3rd Quarter 2024

Data as of July 5, 2024

Nationwide Market Insights℠

Our perspective on the market and economic forces influencing investment planning and retirement

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Nationwide Market Insights℠

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Executive Summary

Risk assets stayed on an encouraging path through mid-year as buoyant job and wage gains kept consumers spending and the broader economy maintained positive momentum. Some warning signs are visible in the economic data, but they are not significant enough to throw our constructive growth outlook off track. Fed officials maintain a consistent message, saying they need to see more encouraging data before they can be confident that inflation is on a sustainable downward trajectory.

We expect gradually cooling GDP growth through year end as the Fed successfully navigates a soft landing for the economy. We believe inflation will ease, though the path to achieving the Fed's two percent objective may be long and bumpy. We think the Fed will wait until September to start lowering interest rates amid risks of a later start and fewer rate cuts if inflation and the economy remain resilient.

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Financial Markets

Highlights

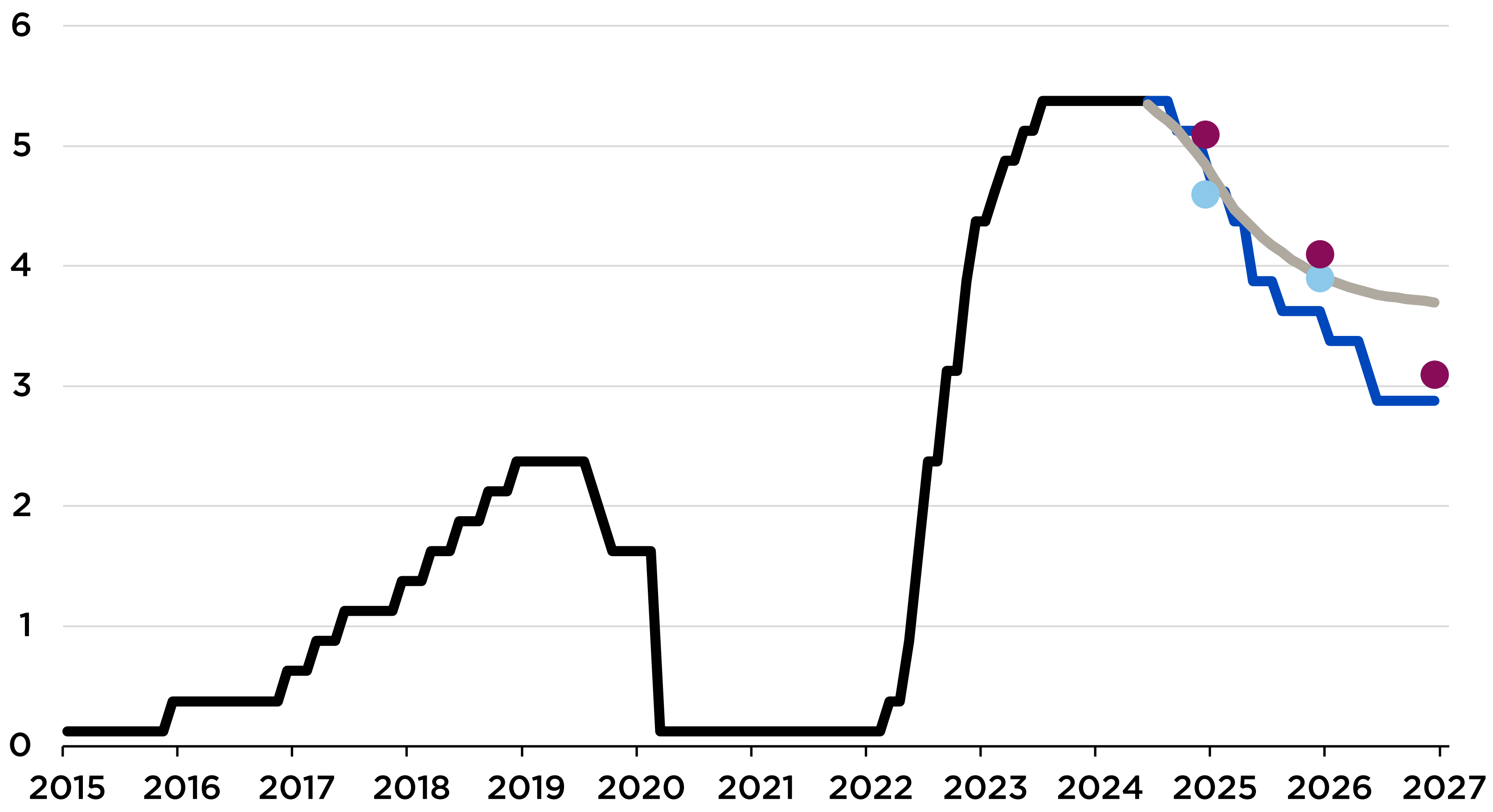
Fed needs more confidence ahead of rate cuts

Fed policymakers believe monetary policy is restricting growth and inflation, but the data are not yet ensuring that two percent inflation is firmly within reach.

While there are risks around the start and extent of Fed policy easing, we think conditions will be right in September for them to start lowering interest rates. We expect the FOMC to lower rates twice in 2024, reducing the target range for the fed funds rate by a cumulative 50 basis points to 4.75 - 5.00 percent by year end.

Fed funds expectations

Percent



- History
- Nationwide's Forecast
- Current Bond Market Expectations
- FOMC's March 2024 Median Forecasts
- FOMC's June 2024 Median Forecasts

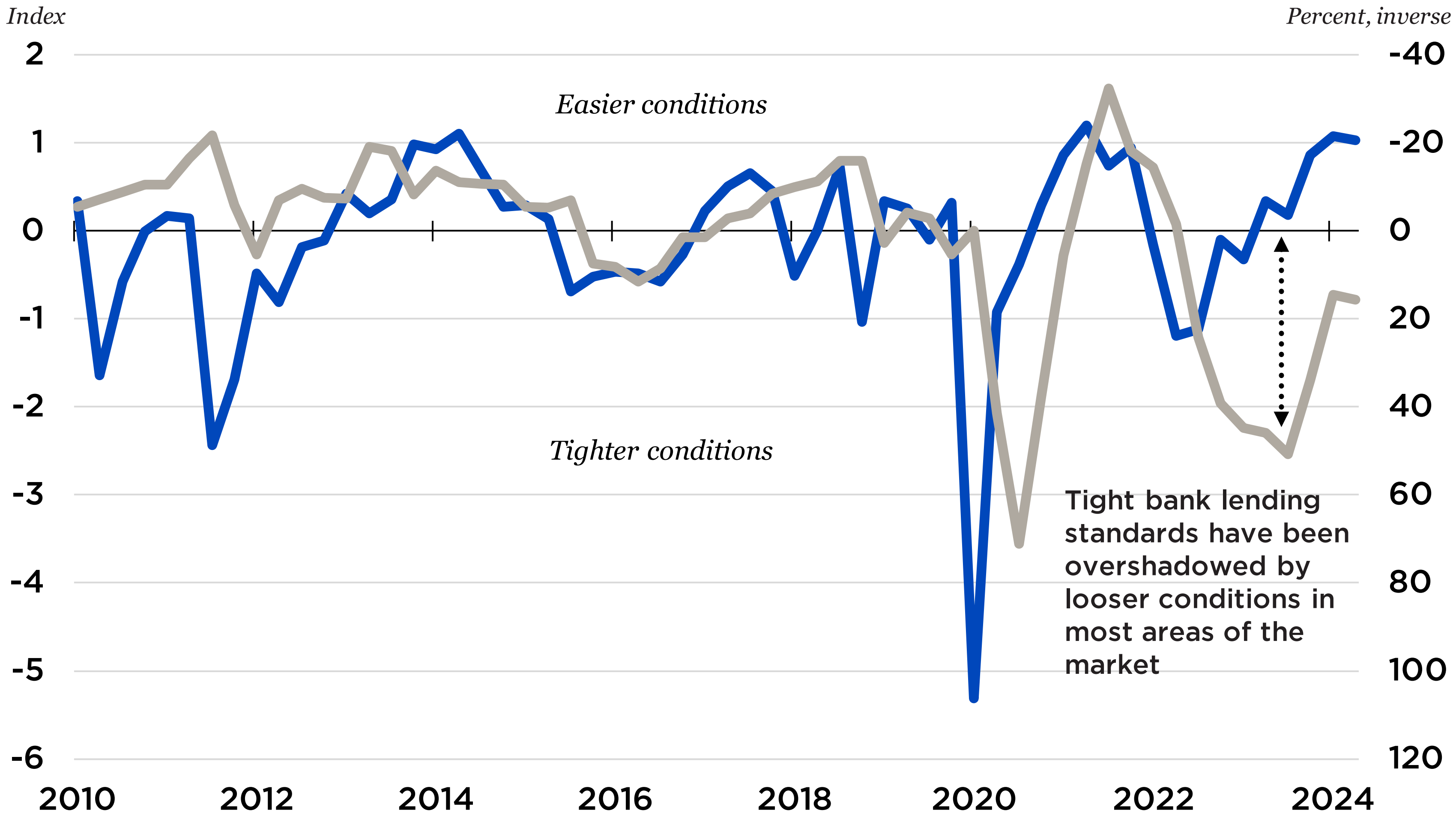
Source: Federal Reserve, Bloomberg, CME, SOFR Futures Data, Nationwide Economics

Financial conditions support a continued economic expansion

Financial conditions in aggregate remain accommodative. This presents upside risks to GDP growth and inflation as well as the path of interest rates.

Importantly, not all sectors of the financial market are bolstering economic activity. Persistently restrictive bank lending standards are constraining activity, namely on the equipment spending front and for small and medium-sized businesses.

Bloomberg Financial Conditions Index & bank lending standards



Source: Bloomberg, Federal Reserve, Haver Analytics, Nationwide Economics

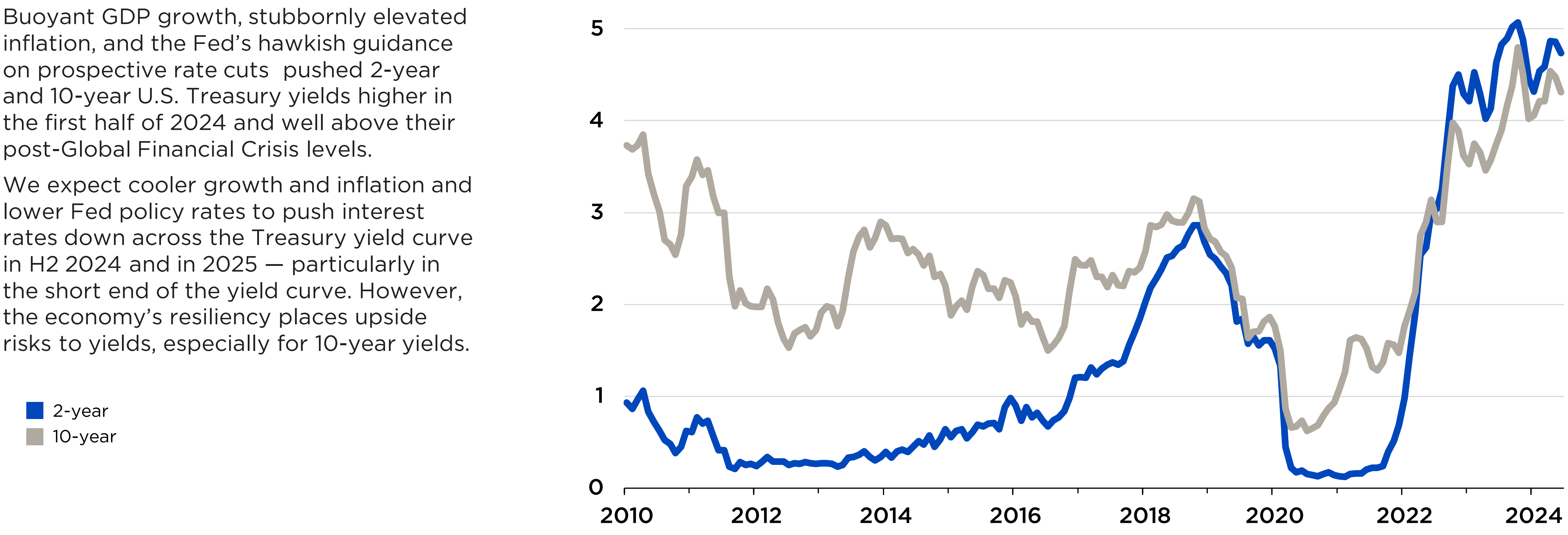
Treasury yields climb higher

Buoyant GDP growth, stubbornly elevated inflation, and the Fed's hawkish guidance on prospective rate cuts pushed 2-year and 10-year U.S. Treasury yields higher in the first half of 2024 and well above their post-Global Financial Crisis levels.

We expect cooler growth and inflation and lower Fed policy rates to push interest rates down across the Treasury yield curve in H2 2024 and in 2025 — particularly in the short end of the yield curve. However, the economy's resiliency places upside risks to yields, especially for 10-year yields.

