Q2 2024 Market Movements & Portfolio Insights

THE MATHER GROUP

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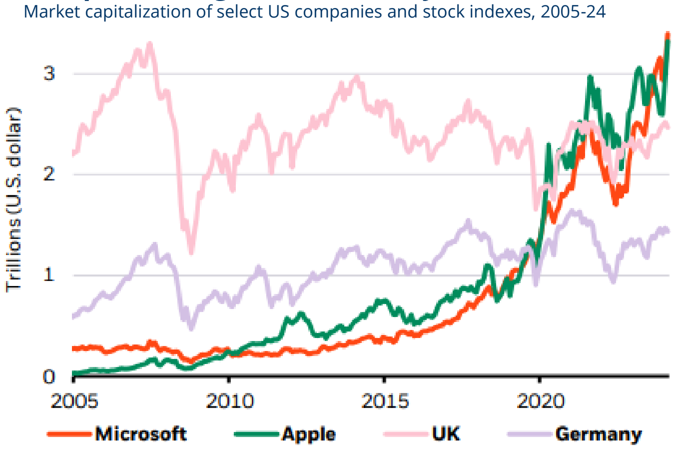
Key Highlights to Keep You Informed

- Higher-than-expected inflation and strong economic growth led to early second-quarter declines in both stock and bond markets. An economy that is too strong could put upward pressure on inflation and may cause the central bank to delay rate cuts.
- The upcoming November election is increasingly in the spotlight and is anticipated to remain a major focus in the months ahead. While economic perspectives often correlate with political affiliations, financial markets have demonstrated resilience across various administrations. Additionally, election years typically witness favorable stock market performance, buoyed by stimulative policies typically pursued by the incumbent party.
- Stock market returns in the US were strong but remain boosted by growth stocks that continue to defy gravity.
- Initial expectations for three Fed rate cuts starting in June have been scaled back to potentially just one cut for the year, supported by recent data showing subdued inflation and labor market conditions.
- The Federal Reserve has continued its cautious and data-dependent approach to monetary policy, maintaining the federal funds rate within a target range of 5.25% to 5.50%. This decision reflects ongoing concerns about inflation, which remains above the Fed's 2% target despite signs of moderation. Key economic indicators, particularly employment and inflation metrics, will guide upcoming rate decisions. Interest rate traders are currently pricing in a 93% probability of the first rate cut happening in September.[1]

Companies larger than country stock markets

Market capitalization of select US companies and stock indexes, 2005-24



Source: Blackrock

Chart takeaway: Some US company stocks are now larger in value then the entire benchmark index of some nations, showing how they can dominate broad index exposures. This emphasizes why investors must be deliberate with their risk-taking.

Notable Events in Q2:

APRIL

April saw a decline in global stock markets, driven by heightened geopolitical risks and uncertainty. Tensions escalated in the Middle East as Iran fired over 300 missiles and drones at Israel on April 13th. Additionally, the US experienced domestic unrest, with protests at Columbia University against Israeli actions. Meanwhile, India commenced its elections, engaging 968 million eligible voters in a significant democratic process. Market returns were further dampened by higher-than-expected inflation readings.

MAY

The primary market themes revolved around weakening economic data affecting corporate earnings, the Federal Reserve's policies shaping market sentiment, and widespread concerns about inflation and stagflation. Reports indicated that slowing growth and reduced gasoline demand were pressuring earnings, while the Federal Reserve's potentially hawkish stance and shifting investor sentiment were closely watched. Additionally, the market was highly focused on inflation trends, with significant concerns about stagflation risks and the mixed implications of falling inflation and slowing growth on stock performance. These interconnected themes underscored a complex and uncertain market environment.

JUNE

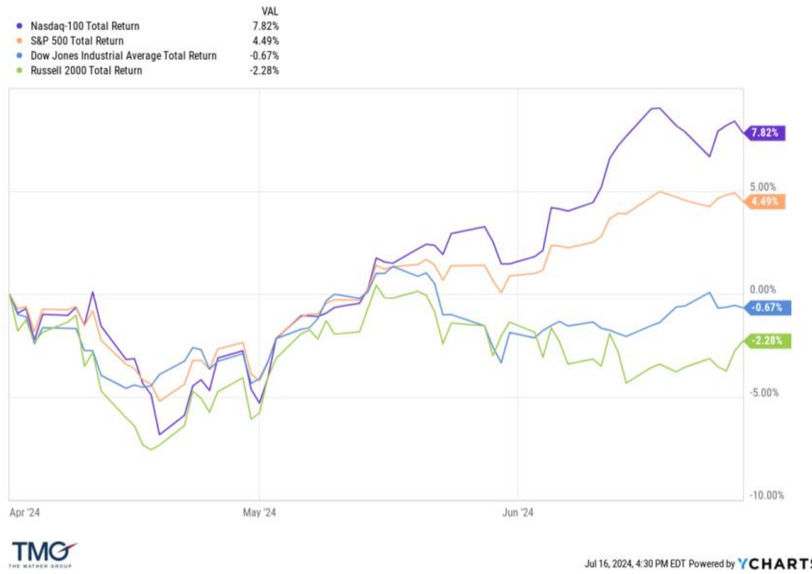
The employment data confirmed a slowing economy, with only 206,000 jobs created in June and downward revisions of 111,000 jobs for April and May. This resulted in the lowest three-month job total since early 2021. The unemployment rate increased to 4.1%, the highest since late 2021, as more people entered the job market. Despite these changes, the economy remains relatively healthy. The slowdown, coupled with lower inflation reports, should maintain market optimism about the likelihood of the Fed implementing a rate cut in the fall.

