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## Market Commentary – 2nd Quarter 2024

It was a loved, and unloved, quarter for U.S. stocks, as the frenzy for a small group of tech giants that are focused on creating or using artificial-intelligence (AI) technology continued. Within the S&P 500, companies associated with AI gained 14.7% in market value this past quarter, while the balance lost 1.2%. For the quarter, the Dow lost 1.7%, the S&P 500 rose 3.9%, and the NASDAQ Composite gained 8.3%. For the first half of 2024, the Dow is ahead 3.8%, the S&P 500 has advanced 14.5% (15.3% with dividends), and the NASDAQ Composite has risen 18.1%.

Of mid-cap, small-cap, international and emerging market equity returns, only emerging market equity returns were positive for the second quarter, and all are lagging the S&P 500 year-to-date. Only five of the eleven S&P 500 sectors were positive for Q2. Information Technology (+13.6%) and Communication Services (+9.1%) were the quarter's best sectors. Materials (-4.9%) and Industrials (-3.3%) were the worst. Year-to-date, ten of the eleven S&P 500 sectors are positive. The Information Technology (+28.2%) and Communication Services (+26.7%) sectors are the best. The Real Estate (-2.5%) and Materials (+4.1%) sectors are the worst. Reversing from the progress it made in Q1, the S&P 500 Value Index fell further behind the S&P 500 Growth Index in Q2, as the stock market's advance narrowed.

Bond returns were relatively flat for the second quarter, and are slightly negative year-to-date. The benchmark ten-year Treasury note yield closed the quarter at 4.34%, up from its 4.19% yield at the end of Q1 2024. Treasury yields have now risen for the second straight quarter, and eight of the last ten quarters. Inflation has come down, but still remains above the Fed's target level of 2%. The labor market has recently cooled, but it's too early to say that it will soften further and result in recession. There are also signs that consumer spending is slowing. At some point, the Fed will want to stop the economy from slowing down further but, for now, Fed officials announced that they can take their time in cutting interest rates, as long as the job market stays healthy. It appears that the Fed will remain disciplined and that interest rates will continue to remain higher (normal), with the probability of one 2024 interest rate cut by the Fed. High-quality fixed income yields of around 5% remain an attractive option for balancing portfolios, where appropriate.

After reviewing the Northport Q2 2024 quarterly performance reports, it becomes clear that S&P 500 index exposure produced significant positive returns, while individual stock portfolios generally lagged behind the index in Q2 and year-to-date. This reflects a theme that I have mentioned in the past, but it's become even more prevalent lately. A look beneath the surface of U.S. financial markets and the economy shows a more complex and often weaker picture than



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index and data points suggest. Average stock performance is notably more tepid than stock indices indicate. If you have relatively few of the largest market capitalization companies driving performance, this keeps stock indices afloat. More indicative of current reality is what the balance of the stock market is doing below the surface. This hidden weakness is reflective of current uncertainties about the economy, the labor market, potential Fed actions, geopolitical risk and the upcoming election.

The three largest stocks in the S&P 500 (Microsoft, Apple and Nvidia) make up nearly 21% of its total market value. Its five largest stocks account for around 27%, and the top ten total more than 36% of the index. Part of my role is to control risk, and concentrating that much money in so few stocks violates this principle. This obscured lack of diversification is concerning. Nvidia alone has accounted for nearly one-third of the S&P 500's total return year-to-date 2024 (S&P Dow Jones Indices). Add Microsoft, Amazon, Meta Platforms and Eli Lilly, and 55% of the S&P 500's return year-to-date came from just five stocks. The ten largest S&P 500 stocks rule the stock market presently, leaving non-owners out in the cold.

The surge in mega-cap tech names has left them richly valued. We need to maintain an upward trajectory in earnings estimates to support these valuations, but we are in a slowing economy. Market pricing may be getting ahead of plausible reality. What should one do now? I believe that we should continue to maintain our emphasis on our value oriented, total return equity investment preference. Value stocks are typically shares of companies that are comparatively inexpensive on metrics such as book value or price-to-earnings, and they pay significant dividends. After badly lagging their growth-focused counterparts this year, value stocks currently offer some of the most compelling valuations in the U.S. equity market. The S&P 500 Growth Index trades at 28.3 times forward earnings, while the S&P Value Index has a forward price-to-earnings ratio of 15.8 (LSEG Datastream). Value is cheap on a relative basis. Dividend payouts will increase over time. The massive current spending on AI by big tech is designed to create tools to benefit other companies. The AI tools being created will benefit our value companies, and will in turn improve their earnings. The future is bright.

John M. Grib, CFA, CFP®