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ASPIRIANT INSIGHTS

THIRD QUARTER 2024 INSIGHT

# Investing Outlook

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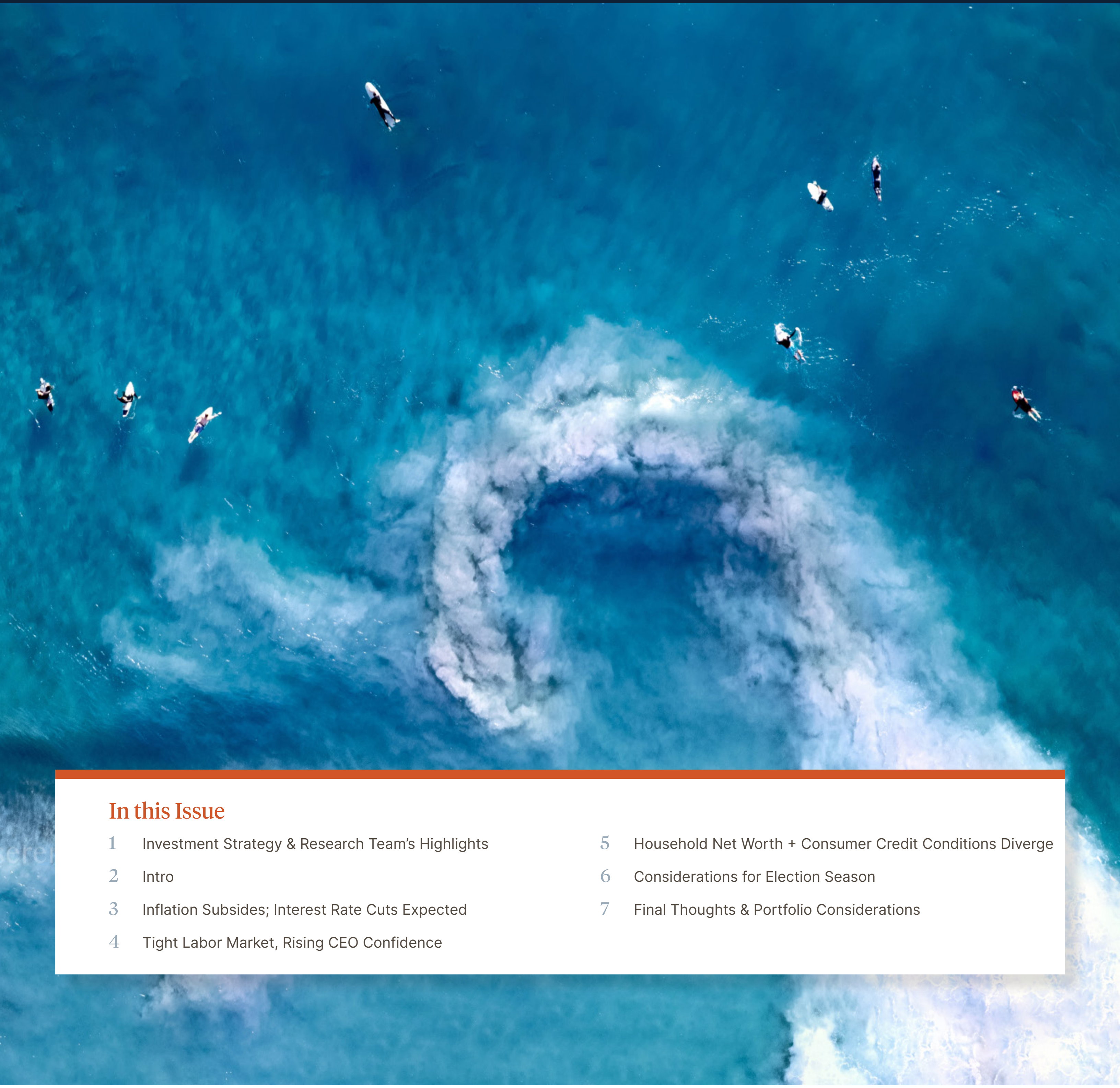


