by CHRIS KONSTANTINOS, CFA

THE RIVERFRONT WRITING TEAM

ADAM GROSSMAN, CFA
Global Equity CIO | Partner

CHRIS KONSTANTINOS, CFA
Managing Partner |
Chief Investment Strategist

KEVIN NICHOLSON, CFA
Global Fixed Income CIO | Partner

DOUG SANDLER, CFA
Vice Chairman

ROD SMYTH
Chairman of the Board of Directors

DAN ZOLET, CFA
Associate Portfolio Manager

SUMMARY

- Riverfront believes the probability of recession is lower than market consensus.
- Our 'Recession Dashboard' suggests US resilience, with low financial stress and improving leading indicators.
- Labor market and consumer signals are more mixed, however.

08.20.2024

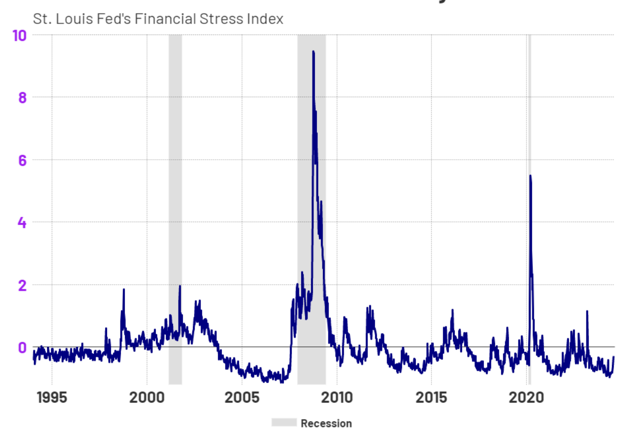
'Recession Dashboard' Update: US Remains Resilient

With US payroll and unemployment data surprising to the downside two Fridays ago, Treasury markets quickly repriced the probability of impending recession, helping set off a volatility spike in stocks across the world. According to Bloomberg, economists' consensus probability of a US recession in the next twelve months is now approximately 30%. By diving deep into our 'Recession Dashboard' – a mosaic of various indicators that, in our experience, gives insight into impending recession risks – **we believe the probability of recession is below what the market is currently pricing in.**

Bond Market Signals: Positive — Lack of Stress So Far in the Financial System

We view the fixed income markets — both government and corporate — as a useful source of macroeconomic signals. For instance, high yield credit yields relative to higher quality corporate and treasury securities have risen some recently, but remain benign overall, in our view. The St. Louis Fed produces a 'financial stress' index consisting of a composite of eighteen different indicators mostly related to interest rates and fixed income yield spreads (Chart 1, below). This indicator remains well below zero, indicating a lack of financial stress in the system. Last, US loan growth remains positive, suggesting banks continue to have both demand and the risk appetite to continue to provide capital to companies.

But what about the yield curve inversion[1] discussed in previous versions of our Recession Dashboard? Any competent economic forecaster must be intellectually honest about the efficacy of their tools — and anyone solely using yield curves to try and predict the timing of a US recession since 2022 would have been sorely disappointed. The Fed's unprecedented monetary policy intervention since the financial crisis in 2008 may have decreased the efficacy of this indicator during the current cycle.



Source: LSEG Datastream, RiverFront. Data weekly as of August 5, 2024; gray bars indicate recession. Chart shown for illustrative purposes only. Past performance is no indication of future results.

Labor Market Signals: Mixed – Valid Concerns... But Not Uniformly Negative

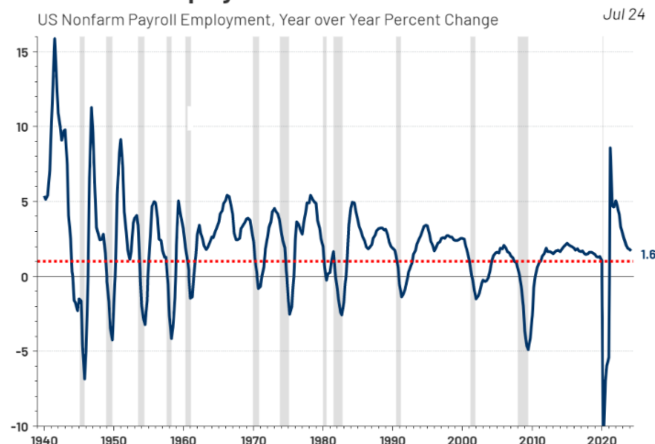
Slowing employment trends can give important warning signals concerning the health of the economy. The weaker than expected payrolls report and the move up to 4.3% in the July unemployment rate caught investors' attention. However, we would note that more

