2024 Midyear *Review & Outlook*

As of June 30, 2024

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PRIVATE WEALTH

At mid-year we pause to reflect on the events of the first half and contemplate the implications for the remainder of the year.

Executive Summary:

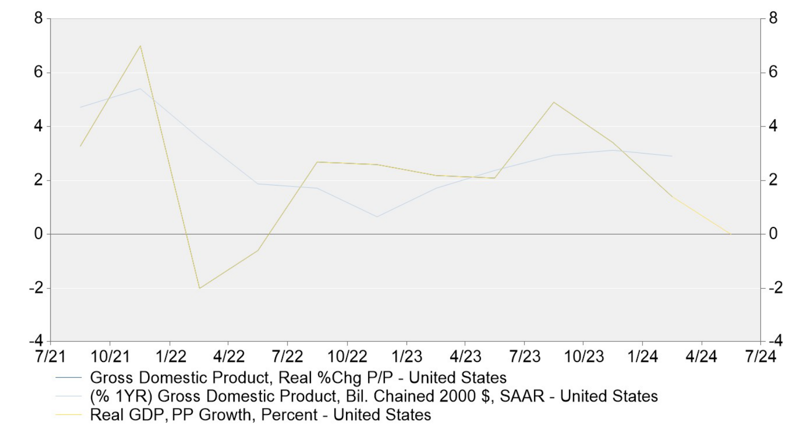
- Central Bank actions have had a profound impact on the broad economy and financial markets.
- Inflation remains stubborn, especially housing and wages, so the Fed's Policy Interest rates are unlikely to change much during the remainder of the year.
- The Consumer has been resilient but is showing cracks around the edges.
- Corporate profitability is at record levels but facing lower projected growth.
- Geopolitical issues are popping up around the world: armed conflicts, snap elections, and potential trade tensions loom. The U.S. election may have profound implications regarding policy.
- Equity markets have enjoyed robust returns albeit with narrow leadership.
- Fixed income markets have struggled in the face of rising interest rate, that now may have peaked.
- The forward view for equities and fixed income are muted based on current valuations and prospects for a slowing economy.
- The case for a comprehensive a financial plan to provide context for investment decisions is strong.

Don't fight the Fed…

During the first half, the old adage 'don't fight the Fed' has been alive and well. Monetary policy, and the anticipation of its direction, was one of the most influential drivers of the first six months. The level of interest rates has had a profound impact on the consumer and the resultant pace of economic activity. Persistent inflation, particularly the 'sticky' components of housing and wages, has kept policy restrictive for longer than initially expected by market participants. The Federal Reserve has consistently reiterated their key messages of "higher for longer" and "data dependence". The latest dot plot suggests two rate cuts in 2024. The CME FedWatch tool now indicates the probability of a September rate cut of 25 basis points (0.25%) at 64%. The path to lower rates is on track albeit delayed from expectations earlier in the year.

Still above Stall Speed …

The economy is expanding. Gross Domestic Product (GDP) was reported during the last week of June. First quarter showed expansion of 1.4 %, and an annualize pace of 2.9%. While declining from the past two quarters, the pace remains above stall speed. Notably, the World Bank increased its outlook for 2024 growth to 2.5% from 1.6%.



The May results of the Conference Board's Leading Indicators which provides a forward, view of economic conditions, shows a moderately expanding economy. The Index declined by 0.5% for the month and has contracted 2.0% over the past six months. The readings are strong enough to suggest that the U.S. avoids a recession but point to muted growth over the foreseeable future.

