Today's decisions may decide the next 30 years

2024 BOK FINANCIAL MIDYEAR OUTLOOK

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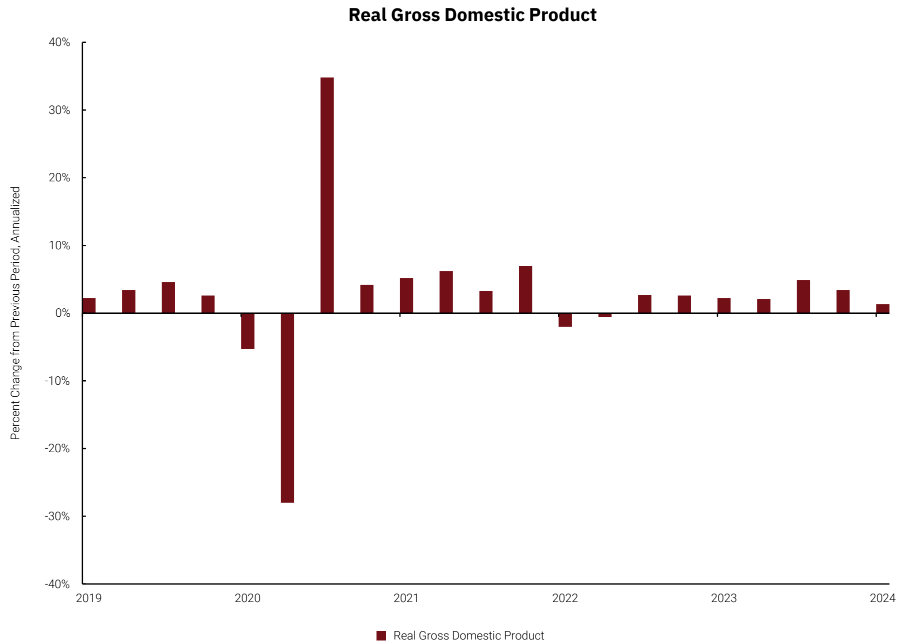
Where we are now

We began our 2024 outlook with questions: Will the U.S. economy achieve a soft landing, rather than going into a recession? What will happen in the job market? When will the Fed begin cutting rates? What will happen in bond and equity markets?

Now, midway through the year, many of those questions remain. However, there is more clarity around just how resilient the U.S. economy is and what makes the situation now so different from recent years.

First, let's consider the question of a soft landing. Gross domestic product (GDP) growth was lower than expected in the first quarter of 2024 due to weaker trade and business inventory drawdowns. However, we are still optimistic about U.S. economic growth through the remainder of the year.

Financially, Americans are coming into the second half of the year from a position of strength. Generally speaking, middle- and upper-income U.S. households are the richest they have ever been due to financial markets being near all-time-highs, home prices continuing to rise and low overall debt levels relative to income. Together with the low unemployment rate and strong labor demand, these conditions set up the economy for continued growth in jobs and personal income.



SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS

However, at the same time, it's important to keep in mind that true soft landings—that is, a slowdown in economic growth without a period of recession—are relatively rare. Instead, the Federal Reserve has a history of keeping rates high for too long or raising them too high too fast, which usually creates a negative financial event. We still don't believe a recession is likely at this point in time, nor do we believe that we will face "stagflation"; however, the jury is still out on whether we will achieve a soft landing.

Much of the answer, of course, will depend on the job market. In the pages that follow, we'll explain our outlook for the job market for the remainder of the year, as well as what we believe is ahead for inflation, artificial intelligence and the need for reliable energy and other natural resources, and finally financial markets.

