

6/4/2024

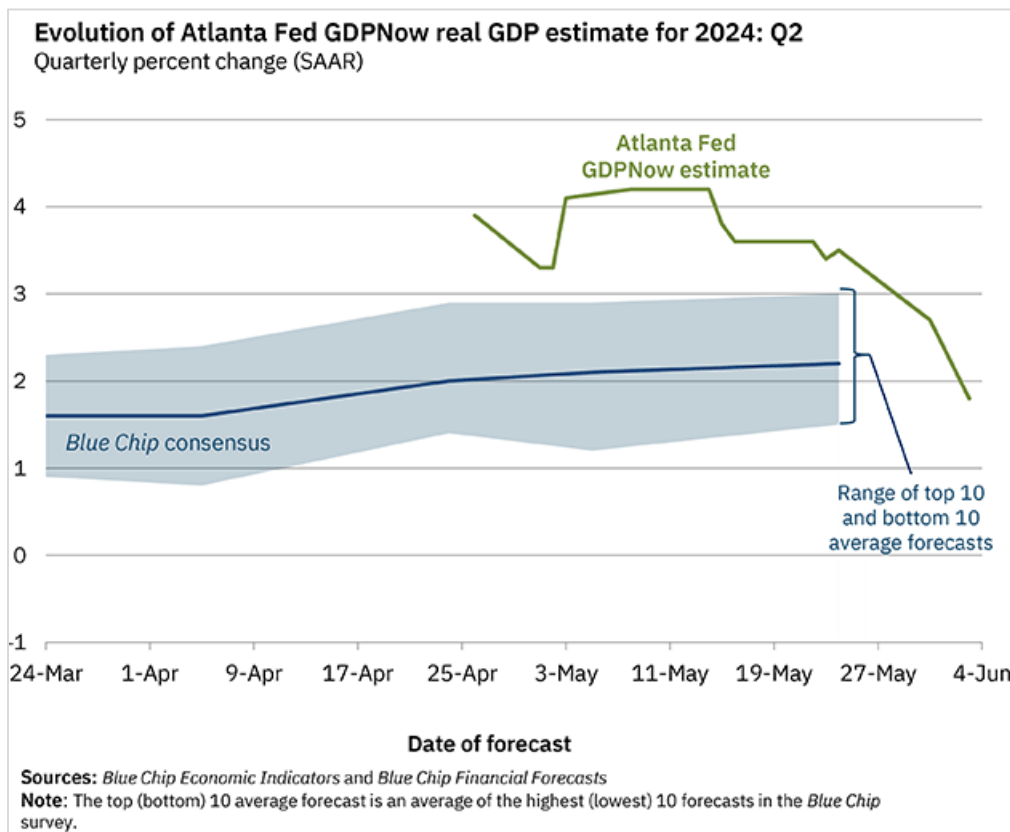
Summary: Increasing economic and market signals suggest a U.S. slowdown, though it's still early to call for a recession, particularly before the upcoming November election. Real economic activity appears to be decelerating this quarter, as indicated by a pullback in commodity prices and a downshift in U.S. spending and investment, despite the upbeat mood among industrial businesses.

Timing the market around adverse macro events remains highly challenging, especially considering the optimistic earnings growth forecast for S&P 500 companies over the next two years. However, investors, particularly those who are more risk-averse or have shorter time horizons, could consider increasing the defensiveness of their portfolios. This can be achieved by extending the duration (interest rate sensitivity) of their fixed income portfolios and incorporating downside protection within equity portfolios while maintaining some upside participation.

2Q 2024 Real GDP Estimate

The real GDP estimate for the second quarter of 2024 has dropped significantly due to a decline in consumer expenditures and private fixed investment, notably fixed residential investment.

According to the Atlanta Fed GDPNow model, the real GDP estimate for 2Q 2024 has dropped to 1.8% annualized, down from over 4% projected earlier in the quarter.



Source: Atlanta Fed (atlantafed.org) as of 6/4/2024

This deceleration in economic activity could be interpreted as confirmation of a soft landing, as there are fewer signs of economic overheating and overinvestment.

The key to the soft landing narrative is whether the U.S. labor market can maintain stability amid economic deceleration. Upcoming non-farm payroll releases are expected to shape near-term expectations regarding potential shifts in Federal Reserve policy.

Real Interest Rates

Real (inflation-adjusted) interest rates remain high as long-term inflation expectations have dropped in response to a slowdown in near-term inflation.



Source: Bloomberg

Long-term real interest rates remain above 2% despite signs of inflation slowing down from peak post-pandemic levels. Real rates remain well above both pre- and post-pandemic levels.

