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CAPITAL MANAGEMENT

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Resilience Amidst Uncertainty: The Market Remains Near All-Time Highs

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SUMMARY

- **macro**cast™ remains positive, indicating a low risk of a recessionary bear market. Our current **micro**cast™ signal remains at an aggressive allocation. Both models continue to indicate a generally optimistic outlook for risk assets.
- Despite unprecedented global challenges over the past four years, markets have proven resilient, driven largely by US innovation. While ongoing issues like elevated interest rates and uncertainty in monetary policy persist, the market's ability to reach record highs in the face of recent turmoil suggests it may continue to defy expectations and weather these challenges.
- Oil price fluctuations can significantly influence expected inflation rates, as shown by the correlation between oil prices and the 5-year breakeven inflation rate. Recently, a 10% decline in oil prices has led to lower inflation expectations, potentially easing one concern for the Federal Reserve as it decides on whether it should cut interest rates.
- The S&P 500 rose more than 10% year-to-date through May. Historically, similar double-digit gains have been a positive signal for the months ahead. On average, the index has increased nearly 9% for the rest of the year, posting positive returns in 16 of the last 19 occurrences.

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See content within for additional information on the summary items discussed above

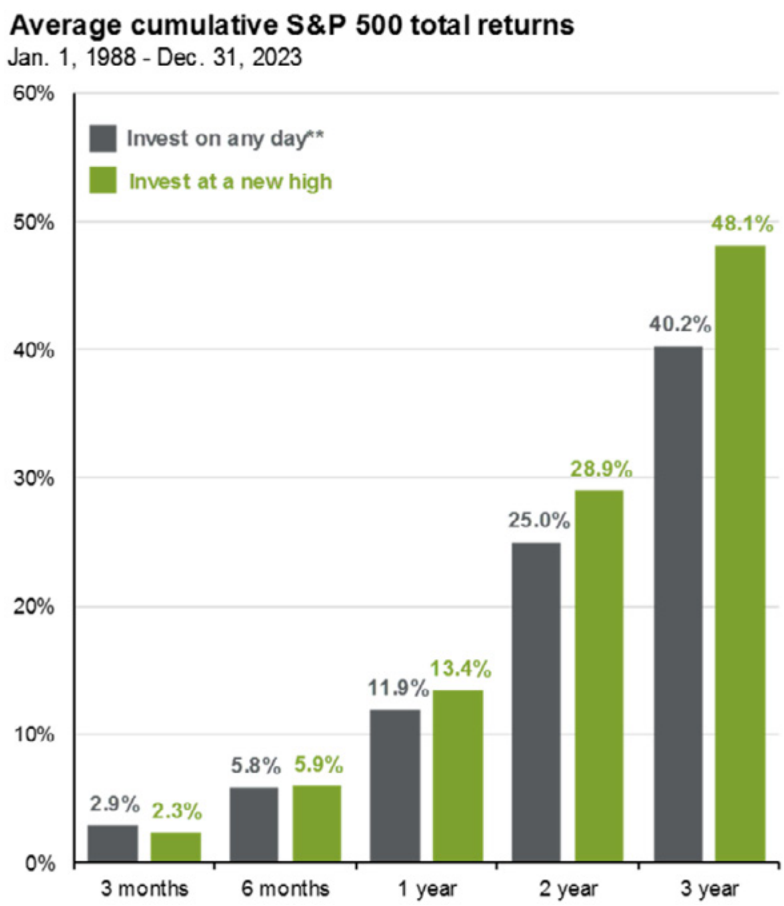
AGAINST MAJOR HEADWINDS,
THE MARKET SITS NEAR ALL-TIME HIGHS

Since the start of the decade, the world has transformed dramatically, upending our preconceived notions of normalcy and stability. Consider the following:

1. A global pandemic triggered unprecedented economic lockdowns, causing the fastest market crash since the Great Depression.
2. Subsequent major supply chain bottlenecks disrupted industries worldwide.
3. The first major war in Europe since the 1990s led to a significant spike in oil prices and other critical commodities.
4. The highest inflation rates in four decades strained household budgets.

Despite the tumult of recent years, the US stock market has demonstrated resilience, largely due to the innovative drive of corporations, especially large, technology-focused firms in which the United States holds a dominant global position.

As the S&P 500 sits near record highs, it's worth remembering that historically, investing at a new high has yielded higher average returns over the next several years than investing on any random day (chart from JP Morgan):



