NBC | SECURITIES

INVESTMENT STRATEGY STATEMENT | September 3, 2024

A Normalizing Economy

by Darren Hinshaw, Pierre G. Allard & Christopher Fidler

Performance Review & Outlook

Disinflation Trend Getting Close to the Conclusion
The July CPI reading showed consumer prices up only 2.9% y/y, the first reading below 3% since March 2021.

Equity Markets Continued to Advance in August
Staples and Real Estate led the way in August, pushing the S&P 500 to finish up 2.4% for the month. The index is now up greater than 19% in 2024.

"The Time has Come for Policy to Adjust"
Fed Chair Jerome Powell set the stage for rate cuts during his press conference at the Federal Reserve's Jackson Hole symposium.

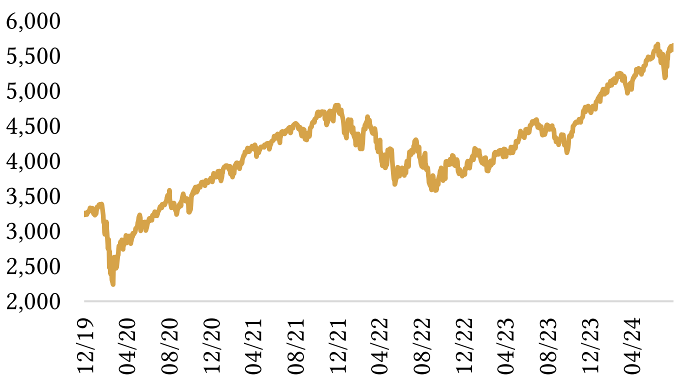
Fixed Income Market Rally Continues
Yields fell again in August, with the 10-year closing the month at 3.9%, down over 10bps for the month and 80bps since the recent peak in late April.

Data Over the Last Year Has Been Consistent with our View
With inflation falling and the economy continuing to grow, the key themes we have been discussing for more than a year have largely played out consistent with our view.

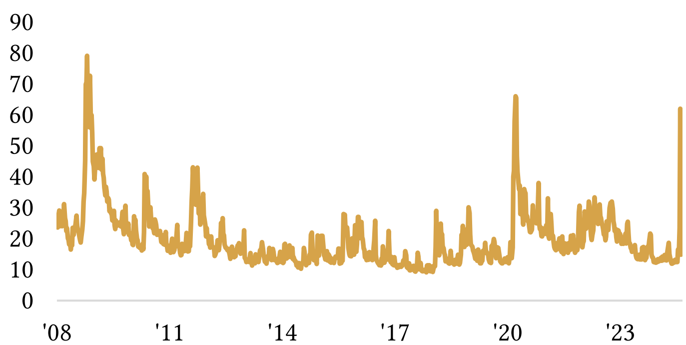
Equity Market Overview

Equity markets got off to a rocky start in August as several factors came together to cause a brief selloff in prices and an (almost unprecedented) increase in volatility. Various reasons were cited for the selloff, including the unwinding of multiple popular hedge fund trades and some weaker than expected economic data. The S&P 500 bottomed on August 5th, falling a total of 6% in 3 trading days. The VIX (a measure of expected volatility over the next 30 days in the S&P 500) registered its 3rd highest reading going back to the Financial Crisis. At the time, we wrote "Media headlines are meant to drive clicks and eyeballs. We advise to focus on the fundamentals." Cooler heads quickly prevailed, with the S&P 500 regaining all of the losses by Friday, August 9th and the VIX falling below its closing July value. The index closed August up 2.4% for the month and is now higher by over 19% for the year.

S&P 500 Index (12/31/19 - 8/30/24)



VIX Index (1/4/08 - 8/30/24)



Staples and Real Estate were the two best performing sectors, both up greater than 5% for the month. Energy (-3%) was the worst performing sector for the month, as falling oil and natural gas prices hit equity values. Consumer Discretionary (-2%) was the only other negative contributor on the back of several negative earnings reports from companies in the sector. For the year, Financials have now joined Technology and Communication Services as sectors that are higher by greater than 20%.

August Returns

+5% Staples	**+5%** Real Estate
-3% Energy	**-2%** Consumer Discretionary

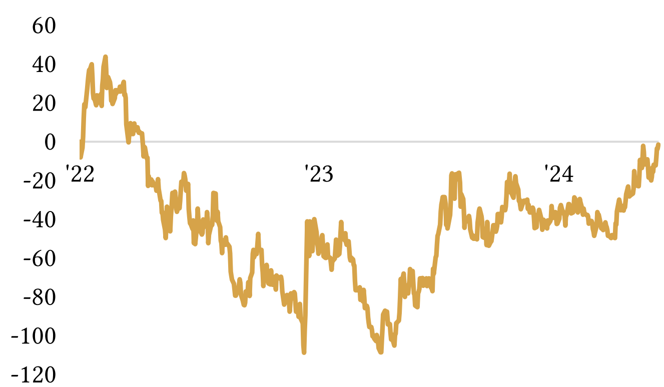
Fixed Income Market Overview

In August, fixed income markets continued to be influenced by expectations around Federal Reserve monetary policy and the Fed's response to economic data for the month. The 10-year U.S. Government bond yield ranged from a high of 3.99% to a low of 3.78%, showing less volatility compared to previous months and remaining on the lower end of the yield spectrum for 2024.