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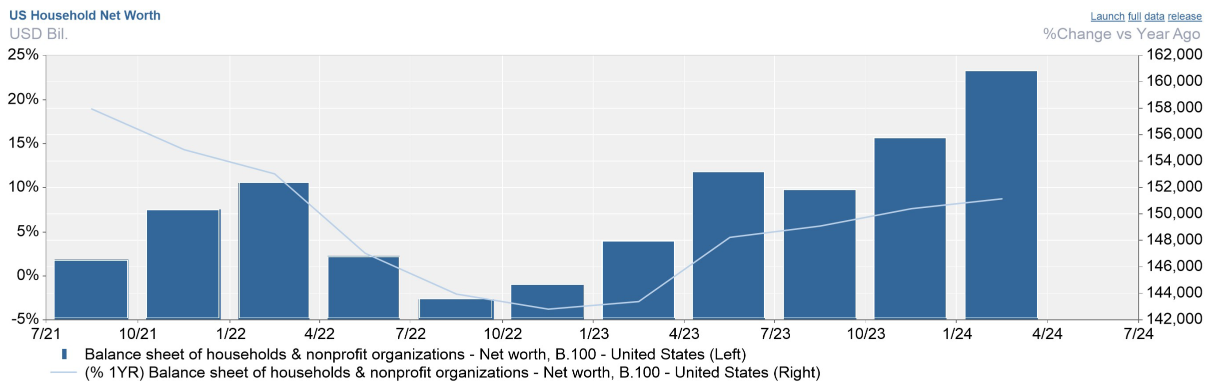
The mighty Consumer may be ready to rest …

Consumer activity represents over two-thirds of the U.S. economy. The combined expectations for the future regarding employment, access to credit, and household net worth support the propensity to spend.

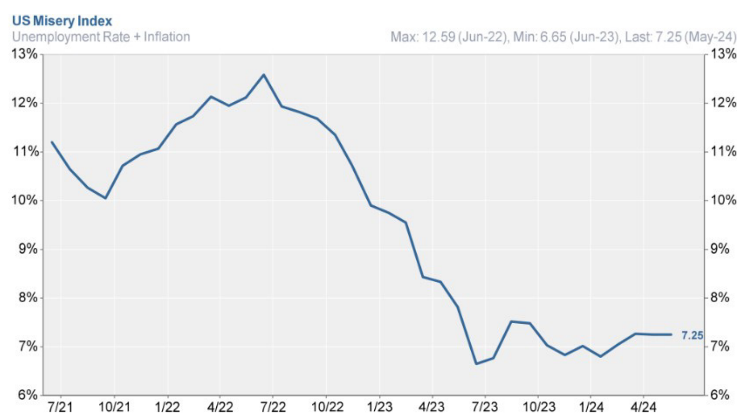
The Consumer Price Index report showed broad based progress toward reaching the 2% inflation target and is supportive of the Fed's message.



Inflation cooled to the lowest rate in three years with headline inflation month-over-month at 0% and core (excluding food and energy) up a modest 0.2%. The annualized headline inflation rate was 3.3% while core was 3.4%, both were 0.1% better than consensus. Similarly, the core personal consumption expenditure (PCE), the Fed's preferred inflation gauge, rose just 0.1% in May, down 0.2% from the April read. Full year-over-year core inflation marked a 2.6% increase, the lowest in three years. May headline inflation matched core at 2.6%, in line with expectations.

The unemployment rate stands at 4.0% which is below the long-term average of 5.7%. Weekly jobless claims have been trending slightly higher and are at the highest since August 2023. Continuing claims surpassed 1.8 million for the first time since November 2021. The weakening labor market suggests that the Fed's approach is working, although, we note that labor is a coincident indicator. Waiting until labor weakens invites criticism that the Fed has waited too long to begin its easing cycle.

The combination of the unemployment rate and inflation is captured in the Misery Index. As inflation has cooled and employment remains steady, the relative 'economic pain' felt by households should be moderating. The combination of higher prices and higher unemployment is impacting consumer sentiment. Despite the decline in the Misery Index, the May result of the University of Michigan's Consumer Sentiment index perked up to 68.2 after recording its lowest reading in seven months in the prior period.