## In this Issue

## Investment Strategy & Research Highlights

- Inflationary pressures continue to subside, and the Federal Reserve seems to be shifting its focus to the strong, though potentially softening, labor market.
- The Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla ) shed over $2 trillion in market capitalization in a brief period, as reporting guidance disappointed and the stocks struggled to overcome macroeconomic headwinds.
- Political and fiscal policy uncertainty remains an overhang on the market.
- Restrictive monetary policy gives the Fed the flexibility to intervene as necessary.
- Investors should aim to maintain a disciplined approach to portfolio construction—diversified, fully invested portfolios—while staying adaptive to the evolving landscape of risks and opportunities.

## Intro

After measured growth in the second quarter, volatility returned to global markets amid uncertainty over interest rates, employment and geopolitical tensions. Domestically, as inflation cooled, the Fed shifted its focus toward the labor market, which remains strong, though concerns linger after a soft July report. These developments fuel speculation about the timing and magnitude of potential interest rate reductions.

At the onset of the year, investors expected significant rate cuts in 2024 and 2025. However, market sentiment has shifted, with projections now indicating five quarter-point reductions this year and four more in 2025. This adjustment has introduced volatility as investors reassess their positions.

Amid this economic backdrop, corporate earnings took center stage, with the Magnificent 7 dominating headlines with their earnings reports. Given their lofty valuations, even small disappointments during earnings season have resulted in meaningful declines in value (or market capitalization), with the group shedding more than $2 trillion since mid-July. Nvidia, the standout of recent years, declined by more than $600 billion, from peak to trough, in market capitalization.

As elections draw nearer, investors increasingly consider how November's outcomes might shape policy and the economy over the next several years. As we navigate these developments, we believe maintaining discipline while adapting to the evolving landscape of opportunities and risks will be essential.

## Inflation Subsides; Interest Rate Cuts Expected

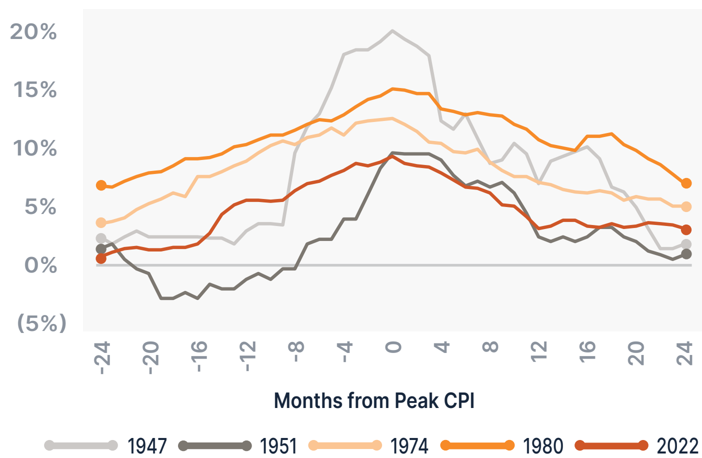
As a reminder, the Fed has a dual mandate to ensure 1) price stability, with a goal of inflation averaging around 2% per year, and 2) full employment, with a goal of sufficient job availability for those seeking work. Higher interest rates have naturally slowed inflation, but recently, real wages have closed the gap on necessities inflation. With inflation seemingly under control, the Fed recently signaled a shift toward focusing on the second prong of its mandate—full employment—as it weighs interest rate policy.

Before addressing the labor market, it's important to understand how the Fed might avoid repeating the 1970s mistake of easing too quickly and reigniting inflation. Today, most measures of inflation continue to ease, and if the labor market continues to cool, we'd expect to see services inflation decrease as well.

The four yellow and grey lines in Figure 1 display previous inflationary cycles that peaked in 1947, 1951, 1974 and 1980. The orange line represents the current inflationary cycle, which reached its peak in 2022.

