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SUMMARY

- US consumers' balance sheets are in solid shape, in our view.
- This balance sheet dynamic is also generally true for large US companies, but less so for smaller-cap firms.
- We remain overweight in stocks, favoring US mega-caps.

07.16.2024

July 2024 Chart Pack Summary:

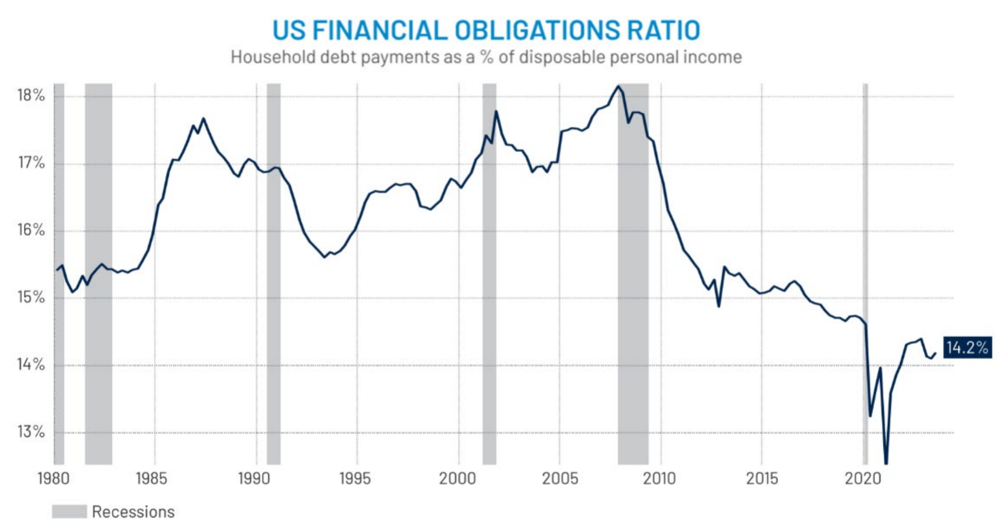
Despite Higher Rates, Consumers and Companies in Good Shape

We are excited to release our July 2024 *Chart Pack*, our visual quarterly designed to walk investors through what's happening in markets and why, what may come next, and how we are positioning RiverFront portfolios. In today's *Weekly View*, we picked a couple visuals from the *Chart Pack* to discuss.

The U.S. economy continues to defy the naysayers with its strength. The foundation for that strength is the healthy condition of both consumers' and corporations' balance sheets, an underappreciated asset in our view. For instance, many assume that the large rise in interest rates over the past two years would correspond to a skyrocketing of consumer debt service costs. However, the monthly carrying cost of that debt as a percentage of disposable personal income remains surprisingly low relative to history, as seen in Chart 1, below.

This dynamic is likely due not only to the sizable wage gains seen over the past couple of years, but also — importantly — to the fact that most US homeowners have locked in lower long-term rates on their mortgage. According to a January 2024 Redfin analysis of data from the Federal Housing Finance Agency's National Mortgage Database, almost 60% of current mortgages outstanding have an interest rate at or below 4%, and nearly 9 in 10 mortgages outstanding are below 6% — despite a 30-year fixed mortgage rate that currently stands at well over 7% for new mortgages.

