

CHIEF INVESTMENT OFFICE

Investment Insights

Four by Four Relay

August 2024

All data, projections and opinions are as of the date of this report and subject to change.

We see four dominant reasons why the markets have been on edge recently and will likely remain volatile into August.

- First, economic data has been slowing consistently across various macro indicators and investors are nervous that these are early signs of a recession. This includes the latest low expectations jobs report for July.
- Second, there is a rising belief that without an August Federal Reserve (Fed) policy setting meeting the Fed may be behind the curve on cutting rates. The fed funds futures market now has over a 30 percent probability of a 50 basis point cut in September.
- Third, the geopolitical environment at home and around the world has become more uncertain.
- Finally, the rate increase by the Bank of Japan and subsequent pull-back on bond buying, which moves them further into phasing out yield curve control policies, has upset currency, rates, and risk asset markets. Since the Japanese yen has been a funding currency—given its decades long zero rates policy—for the purchase of risk assets around the world (namely U.S. mega capitalization Technology Growth stocks) any sharp, consistent strength in the yen can cause unwinds in portfolio positioning since institutional investors would have to raise more capital to pay back the loan in the funding currency.

After such a sharp rise off the lows in equity markets in October 2023 mixed with the recent sharp move lower in yields, we understand the nervousness and expect elevated volatility over the short term but our base case is to buy on weakness in the equity markets and maintain a long term Equity overweight for four fundamental reasons.

- First, our view is the economy is normalizing back to the prepandemic trend which includes an average spending rate by the consumer. BofA Global Research is not expecting a recession, all things considered.
- Second, corporate profits remain healthy. We expect a low double-digit growth rate for the S&P 500 this year and attractive growth likely in the mid to high single-digit growth rates in 2025.
- Third, although a rate-cutting cycle typically induces above average market volatility, it is the reasoning behind the policy about-face that creates the investor concerns. In this environment, it is our view that a rate-cutting cycle is normalizing in rates based on where inflation and employment trends are moving, not a panic move due to concerns over a recession.
- Fourth, the potential long run benefits of generative artificial intelligence across a number of sectors is just beginning. The increase in productivity and significant potential for the production of positive operative leverage in the coming years combined with the speed of innovation in healthcare and modern infrastructure build-out should allow for a more substantive corporate growth outlook than currently expected, in our view.

For now, as short-term exposures are rebalanced, we expect an above average choppy market environment. Long term investors should consider using weakness to their advantage.

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Data as of August 2, 2024

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S&P 500 Index is a market-capitalization-weighted index that is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

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