FIDUCIENT Advisors

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QUARTERLY QUICK TAKE: HOW PRESIDENTIAL ELECTIONS IMPACT YOUR PORTFOLIO — WITH BRAD LONG

Hello and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo, always good to be joined by co -host and my business partner, Devin Francis. Well, we passed the midpoint of 2024 and that means it's time to check in with Fiducient's Chief Investment Officer, Brad Long. Today we'll not only receive our typical recap on the economy and markets, but we'll dive into the fast approaching presidential election and share thoughts on how that might impact your portfolio. Devin?

How's your summer been and how are you doing today?

I'm great. Summer's off to a wonderful start. We welcome the summer with a family trip to Iceland. So that was a highlight so far. And of course, always happy to have Brad on the show. Great to have you back. So Bob mentioned the mid -year recap. So why don't we start with some economic highlights that you might note from the first half of the year.

Sure, well again, thanks for having me back and I'm pretty jealous about ISIL. That sounds like a lot of fun. So on the economy, look, the economy has been robust in the first half of 2024, right? Much to the dismay of many of the prognosticators who were calling for recession in 2023. Clearly we've passed that mark, but sitting here in 2024, really it's been quite a luxury for the Fed. The Fed has a dual mandate.

full employment and price stability. And when we're trying to get inflation under control, the Fed hasn't really had to worry about full employment. We sit here today with a very low unemployment rate and the economy's been chugging along. Now I will say in, call it more high frequency or near return data, you could call it maybe some cracks, not breaks.

ISM manufacturing and services indexes, those are measures of, you know, 100 % is extreme growth and zeros no. So 50 is the line of demarcation. In June, those fell below 50 for the first time in quite a while, both at 48. You know, so that is something where you can start to watch. Jobless claims, you know, still are fairly limited, but one of the things we're watching closely is the resiliency of the consumer. As we all know in the United States here, the consumer is the economic engine.

for US GDP. And, you know, when you look at specific consumer related data, things like credit card receivables, the cost of any kind of debt, whether that's a mortgage, whether that's a home, a loan on a car, it's becoming harder and harder for a consumer to continue to spend at the rate at which they're spending. We've seen a little bit of those cracks and things like auto auto loan and credit card receivable bonds where defaults are rising.

But again, not to the tune of something that's really concerning, but just something that we're continuing to watch. So all in robust economy, but watch on the corners.

Yeah, Brad. I'm so sorry. Do you mind if I jump in? Because I've got a little, OK, OK, great.

So that's the, sorry, Bob. No, it's okay. Not at all.

Yeah, that's great, Brad. And I'm actually in the midst of writing a paper and it plays a little off of some of your and your team's earlier work. And it's just called progression toward recession. Not to say that it's coming tomorrow, next week, next month, but it's coming at some point, right? And you and your team have done a great job of laying out that it's part of a normal cycle. And at some point it will be here. So we're paying attention to all of those things. So maybe a quick recap on the stock and bond markets in the first half of the year.

(03:53) Yeah, so with that backdrop of, you know, continued economic resilience, you know, the S &P is kind of back to its old tricks. So U.S. is outperforming most other countries and other assets. Equity is outperforming debt and specifically within equity markets, you have kind of the larger stocks and the growthier stocks outperforming the smaller stocks and the value oriented stocks. If that sounds like a repeat from specifically a couple of years ago, but even

as of most recently, it's because it is. That is certainly the pattern that has happened here, you know, as the markets continue to move forward. We do still have a handful of stocks driving a lot of the return. You know, Nvidia, which is a name that probably, you know, maybe most investors weren't familiar with at some point, but now many are. Incredibly, you know, at the time of this recording, you're to date up 154%. And that's following multiple years of

incredible rates of return. And so you still do have a handful of stocks leading here in the US. And then on the bond side, kind of similar, right? Where you have credit or basically the risk of default, things like high yield or credit, those continue to do well. And duration or interest rates is largely underperformed. The higher for longer instance of the Fed has led to

you know, longer duration bonds, underperforming shorter duration bonds. And that also sounds like a rinse and repeat from a few years ago.