2-year and 10-year U.S. Treasury yields

Percent



Source: Bloomberg, Nationwide Economics

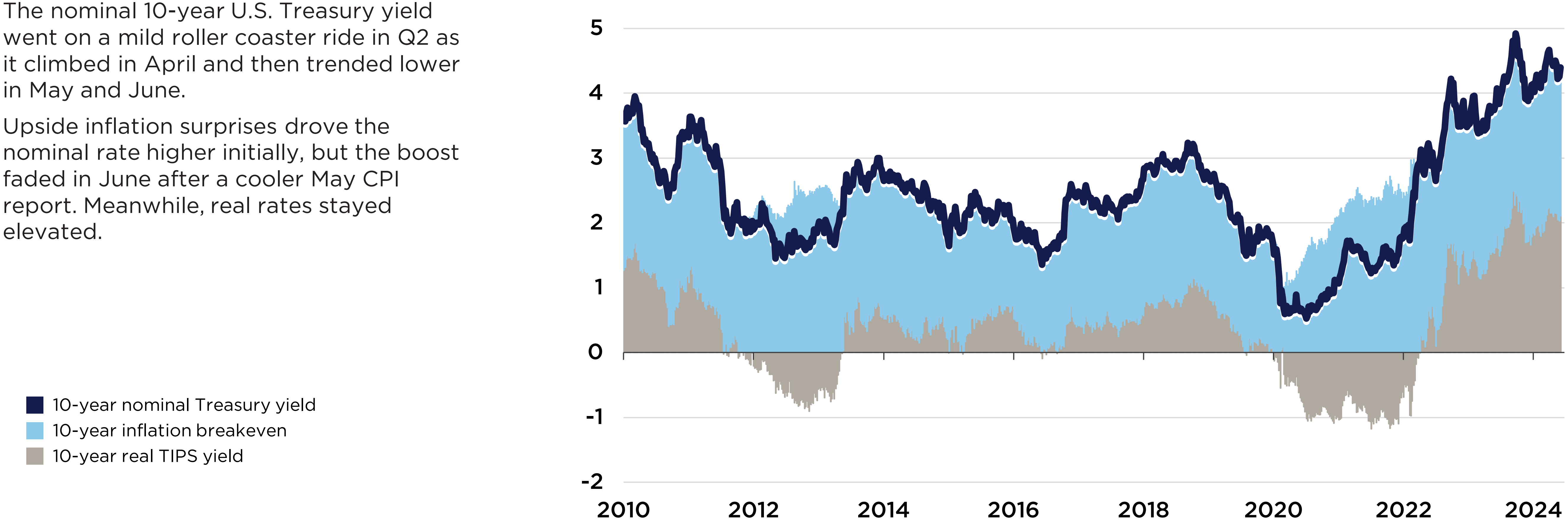
Buoyant growth keeps real rates elevated

The nominal 10-year U.S. Treasury yield went on a mild roller coaster ride in Q2 as it climbed in April and then trended lower in May and June.

Upside inflation surprises drove the nominal rate higher initially, but the boost faded in June after a cooler May CPI report. Meanwhile, real rates stayed elevated.

Breakdown of the 10-year U.S. Treasury yield

Percent



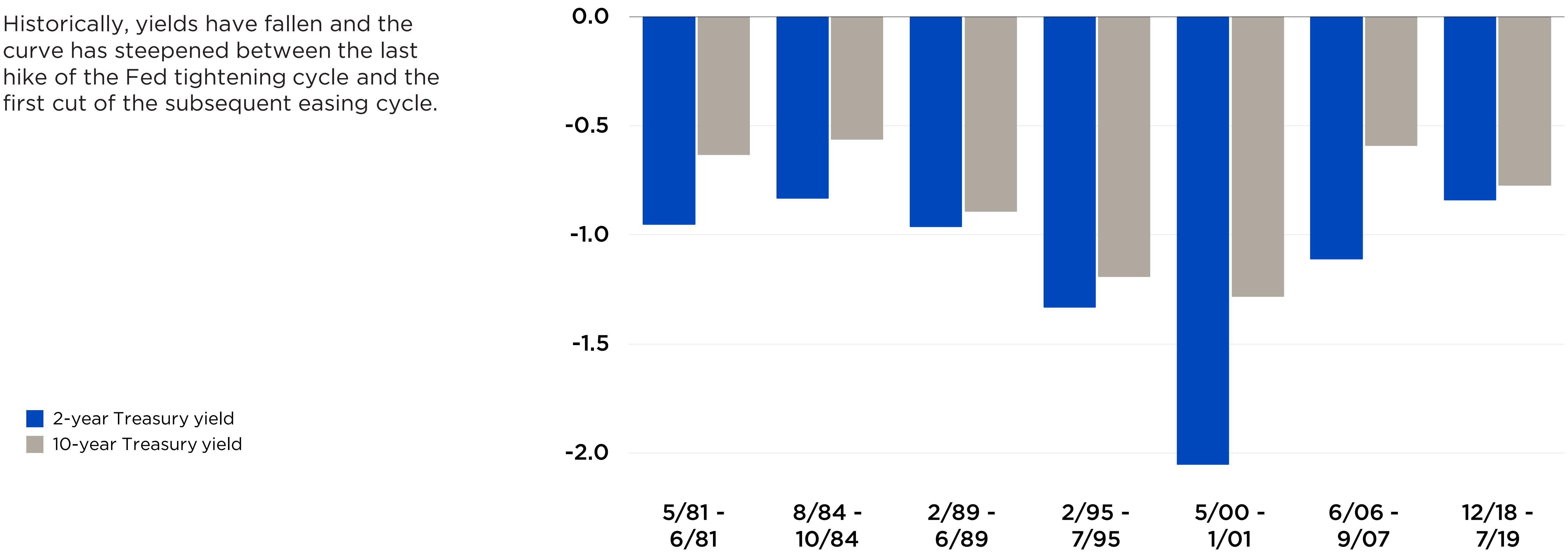
Source: Bloomberg, Nationwide Economics

Treasuries rally between tightening and easing cycles

Historically, yields have fallen and the curve has steepened between the last hike of the Fed tightening cycle and the first cut of the subsequent easing cycle.

Changes in 10-year and 2-year U.S. Treasury yields between Fed tightening, easing cycles

Percentage points



Source: Federal Reserve Board of Governors, Nationwide Economics

Which fixed-income asset classes are gaining or losing in 2024?

High yield continues to outperform its peers through the first half of 2024, posting the highest year-to-date return as investors to take on risk in a positive economic backdrop.

On the other end of the spectrum, Treasuries underperformed other major asset classes.

Yearly changes by asset class

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 YTD
Municipals 3.3%	High Yield 17.1%	High Yield 7.5%	Agencies 1.3%	Corporates 14.5%	TIPS 11.2%	TIPS 6.1%	Agencies -7.9%	High Yield 13.4%	High Yield 2.6%
MBS 1.5%	Corporates 6.1%	Corporates 6.4%	Municipals 1.3%	High Yield 14.3%	Treasuries 10.6%	High Yield 5.3%	Municipals -8.5%	Corporates 8.5%	Agencies 0.8%
Agencies 1.0%	TIPS 4.8%	Municipals 5.4%	MBS 1.0%	Treasuries 8.9%	Corporates 9.9%	Municipals 1.5%	MBS -11.8%	Municipals 6.4%	TIPS 0.7%
Treasuries 0.9%	Bloomberg Agg 2.6%	Bloomberg Agg 3.5%	Bloomberg Agg 0.0%	TIPS 8.8%	Bloomberg Agg 7.5%	Corporates -1.0%	High Yield -11.9%	Bloomberg Agg 5.5%	Municipals -0.4%
Bloomberg Agg 0.5%	MBS 1.7%	TIPS 3.3%	Treasuries 0.0%	Bloomberg Agg 8.7%	High Yield 7.1%	MBS -1.0%	TIPS -12.6%	Agencies 5.1%	Corporates -0.5%
Corporates -0.7%	Agencies 1.4%	MBS 2.5%	TIPS -1.5%	Municipals 7.5%	Agencies 5.5%	Agencies -1.3%	Bloomberg Agg -13.0%	MBS 5.0%	Bloomberg Agg -0.7%
TIPS -1.7%	Municipals 0.2%	Treasuries 2.1%	High Yield -2.1%	MBS 6.4%	Municipals 5.2%	Bloomberg Agg -1.5%	Corporates -15.8%	TIPS 3.8%	MBS -1.0%
High Yield -4.5%	Treasuries -0.2%	Agencies 2.1%	Corporates -2.5%	Agencies 5.9%	MBS 3.9%	Treasuries -3.6%	Treasuries -16.3%	Treasuries 3.2%	Treasuries -2.0%

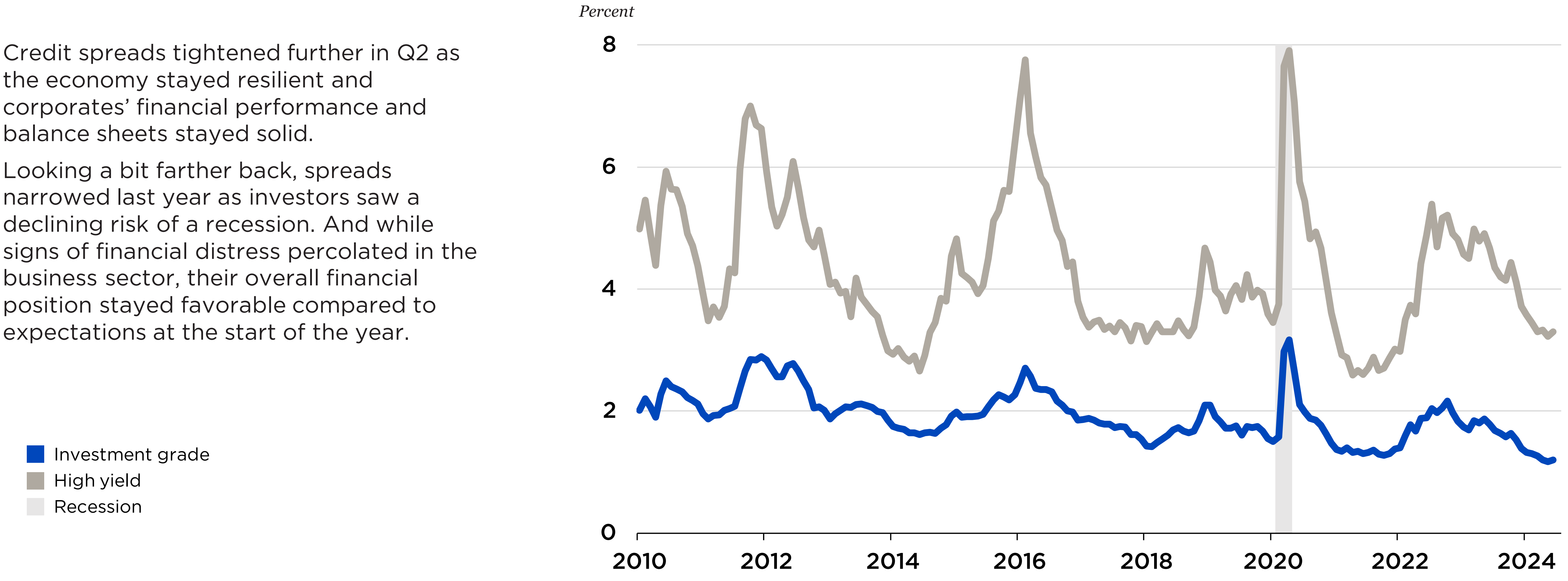
Source: Bloomberg, Nationwide Economics

Corporate bond spreads remain tight

Credit spreads tightened further in Q2 as the economy stayed resilient and corporates' financial performance and balance sheets stayed solid.

Looking a bit farther back, spreads narrowed last year as investors saw a declining risk of a recession. And while signs of financial distress percolated in the business sector, their overall financial position stayed favorable compared to expectations at the start of the year.

Investment-grade and high-yield option adjusted spreads



Source: Federal Reserve Board, ICE/Bank of America Merrill Lynch, Haver Analytics, Nationwide Economics

Will the S&P 500's rally fizzle out?

The impressive rally in the S&P 500 Index this year is driven by an increasingly narrow group of stocks. A cohort commonly known as the "Magnificent Seven" drove the gains at the start of 2024. An even narrower group of stocks accounts for the increase in the latter stages of H1 2024.

As drivers of the rally become increasingly concentrated, it remains to be seen whether the benchmark stock index can extend its robust gains into H2 2024.

S&P 500® Index: Market cap versus equal-weighted

Index, 12/30/22 = 100

Source: Bloomberg, Nationwide Economics

What worked in 2023 works in 2024

Last year's investment themes are extending into 2024. Equities are outperforming other major asset classes as investors seek returns with U.S. large cap equities outperforming their global peers. Bonds are lagging, as they did in 2023 year.

Annual equity returns

Percent

Source: Bloomberg, Nationwide Economics

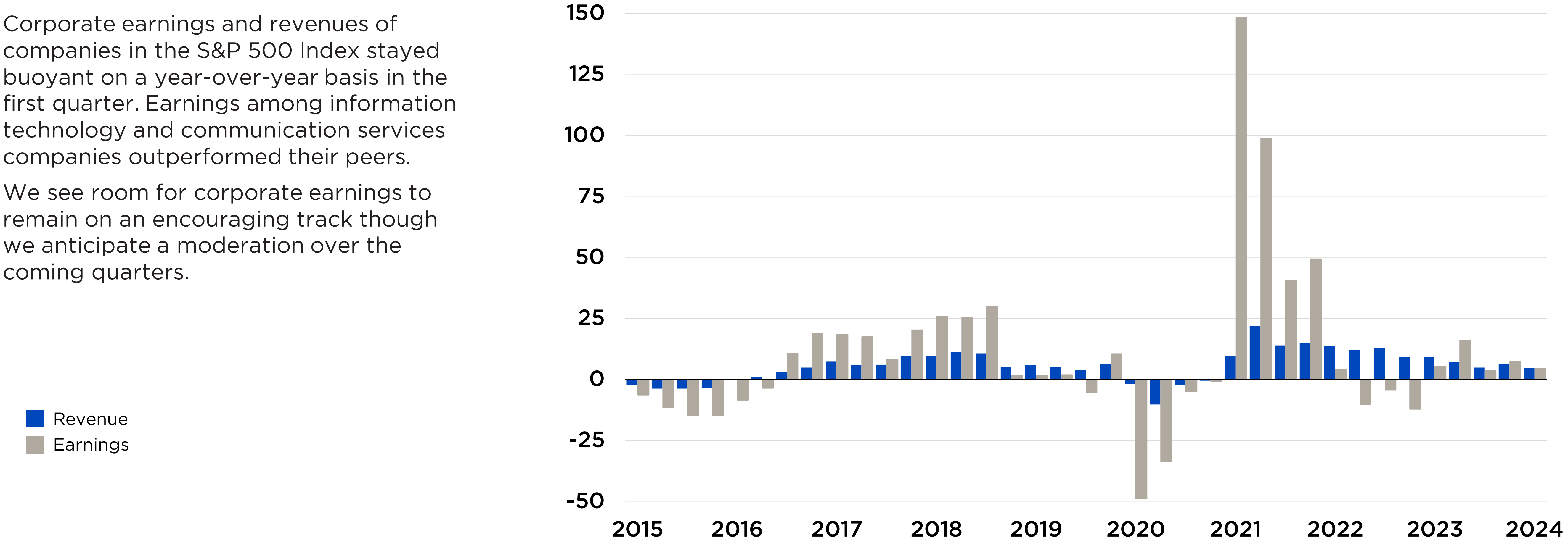
Persistently positive trends for U.S. corporations

Corporate earnings and revenues of companies in the S&P 500 Index stayed buoyant on a year-over-year basis in the first quarter. Earnings among information technology and communication services companies outperformed their peers.

