

Quarterly Market Perspective

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Stocks finished the first half of 2024 in a great position with the S&P 500 appreciating 4% in the second quarter, leading to 15% appreciation for the first half of the year. Thus far during the year, the S&P 500 has reached thirty-five new record highs and counting. Economic growth got off to a strong start (more on that to come), corporate earnings have come in ahead of expectations, and excitement around further advancements in artificial intelligence has garnered additional investor excitement. Collectively these influences fueled a 'Goldilocks' feeling amongst investors.

As we move away from market averages, results are solid but not as robust as they may appear. The reason being is that stock returns have been fueled by a narrow cohort of large, growing technology-oriented businesses. This is a very similar story to what transpired during the first half of 2023. Outside of this cohort, returns are rather pedestrian. Case in point, while the S&P 500 is up 15% in the first half of the year, the S&P 500 Equal Weight Index, a better measure of the 'average' stock, is up only 5%. With the top ten stocks in the S&P 500 now accounting for 37% of its weight¹, the performance of the largest stocks has had an increasing impact on the total return of the benchmark. Outside of large U.S. stocks, returns were

more moderate with small cap U.S. stocks up only 2% year-to-date, while international (developed) markets have appreciated 6%. Bonds returns have been slightly negative as the headwind of higher yields has weighed on bond prices. The barometer for taxable bonds, the Bloomberg U.S. Aggregate Index, has shed -0.7% year-to-date, while the Bloomberg Municipal Index ticked lower by -0.4%. Both measures of the bond market were effectively flat during the second quarter.

As we look ahead, we have begun to see signs that economic growth is beginning to slow. The Bloomberg Economic Surprise Index, which measures whether economic data is getting incrementally better or worse (relative to expectations) shot into negative territory this past quarter. Inflation appears, at a minimum, to be stabilizing and potentially moving lower. However, employment has started to soften around the edges with the unemployment rate now back above 4% and wage growth decelerating. The factors fueling economic growth during late 2022 and 2023, such as heavy consumer spending and an uptrend in government outlays, appear to no longer be increasing and therefore we are beginning to experience a natural deceleration in the rate of economic growth. This doesn't necessarily translate into expectations for a recession, but toward our view that we expect a down-

[1] Source: Source: Standard & Poor's, as of June 30, 2024.

shift in the pace of economic activity.

Despite what has been an increasing number of data points indicating economic deceleration, market sentiment is at elevated levels. Surveys of both individual and institutional investors show bullish appetites and a lack of concern. Options markets, which serve as a means for hedging risk, have become more one-sided with investors speculating on the upside to the market and not hedging the risk of a downside move. More recently the speculative 'meme' stock craze has returned with select individual securities experiencing a roller coaster of volatility. Even within the bond market, the added yield or compensation for owning riskier high-yield bonds sits near a 20-year low. While we feel comfortable with economic conditions, markets have largely priced assets for a continuation of a 'Goldilocks' economic environment. Any change in expectations or increase in risk appetite could lead to a shift away from euphoric positioning, even if it's just a migration toward a more neutral (and no longer bullish) posture. This would lead to a moderate reset in asset prices. This adjustment may be more pronounced in the narrow subset of the market that has recently experienced outsized gains, including stocks most tied to the artificial intelligence (AI) theme.

At a broad level, we share the excitement around artificial intelligence. We recognize the opportunity that is coming from building out the computational infrastructure necessary to support AI deployments. In addition, there are several tangential themes including the opportunity around energy infrastructure, data centers, and non-tech companies that can materially

benefit from leveraging AI routines. However, there remains a great deal of uncertainty around the adoption curve of AI and how the demand for AI capabilities will match the supply of infrastructure.

From a portfolio standpoint, we aim to balance the direct and tangential opportunities in AI with the broader market's evolving pricing of these assets. This involves managing stocks with euphoric expectations and those experiencing excess pessimism. This leads us to seek a portfolio with balance having exposure to both securities that will benefit from these attractive secular trends, while at the same time owning positions of overlooked assets that provide more steady and predictable results.

Outside of equities, we are excited about the present level of yield offered in the bond market. Moreover, while bonds are down marginally year-to-date, we view the upside potential, versus the level of downside risk, to be rather favorable over a multi-year horizon. Collectively this leaves us more excited about the opportunity in the bond market.

Commodities and precious metals have had episodes of strength during 2024. We've seen speculative trading extend into these markets, and where appropriate, we've elected to pull back exposure given what we view to be a rather strong price appreciation and a less favorable fundamental backdrop.

For a more granular view of our perspective within stock and bond asset

SUMMARY	POSITIONING
Expect for interest rates to remain higher for longer and project a deceleration in economic growth.	We have tilted portfolios toward companies with higher quality balance sheets, strong free cash, and less economic variability.
We expect the equity market to gradually broaden as growth expectations between the largest companies and rest of the market converge.	We maintain a balanced posture toward both leading growth companies alongside overlooked companies, whose fundamentals are poised to improve on a relative basis.
Bonds offer attractive yields and possess risk/reward profiles that we deem to be attractive.	We increased allocations to bonds during the quarter where appropriate.
Yields on corporate bonds (investment grade and high yield) do not offer sufficient compensation should economic conditions ease.	We prefer to stay up in quality and have reduced exposure during the year to corporate bonds .
Yields on shorter dated bonds could move lower if/when the Fed begins to cut rates. Heighted levels of Treasury issuance post a risk of higher yields on longer dated maturities.	We have elected to maintain a more neutral interest rate posture given these competing factors.

classes, the table above summarizes how our positioning reflects our expectations around the economy and market conditions.

Conclusion

After a strong 2023 and an impressive start to 2024, compelling returns and a lack of volatility make it easy to be complacent and accept risk. While our base case expectation is for a stable, yet slower economy, we recognize there are a number of risks that could alter risk appetites including a resurgence in inflation, election ambiguity, geopolitical strife, backlash on federal debt issuance, or further fallout in the real estate market. As such, we believe this is an environment where one should build portfolios for a range of scenarios, and not just what may be in favor today.

Therefore, we believe diversification is as important as ever, even in today's 'Goldilocks' environment where holding only a handful of stocks may appear to be a good investment strategy.

We look forward to our interactions with our clients. We value your thoughts and questions. For those that aren't a client, but would like to learn more about our thinking, please reach out. We'd enjoy the opportunity to share and discuss our views and perspectives.