FIGURE 1

### U.S. Consumer Price Index




Data as of 6/30/24. Source: Aspiriant analysis. Data from Bloomberg, Bureau of Labor Statistics. Please see additional disclosures regarding third-party data and other considerations.

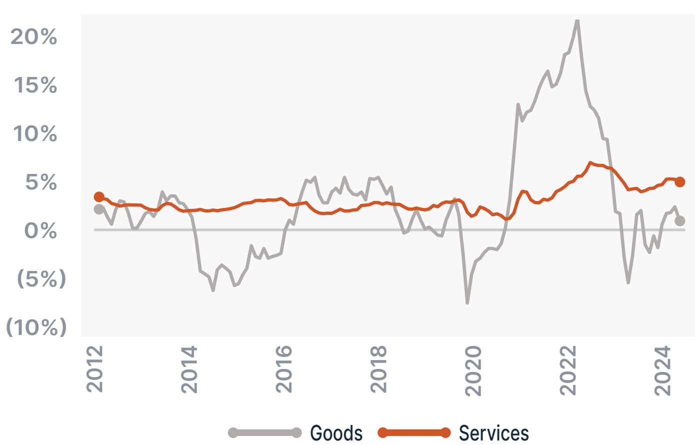
All five lines are organized so that "zero" months on the bottom axis align with the peaks of each inflationary period. Notably, the arc of the current inflationary cycle resembles those of the previous cycles, with each taking roughly 24 months to reach their respective peaks and then settle back near pre-cycle levels. The current cycle (orange line) began its 48-month period with inflation at just 0.6%. Now, 48 months in, inflation is around 3.0% after peaking at over 9% in June 2022. With disinflationary pressures mounting, we believe inflation will likely continue to soften in the near future.

Figure 2 compares the inflation levels for goods and services. Over the past decade, goods inflation (gray line) has oscillated around +/- 0%, with the brief spike during the pandemic when many consumers, stuck at home, bought virtually everything they could find online. Services inflation (orange line) has been significantly more stable over the decade. However, while it has cooled, it could remain elevated if the employment market remains strong. In February 2013, services inflation was running at 3.0% and is now running at about 4.9%, still 1.9% higher than when it entered this cycle. However, if the labor market continues to cool, services inflation is expected to decrease accordingly, giving the Fed another reason to ease its restrictive monetary policy.

FIGURE 2

### Inflation
### Goods vs. Services

Year-over-Year Change



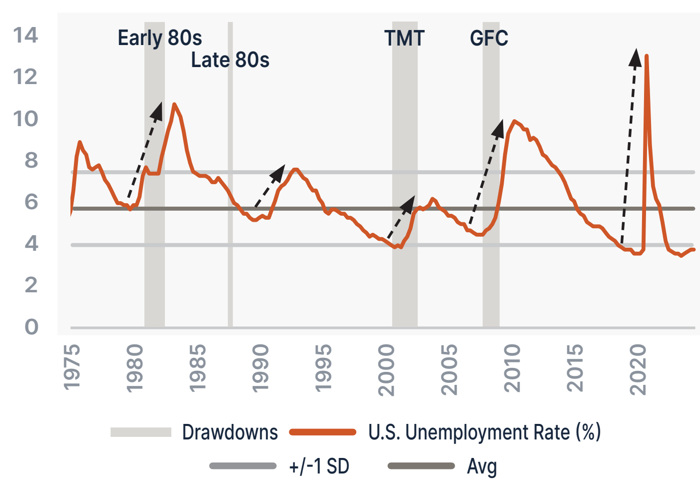

Data as of 6/30/24. Source: Aspiriant analysis. Data from Bloomberg, Bureau of Labor Statistics. Please see additional disclosures regarding third-party data and other considerations.

## Tight Labor Market, Rising CEO Confidence

Figure 3 provides some context regarding the Federal Reserve's second mandate with the orange line tracing the unemployment rate going back to 1975. The unemployment rate is the number of unemployed workers relative to the overall labor pool. The black arrows highlight the abrupt nature of the increases in unemployment that tend to be associated with recessions.

