HERE WE SIT at midyear and many investors should be feeling pretty good. Stocks have very had a strong start to the year, even with some normal bumps along the way. Bonds have been mildly disappointing but high short-term rates are benefiting savers more than they have in decades. And while bonds have briefly stumbled, some other portfolio diversifiers, including gold, have done well.

Despite it all, markets’ ability to distract the mind and jangle the nerves hasn’t stopped. The aim of our Midyear Outlook 2024: Eyes on the Prize is to stay focused on what matters for investors. Think about what’s happened over the last seven years. We had a near bear market in late 2018, then the first Fed rate hiking regime in over a decade (the one before the pandemic), a bear market in 2020, a once-in-a-century pandemic, one of the most contentious elections in our nation’s history, generational high inflation, then the most aggressive Fed rate hiking regimes in 40 years, another bear market in 2022 (along with the worst years ever for bonds), a war in Ukraine (still on-going) perpetrated by an expansionary former superpower, and then one more conflict in the Middle East.

And yet over those seven years, we’ve seen the price index for the doughty old Dow Jones Industrial Average, the grandfather of all indexes, double from just over 20,000 on January 25, 2017, to 40,000 as of this May, with a total return of 135% including dividends. The total return for the S&P 500 over the same period was even better at 163%.

It sounds crazy, no? Many say markets must have been acting irrationally and bidding up prices into a bubble. But if you keep your eyes on the prize, you know that stock prices are mostly driven by earnings growth and the return of profits to shareholders. Of that 163% return for the S&P 500 over the last seven years, 103% of it was from earnings growth and 32% from dividends. There was also valuation expansion, investors willingness to pay more for a dollar of future earnings out of increased confidence (sometimes overconfidence), but it only accounted for 28%-points of the return. Take out the valuation expansion and you still had a 135% return, very good for a little over seven years, and it would have been driven entirely by the strength of fundamentals.
There’s a lesson there. There are tougher and easier economic environments to navigate, and we’ve seen our share of tough environments over the last seven years. But when the going gets tough, business leaders and entrepreneurs don’t throw up their arms in exasperation and give up. They find ways to be resilient. They innovate. They become more efficient. They discover untapped sources of productivity. And they do it all while investing for the future. All that activity can be captured in big picture macroeconomic data and market history that form the backbone of our outlook and help us capture essence of what’s happening in markets without all the noise.

A midyear outlook implies a short-term perspective, just six more months. And we do that. We share our views on what we think the Fed will do, what the election might mean, and our expectations for both stocks and bonds. But we also want to keep our eyes on the prize, on the major trends that are shaping the investment environment and on the fundamentals that drive long-term investing success.

Keeping our eyes on the prize isn’t easy. We are built to be distracted by the 24-hour news cycle, by the endless stream of the next comment, meme, or video clip of the moment, and more simply just by the demands of everyday life. Our minds are also always on the lookout for the next danger, a predisposition that both the passionate doomsayers and the charming curmudgeons know how to take advantage of. But we also have a solution: a team of family, friends, and trusted advisors to keep us on track.

Midyear Outlook 2024: Eyes on the Prize provides an overview of our best ideas looking out over the next six months and the broader trends that may carry over much longer, but it’s only a general guide. To understand how it may apply to you so you can achieve your long-term goals, turn to your team and your trusted financial advisors. Ultimately, that’s what lets us focus on the real prize of effective long-term financial planning: taking care of our families, the freedom to live a life of purpose, whatever we choose that to be, and the legacy we leave behind. That’s a prize always worth keeping firmly in view.
Outlook at a Glance

KEY FORECASTS

» The economy continues to see a solid rate of expansion with low risk of a recession.
» We are targeting a total return for the S&P 500 of 17-20% in 2024.
» The Bloomberg US Aggregate Bond Index outperforms short-term Treasuries in the second half of the year.

SUMMARY OF MAJOR VIEWS

» The economy remains resilient supported by job gains, income growth, and strong consumer balance sheets as well as productivity gains on the business side.
» Inflation will continue to fall and the Fed will begin cutting rates in the second half of the year, with a base case of two cuts in 2024. The Fed's view of the “neutral rate” will be revised upward, keeping us in a higher for longer rate environment.
» This young bull market will continue, supported primarily by earnings growth. Economic strength will support more cyclical stocks, while catch-up for undervalued areas of the market may contribute to a broadening rally. Stocks outperform bonds.
» Bonds will be more resilient in the second half of the year as the Fed begins to cut rates. Historically this has been a good time to shift short-term holdings towards more traditional bond allocations.
» Adding diversifying asset classes beyond bonds will remain attractive, as stock/bond correlations may not run as low as last decade in a higher for longer environment.
## Our Current Views By Asset Class

### U.S. Equities
- **Equities**: Overweight
- **Policy**: Neutral
- **Technical**: Neutral
- **Tactical View**: Overweight

**Economic**: US growth likely to outpace other global economies

**Valuations**: Valuations have become more attractive but economic growth may lag

**Risk**: Policy risk, especially in China, remains a major issue

### US Equities

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<tr>
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<th>Valuations</th>
<th>Tactical View</th>
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<td>Overweight</td>
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</tbody>
</table>

**Solid companies up top but valuations lean unattractive, rising concentration risk**

**Lower rates may contribute to market broadening; valuations attractive**

**Rich valuations a headwind but slower growth may help tactically**

**We continue to like cyclical value sectors as the economy pushes ahead**

**Lower rates, economic growth may contribute to cycicals**

**Industrials and financials may benefit from US resilience, retooling**

### Fixed Income

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<tr>
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<th>Valuations</th>
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**We prefer stocks as we continue to avoid a recession**

**More attractive as spreads tighten, but sensitive to inflation uncertainty**

**Prefer intermediate exposure; credit background looks strong but spread tightening**

**Stocks a better priced risk asset as spreads tighten**

### Diversifiers

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<th>Sector</th>
<th>Strategic View</th>
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<th>Valuations</th>
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**Placing more emphasis on bond and non-bond diversifiers**

**Lower rates would be supportive; office demand still muted**

**Modest strategic exposure to gold as a hedge still merited, trend-following strategies may help provide diversification**

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Source: Carson Investment Research

All investing involves risk, including the possible loss of principal. There is no assurance that any investment strategy will be successful.
**3 Reasons Why Underlying Economic Growth Is Strong, and Likely To Stay That Way**

The workhorse of the US economy remains the consumer, and there’s really not much sign of a slowdown as far as household spending is concerned. Goods consumption has eased, but overall consumption has remained above its pre-pandemic trend because of services consumption. Services spending by consumers, which makes up 45% of the economy (more than twice as much as goods spending) rose at an annualized pace of 3.0% over the first four months of the year, after adjusting for inflation — well above the 2010-2019 trend of 1.8%. Back in 2021, strong services spending (for example airplane tickets, vacation rentals, or going out to eat) was driven by everyone rushing out to spend once Covid looked to finally be mostly behind us. But we’re out of that catch-up phase now. The continued strength of consumer spending now is directly related to the strength of American household finances.
Incomes Are Growing Faster Than Inflation

There’s no question that inflation ran hot in the first quarter, which was a setback after the downtrend in the second half of 2023. The Federal Reserve’s preferred inflation metric, the Personal Consumption Expenditures Index (PCE), rose at an annualized pace of 4.1% over the first four months of the year. But here’s the big picture: income growth is outpacing inflation. [Chart 1] Disposable income grew at an annualized pace of 5.0% over the same period, but that’s also being pulled lower by falling income from assets (like dividends). More importantly, employee compensation surged by 5.9%. That’s the simplest explanation for why consumption continues to run strong.

