Unremarkable

Market Update From Advanced Asset Management Advisors
June 30, 2024

Three months ago, we suggested that "Risks Were Rising" which prompted a reduction in the equity exposure within our Balanced portfolio strategy. Over the last quarter, economic conditions have not changed materially, and market developments have been unremarkable.

A Skewed View

Financial media outlets will recount the number of record highs posted by the "market" as they are fixated on the capitalization-weighted stock market indices. However, these indices continue to be heavily influenced by a handful of large company stock values.

The top ten largest companies represent a historically high 27% of market value[1], exceeding levels from the dot-com bubble and nearing the level of the nifty-fifty market in the mid-1960s.

	Q2 2024 Return
Stock Market	
Dow Jones Industrial Average	-1.41
Average S&P 500 Stock	-2.63
Average S&P Mid Cap Stock	-3.53
Average S&P Small Cap Stock	-4.47
Bond Market	
Barclays Aggregate Bond Index	0.07
Long-Term Treasury Bond Index	-1.81
90-Day Treasury Bills	1.34

Source: Morningstar

Concentration is also evidenced globally with U.S. stocks accounting for 72.3% of the MSCI World Index (up from 50% 15 years ago). Microsoft is the largest single component of the World Index representing 4.5% of the index. Microsoft is worth more than the value of all U.K. stocks (4%), all French stocks (3.1%), and all Canadian stocks (3%)[2].

Highly concentrated markets can, of course, be resolved either by a "broadening" of strength in smaller companies or by a fall of the leaders. At the beginning of the year, optimism was high for the "broadening". However, concentration within the market has continued and the relative performance of the average stock has fallen to a 15 year low.

We suspect relative weakness of the average stock is tied to the negative impact of higher interest rates coupled with continual disappointment in the delayed pivot towards easing monetary policy. Is there still any hope for the "Fed Pivot"?

Inflation Update

Inflation reports improved last month. However, based on the Fed's espoused framework, one month is likely not enough to enact a change in policy.

The Fed's favorite gauge (PCE Services excluding energy and housing) rose at the annualized rate of 1.9% last month, but the six-month average is at a one year high of 4.05%[3].

Annualized Monthly PCE

Core Services Ex-Energy And Housing

Source: Federal Reserve Bank of St. Louis

The Economy

Economic commentary is often synonymous with a recession forecast. We have consistently suggested the widely predicted recession would remain elusive — and it has to date.

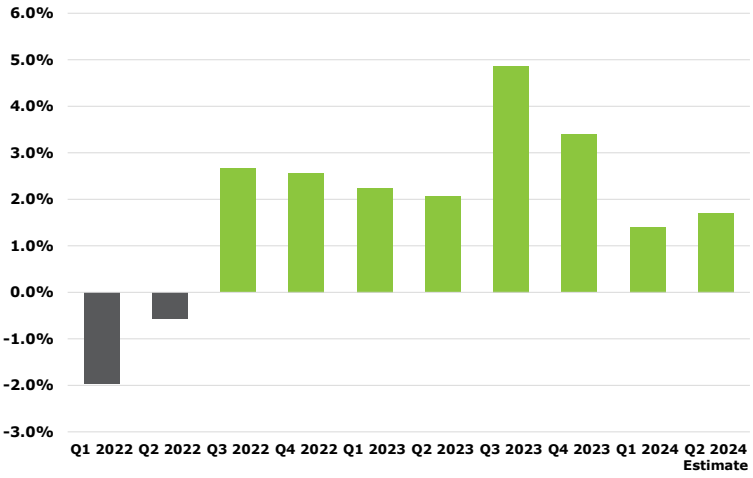
When discussing recession odds, it's important to identify that we aren't discussing if a recession will materialize, but rather when. There is a 100% chance that we will experience a recession — which we define as two consecutive quarters of negative GDP growth — at some point in the future. The most constructive thing we can do is identify, based on the available data, a band of time where a recession could materialize. This band is a moving target, which is determined by various economic data points (GDP components, consumer spending, etc.).

