

Monthly Market Update

June 2024

Highlights:

- The S&P 500 Index increased by nearly 5% in May, bringing the year-to-date return to 11.3%.
- Reminiscent of the dot-com boom, a significant portion of the market's return remains concentrated in just a few mega-cap technology firms.
- The return of rising interest rates has suppressed bond performance, with the Bloomberg Aggregate Bond Index down -1.6% year-to-date.

In the original parable of the blind men and the elephant, not only do each of the men describe the elephant based on a singular part, but they descend into discord arguing their perceptions. In the investing world, we have thousands of practiced eyes fixated on the same financial markets, often coming to a similarly bewildering range of conclusions. Even more puzzling are the times when a consensus appears widespread, only to be proved wrong as markets move to the contrary.

We note this not because this past month was one of those vexing inflection points but rather because markets were largely on the course to which we've become accustomed. The S&P 500 Index ended the month up just shy of 5%, bringing the year-to-date return to 11.3%. Fixed income bounced back with a 1.7% return in May. However, the return of rising interest rates has suppressed performance, with the Bloomberg Aggregate Bond Index showing a 1.6% loss so far this year. The domestic stock market continued to be led by a small number of mega-cap technology firms. Broader returns were fueled by a resilient economy, solid employment numbers, and enough suggestions for an economic slowdown and moderating inflation to maintain expectations of incipient Federal Reserve rate cuts.

Rising markets produce happy investors and tend to create snowballing enthusiasm and risk complacency. A deeper look into the market shows that over half of the S&P 500's return this year is concentrated in four mega-cap technology firms. This sort of concentration should be accompanied by at least a modicum of concern, but the more common reaction is a compulsion to join the trend powered by a fear of missing out.

How singular has the performance concentration become? At the peak of the dot.com boom of the late 1990s and into the 2000s, the S&P 500 became 29% technology-weighted. Looking past the recent reclassifications (from Technology to Communication Services, for instance), today's S&P 500 could be characterized as 40% technology. While some of this increase is secular (with virtually every company depending on technology and technological advancement), it's vital to be clear-eyed about the increased risk of performance concentration. During the ten-year period ending 12/31/23, the technology sector grew earnings at an annualized rate of just over 9% per year while producing an investment return of over 20% annualized, which meant that about half of the investment return came from an expanding price to earnings ratio from about 15x earnings to begin 2014 to over 36x earnings to begin 2024. In a higher interest rate environment, we would typically expect a contraction of price-to-earnings (P/E) ratios for the equity risk premium to compete against higher interest rates and higher bond yields. So far in this cycle, that contraction has not occurred. One thesis supporting technology upside from here despite high P/E ratios is an acceleration of earnings delivered via productivity gains from artificial intelligence.

Lagging bond performance this year has only added to the appetite for stocks with a natural inclination for the leading companies. Fundamental investment principles emphasize rebalancing -- trimming the winning assets and buying the lagging ones. We see this behavior from our most experienced and steadfast institutional accounts, even though it requires overcoming the emotional instincts of performance chasing.

Over the past months and years, we've demonstrated the ability to participate in a rising stock market while still emphasizing valuation and risk assessment. A big part of this discipline means keeping or even increasing fixed income allocations, as appropriate, at a time when immediate rewards may be lacking. We can celebrate new highs in the stock market while simultaneously noting that stock prices are increasing faster than earnings, creating P/E multiple expansion. We believe today's market only increases the imperative for thoughtful asset allocation and careful stock selection.



Portfolio Manager Q&A - Patrick Ryan

The Federal Reserve has held the fed funds rate at the 5.25%-5.5% level since last July. What impact are you starting to see this having on consumers and businesses?

For consumers and businesses, the biggest story continues to be inflation. The Fed's rate hiking campaign to combat inflation hasn't had the effect that the market or Fed were looking for, and now the situation is starting to erode consumer confidence. Maybe not as much if you were able to get a mortgage before 2022 versus after. But we're also beginning to see delinquencies rise. As we've gone through two years of inflation at a very high level, monthly bills are ticking up, consumers are faced with higher credit card interest rates, and it's all starting to have an impact. The market has been looking for cuts; the Fed would like to cut interest rates, but until we can get past inflation, higher rates will continue to challenge consumers and, to a certain extent, businesses.



*Patrick Ryan, CFA
Head of Multi-Asset Solutions,
Portfolio Manager*

Given the Fed wants to cut interest rates this year, how are you currently positioned in your fixed income allocation?

In their last projection, the Fed expected to cut three times this year; at this point, the market is expecting less. For investors stationed in cash or at the short end of the yield curve where rates are highest, it's important to remember that once the Fed starts cutting, those short-term rates will start to evaporate. So, we think it is important to be positioned a bit out of the curve. We believe the intermediate, three to seven-year part of the curve will most likely see the greatest benefit from rate cuts. There is still a bit of risk beyond the seven to ten-year area that you want to be aware of and account for if you are allocated to those longer bonds.

You have said equity valuations are "uncomfortably rich," yet the market keeps moving higher. Where are you finding value in the equity market?

Certainly, some of the expensive areas of the market have become much more expensive as we've progressed through the year. But when talking about uncomfortable valuations, we're referring to the overall top-down index level. There will always be unique opportunities for active managers to find attractively valued securities within large cap stocks, mid caps, and so on. Some sectors we see as having the best value here in the U.S. remain Energy and other dividend-paying sectors. Within Energy, you have companies with very attractive free cash flow generation with modest valuations. Dividend payers were hit hard when interest rates rose over the past two years, and investors moved back to fixed income instruments for yield. So, you have attractive valuations in dividend stocks as well.

