Commerce Trust Market Brief with Scott Colbert

July 15, 2024 – Three economic and market takeaways for the second half of 2024

Scott Colbert: Good morning. It's Monday, July 15th and the markets are trending positively much like they have for most of the year. The S&P 500 (Index) is up a whopping 18.6% so far this year and the markets have broadened out a bit with even the smaller cap stocks as measured by the Russell 2000 (Index) now up 6.8%.

International markets are participating positively, the EAFE (MSCI EAFE Index) is up 10.5%, a measure of large-cap international stocks being pulled forward by those returns out of Japan. Japan is up 23% on a year-to-date basis. The emerging market stocks (as measured by the MSCI Emerging Markets Index) are positive too, about the same amount as the large-cap international stocks. Those are being buoyed by huge returns out of India, with the Indian stock market up about 20% so far this year.

The laggard has been the bond market. Municipal bonds as measured by the broad Bloomberg Municipal Bond Index are up a barely positive 20 basis points and the Bloomberg Aggregate (Bond Index), a measure of all the investment-grade bonds, are up about 80 basis points.

You may have noticed that we've recently published our midyear economic and financial market outlook. I'd like to give you a quick summary of that and there are probably three key takeaways. The number one takeaway is we've avoided a recession and we expect to do so for the foreseeable future. While the economy has cooled a bit — economic growth in 2023 was 2.5% and it's probably only likely to clock in at about 2% this year — that 2% economic growth is still better than what we averaged in the entire economic expansion from the subprime crisis to the pre-pandemic level. Economic growth then only averaged about 1.8%.

And while job growth has cooled, it's still well above average. Back in 2022, we were creating 327,000 jobs per month on average. In 2023, it fell to 251,000 jobs per month and so far, this year it's only 222,000 jobs (per month), but this still compares exceptionally favorably to that long-dated expansion from the subprime crisis to pre-pandemic where average job growth was still just 181,000 (per month). The bottom line is the economy continues to expand.

Point two is we think the markets are likely to broaden out, particularly if inflation continues to cool and we've recently seen some evidence of this. Just last week alone, the Russell 2000 was up 6%, while the S&P 500 was only up 1%. While the (U.S.) dollar is still strong and likely, perhaps, to decline, the biggest driver of global economic earnings have clearly been U.S. companies, as represented by those magnificent seven stocks that we have here domiciled in the United States.

Our third key theme is obviously, bonds have lagged the stock market, as interest rates have been pushed up and up and up. The Federal Reserve (Fed) pushed up rates almost 525 basis points, and the 10-year Treasury (bill) still sits better than 3% higher in yield today than it was during the pandemic.

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With the average bond fund yielding about 4.5%–5%, and the Fed likely to achieve its inflation target of something like 2%–2.5%, this offers bond investors a chance to lock in real returns of 2%–2.5%, which is higher than the long-term average that the bond market has provided.

Emerging market debt is, of course, lower in credit, but still over half of the emerging markets are investment-grade credits. They offer yields that are 2%–3% better than treasuries, and in general, most of that debt is fairly long-term in maturity, affording you the ability to lock in fairly high yields. Finally, emerging market debt tends to do well when the Fed is reducing rates, and we do think that the Fed will be reducing rates as the year progresses.

Finally, the most important recent news has to do with inflation. The recent CPI (Consumer Price Index) statistics show that year-over-year inflation has fallen to 3%, we haven't seen that since 2021, down materially from its 9.1% peak just about two years ago. In addition, the PCE statistics, the Personal Consumption Expenditure(s Price) Index that the Fed likes to focus on, will probably fall to a 2.5% rate when those statistics are provided later in the month. These newer, lower inflationary data provide the Fed the backdrop to likely to begin (to) lower rates by September, and we still have room for an additional rate cut as the year progresses, probably at the last meeting in December.

Quite obviously there's a lot going on in the financial markets and we'll be back in several weeks to discuss all the trends that are affecting your portfolios.

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