Market Commentary
Second Quarter 2024

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MARKET SNAPSHOT

Economic growth in the U.S. remained resilient in the second quarter and equity markets responded with solid returns, particularly in U.S. large-cap and growth stocks.

Trends such as the U.S. outperforming the rest of the world, large caps outperforming small caps, and growth outperforming value continued in the second quarter, and relative performance within these themes are at extreme levels.

Concentration within the U.S. equity market is at levels not seen since before the dot-com bubble, as only a handful of stocks are driving the performance of the S&P 500.

Inflation is clearly moderating, which could give the Federal Reserve confidence to lower interest rates.

We remain vigilant of signs of potential economic weakness in consumer spending, the labor market, and corporate earnings.

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Market Recap

In the second quarter of 2024, the U.S. economy remained resilient in an environment where inflation and interest rates remained higher than expectations. Tighter monetary policy was offset by accommodative fiscal policy, and a still strong U.S. consumer.

The S&P 500 Index gained nearly 4.5% in the quarter, reaching a new all-time high. Gains were again led by technology stocks with the Nasdaq gaining over 8.0% in the quarter. Chip maker Nvidia became the world's most valuable company in late June after its share price climbed to an all-time high, making it worth $3.34 trillion, with its price nearly doubling since the start of this year. We also saw the continuing trend of large-cap stocks (Russell 1000 Index) outperforming small-cap stocks (Russell 2000 Index) and growth (Russell 1000 Growth) beating value (Russell 1000 Value).

Overseas, results were mixed with developed international stocks (MSCI EAFE) falling 0.2%, while emerging-market stocks (MSCI EM Index) rebounded nearly 5.0%.

Within the bond markets, returns were positive across most fixed-income segments. The benchmark 10-year Treasury yield ended the quarter close to where it started, but interest rates were volatile in the period. The 10-Year Treasury yield started at 4.20%, then rose to 4.70% before coming back to the mid-4.20% range. In this environment, the Bloomberg U.S. Aggregate Bond Index gained 0.3% while high-yield bonds (ICE BofA High Yield Index) finished up 1.0% in the quarter.

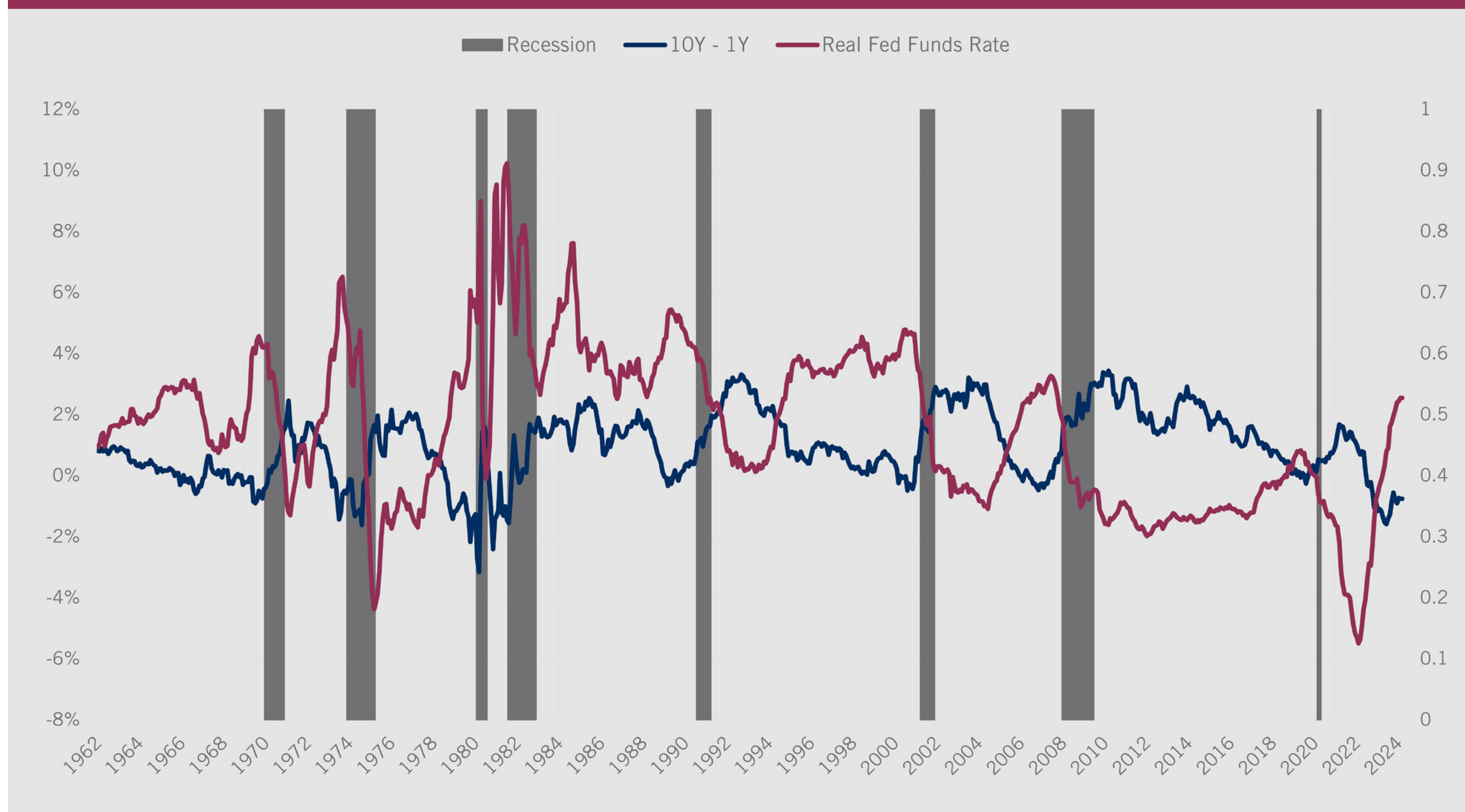
Investment Outlook and Portfolio Positioning