Beyond the U.S., we are seeing reasonable valuations and opportunities in emerging Asia. China continues to be a bit of a wild card in their stimulus efforts and when they will play out, so we may not have a clear catalyst, but the valuations are attractive, nonetheless. The same can be said about European equities, where we are seeing attractive valuations coinciding with a bottoming of economic conditions.

How should investors think about risk and diversification in their asset allocation?

In the short term, while we wait for inflation to be quelled, you could see windows where both stocks and bonds fall. Not to the extent of 2022, when you had fixed income down double digits. However, negative performance is a possibility until we get to the other side of the Fed tightening program.

From a longer-term perspective, in five years, we think investors will be happy that they increased fixed income allocations, as yields are unlikely to rise materially from here. We believe that bonds will act as that negatively correlated diversifier with equities in the future.



U.S. Equities (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	2.6	3.5	20.0	6.0	11.6	11.3
S&P 500	5.0	11.3	28.2	9.6	15.8	12.7
Russell 1000	4.7	10.6	28.0	8.5	15.4	12.4
Russell 1000 Value	3.2	7.6	21.7	5.5	10.7	8.6
Russell 1000 Growth	6.0	13.1	33.6	11.1	19.4	15.8
Russell Midcap	2.9	5.7	23.1	3.1	11.1	9.5
Russell 2000	5.0	2.7	20.1	-1.7	8.6	7.7

U.S. Equity Sectors - S&P 500 (%)

	May	YTD	Weight
Communication Services	6.6	20.9	9.3
Consumer Discretionary	0.3	0.7	9.9
Consumer Staples	2.5	9.2	6.0
Energy	-0.4	12.4	3.9
Financials	3.2	11.2	12.9
Health Care	2.4	5.8	12.0
Industrials	1.7	8.8	8.5
Information Technology	10.1	17.3	30.6
Materials	3.2	7.3	2.3
Real Estate	5.1	-4.4	2.2
Utilities	9.0	15.8	2.5

U.S. Equity Characteristics - S&P 500

	May	2023
Price/Earnings Ratio (NTM)	20.6	19.7
Weighted Avg. Market Cap (\$B)	895.4	721.7
Dividend Yield (%)	1.4	1.5

International Equities (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	4.1	8.9	23.6	5.1	11.7	8.4
ACWI ex USA	2.9	5.8	16.7	0.3	6.8	4.0
MSCI EAFE	3.9	7.1	18.5	3.1	8.0	4.6
Emerging Markets	0.6	3.4	12.4	-6.2	3.5	2.7
China	2.4	6.8	4.3	-17.1	-2.4	1.9
Japan	1.3	7.0	18.6	2.4	7.6	6.2
Germany	4.3	7.5	18.0	-0.9	6.4	2.5
United Kingdom	3.6	8.8	18.9	6.7	7.1	2.9
India	0.7	9.3	31.5	10.7	12.0	9.1

Key Asset Prices

	May	2023
EUR/USD	1.08	1.11
USD/CAD	1.36	1.32
USD/JPY	157.19	140.92
GBP/USD	1.27	1.27
Bitcoin (\$)	67,491.4	42,265.2
Gold (\$/oz)	2,330.0	2,066.0
Crude Oil (WTI) (\$/bbl)	80.9	75.8

Fixed Income (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	1.4	-1.8	-0.1	-3.3	-0.6	0.8
Municipal	-0.3	-1.9	2.7	-1.3	0.9	2.2
U.S. Aggregate Bond	1.7	-1.6	1.3	-3.1	-0.2	1.3
Investment Grade Corporate	1.8	-1.1	4.0	-2.7	0.9	2.2
High Yield	1.1	1.6	11.2	1.8	4.2	4.3

U.S. Treasury Yields (%)

	May	2023
3-Month	5.5	5.4
6-Month	5.4	5.3
2-Year	4.9	4.2
5-Year	4.5	3.8
10-Year	4.5	3.9
30-Year	4.7	4.0



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The Dow Jones Industrial Average® (The Dow®), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The S&P 500® Index is an unmanaged index of large companies and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

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The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

Emerging Markets - MSCI Emerging Market Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

China - MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

Japan - MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

Germany - MSCI Germany Index is designed to measure the performance of the large and mid cap segments of the German market.

United Kingdom - MSCI United Kingdom Index is designed to measure the performance of the large and mid cap segments of the UK market.

India - MSCI India Index is designed to measure the performance of the large and mid cap segments of the Indian market.

Government Bond - Bloomberg US Government Index measures the performance of the U.S. Treasury and U.S. Agency Indices, including Treasuries and U.S. agency debentures. It is a component of the U.S. Government/Credit Index and the U.S. Aggregate Index.

Municipal - Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

U.S. Aggregate Bond - Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Investment Grade Corporate - Bloomberg U.S. Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

High Yield - Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Weighted Avg. Market Cap: measures the size of the companies in which the portfolio invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share.

Price-to-Earnings (P/E) Ratio: measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's earnings per share of stock in a portfolio.

Dividend Yield: the portfolio's weighted average of the underlying portfolio holdings and not the yield of the portfolio.

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Yield Curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward sloping curve), inverted (downward sloping curve) and flat. Yield curve strategies involve positioning a portfolio to capitalize on expected changes.

Diversification does not assure a profit or protect against loss in a declining market.

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