

# CLUTINGER, WILLIAMS & VERHOYE, INC.

REGISTERED INVESTMENT ADVISORS

6398 Del Cerro Blvd – Suite 3 – San Diego, CA 92120

SCOTT B. WILLIAMS, CFA, CFP  
KENT EDWIN STONE

TELEPHONE: 619-326-0900

## Economic and Market Outlook

June 30th, 2024

### The Dog Days of Summer

*The stock market is a device for transferring money  
from the impatient to the patient.*

*-Warren Buffett*

#### **Section I. Introduction**

Mr. Buffett, the Oracle of Omaha, is once again cleverly extolling the virtue of long term investing. Impatience reacts to news in the short term and acts emotionally. Patience understands that time is on its side and allows investment themes to be realized.

Unfortunately, there are always reasons stock market investments are risky and you might be tempted to sell your holdings. However, movements in the stock market, up or down, do not have a single cause and cannot be explained by a single narrative. For any consumer of financial news, this will ring true. Equity markets swing wildly from day to day on the smallest of news, rally and crash on sentiment, and celebrate or vilify the most inane data points. In reality, market prices result from billions of shares being bought or sold in reaction to each investor's interpretation of that news. It's important not to get caught up in the madness and instead to stay rational and patient.

One mantra for traders is to "Sell in May and go away." This may be why sometimes the stock market can seem slow during the summer months or may pull back. Nervous traders don't go away and the confident ones do creating a short term negative bias.

But this creates a new dilemma. When do you get back into the market? If the market goes down in the short term you might be afraid it will continue that trend. Worse is if it goes up and you either get back in at a higher price or don't get back in because you are waiting for a pullback.

## **Section II. The Developing Bull Market**

Just like a bear market is defined by the S&P 500 (S&P) being down by 20% or more, the most basic definition of a bull market is an upward move of 20%. Since the lows of October 2022 through June 24th, 2024, on a closing basis, the S&P was up 52.3%. In addition, the S&P has achieved all-time highs multiple times.

Bull and Bear markets are always part of an economic cycle but they are asymmetric in nature. Since 1929, there have been 27 of these cycles based on the S&P 500. While the average decline during Bear markets is -35.1% and lasts 286 days, the average Bull market is up 114.1% and lasts 1,011 days. Since we are only up 52.3% and 626 days into this Bull market, we can take some comfort that this run may not be about to end.

Based on historic trends, 2024 should turn out to be a positive year for equity markets. Since World War II, whenever the S&P 500 rose in price in January, The market was up an average of 16% for the entire year and was up in price 85% of the time. In addition, for the 9 election years with positive January returns, the S&P gained an average 15.6% and went up 100% of the time. Since World War II, when the S&P rose more than 4% in the half first of the year it rose an additional 5.5% on average during the second half of the year with an 89% success rate. Finally, our own internal proprietary model shows a 7.1% return over the next 3 months with an 80% success rate covering 65 years of data.

To be clear, in the short term we fully expect some type of correction or consolidation for the market over the next few months. Corrections of less than 10% are part of normal volatility, and are healthy for the market. The S&P has already had a correction of 5.5% in the last few months. The Dow Jones Industrial Average had two, 5.2% and 4.7%.

The forward four quarter earnings estimates for the S&P rose to \$253.27. This is an almost \$10 increase from January's \$243.98. In 2023 the estimate dropped from January to June.

Despite recent market fluctuations and uncertainties, the momentum behind AI-driven technologies remains strong. As companies across industries continue to embrace AI to drive innovation and efficiency, investors are presented with unique opportunities to capitalize on the transformative power of artificial intelligence. The AI revolution is not just a fleeting trend but rather a fundamental shift that is poised to reshape industries and create new opportunities for growth and innovation.