[1]*CME FedWatch Tool as of 7/5/2024.*

Economic Indicators

Economic indicators in 2024 paint a complex picture. The labor market shows resilience, though recent upticks in unemployment have tempered gains. Inflation appears to be moderating, but uncertainty around rate cuts has slowed manufacturing investment. Mixed results in the service sector include the Purchasing Managers' Manufacturing Index (PMI) growth alongside unexpected contraction in the Institute for Supply Management (ISM) services report. Consumer confidence holds steady amid inflation concerns and recession risks. Investor sentiment is cautiously optimistic, particularly towards Chinese equities, which saw improved Q2 performance. While not in recession, the economy faces challenges from softening data and persistent inflation, influencing the Fed's cautious approach to rate adjustments.

Major US Market Performance for Q2 2024



Market Impact on Major Asset Classes

Impact on Equities:

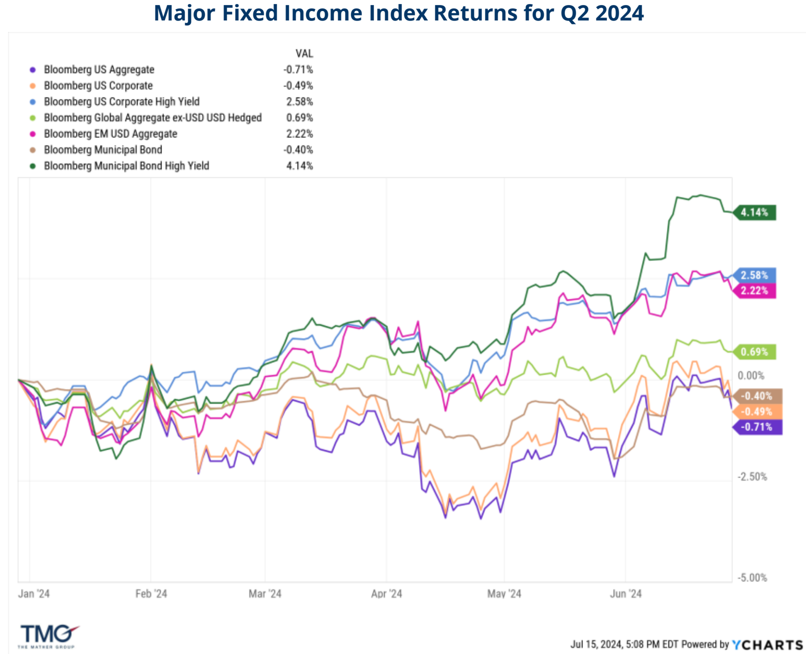
In 2024, the primary growth catalyst within equities continues to be the US Large-Cap market, particularly driven by growth-oriented companies within the Nasdaq 100 index. Per Nasdaq, concentration is highlighted as three companies have a market cap above $3T and combined comprise more than a 20% weighting in the S&P 500. At the height of the dotcom era in 1999, the top three members of the S&P 500 had less than a 10% weighting[2]. Switching focus to the US smaller companies and value-oriented companies, they continue to have attractive valuations but continue to underperform. Outside of the US, foreign stocks according to the MSCI World ex-USA index were slightly down in the second quarter, which was primarily driven by declines in the developed world. In a reversal from previous quarters, emerging markets rebounded and were supported by a +7.16% return from China in the quarter.
All in all, any underweights to expensive US growth stocks was a drag on returns for the quarter.

Impact on Fixed Income:

In Q2 2024, the bond market, tracked by the Bloomberg US Aggregate Bond Index (Agg), saw significant volatility. Despite the volatility, the Agg ended the quarter with a positive 0.83% performance but is still slightly negative YTD at -0.71%.[3], reflecting the impact of fluctuating interest rates and economic uncertainty. Key factors contributing to this volatility included mixed inflation data and varying expectations regarding Federal Reserve policies.