U.S. households have been drawing down savings and tapping credit to fund purchases. U.S. consumer credit expanded at the fastest rate since the end of 2007. Total credit card balances increased to $1.3T, the highest since the New York Fed began tracking in 1999. The savings rate has fallen from an artificially high level of 9% (due to pandemic related stimulus) to 3.6%. Real Household Consumption Growth is expected to remain steady at 2.2% in 2024, and cool in 2025 to 1.9%.

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Household net worth continues to climb. For those with investable assets, the strong equity markets, along with appreciating home values, have provide a strong recovery in net worth. The increase insulates households from the direct impacts of inflation and employment. The bifurcated experience of the 'haves' and the 'have nots' is a politically charged issue that will garner much attention in the coming election cycle.

Expanding margins & higher estimates …

After enduring margin compression during the pandemic due to lack of pricing power and increased input costs due to supply disruption, corporations have been able to regain some control. In the second quarter, corporate profit margins for S&P 500 companies expanded to a record of 13.54%. The rebound in margin has buoyed full year consensus earnings estimates of $244.73, a 10.5% increase over 2023. The estimate for 2025 is $279.06 per share, a 14.0% increase. This rebound and expectation for future growth provides the underlying support for the current (elevated) market valuation.

The greatest show on earth …

Buckle up… election season is coming.

The Presidential Debate between President Biden and former President Trump is in the books. The first 90-minute debate was hosted by CNN on June 27th. The format included no studio audience and muted microphones during opponent's commentary. Fact checkers remained fully employed throughout the evening. Attention now turns to the Republican and Democratic party conventions where they will make their formal candidate selections.

Over time, the market continues to advance regardless of the combination of party leadership in Washington. The underlying driver of growth is corporate profits. That said, the environment for growth is significantly impacted by tax policy, trade policy, and the relative change in the complexities of regulation. Higher taxes, restrictive trade and higher levels of regulation tend to hamper economic activity and corporate profitability.

A review of S&P 500 returns during the post-WWII era indicates that market returns tend to excel during periods split control of Congress. Likely, when control is split, neither party can enact extreme policy changes. The nature of the division requires negotiation and compromise which retrains actions.

Equity Market & Party Control
(S&P 500 Total Return)

President	R	D	D	R	R/D	R/D	R	D	R/D
Senate	R	D	R	D	R	D	Split	Split	Split
House	R	D	R	D	R	D	Congress	Congress	Congress
	9.82%	**12.18%**	**17.03%**	**8.58%**	**13.18%**	**10.50%**	**16.26%**	**19.84%**	**17.61%**
	Average 12.47%								

Sources: Standard & Poors; History.House.gov; MidWestOne Private Wealth Management

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The upcoming Presidential Election cycle will shine a light on the budget deficit, now projected to be at $1.9T for 2024, and the national debt as a percentage of GDP, now at 124.6%. The current pace is unsustainable. In addition to spending, tax and trade policy decision loom large. The Tax Cut and Jobs Act is scheduled to sunset at the end of 2025, unless acted upon by Congress. With no action, the tax rate for the majority of filers would increase along with changes to the standard deduction, child tax credit and estate/gift tax exemptions.

Government spending, outside of transfer payments such as Social Security, represents about 17.5% of U.S. GDP. Consensus forecast for Real Government Consumption Growth in the U.S. are +2.5% in 2024 and +1.1% in 2025. Split control of the Legislative and Executive branches of government has set the stage for contentious debate regarding the Debt Ceiling and future spending. So far in 2024, both sides have shown little willingness to compromise.

Issues such as the debt limit and total government debt as a percentage of national output require attention, especially in election years. In 2024 the interest payment on the debt is about 19% of the federal budget. As rates have risen, the interest expense curtails spending on other items. The narrow senate and house majorities have little room to maneuver, and many votes follow political party lines. The elevated rhetoric during the election cycle has implications on both consumer and investor sentiment.

U.S. government trade policy will be important post-election. The U.S. imports more goods & services than we export. The government often attempts to exert influence over foreign partners via the use of tariffs (a tax on imported goods). The use of tariffs is inherently inflationary. The political discourse regarding the expansion of the use of tariffs is something to pay attention to.