During the second quarter, the U.S. economy began its fifth year of expansion after the brief pandemic-related recession in April 2020. Ongoing economic growth has defied widespread expectations of a recession that were present for most of 2023 and into the beginning of 2024.

Concerns about an economic recession were due to the Fed's rapid and meaningful increase in the fed funds rate (i.e., interest rates) and the potential negative impact they would have on economic growth. The Fed's rapid increase in the fed funds rate resulted in an inverted yield curve with short-term interest rates above intermediate- and long-term interest rates. Historically, an inverted Treasury yield curve has been a reliable predictor of economic recession.

However, as we've communicated for several quarters, our view was that given the elevated level of inflation, Fed policy may not have been as restrictive as it seemed and thus a recession was not imminent. Our view was largely based on the level of the real fed funds rate (fed funds rate minus inflation) and prior recessions. The chart below shows the real fed funds rate (red line) and the shape of the Treasury curve (blue line). When the blue line is above zero it indicates a normally (upward) sloped yield curve and below zero represents an inverted (downward sloped) yield curve. The vertical gray bars indicate a recession.

Real Fed Funds Rate vs. 10Yr-Minus-1Yr Slope



Source: Bloomberg. Data as of 6/30/2024.

We can see that while the yield curve has been inverted since July 2022 (i.e., the blue line is below zero), Fed policy was very accommodative for most of that time (i.e., the real fed funds rate was sharply negative when the curve first inverted). It's only more recently been that Fed policy started to move toward restrictive levels. In prior cycles, real fed funds proved restrictive at the 3.5% (or higher) level. To the extent that inflation continues declining, which we think it will, and the Fed keeps rates unchanged, Fed policy will become proportionately tighter and slow the economy.

Indeed, recent data suggests that higher interest rates and inflation have started to take a bite out of the U.S. consumer. The University of Michigan Consumer Sentiment Index fell to a seven-month low in June, indicating a pessimistic view of personal finances. In the May retail sales report, growth was positive but slower than expected. This recent data point suggests consumers are exercising more caution amid tighter budgets. Specifically, headline sales rose 0.1% from the prior month versus the consensus for a 0.3% rise.

