



QUARTERLY INVESTMENT REVIEW & OUTLOOK– Q2 2024

In Q2, stocks added to their positive returns for the year while bonds experienced swings but ultimately held steady. The US economy continued to grow but shows signs of weakening. The Presidential Debate and its aftermath created nothing less than political chaos. Q3 should be interesting to say the least.

- **Equities:** US large caps continued to dominate with the S&P 500 at +15.3% YTD compared to Russell 2000 at +1.7% YTD. International stocks continued to lag US with MSCI EAFE at +5.3% YTD while MSCI Emerging Markets picked up pace to +7.5% YTD. The US market remained heavily concentrated with the “Magnificent 7” comprising 29.5% of S&P 500 market cap and accounting for 59.6% of the index’s total return in the first half of 2024 (the “Magnificent 7” returned +33% YTD, while the rest of the S&P 500 return just +5%). The top 10 names are trading at expensive valuations, with forward P/E ratios at ~30x while the other 490 stocks trade around 17.6x. These compare to a historical fair value of around 15-16x for the S&P 500 over the long-term (interestingly, where value stocks are today). International stocks trade near or below their historical forward P/E ratios, so many expect foreign stocks to outperform, although we’ve heard that before.
- **Fixed Income:** Evolving expectations around the direction of inflation and whether/when the Fed will start to cut rates continued to roil the bond market. In Q2 rates were volatile again but ultimately settled and rose slightly by quarter-end. While the 6-month Treasury yield continued to hover near 5.3%, the 2-year moved up slightly from 4.6% to 4.7% and the 10-year moved up from 4.2% to 4.4%. Currently, the real federal funds rate is the highest it has been since August 2007. With a 5-year break-even inflation forecast of 2.18% and 10-year of 2.25%, inflation-beating yields are a welcome sight for bond investors.

Credit spreads (i.e. incremental rewards for accepting lower credit quality) remain at historically tight levels. This suggests caution and a focus on higher-quality credit. The shift in the composition of the investment grade (IG) credit corporate bond market has been noteworthy. Since 2007, IG has grown +\$6.7 trillion in issuance due to low borrowing costs. Since then, Baa (lowest tier of IG credit quality) has grown from 26.3% of the market to 40.2% while lower-rated high yield (“junk”) bonds shrunk from 19% to 11.1%. As such, lower credit quality comprises a larger share of IG credit. This is something to watch if there is deterioration in corporate earnings and the economy, especially given the need to refinance at rates that have risen since many of these bonds were issued. Regarding duration and maturity, the outlook for interest rates suggests extending duration while persistent yield curve inversion offers temptation to stay short.

- **Economy:** The US economy shows signs of weakening. Unemployment has ticked up to 4.1%, triggering the *Sahm Rule*, an indicator of recession, which suggests that if 3-month



average unemployment exceeds the lowest unemployment in the past 12 months by more than 0.5%, recession has begun. June's ISM PMI index for manufacturing (48.5) indicated contraction again (18 of past 19 months) while the Services PMI surprised negatively at 48.8, denoting contraction for only the 3rd time in the past 49 months. Consumers have pushed forward (personal consumption growth of +5.1% YOY), although they appeared to dip into savings to do so (personal income grew more slowly at +4.6%). Consumer delinquencies have risen to a 13-year high (same level as when unemployment was 8%). Fed rate increases typically have a lagged effect (average lag between first increase and recession is 29 months which would correlate with August 2024). The yield curve remains inverted (generally implying recession). That said, corporate earnings have been resilient and GDP growth remains positive, but the pace appears to be slowing. Inflation has moderated, so the Fed might likely cut rates in September, although inflation remains a headline risk. CPI is still around 3.3%, although the PCE deflator sits at 2.6% and 10-year breakeven inflation hovers around 2.3%, which is closer to the Fed target.

2024 PERFORMANCE – BENCHMARK INDEXES

Index	Quarter	YTD	5 Yr Ann	10 Yr Ann	15 Yr Ann
<i>S&P 500 (US large cap stocks)</i>	+4.3%	+15.3%	+15.0%	+12.9%	+14.8%
<i>S&P 400 (US mid cap stocks)</i>	-3.4%	+6.1%	+10.3%	+9.1%	+13.1%
<i>Russell 2000 (US small cap stocks)</i>	-3.3%	+1.7%	+6.9%	+7.0%	+11.2%
<i>MSCI EAFE (devel int'l large cap) - US\$</i>	-0.4%	+5.3%	+6.5%	+4.3%	+6.8%
<i>MSCI EM (emerging mkts int'l) - US\$</i>	+5.0%	+7.5%	+3.1%	+2.8%	+4.9%
<i>Barclays US Aggregate (US bonds)</i>	0.0%	-0.7%	-0.2%	+1.3%	+2.5%

Data as of 6/30/24. Returns represent total returns (dividends & capital appreciation/depreciation). Past performance is NOT predictive of future performance.