### **Section III. Inflation**

The readings for inflation continue to moderate. Currently the Consumer Price Index (CPI) is up 3.3% on an annual basis, and core CPI, which excludes food and energy, is up 3.4%. Both readings are for May 2024. While CPI was unchanged since our last report, core CPI continued its descent. The CPI reading has leveled off after peaking in June of last year at 9.1%. The core rate actually peaked in September at 6.6%. This is still well above the Federal Reserve's 2% target. The problem with all these measures of inflation is that they are backward looking and lagging indicators. The efforts by the Federal Reserve to reduce inflation by raising the Fed Funds Rate by 5.25% will continue to have a delayed effect on the economy.

The Federal Reserve prefers to use a measure called the Personal Consumption Expenditures (PCE) Price Index to gauge inflation. The reading for PCE in April was 2.7% and the core rate was 2.8%. May data will be released June 28<sup>th</sup>. Inflation in the Euro Zone increased 0.1% to 2.7% in May.

Remember that containing inflation is not about lower prices, but about stable prices. It appears that the Fed's aggressive approach is already having some effect. The normal lag for the effect of rate hikes is 12 to 24 months or more. Our first hike was last March, 27 months ago. The resilient economy continues to mute the effects of restrictive Fed policy.

Wages are starting to moderate as job openings drop and adjustments for increases in the minimum wage start to moderate. Wage increases trail inflation so it is not the problem that many believe. Wages tend to increase in order to keep up with inflation, as opposed to causing inflation.

## **Section IV. The Federal Reserve and Interest Rates**

Because of inflation, the financial media, the Fed and the equity markets have become more focused on interest rates. We were spoiled by ultra-low rates before and during the pandemic.

The Federal Reserve has continued to alter their previous monetary policy path of hiking interest rates. Federal Reserve Chairman Jerome Powell held rates steady for the seventh time in a row at their last meeting earlier this month, but stated the committee is still data dependent, and appeared to open the door for possible rate cuts in the future. This probably does mean the Federal Reserve is done with the rate hiking cycle, a bullish sign. They also cut to \$60 billion from \$95 billion in bonds that roll off the Fed balance sheet each month. Slowing down the roll off will give the Fed greater flexibility to maintain ample liquidity in the system. Shrinking the Fed balance sheet will tighten money supply which once again means lessening consumer demand. This is reflected by the fact that growth in M2 money for February year over year is now -2.56% (Chart #1).

We do expect the Fed to start cutting interest rates, probably with the first cut in September or November. This brings us to another study that found that after the first rate cut, if no recession materializes, the market is up 24% on average over the next year. Even if a recession comes the market rose 10% on average over the following year. Remember that cutting rates is usually a sign that the economy is slowing.

One problem we have had with the Fed's path is the pace at which they raised rates. It takes time for interest rate hikes to have their full effect on the economy and inflation. The economy does not turn on a dime. The rapid pace and size of the rate increases have partly contributed to the gap on some bank balance sheets, causing some concern regarding the stability of the regional banks. With rates now starting to drop that concern is lessening. We view the continued pause in recent months a positive sign that the Fed is starting to let previous hikes take their full effect.

Rates in most European 10-year bonds are pulling back along with the U.S., because of a slowing global economy. The U.S. 10-year bond still remains more attractive to international investors for its yield and AA+ credit rating. The U.K. 10-year yields 4.08% (AA), German 10-year yields 2.40% (AAA), France 10-year yields 3.11% (AA), Italian 10-year yields 3.93% (BBB) and Swiss 10-year yields 0.57% (AAA). These compare to our 4.25% 10-year yield.

## **Section V. The Recession Model**

As we have discussed in past reports, earnings and the economy are the true long term influences on the stock market. Recessions, or fear of recessions, are the major reason we experience corrections of more than 10%. Corrections of less than 10% are just part of normal volatility and tend to happen multiple times each year.

The official arbiter of recessions in the U.S. is the National Bureau of Economic Research (NBER). They determine when our economy enters and exits recessions. The problem is that usually by the time they declare the official start date of the recession the economy is probably coming out or already done with that recession, in other words no predictive value.