FIGURE 3

### U.S. Unemployment Rate (%)




Data as of 6/30/24. Source: Aspiriant analysis. Data from Bloomberg. Bureau of Economic Analysis, Bureau of Labor Statistics. TMT is the technology, media and telecommunications drawdown. GFC is the global financial crisis. Please see additional disclosures regarding third-party data and other considerations.

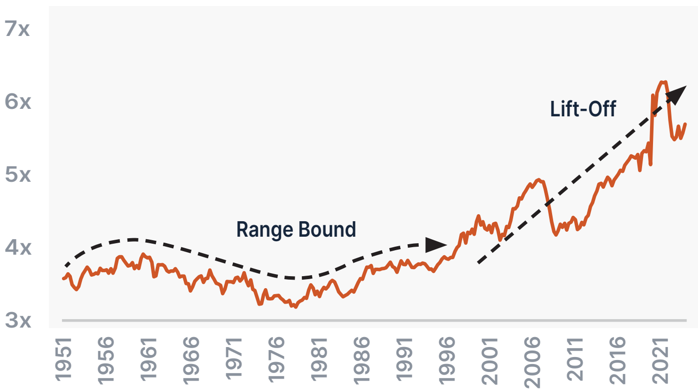
In recessions, consumers and businesses cutback, creating a self-reinforcing cycle of lower and lower spending and economic growth. An extreme example of this occurred in the early weeks of the pandemic when the unemployment rate peaked at 14.7%. Then, as is often the case, fiscal and/or monetary policy is used to break the downward spiral and animate a recovery. Given the magnitude of the stimulus—roughly $9 trillion in aggregate—unemployment fell much quicker than in past cycles and reached a 60-year low of 3.4% last April. Note this is similar to its reading in December 2019, just prior to the start of COVID. But over the past few months, the labor force has drawn in more people, and job terminations have edged up, causing the unemployment rate to increase to 4.3%. By any measure, unemployment is still historically low. However, the drift upward in unemployment is a new variable the Federal Reserve needs to weigh in future decisions. Interestingly, this news comes at a time when CEOs, surveyed by the Conference Board, are indicating a sense of optimism, especially in relation to the pre-pandemic period of 2019.

# Household Net Worth + Consumer Credit Conditions Diverge

While CEOs are increasingly confident in their companies' economic prospects, consumer data presents a more mixed picture. As shown in **Figure 4**, household net worth as a percentage of GDP suggests that U.S. households are as financially secure as they have been since the 1950s. From 1950 to the 1990s, aggregate household net worth to GDP oscillated around 3.5x GDP. Since then, it has climbed and recently approached 6x GDP. Factors such as lower labor and debt costs, fewer regulations, declining taxes, and advances in technology and medicine have contributed to economic growth, which in turn has driven the surge in household net worth. Today, aggregate U.S. household net worth exceeds $160 trillion. As a result, consumers, particularly affluent ones, have a greater ability to maintain their spending across economic cycles. Unfortunately, this increase in net worth has not been universal. Lower-income households have struggled to maintain their living standards, especially in recent months, amid mounting inflationary pressures.

**FIGURE 4**

## Household Net Worth to GDP

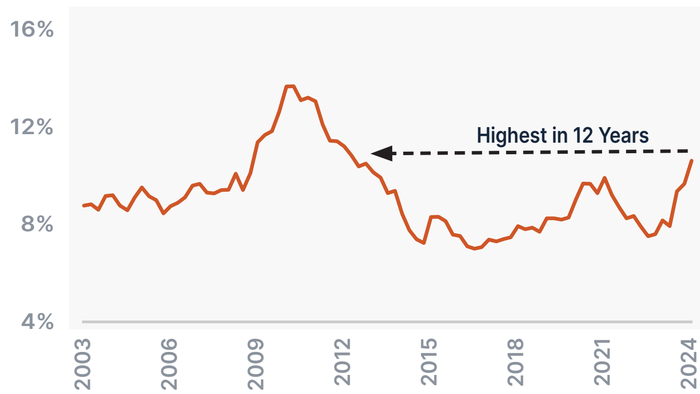



Data as of 6/30/24. Source: Aspiriant analysis. Data from Bloomberg, Bureau of Economic Analysis. Please see additional disclosures regarding third-party data and other considerations.

