Buckingham
STRATEGIC WEALTH

Q2 2024

Quarterly Outlook

Perspectives on Markets and Economic Conditions

Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.

Economic Momentum Continues

Main Takeaway

Although markets had a strong first quarter, inflation has been stickier in some key areas of the economy. The services industry continues to be resilient, with employment rising and inflationary pressures increasing, while more interest rate sensitive areas, such as manufacturing, are weaker. The optimistic tone from the Fed has improved the outlook for interest rate cuts, though less liquidity in the banking industry, plus continued fiscal deficits, may keep rates higher for longer.

Top Risks

Rising geopolitical tensions and rate cut predictions have been the main themes this presidential election year. Low office occupancy rates have renewed concerns about the banking sector's stability, contributing to tighter lending conditions. Municipal finances are coming under pressure in large cities. Government debt levels in most developed nations and China are at all-time highs. Inflationary pressures in the services sector could keep inflation above the Fed's 2% target for some time.

Sources of Stability

While the Fed's battle against inflation may not be over, it has made some progress in interest rate sensitive areas of the economy. House prices have stabilized and show signs of rebounding, and businesses are still increasing wages, suggesting a strong economic undercurrent. The S&P 500 has continued its upward climb, credit spreads have tightened, and IPO and M&A activity have picked up. The likelihood of a recession has fallen, barring an unexpected event.

ECONOMIC SPOTLIGHT:

What is Keeping the American Economy So Resilient?

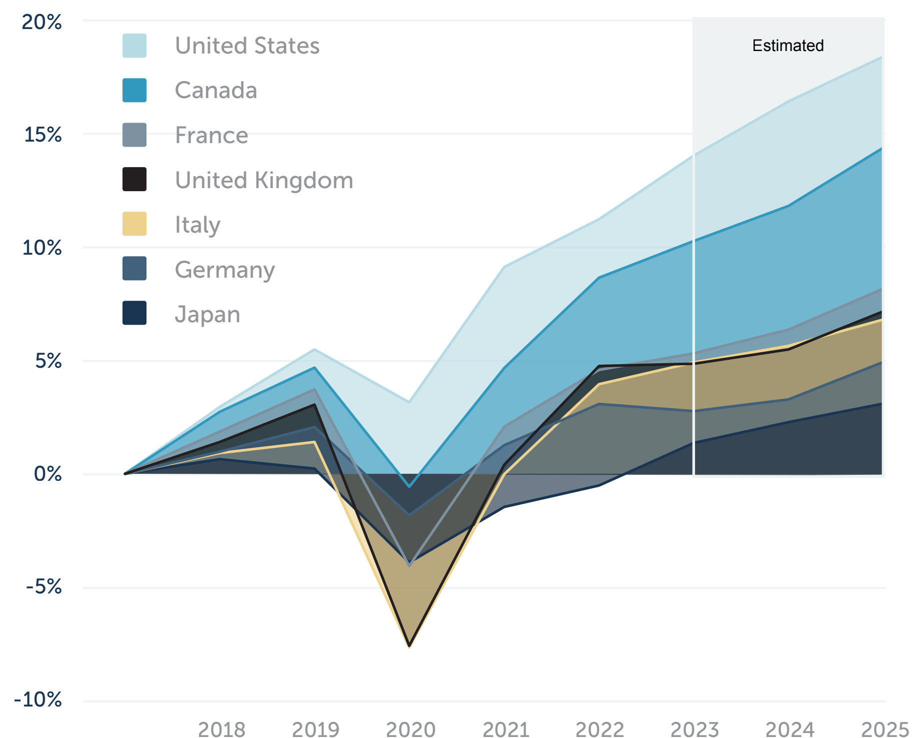
The U.S. grew by 2.5% in 2023[1], after accounting for the higher cost of goods and services, defying estimates of flat growth or even a recession.[2] Notably, the eurozone, U.K., Canada and Japan are all close to or currently in a recession. Meanwhile, the Atlanta Fed estimates the U.S. grew at an annualized pace of 2.8% in the first quarter of 2024.[3] How has the U.S. managed to escape the same recessionary fate?

For one, American households, through fixed-rate mortgages and excess savings built up during the pandemic, have been more insulated from higher rates. Public investments in clean energy and infrastructure have spurred economic activity. And legal immigration has boosted the labor force while the entire workforce has simultaneously become more productive.