At Clutinger, Williams & Verhoye we have developed what we view as a recession indicator which tracks 5 data sets on a monthly basis. If 3 of the 5 indicators are negative and the S&P 500 is below its 40 week moving average, it is a very strong indication that a recession is near or may already be underway.

Indicator number one compares the current monthly unemployment rate to its 12 month moving average. As of May, the unemployment rate was 4.0% and the 12 month moving average was 3.78%. By being above the moving average this indicator has stayed negative.

Indicator number two is represented in Chart #2. This represents the year over year percentage change of Advance Real Retail and Food Service Sales. This is one method to measure the strength of the consumer. Currently the reading is -0.95% for May, so this indicator remains negative. Any reading below 0 is negative.

Indicator number three is represented in Chart #3. This shows the year over year change in Industrial Production. This indicator has turned slightly positive. It currently sits at 0.39% for May 2024. This is not surprising given the still positive GDP number from the first quarter along with the GDP estimate for the second quarter.

For indicator number four (Chart #4), we look at Total Nonfarm Payrolls divided by the Civilian Labor Force Level on a year over year percentage change basis. This indicator stands at 1.22%. A zero reading represents neutral therefore this indicator is positive.

Indicator number five (Chart #5) represents the Average Weekly Hours of Production and Nonsupervisory Employees-Manufacturing on a year over year

percentage basis. Currently the reading is 0.00%, so this indicator is neutral but is higher than our last report. This reflects the possibility that inflation is easing.

Currently three of the five indicators are positive or neutral and the S&P 500 Index is 12.15% above its 40-week moving average as of June 21<sup>st</sup>. With the S&P 500 above its forty week moving average this model is not giving a recession warning sign. We will be closely monitoring these indicators in the coming months.

The above indicators are only updated on a monthly basis. To offset this situation we also track two other indicators. They are both indicators that are updated more frequently (on a weekly or daily basis) and we consider them as early recession indicators. Both are somewhat volatile so we track three month moving averages. These two indicators are separate and independent of the first five and either one can indicate the possibility of recession on its own.

The first one is the Aruoba-Diebold-Scotti Business Conditions Index which is updated on a daily basis and published by the Philadelphia Federal Reserve. The 91 day moving average is slightly positive and is at 0.06 currently. The divining line for entering and exiting recessions is -0.8.

The second indicator for recessions is the Chicago Fed Business Activity Index. It is reported weekly and the divining line for entering recessions is -0.7. The three month moving average remained relative steady at -0.09.

In summary, the two “early warning signs” are not predicting recession at this time. We still believe that in February 2023, when our indicators predicted recession, we may have already experienced the mild recession everyone keeps predicting.

## **Section VI. Market Psychology**

For decades we have measured market psychology using price and volume data in the short and long term from the Dow Jones Industrial Average as well as a 17 week moving average of advancing and declining stocks on the New York Stock Exchange.

Currently, 9 out of 12 of our price/volume indicators are positive, which puts us in a good position, but not too good. The S&P has reached 5487 and keeps making all-time highs. But that doesn't necessarily mean the end of the rally. The market needs corrections from time to time in the short term to stay healthy and growing over the long term.

Our advance/decline line has been positive for the last several weeks and sits at 50.9%, and is reflecting a slight positive but is no longer overheating with enthusiasm.

Our technical model measures the first and second derivative of price and volume for the market. We have developed this model to recognize patterns and spot buy and sell signals from reviewing years of historical data. This model is providing neutral signs and our proprietary charting is reflecting a pattern seen during past consolidations in the market.

### **Section VII. The Economy**

Indexes that measure manufacturing data are mixed. The Philly Fed Manufacturing Index has now been positive for five months. It also recorded its lowest positive reading in five months at 1.3 in June of 2024. The Empire State Manufacturing Index increased to -6 in May, its best reading in four months. The national ISM manufacturing index was 48.7% in May and the ISM services index was 53.8% (above 50 is considered growth, above 55 is considered exceptional growth). S&P Global also releases its own Manufacturing Index and that rose to 51.7%. All these readings reflect a moderately strong economy and the fact that the Fed may just pull off the goldilocks soft landing scenario or even possibly no landing.