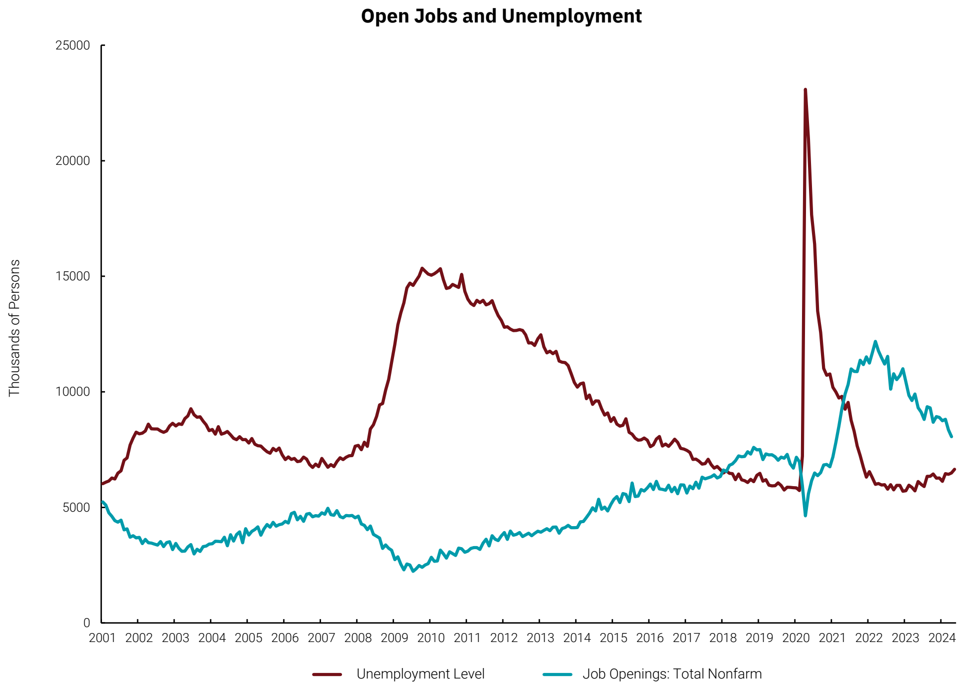
01

The job market

Overall, the job market remains strong and supportive of the U.S. consumer, especially in light of how long we've been in a high-rate environment. For 27 consecutive weeks leading up to May, unemployment was less than 4%, a duration of sub-4% unemployment not seen since the 1960s. Why is this duration so surprising? Unemployment levels this low normally are associated with a tight labor market, too much demand and prices rising too rapidly. And so, when unemployment is below 4%, the Fed tends to hike interest rates to slow demand, which then usually causes unemployment to rise.

Except during this rate-hiking cycle, unemployment hasn't risen significantly yet. One factor that has made this situation different is the severity of the worker shortage after the pandemic. There were two open positions for every person seeking work in 2022. That figure has come down due to increased immigration and labor force participation. Nevertheless, the fact that there were so many open positions played a role in the decisions made by companies as rates increased. Namely, rather than laying off employees, some companies just eliminated open positions, which helped unemployment stay low.

Looking forward, the labor market will likely continue to moderate as the gap between labor demand and supply comes down. All else equal, this reduction in excess labor demand should result in less inflationary pressure, without a sharp increase in unemployment. However, labor markets can turn suddenly, and we will closely watch for any signs of significant deterioration.



SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS

A DEEPER LOOK AT THE JOB MARKET

The changing face of the US worker

As more Baby Boomers retire, who will fill the demand for labor?

America is aging and it may have serious ramifications for the job market.

"Labor force participation rates started to rise in the mid-'60s when the Baby Boomer generation entered the workforce. Then, in the late '90s, the late Baby Boomers started retiring and that has been continuing ever since, dwindling the number of eligible workers," said BOK Financial® Chief Investment Officer Brian Henderson.

Over the next six years, employers may have to replace between 10.8 million and 14.8 million employees who are "Peak Boomers"—that is, people who will reach the peak retirement age of 65 between now and 2030.

This potential surge in retirees comes after the COVID pandemic already accelerated the pace of Baby Boomer retirement. In 2020 alone, the most recent year for which there was data available, there was a 3.2 million increase in Baby Boomer retirees, compared to only a 1.5 million increase in 2019, according to the Pew Research Center.

Will there be another worker shortage?

