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Investment Insights Quarterly

From the Desk of Bill Hornbarger, Chief Investment Officer

July 2024

Thoughts on the Second Half of the Year

At a broad level, the first half of 2024 was a good one for investors. Looking across the different segments of the equity and fixed-income markets, most are higher, and the widely followed benchmarks of the S&P 500 and Bloomberg Barclays Aggregate Bond Index are up over 15% and 2.5%, respectively. The second quarter was not quite as strong. The S&P 500 was higher (4.3%), but small-cap stocks, real estate investment trusts (REITs) and international developed stocks were lower, and core bonds were basically flat.

The major market themes of the second quarter included:

1. **Falling Inflation.** The U.S. Core Consumer Price Index (CPI) declined from 3.8% to 3.3%, the lowest year-over-year reading since April 2021. At the same time, overall CPI fell to 3%, and the trajectory of inflation has been lower after several higher-than-expected readings in the spring.

2. **Fed Easing.** Generally falling inflation has kept the prospects of U.S. Federal Reserve (Fed) rate cuts in 2024 on the table. At the end of the second quarter, the futures markets were priced for the first interest-rate cut at the September meeting, with a total of two for this calendar year.

3. **Narrow Market Breadth.** Concentration continued to drive returns in the S&P 500, with the top 10 stocks comprising 37% of the index and almost half (48%) of the stocks underperforming the index during the quarter.

4. **Yields.** Yields increased slightly, and the yield curve wasn't quite as inverted at the end of the quarter.

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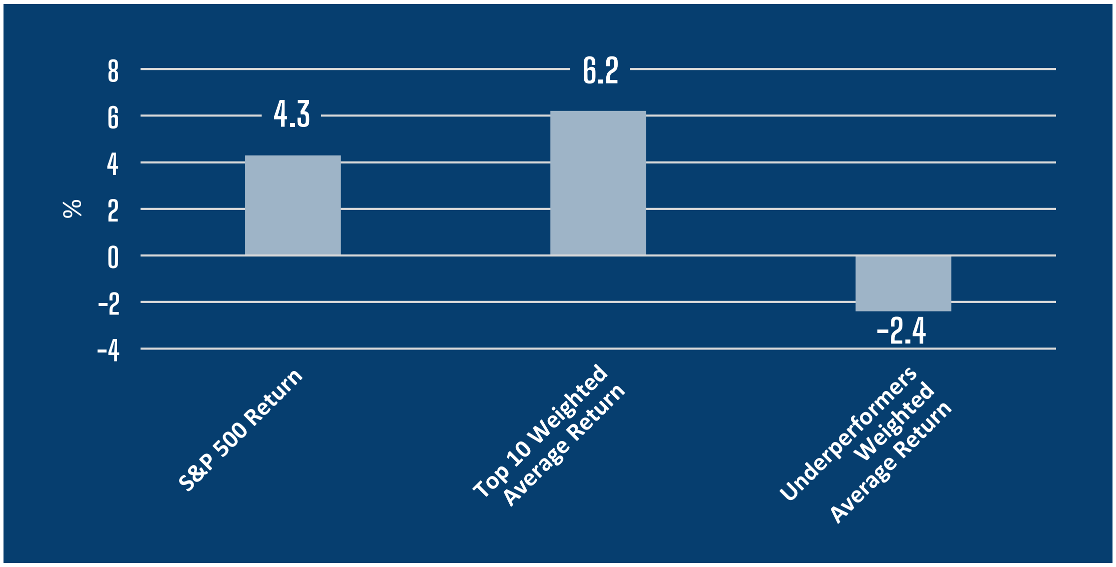
S&P 500 - Bifurcation of Returns

Q2 - 2024



As of June 30, 2024
Source: Fiducient, Morningstar

Some of these same themes will remain in focus as we move to and through the second half of the year. We are also mindful that this is an election year, which could also have some impact on the markets as the candidates' odds of winning wax and wane. As we start the second half of the year, here are some of the things we are watching:

1. **The Economy.** It's rare that all the economic statistics point in one direction, and the current environment is no exception. Manufacturing remains in recession, according to the Institute for Supply Management survey; the index of leading economic indicators has been down month-over-month for 27 of the last 28 months; and consumer spending has moderated. Balanced against this is declining inflation; the fact that the Misery Index (calculated by adding CPI to the unemployment rate) fell to 7.1% in June (lower than 70% of the time since 1948); and the Atlanta Fed GDPNow forecast for the second quarter was recently bumped up to 2.7%. To date, the Fed has engineered what appears to be a soft landing. The economy remains remarkably resilient, and we expect healthy economic growth to persist.

2. **Monetary Policy.** Fed officials continue to preach data dependence, and we will take them at their word. The broad trajectory on inflation has been lower, but we have thought all along that the "last mile" to the 2% target would be difficult, and we continue to hold that stance. The futures markets are currently priced for three rate cuts (25 basis points each) prior to year-end, which we feel is slightly too aggressive. Various Fed speakers (including Chairman Powell) have recently sounded more confident that the Fed is nearing a pivot on policy but have given no indication on timing.

3. **Equities.** There remains some concentration risk in a handful of prominent, mostly tech and tech-

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adjacent names, but in early third-quarter trading, the market shows signs of broadening with small caps in particular very strong. The outlook for solid growth in the second half is supportive of earnings growth, and valuations outside of the group of high-flying stocks are better, with some areas (international and small cap) at or below long-term valuation levels. Intrayear corrections (-10%) are normal, and we wouldn't be surprised to see one in the second half of the year, but the environment of falling inflation, potential rate cuts and economic growth remains attractive for equity investing.

4. **Yields.** Falling inflation and the prospects of a pivot in monetary policy argue that the peak in long-term yields for this cycle is already behind us.

We would be remiss if we didn't reference the upcoming presidential election. The past several weeks have been remarkable and discouraging at the same time. One candidate has been urged to step down by his own party and the other was the subject of an assassination attempt, all of this against the backdrop of a country deeply divided. Instead of opining on who will win or dissecting each candidates' policies, we will remind investors that there is little to no conclusive evidence that the president's party has a meaningful impact on stock market returns. Instead, investors should stay focused on the economy, earnings and inflation. While election results can impact certain sectors and specific industries, a disciplined and diversified portfolio should be able to withstand any shorter-term volatility caused by election-related headlines.

In closing, despite the elevated temperature of the election cycle and the first-half strength of the equity markets, the environment remains positive for stocks. Corrections are inevitable and should be expected, but in our opinion, the conditions for it to turn into something more serious don't appear to be the highest probability, currently. We would encourage investors to take the current healthy market conditions as an opportunity to align their portfolio with their goals and risk tolerance and would not make any major changes based on the potential election outcomes.

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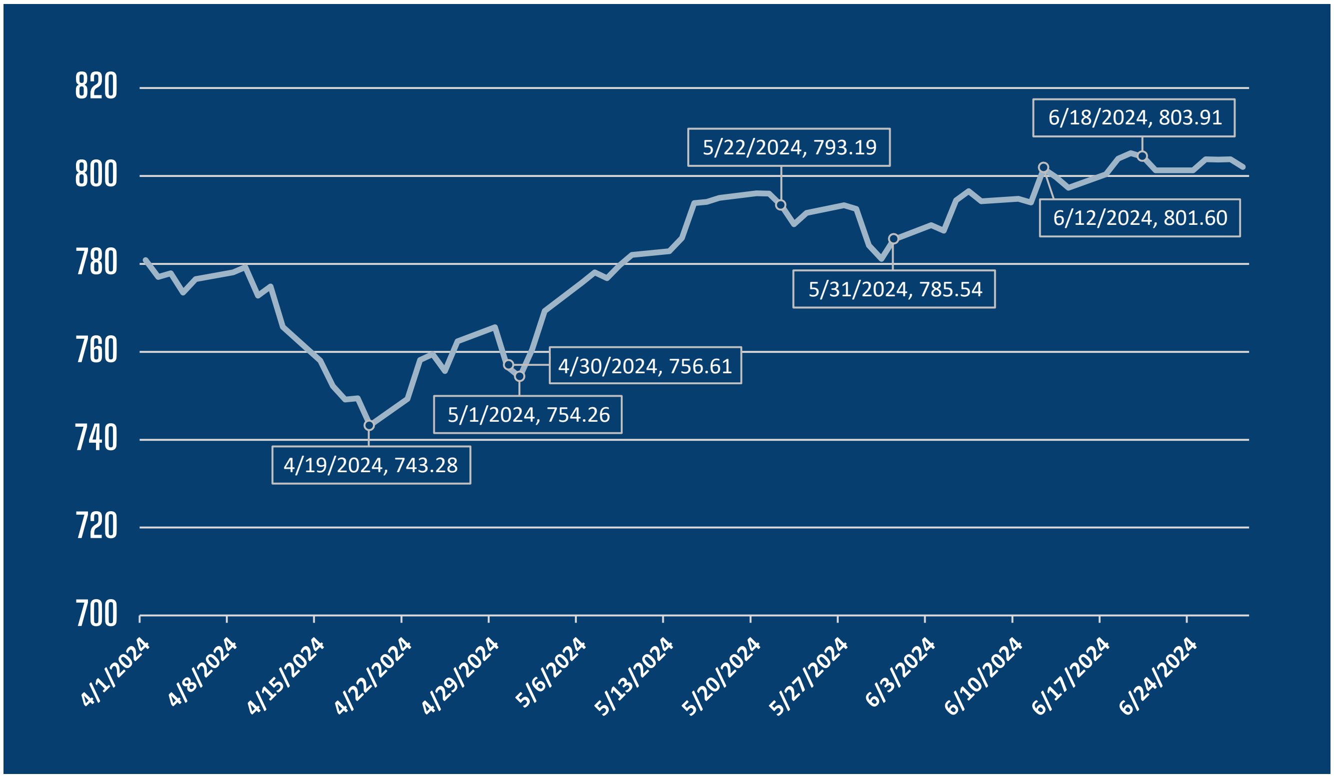
Key Q2 Dates

