"TOMORROW NEVER KNOWS"

(THE BEATLES)

As we are now almost halfway through 2024 and continue to see the U.S. economy and stock market pushing higher, we ask ourselves: what happened to the recession that everyone predicted was coming? Why did the Federal Reserve's most aggressive rate hiking campaign in over 30 years not have the impact that everyone's models predicted would cause an increase in unemployment and recession?

Reflecting on the current landscape of the U.S. economy and capital markets, a series of resilient factors have contributed to sidestepping the most anticipated recession. First, immigration has played a role in both employment and economic growth. Data from the Bureau of Labor Statistics suggests that immigrants have a 75% labor force participation rate, and it takes on average 2 years to reach that rate. This would mean that the US will continue to benefit from this labor supply for at least another 2 years. This dynamic could provide a disinflationary, pro-growth positive to the economy. The stability in overall employment continues to support economic momentum, defying typical recessionary trends.

Interestingly, the resilience of the U.S. economy is further evidenced by the lesser impact of higher interest rates compared to previous cycles. Many homeowners are insulated from the rate hikes due to mortgage-free homes or locked-in rates below 4%, mitigating typical pressures that might otherwise amplify recessionary forces. This unique structural aspect of the housing market supports sustained consumer spending and broader economic stability.

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ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor.

As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results. FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

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Moreover, fiscal stimulus continues to play a crucial role in maintaining economic stability. The upcoming decisions post-November elections regarding the $3.5 trillion personal income tax cuts expiring in 2025 will significantly impact fiscal policy. With the Congressional Budget Office projecting a persistently large fiscal deficit driven by high interest-rate payments on federal debt, the approach to managing this deficit—whether through increased tariffs or raised taxes—will be pivotal. These fiscal maneuvers are critical as they navigate through entrenched political challenges and the ballooning mandatory expenses on entitlement programs.

The Federal Reserve's delicate balancing act in its monetary policy is another cornerstone supporting the economic outlook. The distinctions between normalizing policy and reacting to economic slowdowns are critical, with current trends suggesting a scenario closer to a 'no landing'—where the economy remains robust enough to endure higher rates without derailing growth. This is echoed in the bond markets, where credit spreads indicate a tempered risk sentiment, suggesting that investors may not be adequately considering the risks, despite yields being at historically reasonable levels.

As we delve into specific asset classes, the overall environment for bonds appears increasingly attractive. Notably, leveraged loans offer compelling yields and are poised to deliver robust returns even if interest rates change. As we look at the overall environment for bonds, we see that the risk versus reward relationship is at appealing levels. While it is typically true that bond investors will benefit from rates coming down, we find ourselves in a unique environment wherein bond investors will still realize positive total returns even if rates increase. For instance, if interest rates were to rise a full 1% from today's levels, we would still expect positive total returns for most categories.

The credit market also reflects a sturdy outlook, with a notable shift in refinancing risks. The maturation profiles of high yield bonds over the next two years show minimal immediate refinancing needs, coupled with a credit quality significantly stronger than what was observed during the last financial crisis. This fortifies the market's capacity to absorb shocks and underscores a less precarious credit environment.

Stocks are supported by rising earnings which have continued to surprise to the upside in 2024. Typically, we see downward revisions as the year progresses, but so far this year we have seen estimates climb higher. The consensus forecast is expecting 11% earnings growth for 2024 and a 14% growth rate for 2025. Share buybacks are also approaching all-time highs, which further supports the market. However, valuations of U.S. stocks are much higher relative to recent history and the rally lately has been narrower, focused on AI and utility companies that cater to AI.

As the probability of a near-term recession continues to fade, investors are faced with several key themes that should impact markets throughout 2024. The market remains worried about the stickiness of inflation and what that means for future Federal Reserve policy. Despite initial doubts about the feasibility of a soft landing, current evidence increasingly supports this scenario. Although we expect Central Banks to keep monetary policy restrictive, there is a light at the end of the tunnel, and we should see rate cuts sometime this year.

Looking ahead, while the market grapples with persistent inflation concerns, the overarching economic indicators remain supportive. The fiscal stimulus from major legislative measures, alongside substantial investments in infrastructure necessary for burgeoning sectors like artificial intelligence, will bolster economic growth and corporate earnings. Moreover, the positive shifts in business sentiment and a more vibrant M&A landscape suggest an economy brimming with opportunity.

While an economic downturn remains a risk, consumers are coming from a strong financial position. We are not seeing massive layoffs, and those workers who are unemployed do not appear to have a difficult time finding jobs. All-in-all, we see a resilient U.S. economy that has already experienced higher returns versus the rest of the world.

In conclusion, our asset allocation strategy for the remainder of 2024 aligns with a cautiously optimistic outlook. We remain relatively neutral compared to our client's long-term asset allocation. We continue to favor investing in diversified fixed income assets that offer equity-like returns with lower volatility and exploring structured credits that provide robust yield opportunities. We believe in this type of setting, investors must remain nimble and not complacent.

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While we expect continued growth, our years of experience have shown us that these types of environments can shift quickly. We will continue to monitor the landscape and make adjustments as needed to help our clients meet their long-term goals.

On a firm level, we are excited about two new additions to the FSA Investment Group team. In early May, Matthew Durham joined us as our Chief Operating Officer. His over 20 years of experience working in investments will be invaluable to our firm. We are also excited to welcome Shawna Belgarde as our Operations Manager. Shawna is an enrolled member of the Fort Peck Assiniboine and Sioux Tribe, and she brings over 5 years of experience in bank operations, most recently with Wells Fargo. We appreciate your trust in us as we continue this journey together, aiming for a path that, while uncertain, holds considerable promise for those who remain engaged and informed. Your continued partnership is invaluable as we seek to capitalize on these opportunities and navigate the complexities of the markets together.

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