At this point, we would describe the slowdown in consumer spending as a normalization after a period of splurging, rather than something more ominous. So far, any concerns around the consumer have not seemed to scare investors

as the S&P 500 has made 30 new highs and as the economy has grown at nearly 3% (after inflation) over the past four quarters. Our base case is for the economy to continue growing, albeit at a slower pace, for inflation to grind lower, and the backdrop for risk assets to remain supportive (for at least a while longer). That said, we will closely monitor the labor market and the consumer for signs of further deterioration, which could impact our views and portfolio positioning.

Within U.S. equity markets (S&P 500 Index), a handful of U.S. mega-cap technology stocks continue to outpace the rest. Last year just 30% of stocks within the S&P 500 outperformed the index. This was a historically low figure—a level not seen since the late 1990s. Yet, so far in 2024, the concentration of returns moved even higher. Through late June 2024, only 27% of stocks are outperforming the S&P 500. This is the lowest reading on record going back more than 50 years. As shown in the table below, the top 10 contributors in 2024 have accounted for 70% of the S&P 500's 15% year-to-date return.

Top 10 Contributors to S&P 500's 15% YTD Return

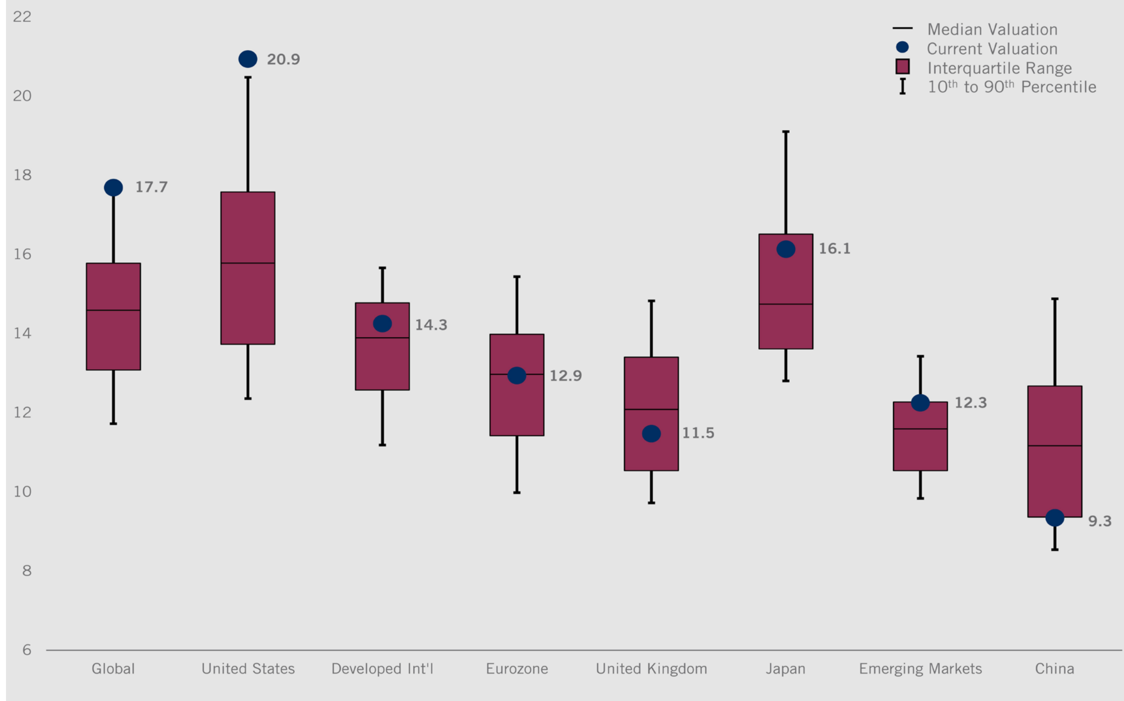
Company	Ticker	GICS Sector	Portfolio Weight	YTD Return	Contribution to Index Return	% Contribution to Index Return
NVIDIA	NVDA	Information Technology	6.3%	138.5%	4.2%	28%
Microsoft	MSFT	Information Technology	7.3%	19.5%	1.4%	9%
Alphabet	GOOGL/GOOG	Communication Services	4.2%	28.4%	1.1%	7%
Meta Platforms	META	Communication Services	2.4%	41.2%	0.8%	5%
Amazon.com	AMZN	Consumer Discretionary	3.7%	22.1%	0.8%	5%
Eli Lilly and Co	LLY	Health Care	1.6%	53.2%	0.6%	4%
Apple	AAPL	Information Technology	6.5%	8.4%	0.6%	4%
Broadcom	AVGO	Information Technology	1.5%	43.7%	0.5%	4%
Berkshire Hathaway	BRK.B	Financials	1.6%	16.1%	0.3%	2%
JPMorgan Chase & Co	JPM	Financials	1.2%	18.3%	0.2%	1%
Top 5 Contributors			**23.9%**		**8.3%**	**55%**
Top 10 Contributors			**36.4%**		**10.5%**	**70%**