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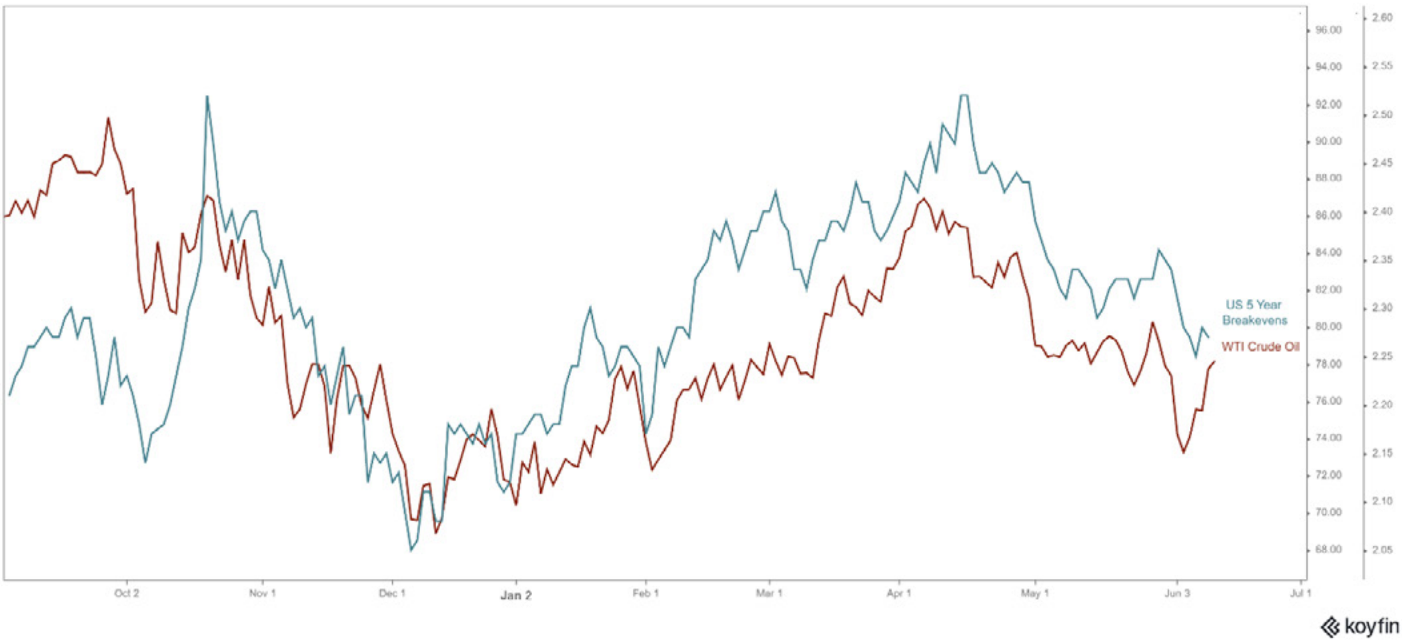
This isn't to say that broader equity markets are without challenges. For instance, small-cap stocks have struggled due to the burden of higher interest rates, which increases their borrowing costs and hampers growth. Similarly, international stocks, particularly in emerging markets, have lagged because they lack significant exposure to the booming tech sector that has driven much of the US stock market's recent gain.

Inflation remains above the Federal Reserve's target, hinting at only one or two rate cuts this year. The growth driven by AI could slow down or—if the technology disappoints—prove to be a significant misallocation of capital, which would be worse.

However, these concerns seem less significant than the events we've weathered over the past few years. In other words, if the market could reach record highs despite the turmoil of the last four years, it's hard to imagine it suffering long-term damage simply because inflation is slightly above target or because the Fed lowers interest rates at a marginally slower pace.

IF OIL PRICES REMAIN TAME, **THEN ANOTHER SURGE IN INFLATION IS UNLIKELY**

Changes in oil prices significantly impact expected inflation rates. The following chart illustrates the correlation between oil price fluctuations and the 5-year breakeven inflation rate, which represents the expected average annual inflation rate over the next five years. The 5-year breakeven rate is calculated by comparing the yields of regular government bonds to those of inflation-protected bonds, which adjust their payouts based on inflation. (Chart from Koyfin):



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Oil prices have declined approximately 10% since their early April peak. Concurrently, inflation expectations decreased from 2.5% to 2.27%. Given the trend in inflation expectations is a key consideration in monetary policy, if oil prices stabilize or decline further, this would alleviate one concern for the Federal Reserve as it considers the timing and magnitude of potential interest rate cuts.

STRONG RETURNS THROUGH MAY **USUALLY LED TO FURTHER GAINS**

The S&P 500 is up more than 10% through May. Historically, the momentum continued after similar periods (table from Carson Group):

More Reasons For The Bulls To Run

S&P 500 Returns After >10% YTD End of May

		S&P 500 Index Returns	
Year	YTD Return	June Return	Rest of Year
1950	11.9%	-5.8%	8.8%
1954	17.7%	0.1%	23.3%
1958	10.3%	2.6%	25.2%
1961	14.5%	-2.9%	7.5%
1963	12.2%	-2.0%	6.0%
1967	10.9%	1.8%	8.3%
1975	32.9%	4.4%	-1.1%
1976	11.1%	4.1%	7.3%
1983	15.5%	3.5%	1.6%
1985	13.3%	1.2%	11.5%
1986	17.1%	1.4%	-2.1%
1987	19.8%	4.8%	-14.8%
1989	15.4%	-0.8%	10.3%
1991	18.1%	-4.8%	7.0%
1995	16.1%	2.1%	15.5%
1997	14.5%	4.3%	14.4%
1998	12.4%	3.9%	12.7%
2013	14.3%	-1.5%	13.3%
2021	11.9%	2.2%	13.4%
2024	10.6%	?	?
	Average	1.0%	8.8%
	Median	1.8%	8.8%
	% Higher	68.4%	84.2%
Average Year (1950 - 2023)			
	Average	-0.1%	4.9%
	Median	0.1%	6.4%
	% Higher	55.4%	71.6%

Source: Carson Investment Research, FactSet 06/03/2024
@ryandetrick

CARSON

In almost all instances where the stock market saw double-digit gains through May, the rest of the year was positive with only three exceptions. In 1975, stocks ended slightly lower after a significant early surge. In 1986, despite a 2% decline over the final seven months, the market still finished the year with a substantial gain. Last, in the infamous 1987 crash, the market continued to rally for several months before the sharp October decline that was driven by idiosyncratic factors.

Overall, the market has historically shown higher average returns and more positive outcomes following a 10%+ gain through May compared to any random year since 1950.

In summary, the market has demonstrated remarkable resilience in the face of unprecedented challenges over the past few years, largely due to the innovation and strength of US companies. Looking ahead, falling oil prices have helped to ease inflation expectations, potentially alleviating the Fed's concerns of resurgent inflation and allowing room for rate cuts. Following strong double-digit gains through May, history suggests a positive outlook for the rest of the year, further bolstering confidence in the market's strength.

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Use of Indicators

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