Of course, that’s aggregate income growth across all workers in the economy, which has been helped by an increase in the number of workers. However, inflation-adjusted hourly wages are growing even when you look at the average worker if you focus on non-managers.

Since the pandemic started, average wages for non-managers (usually lower income compared to managers) have grown faster than the pre-pandemic trend, after adjusting for inflation (navy line in the chart below). [Chart 2] Over the last year it’s up 1.5%, matching the pre-pandemic trend. Interestingly, wage growth for managers has fallen behind inflation since the pandemic, but the good news is that it’s been picking up recently. Over the last year, inflation-adjusted wage growth for managers is up 1.1%, also close to the pre-pandemic trend. Keep in mind that non-managers typically tend to spend a greater proportion of their incomes.
Household Balance Sheets Are Strong

Rising stock prices and home prices have resulted in more wealth for American households. At the same time, liabilities – especially mortgage debt, but also personal loans – have not increased at the same pace, especially relative to disposable income. At the end of 2023, household net worth was 736% of disposable incomes, well above historical levels. That’s on the back of household assets running at 836% of disposable income, even as liabilities stay at 100% of disposable income (in line with what we’ve seen in the past). Simply put, liabilities (debt) as a percent of disposable income is almost exactly where it was in 1999. We hear how people are flush with record debt, but that simply isn’t true, while assets (wealth) have soared. This is a big reason why the savings rate has fallen since the pandemic. The savings rate averaged above 7% in 2019, but it’s now running just over 3%. This is not surprising considering net worth is higher. Why save more if you’re worth more?

The savings rate averaged above 7% in 2019, but it’s now running just over 3%.

Ultimately, what matters when we talk about household debt is the proportion of income that goes toward servicing that debt. Household debt service payments are running at 9.8% of disposable income, slightly below pre-pandemic levels and well below the historical average of over 11%. At the same time, a typical question is, “How does the picture look outside of the wealthiest groups, considering we have a lot of inequality?” Turns out the picture looks good. Across all income groups, liabilities as a percent of assets are well below what we’ve seen historically. In short, households are significantly less levered than in the past.
The Labor Market Is Strong

The labor market is the entire ballgame as far as the consumer is concerned. If the labor market deteriorates, incomes fall, consumption falls, and the economy is in trouble. But we have the opposite now. Payroll growth has averaged 248,000 a month over the first five months of 2024, and the unemployment rate has remained at or below 4% for 30 straight months (the longest streak since the late 1960s). [Chart 5] Perhaps a better metric than the unemployment rate is the “prime age” (25-54 years) employment-population ratio, since it gets around definitional issues that crop up with the unemployment rate (someone is counted as being “unemployed” only if they’re “actively looking for a job”) or demographics (an aging population with more people retiring and leaving the labor force every day). [Chart 6] The prime age employment-population ratio is currently at 80.8% — that’s only slightly below the high from last summer, and above anything we saw between 2001 and 2019 (when it peaked at 80.4%). In fact, the prime age employment-population ratio for women just hit an all-time record high of 75.7%. This by itself should tell you the labor market is strong, with more people participating in it.

Ultimately, here’s what’s important to keep in mind. Consumer spending makes up 70% of the US economy, and right now spending is running strong, thanks to:

- Strong labor markets, which are pushing incomes above the pace of inflation
- Higher net worth, which means households can spend more

A strong labor market, with less turnover (meaning people are staying at their job longer), is also likely to push productivity growth above the 2005-2019 trend of just 1.5%. Over the last year (through Q1 2024), productivity grew an impressive 2.9%. The decreasing availability of cheap labor is likely
to incentivize businesses to invest more, and that’s what you need for productivity growth. Importantly, with productivity growth, workers can see strong wage growth with potentially lower inflation. Falling inflationary pressures can in turn allow the Fed to ease interest rates. Even if rates are shifted lower by a relatively small degree, that can further boost investment and keep the productivity growth engine running. So higher productivity allows for higher wages, but puts a cap on inflation, while opening the door for Fed cuts. This is something we saw in the mid-to-late 1990s, a great time for investors and the economy. A similar situation bodes well for the economy and stocks.
Our Leading Economic Indicators Still Point to a Strong Economy

We got a few softer-than-expected economic reports in April and May, and suddenly we're hearing more about an impending recession again. In fact, the combination of these reports with hotter than expected inflation in Q1 has raised chatter about the dreaded “stagflation” scenario of low growth with high inflation.

Let’s be clear. Our view is we’re nowhere close to a recession, let alone stagflation.

It can be hard to get a full picture of the economy as the data comes rolling in week after week. This is why we have our own Carson Leading Economic Indicator (LEI) for the US and 28 other countries. For the US, the LEI includes more than 20 components that capture the dynamics of the US economy. These include:

- Consumer-related indicators
- Housing indicators
- Business and manufacturing activity
- Sentiment
- Financial markets

The Carson LEI tells us whether the economy is currently growing below trend, above trend, or on trend (with a value close to zero). Remember, at trend is still solid growth. Think of the LEI as a “nowcast” of the economy as opposed to a forecast. In other words, we’re trying to figure out what the economy is doing now, which can be hard enough, instead of figuring out what the economy will be doing 6-12 months from now, which is even more difficult. And since economic conditions typically don’t change on a dime (except in March 2020 due to the response to Covid-19), we’re comfortable projecting that view over the near term (1-3 months), all the while continuously updating our index with new data.

As you can see in the chart below, our LEI did not point to a recession in 2022 or 2023, which is why we maintained that the US would avoid a recession throughout the last year and half, even though many others were expecting a recession.

