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Economic & Market Summary
July 2024

After growing above-trend at 2-3% for the last several quarters, real economic growth fell to 1.4% annualized in Q1. Consumer spending, which is about 2/3 of the economy, is softening. Retail sales have slowed to a growth rate below inflation suggesting consumers are pulling back in the face of rising prices. Accordingly, earnings from many of our consumer companies have been weak lately. The housing market is also struggling as evidenced by soft home sales and housing starts (especially multifamily units). For single-family homes, a big part of this is likely due to the "lock in" effect where homeowners that want to move feel they cannot because they refinanced or bought at lower mortgage rates. This limits market inventory and supports elevated prices.

Progress on inflation has been mixed this year. Consequently, expectations for rate cuts continue to come down. At the June meeting, Federal Reserve policy makers signaled one rate cut this year which is down from three in March. Recall, markets expected as many as six cuts entering the year. Housing remains a key inflation driver, but real-time measures of housing costs show an encouraging deceleration. This should eventually put downward pressure on overall inflation. While we expect one rate cut before the year ends, we need to monitor the recent acceleration in producer inflation. We are also wary of the federal government's ballooning deficits. Reckless spending combined with political volatility signal a lack of stability to global financial markets potentially leading to higher interest rates.

Earlier this year, the stock market's performance was broadening beyond the large tech companies. However, this trend reversed in Q2. Year-to-date, the S&P 500 index, which weights companies by market cap (price multiplied by the number of shares outstanding), gained 4% in the second quarter and is up 14.5% year-to-date. However, the equal weight version of the index *declined* 3% in Q2 and is up only 4.1% year-to-date. This large performance disparity is driven by six enormous companies that together make up about 32% of the market cap weighted S&P 500. The market is in a state of euphoria over AI which has helped drive the huge price increases of those six stocks. Human nature tends to overestimate the scale and timing of significant technological shifts. During periods of wild optimism, it is difficult to separate hype from actual economic impact. For now, expectations for AI are very high.

With so much performance concentrated in so few names, owning a diversified stock portfolio can seem quaint. However, returns will eventually converge. Potential near-term catalysts include a correction in technology stocks, possibly driven by a change in sentiment around AI, or rate cuts which could help non-tech stocks close the performance gap. Patience is the most difficult part of being a long-term investor. It takes courage and conviction to own high-quality businesses when their stock prices are temporarily out of favor.

Mark J. Sprtel, CFA

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.