Notably, following the July year-over-year CPI reading of 2.9%, the 10-2 year U.S. Government bond yield curve briefly turned positive intraday, marking its first instance of non-inversion since July 5, 2022. The un-inversion was short lived, but the yield curve remains tight and inverted by only 2 basis points.

10 Year US Treasury Yield (%)

2Yr/10Yr Spread (bps)



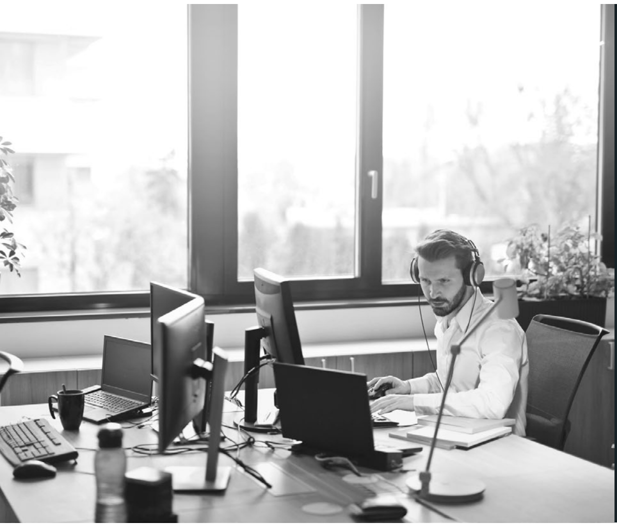
At the end of August, the Federal Reserve held its annual economic conference in Jackson Hole, WY. For the first time in over two years, Fed Chairman Jerome Powell indicated a potential easing of monetary policy. In his keynote speech, Chairman Powell remarked, “The time has come for policy to adjust” and indicated that “The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.” While he mentioned the possibility of multiple rate cuts, he did not specify when they might start or their magnitude. Futures markets are currently predicting a modest quarter-point cut in the benchmark rate when the Fed meets in mid-September.

“The time has come for policy to adjust” and indicated that “The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.”

Next month is expected to be pivotal as we await the Fed's next move. Will we see a rate cut and will the longest inverted yield curve in U.S. history finally come to an end? The answers may soon be revealed.

Economic Overview

Key Economic Indicators



JOB MARKET

Job Gains
The Bureau of Labor Statistics (BLS) reported that the U.S. economy added 114,000 jobs in July 2024, a sharp slowdown from June. The unemployment rate ticked up to 4.3% in July from 4.1% in June, the highest level since October 2021. In addition, they also reduced the previous reported figures down by 818,000 for the 12 months ending in March 2024. This 0.5% downward adjustment reflects slower job growth than expected. Despite the revisions, the monthly average of 174,000 versus 242,000 jobs still indicates solid economic expansion. Through July the US had had a positive job growth for 43 consecutive months-the fifth longest streak in history.

HOUSING MARKET

House Prices
Home prices continued to trend upwards in June as the benchmark 20-city index rose for a sixteenth consecutive month to a new all-time high. The S&P Case-Shiller Home Price Index revealed seasonally adjusted home prices for the 20-city index saw a 0.4% increase month-over-month (MoM) and a 6.4% increase year-over-year (YoY).

Existing Home Sales & Inventory
For July, Realtor.com reported inventory was up 36.6% YoY, but still down 30.6% compared to April 2017 to 2019 levels.

PERSONAL INCOME & SPENDING

Retail Sales
Retail sales were up 1.1% from June 2024, and up 2.6% from last year.

Personal Income & Spending
Personal income increased 0.3%, slightly higher than the 0.2% estimate, while consumer spending rose 0.5%, in line with the forecast.

Economic Overview

Key Economic Indicators

ECONOMIC GROWTH

GDP Growth

Gross domestic product increased at a 3.0% annualized rate last quarter, the Commerce Department's Bureau of Economic Analysis said in its second estimate of second-quarter GDP on Thursday. That was an upward revision from the 2.8% rate reported last month. Consumer spending, which accounts for more than two-thirds of the economy, increased at an upwardly revised 2.9% rate. It was previously reported to have grown at a 2.3% pace. That offset downgrades in business investment, exports and private inventory investment.

INFLATION

CPI

Over the year ended July 2024, the Consumer Price Index for All Urban Consumers increased 2.9%. This was the first time since March 2021 that the 12-month increase was below 3.0%. The index for all items less food and energy increased 0.2% in July; up 3.2% over the year

PCE

The Fed’s favorite inflation indicator, PCE, the personal consumption expenditures price index rose 0.2% on the month and was up 2.5% from the same period a year ago, exactly in line with consensus estimates. Excluding volatile food and energy prices, core PCE also increased 0.2% for the month but was up 2.6% from a year ago. The 12-month figure was slightly softer than the 2.7% estimate.

Conclusion

With inflation falling and the economy continuing to grow, the key themes we have been discussing for more than a year have largely played out consistent with our view. With backward looking measures of inflation inching closer to the Fed’s 2% target and expected breakeven inflation rates over the next couple years currently below 2%, the disinflation narrative appears to be drawing to its conclusion. This should allow the Federal Reserve to shift monetary policy to support a normalizing economy. As this dynamic evolves, NBCS Asset Management will continue to monitor and discuss inflation but we’ll likely place more of an emphasis on the labor markets, key indicators for the health of consumers and the economy, and the overall impact on earnings for equity markets and rate moves for the fixed income markets.

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