Weekly Investment Insights

June 24, 2024

Key Takeaways:

- Consumers increase spending less than expected.
- Housing data remains weak amid higher interest rates.
- Leading Indicators Index falls as expectations dwindle.
- Value sectors outperform growth sectors; NVDA lower.
- Yields inch higher as investors digest economic data.
- Crude oil demand surges to pre-pandemic highs.

Weekly Economic Recap –

Consumer spending slows

Retail sales increased less than expected in May as consumers showed strain in the face of elevated prices. The index, which is unadjusted for inflation, increased 0.1% (vs. 0.2% est.). Sales at gasoline stations fell by the most since November 2023. The control group, which is used to calculate GDP, increased 0.4% in May, however all measures of sales were revised lower in the month prior.

Construction of new homes in the U.S. fell to the slowest pace in four years as builders continue to contend with higher interest rates. Construction delcined in three of the four regions, led by a 19% decrease in the Midwest.

Building permits, a proxy for future construction, fell to the lowest level since July 2020. The decrease was led by permits in the Northeast plunging 22.4%, offsetting increases in the Midwest and West.

The S&P Global Composite PMI Index increased to the highest level since April 2022. Expansion in the service sector also increased at the fastest pace since April 2022 and optimism for future business activity increased to a three-month high.

The Leading Economic Indicators Index fell for the third straight month in May and has declined for 26 out of the past 27 months. Continued downward pressure on ISM new orders and consumer expectations for business conditions detracted the most from the headline index.

Weekly Market Recap –

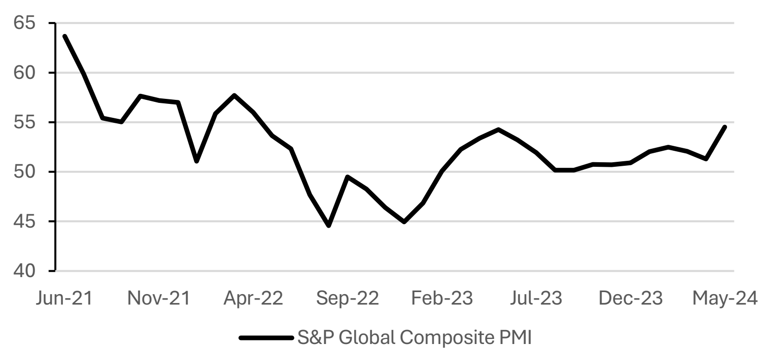
Growth Sectors Underperform as Traders Anticipate Path Forward for Fed Rate Cuts

Equities: The MSCI AC World Index was higher for the third straight week. The Dow Jones Industrial Average posted its best weekly performance since May and led U.S. market performance. Value sectors broadly outperformed growth sectors as tech darling NVDA posted its first weekly loss in nine weeks. Internationally, emerging markets outperformed developed markets by ~60bps.

Fixed Income: The Bloomberg Barclays Aggregate Index was lower for the first time in four weeks. Treasury yields inched higher during the week (bond prices lower) as traders digested the latest economic data and what it could mean for the Fed's path forward. Investment grade corporate bonds were the weakest performing area of fixed income, falling for the first time in four weeks.

Commodities/FX: The Bloomberg Commodity Index was lower for the fourth time in five weeks despite a rally in crude oil prices. Crude oil was higher for the second straight week as data showed demand surged to the highest since pre-pandemic levels. Gold prices ended the week lower amid rising Treasury yields and a stronger U.S. Dollar.

Business Activity Increases to Highest Since Apr. '22



Footnotes: Data is as of May 2024.
Source: FactSet Research Systems, Verdence Capital Advisors.

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Past performance is not indicative of future returns.

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Key Takeaways:

- CBO projections cause alarm bells to ring.
- Inflation expected to remain stubborn, putting pressure on the Federal Reserve.
- Government budget deficit continuing to widen.
- Net interest expense passes defense spending; projected to get worse.
- Mandatory spending programs climb above historical 50-year average.

Alarm Bells Sound After CBO Releases Updated Spending Figures

Last week, the nonpartisan Congressional Budget Office (CBO) released their updated economic outlook for the period 2024 – 2034.[1] The report was discerning as the organization increased their estimates for the size of the government budget defict from prior predictions. The organization sees the deficit ballooning 27% to nearly $2 trillion by the end of the fiscal year (September 2024). Additionally, the report indicated the potential for higher economic growth and inflation this year, which would put pressure on the Federal Reserve. This week, we wanted to highlight some of the key takeaways from the report.