We see room for corporate earnings to remain on an encouraging track though we anticipate a moderation over the coming quarters.

S&P 500® Index: revenue and earnings growth

Year-over-year percent change



Source: Standard & Poor's, Nationwide Economics

Earnings expectations are being revised higher

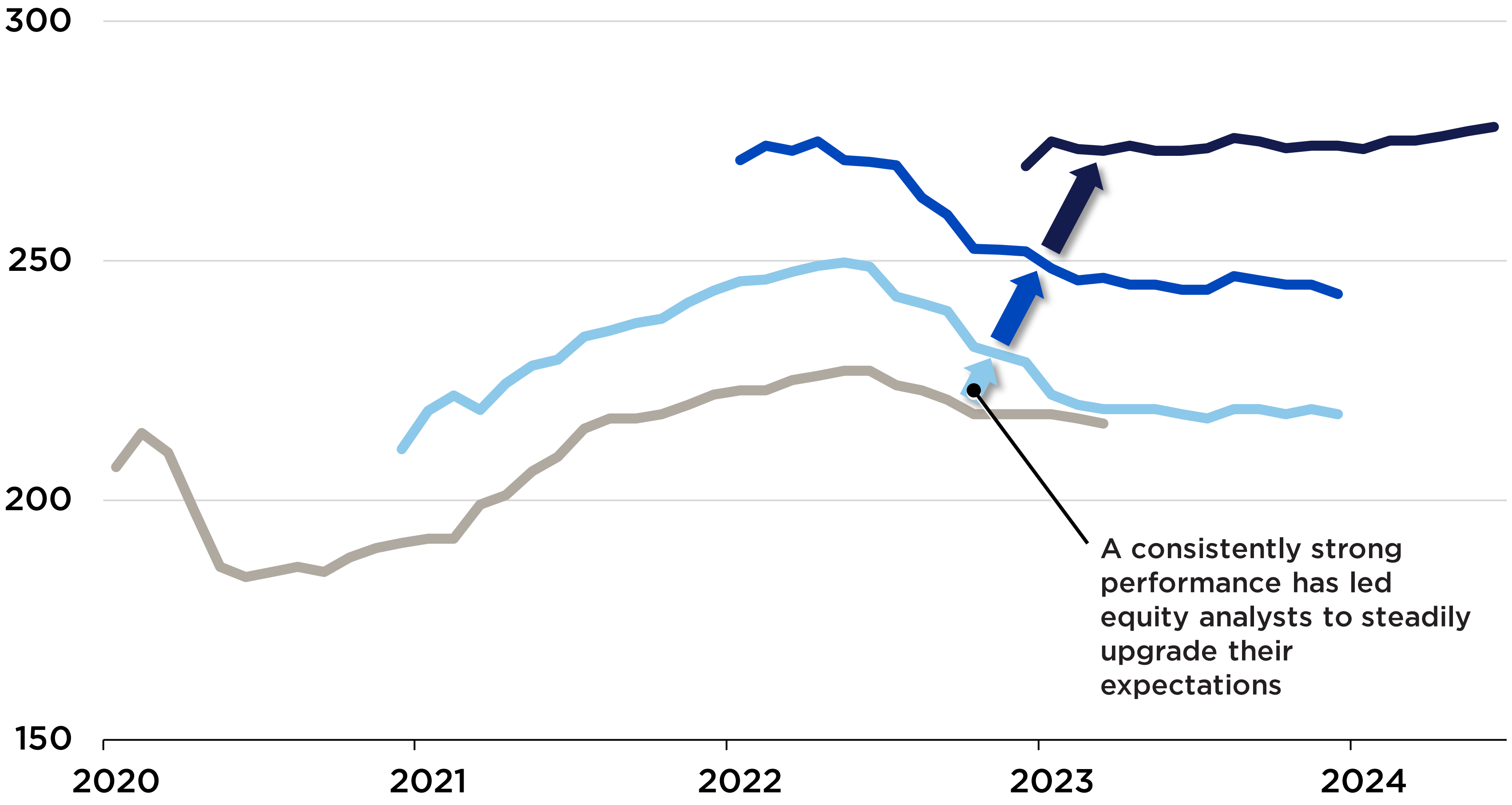
Company earnings expectations remain positive, supported by upbeat domestic demand and an improved global backdrop. However, there are signs of waning pricing power and moderating consumer spending.

Corporations will keep a close eye on expenses as they navigate the slowing growth environment this year. They have already trimmed expenses where possible so future spending cuts may be more be harder to come by.

2025
2024
2023
2022

Earnings evolution: S&P 500® Index

$ earnings per share



Source: FactSet, Nationwide Economics

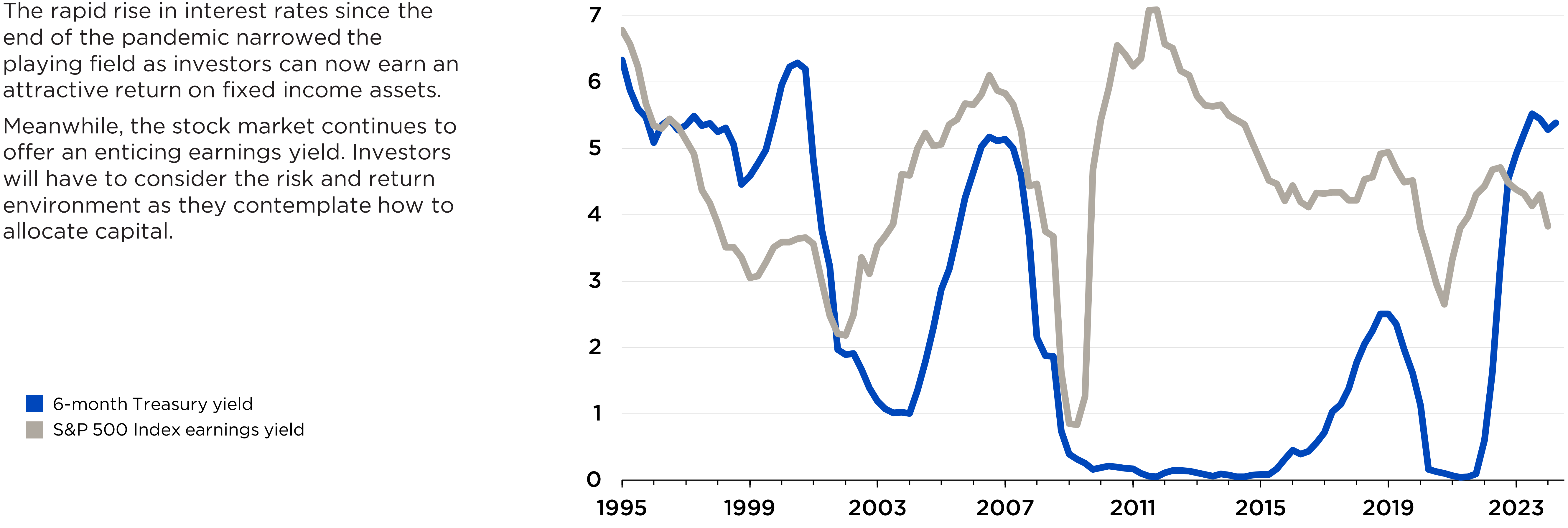
High rates give investors options

The rapid rise in interest rates since the end of the pandemic narrowed the playing field as investors can now earn an attractive return on fixed income assets.

Meanwhile, the stock market continues to offer an enticing earnings yield. Investors will have to consider the risk and return environment as they contemplate how to allocate capital.

6-month Treasury yield and S&P 500® Index earnings yield

Percent



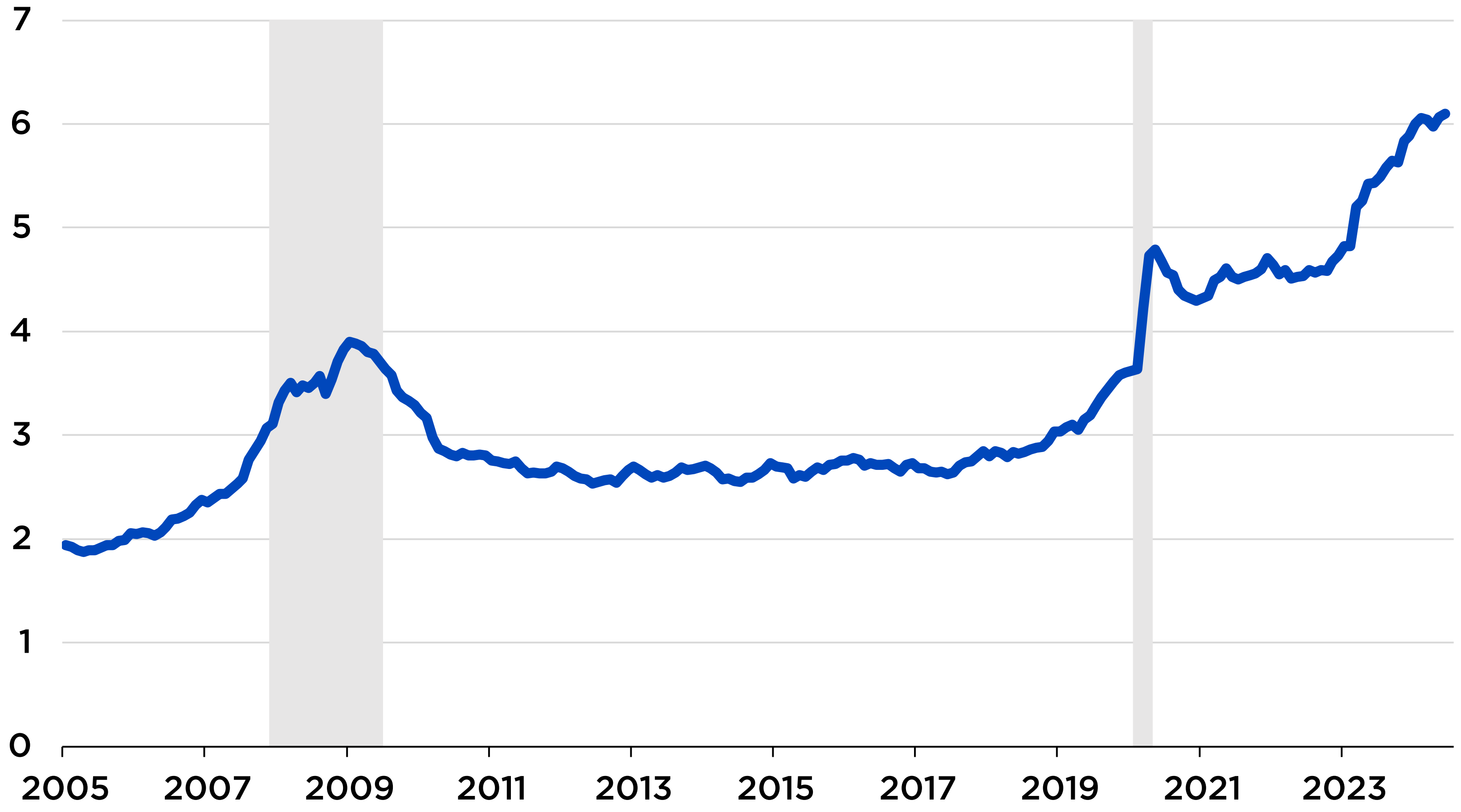
Source: Standard & Poor's and Bloomberg, Nationwide Economics

Allocation to money market funds is extremely high

A lot of money remains on the sidelines as more than $6 trillion sits in money market funds — earning a handsome return thanks largely to the Fed's current interest rate setting. This suggests the equity rally could extend its gains as the Fed proceeds to lower interest rates.

Money market fund assets

$ trillions

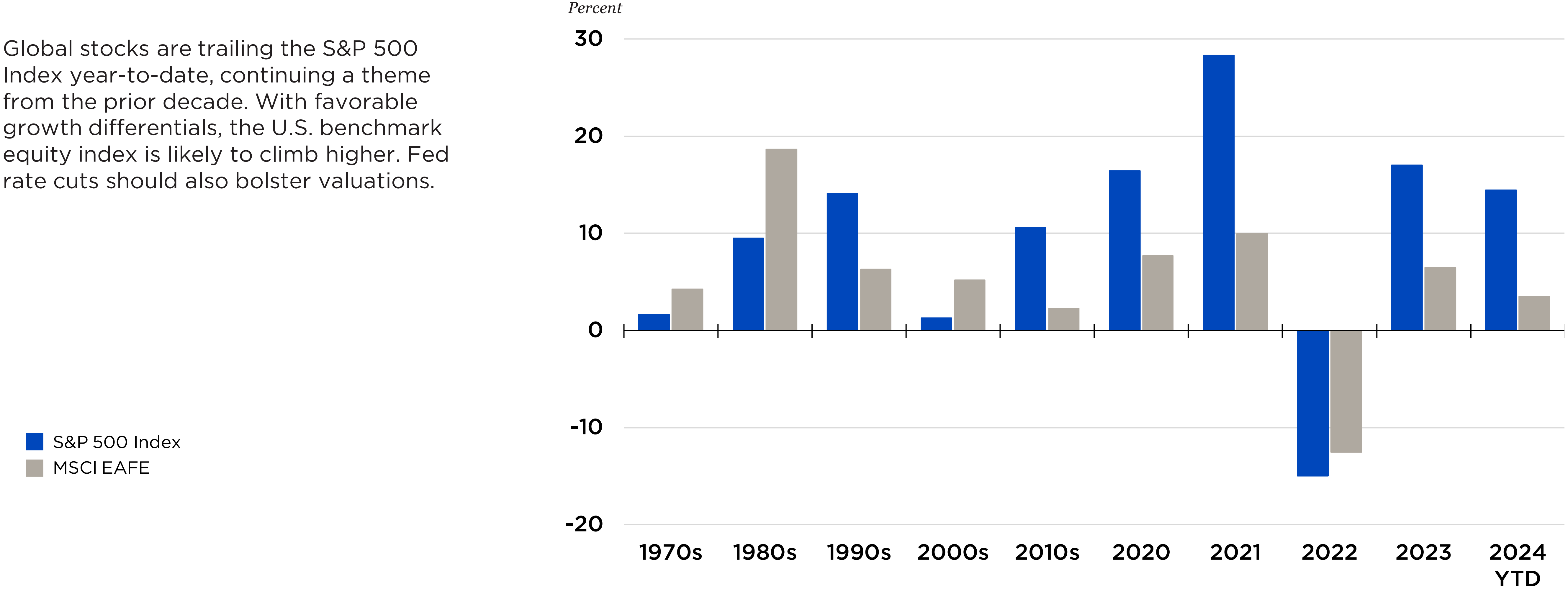


Source: Bloomberg, Nationwide Economics

U.S. equities outpace their global counterparts

Global stocks are trailing the S&P 500 Index year-to-date, continuing a theme from the prior decade. With favorable growth differentials, the U.S. benchmark equity index is likely to climb higher. Fed rate cuts should bolster valuations.