The good news is that our US LEI currently points well away from a recession. The index has been rising in recent months, indicating underlying growth is running close to trend, if not slightly above it. The recent upswing has come on the back of a strong consumer, coupled with rising investment spending. Housing is no longer a drag as well, as it was in 2022 and most of 2023. The economic picture is certainly better than a year ago.
The Fed and Inflation: Eyes on The Big Picture

There’s no question that inflation ran hot in the first quarter (Q1), especially relative to the second half of 2023. It looks like inflation progress has stalled, with PCE running at 2.5-3% trailing year since December. Core inflation, which strips out volatile food and energy components, is up 2.8% trailing year as of April. It’s been going the wrong way recently – over six months through April, core PCE is running at an annualized pace of 3.2%. It would be easy to look at this data and say that the inflation progress made in the second half of 2023 has reversed. However, Fed Chair Jerome Powell and his colleagues did not say this. Instead, they emphasized that inflation has eased a lot over the past year (core PCE was running close to 5% a year ago).

Yet, it’s clear that inflation remains elevated relative to the Fed’s 2% target, hence the need to keep rates where they are for now. In fact, Powell added that they expect inflation to continue to ease, for two main reasons:

- **Supply-side improvements** — This was behind the historic drop in inflation in 2023, and they believe there’s more supply-related relief to come.

- **Policy rates** — Policy rates are restrictive, but they need time to play out.

The Q1 inflation data did not really suggest anything that foreshadows higher inflation ahead. A lot of the heat was due to post-pandemic catch-up effects, including idiosyncratic factors like housing inflation and auto insurance.

All this is why Powell said the next move they make will likely be an interest rate cut, rather than a rate increase. The hurdle for a rate hike at this point is fairly high. As far as the Q1 inflation data is concerned, the signal the Fed took from the data was that it’s going to take longer for them to gain confidence that inflation is headed back to their target – confidence they would need in order to start cutting interest rates. [Chart 8] The April and May inflation data were a step in the right direction. The good news is that several forward-looking indicators of underlying inflation don’t give us any cause for concern:

- Wage growth for workers is running at the pre-pandemic pace of around 3%, which means there’s no underlying demand-side pressure on inflation.

- Broad commodity prices are not surging like they did in 2022, which means a commodity-driven supply shock is not in the cards for now.
Market-implied expectations for future inflation are consistent with the Fed’s 2% target, and well off their 2022 peak.

Consumer expectations for inflation are not far above what we saw before the pandemic, and this should ease further as gas prices pull back.

Business expectations for inflation in the year ahead are running at 2.3%, which is also close to pre-pandemic levels, based on the Federal Reserve Bank of Atlanta’s monthly Business Inflation Expectations survey.

All said and done, we may still be on track for at least a couple of 0.25%-points of interest rate cuts in 2024, as long as the inflation data cooperates.
CHECKPOINT

Looking Under the Hood at Inflation: Fewer Categories at Extremes

The overall inflation numbers, including for core inflation, can hide what’s happening under the surface. We looked at all 178 categories within core PCE inflation and calculated the distribution of year-over-year inflation at three different times. You can see how inflation really broadened out in June 2022 relative to December 2019. The good news is that the distribution is narrowing once again. The picture for April 2024 looks closer to what it looked like in December 2019, than June 2022. [Chart 9]

» In December 2019, just 10% of categories had inflation rates above 4%.
» In June 2022, 58% of categories had inflation rates above 4%.
» In April 2024, 33% of categories had inflation rates above 4%.

Even if inflation remains elevated, we’ve made considerable progress on inflation over the last two years and we expect that to continue. In fact, we actually made some progress on inflation even in 2024. Back in December 2023, 42% of categories had inflation rates above 4%, versus 33% of categories in April. Ideally, we’d have seen even more progress, but it’s still progress. The improvement gets to why the Fed isn’t panicking about the Q1 inflation data. Neither are we. It helps to focus on the big picture, and the ultimate prize.

[Chart 9]

Inflation is Narrowing Once Again
Distribution of Core PCE Categories (Year-Over-Year Change)

Source: Carson Investment Research, BLS 5/31/2024
The Bull Market Is Alive and Well

2024 has picked up where 2023 left off. The S&P 500 gained more than 20% in 2023, including double digit gains in the fourth quarter, and followed up with just over another 10% in the first quarter of 2024. In the face of continued worries over valuations, geopolitical concerns, inflation, an economic slowdown, and more, the bull market that started back in October 2022 is still alive and well. More than a year ago, many expected a recession and bear market was coming, something we pushed back against regularly since our December 2022 call to overweight equities. Many have come around to the realization that stocks could continue to do well, but the number of skeptics are starting to grow again.
We came into the year expecting the S&P 500 to have a very solid year, up between 11-13%. As we re-evaluate where things stand, we are raising our target to 17-20%, as the overall economic backdrop remains quite healthy, inflation should continue to come down, the employment backdrop is supporting consumer spending, and we believe overall corporate earnings should remain robust.

Something that might surprise many investors is this bull market is actually quite young relative to history and could have a long time left. [Chart 10] Looking at the past 12 bull markets going back to World War II, the average length was more than five years (61 months)! The shortest bull market ever was the most recent one off the pandemic lows, so it seems unlikely that another short bull market would immediately follow. Given the current bull market is just over 20 months old, investors should be open to this one lasting much longer than most expect.

The election cycle also supports the continuation of the bull market. We noted in our Outlook 2024 that historically stocks have done quite well in election years under a President up for re-election, with stocks higher for the year the past 10 times. We see little reason to expect this streak to end now, especially with the strong start to 2024. Second half strength during the fourth year of a new President is quite common, while lame duck Presidents tend to see stock market weakness later in the year, perhaps due to lesser known candidates creating greater uncertainty. [Chart 11] Yes, emotions will be running high ahead of the

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**Chart 10**

Bull Markets Historically Last Longer Than Many Think

Length of Bull Markets (Months) and When They Started

[Graph showing length of bull markets from 1949 to 2022, with an average length of 61 months]

Source: Carson Investment Research, FactSet 6/12/2024

**Chart 11**

Stocks Don’t Like Lame Duck Election Years Historically, Good Thing ’24 Isn’t One

How the S&P 500 Does in an Election Year if the President is Up for Re-Election or Not

[Graph showing performance of S&P 500 in election years with green line representing new President, blue line representing lame duck President]

Source: Carson Investment Research, FactSet 6/12/2024 (1950 - Current)
election, but with the underlying economy likely strong, we expect this typical late year strength to show up once again in 2024.

Corporate profits for the S&P 500 are expected to hit an all-time high this year, with a gain in ‘24 of close to 11%. We’ve found that periods that have strong productivity (like we are seeing now) tend to come in even better than expected and we think 11% could be a tad low as a result. The mid-to-late ‘90s saw strong productivity, and also saw earnings and GDP growth consistently come in better than was expected. It was the last decade, when productivity was low, that GDP disappointed consistently.