Multiple Wall Street and Federal Reserve predictions for GDP have stayed around 2%. GDPNow is estimating GDP for the second quarter of 2024 at 3.0%. This shows the economy is resilient even with the headwind of higher rates and probably explains why the Fed is hesitant to start cutting rates.

### **Section VIII. Conclusion**

The second quarter has seen a continuation of the market rally that started last year. We have sighted many reasons why we believe this will continue in the long run.

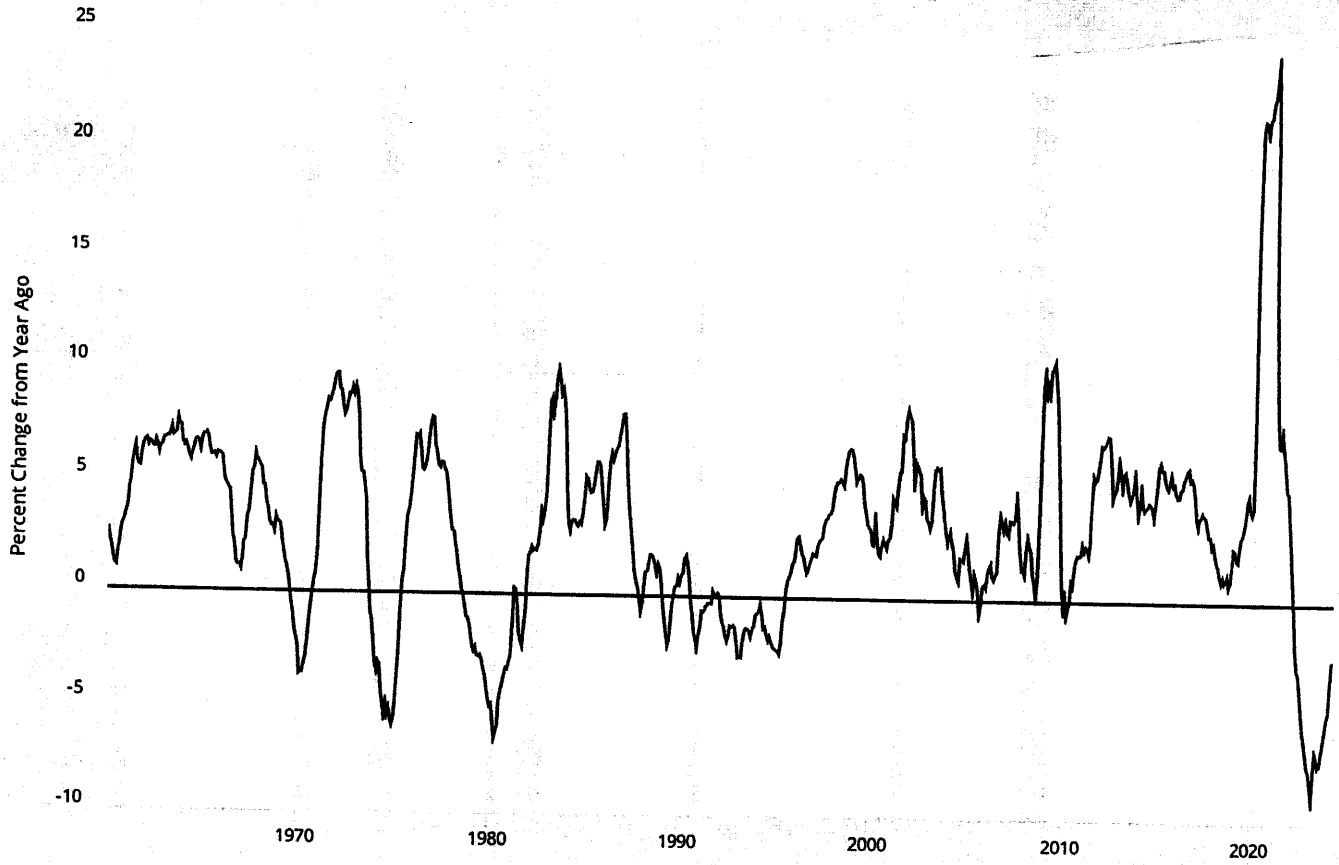
We continue to be optimistic for 2024. Over the short term, directional moves in the stock market are always going to be somewhat unpredictable. Though a crash remains within the realm of possibilities, given what history tells us about market valuations, the historic data on market returns and economic growth is crystal clear that being an optimist and investing for the long haul is a winning formula.