The divergence in spending habits is evident in the increase in credit card delinquencies (see **Figure 5**). Consumer spending is financed through three main sources: income, savings and credit. Higher-income households typically fund their spending with income and savings, while lower-income households rely more on income and credit. Inflation puts additional pressure on lower-income households, who spend a larger portion of their income on essentials, often living paycheck to paycheck, with little in savings or other assets. As a result, lower-income households are more likely to use credit to cover the gap between their income and spending. With higher prices consuming more of their income, they need more credit at a time when the average credit card interest rate has jumped from 15% to over 21% in the past three years. Not surprisingly, credit card delinquencies have risen sharply as these stresses have intensified over the last 18 months and are now above pre-pandemic levels, the highest in about 12 years.

**FIGURE 5**

## Credit Card Delinquency Rates




Data as of 6/30/24. Source: Aspiriant analysis. Data from Bloomberg, Bureau of Economic Analysis, New York Fed Consumer Credit Panel, Equifax. Please see additional disclosures regarding third-party data and other considerations.

# Considerations for Election Season

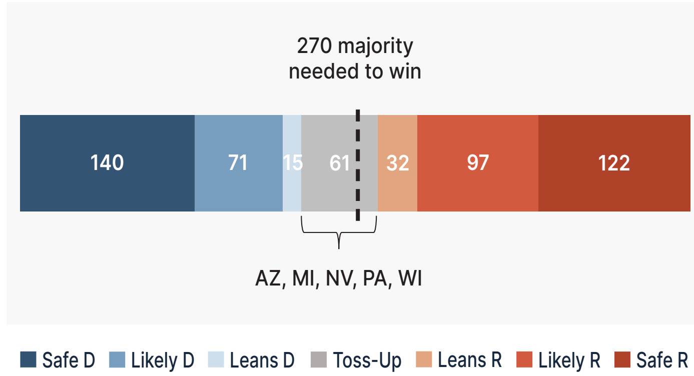
Once you get past the obvious changes in the Presidential race of the past month, the outlook, for now, is eerily similar to where we stood a few months ago. A very close race. At the time of publication, Harris is polling better than Biden, especially after the June 27 debate between President Biden and former President Trump, but neither she nor Trump has a decided advantage over the other. Most models have the race as a toss-up with probabilities between 45% and 55% for either.

The outcome will be decided in the handful of battleground states, with Pennsylvania likely the most pivotal. As shown in **Figure 6**, the candidates will fiercely compete over the next three months for the 61 Electoral College votes in the battleground states of Arizona, Michigan, Nevada, Pennsylvania and Wisconsin.

Turning to the congressional races, **Figure 7** shows the current breakdown of potential House seats. The safe, likely, and leaning seats in either direction sum to 201 for the Democrats and 209 for the Republicans. Republicans need to win just a third of the 25 toss-up races to reach the majority of 218. The 25 toss-up races are split relatively evenly between incumbent Republican and Democrat representatives. Notably, seven of the Republican toss-up races are in California and New York, two states that generally lean blue. Voter turnout is especially critical in close races, and this year will be no different. Earlier this year, a Pew survey identified the economy, national security, crime and immigration as top voter priorities. The carry over from the Supreme Court's Dobbs ruling will be another closely watched element of the upcoming cycle, especially now with the vice president at the top of the Democratic ticket and her lead role in advocating for reproductive rights following the Court's decision in 2022.

