July 15, 2024

Quarter Ending June 30, 2024

Quarterly Performance	Q2 Index	YTD	Close
Dow Jones Industrial Average	1.73%	3.79%	$39,118.86
NASDAQ Composite Price	8.26%	18.13%	$17,732.60
Standard & Poor's Averages	1.73%	14.48%	$5,460.48

The positive market momentum took a brief pause during the second quarter. During April, broad-based indices had their worst individual month since 2022. The S&P 500 was down approximately 4% during the month. That said, the markets quickly corrected and returned to trading at all-time highs. For the quarter, the S&P 500 was up approximately 4%.

However, overly optimistic investors were caught off guard by some disappointing economic data. The Bureau of Economic Analysis reported that in Q1, U.S. GDP unexpectedly collapsed to just 1.6%, down more than 50% from the Q4 data point of 3.4%, the lowest point since Q2 2022 when the U.S. underwent a brief technical recession. Leading up to the Q1 report, economists were anticipating an estimate of 2.5%.

Similar to 2022, broad-based indices are giving the illusion of strength for the market and economy. As of today, five stocks (MSFT, NVDA, GOOGL, AMZN, and META) have accounted for 60% of the S&P 500 total year-to-date returns. On its own, Nvidia (NVDA) accounts for 34% of the S&P's gains. By comparison, the S&P 500 equal-weight index (all 500 companies getting an equal percentage vs. capitalization weighted) is **unchanged** since the start of 2022. The performance gap between the S&P 500 cap-weighted and equal-weighted indices over the last two years is the widest in nearly 24 years!

We have touched on this in past letters, but the price-to-earnings ratio (P/E) is one of the many financial metrics investors use for evaluating companies. At the beginning of the second quarter, in relation to the MSCI U.S. Index, the U.S. P/E was at 21.4. This P/E ratio is 32% above the average of 16.2. Is this generally good or bad? Not necessarily. It's just another indication that broad markets are trading at high valuations.

Over the last few years, we have transitioned out of the "everything bubble," which was built on over a decade of 0% interest rates and trillions of dollars of worldwide "quantitative easing," and into a scenario with 5% interest rates and quantitative tightening by the Federal Reserve. Investors' willingness to take on risk (whether they realize it or not) has continued to support the equity markets. Much like 2022, many retail investors continue to funnel money into exchange traded and index funds because they are inexpensive and "have worked." As it stands for the overall market, we feel investor expectations exceed the underlying fundamentals. We must never forget the famous words from economist John Maynard Keynes: “The markets can remain irrational longer than you can remain solvent.”

Finally, we would like to leave you with an interesting example of just how quickly portions of the markets have gotten out of control. It’s taken 60 years for Warren Buffet to build his investment company, Berkshire Hathaway. The current valuation of Berkshire Hathaway is approximately $880 billion dollars. When you contrast that with Nvidia - which went from just below $2 trillion market cap on April 24th to over $3 trillion just 30 days later, making it the largest company in the world – you truly understand how much the markets of today have changed.

Summer sure is here! Try to stay cool!

Regards,

Jeffrey L. Farni, Sr.

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