The future is not without risks, however: prices for office space are adjusting to the era of remote work, leading to risks in commercial loans, bank balance sheets and municipal tax revenues, especially in big cities. For consumers, higher rates have already led to an uptick in credit card and auto loan defaults. One of the biggest risks is the growing deficit. The U.S. has been borrowing to fund spending, which could keep upward pressure on interest rates. Neither political party has put forth a cohesive plan to balance the budget.

While the deficit poses a significant risk, overall, the American economy has shown remarkable resilience in the face of uncertainty and should be poised for continued growth.

Real GDP Growth Since the End of 2017



Source: International Monetary Fund, World Economic Outlook, January 2024 Update.

Key Areas to Watch

Economic Growth

We continue to have a bifurcated economy, with interest-sensitive sectors in or close to a recession at the same time that we have a strong services sector. The Philly Fed's first-quarter 2024 survey[4] projected that real U.S. GDP will grow 2.4% in 2024, up 0.7 percentage points from the estimate in the previous survey. The current forecast does not include a single quarter of negative economic growth in 2024. America is the only large economy back to its pre-pandemic growth trend.[5]

Inflation Trajectory

In its March meeting, Fed officials said that inflation is still too high, though they maintained their expectation to cut rates three times in 2024.[6] Through February, headline CPI increased 3.2% on a year-over-year basis, up from 3.1% in January.[7] Core CPI (which excludes the more volatile food and energy sectors) grew 3.8%. The service sector is experiencing inflation pressures. Costs for auto and home insurance and home repairs have risen rapidly over the past year.[8]

Monetary Policy

The Fed chose not to cut rates in the first quarter but left open the possibility of rate cuts throughout the year. With a growing fiscal deficit, a shrinking pool of international buyers of Treasuries, and a trend toward onshoring more production (in some cases for national security), we see risk the Fed may need to keep rates higher for longer than the market is currently pricing. In addition, since September 2022, the Fed has been running down its balance sheet holdings by $95 billion per month.[9] The ability of the markets to absorb all that debt could be challenging.

Fiscal Policy

With the Congressional Budget Office forecasting a $1.66 trillion deficit[10] and a record $8.9 trillion of government debt maturing over the next year, the Treasury will have to find buyers of more than $10 trillion[11] in U.S. government bonds in 2024—more than one-third of U.S. government debt outstanding and more than one-third of U.S. GDP. Research shows that, if debt levels are not addressed, they can be a drag on economic growth once the debt-to-GDP reaches 70%-90% or higher. The U.S. is close to 100%, posing a risk to future economic growth.[12]

Key Areas to Watch (Cont.)

Commercial Real Estate

Apollo's Torsten Sløk noted that office occupancy rates around the country are around 50%, as the hybrid work model is here to stay.[13] As a result, office valuations have fallen, with a 40% decline in the price per square foot for office space. There were 635 U.S. commercial real estate foreclosures in January, up 17% from the previous month and roughly twice as many as in January 2023.[14] This poses a challenge for banks, particularly as small banks account for almost 70% of all commercial real estate loans outstanding.[15]

Consumer Lending

Credit card delinquencies rose more than 50% in 2023, while auto loan delinquencies reached 7.7% in the fourth quarter of 2023, their highest level in 13 years.[16] Bank balance sheets are still recovering from the rate increases of 2022 with $684 billion in unrealized losses for Treasuries and mortgages, roughly 30% of the bank equity capital, forcing banks to be more selective with their loans. Meanwhile, the housing market has started to rebound. Home sales rose 9.5% in February and prices rose 5.7% from a year earlier.[17]

Global Economy

The U.S. is not the only country facing problems related to rising debt-to-GDP ratios. Since 2010, debt-to-GDP has increased in all G7 countries except Germany (the U.K., Canada, France, the U.S., Italy, and Japan), pushing each to a debt-to-GDP ratio near to or over 100%.[18] The U.K. is now technically in a recession. The rising debt problem is compounded by Europe's need to significantly increase defense spending due to the ongoing war in Ukraine.

Municipality Health

The decline in commercial real estate valuations is likely to lead to budgetary problems for some large municipalities. Lower valuations for commercial real estate will lead to lower property taxes on those buildings, which municipalities rely on for their spending. This, combined with higher spending related to illegal immigration for some cities and a flight of high-income individuals and companies from high tax states, will put pressure on municipal budgets and could lead to downgrades of municipal bond issuers.

