PeoplesBank
WEALTH MANAGEMENT

Quarterly Economic & Market Perspectives

July 2024

"The hardest thing to do in baseball is to hit a round baseball with a round bat, squarely"

— Ted Williams

As we near the midpoint of this baseball season, traditionally marked by the annual All-Star game, a quote by Ted Williams about hitting comes to mind. Williams, arguably one of the greatest hitters in baseball history, was the last player to hit over .400 in a season, a feat he accomplished in 1941.

The Federal Reserve (the Fed) is attempting to achieve an economic soft landing—slowing the economy just enough to curb inflation without triggering a recession—using the round bat of monetary policy. Much like in baseball, hitting this target "squarely" has proven challenging. However, the Fed acknowledges that there has been modest progress.

A Shift in Language

Although the Fed is dedicated to restoring price stability and achieving maximum employment, it is cautiously avoiding a premature reduction of interest rates. The Fed must carefully balance its actions: lowering rates too early could entrench inflation above its target, while delaying could harm the economy through sustained high rates.

During its June 11-12 meeting, the Federal Open Market Committee (the FOMC) maintained the federal funds rate at a steady range of 5.25% to 5.5% for the seventh consecutive meeting. Despite a deceleration in inflation, the Fed has projected only one rate cut in 2024. Although there has been progress on inflation, it is not sufficient for a reduction in the key interest rate. The FOMC noted, "Inflation has eased over the past year but remains elevated. In recent months, there has been modest further progress toward the Committee's 2 percent inflation goal." This statement marks a shift from their previous remark about the "lack of further progress."

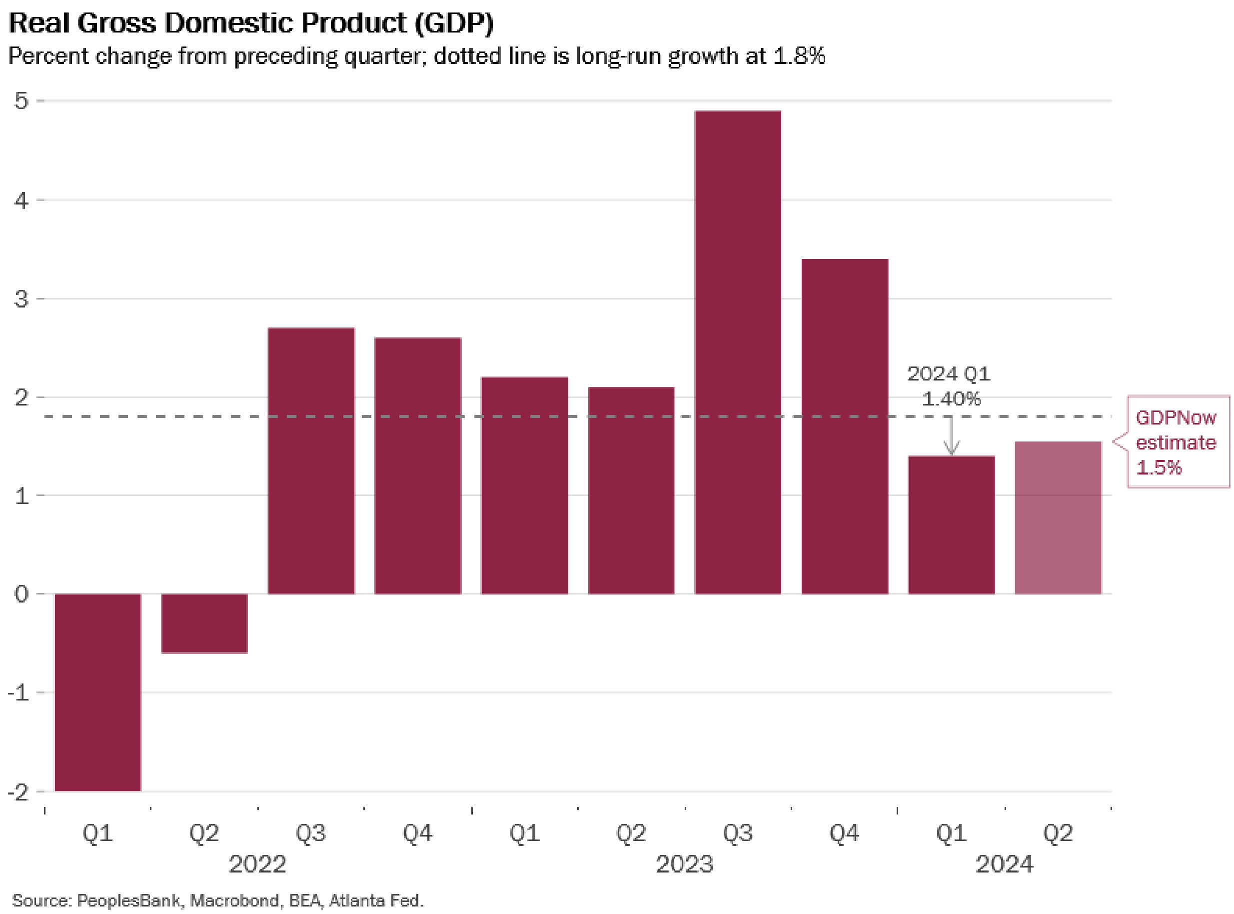
The Fed's Summary of Economic Projections showed:

