Market Intelligence

July 2024

Executive Summary:

Stocks Higher in 2024: Most major market indicies are continuing last year's positive gains through the first half of 2024, with US large-cap technology stocks leading the way yet again.

Mixed Economic Signals: The economy has exceeded expectations in 2024. Resiliency has been driven by strength in the consumer and the labor market, but inflation remains persistently high and some signs of stress are emerging.

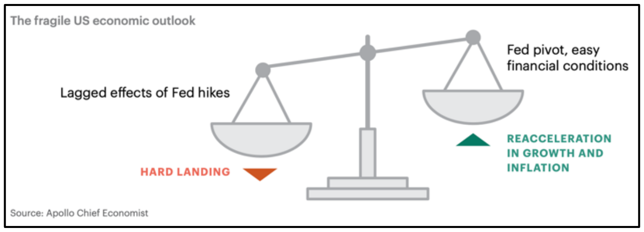
Upcoming US Election: The first US Presidential debate has officially kicked off the race for the White House. However, typical election-year market volatility has yet to materialize in 2024. This may change in the second half of the year, but history suggests that markets tend to perform relatively well regardless of which party is in control.

Investment Themes for the Remainder of 2024: While markets have generally advanced and some parts of the market look somewhat expensive, we continue to find opportunities in some of the unloved corners of the market.

Through mid-year, most equity asset classes have continued to build off of positive returns in 2023, with the S&P 500 showing a year-to-date increase of approximately 15%[1]. The rise in the S&P 500 has been driven largely by gains in the technology sector, especially companies like Nvidia, which reached a market cap of more than $3 trillion and briefly became the world's most valuable public company (though it later retreated). In fact, the group of technology stocks known as the "Magnificent Seven" are responsible for a staggering 60% of the S&P 500 total returns so far this year.[2]

The U.S. economy has produced mixed signals to begin the year. Inflation remains stubbornly persistent, staying above the Federal Reserve's target range. Despite this, consumer spending has been robust, supported by household savings accumulated during the pandemic. The Federal Reserve (Fed) has maintained high interest rates to combat inflation, which has been hovering between 3.0 and 3.5% for several months.[3]

The labor market remains a key pillar of strength and resilience for the US economy, with a relatively low unemployment rate of around 4%.[4] However, there are signs of stress, particularly in sectors like accommodation and food services, which are still below pre-pandemic employment levels. Despite these challenges, overall employment levels have increased, and wage growth has been notable.



Looking ahead, the market's performance in the second half of 2024 may hinge on the Fed's actions regarding interest rates. The consensus is for 1-2 rate cuts later in the year if inflation continues to ease.[5] However, the Fed finds itself in a difficult position as it tries to thread the "soft landing" needle. Keeping rates high for too long risks a recession, while lowering rates too early could reignite inflation. To make matters worse, the decision-making will play out during a US Presidential Election, increasing the odds that they will be blamed by one side or the other regardless of their decisions.

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[1] Source: YCharts
[2] No Nvidia in Your Portfolio? 'You're Just Toast' - WSJ
[3] Source: YCharts
[4] Source: YCharts
[5] Source: Bloomberg World Interest Rate Probability

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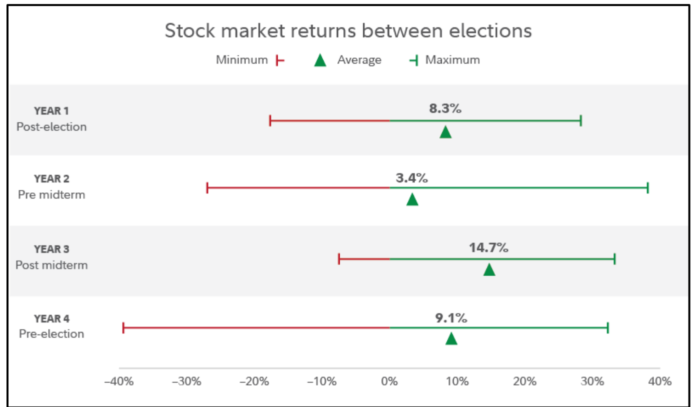
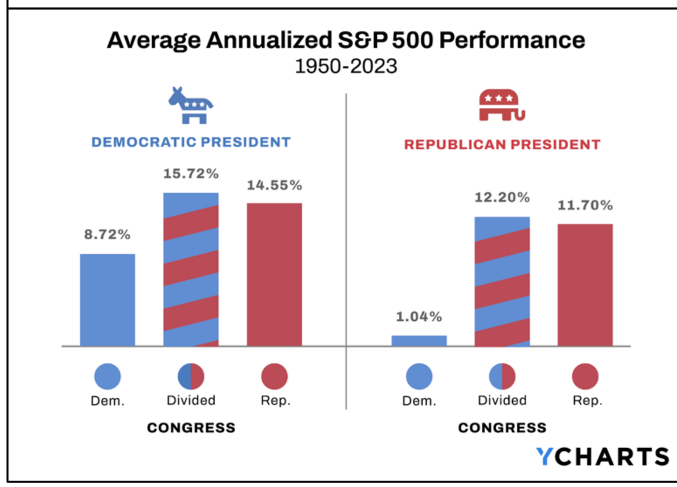
Upcoming US Election & Geopolitical Tail Risks:

