ZWJ INVESTMENT COUNSEL

MARKET OUTLOOK Second Quarter 2024

Oddities in the markets continue to dominate one quarter into the new year of 2024. We again saw the overall market performance led by a few mega-cap technology names. We continued to get mixed reports from the economy. The impact of artificial intelligence is universally expected to be significant, but nobody has details regarding the particulars. We continued to get mixed messages from the government's financial leaders. And this election year is very likely to be one of the oddest in history.

Oddities are not investment themes we can use particularly well, but they are signals that caution and discipline are needed. The alternative is capitulation, when investors give up trying to make sense of what is going on and just buy what is working at the time. Big tech has been working, AI has been working, and lately Bitcoin seems to be working again. Everybody understands the law of large numbers, but in the case of Big Tech, investors are told it is not a problem. All computer programmers learn the acronym GIGO (garbage in, garbage out), but somehow these new chips will result in intelligence because they "learn" from someone or something. It's all very exciting and simultaneously somewhat frightening.

There are three tools for economic policy available to the government, and they do not seem to be working in synchronized fashion. Whereas the Federal Reserve has pursued a contractionary monetary policy to reduce inflation to its long-term target of 2 percent, the Treasury Department has been boosting liquidity through extraordinary and emergency programs. The fiscal policy has likewise been expansionary, with government spending now at a rate that CNBC reports will result in an additional $1 trillion to the national debt every 100 days.

Monthly payroll numbers always look quite good, which negates the need to lower the high rates currently set by the Federal Reserve. Yet, regional Federal Reserve Bank manufacturing surveys (Dallas, Richmond) suggest industrial activity is trending down based on weaker consumer activity. Housing prices continue to climb, but household employment surveys suggest more difficulty getting jobs that could support greater home ownership.

In the US stock markets, growth led relative to value. The Magnificent Seven might be culled down to the Fantastic Four, as Tesla and Apple actually posted double-digit negative returns and Alphabet (Google) lagged the broader S&P 500 index performance. NVIDIA was up over 85% for the quarter. Those who do not own it are green with envy, a word that is translated into Latin as *invidia*. On the other hand, the Financial Times reports insider selling at large technology companies has reached its highest level in three years.

The bond markets have likewise moved oddly. After Federal Reserve Chairman Powell's announcement last October that rates might be cut in the future, the market rates moved sharply lower and Wall Street factored into its pricing a full seven rate cuts in calendar 2024. By late March, that expectation has been whittled down to three, and longer rates are now slightly higher than they were at the end of the year. The yield curve remains inverted – with the longer term rates lower than the shorter term rates – and has been so for the longest period ever recorded in the markets. Inverted yield curves are most often taken as an indication of future economic or market weakness. Neither persistent inversion nor persistently high rates have harmed the equity market performance so far this year. It is odd.

Continued on Next Page ☞

As we have noted, oddity is not an investment program. We take it as a sign of uncertainty. When times are uncertain, it's best to stick to bedrock principles and maintain discipline. That has been our course of action. We have been patient with new funds allocated to equities, but we continue to like what we hold and are able to find new investment candidates here and there. We have continued our maturity extension program in funds allocated to bonds, and we think longer term rates around 4.5 percent offer a fair risk/return balance. We are happy to hold back some opportunistic cash; with cash rates above 5 percent one does get some cash flow while looking for a clear path out of the currently odd market environment.

As the second quarter of 2024 opens, we will continue to focus on quality companies with realistic growth expectations for our stock allocations, and quality issuers with near-zero principal risk for our bond allocations. The AI market infatuation could decline, as ESG, EV, meme stocks, and other themes have in the past. A thematic market decline could be healthy for the broader market. The Treasury Department's emergency programs are nearing their termination dates, and that could mean the Federal Reserve's policy would return to a leadership role. We think the net of these changes would bring downward pressure on the overall stock market indices, but our clients would be relatively well positioned with our focus on quality and valuation.

We still have a few significant unknowns that will take months to clarify. The conflicts in Ukraine and the Middle East have not shown signs of ending, and war is always unpredictable. We are in an election year in the U.S., and the country seems no less polarized than it was four years ago. The primary means of moving hazardous materials north and south along the East Coast was just destroyed by a ship, and finding new ways to move industrial gases and chemicals around Baltimore will present both challenges and opportunities.

Amid the oddities and the unknowns, we remain cautious. A bit of a cash reserve is a reasonable risk control measure. Our clients have entrusted their savings to us, and our first job is to protect what we received. Many clients expect to use part of their savings to fund their lifestyles, so our second job is to grow their savings at a rate above inflation. Our clients want to be free to live their lives, so our third job is to be in touch with them to explain what we see and offer some perspective on the best course of action. We take all three jobs quite seriously, and we thank you for your continued confidence in ZWJ.

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