Best Regards,

Scott B. Williams, CFA, CFP

Kent Edwin Stone

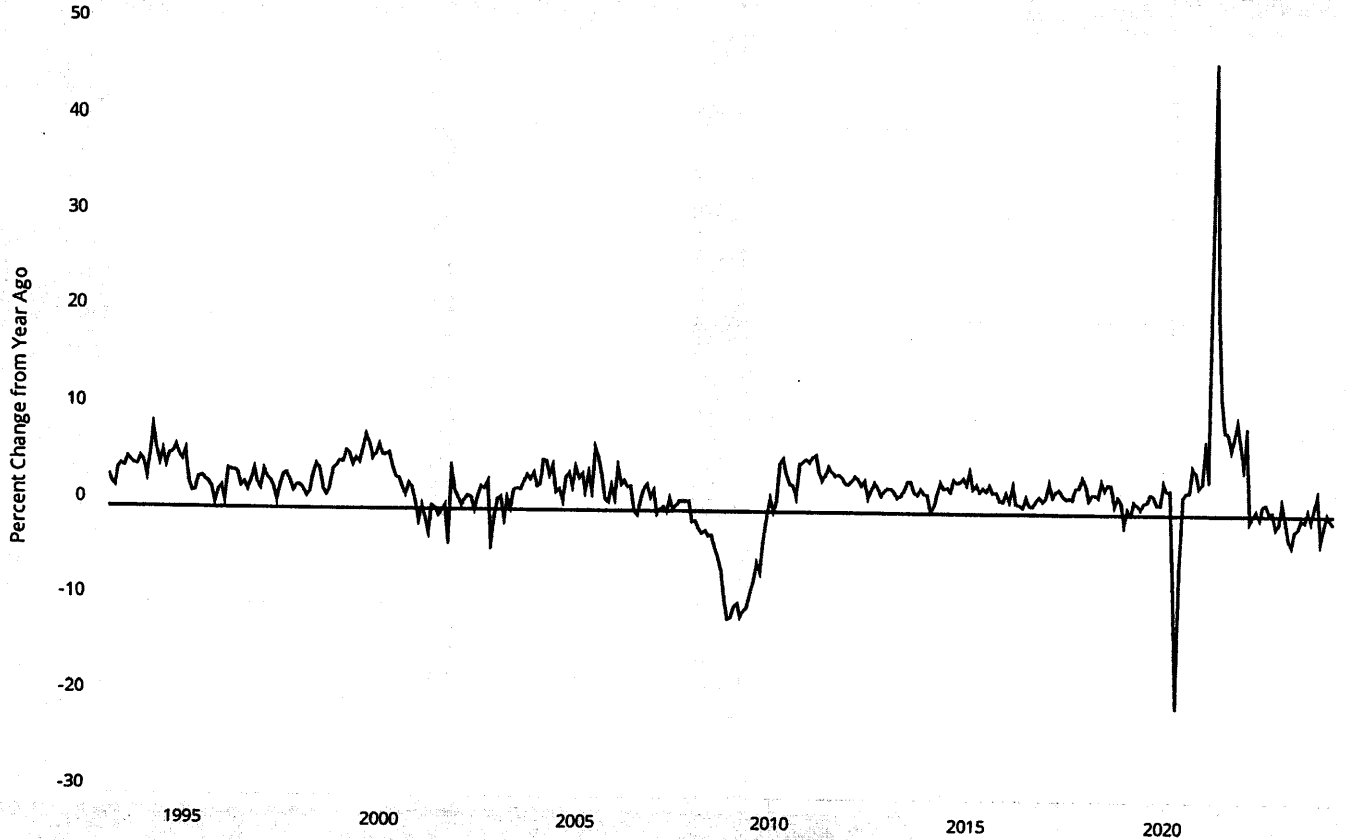
**FRED** — Real M2 Money Stock



Source: Federal Reserve Bank of St. Louis