US presidential elections have historically been a source of market volatility, with a broader range of return outcomes than in other years (see chart at right). However, volatility has been muted so far this year. We believe this is because both candidates are known quantities (a former president facing the current president), and the economy has remained solid.

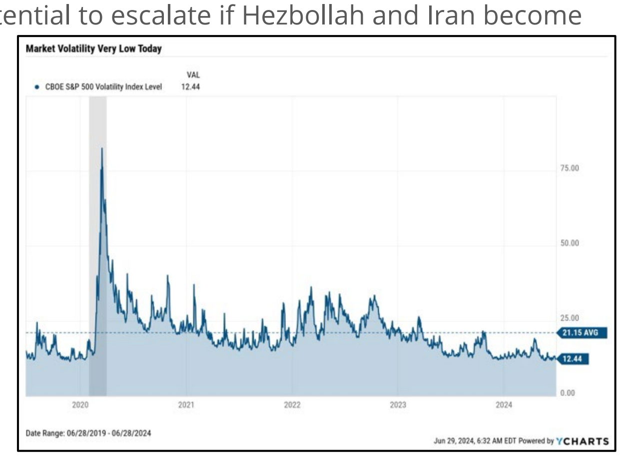




Despite increased election year volatility, the stock market tends to rise regardless of which political party controls the presidency or Congress. The chart at right illustrates that since 1950, the S&P 500 has achieved positive average annualized returns under both Democratic and Republican presidents. In addition, a divided Congress has led to some of the best stock market returns historically. This demonstrates that the market can thrive under different administrations, highlighting the importance of focusing on long-term trends rather than short-term political changes.

Nevertheless, we would not be surprised to see volatility increase from these low levels (see chart, bottom right) in the second half of the year for multiple reasons. The contentious US election is not the only source of potential political drama; 2024 is an election year in over 60 countries worldwide.[6] In addition, a strong showing by the far-right National Rally in France's recent snap election may expose cracks in European unity and bring the NATO alliance into question as the year progresses.[7]

Furthermore, this geopolitical situation is playing out as two regional conflicts (Russia/Ukraine and Israel/Hamas) continue to rage, with the conflict in the Middle East having the potential to escalate if Hezbollah and Iran become more directly involved. Additionally, tensions between the US and China remain high, as the two sides find themselves at odds on topics ranging from advanced semiconductors and tariffs to Taiwan and a renewed space race.[8][9]



That said, tail risks always exist in one form or another; we simply see many of those risks manifesting in geopolitics today. We encourage clients to avoid becoming complacent, especially during good times when markets march forward and volatility is low. We believe that periodic rebalancing and maintaining adequate liquidity for upcoming distributions are prudent risk management approaches regardless of the market environment.

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[6] Source: https://time.com/6550920/world-elections-2024/
[7] Source: https://www.morningstar.com/markets/ian-bremmer-4-big-geopolitical-risks-watch
[8] Source: https://www.reuters.com/technology/space/china-lands-uncrewed-spacecraft-far-side-moon-2024-06-01/
[9] Source: https://investmentresearchpartners.com/insight/geopolitics-from-coordination-to-competition-march-29-2023/

Investment Themes for the Remainder of 2024:

We began this year with several big questions – questions about inflation, interest rates, the economy, elections, and conflicts. However, very few of those questions have been answered definitively year-to-date. As a result, we begin the second half of the year with a higher equity market but little additional clarity on some of the critical issues.