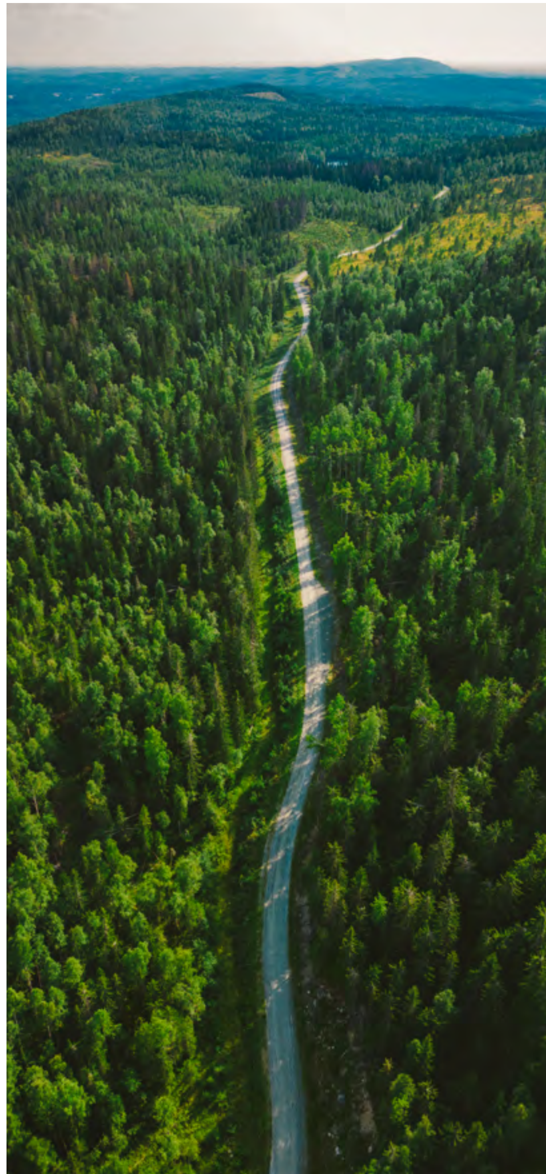
Baby Boomers taking early retirement was one of the factors that contributed to the worker shortage after the pandemic, which was so severe that there were two open positions for every person seeking work in 2022. Other reasons for the worker shortage included people fearing exposure to COVID, families facing childcare issues and a reduction in immigration during the pandemic, Henderson explained.

Since then, the ratio of open jobs to unemployed persons has been trending down. However, as more Baby Boomers retire, that could change—if there aren't enough workers to fill the dwindling supply, Henderson said.

One potential source of new workers is immigration, he continued. For instance, the more open immigration policy after the pandemic has increased the number of workers available, especially for service positions in leisure and hospitality. "They've also helped contribute to economic growth through more consumer spending and increased the demand for housing," he explained.

Meanwhile, the rising number of remote and hybrid positions is also helping to increase the supply of workers in the labor market because the flexibility is enabling people to work who might not otherwise be able to, Henderson said.

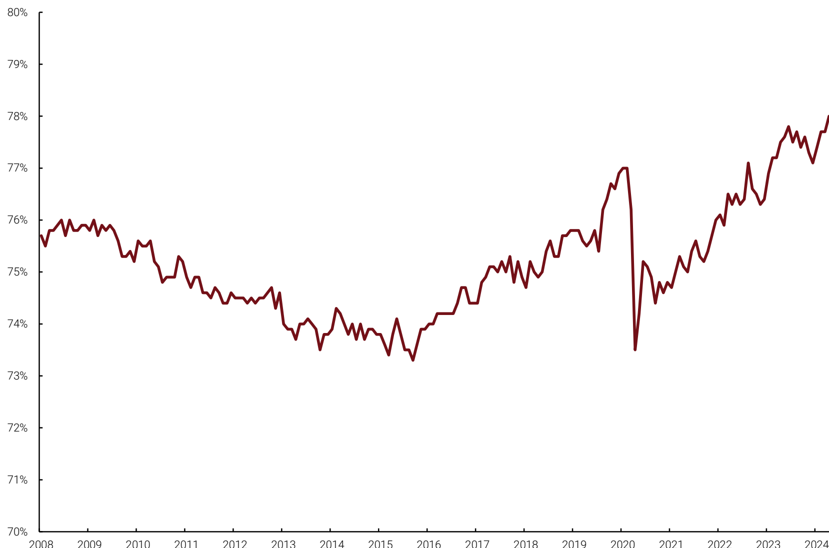
"With remote work, the quality of work-life balance has increased for some," Henderson explained. "Childcare was difficult to obtain after the pandemic and, even now, remote work tends to help the primary childcare provider the most."