Economic and Market Snapshot

Global stock markets, led by large, tech-oriented firms in the U.S., continued their climb. Valuations for the Magnificent Seven stocks have risen fast, but fortunately the rest of the market has valuations much closer to their historical averages.*

Bond markets have remained resilient. Bond spreads, or the additional interest a company must pay above a similar Treasury bond, have tightened considerably for higher rated U.S. companies, helping to buoy company balance sheets.

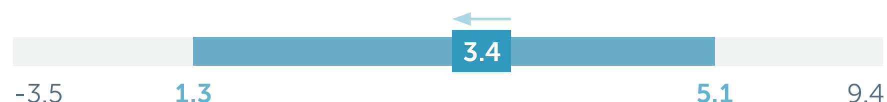
Major Asset Class Returns**

Q1 2024

		Quarterly Return	Past 12 Months
Stocks			
U.S. Stocks	▲	10.0%	29.3
International Stocks	▲	5.2%	14.6
Emerging Markets Stocks	▲	2.2%	9.8
Bonds			
U.S. Government Bonds	▼	-0.3%	1.6
Global Bonds	▲	0.3%	3.7

Key Economic Indicators**

Real GDP Growth (%)

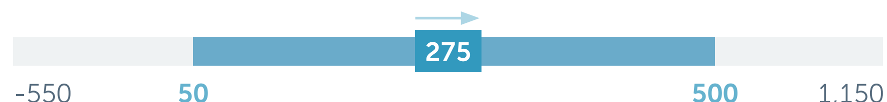


Core CPI (%)

Consumer Sentiment

Unemployment Rate (%)

Jobs Added (Thousands)



*The Magnificent Seven stocks include Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta, and Tesla.
**See Appendix on page 8.

Investment Planning Implications

Where do markets go from here?

Corporate profits. Analysts estimate earnings growth for the S&P 500 at over 11% this year. However, the downward-sloping yield curve indicates that the bond market expects interest rates to decline in the near future, which would be more indicative of weakening economic fundamentals.

Stock share prices. Stock buybacks, where a company uses a portion of profits to repurchase its own shares, are likely to decline due to recession fears, a new tax on buybacks and higher financing costs. Stock buybacks have historically been a tailwind to stock returns.

Inflation fears. While investors have many reasons to be less than optimistic as most central banks around the globe continue to engage in more restrictive monetary policy to fight inflation, valuations generally already reflect that concern.

What are the investment planning implications?

Expect volatility. The surge in deficit spending at a time of overall growth in the economy is likely to shape a fierce debate on Capitol Hill about the nation's fiscal policies as lawmakers face a potential government shutdown early next year and make choices over trillions of dollars in expiring tax cuts.

Be prepared for lower returns from stocks. Given the cost projections and expected growth of the budget deficits, research on historical environments suggests economic growth could be sluggish. This combined with historically high stock market valuations (particularly in the U.S.) may translate to lower forward-looking stock returns than what we've experienced historically.

Take the appropriate amount of risk. If you are concerned about the potential for losses in your portfolio, consider reducing your exposure to stocks. Given the rally in stock markets, many clients have plans that are "overfunded" and can be equally successful with less invested in stocks. Ask your advisor how your plan might change with less invested in stocks.

About the Buckingham Team

Larry Swedroe

Head of Financial & Economic Research

In his role and as a member of Buckingham's Investment Policy Committee, Larry regularly reviews the findings published in peer-reviewed financial journals, evaluates the outcomes and uses the result to inform the firm's formal investment strategy recommendations.

Kevin Grogan, CFA, CFP®

Chief Investment Officer

Kevin is a member of Buckingham's Investment Policy Committee and helps lead the firm's investment strategy, portfolio management and fixed income teams. He has co-authored three books on investment topics and enjoys educating others on concepts that will have a tangible effect on their financial lives.

Blerina Hysi

Director, Fixed Income

Blerina works with fixed income and advisory teams to help construct and maintain customized bond portfolios, with an eye toward finding the best way to implement comprehensive financial plans. Her duties include fixed income analysis, bond trading and building tailored, client-focused portfolio solutions.