Forward-looking expectations also continue to improve. Forward 12-month S&P 500 earnings have soared from $243 at the start of the year to $258 currently. When companies post record profits you tend to see stock prices follow suit and we don’t think this time will be any different.

Earnings growth can be broken down into sales growth and profit margin growth. Sales growth generally tracks nominal GDP growth, which makes sense since one way to measure GDP is the total final sales across the economy. Nominal GDP came in near 6% last year for one of the best years in recent memory, but the stage is set for similar growth this year.

Meanwhile, stronger profit margins could be another reason to expect solid earnings growth to continue to support the bull market. Yes, profit margins are improving due to cost-cutting, but this will likely create a leaner, more agile, and more productive corporate America in the second half of this year.

The combination of strong sales growth and improving profit margins should continue to support earnings growth, which is the foundation for higher stock prices.

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<thead>
<tr>
<th>Chart 12</th>
<th>Forward Earnings Expectations Continue To Move Up</th>
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<tr>
<td><strong>S&amp;P 500 Index - Next 12 Month Earnings Per Share</strong></td>
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<th>Chart 13</th>
<th>Margins Moving Higher and Powering Returns</th>
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<tr>
<td><strong>S&amp;P 500 Index - Next 12 Month Profit Margin</strong></td>
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Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed. Past performance does not guarantee future results.
Stock Market Valuations

Resurgent interest rates have not been enough to slow the equity rally in 2024, as growth stocks have led the way once again, building on strength in 2023 on the back of AI hype and strong earnings results. [Chart 14] For example, Nvidia has added more than 4.5% to the year-to-date return of growth stocks just by itself, versus the largest contributor to value’s year-to-date return being only 0.5% (led by Berkshire Hathaway), a much more balanced picture. This strength in the top names in growth stocks is nothing new, but it has pushed valuations to new highs relative to the rest of the market, where we are seeing a number of attractive opportunities.

Below is a look at the valuations of the major equity asset classes around the world, relative to the entire global stock market. We use a composite of valuation metrics and then look at the difference to their own history using a standardized measure, called a Z-score. A Z-score of 0 means the current value is at the long-term average and other scores are the number of standard deviations (a measure of dispersion) above or below the average.

The overall story here has been similar for a number of years. (We talk about valuations not being a timing mechanism for a reason! But valuations do eventually matter.) US large cap stocks, dominated by large growth names, command a higher valuation relative to the global market than they normally have in their history. [Chart 15] On the flip side, the remainder of the US market – value stocks, mid-caps, and small caps – all trade cheaper than they historically have, in some cases meaningfully so. US small caps trade nearly two standard deviations below where they have traded historically. Put another way, US small caps have only been cheaper than they are today 6% of the time! It should be mentioned that developed international markets also look attractive from this metric. We have seen some positive momentum in areas like Japan, but remain tactically neutral as we observe the relative economic and price performance of these markets.

Using the same lens to look at domestic stock sectors, a similar story emerges. [Chart 16] The technology and tech-adjacent sectors such

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Investors cannot invest directly in indexes. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing.
as communication services and consumer discretionary are large portions of the market cap of domestic indices, and trade above their historical average valuation – although maybe for good reason! Most other sectors are trading at or well below their historical averages. Consumer staples and energy appear to have some of the cheapest valuations relative to their history, and other sectors such as financials and health care trade at well below average levels. Financials in particular stand out to us as an attractive area to take advantage of economic growth, benefiting from the potential for a steepening yield curve, fortress level balance sheets given regulations and the response to the 2023 regional bank shake out, and a valuation tailwind.

Where to Invest

We believe investors should remain overweight stocks relative to bonds, with a focus on the US. Looking globally, we are more neutral developed international and remain underweight emerging markets (mainly due to China).

A potentially major driver for stocks during the second half of this year will be improvement in inflation, which likely will lead to two cuts from the Fed this year and likely help lower yields across the curve. All of this should be a boost to both small and midcaps, areas we remain overweight, as they are more sensitive to rates. Valuations are historically cheap for small caps relative to large caps and with a domestic economy that should continue to be the envy of the rest of the world, small and midcaps are two areas that may lead.

Given our overall stance for a stronger economy, we also like industrials and financials. These cyclical areas are ripe for continued strength after a nice start to 2024, as broadening sector leadership continues. Tech continues to be a big winner, and although we have no issues with tech and remain neutral, we do see potentially better opportunities for investors elsewhere the rest of 2024.
Sources of Aggregate Profits

A common refrain is that the stock market is not the economy (and vice versa), sometimes couched as “S&P is not GDP.” That’s true but profits matter for markets, and over the long run, market returns are mostly driven by profit growth, which depends on the economy. It’s the net result of saving and consumption by four sectors of the economy: households, businesses, governments, and the rest of the world via trade. In fact, there’s a national accounting identity that precisely relates profits to the various components of GDP, called the Levy-Kalecki profit equation:

Corporate Profits After Tax = Corporate Investment + Dividends – Household Savings – Government Savings + Current Account Surplus

What it captures is the various sources of profits on a macro aggregate level:

» **Investment**: More businesses investing in equipment, structures, etc., increases profits. The idea is that one business’s investment is another business’s revenue, and profits.

» **Dividends**: Income received by shareholders tends to get spent, unless households increase their savings, so dividends go back to businesses as revenue, any part saved reflected in the next category.

» **Household savings**: If households spend more, that translates to more revenue and profits for businesses. Conversely, increasing household savings reduces profits.

» **Government savings**: Rising government savings reduces corporate profits, and vice versa. In other words, deficit-financed spending adds to profits, all else equal. There may be negative long-term consequences of deficit spending, but in the near term, it pumps more money into the economy that goes to corporate profits.

» **Current account surplus**: A rising current account surplus means the rest of the world is buying more US-made goods and services than Americans buy from foreigners, and that increases business revenues and profits, whereas a current account deficit (which is typically what the US has) means Americans buy relatively more from abroad, and that’s a drag on profits.

By definition, this accounting identity has to be true. It doesn’t tell us which companies are growing profits, or how profits are distributed across industries. But it tells us what can happen to drive profits up or down. For example, if the government is reducing its deficit, corporate profits will rise only if the private sector is increasing consumption such that it offsets increased government saving. If not, corporate profits will fall.
Chart 17 shows an attribution of corporate profit growth over several sub-periods since 2010. Note that this is not equivalent to S&P 500 profits, as it comes from macroeconomic data and includes all businesses in the US, public and private.

» **2010 - 2015**: Business investment and dividends drove profit growth, overcoming the drag from the reduction in government spending.