Workforce becoming more diverse and educated

Since women tend to take on more childcare responsibilities than men, according to some studies, the increase in remote work opportunities may have helped more women in particular enter the workforce. In fact, the percent of women aged 25-54 in the workforce has risen to record levels—at 78.1%, as of May 2024, according to St. Louis Fed data.

However, the record number of prime-age women in the workforce also continues pre-pandemic trends. First, rising costs have made many families unable to live on one income alone and, second, more women—and men—have been going to college, resulting in a more diverse and more educated workforce, Henderson continued. As of 2021, 37.9% of people in the U.S. aged 25 and older had completed a bachelor's degree or higher, according to U.S. Census Bureau data. By comparison, in 2000, that figure was 24%.



SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS

Workers with and without college degrees in demand

Today, those with a bachelor's degree have an extremely low unemployment rate—at only 2.4%, as of June 2024, according to the Bureau of Labor Statistics. However, this figure just means that they have a job—not necessarily that they have a job in line with their education level. They may be "underemployed," meaning that they are working at jobs that don't require a college degree.

Yet it's not just college-educated workers who are experiencing the benefits of the still-tight labor market. The unemployment rate for those with just a high school diploma was 4.2%, as of June. "The fact that this figure is so low shows the receptiveness of the job market to people who don't want to incur student debt or don't want to pursue college for other reasons," Henderson noted.

Meanwhile, June's overall unemployment rate of 4.1% was also surprisingly low, given how much the Fed raised rates in this cycle and how quickly they've done so, Henderson said. Moreover, for 27 consecutive weeks leading up to May, unemployment was less than 4%, a duration of sub-4% unemployment not seen since the 1960s.

But low unemployment came at a cost back then, Henderson warned.

"There was a new economic model that had really captivated policymakers called the Phillips Curve. This model created some hubris in which economic policymakers felt like they could run the economy a lot faster than they really could," he explained. "This approach has been debunked since then, but it set the stage for the stop-go central bank policy and the high inflation that started in the '70s."

It's this stop-and-go approach that the Fed is trying to avoid now, which has led them to take a higher-for-longer approach to rates. However, even after one of the most aggressive rate-hiking cycles the U.S. has ever seen, unemployment has remained low.

All of that said, when unemployment does rise, it may rise rapidly, Henderson added.

> "The Fed doesn't have a great track record on hiking just enough. In fact, in most periods, they've hiked too much and, once the unemployment rate starts moving up, it tends to spike up."
>
> **BRIAN HENDERSON, BOK FINANCIAL CHIEF INVESTMENT OFFICER**

The future face of the U.S. worker

Looking forward, experts predict that the American workforce will continue to grow more diverse and educated—but that some types of jobs may disappear while other fields grow. For example, as a result of deglobalization, more manufacturing will return to the U.S., as U.S.-based companies move production away from countries like China and to the U.S. and Mexico. Some legislation has been positive for American manufacturing as well. The CHIPS Act, for example, has increased the need for construction workers to build semiconductor plants in the U.S. and also for workers to work in those plants, Henderson noted.

However, at the same time, developments in robotics and automation may mean that some manufacturing jobs will be replaced by robots. An Oxford Economics report predicts that 20 million manufacturing jobs will be displaced by robotics by the year 2030, meaning that 8.5% of the global manufacturing workforce stands to be replaced.

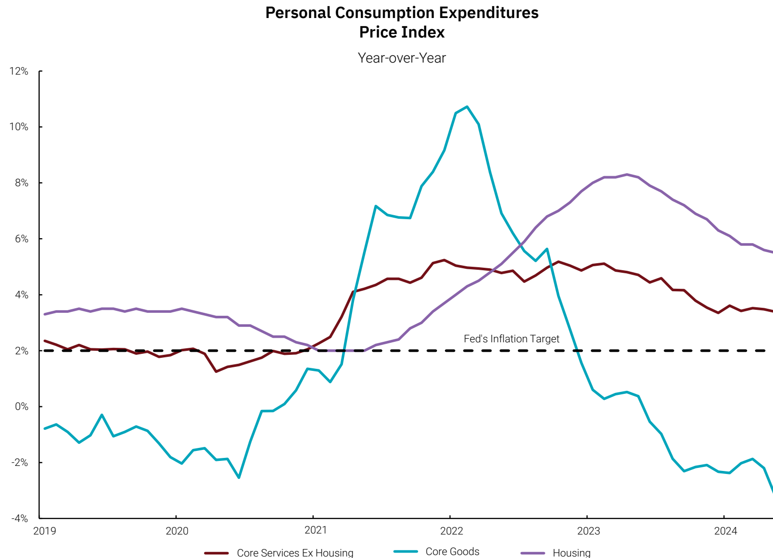
In other fields, too, the types of jobs may change, with some jobs going away and others being added, but the overall increase in productivity that AI and other technology is expected to bring will benefit everyone, Henderson said.