- April 19 – Tech sell-off handed Nvidia worst day in four years; Nasdaq, S&P 500 fell for sixth consecutive day.
- April 30 – The benchmark S&P 500 Index dropped over 1% after quarterly labor costs came in hotter than expected.
- May 1 – Fed held funds rates steady at 5.25%-5.5%, citing lack of inflation progress. The S&P's upward movement reflected relief that the Fed is still unlikely to raise rates again.
- May 22 – Fed left rates unchanged with hawkish rhetoric.
- May 31 – S&P 500 closed up 3.94% in May, its best May performance since 2009. Magnificent 7 stocks added $1.3 trillion in market cap, accounting for 76% of the S&P's total gains.
- June 12 – Fed left rates unchanged.
- June 18 – The S&P 500 and Nasdaq closed at record high levels.

Global Stock Market
MSCI ACWI in USD



As of June 30, 2024
Source: Bloomberg

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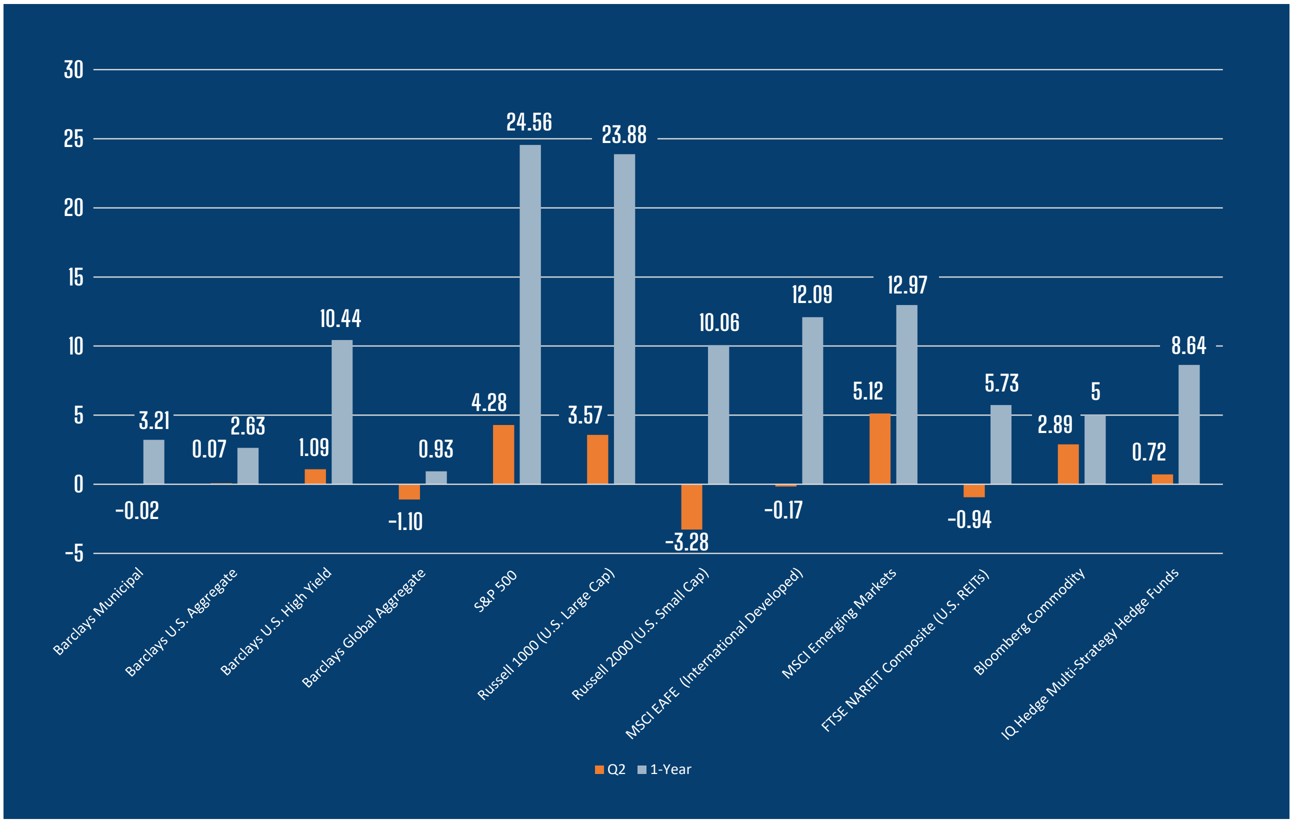
Asset Class Returns
Q2 2024



As of June 30, 2024
Source: Conway

Fixed Income

- Treasury and other sovereign debt yields fell in June, leading to solid gains in core fixed income and municipal bonds.
- While credit spreads widened slightly last month, the higher carry/yield was more than sufficient to offset any loss of principal.
- Bonds outside the United States benefited from falling yields, but U.S. dollar strength was a significant headwind as the European Central Bank cut rates ahead of the Fed.

Equities

- U.S. equities broadly gained ground with most of the gains coming from large-cap stocks and particularly large-cap growth.
- Value stocks underperformed across all market caps, and small caps lagged large caps by a wide margin.
- U.S. large-cap equities posted strong gains through the first half of 2024, but breadth remains fairly narrow and the discrepancies between growth/value and large/small remain firmly entrenched.
- Equities outside the U.S. lagged their U.S. counterparts, largely due to strength in the U.S. dollar.
- Similar to what occurred in the United States, growth beat value and large caps outperformed small caps.
- Emerging markets outperformed most other developed markets due to strength in Asia ex-China.

Alternatives

- Real estate had a weak (and negative) quarter, although posted solid gains in June.
- Commodity prices, including energy, were higher in Q2.
- Multi-strategy hedge funds continued to post gains similar to fixed income.

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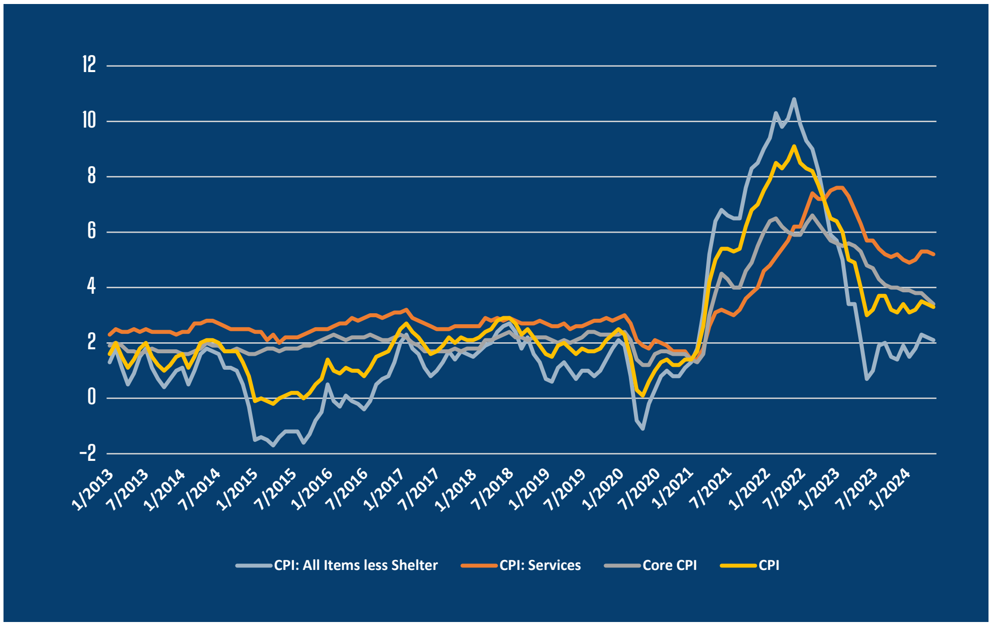
Inflation

