First Carolina Wealth

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THOUGHTS TO START YOUR WEEK

President Biden's 2025 Budget Proposal

Known as "The Green Book," the President issues a budget proposal for the next fiscal year around this time each year. President Biden has made significant proposed changes in the past and the divided Congress has failed to implement them. Will this continue?

- It is worth our time to focus on these proposals in this and future submissions, because, while no one knows the future makeup of the White House and the two branches of Congress, if even some of these proposals are enacted into law, it could dramatically alter the taxation of the wealthiest taxpayers and substantially reduce the wealth that will transfer to future generations (rather than the U.S. Treasury). No one enjoys focusing on estate planning or their own mortality, but this involves REAL MONEY.
- An example is the proposed elimination of the preferred long term capital gains rate when incomes exceed $1 million. This might be considered limited to the rich until you consider that the sale of a business or a large investment property could easily raise AGI over $1 million in the year of sale, removing long term capital gain at a crucial point.
- Similarly, the proposed replacement of step-up in basis at death with a realization event on gift or death would remove a foundational estate planning tool to avoid capital gains tax. While the proposal includes a $5 million exemption, this will be a major hit for larger estates, occurring either at death or at an earlier transfer to a trust for asset protection or estate planning purposes.
- We will revisit these issues in future submissions.

Weekly Economic Insights From Our Investment Managers

Stocks experienced a relief rally last week as tensions in the Middle East eased and better-than-expected earnings from some of the corporate giants mitigated concerns despite what was a mostly negative week of economic data. The S&P 500 climbed over 2.5% for the week, bringing this year's total increase to just under 7%.

Markets began stabilizing on Monday as fears over escalating conflicts between Israel and Iran subsided and what appeared to be a short covering rally from technical levels ensued. Tuesday saw a further boost with positive earnings reports from a few of the core cyclical names, but the momentum slowed on Wednesday. Thursday wasn't pretty due to disappointing tech earnings and a troubling GDP report that, when paired with hot inflationary data from the core prices index, hinted of stagflation. Friday's Core PCE data coupled with strong earnings from a couple of tech giants seemingly calmed investors' nerves and gave the markets a boost heading into the weekend.

Key Takeaway:

Last week's economic data was not pretty. Thursday morning felt like one of those "oh crap" moments where I had to remind myself that one poor set of information does not define a trend or change the overall environment. Slowing growth and sticky inflation are the market's worst fears, and I was quite surprised to see the rebound Thursday afternoon and Friday with a relatively extensive move up, given that Core PCE was not exactly a positive read either. With that being said, the recent 5% pullback we've witnessed seems justified, and it's always nice to see technical levels respected as that implies an orderly flow is still intact. The round number of 5,000 for the S&P, together with the large gap dating back to Nvidia's earning spark back in April are, for now, the critical technical support levels we will be keeping an eye on and would like to see the recent lows hold.

The Week Ahead:

The pivotal event this week is Wednesday's FOMC decision and without updated dots in this meeting, any clues regarding a potential rate cut in July will emerge from the FOMC statement or Powell's press conference. The Board releases "dot plots" showing what each member expects future rate policy to be. They did not do that at this meeting. Factors favoring a July rate cut will help market sentiment, while indications against it will likely drive yields up and impact stocks down.

Economic data focus this week centers on the three key reports: the Jobs report, ISM Manufacturing PMI, and ISM Services PMI. A drop below 50 in the PMIs could signal an economic downturn and when combined with last week's soft data, would not look nice. Friday's jobs report will also be closely watched as everyone is now on a heightened alert coming out of last week's surprisingly soft data.

Tidbits & Technicals: (No change from last week)

Current Headwinds:

- Valuations seem frothy given the current rate environment, leaving the markets subject to a potential swift pullback
- "Higher for Longer" – Risk that the Federal Reserve waits too long to begin lowering rates and threatens economic growth
- 10-year treasury yields broke out to new highs for the year, signaling that bond investors may be beginning to believe in the "Higher for Longer" thesis

Current Tailwinds:

- Optimism surrounding Artificial Intelligence (AI)
- Fed pivoting from raising rates to potentially cutting in the future
- Strong labor market
- Solid economic growth
- Continued earnings growth (the pace of which may be slowing)
- Momentum

- Participation is broadening with cyclicals taking a leadership role while the tech-trade begins to fade

Sentiment:

- Credit spreads remain tight, signaling the bond market (aka "smart money") is not worried about a recession soon.
- The VIX (CBOE Volatility Index) has broken through this year's "complacency zone."
- The CNN FEAR & Greed Index fell into the "FEAR" territory last week. "Buy when others are Fearful" should ring a bell.

Intermarket Trends:

- The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) all posted new highs in the past few weeks, signifying a positive trend.
- Bond investors have been pricing in the idea of "Higher for Longer" recently, with 10-year treasury yields above this year's trading range to make new highs.
- The US Dollar is trading near the upper end of this year's trading range due to foreign central banks being the first to cut rates and others taking further rate hikes off the table while the Fed continues its campaign of tough rhetoric.
- Gold continues to set record highs.
- Industrial metals caught a bid recently, and copper recently broke out of a multi-month trading range to the high side. Discussions on supply shortages are emerging.
- Oil is trading near the top of its 2024 range but well below last year's highs.

Tying it all together:

Following a 25% surge in the S&P 500 over the past several months, it should come as no surprise that recent market sentiment has shifted. Declines such as these are very common in the marketplace and tend to occur several times per year in a normal bull market cycle. Investors tend to push things too far when optimism prevails and momentum takes over, which may trigger a "cooling period" to allow the fundamentals to play catch up and investors a chance to reallocate funds from those areas of the market that may have gotten ahead of themselves (think AI and tech stocks) into the underappreciated.

This current volatility seems to stem from three main factors: a recalibration of expectations regarding Fed rate cuts, geopolitical tensions in the Middle East affecting oil and commodity prices, and a mixed outlook from companies during the S&P 500 first-quarter earnings season, despite beating forecasts. While these are important factors in determining valuations, they are (for now) considered short term in nature.

When assessing the current situation, one must also consider the underlying strength of the U.S. economy which is being supported by robust consumer demand and a healthy job market, along with signs of stabilization in global economic growth and the fact that inflation is trending downward. These are the variables that will shape future market dynamics and should play a far more important role in shaping one's allocation decisions. Very recent data has been soft and warrants our attention, however, we must gather more clues and not attempt to make any rash predictions based off a few weak data points. We will follow all future developments closely and report our findings to you here.

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