

Growth Scare? Focus on Building a Portfolio that Can Weather the Storm



Nasdaq & S&P 500 Rally in First Half of 2024

Despite still-elevated inflation and uncertainty around monetary policy, all three major equity indexes were up in the first half of 2024 on the back of AI-technology optimism and strong earnings. Notably, the Nasdaq Composite gained 18.6% and the S&P 500 increased 15.3%, while the Dow Jones Industrial Average was up 4.8%. US growth stocks (+23.5%) were among the best performers, followed by US large-caps (+15.2%) and emerging market equities (+7.7%). Bonds were mixed as high yield credits and Treasury Inflation Protected Notes rose (+2.3% and +1.4%, respectively) while 7-10 year US Treasuries and the US Aggregate Bond Index fell (-1.5% and -0.6%, respectively). Commodities fared well as silver was up 22.0%, crude oil gained 19.4%, gold increased 12.5%, and broad-based commodities rose 5.0%.

Fed Signals Only One Cut Coming this Year

The Federal Reserve kept interest rates unchanged at the June FOMC meeting, leaving the fed funds rate at the 5.25–5.50% range. Although the May Consumer Price Index (CPI) release ahead of the meeting suggested inflation eased slightly, Fed Chairman Jerome Powell stated, “We don’t see ourselves as having the confidence that would warrant beginning to loosen policy at this time.” This was further expressed in the updated Summary of Economic Projections, in which the median dot plot signaled only one 25 bps rate cut to occur by the end of the year, down from three cuts indicated in March. Moreover, policymakers increased their year-end inflation forecast via the core Personal Consumption Expenditures Index (PCE) from 2.6% to 2.8%. While a stronger-than-expected economy and labor market have contributed to inflation’s stubbornness, recent indicators such as weaker Q1 GDP, contracting ISM Manufacturing, and elevated jobless claims imply that economic activity is starting to soften, and inflation may continue to ease. Currently, a 58% chance for the first 25 bps rate cut to occur in September is priced in per the CME FedWatch Tool.

Exhibit 1: Trailing Returns as of June 28, 2024

Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities						
US Growth (SPYG)	6.99%	9.71%	23.54%	34.69%	9.46%	16.84%
US Large-Caps (SPY)	3.53%	4.38%	15.23%	26.40%	10.00%	14.99%
Broad-based Emerging Markets (SPEM)	2.20%	5.33%	7.65%	13.16%	-3.28%	4.00%
US Value (SPYV)	-0.72%	-2.15%	5.69%	16.91%	9.56%	11.85%
International Developed Equities (SPDW)	-1.63%	-0.40%	4.96%	11.87%	1.29%	6.42%
US Mid-Caps (SPMD)	-1.67%	-3.44%	6.06%	15.56%	4.40%	10.26%
US Small-Caps (SPSM)	-2.19%	-3.03%	-0.70%	10.62%	-0.24%	7.96%
US Fixed Income						
US Treasury 7-10 Year (IEF)	1.22%	-0.19%	-1.48%	-0.67%	-4.58%	-1.37%
Municipal Bonds (MUB)	1.03%	-0.23%	-0.49%	2.36%	-0.80%	1.08%
Treasury Inflation Protected Notes (SPIP)	1.03%	1.18%	1.38%	2.03%	-1.63%	1.89%
US Aggregate Bond Index (SPAB)	0.93%	0.21%	-0.60%	2.15%	-3.01%	-0.29%
Investment Grade Corporate Bonds (SPBO)	0.55%	-0.10%	-0.26%	4.57%	-2.87%	0.74%
High Yield Credit (JNK)	0.48%	0.70%	2.34%	9.70%	0.76%	2.72%
Commodities						
Crude Oil (USO)	6.38%	1.09%	19.41%	27.24%	17.12%	-3.74%
Gold (GLD)	-0.13%	4.52%	12.47%	21.23%	8.88%	10.05%
Broad-based Commodities (BCI)	-1.74%	2.83%	5.01%	5.95%	5.40%	6.78%
Silver (SLV)	-4.29%	16.79%	21.99%	27.43%	3.15%	13.14%

Source: FactSet. Data as of June 28, 2024. 1Y, 3Y, and 5Y numbers are annualized.

US Economic Data Surprises to Downside

In recent weeks, the Bloomberg US Economic Surprise Index, which measures the degree to which economic data is coming in below or ahead of economic forecasts, hit its lowest level since early 2019. This indicates that economic data has been surprising to the downside as the effects of tight monetary policy have started to materialize.