Consumer Price Index and Selected Categories

% Change Year-over-Year

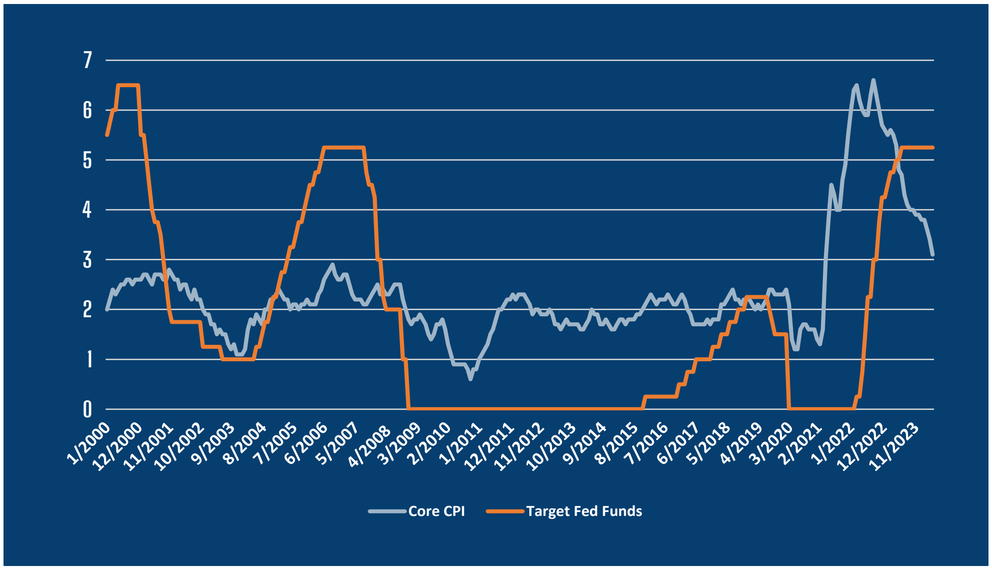


As of June 30, 2024
Source: Haver

- Inflation remains above the Fed's stated comfort level but remains on a downward trajectory.
- Services and shelter continue to be sticky, keeping inflation elevated.
- The Consumer Price Index remains higher than the Personal Consumption Expenditures Index, the Fed's favored inflation measure.

Inflation/Monetary Policy

Fed Funds vs. Core CPI



As of June 30, 2024
Source: Haver

- Monetary policy has become more restrictive as inflation has declined.
- At a spread of 2%+ relative to inflation, monetary policy is now the tightest it has been since pre-Global Financial Crisis.

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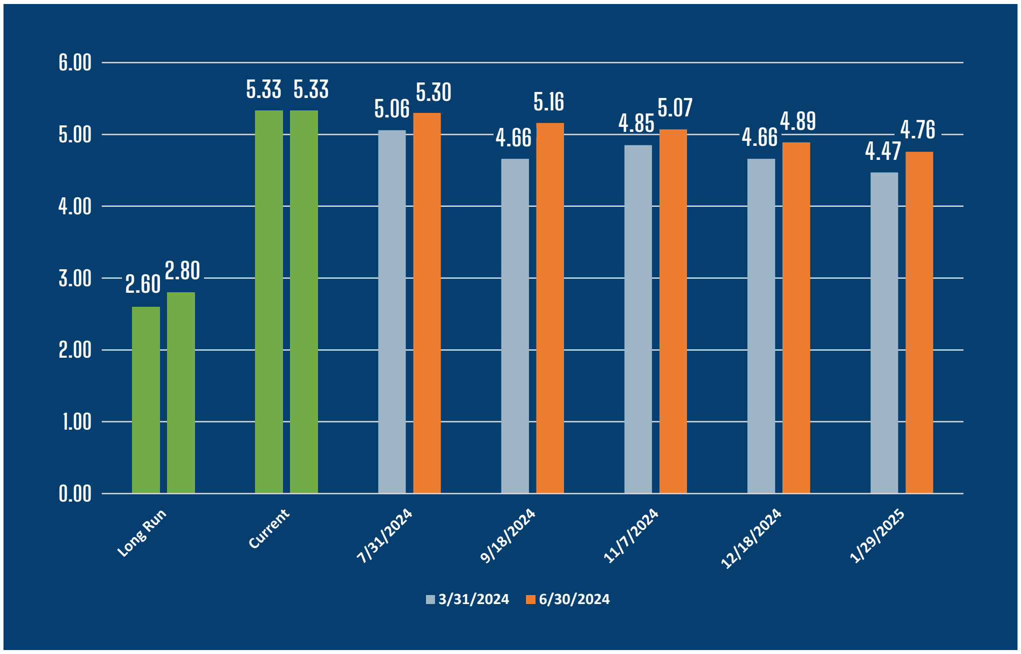
Monetary Policy

Implied Policy Rate (%)
End of Q1 vs. Q2



As of June 30, 2024
Source: Bloomberg

- Fed expectations continue to evolve.
- The markets are now priced for one to two cuts this calendar year, down from five to six in January.
- The Fed continues to indicate it will be patient prior to lowering rates, in a desire to ensure inflation has been defeated.

Market Breadth

Price/Earnings Ratio of the Top 10 and Remaining Stocks in the S&P 500

	Current	Average	% of Average
Top 10	30.3x	20.4x	148%
Remaining Stocks	17.6x	15.7x	112%
S&P 500	21.0x	16.6x	127%

As of June 30, 2024
Source: J.P. Morgan

- Performance of the S&P 500 in Q2 was heavily influenced by a few select stocks.
- The top 10 S&P 500 companies by size currently are Microsoft, Apple, Nvidia, Amazon, Meta, Alphabet, Berkshire Hathaway, Eli Lilly, J.P. Morgan and Broadcom.
- These 10 stocks account for 37% of the index market capitalization.
- Over the trailing 12 months, the 10 stocks accounted for 26.8% of the index's earnings.

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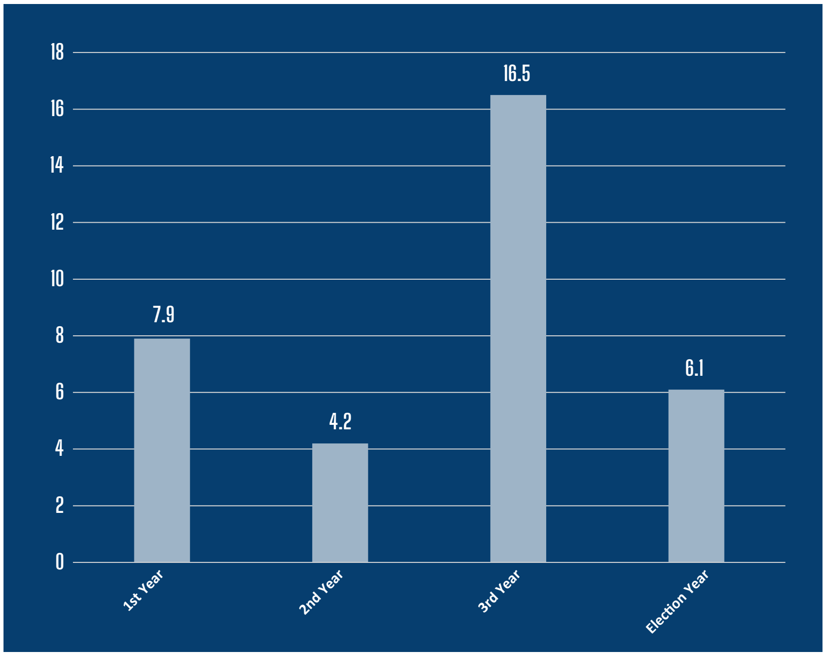
The Election

