Think Strategically

2024 Mid-Year Market Outlook: Key Insights and Projections for the Second Half

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Francisco Rodríguez-Castro, President & CEO

Looking Back at the First Half of 2024

U.S. equity markets rose in the first half of 2024, with the five indices we follow all in positive territory. However, the main growth drivers were the large-cap stocks, which gained 15.3%.

The Birling U.S. Bank Index led the way with an 18.98% return, followed by the Nasdaq Composite with 18.13%, the S&P 500 with 14.48%, the Dow Jones with 3.79%, and the Birling Puerto Rico Stock Index at 1.32%.

Technology and communications services stocks benefited from the furor around artificial intelligence (A.I.) and strong profit growth.

The European Central Bank (ECB) and Bank of Canada (BoC) were the first among G7 central banks to lower policy rates after rate hikes to curb inflation. U.S. inflation resumed its downward trend in Q2 after higher-than-expected inflation at the start of the year.

International stocks also gained, with emerging-market stocks outperforming developed international large-cap stocks. Fiscal support from China boosted emerging-market stocks, while improved economic growth in Europe and substantial corporate profits in Japan benefited developed international stocks despite a stronger U.S. dollar.

Economic Outlook: Slower Growth

U.S. GDP growth slowed to 1.4% annualized in Q1 2024, indicating a cooling economy. The latest GDPNow for 2Q24, reported on July 10, rose to 2.00%, up from 1.5%, increasing 25.0%. We expect this moderation to continue in the latter half of 2024, driven by a normalizing labor market and softening consumption.

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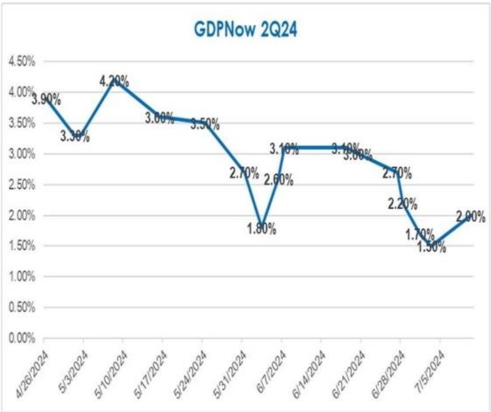
GDPNow

Date	GDPNow 2Q24	Change
4/26/2024	3.90%	Initial Forecast
5/1/2024	3.30%	-18.18%
5/2/2024	3.30%	0.00%
5/8/2024	4.20%	27.27%
5/16/2024	3.60%	-14.29%
5/24/2024	3.50%	-2.78%
5/31/2024	2.70%	-22.86%
6/3/2024	1.80%	-50.00%
6/6/2024	2.60%	30.77%
6/7/2024	3.10%	16.13%
6/18/2024	3.10%	0.00%
6/20/2024	3.00%	-3.33%
6/27/2024	2.70%	-11.11%
6/28/2024	2.20%	-22.73%
7/1/2024	1.70%	-29.41%
7/3/2024	1.50%	-13.33%
7/10/2024	2.00%	25.00%



The labor market has balanced, with the unemployment rate rising to 4.1%, the highest since 2021. The leading indicators suggest further softening, with job openings at 8.14 million and job seekers at 6.36 million moving closer to balance just 27.98% apart. An increase in labor supply, supported by immigration, may further pressure wage growth downwards.

For June, the U.S. CPI inflation data supported the narrative of a resuming disinflation trend. Headline CPI came in at 2.97%, lower than May's 3.27% and the forecasted 3.12%. Core CPI inflation, excluding volatile food and energy prices, was 3.28%, down from the previous month's 3.41% number and 6.82% ahead of the Inflation Nowcasting of 3.52%. Key trends showed a decrease in energy prices, with gasoline down by about 3.8%. Used vehicle prices fell by over 1%, and airline fares dropped by more than 5%. Shelter and rent prices, significant contributors to core inflation, increased by about 0.2%, the slowest rate this year. All potential drivers that could bring inflation closer to the Fed's 2% target.

Equity Outlook: Earnings Drive the Markets

Technology-focused sectors will continue to play a significant role in portfolios. Over half of the S&P 500 comprises technology, communication services, and consumer discretionary sectors, including mega-cap A.I. stocks. These companies have solid earnings and cash positions, enabling reinvestment and shareholder returns.

However, we expect market leadership to broaden beyond mega-cap tech. By the fourth quarter, other sectors will likely drive earnings growth. As we approach potential Fed rate cuts, cyclical areas may catch up, supported by lower yields. Over time, productivity gains from A.I. are expected to benefit all sectors.

Historically, stock markets have been volatile before U.S. elections but typically recover afterward. We expect a divided Congress post-election, which means no significant new regulations or legislation, a scenario markets usually prefer. In the long term, markets tend to follow fundamentals like inflation, interest rates, and economic growth more than political events.

Fixed-Income Outlook: A Fed Pivot in the Making

The Fed's June meeting indicated one interest-rate cut for this year. We expect moderating inflation to allow the Fed to cut rates, possibly in September or December. As the timing of cuts becomes clearer, short-term yields should decline, steepening the yield curve and increasing reinvestment risk for short-term bonds. We see value in intermediate- and long-term bonds and bond funds for locking in rates.