**FIGURE 6**

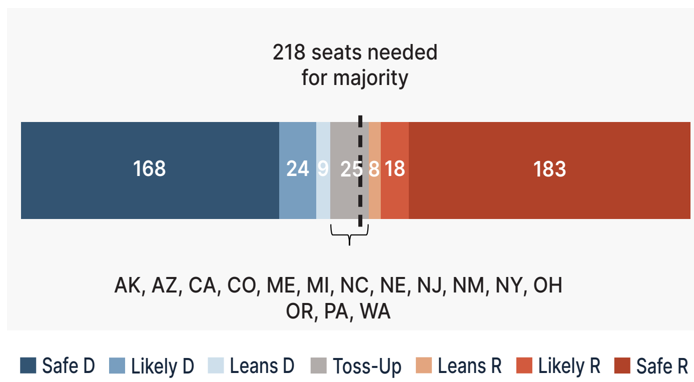
## 2024 Consensus Presidential Election Forecast




Data as of 8/4/24. Source: Aspiriant analysis. Data from 270 to Win. Charts represent composite average for several national polls. Please see additional disclosures regarding third-party data and other considerations.

**FIGURE 7**

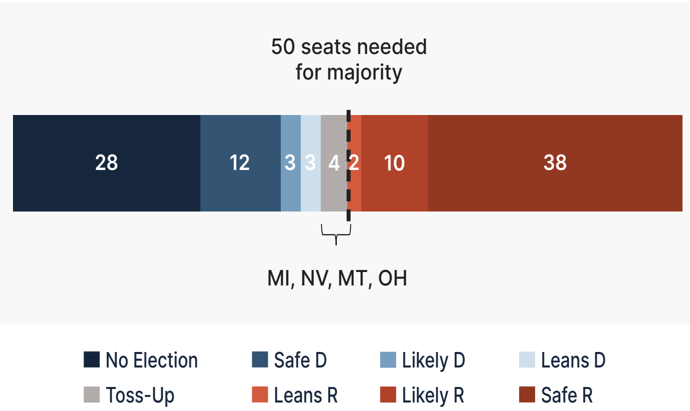
## 2024 House Consensus Forecast




Data as of 8/4/24. Source: Aspiriant analysis. Data from 270 to Win. Charts represent composite average for several national polls. Please see additional disclosures regarding third-party data and other considerations.

FIGURE 8

2024 Senate Consensus Forecast: 34 Seats up in 2024




Data as of 8/4/24. Source: Aspiriant analysis. Data from 270 to Win. Charts represent composite average for several national polls. Please see additional disclosures regarding third-party data and other considerations.

In the Senate, as shown in **Figure 8**, Republicans have the advantage of defending only 11 seats, while Democrats are defending 23 of the 34 seats up for election. The safe, likely, and leaning seats bring the Republicans to a count of 50, which would give them control of the Senate if Trump retakes the presidency. If he doesn't, they need to win just one of the four toss-up seats to reclaim the Senate.

On balance, while the races are all still tight, both parties have viable paths to success. Incumbents, as we have seen in recent UK and French elections, are on the defensive and susceptible to losses given the unevenness of the economic recovery and the toll that inflation has taken on lower-income voters.

Win or lose, the majority margins in both chambers of Congress will be incredibly narrow. As such, the likelihood of passing significant legislation through Congress appears limited, particularly if control of the executive and legislative branches is split. Due to this inertia, fiscal spending, regardless of the November winner, will likely remain elevated. For example, the Congressional Budget Office projects deficits of greater than 5% of GDP for the remainder of the decade.

# Final Thoughts & Portfolio Considerations

It has been over four and a half years since the start of the pandemic. Given the size of the dislocations and policy responses that stemmed from the pandemic, it has taken some time for the economy to normalize. And in the last few months, we are seeing economic data synchronize with pre-COVID levels. The Fed's preferred inflation measure, the core personal consumption expenditures price index, posted a year-over-year increase of 2.6% in July. Not too far from the Fed's target of 2% and its pre-pandemic reading of 1.5%. The unemployment rate of 4.3% is roughly a half a percent higher than its level in December of 2019. And real GDP growth over the past year is virtually identical to its pace in 2019.