"Companies will have to create new types of jobs that we don't even know about right now—people who are specialists in the new technology," he said.

02

Inflation and the Federal Reserve

Although inflation is moderating, it's still above the Federal Reserve's 2% target—and this last leg of the journey towards 2% is proving to be the most difficult. That's even the case as core good prices have been falling and approaching actual disinflation, as we unwind from pandemic-related supply issues. It's more secular inflation like rents, wages and insurance that remain an issue, as these are falling more slowly or even showing recent increases.



SOURCE: BLOOMBERG

Looking within the services sector, housing and rent costs are improving but remain well above the Fed's target. Single-family homes are unaffordable for many buyers, given the current interest rate and home price environment. However, even with this lack of affordability, demand for these homes still exceeds the current supply. In response to the lack of available and affordable single-family homes, more multi-family units have been built. However, looking forward, this additional supply of multi-family homes could slow based on elevated material, labor and capital costs. This slowing could exacerbate the housing shortage even further.

Nevertheless, the overall trend towards lower inflation is still intact, and financial markets still expect the Fed to cut rates sometime this year. With economic growth remaining robust, the Fed is keeping rates higher for longer, which could ultimately tip the economy into recession. However, the Fed is also concerned about the history of inflation coming in waves, and they don't want to risk such an "echo wave" of inflation.

Due to the aftereffects of the pandemic, the economy today is different than it was during past inflationary periods, and nothing is ever known for certain. Although we expect the first rate cut to come during the second half of the year, it's also important to keep in mind that Jay Powell probably does not want his legacy to be that he was a Fed governor who lowered rates too quickly, so we expect continued caution from him and the Fed as a whole.

A DEEPER LOOK AT INFLATION

We live in a headline inflation world

Consumers feel the impact of inflation building on itself

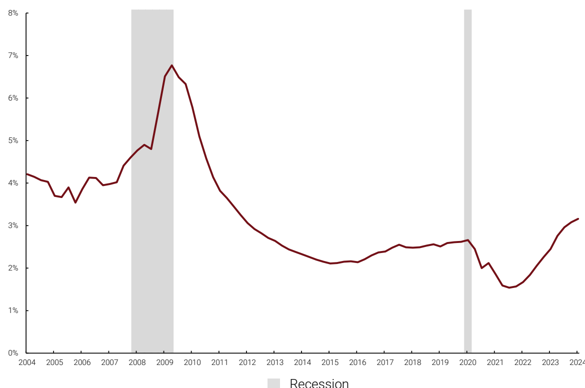
For many consumers, there's a tale of two inflations.

There's the story of inflation they learn through the news—that year-over-year inflation has moved downward from its peak but is still higher than the Fed wants it to be.

Then there's the story of inflation that they experience in their everyday lives—more expensive household bills plus higher prices at the grocery store, at restaurants and sometimes at the gas pump.

Lower-earning consumers are experiencing the negative effects of these higher prices, coupled with high interest rates, the most. As BOK Financial Chief Investment Officer Brian Henderson explained, "Inflation certainly hurts low-income consumers more because they don't have a financial cushion. Without significant savings or wealth, they don't have a lot of flexibility when car insurance companies are raising rates or landlords are increasing rent. Credit card delinquency rates are high but not on an alarming level. These consumers feel the brunt of the affordability issue."

Delinquency Rates
Credit Cards - All Banks



SOURCE: BLOOMBERG

Inflation 'getting better' might not feel that way to consumers

"When economists, the Fed and politicians say that inflation is getting better, we mean that the year-over-year rate of inflation is lower than it was the previous month," he explained. In other words, while prices are still rising, they are not rising by as much as they were before. But the bottom line is that prices are still rising.