fred.stlouisfed.org

**FRED** — Advance Real Retail and Food Services Sales

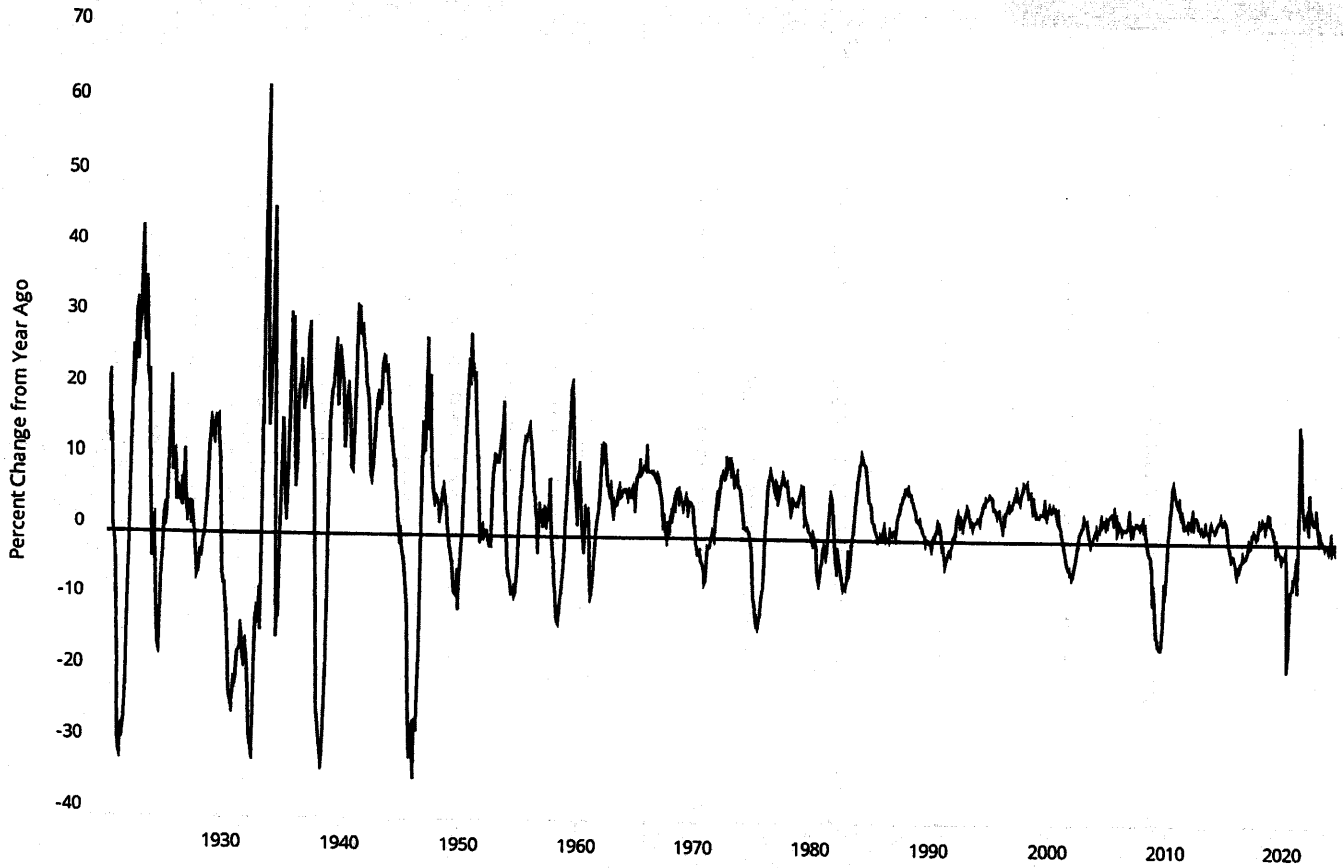


Source: Federal Reserve Bank of St. Louis