[1] *An inverted 'yield curve' – the difference in yield between long-term and short-term interest rates - has historically been a signal of impending recession, as falling long-term interest rates often mean bond investors expect some combination of lower future inflation and growth. When they fall below the levels set by the Federal Reserve, the bond market is suggesting the Fed has raised rates too much.*

than half of the unemployment increase was related to 'temporary layoffs' — a category possibly affected by inclement weather, and one that does not tend to strongly correlate to recession risk, in our view. Helping corroborate this point, other employment-related indicators such as our non-farm payroll tracker — while clearly slowing from 2023's torrid pace — remains above 1%, a level we view as being consistent with suggesting imminent recession (red dotted line, Chart 2, below).

Consumer-Related Signals: Mixed - Confidence Weak, but Spending Solid

Monitoring the consumer is important, given that consumer spending represents nearly 70% of the US economy. Here the news is mixed. A large drop in the difference between the Conference Board's Consumer Expectations Index and its Present Situation Index has historically presaged recession, but the lag times vary greatly. This indicator has been in negative territory consistently since inflation flared in the wake of the pandemic. However, in addition to the level of this indicator, we think direction also matters. From a directional perspective, this indicator has been generally trending up (i.e., less negative) since February of last year, as inflation started to trend down. This seems more congruent with strong recent retail sales and personal consumption expenditures (PCE) data, as well as positive earnings and commentary from the largest retailer in the US by volume. Putting the mosaic together, we would currently categorize the US consumer as wary but resilient…particularly among higher earners.



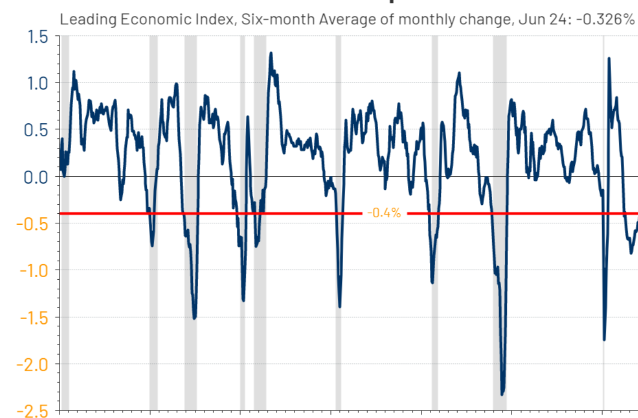
Source: LSEG Datastream, RiverFront. Data monthly as of July 2024; gray bars indicate recession. Chart shown for illustrative purposes only. Past performance is no indication of future results.

Construction Spending: Positive – More Measured but Growing

Construction plays an important role as a job creator across many industries and as a driver of demand for both natural resources and finished goods. Construction spending grew around +6% as of June, the most recent data release. We track this closely, as construction spending historically has a high correlation to US GDP. Another related data point is yearly heavy truck sales[2], which are running around 40k units/month…suggesting reasonably strong demand for goods and construction.

Leading Economic Indicators (LEI): Positive – LEI Continues to Improve

The Conference Board's 'Leading Economic Indicators' (LEI)[3] is a predictive variable that is designed to anticipate turning points in the business cycle by roughly 7 months. The LEI has now risen consistently since the spring and has now moved above the level which we typically associate with pre-recessionary conditions (red line, Chart 3, at right). Other indicators of economic activity we track tell a similarly constructive story; US composite Purchase Managers Index (PMI) readings are still in expansionary territory, and US industrial production recently hit a cycle high. Lastly, we would note that potentially one of the best leading indicators of the economy — the stock market itself — remains only a few percentage points off its' all-time high made in July…even after the recent bout of volatility.



Source: LSEG Datastream, RiverFront. Data monthly as of June 2024; gray bars indicate recession. Chart shown for illustrative purposes only. Past performance is no indication of future results.