(05:26) So Brad, you and your team published the full year outlook at the beginning of the year and given results so far in 2024, have expectations for returns changed at all? And if so, how have they changed?

(05:40) You know, substantially, not really. You know, Devin, as you and Bob well know, as we're building our expectations, we're certainly not building them from a calendar year perspective. You know, we're building 10 year forward looking risk and return expectations. You know, and while markets have been up, you know, here in the US included, earnings have done well as well. So equity markets are not cheap, especially here in the United States.

but they haven't substantially changed from the beginning of the year. So, you know, as we look at our, you know, long -term capital market assumptions, we certainly do see, you know, maybe a little bit lower expectations from where we started the year, but we also come out each year and really describe kind of

three primary themes driving markets. So for 2024, those were the messy middle of inflation, you know, basically having gone from nine and change, you know, towards the Fed's target of 2%.

our expectation was we'd be moving in the right direction, but it would be a rocky road along the way. And that certainly has been the case. Prepare, not predict. Maybe that's a progress towards recession or Bob, as you were phrasing it, this idea that we don't have to predict when markets will turn. We have to build a portfolio that's resilient enough to handle that. And that's certainly something we did coming into the year. And then our third theme was really concentrated consequences.

It's the idea of a handful of stocks driving the vast majority of share return. And we certainly have no crystal ball as to when that will change. But we talked a little bit about this last time, this idea of economic gravity, that things ultimately do tend to revert. And we wouldn't expect just the same handful of a handful of stocks here in the United States to be the only winners.

But that has certainly been the case year to date. So our positioning by and large has not shifted mid -year, but as you would expect, right, without material changes in either valuation risks or opportunities, you wouldn't expect, you know, some mid -year shifts.

(07:44) Brad, I think a lot of our listeners are frankly any investor overseeing a pool of money is pretty interested in the elections and how that might potentially impact their portfolio. We'll get to that in just a moment. Curious first, if there are any, we'll call them wild card considerations for investors at this point, whether it be, you know, Nvidia's outperformance, the over -weighting of a select number of stocks in the S &P or even things like private credit. Does anything have your spidey senses up at this time?

(08:14) Yeah, I'll do a bit of a grab bag on the grand bag, if you will. So starting with the maybe more common mainstream and talked about ones. So election, I know we'll get into in a moment. Until basically the 27th of June at the debate, the conversation was really around what will policy look like under a second term of Biden or a second term of Trump?

some of the conversation has shifted here to see, will it be a Biden or Trump election full stop come November with some of the calls for Biden perhaps giving up his candidacy? That was always kind of a wild card in our minds, not because of maybe performance from a debate, but just frankly, the elevated age of both of the candidates, it's not a 0 % probability that there would have to be a shift.

perhaps medically induced, right? So that was something that was a little bit always in the back burner for us. And it seems like has come a bit more to the front burner.

(13:32) Bob, you mentioned private credit. Private credit is an interesting space. I was actually on a panel just a few weeks ago, an adjacent panel speaking on private credit, and the three individuals that were up were basically competing for who loved private credit the most. So a lot of money flowing in that direction. And as an asset, there are some things that are certainly attractive about it. But we would probably caution in to say,

(13:58) We don't think many investors kind of fully appreciate the amount of risk that goes into an illiquid asset lending to usually a kind of a smaller sized business that's a non -investor grade credit. And so the allure of kind of higher income and return is certainly attractive and something we pay attention to. But it has to be relative, relative risk. We don't feel like we don't get the sense that many investors are as attuned to that because private credit has really come into its own

and has never seen a default cycle like we saw in the GFC when private credit was a very nascent small asset class. And so that would maybe be something we would caution someone that really seemed to be pretty effusious over the asset class today.

(14:42) You remind me of just kind of an age old lesson that we sometimes forget, which is wherever the money is really flowing, you know, have some sensitivity and maybe some caution around that, around that space.

(15:00) So we've kind of teased the election a little bit, and I know that we don't want to get into the details of this particular election, and indeed, perhaps we don't even know the details of this particular election. But Brad, what's the overall perspective on how elections impact economies and markets?