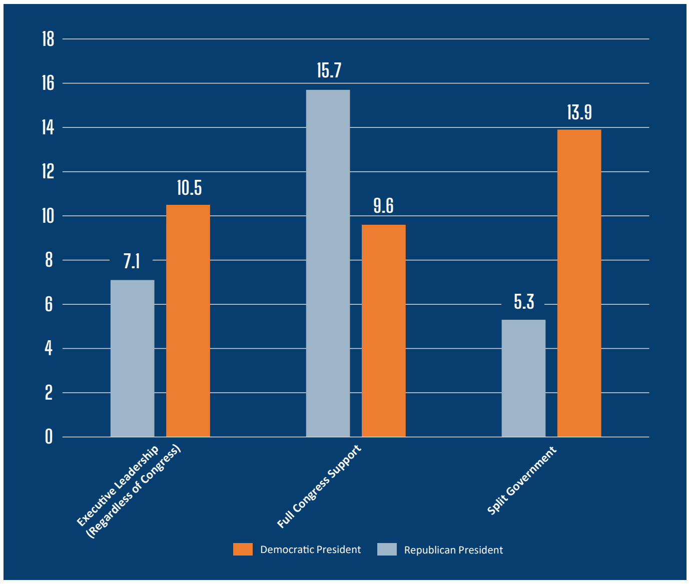
Presidential Cycle: Average S&P 500 Return by Year



As of June 30, 2024
Source: Northern Trust Asset Management

The Election

Presidential Cycle: Average S&P 500 Return by Year



As of June 30, 2024
Source: Northern Trust Asset Management

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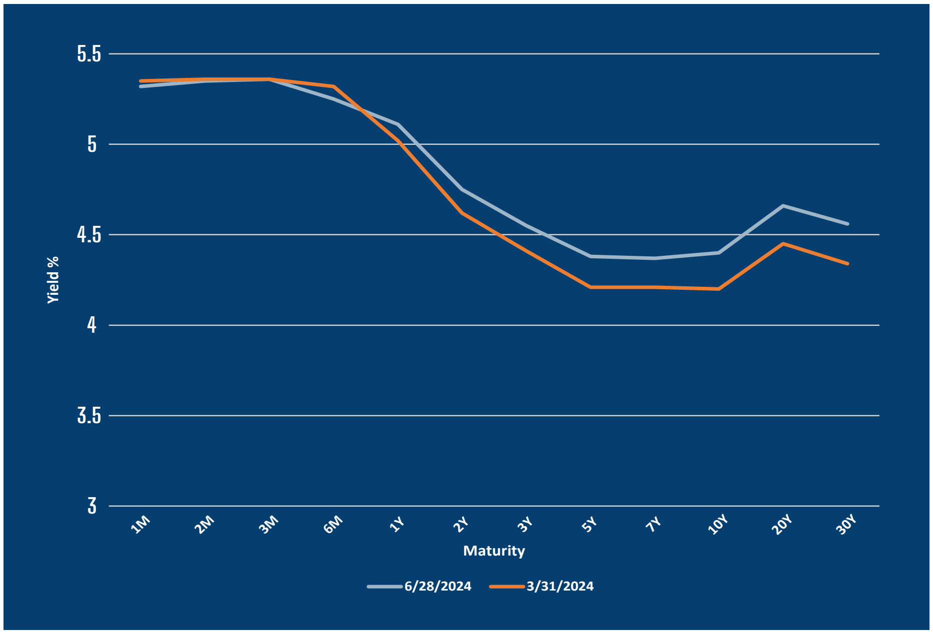
U.S. Treasury Curve

Yields rose slightly during the quarter as the prospects for Fed easing were pushed further into the future. Inflation remains "sticky," and Fed rhetoric remains somewhat hawkish.

U.S. Treasury Yield Curve



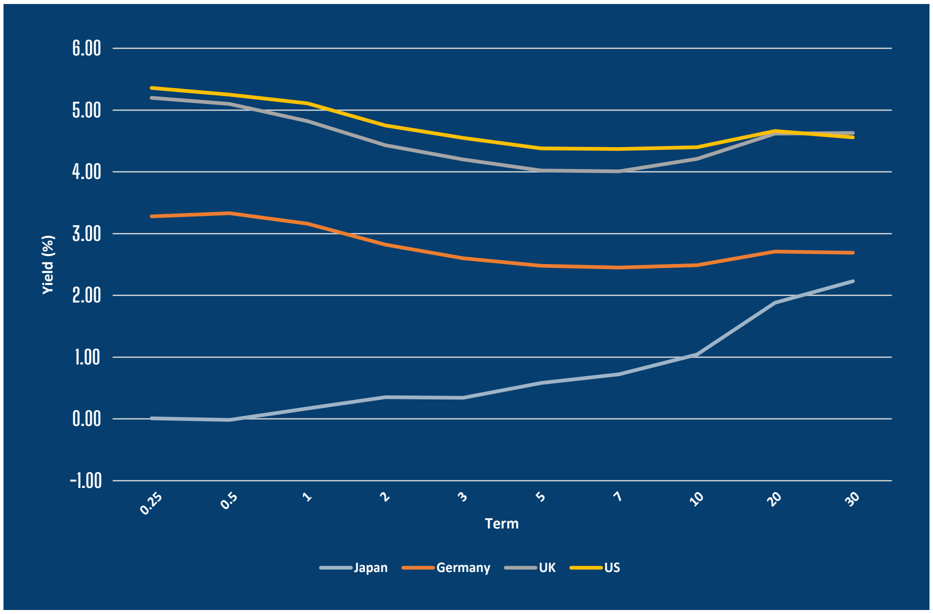
As of June 30, 2024
Source: Bloomberg

Government Bond Curves

Global bond yields continue to generally increase as inflation has remained more stubborn than policymakers desire.

Government Bond Yield Curves

End of Q2 2024



As of June 30, 2024
Source: Bloomberg

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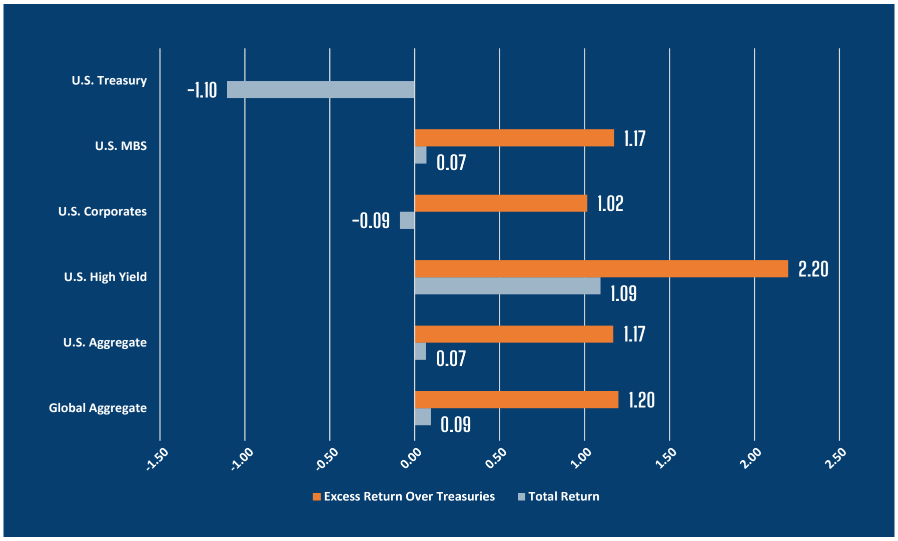
Fixed Income Performance (Q2)

Rising yields were a headwind for fixed-income investors in Q2. The benchmark Treasury index was down over 1%. Investment-grade corporates also posted negative returns while high yield was up over 1%. All "spread" sectors outperformed Treasuries by significant margins.

Fixed Income Performance

Q2 2024

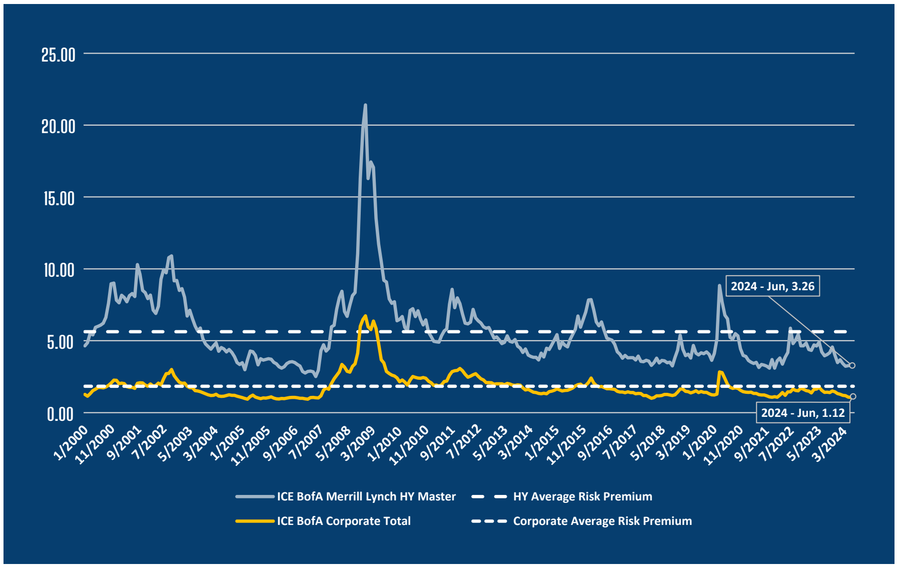


As of June 30, 2024
Source: Bloomberg

Credit

Credit spreads remain narrow relative to history, but yields (carry) are compelling for multi-asset portfolios due to higher benchmark yields.