[2] *Heavy trucks weigh over 26,000 pounds and include 18-wheeler tractors, cement mixers and city buses.*

[3] *The LEI is comprised of ten indicators related to employment, business orders, residential housing demand, stock market prices and bond market credit conditions.*

CONCLUSION: Weight of Evidence Does Not Suggest Imminent Recession

The weight of the evidence in our dashboard points to a slowing US economy in the back half of the year in our view, but not a recession. This is commensurate with a US economy that, according to the Atlanta Fed's GDPNow tracker, is growing at close to a 2.5% clip for Q3, a little slower than last quarter. While we do not expect as many rate cuts as the market is pricing in, we do expect the Fed to cut in '24 — a stance underlined by benign recent inflation data such as last week's lower-than-expected producer price inflation (PPI) and in line consumer inflation (CPI) readings.

While stock volatility is likely to remain elevated into the US election, we believe an growing economy combined with a likelihood of Fed rate cuts should continue to be constructive backdrop for equity investors. We remain overweight stocks, with an emphasis on the US, across our balanced portfolios. However, in keeping with our investment mantra of 'Process Over Prediction,' we recognize data can change quickly and we will remain vigilant in monitoring macro risks.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

Important Disclosure Information:

The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Information or data shown or used in this material was received from sources believed to be reliable, but accuracy is not guaranteed.

This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

Chartered Financial Analyst is a professional designation given by the CFA Institute (formerly AIMR) that measures the competence and integrity of financial analysts. Candidates are required to pass three levels of exams covering areas such as accounting, economics, ethics, money management and security analysis. Four years of investment/financial career experience are required before one can become a CFA charterholder. Enrollees in the program must hold a bachelor's degree.

All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit www.riverfrontig.com or contact your Financial Advisor.

Index Definitions:

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Definitions:

The dividend yield, expressed as a percentage, is a financial ratio (dividend/price) that shows how much a company pays out in dividends each year relative to its stock price.

The Composite Index of Leading Indicators, otherwise known as the Leading Economic Index (LEI), is an index published monthly by the Conference Board. It is used to predict the direction of global economic movements in future months. The Index is composed of 10 economic components whose changes tend to precede changes in the overall economy. Businesses and investors can use the index to help plan their activities around the expected performance of the economy and protect themselves from economic downturns.

The Expectations Index is a component of the Consumer Confidence Index® (CCI), which is published each month by the Conference Board. The CCI reflects consumers' short-term—that is, six-month—outlook for, and sentiment about, the performance of the overall economy as it effects them. The Expectations Index is made up of the average of the CCI components that deal with six-month outlooks for business, employment, and income.

The Present Situation Index is a subindex that measures overall consumer sentiment regarding the present economic situation. This index is determined via a survey conducted for the Conference Board by Nielsen, and it is used to derive the Consumer Confidence Index. This is also sometimes known as the Current Situation Index.

Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by people of the United States. According to the Bureau of Economic Analysis (BEA), a U.S. government agency, PCE accounts for about two-thirds of domestic spending and is a significant driver of gross domestic product (GDP).

Real gross domestic product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. Real GDP is expressed in base-year prices. It is often referred to as constant-price GDP, inflation-corrected GDP, or constant-dollar GDP. Put simply, real GDP measures the total economic output of a country and is adjusted for changes in price.

The Purchasing Managers' Index (PMI) is an indicator of the prevailing direction of economic trends in the manufacturing and service sectors. The indicator is compiled and released monthly by the Institute for Supply Management (ISM), a nonprofit supply management organization.

A yield curve is a line that plots yields, or interest rates, of bonds that have equal credit quality but differing maturity dates. The slope of the yield curve can predict future interest rate changes and economic activity. There are three main yield curve shapes: normal upward-sloping curve, inverted downward-sloping curve, and flat.

RiverFront Investment Group, LLC ("RiverFront"), is a registered investment adviser with the Securities and Exchange Commission. Registration as an investment adviser does not imply any level of skill or expertise. Any discussion of specific securities is provided for informational purposes only and should not be deemed as investment advice or a recommendation to buy or sell any individual security mentioned. RiverFront is affiliated with Robert W. Baird & Co. Incorporated ("Baird"), member FINRA/SIPC, from its minority ownership interest in RiverFront. RiverFront is owned primarily by its employees through RiverFront Investment Holding Group, LLC, the holding company for RiverFront. Baird Financial Corporation (BFC) is a minority owner of RiverFront Investment Holding Group, LLC and therefore an indirect owner of RiverFront. BFC is the parent company of Robert W. Baird & Co. Incorporated, a registered broker/dealer and investment adviser.

To review other risks and more information about RiverFront, please visit the website at riverfrontig.com and the Form ADV, Part 2A. Copyright ©2024 RiverFront Investment Group. All Rights Reserved. ID 3799897