» **2016 - 2019**: Profit growth surged thanks to rising fiscal deficits (on the back of the 2017 tax cuts), even as households savings increased.

» **2020 Q1 - 2021 Q2**: Profit growth was driven by massive fiscal deficits, which overcame the drag from rising household savings, lack of business investment, and rising trade deficit (as Americans purchased more goods from abroad).

» **2021 Q3 - 2022 Q4**: Recovering household consumption (as consumers spent their excess savings) and business investment drove profit growth, overcoming the drag from falling fiscal deficits.

» **2023 Q1 - 2023 Q4**: Profit growth was once again boosted by rising fiscal deficits (especially as interest costs rose), more than offsetting rising household savings.
Separate Your Political Beliefs From Your Investments

So far, this year is playing out like other election years under a first-term President, with nice gains. As we mentioned in the stocks section, the past 10 times a president was up for re-election the S&P 500 was higher and this year is looking like number 11.

One important concept we want to stress regarding election years is politics and investments don’t mix. Unfortunately, many people have chosen to limit exposure to markets based on who is in the White House. Many people didn’t like President Obama, exited markets, and missed out on huge gains. Many people didn’t like President Trump, exited markets, and missed out on big gains.
Many don’t like President Biden and stocks have once again done very well. History has shown this time and time again. Whatever happens this November, we can’t stress this enough, don’t let it determine what you think broad markets will do.

Here are some numbers: Starting with President Eisenhower in 1953, if you invested $1,000 in the S&P 500 and only invested under Republican presidents, you’d have just under $30,000 today. If you did the same thing but only for Democratic presidents, you’d have just over $60,000. But if you stayed invested you’d have close to $1.7 million today!

What matters more is how the economy, profits, inflation, and Fed policy all line up, not who is in the White House. What should matter for investors is that all of those things are likely tailwinds for the foreseeable future. The chart below shows stocks tend to do quite well regardless of the party in power.  

Yes, historically stocks have done a little better when the president was a Democrat, but the flipside is stocks have done better when Republicans have controlled both chambers of Congress than when Democrats have.

One of the better scenarios for investors is a split Congress. What markets don’t like is too much power with any party, so think a red or blue wave. Checks and balances are important and a split Congress has this dynamic built right in.

Right now, Democrats have a 51-49 majority in the Senate, while the Republicans have a 217-213 majority in the House (with 5 vacancies), which is the smallest majority in 140 years. For something to pass right now it will take both sides working together, and usually that means a focus on things our country really needs. Infrastructure and the CHIPS act are both good examples in the past few years, as who thinks new roads, bridges, and bringing high tech back home are bad things? Even on trade, President Biden has

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**Chart 18**

**Stocks Historically Tend to Gain Regardless of Party**

S&P 500 Returns Based on Presidential Terms

Source: Carson, Factset 6/12/2024 (1945 - Current)

Investors cannot invest directly in indexes. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing.
kept the Trump administrations tariffs in place, and recently implemented even more on China.

The last 12 times Congress was split, stocks gained for the year and 2024 may be lucky number 13. Republicans are heavily favored to win the Senate right now; Democrats slight favorites to win the House. Should we get a split Congress, no matter who wins the White House, investors should be in a better mood. As the chart above shows, it isn’t about red, it isn’t about blue, it’s about green. [Chart 19]

**Deficit Spending Is Not Going Away**

With respect to President Biden and former President Trump, we actually have a reasonably good idea of policies they’ll implement – and either way those are likely to drive the deficit higher over the next few years. The big one is tax policy. The 2017 Tax Cuts and Jobs Act (passed under then President Trump) had a slew of individual tax cuts that are all slated to “sunset” at the end of 2025. Renewing them all, as Trump has said he’ll do, means the deficit remains high (and he’s indicated there may be even more tax cuts to come). There will be some revenue coming in if he raises tariffs but that won’t be nearly enough to offset tax cuts. Also possibly confounding this will be who controls Congress.

On the other hand, Biden has said he wouldn’t renew all the individual tax cuts, so cuts for the highest tax brackets would go away. He’s also raised the possibility of raising corporate taxes. Of course, he’ll need a Democratic sweep of the House and Senate for this to happen, and right now, that’s looking very unlikely. The table below shows scenarios for control of Congress under President Biden or Trump, and the likely impact on the fiscal deficit. [Chart 20]

Of course, the question is how deficit spending matters to markets. Deficit-financed spending can add to corporate profits if it doesn’t crowd out consumer spending or private sector investment, especially in the near term (see the discussion of where profits come from at the end of the equity section). In fact, this is something we saw as recently as 2016-2019, when profit growth surged on the back of higher fiscal deficits due to the 2017 tax cuts.

While we do believe that far too much emphasis is put on elections when it comes to the election outlook, elections do matter. Policy matters, sometimes a lot. But each election, each presidency, each Congress, is just a leg in the longer course that makes up our nation’s history. Ultimately, that longer course that evolves over time is what matters to markets, not the individual legs.
By not focusing on individual election outcomes, markets signal a kind of implicit trust in the collective wisdom of the American electorate and the ability of our democracy to adjust and endure. If we go wrong in one election, we can course correct in the next. We almost always see that in mid-term elections (too soon?), where voters typically pull the balance of power in the opposite direction as the presidential election outcome. In the meantime, parties steal some of the best ideas from the opposing platform (putting their own party spin on it), alliances shift, and some ideas realign. No individual election sets an indelible long-term path for the nation’s direction.

As important, businesses know how to adapt to different policy environments, even if some are easier to navigate than others. Large businesses, which make up most of publicly traded markets, may even find an advantage in their ability to respond at scale to the broader policy mandates you often get from Democrats, while smaller businesses may benefit more from the greater flexibility you typically get from Republican administrations. But both small and large businesses will strive to find the path to success with the policy hand they are dealt, and then lobby for changes, support friendly policymakers, and prepare for the next election, where there will be a new opportunity to set a better course. Don’t take our word for it. Just look at the numbers.
An Easy Bond Story Is Getting More Complicated

The Bloomberg US Aggregate Bond Index (Agg) has been around since 1976. In its first 46 years, it was down in just four years, in 1994 (-2.9%), 1999 (-0.8%), 2013 (-2.0%), and 2021 (-1.5%). Then came 2022, when the Agg was down 13.0%, more than four times its previous worst year but still well ahead of the S&P 500 that year (-18.1%). Remember, higher interest rates pressure bond prices (and vice versa) and that is why bonds had such a bad year in 2022. Still, it’s not what we had come to expect from bonds during challenging periods for equity markets.
Last year the Agg was up 5.5%. Few people remember the Agg actually did better than Bloomberg’s short-term Treasury index (+5.1%) in 2023. Still, the Agg was down 2.8% at the end of October last year and it took a historic two-month rally to turn things around. Seen in that light, we wouldn’t be too worried about a tepid start to this year.