Annualized changes in the S&P 500® Index and the MSCI EAFE Index



Source: Bloomberg

The greenback stands its ground

The U.S. currency will remain strong by historic standards, backed by favorable growth and interest rate differentials as well as elevated geopolitical risks.

The dollar's position as the world's reserve currency and its pivotal role in global financial markets will support the currency's value. The federal government's significant debt burden poses a risk to the currency in the long-term.

The trade-weighted U.S. dollar index

Index

Source: ICE, Bloomberg, Nationwide Economics

Commodity prices have retraced their H2 2023 losses

Commodity costs have risen this year, pushing the benchmark CRB commodity price index up almost seven percent year-to-date.

Higher crude oil prices feeding into gasoline prices have arguably garnered the most attention, though the increase isn't limited to hydrocarbons. Various non-precious metals have also propelled the advance. And the price of agriculture goods have also increased.

Source: Commodity Research Bureau, Haver Analytics, Nationwide Economics

U.S. Economy

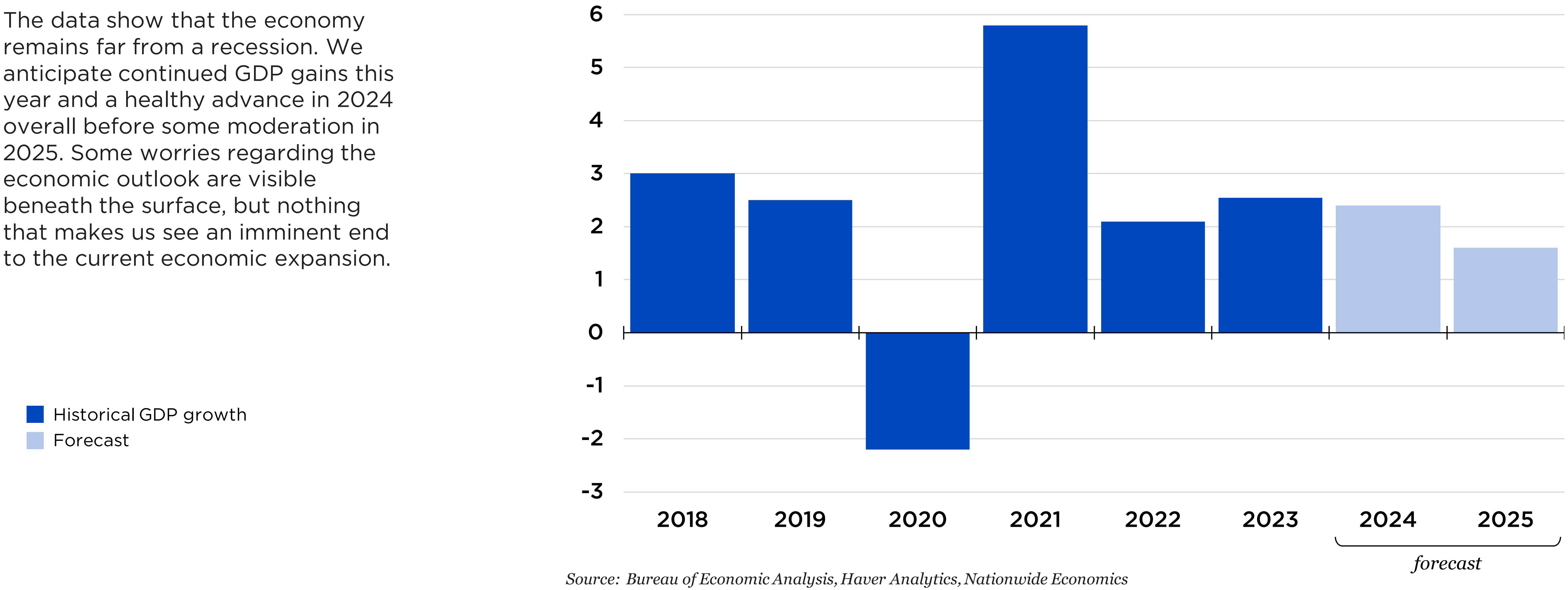
Highlights

Gradually cooling economic activity

The data show that the economy remains far from a recession. We anticipate continued GDP gains this year and a healthy advance in 2024 overall before some moderation in 2025. Some worries regarding the economic outlook are visible beneath the surface, but nothing that makes us see an imminent end to the current economic expansion.

GDP growth – historical and forecast

Percent, annual average



Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

Where are we in the business cycle?

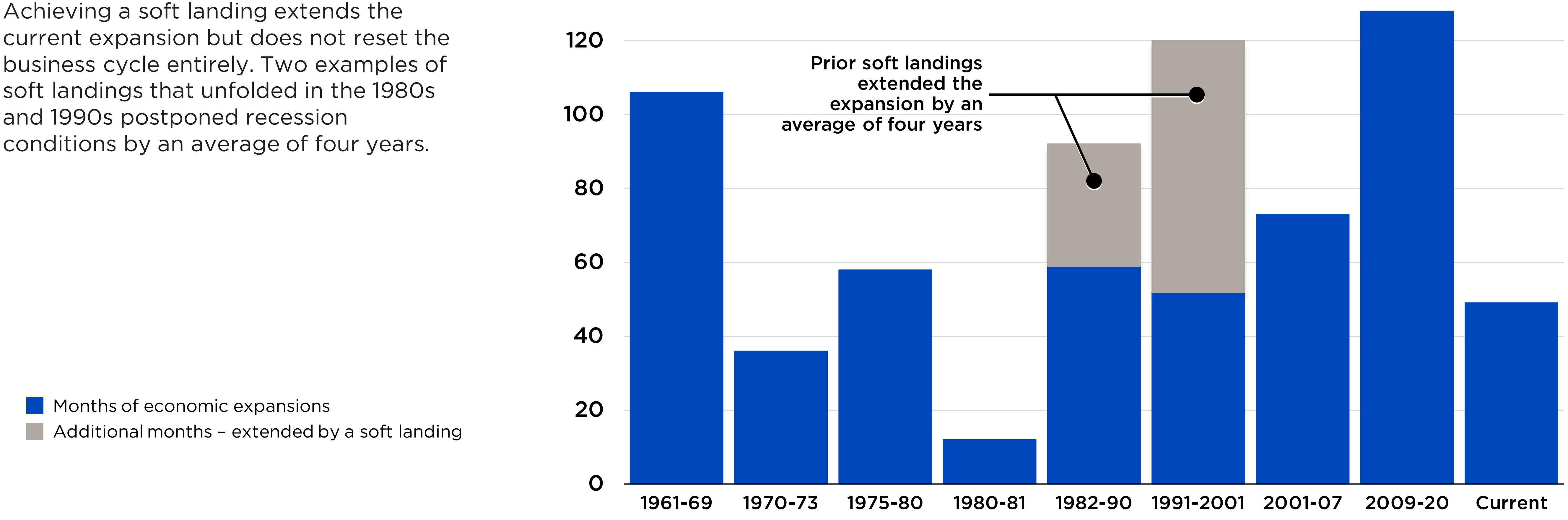
The fundamental economic backdrop remains encouraging even as an inverted yield curve and the monthly data flash some warning signs. We believe the economy is late cycle and envision a gradually cooling economic expansion in H2 2024 and in 2025.

Soft landing doesn't mean the start of a new expansion

Achieving a soft landing extends the current expansion but does not reset the business cycle entirely. Two examples of soft landings that unfolded in the 1980s and 1990s postponed recession conditions by an average of four years.

Length of economic expansions

Months



NBER, Haver Analytics, Nationwide Economics

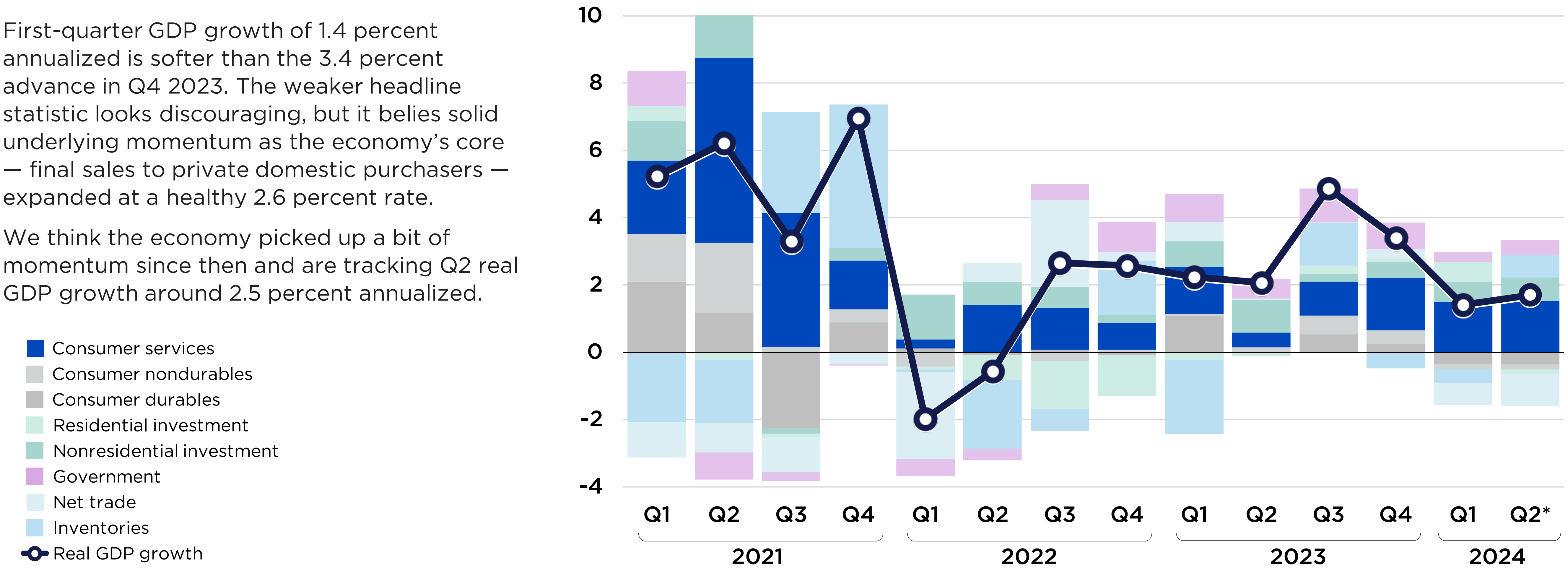
Solid Q1 growth likely extended into Q2

First-quarter GDP growth of 1.4 percent annualized is softer than the 3.4 percent advance in Q4 2023. The weaker headline statistic looks discouraging, but it belies solid underlying momentum as the economy's core — final sales to private domestic purchasers — expanded at a healthy 2.6 percent rate.

We think the economy picked up a bit of momentum since then and are tracking Q2 real GDP growth around 2.5 percent annualized.