- **Economic outlook expected to slow:** The CBO projects economic growth to remain strong this year before showing signs of cooling. The projections show unemployment increasing to 4% by the end of 2025 and 4.5% by the end of 2030 before falling slowly thereafter. Inflation, as tracked by the PCE Price Index, is expected to increase less in 2024 and 2025 than it did in 2023 but remains a key headwind for the economy. The organization does not anticipate Federal Reserve rate cuts until early 2025 because of higher growth and stubborn inflation.
- **Government budget deficit to widen, not shrink:** The CBO projects the budget deficit widening to $1.9 trillion for FY'24, ~$400 billion larger than their projections in February. The increase has been attributed to further government spending habits, including aid for Ukraine, Israel, and Taiwan (~$60 billion), President Biden's student loan forgiveness plans (~$145 billion), and a reduction in the estimated amount the FDIC will recoup from payments made to cover bank failures (~$70 billion). This would bring the deficit to roughly 7% of GDP.
- **Interest expense on debt driving the deficit:** Net interest outlays are expected to total $892 billion in FY'24, surpassing discretionary outlays for defense spending. As a percentage of GDP, interest expense is expected to be ~3.1% in 2024 and climb to 4.1% in 2034. Since 1974, net outlays for interest expenses have averaged ~2.1% of GDP and since 1940, have never exceeded 3.2% of GDP. Given the current projections, net outlays for interest are expected to exceed this value every year 2025 – 2034.
- **Mandatory spending programs climbing:** Mandatory spending programs, which include outlays for federal benefit programs and state/local governments, are projected to increase on average 4.2% per year from 2024 – 2034. This would equate to ~15.3% of GDP in 2034, which is four percentage points higher than the last 50 years average. The report cites two underlying trends as main causes of the increase in spending, including the rising average age of the population and growth in federal health care costs.

The Bottom Line:

As a nonpartisian organization, the CBO remains neutral on their projections and does not take into account the potential for new spending proposals to be passed by Congress. As the November Presedential election nears, we will revist this report in the coming weeks and outline the budget proposals for both Joe Biden and Donald Trump. Whoever takes office in November, finding a way to control spending should be, in our opinion, a top priority.

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Global Equities Rally But Tech Cools

U.S. Equities

	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	39,150	1.5%	-1.6%	-1.1%	17.7%	4.9%
S&P 500	5,465	0.6%	2.8%	4.6%	27.1%	15.4%
Russell 1000 Growth	3,664	0.3%	5.5%	7.6%	36.2%	20.5%
Russell 1000 Value	1,723	1.2%	-1.7%	-0.7%	15.3%	6.8%
Russell Midcap	3,249	1.0%	-2.1%	-2.2%	15.8%	5.2%
Russell 2000	2,022	0.8%	-3.5%	-3.3%	10.2%	0.4%
Nasdaq	17,689	0.0%	5.2%	8.0%	32.1%	18.3%

International Equities

	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	801	0.5%	0.8%	2.8%	20.5%	11.2%
MSCI EAFE (USD)	2,308	0.1%	-2.9%	-0.8%	10.8%	5.0%
MSCI Europe ex UK (USD)	2,611	0.7%	-2.8%	-0.2%	12.9%	5.7%
MSCI Japan (USD)	3,798	-2.1%	-3.6%	-7.0%	8.2%	3.6%
MSCI UK (USD)	1,239	1.0%	-2.6%	5.1%	12.8%	7.7%
MSCI EM (USD)	1,087	1.0%	-0.3%	4.5%	11.1%	7.4%
MSCI Asia ex Japan (USD)	698	0.7%	0.7%	6.6%	11.6%	9.9%

Fixed Income

	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	4.9%	-0.2%	1.3%	1.3%	2.9%	-0.1%
U.S. Govt/Credit	4.8%	-0.2%	1.2%	1.2%	3.0%	-0.1%
U.S. 10 Year Treasury	4.3%	-0.3%	1.7%	1.3%	-0.5%	-1.2%
U.S. TIPS (1-10YR)	4.7%	0.2%	0.8%	1.4%	3.8%	1.3%
U.S. High Yield	7.9%	0.2%	0.6%	1.2%	10.8%	2.5%
EM Bonds (USD)	7.1%	-0.1%	0.5%	1.5%	8.5%	2.6%
Municipal Bonds	3.7%	0.0%	0.8%	0.0%	3.5%	-0.2%

Commodities

	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	240	-0.6%	-4.5%	3.7%	2.5%	5.8%
Crude Oil (USD/bbl)	$80.7	2.7%	1.5%	-0.3%	8.2%	9.1%
Gold ($/oz)	$2,322.0	-0.5%	-4.1%	6.4%	20.2%	12.6%
Copper	$444.2	-0.9%	-13.2%	9.8%	13.5%	14.2%
Wheat	$575.8	-9.7%	-19.8%	-0.3%	-26.0%	-12.3%
U.S. Dollar	106	0.6%	1.1%	1.7%	3.6%	4.4%
VIX Index	13.2	4.3%	11.3%	2.2%	0.0%	6.0%

[1]: https://www.cbo.gov/system/files/2024-06/60039-Outlook-2024.pdf

Footnotes: Data is as of April 19, 2024.

Source: Bloomberg Finance LP, Verdence Capital Advisors.

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