Chart 3

**FRED** — Industrial Production: Total Index

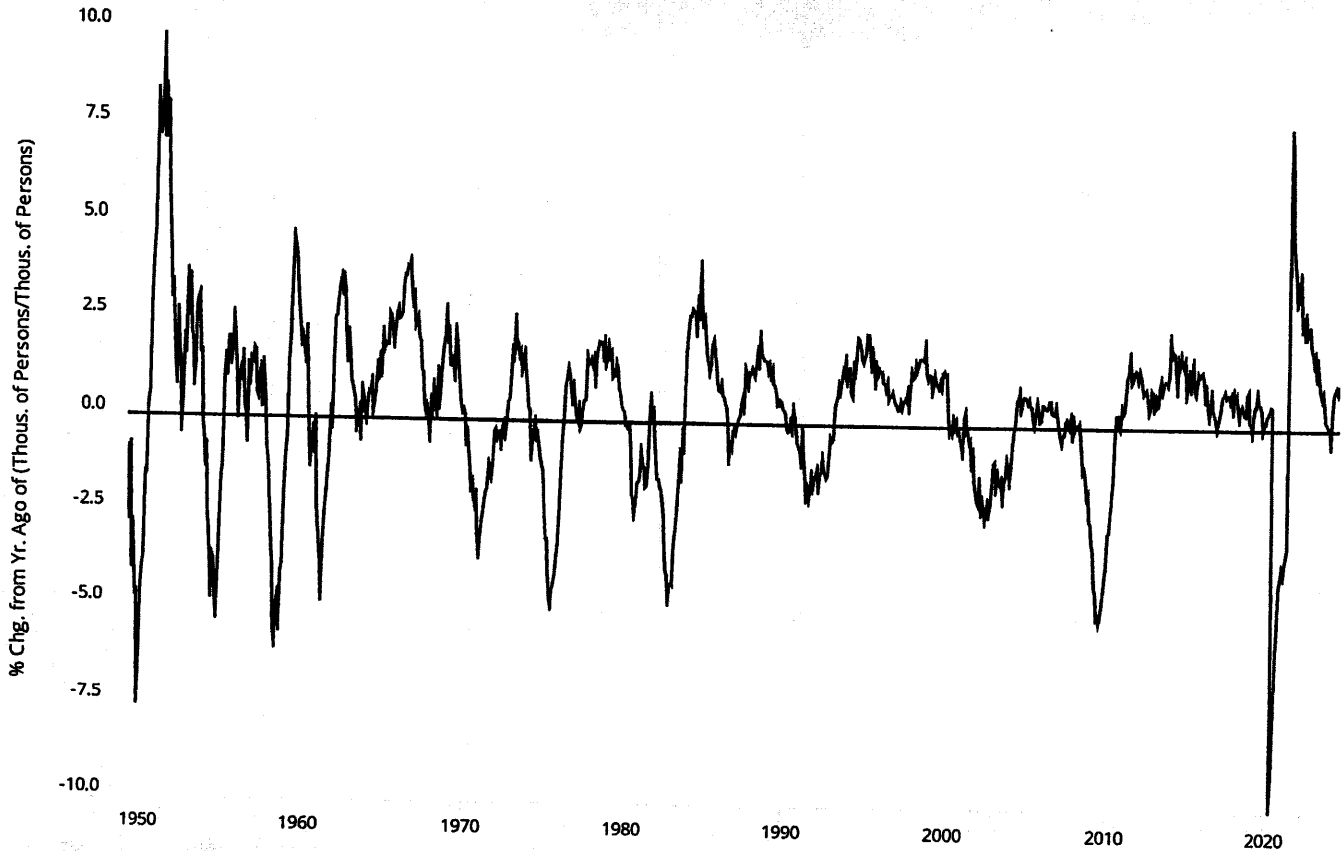


Source: Board of Governors of the Federal Reserve System (US)