- No changes to the median real Gross Domestic Product (GDP) growth projections from 2024 through 2026, indicating a stable economic growth outlook.
- Minor adjustments in the median unemployment rate forecasts, demonstrating a stable job market.
- Updated core Personal Consumption Expenditures (PCE) inflation estimates remain high for 2024 and 2025, with a gradual approach to the 2% inflation target.
- Modifications to the median projections for the federal funds rate suggest a more cautious stance on rate cuts this year, including a slight increase in the long-term neutral rate estimate.

Given this more cautious stance, investors, as of July 1, are pricing in a better than 65% probability that the Fed will cut the fed funds rate by at least 0.25%, at the FOMC meeting in September, according to the CME Group's FedWatch Tool.

The Economy Grows at Slower Pace

The economy grew at a modest annual rate of 1.4% in the first quarter of 2024, marking the weakest performance in nearly two years. This sluggish GDP growth was mainly attributed to a larger trade deficit and reduced inventory production. However, excluding the impact of inventories, trade, and government spending, the economy expanded at a more robust rate of 2.6%. Looking ahead, the prospects for the second quarter seem lackluster, with the Atlanta Fed's GDPNow model predicting an annualized growth rate of 1.5%, which falls short of the Federal Reserve's long-term growth forecast of 1.8%.



In June, the labor market displayed strength as U.S. employers added 206,000 jobs. However, the Bureau of Labor Statistics revised the job creation figures for April and May, reducing them by 111,000. The unemployment rate increased to 4.1%, its highest level since November 2021, after being as low as 3.4% just 14 months earlier. While wages rose again in June, the annual growth rate of worker pay slowed to 3.9% from 4.1%, the lowest in three years. The Federal Reserve aims to moderate wage increases to around 3% or lower to meet its low-inflation targets.

May also saw a deceleration in inflation, with the consumer price index remaining virtually unchanged from the previous month and rising 3.3% year-over-year. In contrast, April saw a 3.4% increase. Core inflation, which excludes the more volatile food and energy sectors, recorded its smallest increase since 2021, yet it continues to exceed the Fed's 2% target for the longer term.

The Conference Board's U.S. Leading Economic Index® suggests that softer economic conditions may lie ahead. "We anticipate that elevated inflation, high interest rates, increasing household debt, and dwindling pandemic-era savings will persist as significant burdens on the U.S. economy throughout 2024," states Justyna Zabinska-La Monica, Senior Manager of Business Cycle Indicators at The Conference Board.

Risk-on Market

The U.S. stock market remains strong, driven by a resilient U.S. consumer and growing enthusiasm for artificial intelligence. Year-to-date, U.S. large-cap stocks have surged by 15.3%, significantly outperforming small-cap stocks, which have seen a modest 1.7% gain. A closer look at the S&P 500 index, a benchmark for U.S. large-cap stocks, shows that much of its growth is due to the top 10 stocks. These stocks, which comprise just over a third of the index's total market capitalization, have contributed to nearly three-quarters of its year-to-date return—see the chart on the next page. International stocks have lagged behind, with developed market and emerging market equities rising by 5.7% and 7.7%, respectively.