(15:17) Yeah. I mean, look, if investing was as easy that every four years on an economic cycle for a general election would be a bad year for the market, like, I don't know that I would certainly have a job, right? So there's a lot more to it than that. Practically, the punchline for us is oftentimes elections don't tell us a whole lot about markets. When you look

back over history. Markets have been up in general elections years. They've been down in general election years. Frankly, in just the calendar year alone, the average return in the general election year is about 11 and a half percent. Like that's a that's a very good return. So it's not as if it's, you know, it's this harbinger or bearer of bad news. Now, relative to non -election years, general election years tend to underperform a little bit. Why is that? Behaviorally,

You know, we are wired as investors to kind of fear the unknown. Elections, if anything, drum up a lot of emotions in individuals, and emotions and elections don't often go well together. Now, what actually is fairly interesting is the economy or the markets tend to tell us quite a bit about elections, but the inverse isn't exactly true. So if you look back, you know, since the 1930s,

the vast majority of sitting presidents, right, an incumbent running for a second term, if there was no recession in the previous two years, all but one, really Lyndon Johnson, who ran, departed the race, were reelected. Whereas the inverse, if you look at the number of elections where a recession happened, where an incumbent was rerunning, really very few were reelected, except for Harry Truman, kind of following World War II. And so,

Markets actually end up telling us a little bit more about elections than the inverse.

(17:20) So do you have any insights on market performance in the second half of the year following such a strong start to the year? And then I guess more specifically, if we kind of hone in on an election year with that type of dynamic, any thoughts about that?

(17:35) Yeah, I mean, first half versus second half, there's not a kind of a strong correlation of, you know, the closer we get to an election, maybe the rockier it gets. I would say what would probably be more predictive or interesting for the second half of this year is one, as we just talked about kind of the perhaps building uncertainty of even the candidacy of, you know, those the presumed candidates for this election cycle, as we noted before, uncertainty is one of those things that markets dislike even more than bad news. Bad news, we can

consume, we can understand, and we can try to quantify. And unknown creates even more unease, right? And that tends to be more impactful on markets. That being said, like if we were more interested in trying to predict or understand the second half of the year, I'd be thinking more about the earnings cycle, what current valuations are, potential policy and change coming down the pike from either parties, whether that's tax reform, whether that's trade and tariff.

you know, not necessarily is it a blue or a red ticket in Pennsylvania Avenue. Those don't tend to be as meaningful.

(18:44) And then the final politically related question, you already talked about how the stock market generally rises and there's no prescription as to how it's going to behave in an election year. But is there anything history can tell us about the breakdown in political leadership? So is one party in the White House and controlling Congress, does that tend to be better for the economy and for markets or does split government tend to be more beneficial?

(19:12) Yeah, it's a great question. In short, the markets have succeeded under, call it blue, red and purple, right? You've got the executive, the legislative, and then you have kind of the trifecta where you have a one party's control of the executive branch and the Senate and the House. When you break down each of the math, you know, in the return over those years, it's pretty fairly split. Yes, in some instances,

You know, a Republican controlled Senate has done better than a Democratic controlled Senate or an executive branch led by the Democratic party has outperformed a Republican led, but the margins are fairly thin. And frankly, there's nothing definitive to say, okay, if it were this or that, this is the best for the market. I remember the first Trump election cycle. We had clients, we have clients on all ends of the political spectrum.

Some calling in and saying, you know, if he gets elected, you know, I want to go to cash before, you know, the inauguration and vice versa, right? So I'm calling in saying, this is going to be very good. As we know, like that just doesn't end up being the primary driver. And the good news really for investors is like markets just don't play politics. Now policy from elections, from laws enacted from the Senate and the Congress and, you know, signed into law by the executive branch.

Those can impact markets and companies and earnings. Elections though are more about votes than they are about policy. And so they just don't tend to be as predictive when it comes out.