We provide some scenario analysis for bonds that follows, based on what rates might do, but the bottom line is we believe the Agg will outperform short-term Treasuries over the second half of the year, since longer maturity bonds benefit more from a decline in rates than short maturity bonds. It may be tough for the Agg to make up all the ground it lost to short-term Treasuries in the first half, but it’s still likely to be more attractive than short-term Treasuries going forward. (Historically, the Agg has averaged a little more than 2% better than short-term Treasuries per year.)

We don’t think bonds will be as strong a diversifier as they’ve been historically, for reasons discussed below. But we still think of them as largely oriented toward playing defense. Given we are overweight equities and recommend using some diversifiers outside of bonds, even maintaining a similar level of rate sensitivity as the Agg in bond holdings will leave the portfolio underweight rate sensitivity overall.

We are increasingly shying away from corporate debt. We think the economic environment will still be supportive, but credit spreads are tight and there’s not much compensation for the added risk. Correspondingly, we are also increasingly warming to mortgage-backed securities (MBS) and Treasuries and think a small allocation to long maturity Treasuries would have enough value in a surprise deflationary downturn, or even just with a modest decline in rates, that it can help balance out portfolio exposures. Remember, long-term Treasuries should benefit mightily if rates tumble, not our base case, but always a possibility.

Why We Believe Rates Will Be Higher for Longer and What It Means for Bond Investors

As we start to look toward the second half of the year for fixed income, one unheralded theme is changing expectations about the “neutral” fed funds rate, the rate that would be low enough to support full employment but high enough that it would still promote low and stable inflation near the Fed’s target of 2%.

The neutral rate exists by definition, but it’s not directly known. It can only be modeled or estimated and can change with structural changes in the economy. Keep in mind that much of the time, the Fed is not “neutral”— policy is either restrictive or accommodative. But the neutral rate is a kind of center of gravity. All else equal that’s where restrictive or accommodative rates will be pulled.

A key piece of rising rates this year has been a shift in the market’s estimate of the long-run fed funds rate, which far enough out is the neutral rate by another name. Using market-implied
expectations of the fed funds rate five years from now as a reasonable proxy for the neutral rate, the market view has changed from about 3.5% toward the end of last year to almost 4.0%. Given a fairly stable market-implied view of long-term inflation over that period, the market has been implicitly projecting higher growth expectations. Notably, even at 3.5% the market was well above the Fed’s current view of a neutral rate of 2.8%.

In contrast to market views about the neutral rate, which can be quite volatile, the views of the Federal Reserve tend to be sticky. From a policy perspective, the views the Fed presents are a communication tool and the perception of a flaky Fed that changes its forecasts as actively as markets would have the potential to undermine policy.

While the market implied view is volatile, we do think the change has a solid basis and the Fed has been slow to adjust. The main upshot is our belief that rates will be higher for much longer, our basic theme for interest rates over the second half of 2024 and into 2025. We don’t expect rates will necessarily press higher. They still need to decline to get to neutral. But the neutral rate, the center of gravity, will be higher than it has been in a while and the Fed will likely need to adjust.

The Fed's Anchored to a Pessimistic Outlook

We get a picture of the Fed's view of where rates should be over the longer run from the summary of economic projections (SEP), which the Fed shares every other Fed meeting, which includes the “dot plot” of rate expectations. All members of the Federal Open Market Committee (FOMC), voting and non-voting, share their view of the economic outlook, with the median of those views taken to be the consensus, although it’s important to remember that there are actually a wide range of views.

As seen below, the Fed’s median estimates of the fed funds rate over the longer run has steadily declined from 4.25% to 2.25% since it first started sharing the dot plot in 2012. [Chart 21] Meanwhile, the median estimate of long run inflation (PCE) has never really strayed from the Fed's target of 2.0%, which is just the Fed's way of saying it believes it's capable of meeting its 2% target. That leaves us with a “real” longer run rate (taking out inflation) that has steadily moved from 2.25% to just 0.6%. By contrast, as seen below, modeled views of the neutral rate (adjusted to put them in nominal terms) have actually climbed over the same period.

[Chart 21]

Fed Member Projection for the Neutral Rate has Steadily Declined Until Recently

Modeled Values Have Increased

Source: Carson Investment Research, Federal Reserve, New York Federal Reserve 6/14/2024
Modeled values have been adjusted by the Fed’s long-run inflation expectation.
How did the Fed’s neutral rate fall so much? The Fed was responding to an extended period of low productivity and slowing labor force growth where inflation was muted. Some central banks, such as the Bank of Japan, were even having chronic problems raising inflation to meet its target despite extremely accommodative policy. In the face of those challenges, the Fed adjusted its policy framework to help justify low rates. Most notably, in August 2020 the Fed announced a policy of “flexible average inflation targeting” to allow inflation to run a little hot (that is, keep rates lower than they would have otherwise) when it had run a little cool for an extended prior period. Yes, the timing for implementing that policy is one of life’s not so surprising ironies. The other side of this is that it likely biases the Fed towards maintaining the full employment side of their mandate.

In August 2020 the Fed announced a policy of “flexible average inflation targeting” to allow inflation to run a little hot.

But there’s also a pragmatic element to the Fed’s adjustment. Back in 2019, an upper bound on the fed funds rate of just 2.50% was enough to start breaking the economy, amazing to think given this economy’s resilience facing a fed funds rate over 5%. Former President Donald Trump called out the economy’s vulnerability to higher rates and pressed the Fed to lower them. Despite criticism for playing politics, the president had gauged the economy’s weakness accurately and given inflation was low the Fed had the scope to make the move. The Fed actually achieved a pragmatic, successful mid-cycle adjustment to rates, which was soon lost to the economic consequences of the pandemic. From a practical perspective an upper bound of 1.75% seemed like the right point-in-time rate for the state of the economy.

We’re Optimistic About Growth, But That Means Higher for Longer

We acknowledge that the neutral rate can’t really be known until we get feedback from the economy and markets in real time, but part of our job is to establish a baseline view. As a rough estimate, we believe a nominal fed funds rate of around 3.5% with a mild bias to the upside would probably be a reasonable view of the neutral in the current context. That’s almost a full percentage point higher than the Fed’s current estimate.