A Fed pivot to rate cuts should support the economy, benefiting stocks. Bonds generally perform well during Fed rate-cutting cycles, though they might underperform U.S. mid-cap stocks, which balance quality and cyclicality. The resilient economy supports lower-quality issuers like U.S. high-yield bonds, though credit spreads are below historical averages, limiting further narrowing. Emerging-market debt appears more attractive, benefiting from lower rates due to its higher quality and longer duration.

International Outlook: Complex Dynamics Globally

A modest eurozone recovery is underway, with growth exceeding expectations in Q1. Despite historic low unemployment, inflation pressures have eased, and the ECB has started to ease policy. International developed-market stocks offer catch-up potential and diversification benefits as eurozone activity rebounds and U.S. economic activity normalizes.

In China, policymakers have taken steps to support the economy amid uncertainty and a real estate crisis, sparking a rebound in stocks. However, we remain cautious about the rally's sustainability as earnings estimates remain low.

More central banks began easing policy in Q2, with the ECB and BoC lowering rates in June. Central banks will likely be cautious with rate cuts to contain inflation, but a multiyear easing cycle is expected to continue. Lower rates can drive a recovery in manufacturing activity and benefit cyclical sectors. A Fed pivot to rate cuts could weaken the U.S. dollar, supporting international investments.

U.S. Election Issues and Implications

The attempted assassination of former President Trump has created a critical and sensitive moment in an already complex national political landscape. The potential impacts in the near term go from increased security concerns and political repercussions. Both campaigns will need to reassess their strategies and messaging.

The attack may influence public sentiment, with increased emphasis on national security and political stability. There is no space in the U.S. Democracy for political violence, and the incident is a reminder of the importance of maintaining civility and respect in our political discourse. An attack on any Presidential Candidate is an attack on our democracy.

Other issues that could become part of the political dialogue include the U.S. budget deficits that have exceeded 6% of GDP in recent years. Historically, larger deficits have accompanied periods of economic weakness, but current deficits occur despite above-average GDP growth. We foresee a need for more fiscal restraint, though the growing debt still needs to be at a level that limits borrowing at reasonable rates. Favorable economic policies can mitigate risks, but budgetary spending and tax adjustments will be necessary. We don't expect significant policy changes from either candidate this year.

Trade with China continues to be a crucial issue on the campaign trail. While the U.S. economy is not heavily reliant on trade, tariffs pose an inflationary risk. This could lead to trade-war anxieties, but domestic consumption and investment trends will likely substantially impact economic outcomes.

We expect the Fed to act based on incoming data, with rate moves potentially timed around the election. If the election results lead to a proposal for a new Fed chief, there could be uncertainty regarding Fed Chair Jerome Powell's future.

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Weekly Wall Street Comparison Week Ending July 12, 2024

Weekly Market Close Comparison	7/12/24	7/5/24	Return	YTD Retun
Dow Jones Industrial Average	40,000.90	39,344.79	1.67%	6.13%
Standard & Poor's 500	5,615.35	5,572.85	0.76%	17.73%
Nasdaq Composite	18,398.44	18,403.74	-0.03%	22.56%
Birling Puerto Rico Stock Index	3,507.80	3,314.85	5.82%	4.92%
Birling US Bank Index	5,329.28	5,272.21	1.08%	22.26%
U.S. Treasury 10-Year Note	4.18%	4.28%	-2.34%	0.03%
U.S. Treasury 2-Year Note	4.45%	4.60%	-3.26%	2.77%

Dow Jones, S&P 500, Nasdaq Composite, Birling PR Stock Index & Birling US Bank Index YTD Returns 7.12.24

The Final Word: Four Issues to be Watchful for Market Developments

As we navigate the second half of 2024, four key issues will shape market sentiment and investor decisions.

Firstly, economic growth is slowing but remains positive. The GDPNow estimate for Q2 2024 is 2%, and inflation is moderating, creating a favorable environment for stocks. This is reflected in the recent record highs for the S&P 500 and Nasdaq.

Secondly, while consumer price index (CPI) inflation dropped to 3.0% year-over-year in June, the lowest since March 2021, the producer price index (PPI) rose to 2.6%, exceeding expectations. This increase, driven by broader wholesaler margins, suggests that inflation pressures could persist if end demand stays strong, influencing the Federal Reserve's decisions on rate cuts by year-end.

Thirdly, the corporate earnings season is underway with promising results. Earnings are projected to grow 8.8% year-over-year, the fastest pace since Q1 2022. Notable financial institutions like JP Morgan Chase, Citigroup, and Wells Fargo have reported robust earnings, beating expectations and highlighting the sector's resilience. JP Morgan Chase reported a 20% revenue increase, Citigroup a 4% rise, and Wells Fargo a modest 1% revenue increase despite a slight dip in net income.

Lastly, the labor market is showing signs of rebalancing. The unemployment rate has risen to 4.1%, slightly above the Fed's forecast, and nonfarm payroll growth has slowed to an average of 232,000 in 2024 from 247,500 in 2023. This cooling in the labor market could ease wage growth pressures, impacting consumer spending and overall economic momentum.

In summary, as we progress through 2024, market participants should remain vigilant regarding these developments. Slower economic growth, evolving inflation trends, corporate earnings performance, and labor market dynamics will be pivotal in shaping the broader market landscape. Staying informed and adaptive will be crucial for navigating the opportunities and challenges ahead.

Francisco Rodriguez-Castro, President & CEO • frc@birlingcapital.com
PO Box 10817 San Juan, PR 00922 • 787.247.2500 • 787.645.8430