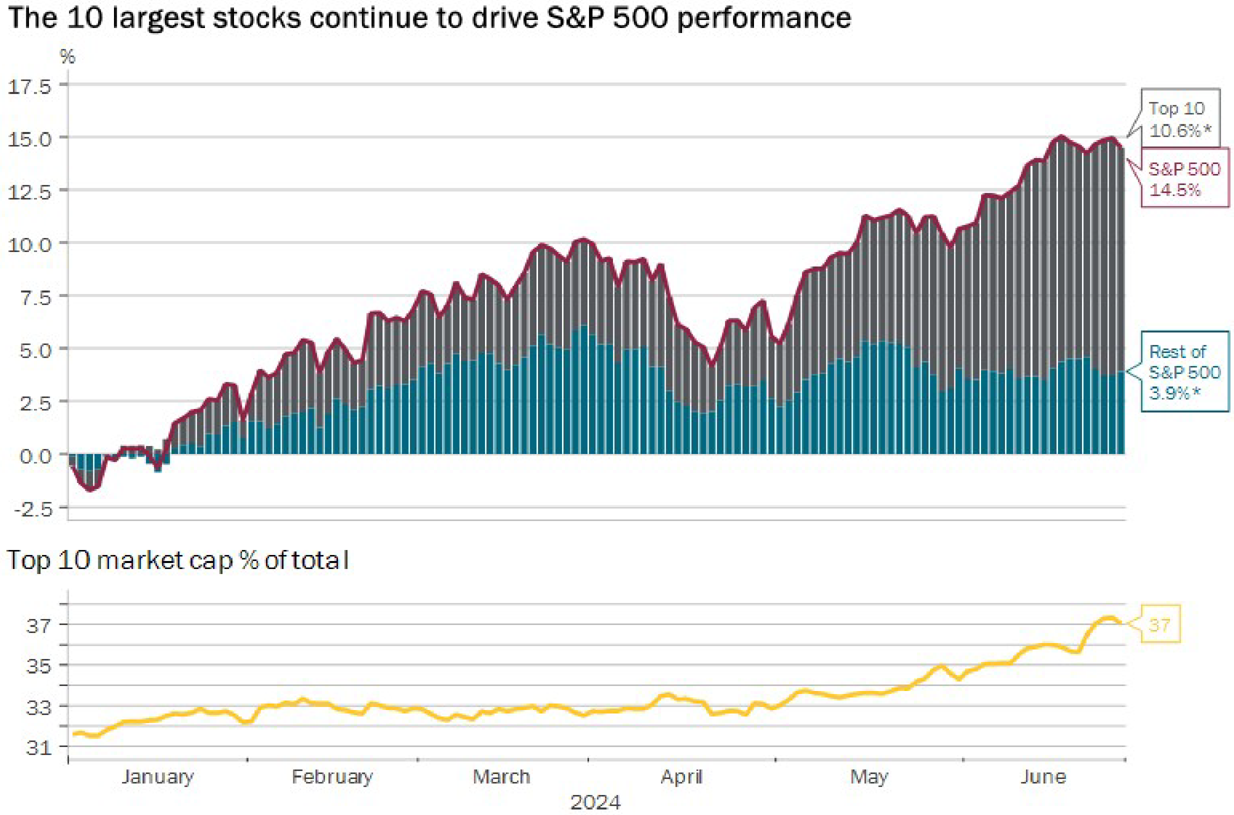
On the other hand, the U.S. bond market has faced challenges, with the broad-based, market capitalization-weighted bond market index declining by 0.7% year-to-date. The yields on the 10-year Treasury note have increased by 0.48% since the start of the year. Despite this, global high-yield securities have shown impressive performance with a gain of 3.2%.

The outlook for equities appears positive, supported by improved earnings expectations driven by stable economic performance, particularly in the technology and pharmaceutical sectors. However, high valuations may limit further gains. Europe shows potential with decreasing inflation and growth in the service sectors, while China's economy seems to be stabilizing despite ongoing challenges.

Emerging markets present attractive valuations and could benefit from more accommodating monetary policies. Countries like Korea and Taiwan are showing brighter prospects compared to a steady but still troubled China.

In terms of fixed income and cash, appealing yields persist despite volatility caused by global economic disparities and central bank strategies. Cash is currently attractive, offering solid liquidity options due to high yields from an inverted yield curve. U.S. investment-grade bonds and long-term treasuries remain reliable, though they are vulnerable to potential increases in long-term yields driven by ongoing growth and inflation pressures.

In the U.S. market, value stocks show promise due to a stable economic environment, particularly in the energy and cyclical sectors. Despite more appealing valuations, small caps have faced challenges, dealing with the effects of persistently high interest rates on profit margins and concerns over leverage.



*Weighted average return contribution
Source: PeoplesBank, Macrobond, S&P Global. Data as of 6/28/2024

Several risks accompany this outlook, including unexpected shifts in economic indicators, geopolitical tensions, and political events, particularly those related to the presidential election. We remain committed to managing diversified investment strategies that aim to mitigate these risks for our clients and capitalize on longer-term investment opportunities.

PBWM's STRATEGIC AND TACTICAL ASSET ALLOCATION

	Asset Class	Strategic (%)	Under/Overweight (%)	Tactical (%)
Equity	U.S. large cap stocks	28.8	-1.8	27.0
	U.S. mid and small cap stocks	7.2	5.8	13.0
	Int'l developed market stocks	18.3	-1.3	17.0
	Emerging market stocks	5.8	0.2	6.0
Fixed Income	Core fixed income	38.0	-7.0	31.0
	Non-core fixed income	0.0	4.0	4.0
	Cash & cash equivalents	2.0	0.0	2.0

PeoplesBank Wealth Management's (PBWM's) strategic and tactical asset allocation for its total return moderate growth strategy as of April 2024.

Notes

PeoplesBank Wealth Management is a division of Orrstown Bank. PeoplesBank Wealth Management's Investment Strategy Committee (ISC) develops both long-term (strategic) and short-term (tactical) asset allocation recommendations for Wealth Management’s investment management and trust accounts. Strategic recommendations are based on how the ISC believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. Tactical recommendations are based on where the ISC sees either increased opportunity or risk over the next one to two years. The ISC is also responsible for selecting and monitoring strategies, managers, and funds implemented within client portfolios. The ISC is comprised of senior members of the Wealth Management team and meets monthly. If you have questions or would like additional information regarding PBWM’s investment process, please call or send an email to your relationship or investment officer.

Sources: Atlanta Fed, Bureau of Economic Analysis, Federal Reserve, Goldman Sachs Asset Management, J.P Morgan Asset Management, Macrobond, MarketWatch, MLB.com, T. Rowe Price, The Conference Board, The Daily Free Press, and The Wall Street Journal.