Investment Grade and High Yield Credit Spreads



As of June 30, 2024
Source: Haver

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Municipal Bonds

Municipal bonds continue to offer a yield advantage for high tax bracket investors.

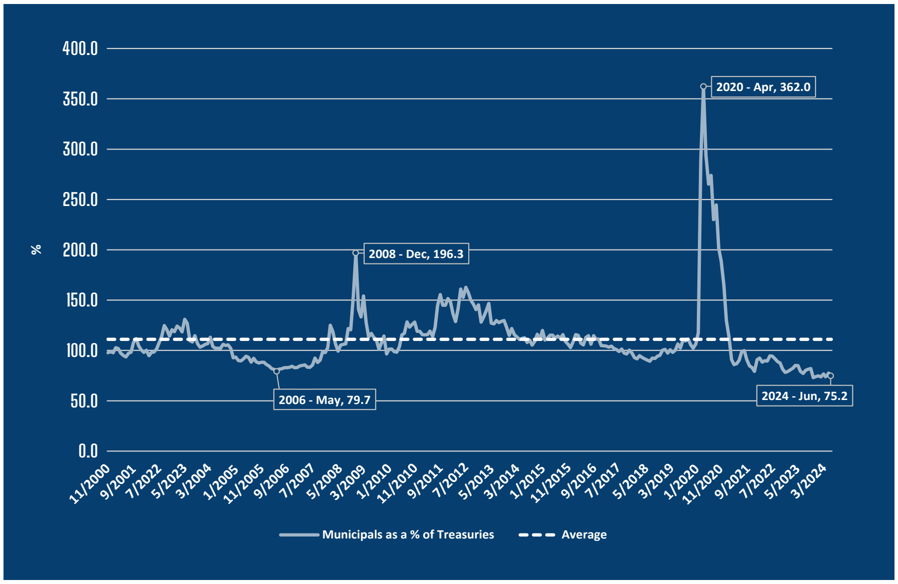
Term	AAA General Obligation	U.S. Treasury	Municipal % of Treasury
1	3.18	5.13	62.0%
2	3.12	4.72	66.1%
3	3.00	4.51	66.5%
4	2.95	4.41	66.9%
5	2.93	4.36	67.2%
7	2.90	4.35	66.7%
10	2.85	4.38	65.1%
15	3.02	4.48	67.4%
20	3.44	4.67	73.7%
25	3.65	4.65	78.5%
30	3.74	4.53	82.6%

As of June 30, 2024
Source: Bloomberg

Municipal Bonds

Municipal bond credit quality remains strong, reflected in valuations relative to Treasuries.

Municipal Yields as a Percentage of Treasury Yields
ICE/Bank of America Municipal Master/10-Year Treasury



As of June 30, 2024
Source: Haver

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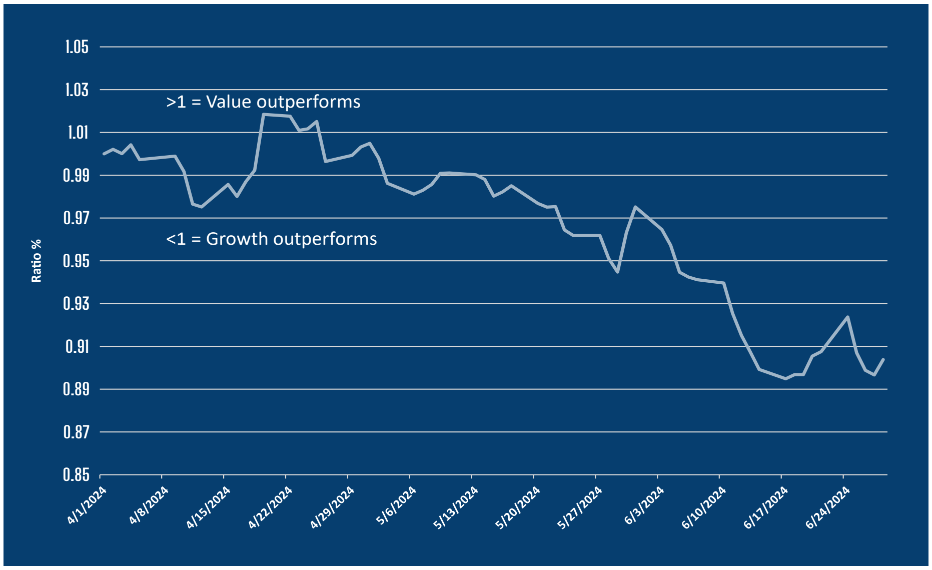
Equity – Value vs. Growth

Growth outperformed value across the size spectrum.

Large Cap Value/Large Cap Growth - Q2 2024

Russell 1000 Value/Russell 1000 Growth



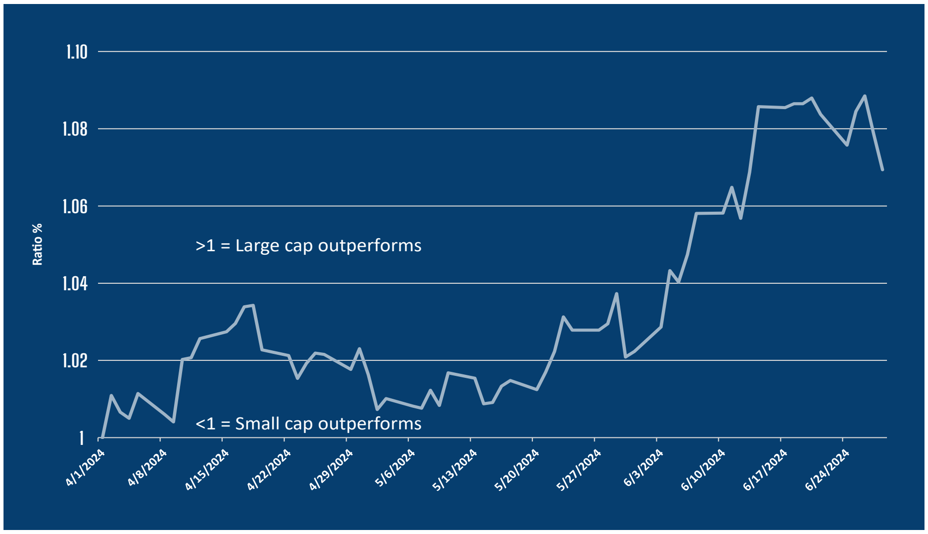
As of June 30, 2024
Source: Bloomberg

Equity – Large vs. Small

Large cap outperformed small cap during Q2.

Large Cap/Small Cap - Q2 2024

S&P 500/Russell 2000



As of June 30, 2024
Source: Bloomberg

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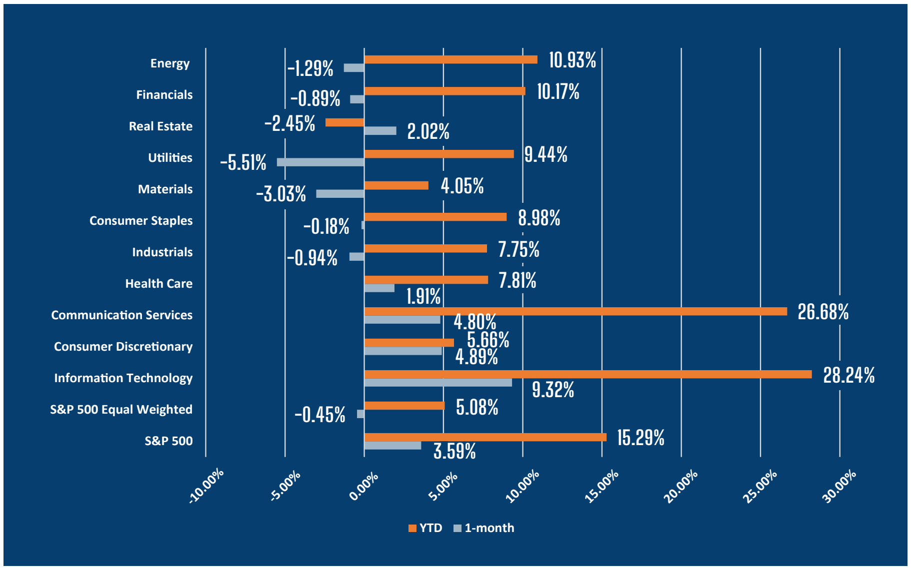
U.S. Equities – Return by Sector

The S&P 500 posted a solid gain for Q2, although the breadth of the market was very narrow. Technology stocks were strong while several sectors finished negative. The lack of breadth can be seen in the difference in returns between the cap-weighted and equal-weighted S&P 500.