Source: Morningstar Direct. S&P 500 Index proxied as iShares Core S&P 500 ETF. Data as of 6/24/2024.

While the concentration levels at the index level are noteworthy, it's possible that this trend can continue. After all, the strong run for artificial intelligence (AI) stocks has been justified as companies such as Nvidia continue to deliver and beat earnings estimates. Moreover, expectations for future earnings growth are robust.

While large-cap tech and growth stocks have outperformed on the back of strong fundamentals, large-cap value and small-cap U.S. stocks are trading at more attractive valuations and offer important diversification benefits. Smaller-cap U.S. stocks, for example, are trading at valuations relative to large-cap stocks that haven't been seen in years, dating back to the late 1990s. We should also note that we think it's quite possible that areas of the equity market that have lagged and have lower valuations—small-cap companies and value stocks—could benefit from an ongoing expansion and a broadening out-of-the-market rally.

From a valuation perspective, the discount for developed international (MSCI EAFE) and emerging-market stocks (MSCI EM) versus the U.S. remains extremely wide. The story can be seen in the next chart. U.S. stocks trade near peak valuations, while other regions may offer better relative values as their valuations are not as extended. All else equal, lower starting valuations imply better long-term expected returns and could provide more of a valuation cushion in the event multiples contract in a stock market sell-off.



Source: Bloomberg. Data from 1/1/2006 to 6/30/2024.

Closing Thoughts

The U.S. economy looks set to benefit from a continuing gradual moderation in growth, inflation, and jobs, creating a backdrop that could support risk assets. As was the case last quarter, the stock market continues to hit new highs as economic growth continues to benefit corporate earnings. U.S. concentration remains high with the Magnificent Seven representing over 25% of the S&P 500. There's no doubt that the other 493 stocks of the S&P 500 have struggled on a relative basis, but they could be set to move higher if the key economic drivers outlined above continue to fuel the economy. That said, fears of a recession haven't completely abated. Looking out to the end of the year and into next year, the question remains whether a recession will be avoided or delayed. As such, we are keeping a close eye on the typical drivers of recession, including the labor market, consumer spending, and corporate earnings, where a deterioration in these variables could influence portfolio positioning.

Heading into the second half of the year, we continue to anticipate pockets of volatility given headline risks related to Fed policy, geopolitical events, and the upcoming U.S. presidential election. In the event of volatility, we will look to be opportunistic, taking advantage of any attractive risk/reward opportunities that arise.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors

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Market Indicators
Second Quarter 2024

S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	8.76	18.01	31.20	25.02
S&P Financial Select Sector TR USD	-2.03	10.17	24.21	10.58
S&P Consumer Disc Select Sector TR USD	-0.67	2.44	8.29	9.95
S&P Health Care Select Sector TR USD	-0.96	7.81	11.68	11.53
S&P Industrial Select Sector TR USD	-2.90	7.75	15.53	11.52
S&P Cons Staples Select Sector TR USD	1.05	8.01	6.40	8.66
S&P Energy Select Sector TR USD	-2.62	10.58	16.26	13.05
S&P Utilities Select Sector TR USD	4.66	9.44	7.82	6.11
S&P Real Estate Select Sector TR USD	-1.91	-2.45	5.60	4.42
S&P Materials Select Sector TR USD	-4.50	4.14	8.79	10.86
S&P Telecom Select Industry TR USD	4.99	-2.22	1.30	4.05

Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	4.28	15.29	24.56	15.04	12.86
Russell Mid Cap	-3.35	4.96	12.88	9.45	9.04
Russell 2000	-3.28	1.73	10.06	6.94	7.00
MSCI EAFE	-0.42	5.34	11.54	6.46	4.33
MSCI Emerging Markets	5.00	7.49	12.55	3.10	2.79
BBgBarc U.S. Agg Bond	0.07	-0.71	2.63	-0.23	1.35
High Yield	1.09	2.58	10.44	3.92	4.31

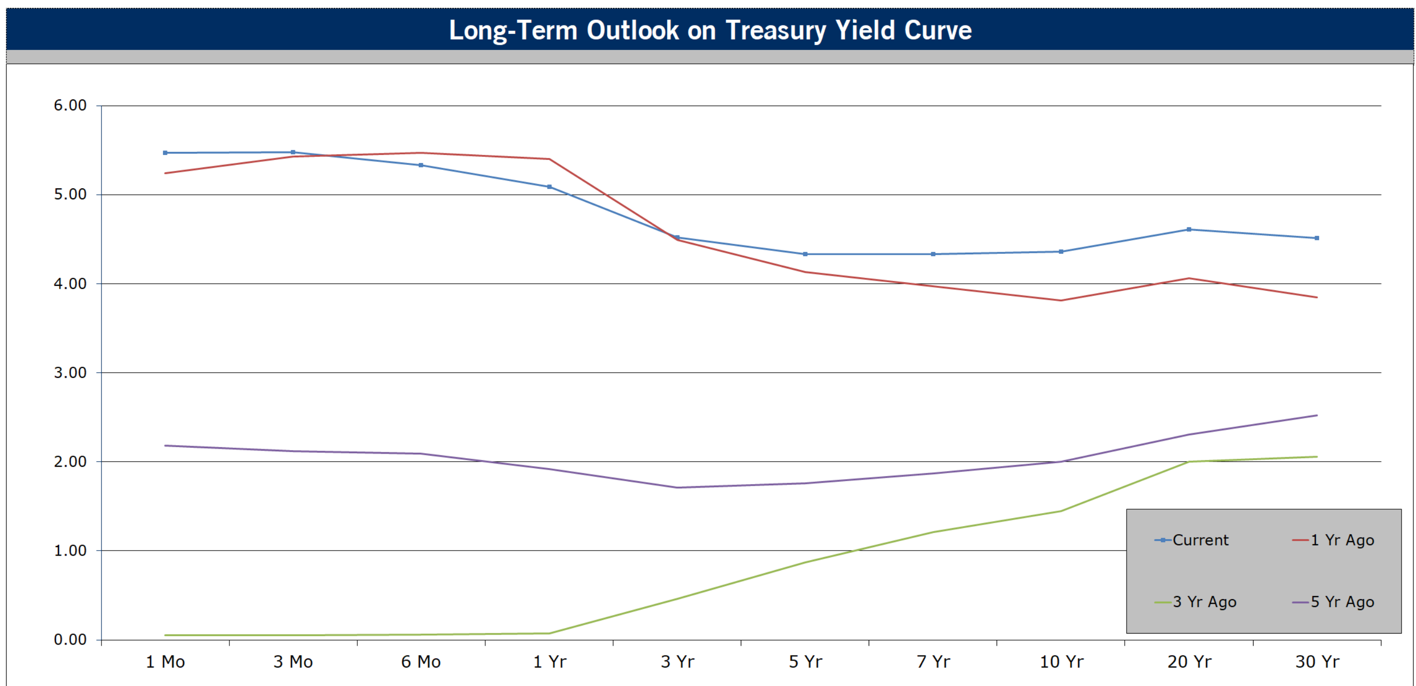
Value / Growth Returns

	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	5.79	0.45	-5.85	22.23	15.39	12.30
Growth	23.56	11.70	3.30	30.03	17.49	17.10

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	26.54	22.20	1.26	4.50%
Russell Mid Cap	20.28	17.76	1.35	5.63%
Russell 2000	15.86	14.93	1.30	6.70%
MSCI EAFE	16.00	14.53	2.98	6.88%
MSCI Emerging Markets	14.98	12.67	2.43	7.89%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

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