Market Commentary

Weekly perspective on current market sentiment **July 24, 2024**

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Last week's S&P 500 Index: -2.0%

Different week, similar conclusion

Key takeaways

- We are focused on the economy and where it is likely headed between now and the end of next year.
- It may be a different week, but our conclusion is the same: position for the economy, not the election.

With more than three months remaining until the November elections, the political landscape is likely to remain volatile if recent events are any indication. A former president narrowly avoiding an assassin's bullet and the current president deciding not to seek reelection, all in the span of eight days, are sure to keep tensions high for many Americans. And this doesn't begin to take into account the effects of a slowing economy and labor market along with price pressures that have dimmed the confidence of many of our fellow citizens. The PredictIt betting market site is showing a 61% chance of a Trump win in November at the time of this writing. He is still the clear favorite based on this indicator, but the likely winning probability is down from a July 15 level of 69%, just after the Pennsylvania rally shooting.

As we have discussed, we are focused on the economy and where it is likely headed between now and the end of next year. That encompasses our tactical time frame and allows us to favor and allocate funds toward those asset classes and sectors we believe offer the best opportunity to outperform their respective benchmarks over a short-to-intermediate term horizon. Elections certainly matter, but we believe investors need to focus on the underlying fundamentals rather than on a political environment that can clearly change on very little if any notice.

The financial markets appear convinced that the Federal Reserve (Fed) will begin cutting interest rates soon. In fact, based on Bloomberg data, the market is pricing in a nearly 95% probability that the Fed begins cutting rates at the September Federal Open Market Committee (FOMC) meeting in September. The market is also pricing in a cut at the November and December meetings. Recent inflation data have supported the rate-cutting thesis. For example, the year-over-year Consumer Price Index (CPI) came in at a better-than-expected 3% in June.

Falling interest rates tend to help the Financial sector. Based on our outlook, we increased the rating on this sector to favorable last week. We expect short-term interest rates to fall relative to long-term rates. Over time, we see easier monetary policy leading to improved economic performance, better loan demand, and increased merger and acquisition activity.

One asset class that has recently garnered attention is small-cap domestic stocks as represented by the Russell 2000 Index (RTY). Money flowed into small caps starting in the second week of this month in response to the increased probability of lower interest rates along with the potential for lower taxes and less regulation should former President Trump win back the White House. However, keep in mind that potential tariffs could hurt the sourcing ability for many small companies and over 40% of RTY stocks are not profitable. We do not believe the underlying fundamentals are in place for an upgrade to small caps. Our rating remains most unfavorable.

It may be a different week, but our conclusion is the same: position portfolios for the economy and not who you think might win the election.

Risk considerations

Forecasts, estimates, and projections are not guaranteed and are based on certain assumptions and views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector.

Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

An index is unmanaged and not available for direct investment.

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