Contribution to real GDP growth

SAAR, percent



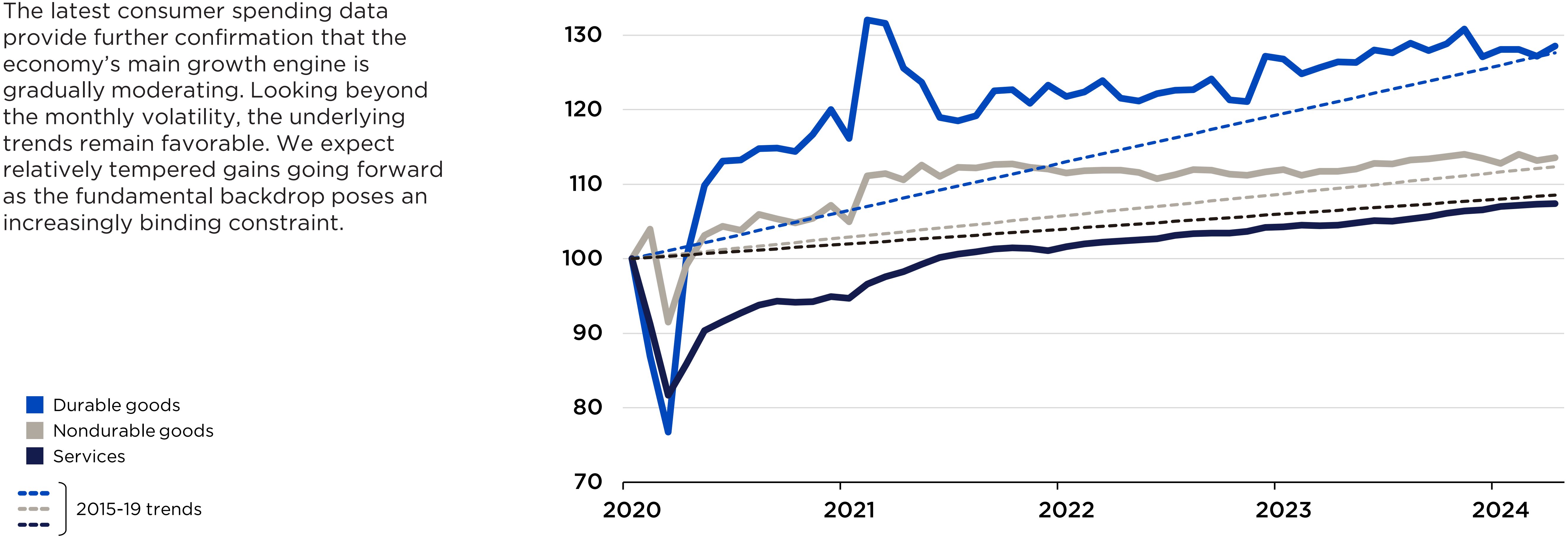
*Note: * Represents Federal Reserve Bank of Atlanta's GDP estimate*
Source: Bureau of Economic Analysis, Haver Analytics, Federal Reserve Bank of Atlanta, Nationwide Economics

Consumer spending is normalizing

The latest consumer spending data provide further confirmation that the economy's main growth engine is gradually moderating. Looking beyond the monthly volatility, the underlying trends remain favorable. We expect relatively tempered gains going forward as the fundamental backdrop poses an increasingly binding constraint.

Real consumer spending

Index, Feb. 2020 = 100



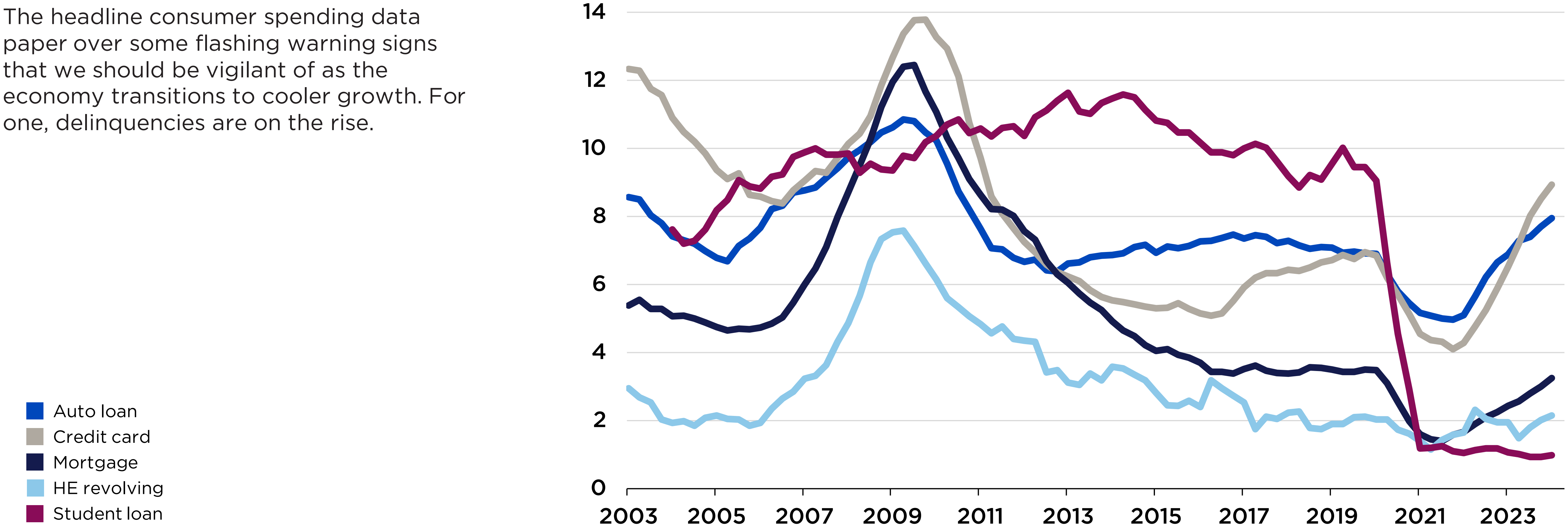
Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

Delinquencies flash warning signs

The headline consumer spending data paper over some flashing warning signs that we should be vigilant of as the economy transitions to cooler growth. For one, delinquencies are on the rise.

Transition into delinquency (30+) by loan type

Percent of balance



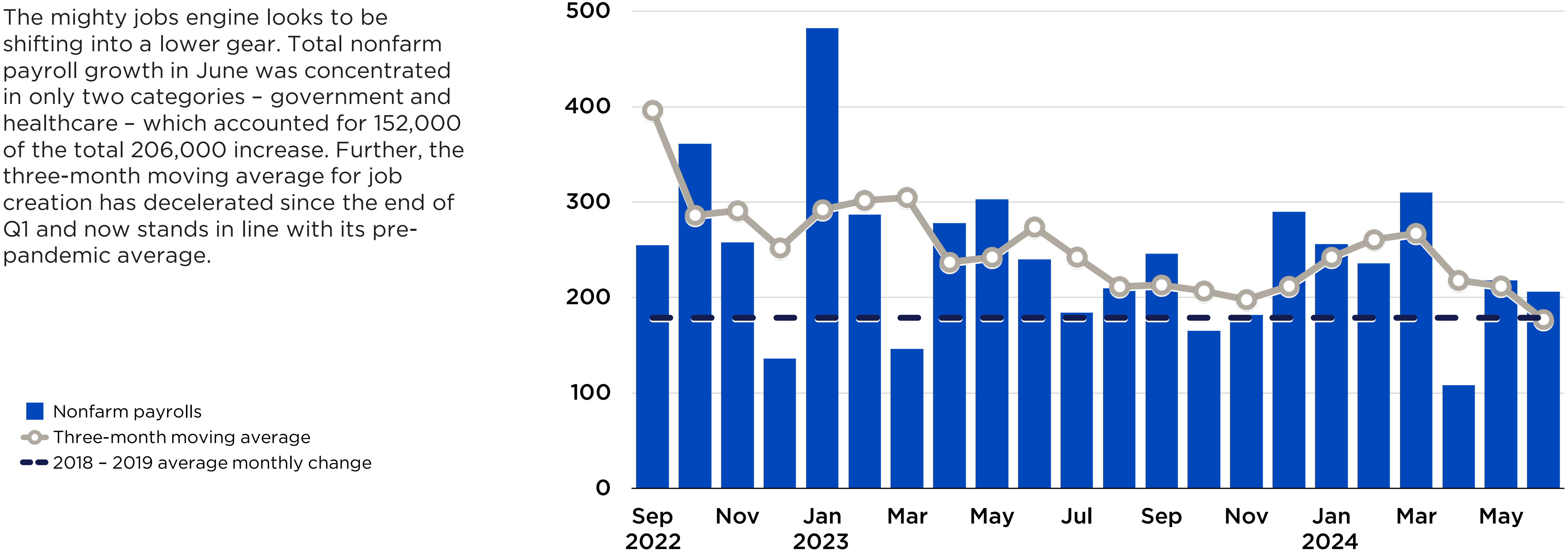
Source: New York Fed Consumer Credit Panel/Equifax

Downshifting employment growth

The mighty jobs engine looks to be shifting into a lower gear. Total nonfarm payroll growth in June was concentrated in only two categories – government and healthcare – which accounted for 152,000 of the total 206,000 increase. Further, the three-month moving average for job creation has decelerated since the end of Q1 and now stands in line with its pre-pandemic average.

Nonfarm payrolls growth

Thousands

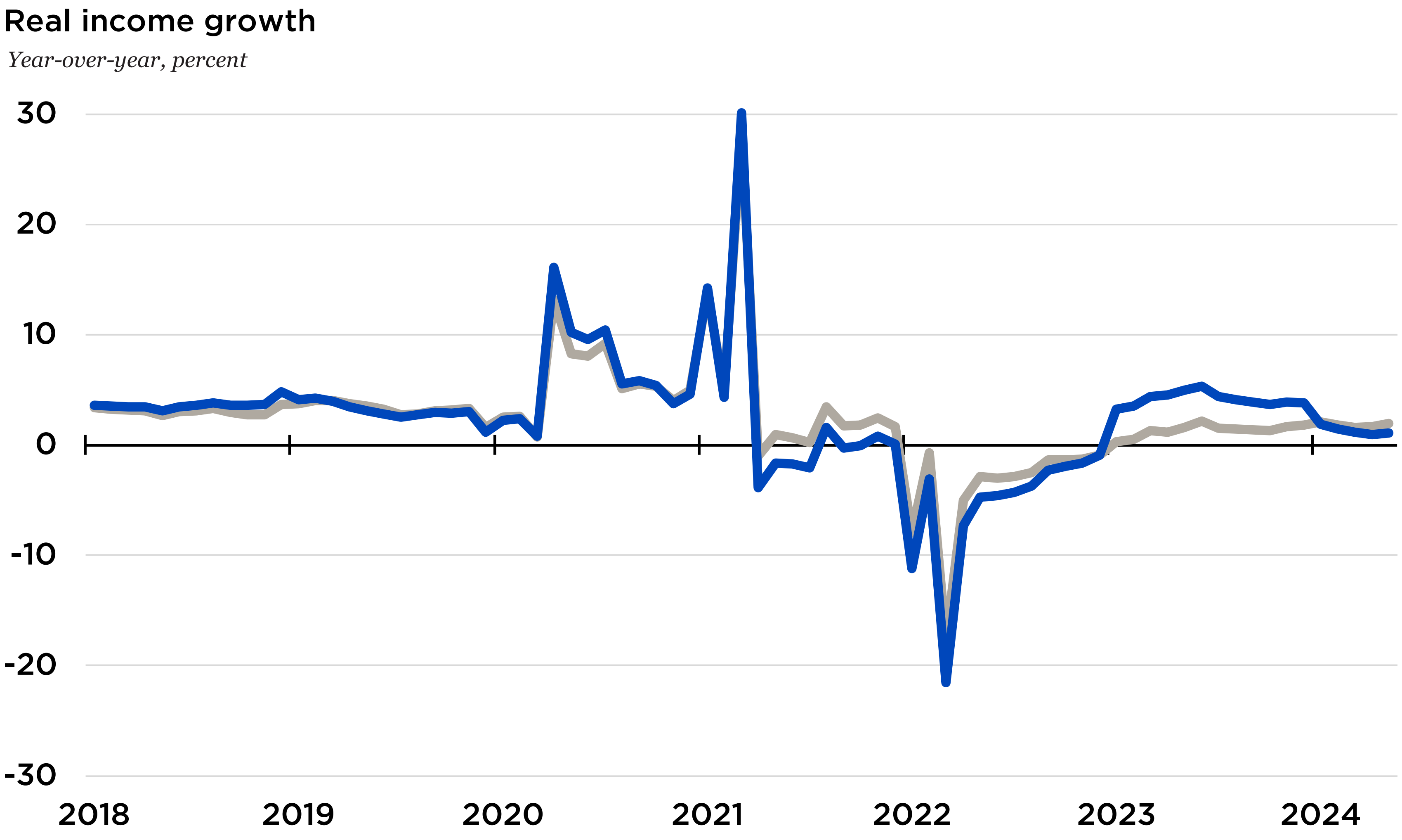


Source: Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

Real income growth is losing steam

Real income trends are moderating even as the U.S. jobs machine continues to chug along at a health pace. Rising real incomes are the main propellant of consumer spending increases this year.

This is the most important dynamic to watch in the economy and the primary reason the economy has escaped recession. As long as real incomes continue to grow, we can expect consumers to keep spending.



Real disposable income growth
Real personal income growth

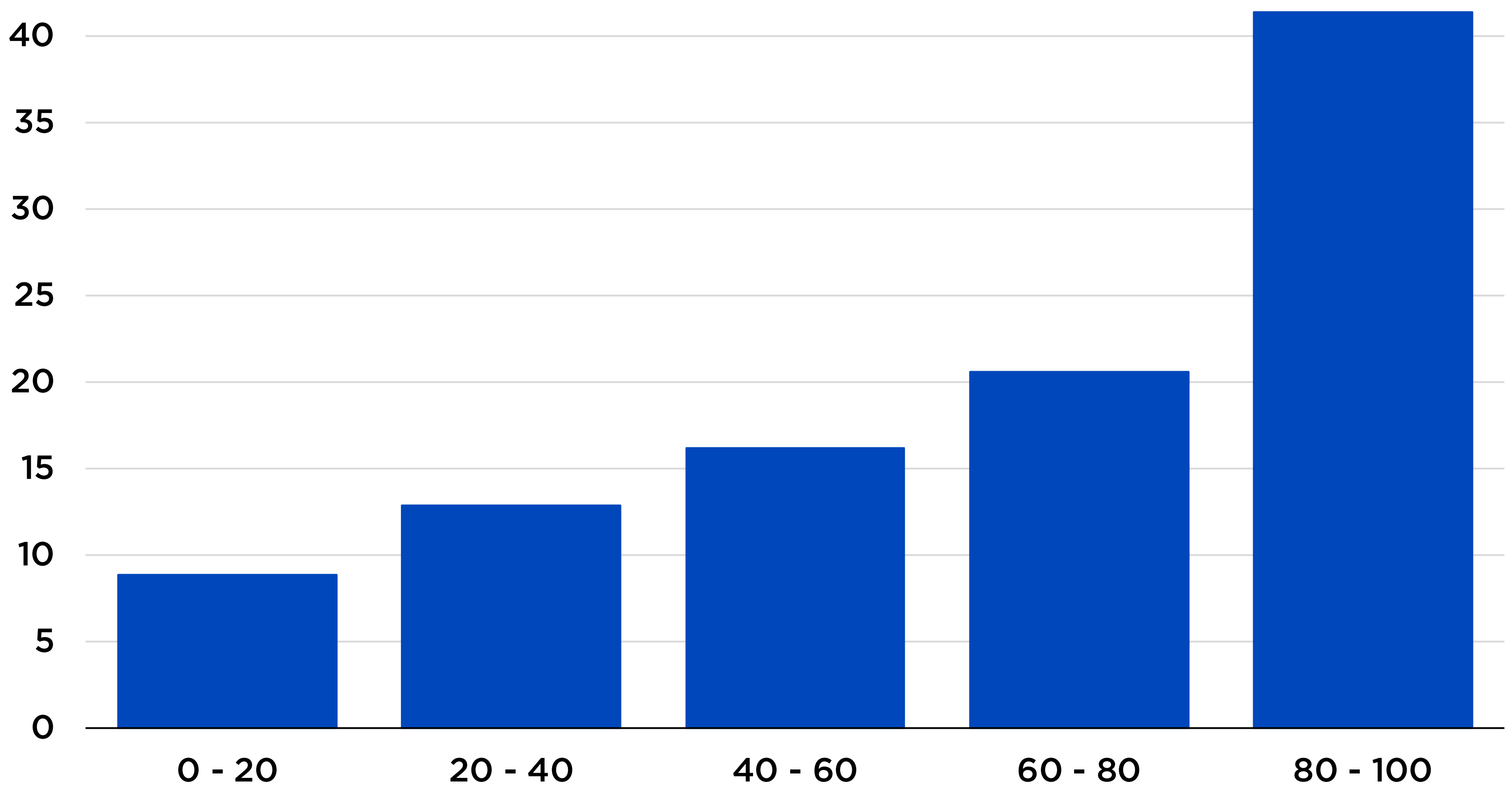
Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

Low-income households are most vulnerable

Consumers at the lower end of the income spectrum will be most vulnerable to moderating income trends. Lower income households do not account for the majority of total consumer spending, but they raise the risks of turbulence as the economy normalizes.

