The Bottom Line - Q3 2024

THE BOTTOM LINE

THIRD QUARTER : 2024

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

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MARKET INSIGHTS

BY JEREMY I. BECK

The markets have been obsessed with the timing and number of the Federal Reserve Interest rate cuts in 2024. More than halfway through the year, the Fed has maintained the federal funds rate at the current level, with only one rate cut expected later this year. Magically, Chairman Powell is having his Captain Sully moment, navigating a soft landing for the economy, which has only happened four times since World War II and the first in over 30 years. Notably, despite a slowdown, the economy has avoided entering a recession.

Significant progress has been made in controlling inflation over the past couple of years.

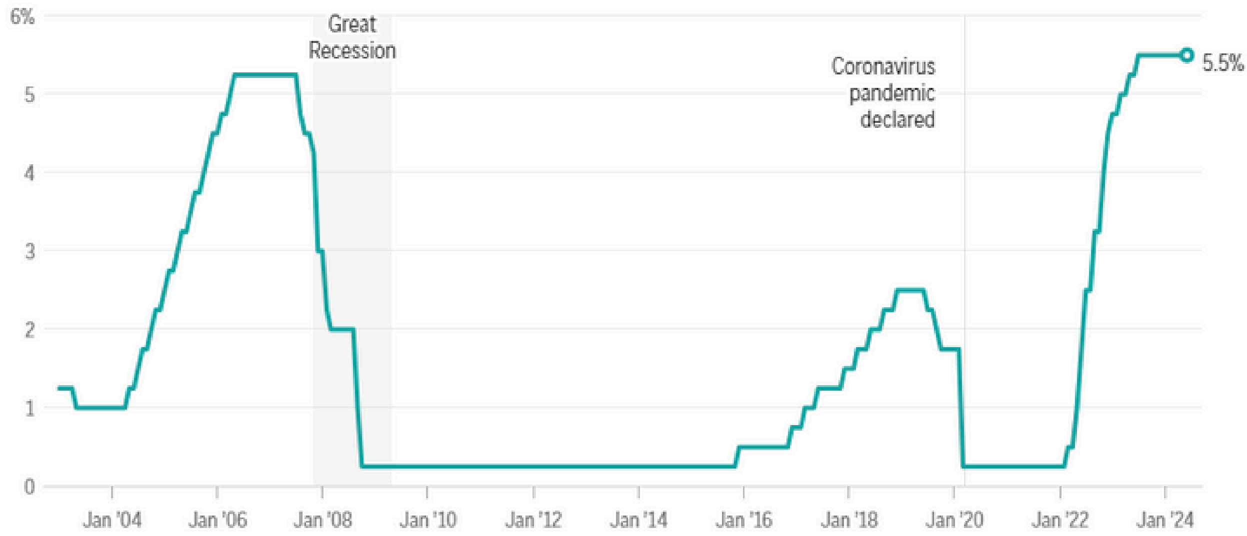
MARKET INSIGHTS - CONT'D

According to the Bureau of Labor Statistics, the Consumer Price Index (CPI) reached a peak annual rate of 9.1% in June 2022 but fell to 3% a year later, settling at 3.4% in April 2024. While the Fed is likely pleased with this deceleration, it remains cautious, maintaining the 5.5% Federal Funds rate (chart below). Investors have responded positively to the soft landing, driving global stock markets to all-time highs. Additionally, credit spreads are exceptionally tight, and most indicators of capital market volatility are subdued.

While the environment for risk assets remains generally favorable, the early gains from the soft landing may now be behind investors. The road ahead is likely to be more challenging. Factors such as the soft landing, a resilient labor market, declining inflation, robust consumer spending, strong corporate performance, and anticipated Fed rate cuts are already reflected in stretched valuations and record-high asset prices.

Since 2020, we have witnessed significant upheaval, with the largest fluctuations in output and inflation since World War II. The initial drop in output during the pandemic was brief, but the effects of excessive stimulus and rising consumer prices have lingered. Additionally, the Russia-Ukraine conflict has severely disrupted energy supply chains.

Federal funds rate



Values represent the upper limit of the target range for overnight loans between banks.
Source: AP reports; Federal Reserve Bank of St. Louis

AP

However, greater stability is emerging, with inflation on a downward trajectory. While US inflation has proven more persistent than expected, the combination of aggressive monetary tightening, easing supply chain issues, and more stable demand patterns as COVID-related spending subsides suggests a gradual improvement. The Federal Reserve remains committed to its 2% inflation target, and we anticipate inflation to settle between 2.25% and 2.75% by the end of 2024.