S&P 500 Sector Returns
Q2 2024

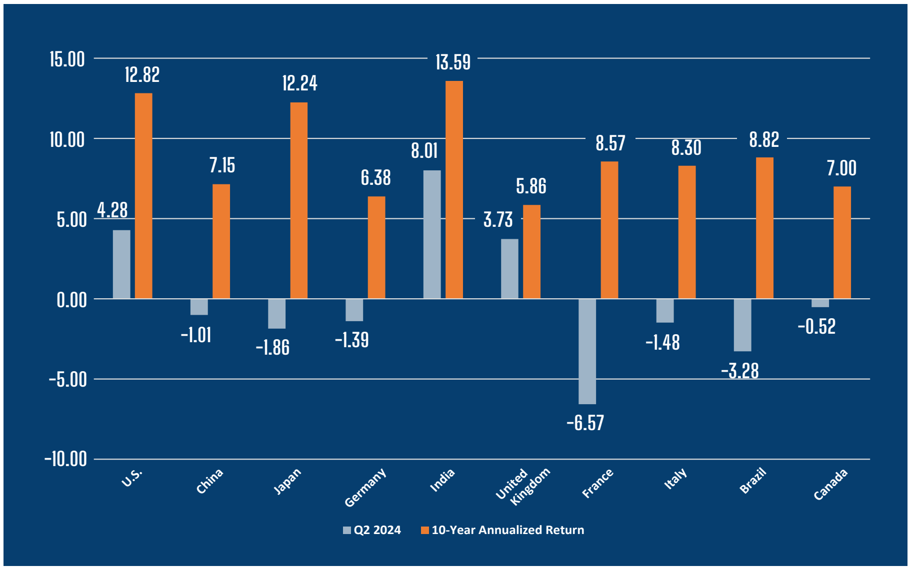


As of June 30, 2024
Source: Conway

Country Total Returns (%) – 10 Largest Economies

Global equities were mixed in Q2, with the Eurozone generally under pressure. Longer-term trailing returns have been very strong, led by the United States, India and Japan.

Country Total Equity Market Returns



As of June 30, 2024
Source: Bloomberg

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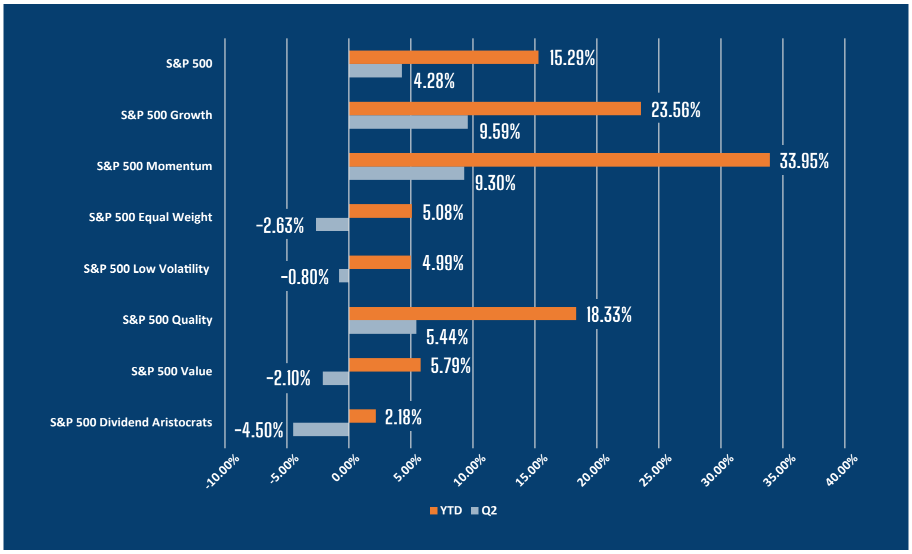
U.S. Equity Factors – Total Return Q2

Momentum and growth continue to lead while value and income-oriented factors lagged in Q2. The largest tech stocks in the S&P 500 continue to dominate returns.

Total Return: Core Factors

Q2 2024

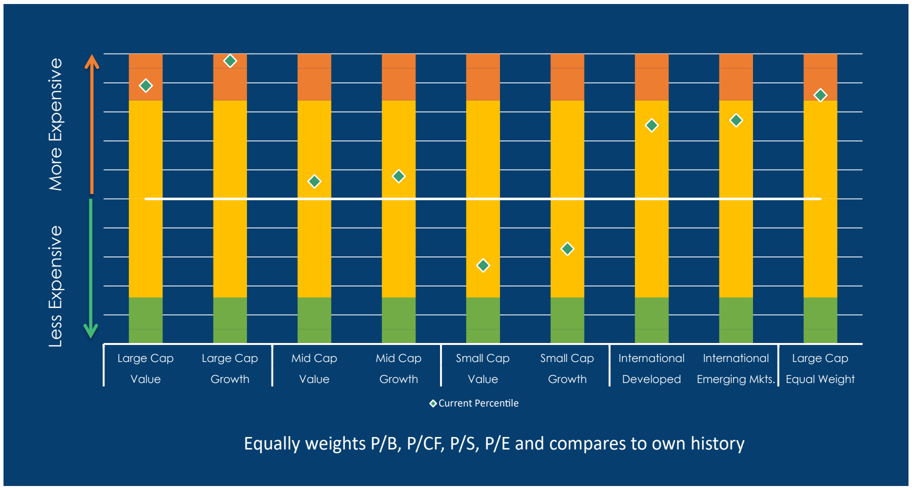


As of June 30, 2024
Source: S&P

Valuations

Large-cap stocks remain expensive relative to history while small-cap stocks are at historically inexpensive levels relative to their large-cap brethren.

Equity Asset Classes Value Rank to Own History



As of June 30, 2024
Source: BFE, Bloomberg

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Breadth

While the Russell 1000 was up 3.57% in Q2 at the cap-weighted index level, the average stock in the Russell 1000 was actually down 4%. Performance was driven largely by a handful of tech stocks.

Russell 1000 Deciles: Average Q2 Performance (%)

Decile	1	2	3	4	5	6	7	8	9	10
Price (Lowest to Highest)	-6.18	-5.52	-4.94	-3.68	-5.62	-1.44	-4.63	-2.98	-4.51	-2.17
Market Cap (Lowest to Highest)	-9.84	-3.40	-5.33	-5.51	-5.68	-4.17	-2.85	-3.53	-2.08	0.76
Price to Earnings (Lowest to Highest)	-5.92	-7.60	-3.79	-4.93	-2.48	-2.11	-4.16	-2.72	-2.31	-5.71
Price to Sales (Lowest to Highest)	-5.56	-5.69	-5.34	-5.49	-4.16	-4.82	-2.92	-4.53	-0.14	-3.03
Price to Book (Lowest to Highest)	-6.67	-4.11	-4.44	-5.36	-2.88	-6.07	-5.35	-3.34	-1.21	-2.25
Dividend Yield (Highest to Lowest)	-1.78	-3.27	-4.57	-4.00	-3.78	-6.18	-3.58	-3.54	-0.50	-5.69
Short Interest (Lowest to Highest)	-0.83	-0.54	-2.35	-3.06	-2.58	-3.79	-5.26	-7.43	-7.33	-8.65
Analysts Sentiment (Best to Worst)	-0.87	-3.40	-1.38	-3.06	-3.89	-5.02	-4.60	-5.39	-7.23	-6.94
Q1 Performance (Worst to Best)	6.09	-6.40	-4.12	-4.47	-3.51	-3.52	-5.36	-3.71	-3.37	-1.12