Consumer spending by income quantile

Percent



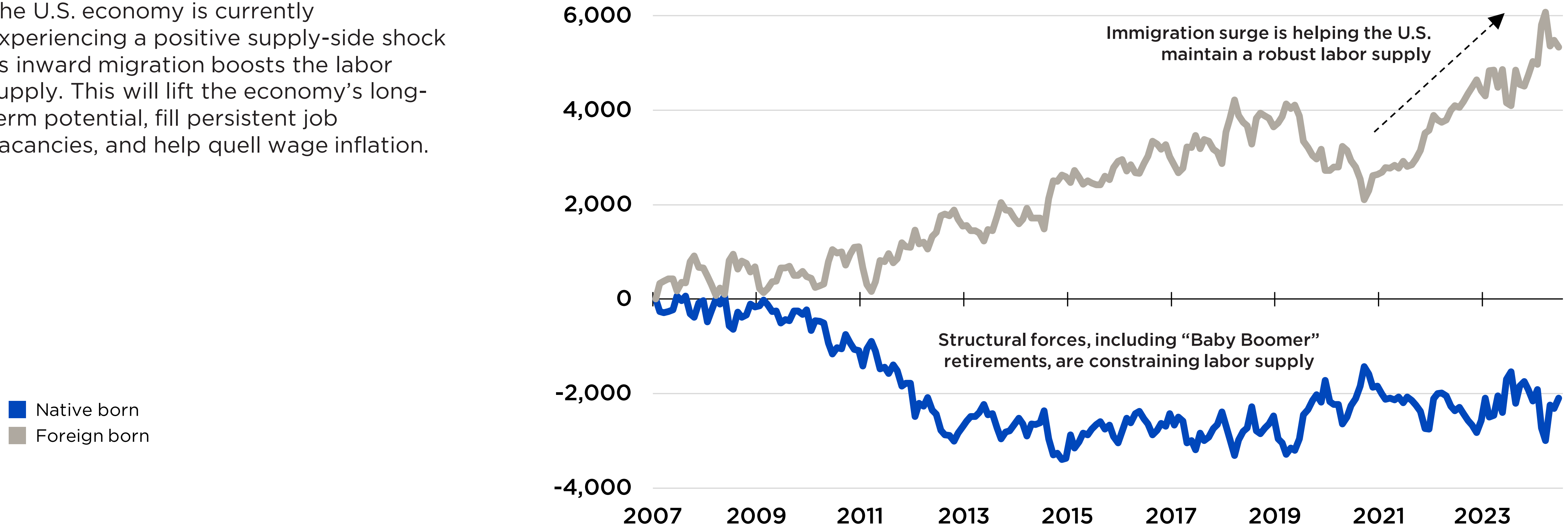
Source: Bureau of Labor Statistics Consumer Expenditures Survey, Nationwide Economics

Rising labor supply raises the economy's potential

The U.S. economy is currently experiencing a positive supply-side shock as inward migration boosts the labor supply. This will lift the economy's long-term potential, fill persistent job vacancies, and help quell wage inflation.

Prime working age population growth, U.S.

Change since January 2007, thousands

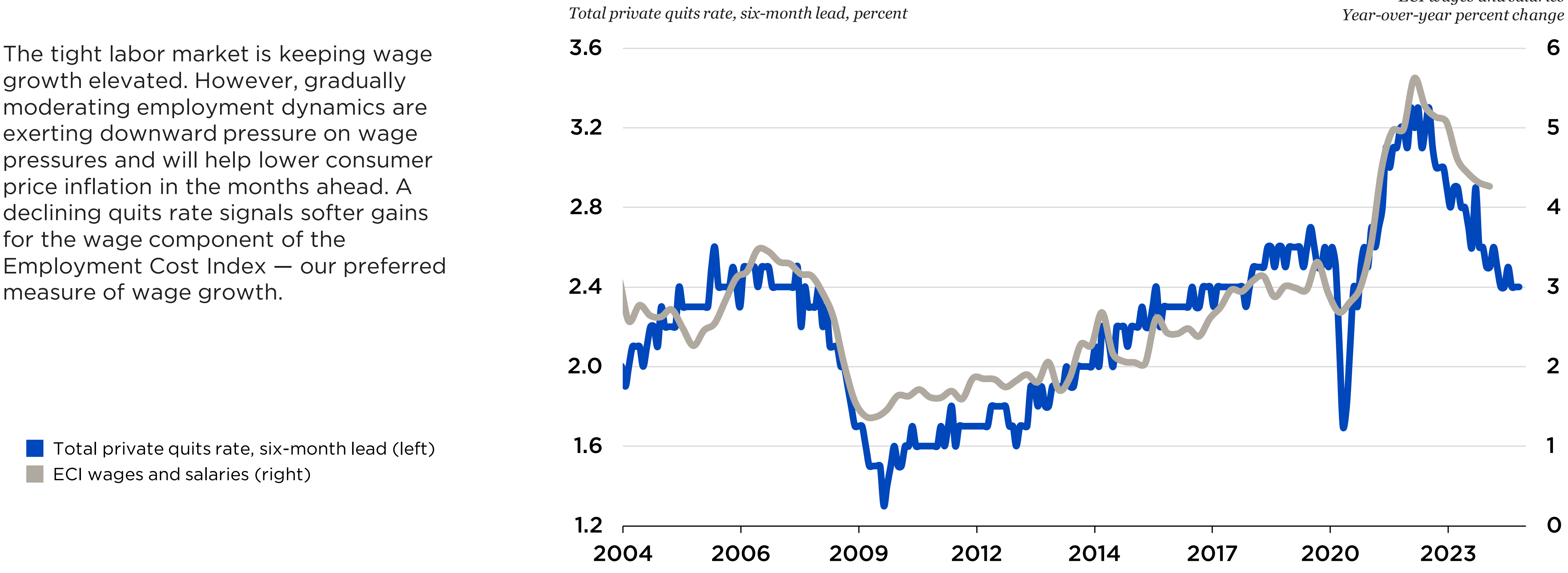


Source: Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

Falling quits rate portends cooler wage growth

The tight labor market is keeping wage growth elevated. However, gradually moderating employment dynamics are exerting downward pressure on wage pressures and will help lower consumer price inflation in the months ahead. A declining quits rate signals softer gains for the wage component of the Employment Cost Index — our preferred measure of wage growth.

Quits rate and Employment Cost Index (ECI) wages and salaries



Source: Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

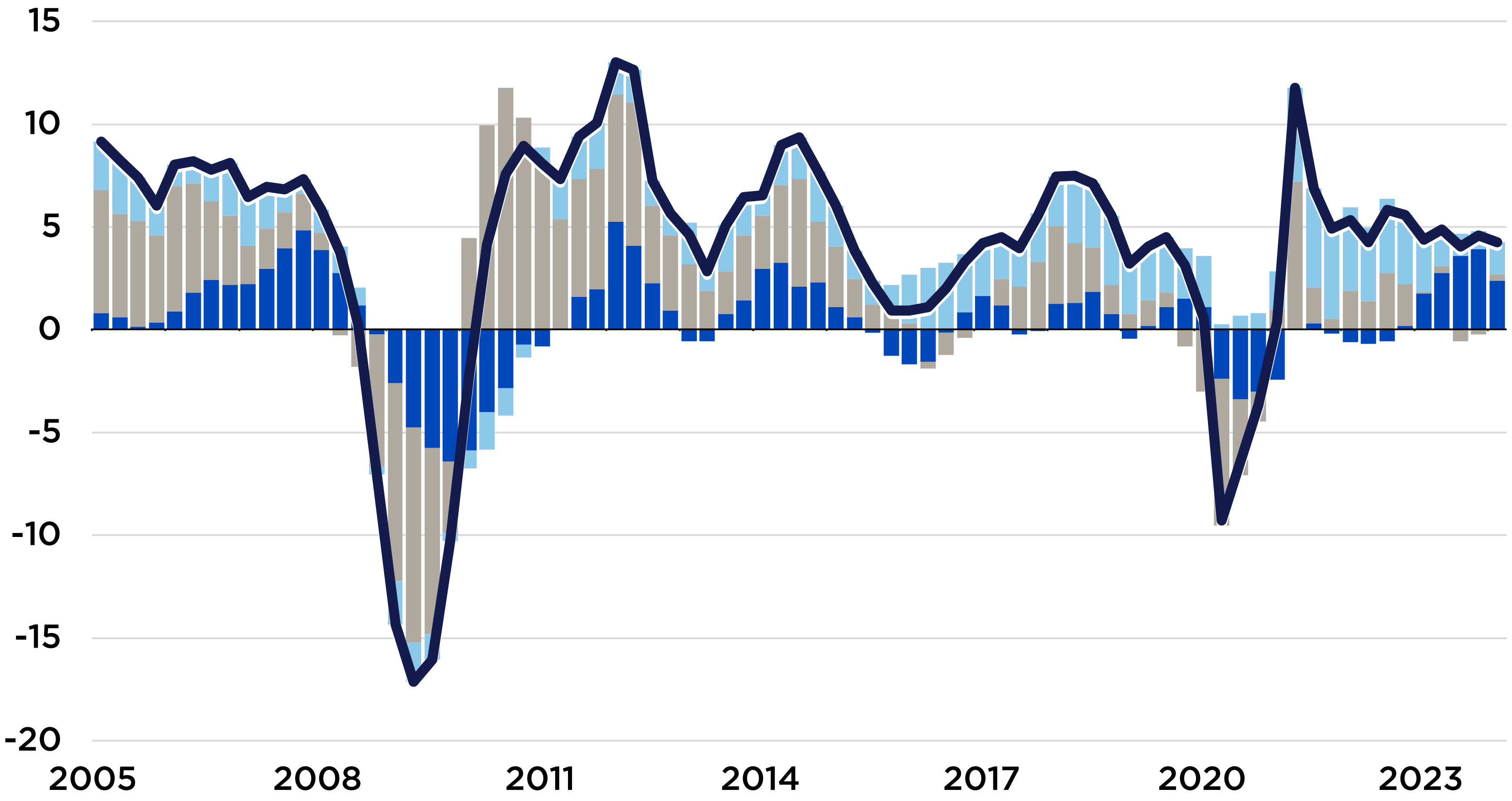
Rising IP and structures spending support business investment

Total business investment has more than recouped the losses sustained during the pandemic, now nearly 13 percent higher than at the end of 2019.

Strong intellectual property investment in the wake of the pandemic and rising structures spending, driven partly by the Biden Administration's initiatives, are keeping total investment on a rising trend. Meanwhile, high interest rates and tight bank lending standards are constraining equipment spending.

