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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **August 14, 2024**

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Last week's S&P 500 Index: -0.04%

Opportunities and considerations

Key takeaways

- An opportunity presented itself over the last couple of weeks as the combined fears triggered by a suddenly weaker employment report and a soft reading on manufacturing gripped investors.
- In response to the volatility, early last week we suggested that investors make a number of portfolio adjustments.

Our regular readers know that we have strived to exercise patience this year as the S&P 500 Index (SPX) rallied to new all-time highs. Valuations were stretched in our view, and we felt that a pullback was overdue. We have consciously avoided chasing the equity markets higher when, in addition to high valuations, we believe the economy appears likely to continue to slow down in coming quarters as the labor market weakens and consumer spending headwinds become more apparent in the near-to-intermediate term. Our analysis suggested investors were too optimistic as the SPX was notching new record highs. However, we have been of the opinion that, based on our economic outlook through year-end 2025, downdrafts in the SPX may represent buying opportunities.

An opportunity presented itself over the last couple of weeks as the combined fears triggered by a suddenly weaker employment report and a soft reading on manufacturing gripped investors. The data triggered fears that the Federal Reserve (Fed) had fallen behind in cutting interest rates. The SPX traded to an intraday low representing a nearly 10% correction from the highs in response to these concerns over the following two trading days. Some in the financial media and other analysts went as far as calling for an "emergency" Fed meeting so our central bankers could cut rates immediately.

While we do not buy into the emergency-cut thesis, we do believe the Fed will cut rates a total of 100 basis points (100 basis points, or bps, equals 1%) over the balance of the year, starting with a 50 bps cut at the September policy meeting. In addition, we are expecting a total of 75 bps of cuts in 2025. We believe this magnitude of fed funds rate reductions will lead to improved economic performance as we move through next year. Thus, as stated, we see market corrections as buying opportunities.

In response to the volatility, early last week we suggested that investors make a number of portfolio adjustments. From a high level, we favor moving funds from short-term fixed income (our "parking spot") and long-term fixed income into large-cap equities (favorable) and small-cap equities (upgraded to neutral). We also moved some of the funds into intermediate-term fixed income and now are largely carrying a neutral position between stocks and bonds. Basically, we took advantage of the rally in bonds and the decline in stocks. We continue to favor large caps over small caps and domestic equities over international markets.

Quality continues to be a major theme of our portfolio allocations. Near-term geopolitical tensions are on the rise in the Middle East, and the ultimate outcomes there and in Ukraine are uncertain at this point. In positioning portfolios as we look ahead, we want to take advantage of opportunities while also considering the potential risks that exist.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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