As of June 30, 2024
Source: Northern Trust

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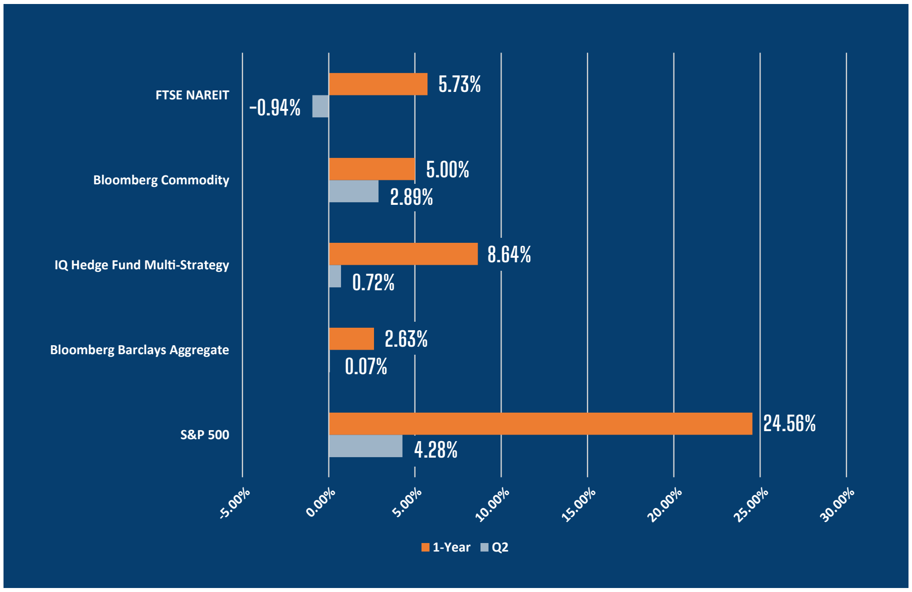
Alternative Returns

Alternative strategies and asset classes were generally positive in Q2 and for the trailing year. Lower volatility hedged strategies continue to outperform bonds.

Alternative Returns

Q2 2024



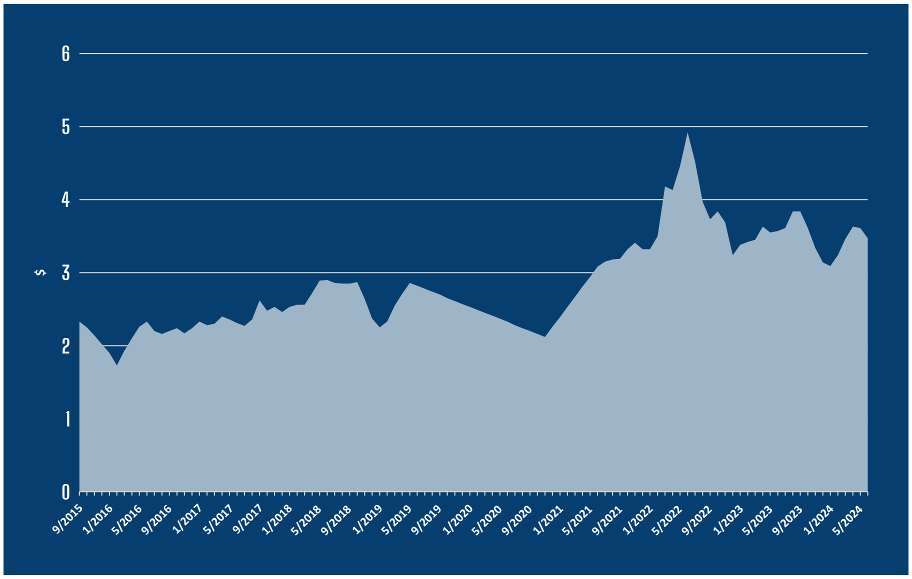
As of June 30, 2024
Source: Conway

Gas Prices

Stable gas prices are a boon for consumers.

AAA Retail Regular Gasoline Prices: U.S. Average

U.S.$/Gallon

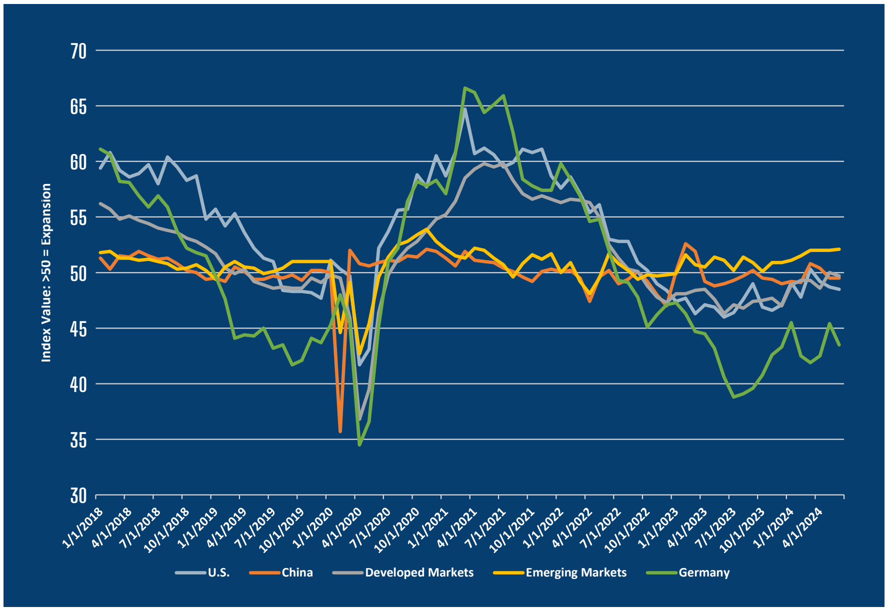


As of June 30, 2024
Source: Bloomberg

PMI Composites

The Purchasing Managers Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector.Readings >50 equal expansion and <50 contraction. Emerging economies continue to show stronger signs of growth than the developed countries.

Global Manufacturing Surveys



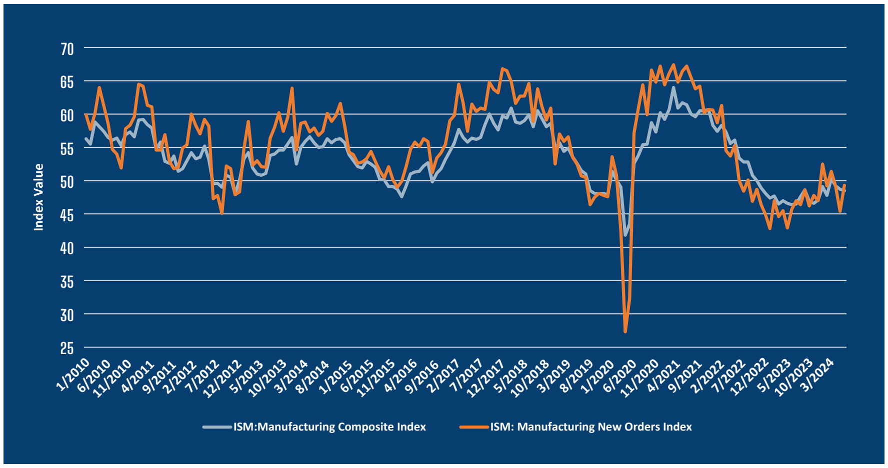
As of June 30, 2024
Source: Bloomberg, Haver

Manufacturing

While manufacturing remains soft, new orders have not hit recessionary levels of activity in this cycle.

Institute for Supply Management Manufacturing Composite Index

New Orders Index, >50=Expansion, <50=Contraction



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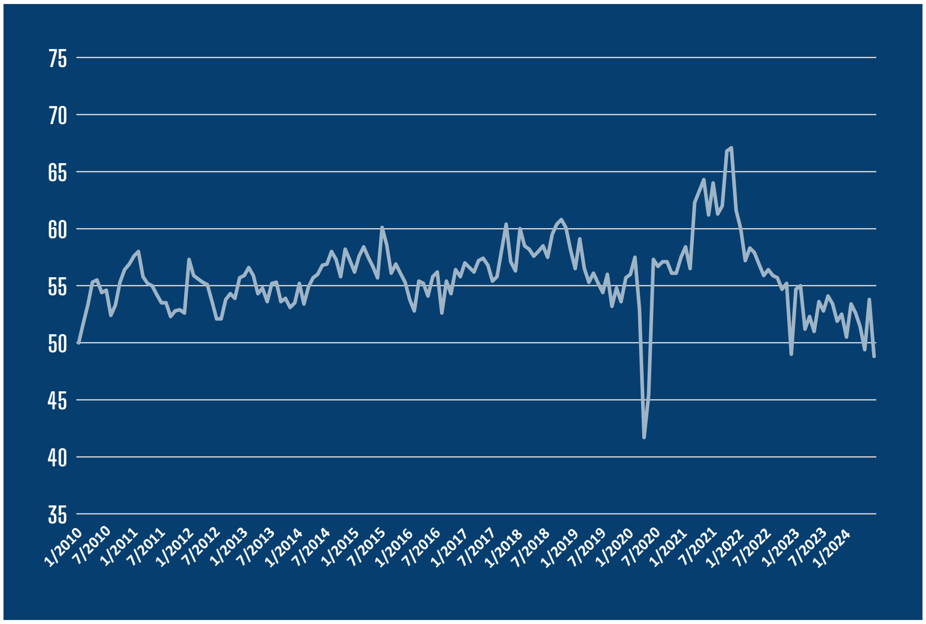
Services

Survey-based indicators show the service side of the economy slowing in recent months.

