Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

Insights from Multi-Asset Solutions' Portfolio Managers

Quarter ending
JUNE | 2024

On the Radar Screen

1. **New unemployment insurance claims have hooked higher in recent weeks.** Some softness is welcome as it implies slower wage gains, but a significant climb — say toward 300,000 a week — would speak to something significantly more ominous.
2. **With the election approaching, the Administration may be inclined to boost fiscal support for the economy.** We are watching payouts from the Employee Retention Tax Credit program as one likely medium for such activity.
3. **The pursuit of AI riches has led to extreme market concentration in a handful of mega-cap technology companies.** The ability of firms like Alphabet, Apple, Microsoft, and most especially NVIDIA to meet lofty sales and profit expectations will have a profound impact on the overall market.
4. **Lower- and middle-income cohorts have been squeezed by the one-two punch of high inflation and high interest rates.** Aggregate consumer spending has thus far remained solid, but that may change as more households come under pressure. Retail sales data is a useful barometer.

"The public buys most at the top and the least at the bottom." – Bob Farrell

Top heavy. Investors' collective love affair with all things AI has been a boon to index performance over the past two years but has led to a disconcerting market structure in which a handful of tech titans command enormous valuations. It's been reported that capital flows have favored the technology sector to the near exclusion of all else in recent quarters. Not since the height of the dotcom bubble has wealth become so concentrated. That makes for a potentially fragile dynamic. Any disappointment — be that from disillusionment with the pace at which AI applications can be effectively deployed; an earnings miss due to the very high costs associated with rolling out these new technologies; or regulatory intervention in the name of restoring competition — could lead to a rout for these names in particular, but one with significant implications for the broader market given the prominence of these firms within major indexes. Valued at more than $3 trillion and trading at an eyewatering 40+ times prior year sales, NVIDIA in particular is deserving of our attention. The company, which few were familiar with just two or three years ago, has fewer than 30,000 employees, meaning that it is valued at over $100 million per employee. Its intellectual property is apparently without peer at present, but there are a multitude of chip manufacturers investing heavily in this area. Competition is on the horizon. Will NVIDIA be able to preserve the fat profit margins it currently enjoys and maintain its valuation premium amid heightened competition?

"There is nothing to be learned from the second kick of a mule" – Mark Twain. This state of affairs is hardly new. We could have (and did) say very similar things a year ago. And yet here we sit with the technology behemoths having posted rapid earnings growth and big price gains in the months since. A fall may be coming, but that doesn't mean it has to come anytime soon. Those of us who cut our teeth in the '90s can recall a comparable experience during which stock prices felt unmoored from intrinsic value, yet they continued their ascent far beyond expectation with the S&P 500 posting returns exceeding 20%

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for five consecutive years (Fed Chairman Greenspan's famous "irrational exuberance" comment was made in December of '96, fully three years before the market finally peaked). We learned our lesson then and wish not to repeat the exercise. Accordingly, we do not advocate shying away from these names for the cost of doing so can be quite steep. But invest with eyes wide open to the possibility that significant volatility may lie in the not-too-distant future — and maybe don't lean too hard into this theme.

"Are we confident our forecasts will be right? No." – Jerome Powell, Federal Reserve System Chairman. Economic forecasting is difficult. That the head of an institution employing scores of PhDs charged with doing precisely this should so candidly admit their lack of conviction in their own work is simultaneously heartening (we're not the only ones that find this challenging) and disheartening (if the Fed can't do it, what's the point in even trying?). Tennis great Roger Federer recently reminded us that we don't have to be right much more frequently than wrong to make a difference. He pointed out that in winning roughly 54% of individual points over the span of his career he prevailed in almost 90% of matches. In that spirit, we'll continue to take a stab at reading the tea leaves, reassured that we can still win the game even when blowing individual calls with some regularity.

From our vantage point, the soft-landing narrative appears to be still intact. The May payrolls number notwithstanding, the preponderance of labor market indicators (household survey, temp help, quits rate, perceptions of job availability, etc.) suggest modest slack is building without falling off a cliff, allowing wage growth to cool. Inflation readings are noisy month to month and even quarter to quarter, but the broad trend lower persists with an important tick down in the services ex-housing metric. Weak consumer confidence readings and high interest costs on revolving debt will keep a lid on household spending, but that's not to say that final demand is rolling over — it continues to grow at a sustainable pace. Capex within the tech sector is a bit of a runaway train, but business expenditures otherwise are reasonable. Likewise, fiscal policy remains supportive, but the administration has thus far wisely refrained from fully opening the spigot. Taken together, all seems well on the economic front.

That said, it's hard to be overly excited about prospects in capital markets given rich starting valuations in both equities and credit. With earnings likely to grow at a steady clip over the next several quarters, we continue to lean gently into risk, but upside potential is limited, given that much good news is already embedded in pricing — particularly among large-cap growth stocks.

There is no assurance that the investment objectives will be met.

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