New Challenges

If inflation proves more persistent than anticipated, interest rates may need to remain elevated for an extended period, even as the job market begins to cool. Additionally, an inflationary supply shock could squeeze profits without alleviating pressure on rates. Higher US borrowing costs and a stronger dollar could have various negative impacts globally, particularly in emerging economies.

In the coming months, we expect the markets to be increasingly focused on the unpredictable outcomes of the US presidential and congressional elections. The election of a US president will significantly influence foreign policy, affecting security and trade relationships. However, this choice is unlikely to determine the broader economic direction or market opportunities. We must remain prepared for a range of potential impacts while ensuring our core portfolios remain resilient.

MARKET INSIGHTS - CONT'D

What Challenges Might the World Face in the Coming Years?

Here are several key concerns that many investors are currently considering:

Heightened Russia-NATO Tensions
As the war in Ukraine continues, the risk of spillover remains significant. The ongoing supply of Western weapons and real-time intelligence to Ukraine has heightened tensions with Russia, especially in light of Ukrainian strikes on Russian territory.

Middle East Conflict Contagion
The hostilities between Israel and Iran in April were intentionally contained. However, the potential for escalation exists. Amnesty International reports that approximately 116 individuals are believed to be held hostage by Hamas and other groups in Gaza, with negotiations for their release yielding no positive results.

Persistent Inflation
Although inflation has begun to slow, essential costs such as food, rent, and healthcare remain significantly higher than pre-pandemic levels. Rental and homeownership costs, which account for over one-third of the Consumer Price Index, rose 0.3% from May to June, with rents increasing by 5.1% year-over-year—much faster than before the pandemic. If inflation does not meet target goals, interest rates are likely to stay elevated, which poses a challenge for the stock market.

Escalating US-China Tensions
The tensions between the US and China are often referred to as a "new cold war." As the world's two largest economies, the rivalry is expected to intensify regardless of the outcomes of the upcoming US elections.

Stretched Tech Valuations
Tech valuations are indicating potential concerns, as the sector now comprises 35% of the S&P 500—the highest level since the early 2000s. This concentration raises alarms, reminiscent of the tech bubble that preceded a significant market downturn in the Nasdaq Composite, which took years to recover from.

What does this mean for investors?
As we evaluate the current risks, several key points emerge for portfolio rebalancing. Firstly, diversifying beyond mega-cap stocks is advisable, as small and mid-cap assets are trading at relatively lower valuations compared to their larger counterparts. On the fixed income side, optimizing income with short-term core bonds, particularly those with investment-grade ratings, is recommended. One- to two-year certificates of deposit (CDs) continue to offer elevated rates, with yields around 5.00% annually. Have a wonderful summer, and get ready for the Buffalo Bills to take the field in less than seven weeks.

-Jeremy Beck, Founder & CEO

FIXED INCOME OUTLOOK: STICKING THE LANDING

BY MATTHEW J. PITROLA

It feels like it has been an eternity since the Fed paused its interest rake hiking cycle in July of 2023. Investors have been patiently waiting for 11 months to hear when the Fed will cut interest rates. The next FOMC meeting will be on July 31st and we all have the same question. Will it be another pause? Or could this be the long awaited first interest rate cut?

Looking at inflation and labor market data, we will see a tale of two stories. The Consumer Price Index (CPI) has not made any significant improvements over the last 12 months, after bottoming near 3% in June of 2023:

FIGURE 1: Consumer Price Index (CPI) - Percent Change YOY

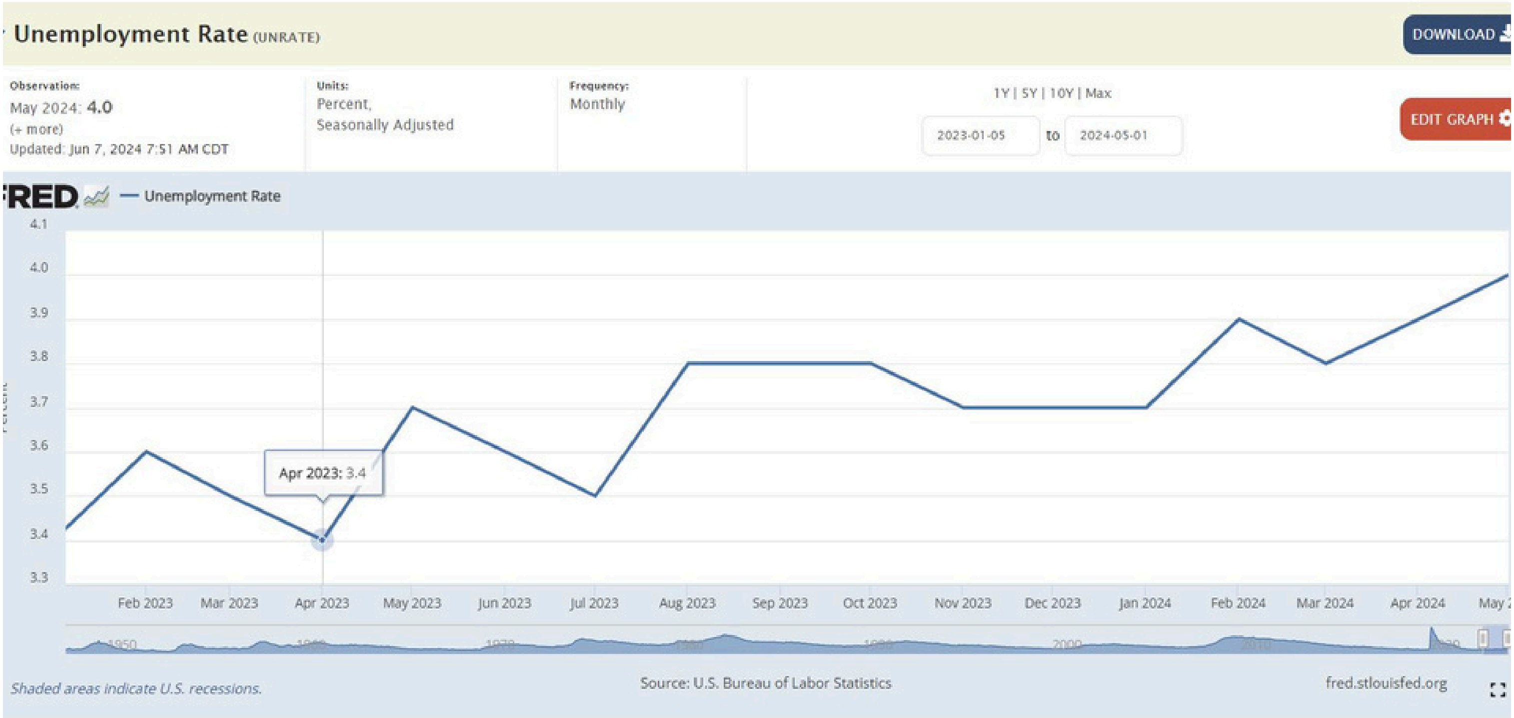
Source FRED (Federal Reserve Economic Database)

While CPI has been stuck in a lull period over the last 12 months. The labor market has started to revert back to pre - pandemic norms. With Unemployment rising back to 4.00% and wage growth continuing to moderate from the peak levels of 2022.

In most economic settings, unemployment rising as it has over the last 12 months would be a larger concern. But with the Fed's current restrictive stance, a loosening of the labor market is exactly what the Fed has been attempting to engineer. I anticipate that the labor market will continue to show signs of weakness over the rest of 2024 as companies continue to grapple with higher financing costs and slower economic growth. Unemployment ending the year between 4.00% - 4.20% is the current expectation for the remainder of the year per the Fed at the June FOMC meeting. Anything above 4.20% should catch investors attention.

STICKING THE LANDING - CONT'D

FIGURE 2: Unemployment Rate - January 2023 - June 2024



Source FRED (Federal Reserve Economic Database)

FIGURE 3: 3 Month Moving Average Unweighted Median Hourly Wage Growth

Source FRED (Federal Reserve Economic Database)

With the labor market showing subtle signs of weakness, the Federal Reserve may have the ammunition needed to begin to slowly unwind their current stance before the end of the year. As of now, based on the CME Fed Watch tool. The market is currently pricing in two .25% interest rate cuts from now through year end. With the first slated to arrive in September of 2024.

STICKING THE LANDING - CONT'D

FIGURE 4: CME Fed Watch Tool - December 2024 Predictions

CME Group

Opportunities / Risk for the remainder of 2024:

After the great reset of 2022 in the fixed income markets, there are still a plethora of opportunities for investors to lock in yields above 5.00% on the fixed income side of their allocation.