As we survey the current investment landscape for risks and opportunities, however, several key themes emerge:

Dividend Stocks

As large technology stocks continue to drive markets higher, we believe both domestic and foreign dividend-paying stocks are often overlooked and offer relatively attractive valuations at current levels. Additionally, the steady cash flow and defensive nature of high-quality dividend payers may prove valuable if we experience economic or geopolitical shocks in the latter half of 2024.

Long-Duration Stocks

The unprecedented rise in interest rates beginning in 2022 and lasting through mid-2023 created a challenging environment for many parts of the market, especially for long-duration (interest rate sensitive) stocks. In fact, some of the more interest rate sensitive parts of the market that sold-off during that period, such as biotechnology and sustainable infrastructure stocks, have yet to meaningfully rebound. While interest rates remain elevated, the aggressive interest rate hikes are beginning to show their intended effects by reducing inflation. We believe that this shift is already fostering a more favorable environment for sustainable infrastructure and biotechnology stocks, and the shift will only be amplified if interest rates begin to fall.

The Second Act of AI – Deployment

We believe that the next act in artificial intelligence is to expand beyond the confines of the technology sector. AI's transformative potential is being realized across various sectors, including healthcare, utilities, and manufacturing, and we believe that companies committed to leveraging AI for productivity gains and to improve output quality can emerge as industry leaders across multiple sectors. We see this second act as broadening beyond the “Magnificent Seven,” benefitting mid- and small-cap stocks that have not kept pace with their larger-cap peers the past few years.

Attractive CD and US Treasury Bond Yields

The rising interest rate environment of 2022/2023 was challenging for many parts of the stock and bond markets. However, one of the benefits of the higher rate environment is that it is now possible to get yields of more than 5% by investing in one-year US Treasury Bonds backed by the full faith of the US government.[10] For clients that are in the distribution phase, in particular, locking in a 5% return without the risks associated with high yield bonds or equity market volatility may help improve their retirement prospects.

As always, we appreciate your trust in our firm as we navigate the complexities of today’s investment landscape. We remain committed to making prudent, impactful decisions on your behalf, and we look forward to continuing our partnership in the years to come.

[10] Source: YCharts

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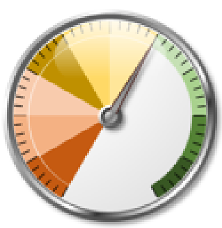
Asset Class Returns

Category	Representative Index	YTD	2023	2022	2021	2020
US Large Cap Stocks	S&P 500 Index	15.3%	26.3%	-18.1%	28.7%	18.4%
US Large Cap Stocks	S&P 500 Equally-Weighted Index	5.1%	13.9%	-11.5%	29.6%	12.8%
US Dividend Stocks	WisdomTree US High Dividend Index	5.8%	0.2%	8.4%	24.8%	-6.2%
US Small Cap Stocks	Russell 2000 Index	1.7%	16.9%	-20.4%	14.8%	20.0%
Foreign Developed Stocks	MSCI EAFE Index	5.3%	18.2%	-14.5%	11.3%	7.8%
Emerging Market Stocks	MSCI Emerging Markets Index	7.5%	9.8%	-20.1%	-2.5%	18.3%
US Bonds	Barclays Aggregate Bond Index	-0.7%	5.5%	-13.0%	-1.5%	7.5%
10-Year US Treasury Yield	Current 10-Year Rate / Value at Year-End	4.40%	3.88%	3.88%	1.52%	0.93%

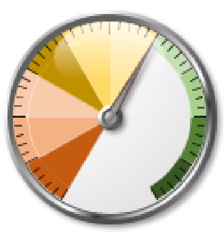
Source: YCharts as of June 30, 2024. Annualized returns for data longer than 1 year

Outlook & Positioning Summary



Economy

✓ Economic Growth	1.4% US Gross Domestic Product (Q1 2024)[1]
✓ Employment	Solid, but showing signs of slowing
• Households	Low fixed rate mortgages, unemployment low, wages growing, but debt / delinquencies rising, savings declining
• Financial Conditions	Inflation Remains Above Target, Interest Rates Elevated, Bank Lending Declining US Government Spending on Infrastructure



Markets

✓ Valuation	Many Assets Trading At-or-Below 15-20 Year Averages
✓ Earnings	Outperforming expectations but relatively modest growth
• Trend	Equity markets are being driven by the anticipated direction of interest rates
• Investor Sentiment	Near Long-Term Averages

Market and economic views are subject to change and may differ significantly from actual events. 1. Source: Bloomberg as of June 27, 2024

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