowing. Economic data points help determine which direction is trending. What other data points should you look at to gauge the current state of the markets? There are many to choose from; here are some of the most useful:

- **Economic growth as measured by gross domestic product (GDP).** This metric measures the value of economic activity within a country. If it beats economic forecasts, it is good for the stock market (and vice versa).
- **Retail sales and consumer confidence.** The consumer makes up almost two-thirds of GDP. So, if the consumer is strong, the economy is as well.
- **Earnings growth.** Are companies making more money than in the previous quarter? William Danoff, a longtime portfolio manager at Fidelity, often talks about finding companies that are industry leaders and growing their earnings. In his opinion, these companies are likely to provide solid returns, no matter what the overall market was doing.
- **Which way the 10-year U.S. Treasury yield is moving.** If the yield is trending higher, bond prices are going down and, more than likely, equity prices are going up.
- **Relative strength of the U.S. dollar.** Is the dollar getting stronger or weaker relative to other countries' currencies? A stronger dollar makes imports cheaper and exports pricier. Moreover, commodity and international stocks perform relatively worse in this environment.

In It for the Long Haul

Trying to time the market based on what you think will happen in the future—never mind just in general—can lower investor returns relative to market returns. It may be wiser to invest for the long term, according to your risk tolerance and investment goals. This method will most likely lead you down the path of financial success.