Increasing Risk of Conflicts …

Geopolitical issues are taking center stage as we head into 2024. The Russia-Ukraine and Israeli-Palestinian conflict are in full force. Rising food and energy prices create a strain, especially in those countries dependent on the export of Russian wheat. The shipping in the Red Sea is slowing due to attacks by Iranian-backed Houthi militias. The impact to shipping costs is inflationary as longer trade routes are utilized. In addition, China's President Xi has reportedly told US President Biden that China intends to 'reunify' Taiwan. The cumulative impact is disruption to trade and potentially slower growth.

The Chinese economy is forecast to grow in 2024 and 2025 by 4.8% and 4.3%, respectively. These growth rates are muted from the double-digit rates experienced over the past decade. The slow pace of growth in China will permeate to emerging market economies that supply raw materials.

Snap elections have been called in France (voting beginning June 30th) and the United Kingdom (July 4th). In France, support for Macron's centrist coalition is fading and influences of the far left and far right are poised to influence the new government. Similarly in the UK, Tory Prime Minster Sunak shocked voters by calling a snap election on July 4th, months earlier than expected. Early polling was predicting strength by opposition parties. Both elections inject relative uncertainty, into markets that hate uncertainty. On the bright side, the election cycles last only a few weeks.

With the backdrop of solid economic activity, the Fed's stable rate outlook and increasing global unrest, the trade-weighted U.S. Dollar has strengthened over 4% since the beginning of the year. For those travelling internationally or buying foreign goods, this strength is a benefit. For U.S. exporters and U.S. based investors the strength is a headwind as foreign currency is translated back into dollars at a lower rate.

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Equity markets mixed …. Fixed income soft...

U.S. Equity markets have finished the first half of the year with mixed results. Domestic large cap and multi-cap growth have enjoyed the gains. Small/Mid value, heavy in real estate and smaller financial firms, have endured headwinds. In terms of both style and sector, the story of the year so far has been the boon in Technology and Communication Services. Just a handful of companies have pulled the market along.

NVIDIA (NVDA) has been the driver of much of the markets return YTD, up 149%. The value of the company is now exceeds $3.1T and represents over 5% of the total U.S. (all-cap) market. The top seven companies in terms of market cap (MSFT, AAPL, NVDA, GOOG/L, AMZN, META) represent over 28% of the S&P 500 and account for 62% of the S&P 500's 1H'24 return of 15.27%. Market breadth has been narrow.

Valuations of S&P 500 companies as measureed by price-to-earnings (PE) are streched relative to history. Based on the full year estimate of $245, PE is 22.4x. The long-term average PE is 17.6x. While PE has a poor record of predicting the timing of market tops, it is worth noting that valuations are full relative to history.

Volatility Indicators indicate relative calm. In equities, the CBOE Volatility Index (VIX) measures expectations for 30-day stock market volatility is reading 12.46. In times of market stress the VIX will routinely exceed 20. In Fixed Income, the ICE BofA MOVE index which measures U.S. interst rate volatility is reading 98 vs 100+ in times of stress.

Market Monitor
YearTo Date (YTD) Return %

Domestic	Value	Core	Growth
Large	4.47%	14.48%	24.11%
Mid	-1.17%	5.19%	11.15%
Small	-6.03%	-1.61%	2.48%
International			
Developed			3.48%
Emerging			5.68%
Fixed Income			
Bloomberg Aggregate			-1.43%
Bloomberg US Credit HY			-0.54%
Real Assets			
Commodities			8.37%
Real Estate			-3.08%
US Dollar			4.48%

Bullish sentiment on the rise… a contrarian indicator?