Nonresidential fixed investment

Percentage point contribution to year-over-year growth

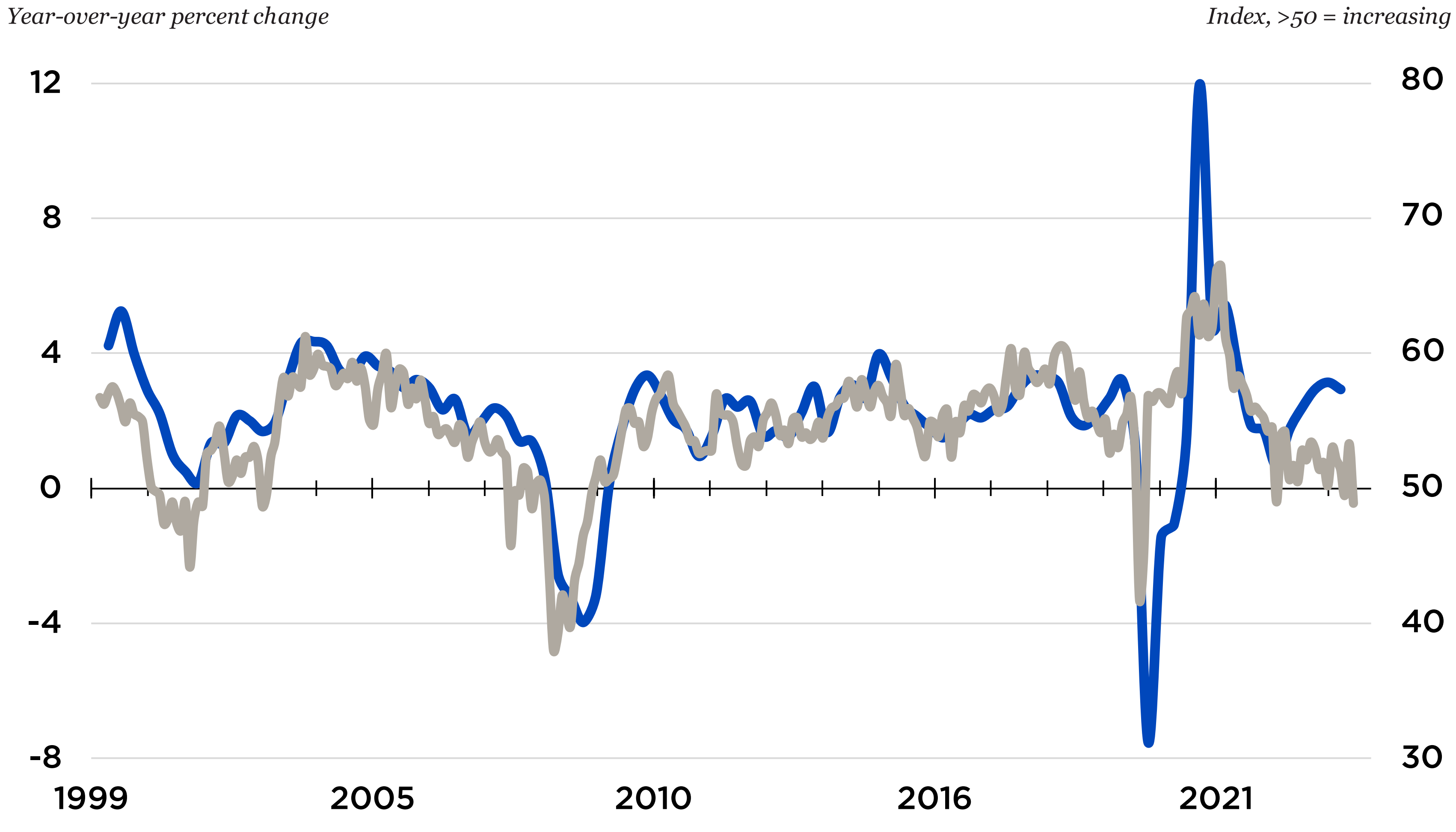


Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

ISMs signal cooler growth heading into mid year

The ISM surveys point to persistent economic expansion heading into the second half of the year, albeit cooler than the gains recorded last year. The services sector is the dominate engine of growth while manufacturing activity is showing signs of bottoming after an extended streak of losses. We foresee continued, albeit relatively moderate, activity gains in H2 2024 and next year as well.

Businesses remain cautiously optimistic

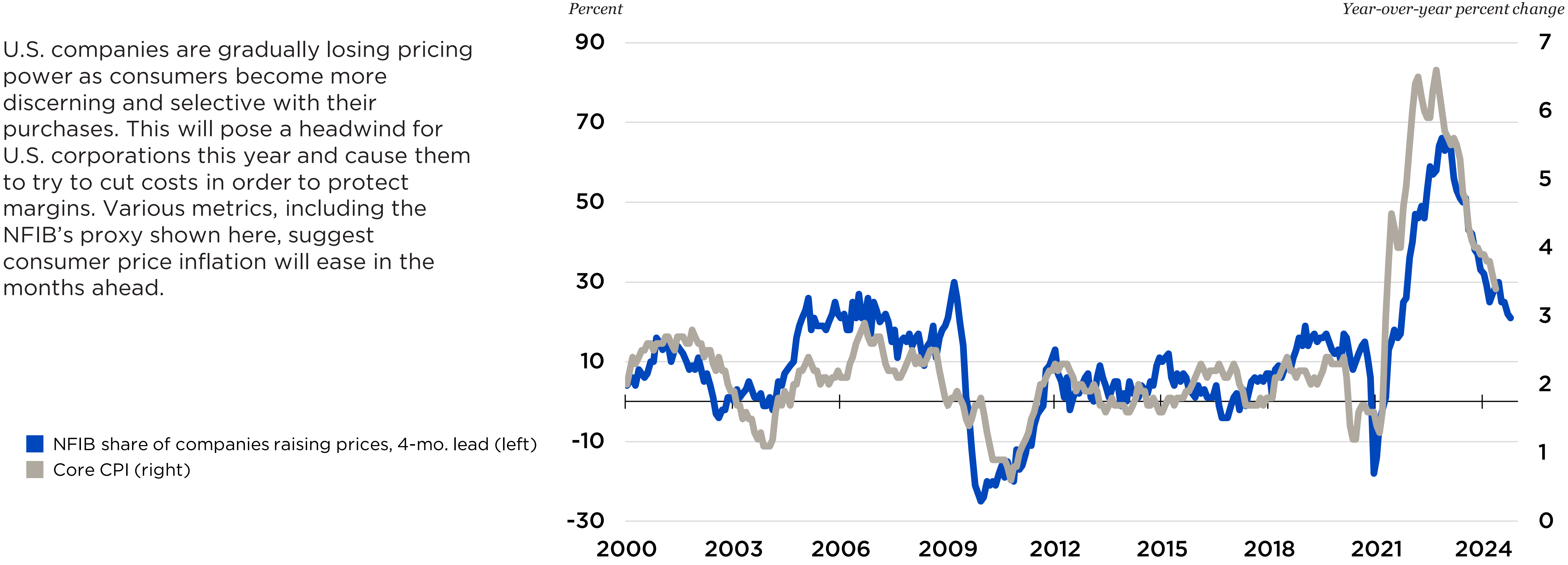


Bureau of Economics Analysis, Institute for Supply Management, Haver Analytics, Nationwide Economics

Pricing power is subsiding

U.S. companies are gradually losing pricing power as consumers become more discerning and selective with their purchases. This will pose a headwind for U.S. corporations this year and cause them to try to cut costs in order to protect margins. Various metrics, including the NFIB's proxy shown here, suggest consumer price inflation will ease in the months ahead.

Easing pricing power portends lower inflation



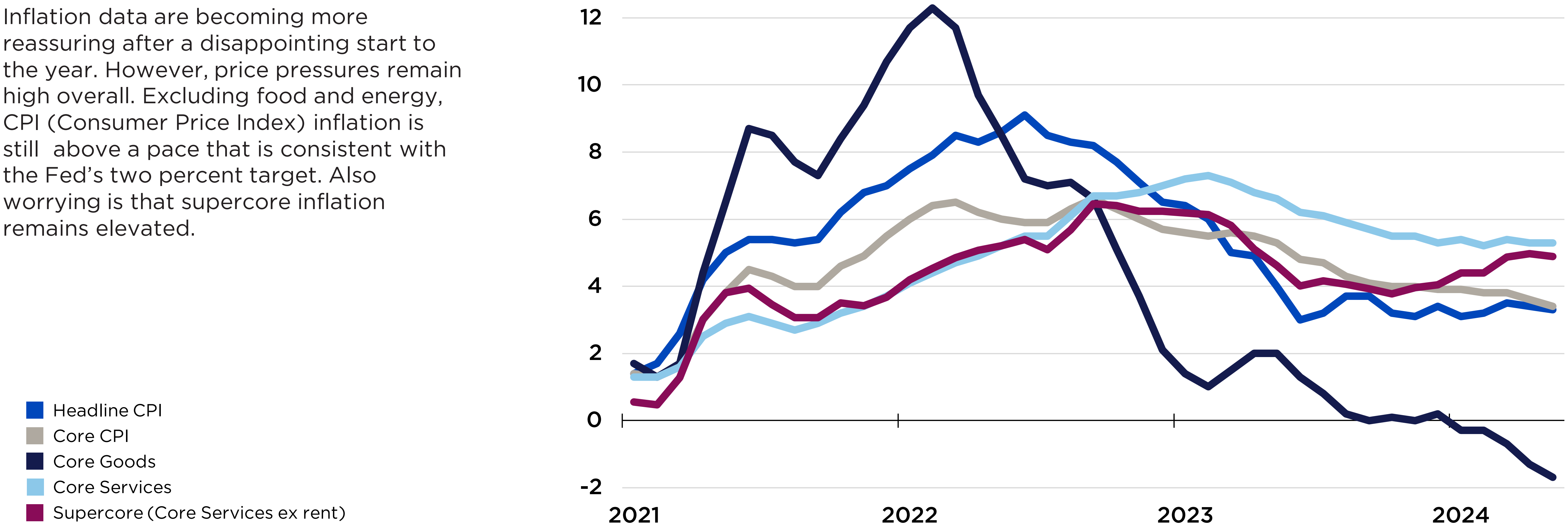
Source: National Federation of Independent Business, Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

Latest inflation data bring more reassurance

Inflation data are becoming more reassuring after a disappointing start to the year. However, price pressures remain high overall. Excluding food and energy, CPI (Consumer Price Index) inflation is still above a pace that is consistent with the Fed's two percent target. Also worrying is that supercore inflation remains elevated.

CPI breakdown

Year-over-year percent change



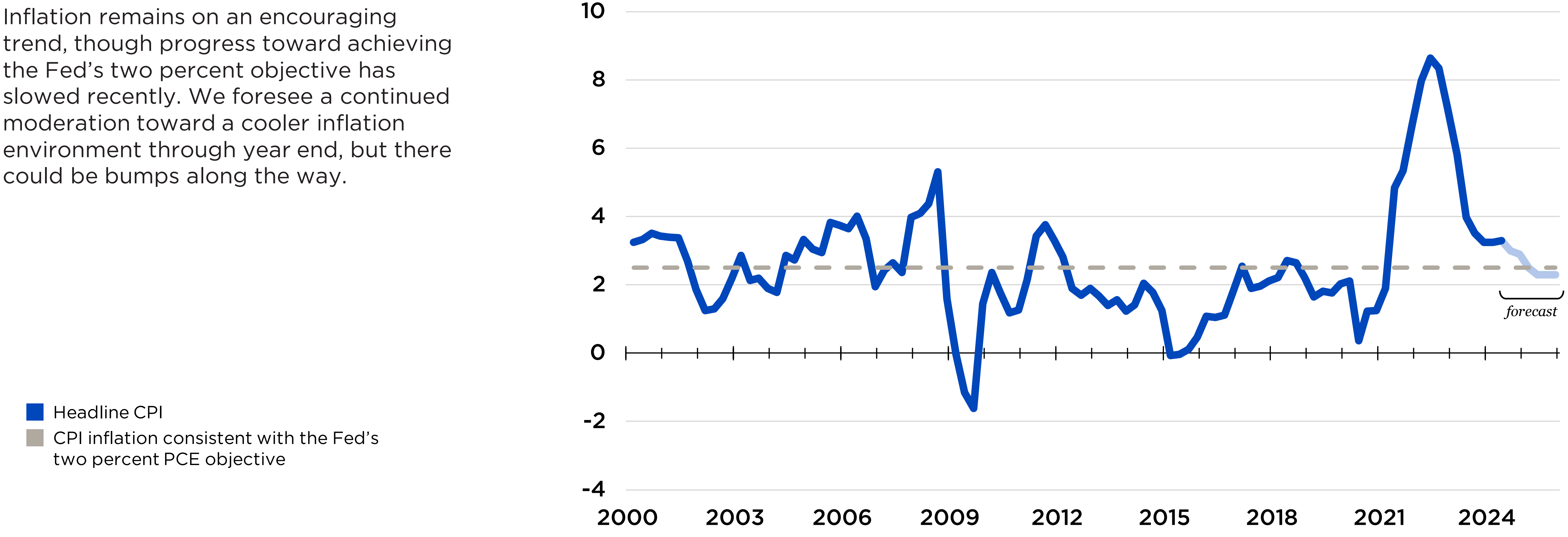
Source: Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

Inflation will cool gradually

Inflation remains on an encouraging trend, though progress toward achieving the Fed's two percent objective has slowed recently. We foresee a continued moderation toward a cooler inflation environment through year end, but there could be bumps along the way.

Headline CPI inflation

Year-over-year percent change



Source: Bureau of Labor Statistics, Haver Analytics, Nationwide Economics

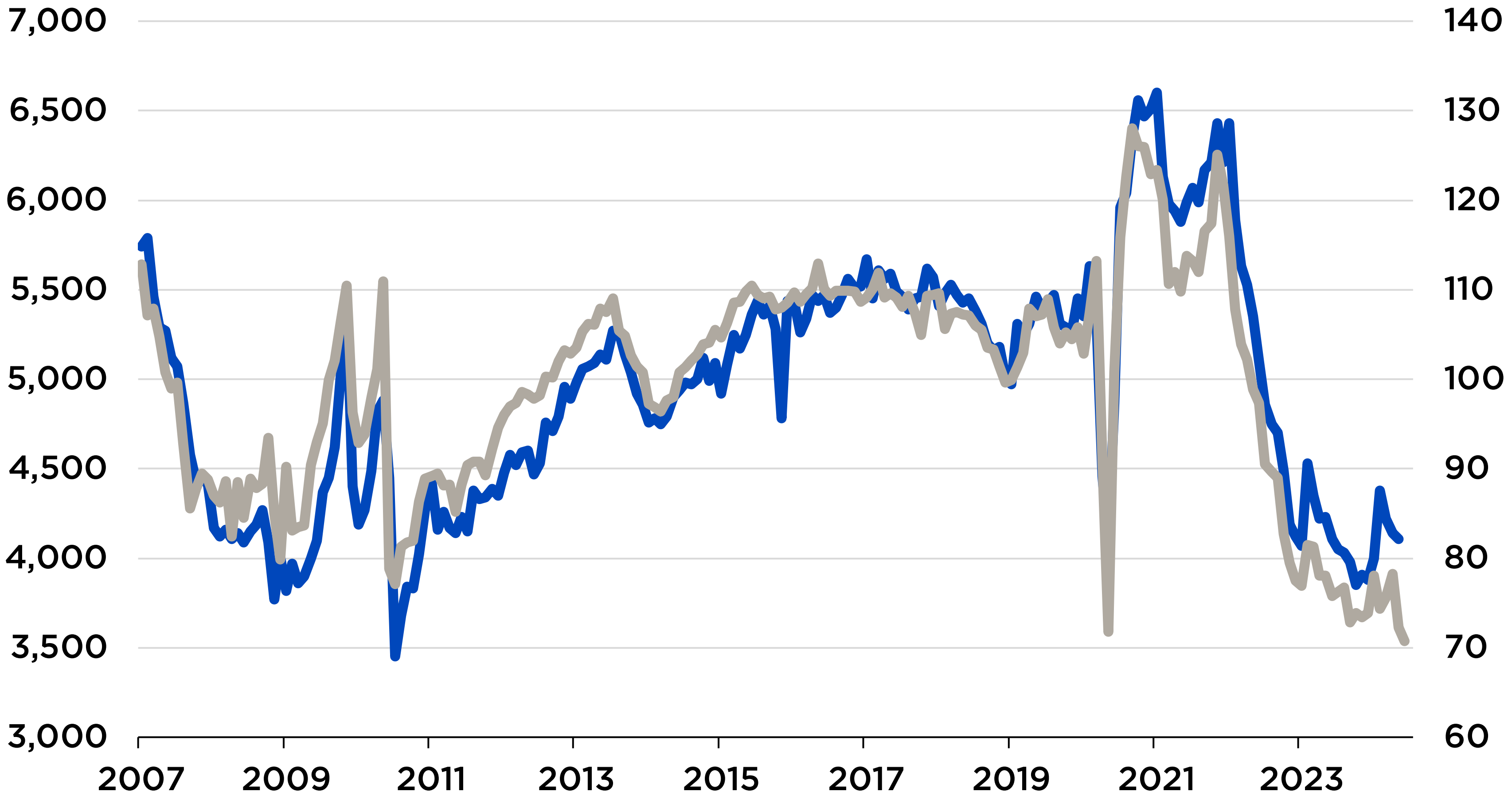
Low affordability and low inventory constrain existing home sales