Today, a recession does not look imminent. Economic growth (GDP) cooled in the first quarter, but remained positive at 1.4%. Current estimates for the second quarter stand at a moderate 1.7%[4]. Based on the data available today, we expect positive GDP growth in the third quarter as well, making a fourth quarter recession unlikely.

While we do not expect a recession to be defined in 2024, the timeframe where a recession could materialize does seem to be moving closer, rather than further away as assessed in our previous commentaries.

Q/Q Annualized Real GDP

Since Rate Hikes Began



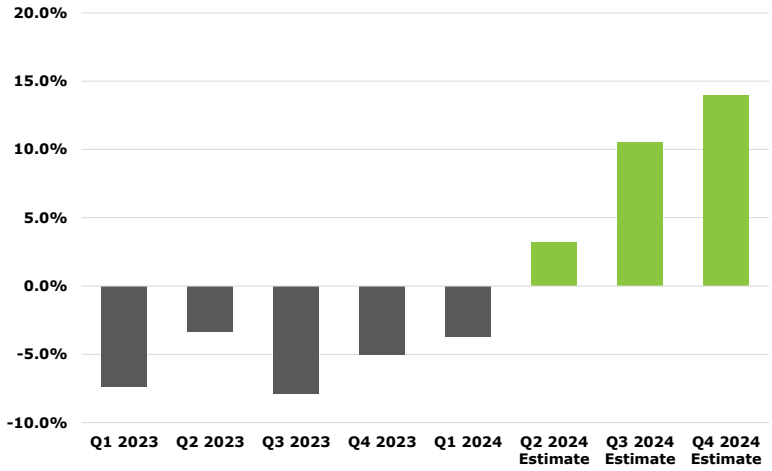
Source: Federal Reserve Bank of Atlanta

Future economic data will ultimately define where the recession time band will settle. Currently, we have the early side of that time band beginning in the first quarter of 2025.

Corporate Profits

Corporate profit expectations remain in line with what we outlined three months ago. Forecasts suggest that the recently completed quarter will finally report operating earnings that exceed the peak from three years ago, then accelerate. Of course, all forecasts are subject to change.

Corporate Operating Earnings Vs. Prior Peak (Q4 2021)



Source: Standard & Poors

More Of The Same

In summary, it was an unremarkable quarter.

The stock and bond markets are treading water. Conditions in the commercial real estate market have not improved and continue as one of those issues that bubbles below the surface of apparently calm waters. We are three months further into the process of reversing 14 years of monetary accommodation that force-fed the global economy, but the process is not complete. Financial conditions, as measured by market indicators, remain relatively unrestrictive.

AAMA's evaluations remain the same — we expect surprises to continue to defy the "lower growth and lower inflation" prognostication, although, as noted above, we have placed the window for possible recession on the calendar beginning early next year. Recession angst seems to have dissipated and media fixation on calling a soft landing has faded, but the market seems to be holding on to lofty valuations. Until financial conditions actually tighten and/or inflation falls convincingly to the Fed's target 2% rate, a less aggressive exposure to the stock market is warranted.

AAMA's equity portfolios remain tilted toward defensive sectors (Healthcare and Consumer Staples stand out) with a focus on earnings stability and balance sheet quality.

In fixed income portfolios, we remain positioned in short-term and high-quality debt instruments — a strategy initiated to reduce the risk to principal in a rising rate environment, which we feel remains appropriate today.

The team at AAMA will continue to diligently monitor and evaluate the markets and will position our portfolios accordingly. If you have any questions about the markets, the economy, or our portfolios, please don't hesitate to reach out to us at engage@aamamail.com.

[1] FactSet, Compustat

[2] Grant's Interest Rate Observer

[3] The Federal Reserve Bank of St. Louis

[4] The Federal Reserve Bank of Atlanta

Disclosures

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