OAK ASSOCIATES

Market Update

Second Quarter 2024

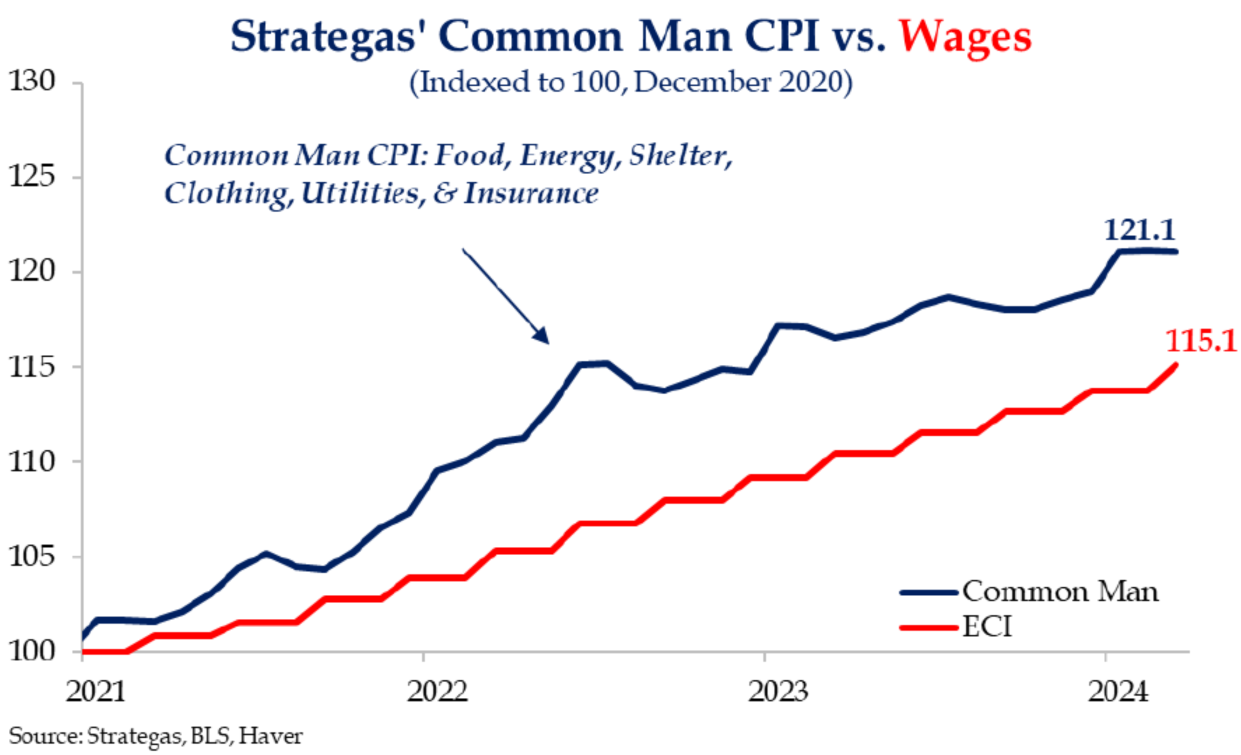
Dueling Data Sets

For much of the first half of 2024, the story of the economy remained relatively the same, offering mixed data, with both bad news and good news, providing something for everyone. As a result, investors have largely stayed in the markets, supporting upward trends for U.S. equities, and the U.S. Federal Reserve (Fed) has remained on hold. But as the second quarter progressed, we believe subtle shifts have appeared below the surface, perhaps leading to a more distinct bifurcation of economic data in the months ahead. These potential changes and the moniker of my son's recent baseball tournament, Dueling Dugouts, inspired the title for this commentary. We remain cautiously optimistic but are watching corporate earnings and the U.S. labor market most closely as we enter the home stretch of the year.

Corporate earnings of S&P 500 firms have remained strong growing over 7% annually in the first quarter, approximately twice as fast as estimates from the start of the year. But excluding the Magnificent Seven, which are the narrow group of high-performing and influential companies in the U.S. stock market that dominated in 2023, earnings actually fell slightly. As we enter the second quarter earnings season in the coming weeks, general expectations among Wall Street analysts are for similar results. However, as we move into the back half of 2024, earnings are expected to broaden and accelerate beyond the Magnificent Seven which would be a welcome signal to investors that this year's advance in equity markets is resting on a firmer foundation.

Within the US labor market, we have also seen a dislocation developing between various employment data and consumer confidence. U.S. unemployment ticked up to 4% during the second quarter of 2024, but the move up from 3.7% at the start of the calendar year was gradual and corporate profit margins remained healthy, supporting personnel headcounts and compensation. The U.S. unemployment rate has been at or below 4% for the past 30 months, the longest stretch since 1970. During the second quarter, we also saw a sharp weakening of consumer confidence. This is important because it is the consumer that does the heavy lifting for U.S. economic growth —accounting for about 70% of the nation's GDP.

In an effort to explain weakening consumer confidence despite falling inflation and a healthy labor market, the economic research firm, Strategas, came up with what they refer to as the Common Man CPI (Consumer Price Index). This series separates consumer spending on necessities, such as food and energy, from discretionary items, such as dining out and jewelry. As you can see in the chart below, while wages have grown nicely over the past three years (red line), they have not kept pace with the rise in prices (blue line) of those things the average person "needs". This may explain why consumers do not feel as they might otherwise given strong employment and moderating inflation.



Overall, the pace of growth in prices has continued to trend lower since its peak in June 2022, but it is the higher absolute levels compared to two and three years ago that has created pain points. The dilemma for the Fed is that to declare victory against inflation, i.e., bringing it down to their stated target of 2%, will likely require further slack in the labor market. A focus on the relative health or weakness of the consumer may well be a key driver of both Fed action and U.S. equity market performance moving forward.
Importantly, U.S. equity markets have performed well and valuations remain reasonable. In our view, negative or bad news that typically would weigh on stocks may actually encourage the Fed to pull the trigger on its first interest rate cut (See our First Quarter

2024 Market Commentary: When Bad News is Good News). As we enter the third quarter of 2024, we believe that until a winner emerges from this duel of data sets, the Fed is likely to remain on the sidelines using rhetoric to manage expectations until the need for a move becomes apparent.

In our cautiously optimistic view, conditions overall remain supportive for U.S. equities. Valuation levels are elevated but still reasonable and the Fed's next move on interest rates is likely lower, albeit later than had been anticipated. Further, fiscal and monetary policies put forth in a Presidential election year are typically stimulative, making a recession highly unlikely. Data points we are watching most closely that have the potential to alter our view in the months ahead include a noteworthy reacceleration of inflation, a significant rise in unemployment or a substantial decline in corporate profits.

As always, thank you for reading and please do not hesitate to reach out to us if we can assist you with achieving your investment goals in any way.

Kindest Regards,

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