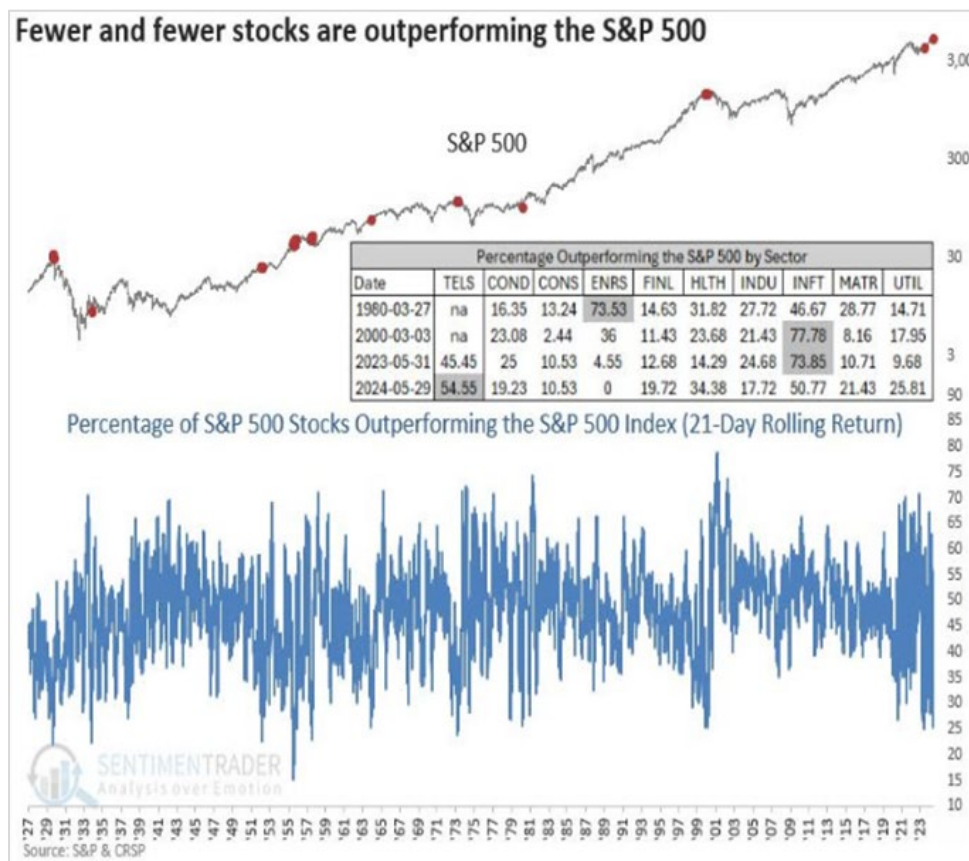
Although the Consumer Price Index (CPI) remains above 3% year-over-year, the Personal Consumption Expenditure Index (PCE) is now below 3% and continues to trend lower. The soft landing narrative requires inflation to slow enough to meet the Fed's long-term projections while labor market conditions remain stable amid decelerating growth.

Short-term interest rates, especially money market funds, remain attractive near 5%, but these rates could drop once the Fed starts cutting rates. Fed Funds futures still anticipate at least two rate cuts for the

remainder of the year, with the first cut expected at the September FOMC meeting. The timing around rate cuts is highly uncertain, depending on how preemptively the Fed shifts policy in response to a labor market slowdown.

Equity Sentiment

Equity sentiment remains highly euphoric despite narrowing market breadth, with capital appreciation concentrated in a handful of technology stocks.



According to Sentiment Trader, the percentage of stocks outperforming the S&P 500 Index has narrowed to levels below those of the dotcom era in the late 90s. This narrow breadth is pervasive across most sectors, not just growth sectors.

Although off recent lows, the Nations Skewdex Index, which measures the value of out-of-the-money versus at-the-money equity put options, still implies low investor appetite for downside equity protection.

This indicates that investors still favor equities but are increasingly concentrating investments in fewer companies, particularly those benefiting from the surge in capital expenditures on the buildout of artificial intelligence capabilities.

Be cautious moving forward as the risk/reward for equities looks increasingly asymmetric. Should the growth environment slow sufficiently, the economic tide may no longer lift all boats, prompting investors to

seek higher ground by crowding into growth technology stocks. With real rates attractive across the Treasury maturity spectrum, investors may consider adding some defense to their portfolios while remaining fully invested in the markets.

Actions for Advisors to Consider Taking Today

Increase duration by shifting out of cash instruments and into intermediate or longer duration fixed income strategies. Consider:

- 3D Fixed Income ETF Models, including the Tax Sensitive versions*
- Ocean Park Strategic Income
- SignalPoint Stable Income
- 3D Targeted Fixed Income (2024-2027 series)*
- Invesco BulletShares Corporate 0-10 Year Portfolio

Increase allocation to managed models that employ dynamic equity hedging. Consider:

- Toews Managed Risk Blueprint
- Swan Defined Risk Fund
- Kensington Dynamic Growth Strategy

Increase the breadth and quality of U.S. equity holdings. Consider:

- Zacks All Cap Core
- Eagle Ridge Global Quality
- Alpha Quant Core Equity

*Freedom proprietary models.

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Except as otherwise specifically stated, all information is as of June 4, 2024.