Letter from the Chief Investment Officer

City of Lights, Market of Opportunities

There's nothing better than rooting for Team USA! Therefore, we borrow from the upcoming Paris Summer Olympics for our quarterly theme—with a twist. Instead of using the most popular events (like gymnastics, swimming, and track & field) to express our views, we'll go beyond the spotlight. The reason: we advocate looking past the obvious and strive to find value in diverse market areas—because that's how you can add value to a portfolio over time. Just as the market has had its share of surprises recently, the Games will have a few as well. It will be the first opening ceremony not in a stadium, but on boats on the Seine River; the mascot won't be an animal but a hat (the French love fashion!), and each medal will be infused with iron from the Eiffel Tower!

Surfing has only been part of the Olympics since 2020 and will take place ~10,000 miles from Paris in Tahiti (an island in French Polynesia). Like a surfer itching to catch a big wave, the extraordinary pent-up demand during COVID *amped* the US economy. But spending is slowing, especially among lower-income consumers as the labor market softens and the impact of inflation takes its toll. The Federal Reserve (Fed) has been *riding the wave* of a healthy economy despite the most aggressive tightening in 40 years. But now, the Fed's *trick* is to extend this recovery by cutting interest rates in time to avoid a *wipeout* (aka recession) without further *swelling* inflation. There is an opening to *keep the surf up* if the Fed cuts rates twice by year end and then more next year.

Just as surfing is far from France, factors beyond the horizons of the consumer and the Fed will impact the economy. Watch for government spending in an election year and business spending concentrated on artificial intelligence (AI) to offset weakness in consumer spending. Keep an eye on oil prices—which could cause some economic *chop* if oil goes above our year-end target of $85/barrel. Overall, we remain optimistic, expecting GDP growth of 2.1% in 2024 and 2% in 2025.

Beach volleyball requires seamless cooperation between the two teammates. Similarly, the bond market has twin dynamics, dictated by the economy and inflation. With both *set* to cool gradually the remainder of this year, interest rates should *tip* lower by year-end (10-year Treasury yield target: 4.0%) and the next 12 months (target: 3.75%). That will *serve* bond market returns' modest capital appreciation. Beach volleyball is the newer, trickier version of indoor volleyball—playing in sand, adverse weather (heat/wind/rain), and in front of a raucous crowd. The modern-day bond market has new challenges as well: record government debt issuance, demand unease, and non-traditional Fed policy. Like a beach volleyball team, investors must read and anticipate market moves quickly. For example, cash investments have *scored* with yields above 5%, but that will likely not last long. So, as the Fed approaches its easing cycle, transitioning to longer-dated bonds seems prudent. Areas to consider: intermediate-maturity Treasurys, high-quality corporate bonds, and longer-maturity municipal bonds.

Like sport climbing, equities have *climbed* a wall—a wall of worry about recessions, higher interest rates, elevated valuations, and geopolitics. Thus far, the path higher has been relatively uninterrupted as the S&P 500 has had only one 5%+ slip this year and only one 10% *tumble* since the bull market started 21 months ago. In sport climbing, the courses get progressively more difficult. The quest for the market to move higher is getting more challenging, especially with valuations at the highest level since January 2022. In the near term, it may be harder for equities to find a *handhold* if volatility increases because of growing economic, earnings, and election uncertainty. Still, in the longer term, the equity market rally is likely nowhere near the top. It should get support from Fed easing, lower interest rates, and some of the ~$6 trillion in money market mutual funds transitioning into the equity markets. And remember, historically, the average bull market lasts over five years, so it should continue climbing! Our year-end and 12-month targets for the S&P 500 are 5,400 and 5,700, respectively. While the Tech sector has dominated, market performance should broaden as smaller company earnings accelerate. Across market capitalizations, we prefer the Technology, Industrials, Energy, and Health Care sectors.

Breakdancing, or breaking, will be in the 2024 Summer Olympics for the first time! Like breakdancing, AI used to be more 'underground' (I was breaking in the 80s!), but it has now emerged onto the brightly lit stage. Since computing capabilities have only recently supported advanced AI at scale, we are in the early stages of this cycle. AI-driven earnings growth should remain robust for semiconductors and cloud computing as well as software and hardware. AI's challenge is a *throwdown* to 'business as usual.' It's likely to continue to receive a standing ovation in the financial markets.

Speaking of ovations, the exploding popularity of women's basketball demonstrates that the US has the infrastructure to develop the most skilled and talented players. The team has been dominant, with no Olympic losses since 1992. It holds the record for the most consecutive team victories in all Olympic sports. The US equity market has similarly *jumped* above the global competition, outperforming developed market equities for eight of the last ten years by a cumulative 170%! The reasons are familiar: the US has the strongest economy (infrastructure) and the most fundamentally sound and profitable companies. The Dream Team of tech-related companies should earn the US another *gold medal*. This isn't a *slam dunk*, as the difference between the US and the rest of the world on both the court and in the equity market has narrowed. Both teams will have to play their best to win. The biggest competitors to US equity dominance are: first, Japan, where strong corporate governance, domestic inflows, and a strengthening yen could bolster performance; and, second, emerging markets, where attractive valuations, healthy earnings growth, and easing central bank policy should help.

In politics, President Biden and former President Trump have already begun wrestling—one of the oldest sports in the Olympics. The candidates are *locked in* and trying to score a *takedown*. The US election outcome in November could dramatically impact trade, immigration, tax policy, and industry regulation. As a result, expect increased market volatility over the summer and early fall. While polls show neither candidate in danger of being *pinned* yet, the match will most likely be determined in the six major swing states. Our base case is that the House and Senate shift power and result in a divided government. But we caution that the market is underestimating sweep scenarios that could lead to more significant policy shifts.

Asset allocation is more important than ever to investors' portfolios. It's like artistic swimming—above water, it is beautifully synchronized, but underwater, team members must do their part under pressure, using incredible strength and attention to detail—while holding their breath. That's our goal—to provide a well-designed asset allocation strategy without burdening you with all the complicated analysis our *top athlete* analysts do behind the scenes. Our goal is aligned with yours: podium-worthy performance for you. A skilled coach—your advisor—can help keep you in sound financial shape in both good times (like recently) and challenging times. But as gold medal-winning gymnast Simone Biles said, "The hardest days are best because that's when champions are made."

See you on the medal podium! Go U-S-A!

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RAYMOND JAMES