(20:52) So Brad, that's super helpful and yet not overly, let's say predictive, right? On how an investor should position themselves. And it has me thinking about what we always talk about, which is let's get clinical, right? Understand the client's objectives, risk tolerance, what they're truly out to achieve, and then try to build a portfolio that gives them a fighting chance of doing that. So with that said,

Here we are today, interest rates will likely be cut at some point, right? And just curious, your thoughts there, and maybe since we want to be clinical about the portfolio, and I'd have things just hinge on what's happening in an election, any other practices or strategies that you'd like to touch on at this point?

(21:41) Yeah. So interest rates, obviously that is a point of focus for the markets for quite some time. The primary component there is inflation, which would allow the Fed to change their open market policies, which would then modify interest rates. As we sat in the beginning of the year, and we talked about inflation coming towards closer to the Fed's target of 2%, maybe

Frankly, we think 2 % is somewhat unrealistic at this point in time, like 3 % is probably better, but the Fed does not have the ability to unwind some of that narrative because it would look like they're giving into inflation. So they're kind of stuck between a rock and a hard place. Now, as the inflation continues to moderate, doesn't reaccelerate, the Fed is, they have their foot on the economic break.

Historically, the neutral rate where the Fed is not on the break or on the gas, they're just gliding, is about a real Fed funds rate of 1%. So, inflations call it mid threes. The Fed's policy rate today is mid fives, five and a half, right? So, there's some space between there. If we just continue to have moderate inflation, it doesn't have to be a perfect 2 % inflation.

That gives room for the Fed to start to slowly ease. So that would be the soft landing scenario. The second way is, they often talk about the Fed often increases interest rates on an escalator, but decreases them on an elevator, meaning they make bigger cuts because of economic weakness. If we do have something like a hard landing, a recession occurs, the inevitability of a recession, it is coming, we don't know when, then interest rates could drop far more precipitously and far faster.

Either way, both of those paths are towards generally lower interest rate policy. And the only path we think higher would be structurally accelerating inflation, probably that above 4%, maybe even getting to 5%, which we just don't see in today's environment. So multiple paths lower, that potentially provides a tailwind for investors just from a price perspective on fixed income. And it also creates this element of resiliency that

If we get a soft landing, guess what? You're getting a bit of a tailwind and fixed income and you get paid to wait. If it's a hard landing, right? Some type of economic event or weakness occurs, then you probably have even more resiliency built in there. And that gets back to your point, Bob. I'm just like, why do we own certain asset classes in the mix of which we own them? It's for a resilient portfolio to be able to weather A,

uncertainty and B, the probability of paths. There's multiple paths of which we could take. We don't know precisely which will go down, but we'll have a

high probability for one and position the portfolios ahead of it accordingly.

(24:38) Great. So we have obviously covered a lot as we always do and we're fortunate enough to have you on the show. Anything else that you'd like to add or underscore to the conversation?

(24:50) I would say as, the general election cycle really starts to ramp up, and we get closer to November, key kind of component that is probably going to be part of the debate and conversation will be just deficits, and kind of spending and policy. That is something that, you know, we're certainly watching and we'll continue to watch and how we position portfolios. But I think.

it's probably something that will start to be on investors minds more. And I just want, you know, especially for our listeners and current clients to know that's something we're well aware of, we're positioning around, we understand and kind of get the knock on effects. But I can just see that being a question that's going to be rising over the coming months. And I would say to prepare for that, you know, we'll be writing on that in the coming months, but just we're well aware of that and we're positioned, we think, according.

(25:50) Great. Well, as always, thank you for your expertise. Thank you for your time. We always love having you on the show. Appreciate it.

(25:57) Thanks for having me.

(25:59) Thanks so much, Brad. And for our listeners and viewers, when you think about some of the topics Brad touched on, interest rates, market value, which the economy and a whole lot more, it's frankly a lot for an investor to process. So if you sit on an investment committee or perhaps you have oversight over an endowment or a foundation that can benefit from informed input, feel free to reach out to me or Devin either on LinkedIn or at the email in the show notes. So to all you good stewards, thanks for investing time to help your nonprofits prosper.

We'll connect with you soon on the next episode.