Picking the correct investment choice ultimately does come down to risk tolerance.

If investors would like to lock in 5.00%+ with limited to no risk, FDIC insured CDs will be able to provide a great inflation hedge.

For investors with a slightly higher risk tolerance, I believe that ensuring your fixed income holdings are slated to benefit from Fed rate cuts is your next best choice. This means finding a bond position that has a duration between 2-4 years ideally.

If you are still skeptical about the US economy, and the likelihood of a recession arising through the end of the year or into early 2025. You may want to consider core bonds, with a more intermediate duration of 7-10 years. These positions should experience a healthy dose of price appreciation if a recession materializes and longer term rates head lower.

Summary:

While we take a moment to celebrate a great start to the year, everyone should continue to keep an eye on the labor market through the remainder of this year and into 2025. Recessions and Soft Landings often look eerily similar to one another in their earliest of innings.

As we cheer on Team USA in the Summer Olympics, let's hope Fed Chairman Jerome Powell can stick the landing as well as Simone Biles.

Have a great summer!

AM I ON PACE TO REACH MY RETIREMENT GOALS?

BY JACOB WOOD

Understanding if you're on target to achieve your retirement goals can be challenging. Determining your retirement needs, including housing and savings from investments, as well as estimating Social Security or pension benefits, adds to the complexity. Buffalo Financial aims to provide a clear, comprehensive view of your retirement outlook. Our goal is to simplify this process, offering guidance to ensure you have a well-defined plan for your future retirement needs.

This article will cover everything you need to know to calculate your Financial Independence Number (FIN). Your FIN represents the amount you need to save to retire. To find it, start by estimating your retirement living expenses and subtracting your expected fixed income (such as Social Security and pension). The resulting figure is your annual shortfall on expenses. Divide this number by 4% to determine the exact dollar amount you need to save to reach your retirement goals.

The first pillar of retirement income is Social Security, which plays a crucial role in retirement planning for many individuals. It provides a steady income stream that can supplement other retirement savings, helping cover essential expenses such as housing, healthcare, and daily living costs. Understanding how much you can expect from Social Security and when to start claiming benefits is vital for maximizing its impact on your overall retirement strategy. We highly recommend logging into your personal Social Security Account at www.ssa.gov and signing up to receive your Social Security statements to estimate your benefits.

For those fortunate enough to qualify for a pension, this would constitute the second pillar of retirement income. Pensions provide a steady income stream for retirees, complementing Social Security. These retirement plans, often sponsored by employers or the government, are designed to offer financial security in later years. Contributions to pensions are made during one's working years, and the funds are managed to grow over time. Upon retirement, the pension provides regular payments, ensuring that retirees have a reliable source of income to maintain their standard of living and cover essential expenses without the need for continued employment.

AM I ON PACE TO REACH MY RETIREMENT GOALS? - CONT'D

The third pillar of your retirement income stream is retirement savings. By strategically placing funds into various investment vehicles, such as stocks, bonds, mutual funds, and ETFs, you can significantly grow your wealth over time. These investments have the potential to offer higher returns compared to traditional savings, helping to build a substantial financial cushion. The key to successful investment savings is regular contributions and the power of compounding. Compound interest is single handedly the strongest and most important tool in the retirement tool belt. Compounding can accelerate your retirement savings, providing the financial independence needed to enjoy a comfortable and secure retirement. Planning and monitoring your investment savings is essential to ensure you are on track to meet your financial independence number and achieve your retirement goals.

Now that we understand the three pillars of retirement income, calculating your FIN is straightforward.
Let's look at an example:

John Doe is currently 60 and wants to know if he can retire at 62. He gathers his Social Security, pension estimates, and retirement savings balances, which total $480,000. John owns his house outright and projects needing $6,000 a month in retirement income to live comfortably. His Social Security benefits at 62 are estimated to be $1,800 a month, and his employer's pension plan is estimated to pay him $2,800 a month. John deducts these income sources from his monthly expenses of $6,000, resulting in a shortfall of $1,400 a month or $16,800 annually. To determine his FIN, John divides his annual shortfall by 4%, giving him a retirement savings need of $420,000. Since John has $480,000 saved up, he knows he can spend $6,000 a month and live comfortably throughout retirement. If John's FIN were higher than his current savings, he would need to either A) ensure his savings reach $420,000 by the time he retires through contributions and investment performance, or B) boost his contributions/delay his retirement age to meet his goals.