Meanwhile, for many consumers, the idea of inflation "getting better" means that prices are dropping. When that happens, that's technically deflation. For instance, used car and truck prices were down 9.3%, according to the May Consumer Price Index (CPI), which represents deflation, even as prices in the overall economy are still in inflation.

While overall prices dropping might, at first, sound positive, deflation is considered negative by economists because of its association with a spiral of decreasing economic activity. On the other hand, some degree of inflation is normal in a growing economy, represented by the Federal Reserve's target for year-over-year inflation of 2%.

Consumers experience the aggregate effects of these yearly increases in inflation, whereas economists tend to focus on the rate of change, and therein lies the disconnect, Wyett said. "From a consumer standpoint, inflation builds on itself. If you go back to before the pandemic, aggregate headline inflation is up 20% since then. That means consumers have lost one-fifth of their spending power."

"So, when we say that inflation is 'getting better,' that's correct from an economic standpoint, but it's still painful from a consumer standpoint because the aggregate price level is still higher," he continued.

Take, food inflation, for example. Food prices were up 2.1% year over year, according to May CPI, which means that consumers were paying 2.1% more for food than they were a year ago. That doesn't sound like a large increase. However, taking a slightly longer view, U.S. food prices rose by 25% from 2019 to 2023, according to the U.S. Department of Agriculture (USDA). Only transportation rose more during that time. And so, while year-over-year price increases may seem small, the aggregate effects of those increases are sometimes much larger, which we're all feeling in our wallets.

"When we say that inflation is 'getting better,' that's correct from an economic standpoint, but it's still painful from a consumer standpoint because the aggregate price level is still higher."

STEVE WYETT, BOK FINANCIAL CHIEF INVESTMENT STRATEGIST

The Fed focuses on core inflation ... but consumers may not

Even when considering the monthly inflation reports, there is sometimes a disconnect between what's prudent for the Fed to focus on and what may impact consumer wallets most.

For the Fed, "core" inflation is the most important inflation data released each month because it excludes food and energy prices due to their volatility. "If the Fed tried to implement monetary policy looking at those very volatile areas, they would be jumping up and down on interest rates very quickly," Wyett explained. "That's not additive to what the Fed is trying to accomplish with monetary policy."

However, for consumers, food and energy prices are often large concerns, especially for lower-income households because these core necessities take up a larger portion of their incomes even when they tend to be buying less. In 2022, the latest year for which there is data available, the lowest-income households spent an average of $5,090 annually on food, making up over 31% of their annual incomes. By contrast, the highest-income households only spent 8% of their incomes on food, according to the USDA.

Although wages on the lower end of the income spectrum have increased more than wages on the higher end, the wage increases have not kept up with the increase in cost of living, Wyett noted.

"And this is where there is no difference of opinion between how the Fed and economists think and how consumers think about inflation: It hurts those who can least afford it the worst," Wyett said. "It highlights why the Fed says we must get inflation down and the importance of what they're doing to lower it."

03

AI, energy and natural resources

In addition to increasing the labor force, an economy can grow through enhancements to productivity. One way to do this is through the development and implementation of artificial intelligence (AI). AI may increase the output for every hour worked by an employee and increase productivity rates overall in the economy, allowing U.S. economic growth to remain above trend.

However, developing and powering advanced AI doesn't come easy. It will depend on the capital available and the efficiency by which it is deployed, but also the availability of cheap, reliable energy. To put it bluntly, AI is an energy hog. For instance, Microsoft's proposed Stargate project, a $100 billion data center focused on AI, could use as much power as 3.5 million homes.

In sum, AI has tremendous potential—if we have the energy and other natural resources to support it. Right now, the conflicts in Russia-Ukraine and around Israel are creating uncertainty in oil markets. Years of production growth in the U.S. have made us more independent, but oil prices are impacted by any escalation in conflicts, nonetheless. Consequently, we are watching natural resources as a possible source of reigniting inflation, a scenario that would be negative for capital markets.

Finally, it's important to keep in mind that these technological developments are occurring as the U.S. is seeking to transition its energy sources. As we seek cleaner fuel sources to power vehicles, data centers and our connected lives, we need to consider a myriad of solutions. The stakes are high: U.S. energy policy today will have a lasting impact on our competitive position in the world for decades to come.