Why the increase? It’s mostly optimism about growth, similar to what’s implied in market-based gauges. A smaller part is due to shifting inflation expectations. While we still expect inflation to stay fairly low, it will also likely be somewhat more volatile given our higher growth expectations. It could also run a little hotter than recent history due to some structural changes in the global economy such as higher global labor costs, changes to global trade policy, and increased “home sourcing.” Finally, a small piece of the adjustment is due to our belief that the Fed’s unspoken bias toward the “full employment” part of its mandate will decrease somewhat given recent experiences.
Investment Implications

Even if 3.5% nominal is the center of gravity for the fed funds rate, it will take time for the Fed to get there. If growth remains on trend, the Fed will probably be biased toward lowering rates slowly. To be conservative, let’s say four cuts over the next year, assuming the labor market remains healthy. The 10-year Treasury yield tends to decline at about half the rate of short-term yields in a rate-cutting regime. We’ve done some simple scenario analysis of what that would mean for short-term bond return versus the Bloomberg US Aggregate Bond Index over the next 12 months, with our baseline outcome highlighted. [Chart 22]

There’s an important takeaway from all this from a portfolio perspective. While the potential return advantage of intermediate bonds over short-term bond looks brighter, as long as rates remain high, bonds’ traditional role as a portfolio diversifier is likely to remain less robust. Because of that, we do continue to see the value of non-bond diversifiers and are actively deploying modest allocations in both our tactical and strategic allocation recommendations.

Fixed Income Valuations

Like equities, bonds can be valued relative to their history. And because you know the price of a bond at maturity, these valuations can be even more relevant in some cases. As mentioned, the best gauge of the future return in a bond is its current yield-to-maturity. With higher interest rates, we can expect higher returns. Above we take a look at where current bonds current trade based on their history from a yield and spread perspective. [Chart 23]

Fixed income valuations read in the opposite manner of equities. High relative yields and wide relative spreads imply value opportunities, all else
equal. The broad aggregate bond index, which consists of 70% Treasuries and government-backed agency mortgage-backed securities (MBS), is trading at top-decile yields – not all that surprising after delivering a -3.5% annualized 3-year return. Agency MBS have become very attractive as well, by some measures yielding more than comparable corporate bonds – something that has rarely occurred. The bifurcation of the mortgage market is striking, as mortgages packaged in groups of 2-3% coupons face almost no foreseeable prepayments, whereas 6-7% coupon mortgages are likely to be refinanced as soon as the borrower is able. These high coupon mortgages trade at a premium due to their very attractive government-backed yield, but once those borrowers are able to refinance, they will be paying back at the lower par value, hurting the value of the MBS month after month. For this reason (amongst others) active management in the core bond space is becoming as important as ever.

On the other hand, while absolute yields are relatively high, spreads versus Treasuries in investment-grade corporates and high-yield bonds are trading near the tightest they ever have historically. This wasn’t always the case – during 2020 and again in 2022 spreads presented opportunities, but markets move fast. At this juncture, the risk/reward opportunity seems to favor higher quality asset classes where absolute yields are high and spread risk is very low.

Fixed income has been a thorn in the side of balanced investors in recent years and it’s no surprise that short-term Treasuries and money market funds have garnered so many assets. That too will change eventually. As rates fall even a little bit of duration will pay off, as shown in the scenario analysis above. Certain sectors of fixed income become more attractive every day rates rise further, and this future predictability of fixed income can be valuable. We will continue to be flexible yet controlled in our allocations, leaning on high-quality active managers where applicable.

The elephant in the proverbial fixed income room today is money market funds. Cash and cash-like securities are paying an attractive yield with little to no market fluctuation – a tough sell to moderate or conservative investors looking to move out of cash and into riskier securities. However, once the Fed cuts interest rates, those cash yields will drop – and in the case of a money market fund – yields will drop without any subsequent capital appreciation, unlike longer maturity bonds.

On the left we can see what happens once the Fed cuts interest rates for the first time, looking back over the past 10 cutting cycles. In short – duration (interest rate risk), even a little, pays off. Broad core bonds (as measured by the Bloomberg Aggregate bond index) return anywhere from 5-10% in the months and years following this first rate cut. In fact, broad bonds have only been negative one time following the first Fed cut over the sample period.

While the comfort of cash – T-bill and chill if you will – is welcome after years of low-to-zero interest rates, controlling for the size of these holdings, especially for investors that have longer time horizons, is very important at this juncture in the cycle.
As we’ve highlighted, we think we may be entering an extended stage of above-trend productivity growth that can improve the overall economic trajectory relative to the last 15 years. At the same time, an economy that is running near capacity means we could see more inflationary pressure. As discussed above, that implies fed funds rate is likely to remain on the higher side longer term, perhaps at around a 3.5% run rate, with a bias to the upside. That’s very different from what we saw over the last decade. Potential productivity growth and the rate environment we believe would accompany it are two of the major themes of our outlook. What would it mean to keep our eyes on the prize in that environment?

Traditional Portfolio Diversification May Not Work as Well in a Higher Rate Environment

One thing that we’ve seen historically is that when inflationary pressure is higher, inflation volatility increases, and stock-bond correlations rise (stocks and bonds tend to move in the same direction). In such environments, bonds are not great diversifiers for stocks, that is bonds may not zig when stocks zag. With higher inflation, the stocks-bonds correlation has been rising – over the last three years, it’s up to 0.56, a big contrast from the -0.28 average between 2000 and 2019. The correlation will likely fall from its current high level, especially when 2022 rolls off, but it could very well settle between 0.2 and 0.4, still well above the 2000-2019 average. Of course, a positive correlation between stocks and bonds is what we saw from the late 1960s through the 1990s, and so in some ways, a return to positive correlations would not be unusual. However, that’s not great news for traditional diversification in a “60/40” portfolio (60% in stocks and 40% in bonds).

Source: Carson Investment Research, Robert Shiller Data 4/01/24
Data are monthly. Stocks proxied by the S&P 500 and bonds by the US 10-year Treasury. Returns are calculated as the compounded geometric average over rolling periods. Past performance does not guarantee future results.
What Higher Rates Imply for Asset Class Returns

While we think interest rates over the next several years will be higher than what we saw over the past decade, we’re not talking about a rising rate environment. The Fed is very likely finished raising rates and any cuts will have some impact across the curve. Nevertheless rates that remain “higher for longer” still have an impact on expected return.