Investor sentiment, as measured by the AAII Sentiment Survey, shows pessimism among individual investors decreased, and bullish sentiment increase in its latest weekly reading. The bull-bear spread increased to 16.2%, well above its historical average of 6.5% for the seventh straight week. Note that this index is a contrarian indicator. Individual investor optimism is viewed as a negative indicator of future market performance.

The Bull case is built on the likelihood of second half Fed rate cuts, moderating inflation, solid corporate earnings prospects, a firm labor market, future growth in the development of Artificial Intelligence, and an uptick in corporate share buybacks.

The Bear case points to the Federal Reserve's higher-for-longer stance, mixed economic data, narrow market breadth, full equity valuations, seasonal trends (slow summer months), the federal debt overhang, and expanding geopolitical risk.

S&P 500 Sector	YTD%
Cyclical	
Materials	3.13%
Financials	9.25%
Consumer Discretionary	5.22%
Real Estate	-4.14%
Sensitive	
Communication Services	26.09%
Information Technology	27.79%
Energy	9.09%
Industrials	6.97%
Defensive	
Consumer Staples	7.55%
Health Care	6.91%
Utilities	7.58%

Key	<-1%	-1 - 1%	+1%

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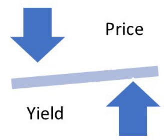
Fixed income … tough sledding…

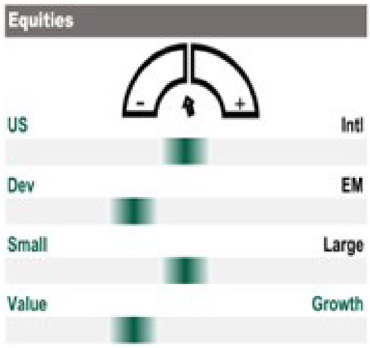
Since the first of the year, U.S. Treasury yields have risen. The 10-year yield is up 38 basis points (0.38%). As yields rise, bond prices fall. Given the upward direction in rates, the Bloomberg U.S. Aggregate Bond index has retreated a little more than 1.4 percent. High yield bonds have faced the same directional pressures but have managed to offset some of the impact by the higher interest coupon paid due to elevated credit risk and lower duration profile.



Portfolio Implications

Equities

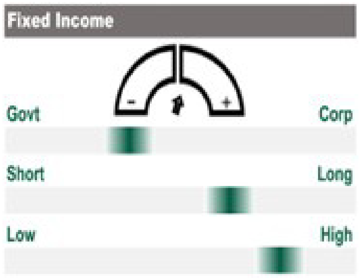
As we head into the second half of the year, we remain cautious on equities. The combination of current valuations, a stretched consumer and election uncertainty suggest a moderately defensive stance. We are currently neutrally positioned U.S. versus international, but favor developed over emerging markets.



From a style perspective, we prefer a slight bias to Value. Growth has been in the driver's seat for the better part of the last 18 months. As such, valuations have run further with this group. Russell 1000 Growth P/Es are currently 149% of their 20-year average. Russell 1000 Value P/Es are currently 112% of 20-year averages. Goldman Sachs notes that investors are paying up for Growth as a factor – it is well above the 90th percentile based on data going back to 1980. The preference for Value is slight at this point as many of the MegaCap stalwarts have delivered top-tier earnings growth and have expanded margins considerably, and to some extent, have justified the multiple expansion.

Fixed Income

In the fixed income space, based on our expectation that inflation will continue to moderate, and the Fed will lower the Fed Funds rate at least once, we are moderately long in average maturity, and favor higher quality bonds. We recommend a barbell structure.



Option Adjusted Spreads over Treasuries are narrow relative to history. The OAS on Investment Grade bonds (rated BBB and higher) based on the ICE BofA Corporate Index is just 88 basis points (0.88%). For high yield, based on the Ice BofAML High Yield index is 328 bp (3.28%). In times of market stress this spread has exceeded 1000 bp (10%). Narrowing spreads have been a tailwind for bond prices during a time of relative calm in the broad economy. As the economy slows the risk of widening spreads increases which would provide pressure on bond returns.