High mortgage rates and home prices alongside meager inventories are weighing on existing home sales. We don't foresee significantly stronger sales momentum in the near term. We'll get some relief on the mortgage front as the economy cools and the Fed eases, but low affordability and meager supply will be steadfast constraints. Cooling income growth and the high cost of homeownership, aside from mortgages, will also weigh on sales.

Existing and pending home sales

Existing home sales, thousands, annualized

Pending home sales, one-month lead
Index, 2001 = 100

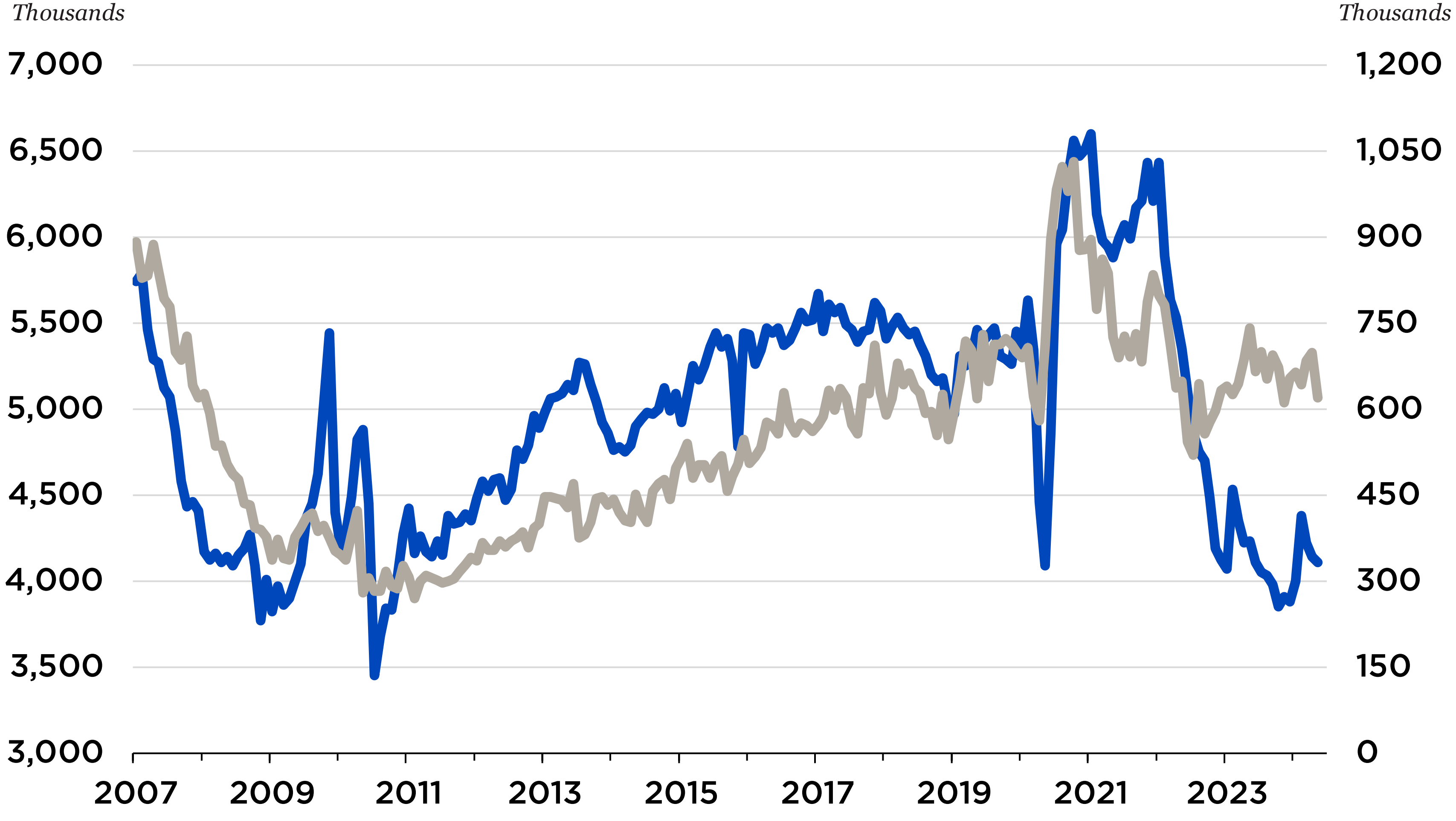


Source: National Association of Realtors, Haver Analytics, Nationwide Economics

New home sales fare better than sales of existing homes

New home sales are holding up relatively well despite the persistent drag from elevated mortgage rates. A mix of factors, including lingering pent-up demand, a persistently low stock of existing homes for sale, and financial incentives offered by builders, are keeping a floor under new home sales.

Housing activity



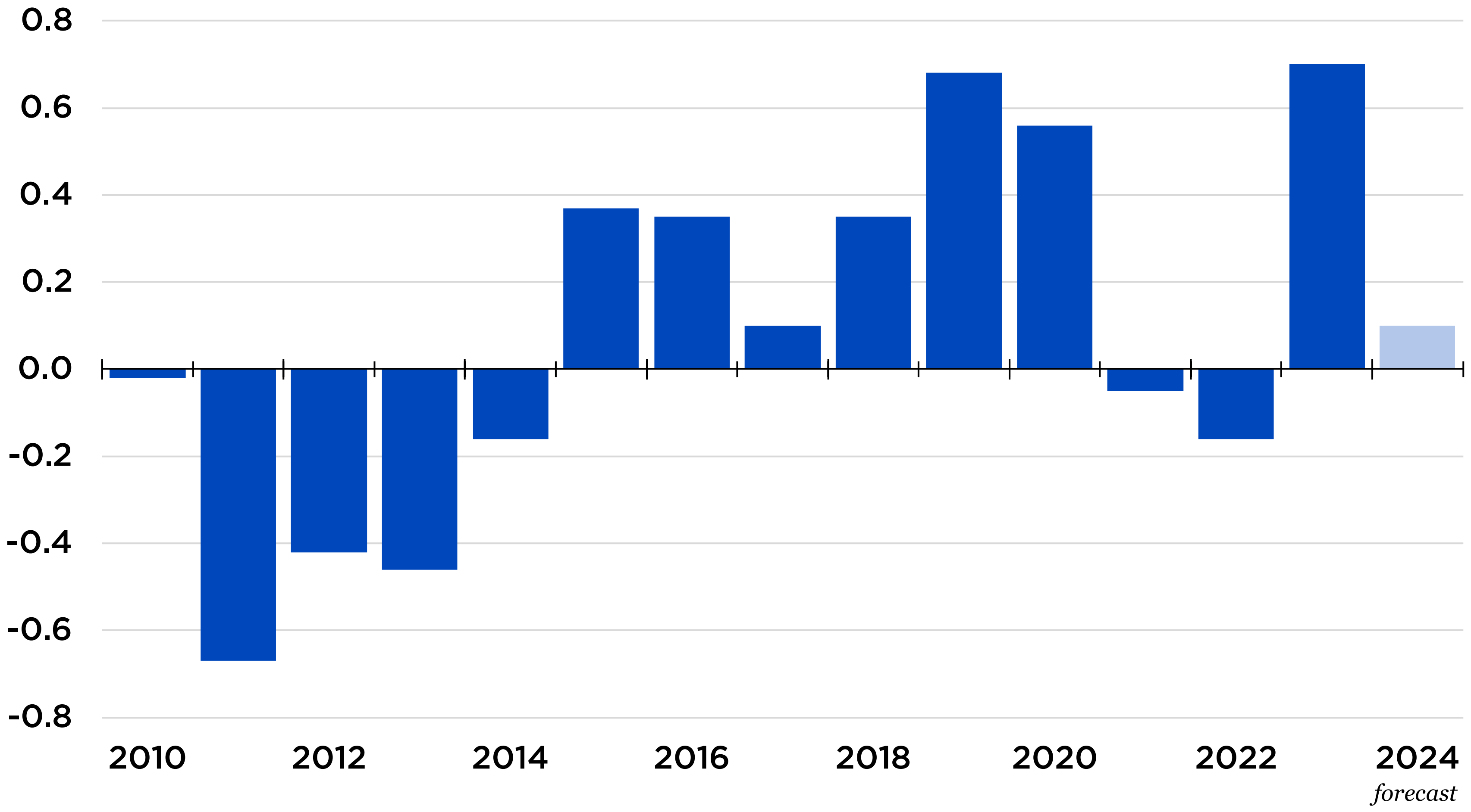
Source: National Association of Realtors, Haver Analytics, Nationwide Economics

Less support from fiscal spending

Federal government spending added about 0.3 percentage points to GDP growth in 2023. We expect fiscal policy to only mildly boost economic growth in 2024.

Contribution of government spending to GDP growth

Percentage Points



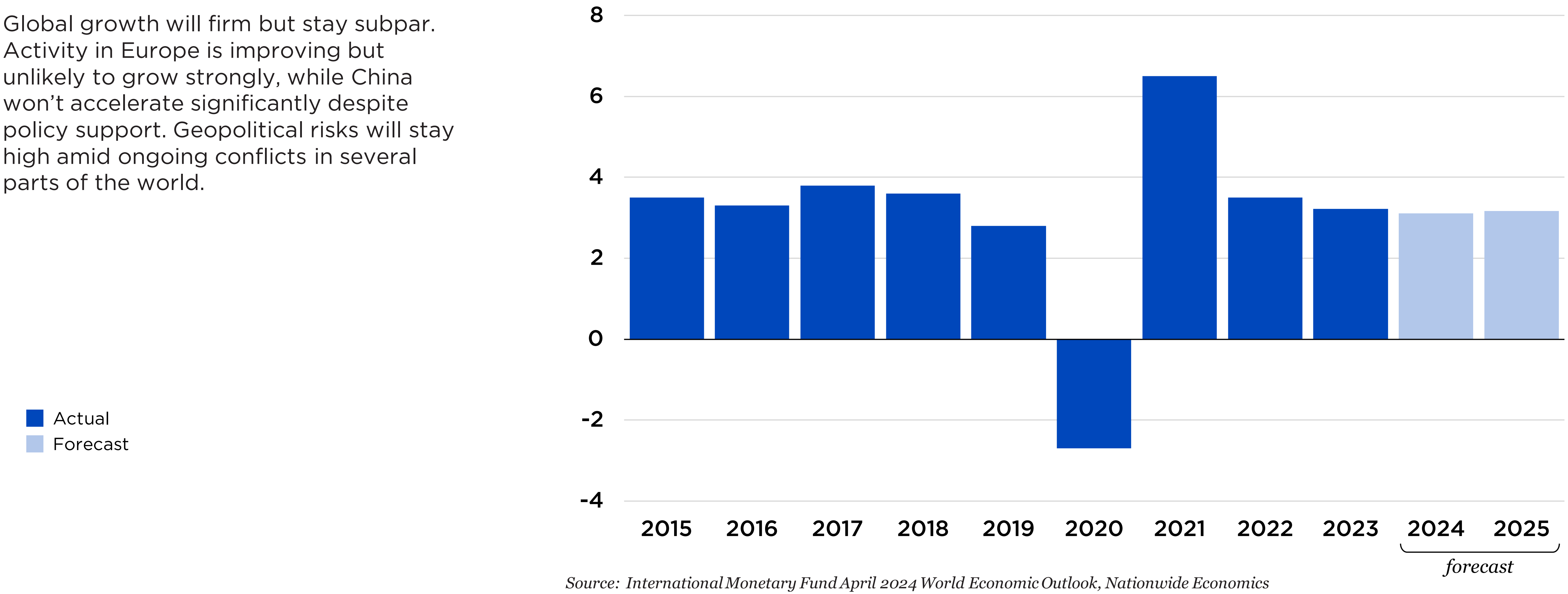
Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

Strengthening global growth will support U.S. exports

Global growth will firm but stay subpar. Activity in Europe is improving but unlikely to grow strongly, while China won't accelerate significantly despite policy support. Geopolitical risks will stay high amid ongoing conflicts in several parts of the world.

Global GDP growth

Year-over-year percent change



Source: International Monetary Fund April 2024 World Economic Outlook, Nationwide Economics
Note: Forecast includes Nationwide Economics' latest U.S. projections

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