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Q3 2024 Outlook

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Economy: Economic growth has moderated in the first half of the year alongside declining inflation as the economy absorbs tight monetary policy and a slight loosening of the labor market.

- After a two-quarter surge in GDP growth in the latter half of 2023, Q1 2024 saw modest 1.4% GDP growth as reported by the BEA with another moderate reading expected for Q2 2024. We still don't see the catalyst for a major pullback, but the next few quarters will likely see limited growth potential until the Fed changes course and becomes more accommodative. The headlines are still full of fear-mongering anecdotes revolving around the collapse of commercial real estate, runaway bad debt, bank failures, election and policy uncertainty, among other concerning topics, however we maintain that these are known, easily observable risks and markets are already positioned for those outcomes. Recessions are not generally triggered by things so well-publicized and easily predicted.

- The labor market does appear to be loosening with the unemployment rate creeping back up to 4%. This should relieve some of the pressure on employers and wage inflation, allowing further stabilization in prices. This is also a data point that the Fed will be watching closely, and any further loosening will help them begin to build the case for a more accommodative policy stance.

- We see continuing moderation in inflation with the Fed's targets achievable by year end. The services component's contribution to inflation is the only portion that appears persistently problematic. We suspect, as the labor market loosens a bit further and economic growth continues to moderate, the pressure on prices for services should abate as well, leaving inflation near target levels. We still see flat to negative rent growth in apartments despite shelter cost's continuing contribution to inflation readings. Shelter's contribution is set to decline as inflation data rely on lagging rent inputs, further making the Fed's target achievable. We are watching the shelter component of inflation to make sure we don't slip towards a more deflationary environment as the apartment market is set to see significant deliveries of new supply over the next 18 months. This supply could put significant downward pressure on rents in some of the markets that have seen the most rent growth and investment activity over the past few years. We do see a "supply cliff" after that time which, in combination with continuing high cost of home ownership, could put renewed upward pressure on rents.

- In private markets we have seen a bit of thawing after about 18 months of wide bid-ask spreads and very limited transaction volume. With buyers previously fearing, and preparing for, a distressed economy and market, many have started to transact closer to the sell side of the market as an increase in confidence and range-bound interest rates have allowed buyers to proceed with greater conviction. Additionally, in commercial real estate, lenders have not exhibited the kind of self-defeating behavior that would trigger forced selling and extreme pressure on prices. Instead, they have elected to let time and solid property-level operations pave the path to value recovery with implicit support from regulators and policy setters preventing well-run institutions from collapsing. This helps give us confidence that well-publicized predictions around the pending collapse of commercial real estate, and the related regional bank failures and credit crisis that collapse would cause, can be avoided.

Stocks: The S&P 500 ended the second quarter up 3.9% to 5,460, bringing its price gain for the year to approximately 14.5%.

- Although market measures, namely the VIX, are indicating very low current volatility in stocks, we did see a couple periods of increased volatility and moderate corrections during Q2, especially during April. Many of the aforementioned risks that we don't suspect will trigger an economic decline could produce increased volatility in stocks, particularly over the upcoming summer months that are usually characterized by lower volume and liquidity with much of Wall Street on holiday. In particular, although we don't subscribe to the idea that one candidate will produce a better long-term market result vs the other, the unique uncertainty that is evolving around the upcoming election could produce a greater increase in volatility than has been seen in past elections. However, with volatility often comes opportunity, so this could provide a welcome trading opportunity or change in leadership in the market.

- After we saw breadth improvement, or more stocks participating in the advance, early in the year, Q2 saw the resumption of concentration among mega-cap tech stocks like NVDA with the vast majority of stocks not in this exclusive club down for the quarter. In fact, Bespoke Investment Group reported that only the top decile of the Russell 1000 as ranked by performance saw gains for the quarter. A handful of sub-industries like semiconductors, fast-casual restaurants, and certain retailers have briefly taken leadership roles, but often have followed those periods with fairly violent corrections, making it a challenging trading environment.

- Hollencrest continues to position cautiously and maintain high-yielding cash balances to offset volatility while selectively increasing exposure to sectors when trading opportunities arise.

Bonds and Rates: Mid and long-term Treasury yields ended slightly higher for the quarter with the 10-Year Treasury yield ending at 4.34%, up only about 13 bps after having traded at 4.70% in the middle of the quarter.

- Expectations of a Fed rate cut, or cuts, have steadily fallen throughout the year as economic growth has shown resilience and inflation has not fallen as fast as some would have hoped. The general consensus now calls for only one to two rate cuts this year with the Fed guiding towards only one cut. The timing of that potential cut is still uncertain. There are numerous theories floating around in the market about possible political motivations the Fed and its chair may have tied to job security or presidential preference that could impact the timing and scale of cuts, however these theories lack the substance to impact forecasts or influence positioning.

- We see potential for the long end of the yield curve to trade in a range of 4% to 5% the rest of the year with a bias towards the lower end of that range. Our observations have been that, if the 10-Year Treasury's yield were to stabilize around 4.3% or lower, most markets could function well and we could see a further uptick in transaction volume and liquidity. Longer term we see potential for rates to drift lower and trade at a traditional spread to inflation expectations, possibly ending up in a range of 3% to 3.5%.

- We have yet to see interesting opportunities arise in credit with spreads still very tight. We still favor fixed income with low, or no, credit risk and focus on Treasuries when considering allocations. We also monitor the private credit market closely and see limited opportunity in that space. We continue to watch for default events that could cause a healthy revaluation in credit markets that would make them more attractive on a risk adjusted basis.