We expect rates to decline moderately as inflation continues to march toward the Fed 2% target. We remain moderately long duration and prefer high quality over high yield.

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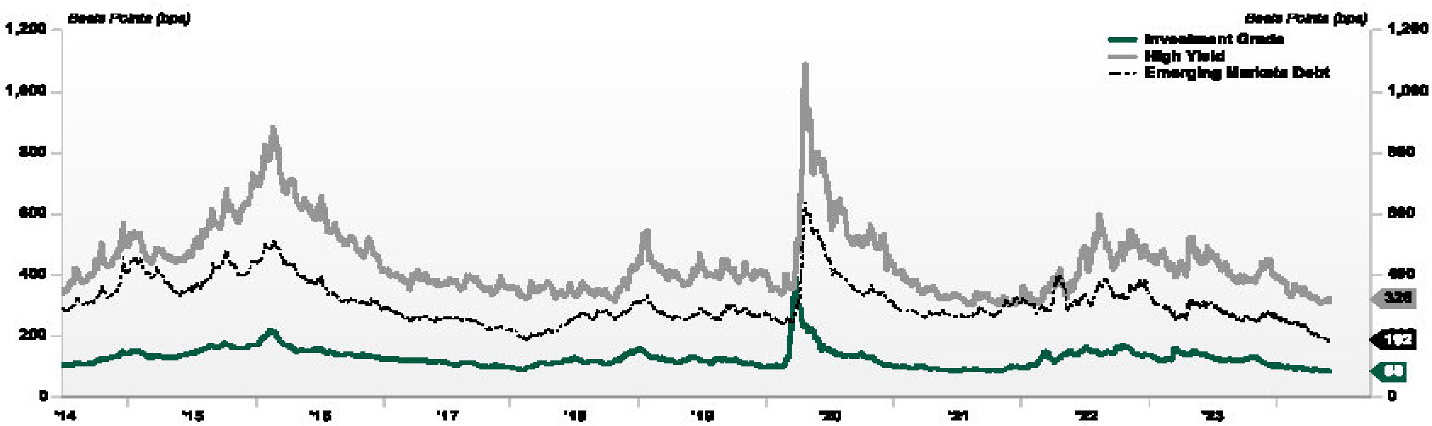
Option Adjusted Spread – 10 year history



Wrapping up ….

Equity markets have enjoyed robust returns through the first six months albeit with narrow leadership. Equities may fare better if the Fed is able to thread the needle and proactively ease monetary policy before too much damage is inflicted on the economy. Fixed income markets have struggled in the face of rising interest rates that now may have peaked. Higher quality fixed income likely fares better in a scenario where the Fed is forced to aggressively ease policy in the face of quickly deteriorating economic conditions. Other riskier asset classes would initially suffer as well (i.e., equities, and lower-quality fixed income). The forward view for major asset classes slightly favors fixed income. Expectations for equities and lower quality fixed income are muted based on current valuations and prospects for a slowing economy. The good news is that the Fed's toolbox is well-stocked with arguably their most effective tool to combat economic weakness; the Federal Funds Rate. In the coming months, we will be closely monitoring the upcoming presidential election for potential policy changes and the implications for spending policies, the budget deficit, inflation and the impact on the consumer.

The case for having a plan….

With equities valuations full and little catalyst for fixed income returns over 'coupon', the case for ensuring that you are positioned correctly is very strong. Your MidWestOne team has the required experience and resources to help you chart your path. A comprehesive plan will help you identify those goals that you value most and align your resources, cash flows and invesmtent portfolio to increase the likelihood of achieving them. Contact **your** MWO team, revisit **your** plan and optimize **your** investment strategy.

Indices used in the Market monitor S&P 500, 400 and 600. Bloomberg US Aggregate, Bloomberg US Credit High Yield (B1), MSCI Eafe, MSCI Emerging Markets, DJ Equity REIT, S&P Goldman Sachs Commodity.

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