fred.stlouisfed.org

Chart 4

**FRED** — All Employees, Total Nonfarm/Civilian Labor Force Level

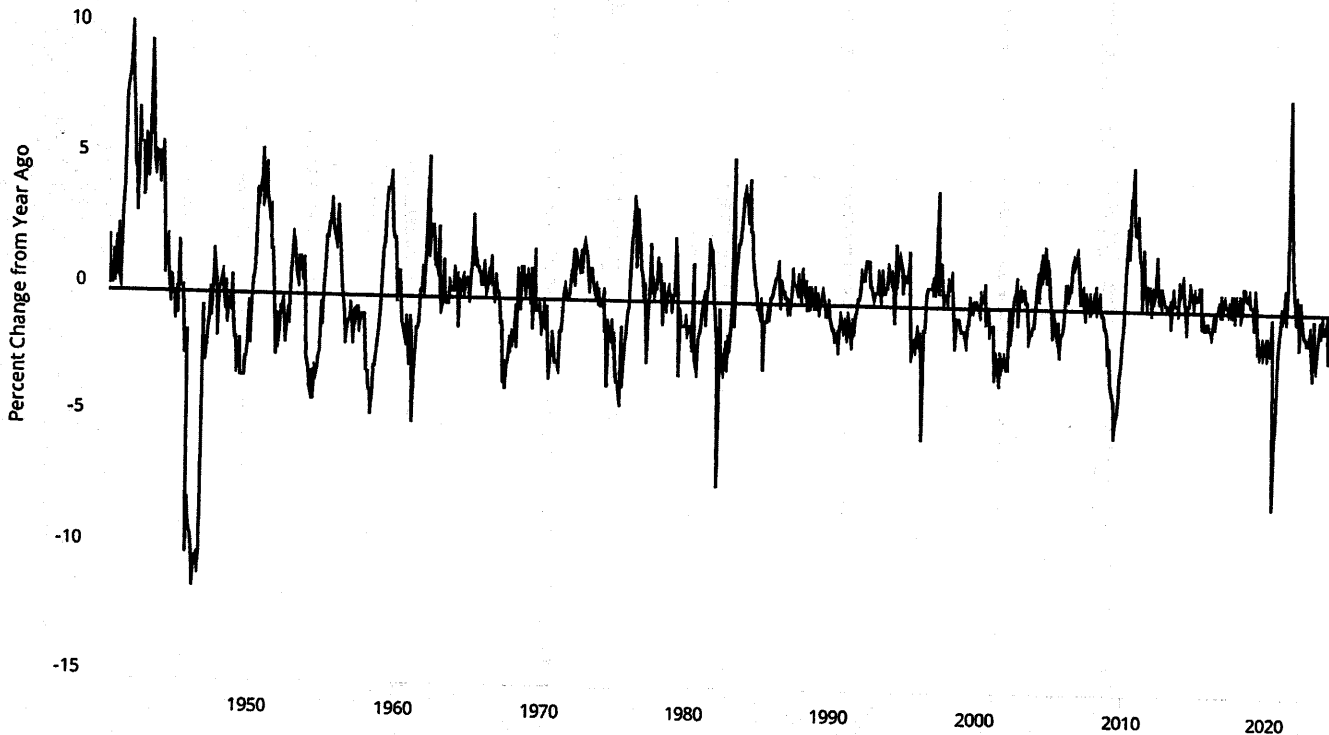


Source: U.S. Bureau of Labor Statistics



Average Weekly Hours of Production and Nonsupervisory Employees, Manufacturing

15



Source: U.S. Bureau of Labor Statistics

fred.stlouisfed.org