In conclusion, planning for retirement can be complex, but understanding and calculating your Financial Independence Number (FIN) provides a clear path to achieving your goals. By considering your estimated retirement living expenses and subtracting your expected fixed incomes, such as Social Security and pension benefits, you can determine the amount you need to save to cover any shortfall. Regular contributions to investment savings and leveraging the power of compounding can significantly boost your retirement funds. Buffalo Financial is here to simplify this process and guide you in creating a well-defined retirement plan. By assessing your financial situation and planning accordingly, you can ensure a secure and comfortable retirement, just like John Doe. Now that you have the knowledge and tools to calculate your FIN, you can confidently work towards financial independence and a fulfilling retirement.

SAM MILLETTE MARKET COMMENTARY

2024 Midyear Outlook: Slower Growth Ahead for U.S. Economy?

So far in 2024, the U.S. economy has traveled a winding road. As we began the year, expectations were for turbulence ahead, given stubbornly high inflation and interest rates, restrictive monetary policy from the Fed, and a slowdown in consumer and business spending. Instead, strength in hiring fueled consumer spending despite rising rates. Still, GDP growth slowed to 1.3 percent in the first quarter (from 3.4 percent in the fourth quarter of 2023), leading to more uncertainty on where the economy will go in the second half of the year.
One of the primary drivers of this economic uncertainty is inflation. After falling from a high of 9.1 percent in summer 2022, year-over-year consumer inflation has cooled, landing at 3.3 percent in May. While this represents an improvement from recent highs, inflation remains well above the Fed's 2 percent target, with the pace of improvement slowed. This will continue to serve as a major risk in the second half of the year for markets and the economy.

All Eyes Are on Consumer Spending

Consumer spending will be pivotal in determining which path the economy takes, as personal consumption growth accounts for almost two-thirds of GDP.

In the first half, consumers remained ready travel companions, and a robust job market fueled their willingness to spend. In fact, the economy added nearly 250,000 new jobs per month through May 2024, leading to strong wage growth on a historical basis.

As we look ahead, though, do signposts indicate bumpier terrain in sight? Hiring and annual wage growth cooled notably in April, and while these numbers unexpectedly popped again in May, the unemployment rate breached the 4 percent mark for the first time since January 2022, while the labor force participation rate declined. This uneven landscape has been paired with wavering consumer confidence so far this year—and confidence has historically been linked to consumer spending growth.

2024 Midyear Outlook: Slower Growth Ahead for U.S. Economy? - Cont'd

Business Spending Will Face Challenges

Business spending, including investment in structures, equipment, and residential real estate, is another key economic growth driver. Gross private domestic investment (GPDI) showed impressive momentum to start the year. Annualized growth jumped from 0.7 percent in the fourth quarter of 2023 to a robust 3.2 percent in the first quarter of 2024.

While providing an initial tailwind, the path ahead looks more challenging. Persistently tight monetary policy from the Fed and declining business confidence suggest that investment growth will likely moderate.

Export Growth Is on the Upswing

Net exports have largely been a headwind to GDP growth in recent years as imports have outpaced exports. This trend continued in the first quarter, as exports rose 0.9 percent while imports surged 7.2 percent.

Keep in mind that net exports can be volatile. So, despite their big pull against growth in the first half of the year, we can expect net exports to become more supportive in the second half as export growth picks up and import growth cools.

November Elections May Impact Government Spending

After experiencing significant growth in 2023, government spending slowed to start 2024 due to waning federal spending. At the state and local level, we saw an uptick in spending to start the year, but those expenditures are expected to cool as states comply with balanced budget rules following 2023's tax revenue slowdown.

Moderate government spending growth is projected through year-end, though the path remains uncertain with potential policy changes after the November elections.

Slow Growth Is Still Growth

Right now, the economy finds itself on reasonably stable footing, with signs pointing to continued though slower growth throughout the rest of 2024. While the pace is set to slow from last year's clip, this can help ease lingering inflationary pressures and set the stage for a potential soft landing that supports financial markets through year-end.

Sam Millette, Director - Fixed Income, Commonwealth Financial Network

NEWS AND EVENTS

Please join us for the third annual Buffalo Financial Charity Golf Tournament to benefit Oishei Children's Hospital! Our golf tournament will be held on Saturday, September 7th at Diamond Hawk Golf Course in Cheektowaga. Jake Wood is challenging all clients to a putting contest (since he can't really hit the ball off the tee)! Please RSVP as soon as possible by contacting Tyler (flyer is below).