A DEEPER LOOK AT AI AND ENERGY

Access to cheap sources of energy will determine the economic winners and losers

AI and other tech to improve productivity—but it will take dependable, efficient power

When politicians talk about what will make a country successful, they often mention an educated workforce and a drive for innovation.

And yet there's an underlying element that's becoming increasingly necessary as technology advances: energy, said Matt Stephani, president of Cavanal Hill Investment Management, Inc.*

"Access to cheap energy is going to be what determines the economic winners and losers in the next 30 years. And so, frankly, what we should be doing is seeking reliable, safe, secure sources of energy and helping our partners do the same," he said.

Of course, energy's key role in economic growth is nothing new: think of electricity's role in ushering in the Industrial Revolution. However, what is new is the technology that energy will be used for—artificial intelligence (AI), which experts say has tremendous potential but will require large amounts of electricity. Additionally, there's the backdrop of deglobalization in which the next 30 years of technological progress will take place.

*Cavanal Hill Investment Management, Inc. is a subsidiary of BOKF, NA

Will AI be at the center of a new Industrial Revolution?

Excitement about AI has been driving the "Magnificent 7's" performance in the stock market (and, arguably, the S&P 500's performance in general). However, for economists, much of the enthusiasm about AI has to do with its potential impact on productivity.

Based on the Solow model of economic growth, three factors influence the growth of an economy—an expanding labor force, increasing worker productivity and the level of capital, noted Brian Henderson, chief investment officer of BOK Financial. "Artificial intelligence has the potential to increase the output for every hour worked by an employee and to increase productivity rates overall in the economy," he explained.

This increased productivity will include workers using AI to perform tasks that AI usually can do more efficiently and quickly than humans, such as coding a computer program, Henderson said. This also would enable people who have no programming experience to create programs.

However, AI can't entirely replace human workers, either, he cautioned. "AI tends to do some skills, such as basic math and retaining information, better than most humans," he explained. "Yet there are some skills that humans will always do better than a computer: teamwork, leadership, soft sales, entrepreneurship and being ethical, for instance. Plus, economic expansion through AI will depend on solid understanding and effective mitigation of AI's risks."

"When AI increases productivity, everyone is a winner. The economy could grow faster without inflation increasing. Income levels could rise faster, and people's standards of living could increase. Corporations could be more efficient and profitable, so their stock prices would rise. Meanwhile, governments could gain increased tax revenues."

BRIAN HENDERSON, BOK FINANCIAL
CHIEF INVESTMENT OFFICER

Energy to determine the economic powerhouse of the future

However, running AI takes energy and, the more advanced it becomes, the more energy it will require, Henderson and Stephani both noted.

"You're electrifying jobs when you go from five accounting clerks inputting data to one artificial intelligence system doing it," Stephani said. Rather than the work being accomplished through the exertion of human energy, it will be accomplished by AI running on electricity, he explained.

The amount of energy required for the most advanced AI systems could reach unforeseen levels. For example, Microsoft's planned Stargate AI Supercomputer may require as much as four to six gigawatts of power, almost the equivalent to the power needs of a large city such as New York.

This power-intensive technology is being developed in the midst of deglobalization, Stephani noted. As the world economy is becoming less globalized, more companies have been moving their manufacturing out of China to the U.S. and neighboring Mexico, which is amplifying the need for cheap, reliable sources of power, he explained. In fact, in 2023, Mexico surpassed China as the largest exporter to the U.S for the first time in over 20 years.

Presidential election will shape U.S. electricity generation

And now, experts say that the upcoming U.S. presidential election will play a significant role in the future of U.S. energy.

While both parties see energy as important to the country's economic growth, whoever wins is "likely to shape the future of electricity generation and transportation fuels in the U.S. economy over the next decade," Stephani said. He detailed the following possible scenarios:

If a Democratic candidate wins, they may take steps to lower U.S. oil demand by increasing regulations. They might also attempt to use liquified natural gas (LNG) export caps to hold down natural gas prices, resulting in uncertainty that would likely slow the pace of LNG facility build out. This might negatively impact allies such as Europe, who depend on U.S. natural gas. There may also be increased subsidies for wind and solar, as well as a reduction or cap on coal shipments out of the U.S., Stephani said.