With the macro data largely aligned, the Fed policy increasingly appears out of step with underlying economic conditions. Today, the effective Fed Funds Rate is almost 4% higher than it was in December 2019. The Fed, rightfully so, doesn't want to repeat the errors of the 1970s and fail to durably contain inflation. Nevertheless, with inflation trending toward the target, the Fed now needs to weigh the risks that its interest rate policies pose to economic growth and employment. Other data, such as the Conference Board's Leading Economic Indicators and Service PMIs, point to an economy operating at a lower speed than before the pandemic. As discussed earlier, broad sections of the country—most acutely lower-income households—are struggling to stay current on their bills after enduring months of higher prices and interest rates. In light of these stresses and a disappointing jobs report, the market is forecasting over 100 basis points of interest rate cuts through year-end. Longer term, the Fed believes short-term interest rates will settle around 3% by 2026 or 2027.

With that backdrop, the outlook for equity markets remains mixed. S&P 500 valuations continue to beat the upper end of their historical range, with gains narrowly concentrated in a handful of large tech platforms. To underscore that point, the equal-weight index, or average stock of the S&P 500, has returned about half of the cap-weighted S&P 500 index over the past three years. Valuations outside the U.S. are considerably cheaper but come with higher risks amid more uncertain economic conditions.

With that in mind, we recommend portfolio positioning is grounded in diversification and purposeful risk-taking. Fixed income looks attractive, with yields offering reasonable spread to inflation. Given that we are closer to the end of the inflation cycle than the start, we expect fixed income and equities markets to be less correlated to one another. This should give fixed income, as we have seen during recent market volatility, the ability to preserve capital during equity market sell-offs.

We continue to see value in diversifiers—investments with low correlation to both fixed income and equities—to protect against market volatility and any resurgence in inflation, should it occur.

Further up the risk curve, we believe holding some defensive equities (stocks with historically lower volatility), especially this late in the cycle, is sensible. These companies possess more durable business models and cash flows, allowing them to better withstand slowing economic growth. International equities, despite the near-term economic risks, trade at lower valuation multiples and are thus priced to capture a wider return premium compared to cash in the years ahead. Finally, we believe investors should have some exposure to private markets in areas such as private credit, infrastructure and secondaries. These investments allow investors to capitalize on market dislocations, long-term secular trends and broaden portfolio diversification.

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**Glossary of Terms Used in this Issue**

**Consumer Price Index (CPI)**: A key indicator of inflation or deflation in the economy.

**Disinflation**: A reduction in the rate of inflation, meaning prices are still increasing but at a slower rate than before.

**Electoral College**: The body of electors established by the United States Constitution that formally elects the President and Vice President of the United States.

**Federal Reserve (Fed)**: The central banking system of the United States, responsible for setting monetary policy, including interest rates and regulating banks.

**Gross domestic product (GDP)**: It measures the monetary value of final goods and services produced in a country in a given period of time.

**Interest Rates**: The percentage charged on borrowed money or paid on investments. Set by the Federal Reserve, interest rates influence inflation and economic growth.

**Leading Economic Indicators**: Key economic metrics that typically change before the broader economy shifts, providing insights into potential future economic activity.

**Magnificent Seven**: Stocks that include Amazon, Alphabet, Apple, Meta, Microsoft, Nvidia and Tesla.

**Market Capitalization**: The total market value of a company's outstanding shares of stock, calculated by multiplying the current share price by the total number of outstanding shares.

**Monetary Policy**: The process by which the Federal Reserve manages the supply of money and interest rates to achieve macroeconomic objectives, such as controlling inflation, managing employment levels and ensuring economic stability.

**Services Inflation**: The rate at which prices for services—such as healthcare, education, and housing—rise over time.

**Unemployment Rate**: The percentage of the labor force that is jobless and actively seeking employment.