Chart 1: US Consumers' Balance Sheet in Better Shape Than Widely Believed

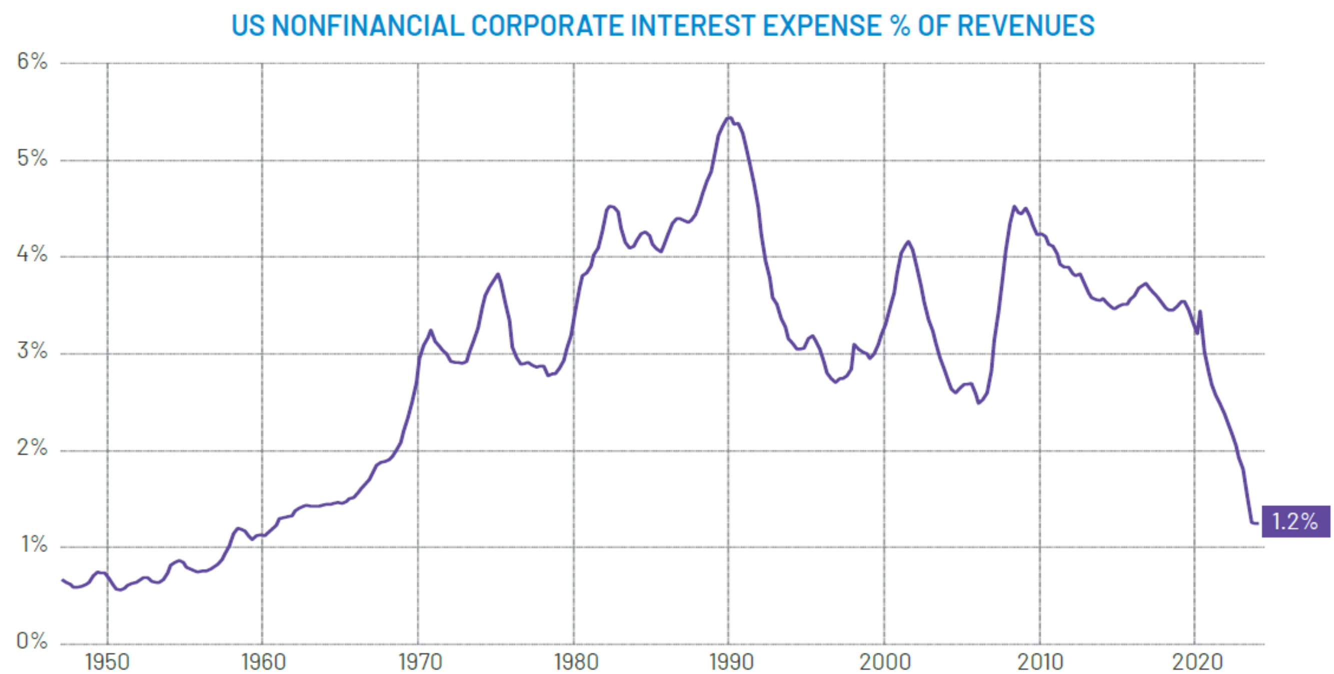


Source: LSEG Datastream, RiverFront, data quarterly, as of Q3 2023. Chart shown for illustrative purposes only.

A corollary is seen when viewing Corporate America's balance sheet through the same lens. Conventional wisdom is that higher interest rates are also a major headwind for US companies. For firms with floating debt, suspect balance sheets and cyclical cash flow, that is likely true. In fact, this dynamic is one of the reasons we remain skeptical of smaller-cap stocks, as we wrote about here. However, for many cash-rich US companies — mega-cap technology in particular — many companies are paying less in net interest expense as a percentage of revenue than prior to rate hikes, not more (see Chart 2, below). near lows last reached in the 1960s.

Many of the largest tech companies have fortress-like balance sheets, with tons of cash and low levels of debt. These types of companies have an incredible advantage over others in a world of higher rates, in our view. This is due to the curious fact that these firms have much more cash and cash equivalents sitting in money markets — earning higher rates of return — than they have debt outstanding. This enables them to make MORE money off the non-operating income generated by their higher-yielding floating rate holdings than they are paying in interest expenses. In essence, they are profiting from rates moving higher.

Chart 2: Corporate America Is Cash-Rich and Relatively Unaffected by Higher Rates



Source: LSEG Datastream, RiverFront, data quarterly, as of Q1 2024. Chart shown for illustrative purposes only. Mega cap is a designation for the largest companies in the investment universe as measured by market capitalization. While the exact thresholds change with market conditions, mega cap generally refers to companies above $200B.

CONCLUSION

The adage 'Sell in May and Go Away' may be weighing on investors' minds in the summer months, a time of lighter news flow and trading volume. The market averages about one double-digit pullback in a calendar year, which we have yet to experience in '24 — this suggests to us the ride could get rockier, especially as we move closer to US election time.

However, our read on stocks' internal 'heartbeat' — the message embedded in the market's price action — remains strong. Further, we believe the current bull market is based on solid fundamentals, not simply irrational exuberance. The economic strength discussed earlier is filtering into corporate earnings strength, one of the most important determinants of stock prices, in our view. Our asset allocation portfolios remain overweight stocks, with an emphasis on the US.

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.

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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.

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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.

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.

Standard & Poor's (S&P) 1000 Index (US SMID Cap) – the S&P MidCap 400 Index and the S&P SmallCap 600 Index are combined to form the S&P 1000.

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).

Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.

High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.

Dividends are not guaranteed and are subject to change or elimination.

Definitions:

Mega cap is a designation for the largest companies in the investment universe as measured by market capitalization. While the exact thresholds change with market conditions, mega cap generally refers to companies with a market capitalization above $200 billion.

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.

Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

In a rising interest rate environment, the value of fixed-income securities generally declines.

Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.

Consumer debt consists of personal debts that are owed as a result of purchasing goods that are used for individual or household consumption.

Disposable income is the amount of money that an individual or household has to spend or save after federal, state, and local taxes and other mandatory charges are deducted.

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