Daniel Campbell, CFA

Investment Strategy Advisor

Dan helps clients and advisors understand and implement an evidence-driven investment strategy. He has a demonstrated ability to understand complex investment topics, but he gets the most energy from conversations with individuals and families in pursuit of financial freedom.

Additional economic and investment resources are available at **buckinghamstrategicwealth.com/resources**

Buckingham's Investment Policy Committee (IPC) is a committee for Buckingham Strategic Wealth, LLC and Buckingham Strategic Partners, LLC (collectively Buckingham Wealth Partners) and not a committee for independent members of the Buckingham Strategic Partners community.

Appendix

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[1]Bureau of Economic Analysis. Gross Domestic Product, Fourth Quarter and Year 2023 (Third Estimate). March 28, 2024.

[2]S&P Global Ratings. Economic Research: Global Macro Update: Surprising Resilience Unlikely To Last Into 2023. Nov. 30, 2022.

[3]Atlanta Fed. GDPNow estimate as of April 4, 2024.

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[4]Philadelphia Fed. First Quarter 2024 Survey of Professional Forecasters. Feb. 9, 2024.

[5]The Economist. America's economy has escaped a hard landing. March 14, 2024.

[6]Federal Reserve's Powell holds briefing after interest rate meeting as inflation. March 20, 2024.

[7]U.S. Bureau of Labor Statistics.

[8]Wall Street Journal. The Cost of Car Ownership Is Getting Painful. Feb. 13, 2024.

[9]Forbes. The Slippery Slope Of The Fed's Shrinking Balance Sheet. Feb. 3, 2023.

[10]Congressional Budget Office: The Budget and Economic Outlook: 2023 to 2033. Feb. 2023.

[11]Apollo Academy. $10 Trillion in US Treasuries Coming to the Market in 2024. Feb. 3, 2024.

[12]Cecchetti, Stephen G. and Cecchetti, Stephen G. and Mohanty, Madhusudan S. and Zampolli, Fabrizio, The Real Effects of Debt (September 1, 2011). BIS Working Paper No. 352, Available at SSRN: https://ssrn.com/abstract=1946170

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[13]Apollo Academy. Work from Home Is Here to Stay. Jan. 29, 2024.

[14]Bloomberg. US Commercial Property Foreclosures Spike in January. Feb. 22, 2024.

[15]Apollo Academy. Outlook for Banks. Feb. 9, 2024.

[16]Wall Street Journal. The Cost of Car Ownership Is Getting Painful. Feb. 13, 2024.

[17]Wall Street Journal. U.S. Home Sales Jumped 9.5% in February. March 21, 2024.

[18]Apollo Academy. Probability of a Fiscal Accident Is Rising. Feb. 18, 2024.

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Major Asset Class Returns: The index representation for the Major Asset Class Returns is as follows: U.S. stocks are represented by the Russell 3000 Index, international stocks by the MSCI World ex U.S. IMI Index, emerging markets by the MSCI Emerging Markets IMI Index, U.S. government bonds by the Bloomberg Government Intermediate Total Return Index, and global bonds by the FTSE World Government Bond 1-5 Year Index. Past performance is not a guarantee of future results. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Information from sources deemed to be reliable, but its accuracy cannot be guaranteed.

Key Economic Indicators: Sources: Bureau of Economic Analysis (BEA) for real GDP growth. Real GDP is the annual rate of change of real gross domestic product, seasonally adjusted. Bureau of Labor Statistics (BLS) for core CPI. The core consumer price index (CPI) is the annual rate of change, seasonally adjusted, and excludes food and energy. Consumer sentiment is from the University of Michigan's consumer sentiment index. Unemployment rate is reported by the BLS, and jobs added is based on nonfarm payroll employment reported by the BLS. Retrieved from FRED, Federal Reserve Bank of St. Louis. For all indicators, the boxed number reflects the latest reading, and the line above the box shows the change since the last update. The shaded areas reflect normal readings compared to history (based on the 25th-75th percentile of historical measures), while areas outside the dark blue reflect more extreme readings compared to history. The ranges are based on the percentile values of historical readings for each economic figure. The lowest number reflects the 5th percentile value, the bottom of the blue range reflects the 25th percentile, the top of the blue range is the 75th percentile, and the highest value reflects the 95th percentile. All ranges are based on the full period available. To account for population and employment, the ranges presented for jobs added are based on the percent change in employment numbers, using December 2023 as the base year.

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