Exhibit 2: Bloomberg US Economic Surprise Index

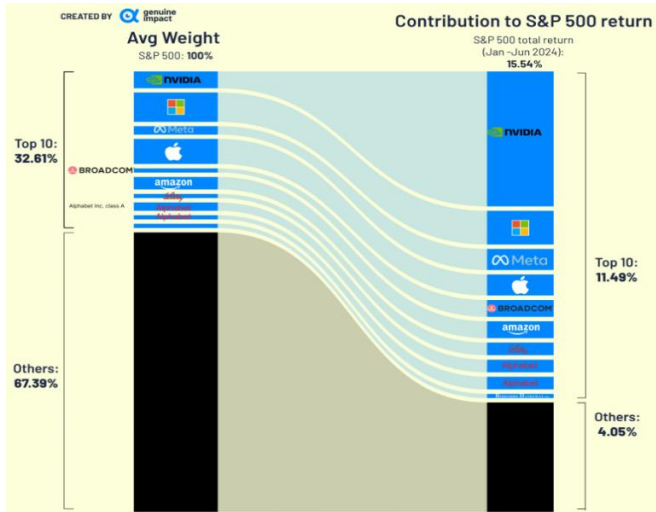


Source: The Daily Shot, Bloomberg

“Magnificent Seven” to “Magnificent One”

Through mid-June, the top ten largest stocks in the S&P 500 have driven more than 70% of the index’s 2024 YTD return. More interestingly, an outsized portion of this is due to Nvidia’s rally alone. Though each of the “Magnificent Seven” stocks delivered a sizable contribution to the S&P’s 2023 return, will 2024’s performance be mainly determined by Nvidia?

Exhibit 3: S&P 500 Constituent Contribution to 2024 YTD Return

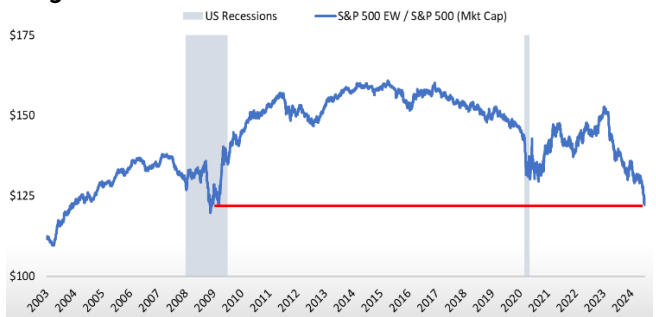


Source: Genuine Impact, Bloomberg, Twitter @Mayhem4Markets

Narrow Breadth

Market breadth has narrowed recently as various macro indicators have weakened and market participants have bid up larger stocks, which are thought to be less vulnerable to economic cycles. This is evidenced by the ratio between the equal and market cap-weighted S&P 500, which currently sits at lows last seen in late 2008.

Exhibit 4: S&P 500 Equal Weight / S&P 500 Market Cap Weight



Source: Source: FactSet, Astoria Portfolio Advisors. Data from January 31, 1990, through June 28, 2024. Calculations use monthly price returns. January 31, 1990 = \$100. Chart is abbreviated to show only calculations from January 1, 2003 through June 28, 2024. Past performance is not indicative of future results.

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Growth Scare? Focus on Building a Portfolio that Can Weather the Storm

Markets seem to be experiencing a growth scare, which we believe is validated by tight monetary policy and weaker macro data. Is the bull market over? Not yet, but noticeably, after 15+ months of high interest rates and stubborn inflation, it appears the US economy is starting to slow. We remain constructive, but we think markets are prone to a 10-15% correction, and in fairness, this is within a normal distribution for equities.

Markets have had quite a ride since the October 2023 lows. What made us so constructive in December 2023?

- o The Fed pivoted and acknowledged that rate cuts were on the horizon for 2024.
- o The average stock had a valuation that made the risk/reward favorable in our view.
- o Market sentiment was poor. Recall that "T-bill and Chill" was the mantra for most of 2023.

However, there has been a material change in several of the above-mentioned areas, coupled with a growth slowdown. Therefore, our ETF portfolios required some tweaking. What has changed as of June 2024?

- o Market cap-weighted index valuations have richened considerably.
- o Inflation has been stubborn (the Fed hasn't been able to cut despite 7-8 cuts priced at the start of 2024).
- o Economic data has softened (i.e., weaker GDP, ISM Manufacturing, Retail Sales, labor market, etc.).
- o Market breadth has been quite weak.

Front-end rates have been anchored, making equity risk premiums the lowest in 20 years. In short, "T-bill and Chill" remains the mantra. Many advisors seem comfortable hiding in T-bills and nibbling on AI stocks, semiconductors, and other growth cohorts. This has made it painful for broader market participation.

We've recently added growth stocks to our portfolios to hedge the risk the economy will continue to materially weaken. The analogy is that large-cap, bellwether stocks can grow their earnings regardless of the macro environment, interest rate levels, or credit cycle.

Rather than trying to determine the timing of Fed rate cuts, advisors should focus on the big picture and build a portfolio that can weather the storm. We prefer to stick with high quality stocks and a globally diversified, multi-asset portfolio that aims to deliver upside while hedging the downside. Markets never go up in a straight line, and bull markets can last longer than one can imagine.