Meanwhile, if a Republican candidate wins, it would likely be positive for coal and natural gas and negative for solar, wind and hydrogen power, Stephani said. Coal will continue to be mined and shipped to China and India. A Republican win may also result in reduced regulation on the U.S. oil and gas industry, increased LNG shipments and reduced stimulus for electric vehicles, he explained.

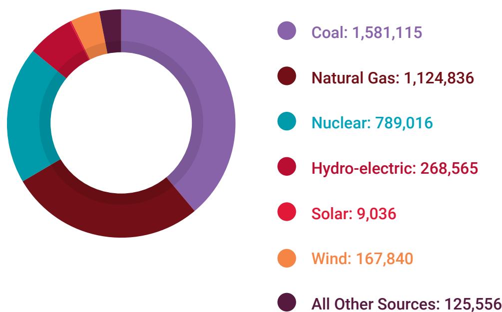
But there's one energy source that's likely to be supported in either scenario, Stephani continued: "Nuclear is probably a win either way."

Looking forward, whichever candidate becomes the next president, the U.S. will need cheap, reliable energy to fund the next 30 years of technological advancements, experts agreed.

"If we think of it as, it's the year 2050 and who won the economic war, the answer will be the country with access to reliable electricity. Having access to cheap electricity is going to determine who will be the economic powerhouse and who will win the manufacturing and technology race currently being driven by AI," Stephani said.

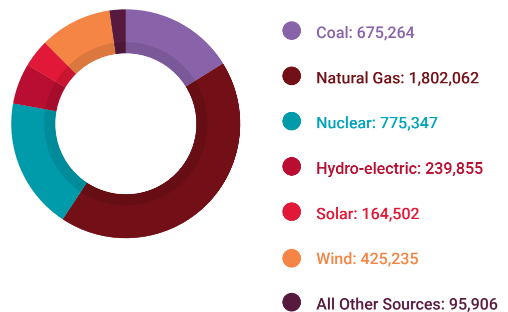
2013 Electricity Generation by Sector

Million Kilowatthours



2023 Electricity Generation by Sector

Million Kilowatthours



SOURCE: U.S. ENERGY INFORMATION ADMINISTRATION

04

What this means for financial markets

Although first-quarter economic growth was lower than expected, we are optimistic that economic growth will support financial markets through the remainder of 2024. One reason for this is the upcoming presidential election. Election years tend to be good for financial markets, as the incumbent party always does what it can to support economic growth in the hopes of reelection. However, even with the election aside, the job market is still relatively strong, which also should support positive growth.

That said, there are always potential risks and questions to consider. For example, with valuations already so high, how much higher could they go? Credit spreads are also very tight. The fact is: When stock and credit markets are priced as high is they are, it doesn't leave much cushion for a financial slowdown. Furthermore, as inflation continues to decline, we will continue watching corporate margins closely. Inflation kept pricing power relatively high, so lower inflation may limit pricing power, pressuring margins.

There also remains the potential for outlier scenarios. For instance, there is the small possibility that monetary policy isn't tight enough and the Fed will have to hike rates again, which would be negative for markets. The effects of geopolitical conflicts, especially in Eastern Europe and the Middle East, on financial markets also remain a risk.

Meanwhile, there is also the impact of the presidential election itself to consider, even if the results are close and not known right away. Leading up to the election, if one candidate is moving up or down significantly in the polls, it would likely affect the stocks of the companies that would or would not benefit if that candidate were elected. For example, if a Democratic candidate is elected, it would help alternative energy investments, while if a Republican candidate wins, it would help traditional energy investments. Meanwhile, no candidate seems to be focused on federal deficit reduction.

As always, we will continue to monitor these events and their impact to financial markets—and your money—closely.

Meet our experts

Brian Henderson, CFA, is chief investment officer for BOK Financial, a position in which he leads the alternative investments group, strategic investment advisors and Cavanal Hill Investment Management, Inc.

Steve Wyett, CFA, is chief investment strategist for BOK Financial, a role in which he communicates the organization's investment management message and serves on a variety of investment-related committees.

Matt Stephani, CFA, is president of Cavanal Hill Investment Managements, Inc., a position in which he is responsible for the fixed income, cash and equity management teams of Cavanal Hill, as well as all other aspects of the firm.

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