Institute for Supply Management Services Index

>50=Expansion, <50=Contraction



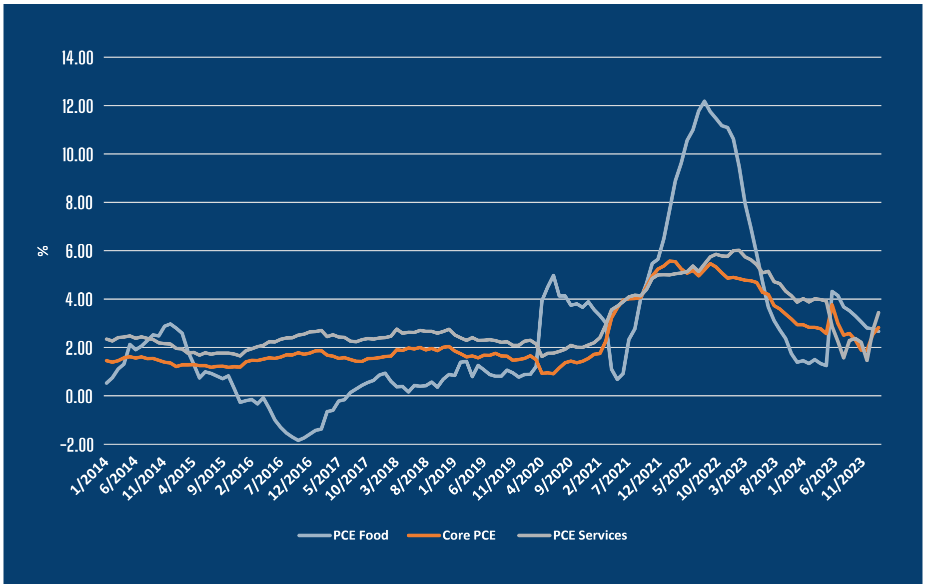
As of June 30, 2024
Source: Haver

Inflation

The Fed's favored measure of inflation for its 2% target is core personal consumption expenditures (PCE). It remains stubbornly above the 2% stated goal. Services continue to run hot while goods and even food prices have declined. Goods are now negative year-over-year.

Inflation

Personal Consumption Expenditures



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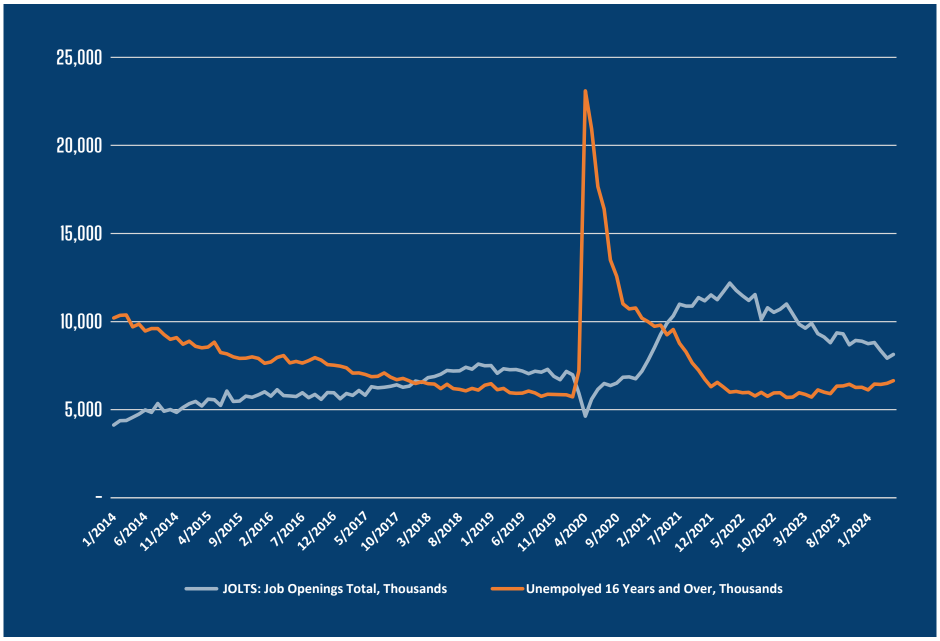
Employment

The gap between the amount of job openings and people unemployed has narrowed as hiring is slowing.

Job Openings vs. Unemployed



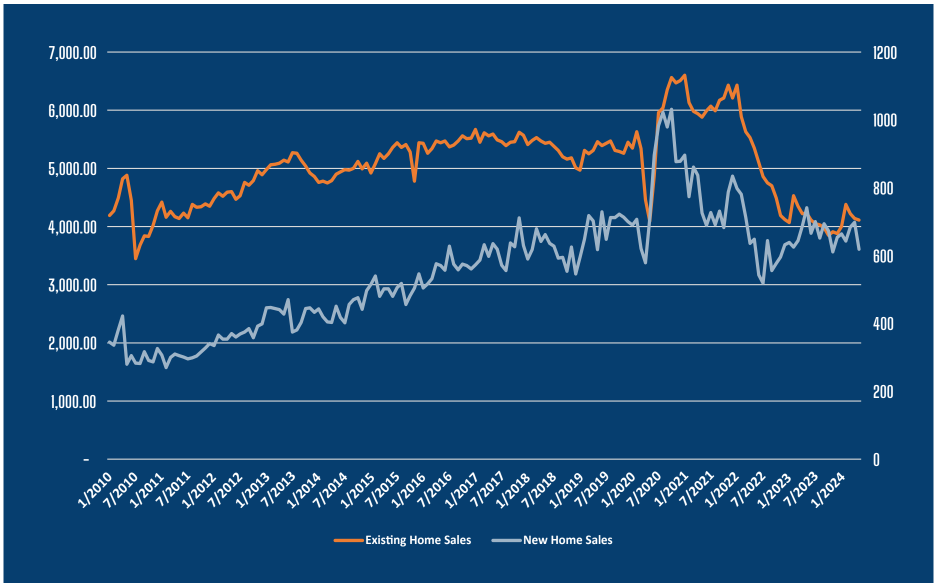
As of June 30, 2024
Source: Haver

Housing

Housing data has softened since the torrid pace of the pandemic.

New and Existing Home Sales

Thousands, monthly



As of June 30, 2024
Source: Haver

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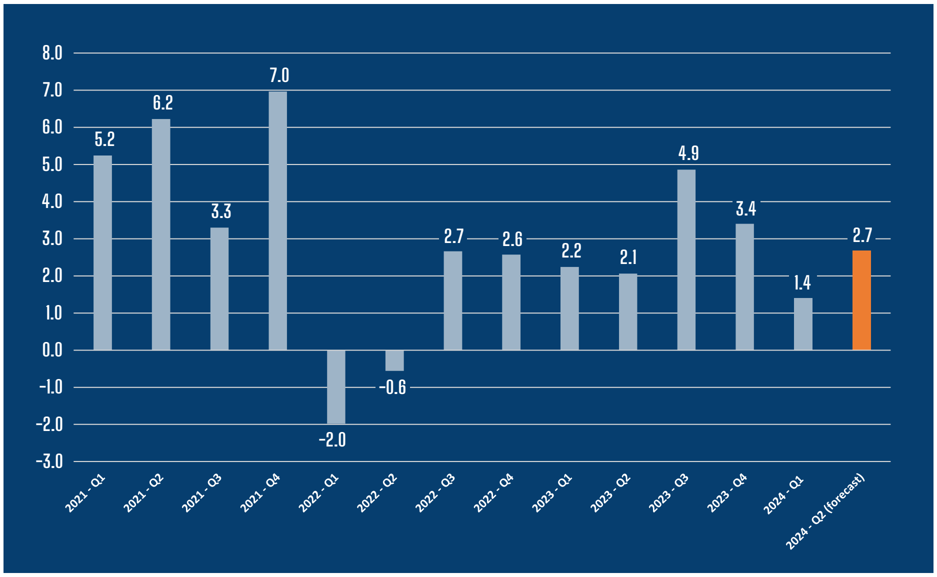
ECONOMIC REVIEW

Growth

The economy has decelerated in the first half of 2024. The GDPNow forecast for Q2 currently stands at 2.7%.

Real Gross Domestic Product

% Change - Annual Rate



As of June 30, 2024
Source: Haver, Atlanta Fed

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