![Chart 26]

<table>
<thead>
<tr>
<th>Average Returns in Higher and Lower Rate Environments</th>
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</thead>
<tbody>
<tr>
<td>Lower Rate Environments</td>
</tr>
<tr>
<td>Higher Rate Environments</td>
</tr>
<tr>
<td>Total Return</td>
</tr>
<tr>
<td>US Equities</td>
</tr>
<tr>
<td>11.7%</td>
</tr>
<tr>
<td>US Treasuries</td>
</tr>
<tr>
<td>10.5%</td>
</tr>
<tr>
<td>US IG Credit</td>
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<td>4.1%</td>
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<td>Private Equity</td>
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<tr>
<td>4.1%</td>
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<tr>
<td>Real Estate</td>
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<tr>
<td>4.1%</td>
</tr>
<tr>
<td>Cash</td>
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<td>1.2%</td>
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</tbody>
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Source: Carson Investment Research, AQR 5/31/24


Obviously, higher short-term rates are great if you have a lot of cash. Just look at the many money market fund with yields up near 5% to see how that works. In fact, forward-looking bond returns at longer maturities are likely to be higher if current rates are on the high side (since the best predictor for future bond returns is current yields). However, the bad news is that returns for stocks, real estate, and even private equity are lower during higher-rate environments compared to what you see when rates are very low. In contrast, alternative asset class returns are usually stronger in higher-rate environments, for example, trend following futures strategies, commodities like gold, global macro strategies, and long/short market neutral strategies.

Note also that average returns for stocks is still higher than bonds – so the equity risk premium still exists when rates are high.
So What’s Next For Portfolio Positioning?

Here’s a quick overview of our major themes before we get into portfolio positioning:

» We expect higher economic growth over the next few years (compared to the last decade). This is on the back of a strong labor market and investment spending driving productivity gains above what we saw over the prior 15-20 years.

» We think this will also be accompanied by higher inflationary pressure, so interest rates will likely be higher than what we were used to in the 2010s. At the same time, we do think the Fed will cut rates from their current high level of almost 5.5%, likely starting in September.

» We also believe additional deficit-financed government spending and a constructive corporate tax regime will be supportive of economic growth and profits no matter who wins the election.

It’s important to point out that we expect higher rates due to strong growth and more inflation volatility. That’s very different from a stagflationary environment, one with weak growth (including high unemployment) and rising inflation.

Chart 27 provides an overview of assets that tend to perform better in different macroeconomic environments. Based in part on this, from a portfolio perspective our views imply:

» **Overweight equities** – If nominal GDP growth is strong, profit growth is likely to be strong as well. Within equities we prefer the US as we believe economic growth will continue to be stronger. We are also overweighting cyclical sectors and mid- and small-cap stocks (which also have relatively attractive valuations).

» **Underweight bonds** – Bonds may have lower diversification potential than they had from the mid-90s through 2020. We wouldn’t get rid of bonds altogether, especially longer-term Treasuries, since they’re likely to still diversify effectively in the event of a crisis or an unexpected deflationary recession that results in sharp rate cuts.

» **Overweight alternatives** – Alternatives may act as better diversifiers than bonds. This includes some of the strategies mentioned earlier, including a small allocation to gold, which we’ve held in our tactical portfolios since March 2023.

Interestingly, our strategic and tactical positioning are fairly well aligned at the moment, mostly because our longer-term views are downstream of our short-term views – like a strong labor market and higher productivity growth (which is actually helped by strong labor markets). The possibility of a mixed government (discussed above) may also be positive for stocks, and also means corporate taxes are unlikely to rise.
It may seem curious that we’re overweighting equities given possible inflationary pressure. But that’s where alternative asset classes like managed futures and commodities come in. These can act as inflation hedges and help diversify portfolios during inflationary surges (which typically occur due to a spike in commodity prices). However, over the long run you also need inflation “protection,” and the best defense for that is strong real returns. It turns out stocks are the best real asset, since corporate earnings move higher with inflation as companies can pass rising input costs on to customers. Pricing power is evident in the ability of long-term earnings and dividend growth to outpace inflation, even during the 1970s and 1980s when inflation was historically high.

Stocks have been relatively “stable” assets over the long run, since time diversifies risk, but that’s true even after adjusting for inflation. [Chart 28] Real (inflation-adjusted) returns are variable over short-time horizons (one to five years), but the dispersion tends to narrow as you expand the time horizon further. From 1994 to 2023, the CPI Index rose 110%, translating to average annual inflation of 2.5%. An item that cost $1 at the end of 1993 would have cost $2.10 in 2023. At the same time, stocks (the S&P 500) gained 1,662%, translating to an annualized return of 10%. In inflation-adjusted terms, the real return for stocks was 7.5%, which is very close to its average long-term real return.

In short, stocks work well for long-term inflation protection, something to keep in mind when constructing portfolios for long-term inflation-adjusted growth.
WE AT CARSON INVESTMENT RESEARCH are strategic long-term investors who make tactical decisions and offer advice about tactical positioning. On the tactical side, we follow a kind of investor’s version of the Hippocratic Oath, the doctor’s oath to “first do no harm.” Our version is when making tactical investing decisions, first do no harm to long-term investment plans. And even better as it fits the moment, try to materially support them.

That still leaves a reasonable amount of scope for tactical decision making. But the first step to investing successfully isn’t just to start making decisions. It’s making a long-term plan based on reasonable assumptions (an art in itself) and then setting things up so that it’s easy to stick to it.

The costliest investing mistakes are often not missed opportunities but straying from a long-term plan to pursue the wrong opportunities at the worst possible time. Those come in three basic flavors: 1) being too aggressive when markets are overheated; 2) just as dangerous, being too conservative when markets are beaten up; and 3) overconfidence in the ability to jump in and out of different investments without paying attention to basic investing principles.

These lessons are usually hard to learn. Like so many of the most important lessons in life, it usually takes a combination of a few hard knocks and finding a trusted and thoughtful mentor, advisor, or confidant whose guidance we’re willing to give a genuine hearing.

We chose “eyes on the prize” as our Midyear Outlook theme because recently some of those lessons have been hitting home. Many investors received some hard knocks due to missed opportunities after the bear market low in October 2022, in part because many financial industry pundits remained sour on the economy and equity markets. We
also saw a recent example of overconfidence, starting back in 2020 following a strong bond rally that led some to believe that bonds would always have a low risk profile, provide diversification in any down market, and offer a steady return. (Now we're more on the fear side of the bond cycle, although it's not quite at an extreme.)

Those events were an opportunity to see the value of a trusted mentor or advisor who was able to keep things on course. There's nothing wrong with a tactical decision to lean one way or another. Over time they can potentially add significantly to returns and we share our long-term and short-term tactical views throughout this Outlook. But it's important to keep eyes on the prize and not overcommit to a decision that can undermine a good long-term plan.

That long-term focus is so important because a good financial plan (of which investing is only a piece) is in the service of the real prize, the chance to discover and live our best lives and to support and spend time with the people we care most about. That's a prize worth always keeping an eye on.

We hope you found value in our Midyear Outlook. We will continue to communicate our views throughout the year. Please reach out to your trusted financial advisor with any questions about your long-term investing plan and how to stay on course.
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Additional risks are associated with international investing, such as currency fluctuations, political and economic stability, and differences in accounting standards.

Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed. Past performance does not guarantee future results.

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.