While demand for fixed-income assets remained robust, the market faced headwinds from new bond issuance and concerns over potential economic slowdown and inflation risks. A resilient economy has helped companies retain profits near record highs, benefitting both investment grade and high yield issuers, with high yield showing strong inflows. In the municipal bond space, states' rainy-day funds continue to be high even though slower economic activity may hurt tax revenues, helping mitigate any short-term pressures.

Major Fixed Income Index Returns for Q2 2024



[2]*Nasdaq, First Half 2024 Review & Outlook.*
[3]*Source: YCharts; Bloomberg US Aggregate Total Return Index.*

Impact on Alternatives:

Private market alternative investments have felt the impact of sustained higher interest rates. As an income producing asset, real estate is particularly sensitive to interest rates. Even healthy parts of the real estate market, such as multi-family homes, have shown signs of distress. In cases where buyers used excessive amounts of leverage to purchase buildings, they are now forced to refinance at higher interest rates as loans mature, meaning that the equity may not be sufficient to finance the building and higher interest rates consume a higher portion of rental income. This has created good opportunities for well capitalized buyers to purchase quality assets from distressed sellers and private credit investors to get attractive terms as regional banks scale back lending, making loans much harder to secure.

Higher interest rates have also significantly slowed the pace that private equity firms exit investments as buyers of these investments need to look more carefully at capital allocation decisions and the market for Initial Public Offerings (IPOs) has slowed. Slower exit activity means that current fund investors need to wait longer to realize expected returns on their investments and have less capital available to allocate to new funds. This sluggish exit activity has created opportunities for buyers on the secondary market to purchase fund holdings from their original owner at substantial discounts. Investors in private equity secondaries should benefit from attractive pricing and quicker hold periods.

Performance of Alternative Assets

	Q4	1-Year	3-Year	5-Year	10-Year
Real Estate	-1.46	-3.99	7.80	6.89	8.96
US Private Equity	2.97	9.31	14.11	17.92	15.59
US Venture Capital	0.46	-3.45	6.72	18.10	15.33

Per Cambridge Associates through 12/31/23.

Investment Opportunities

Looking solely at the widely tracked S&P 500 index of large US stocks might give the impression that stocks have enjoyed a sustained period of robust returns over the past 18 months, with valuations reaching levels that could be hard to maintain. However, it's important to note that much of these returns and valuations in the S&P 500 are driven by a handful of stocks. Taking a broader perspective reveals opportunities beyond markets dominated by large US growth stocks. In the US, value stocks are currently trading near their long-term average price-earnings multiples and typically perform well in periods of higher interest rates. Compared to growth stocks, value stocks are priced similarly to the discounts seen in late 2021 following the pandemic-induced surge, reminiscent of levels last seen during the late 1990s technology bubble. Small-cap stocks, whether growth or value-oriented, are also trading much closer to historical average valuations. Internationally, stocks are trading at very attractive valuations, with a significant 36% discount to the price-earnings ratios of the S&P 500. Non-US stocks offer dividend yields of 3.2%, which are compelling and more than double the yield of the S&P 500. While artificial intelligence continues to drive segments of the economy and the performance of the S&P 500, allocations to value stocks, small-cap companies, and international stocks present potentially stronger long-term investment opportunities.

Fed Nearing Rate Cut: Move Cash Off Sidelines into Fixed Income to Lock in Higher Yields

Yields are still attractive if you have cash on the sidelines. Assets tend to flow out of money market funds into longer term debt during easing cycles as investors try to lock in current high yields, driving bond prices up. During the last 6 easing cycles, average 12-month forward returns for the Bloomberg US Aggregate Bond Index have historically been between 7.55% - 13.75%[4], with higher returns for investors that got back into the bond market before the cutting cycle began. Today's high starting yields help mitigate potential downside for bonds because when bond yields start high, the income generated can help offset any potential price declines that result from rising market yields.

Assets Tend to Flow Out of Money Market Funds During Easing Cycles
Money Market Fund Assets (USD Billions)

Historical analysis does not guarantee future results. Through December 31, 2023
Source: Morningstar, US Federal Reserve and Alliance Bernstein (AB)

[4] *Bloomberg, Morningstar, US Federal Reserve and Alliance Bernstein (AB).*

Looking Ahead

In the evolving economic landscape of 2024, the impact of inflation and robust growth has shaped market expectations, recalibrating anticipated Fed rate cuts and intensifying focus on the upcoming November election. Amidst varied economic data, including moderated inflation and mixed sectoral performance, investors are cautiously optimistic but mindful of lingering uncertainties. Opportunities emerge beyond the S&P 500's concentrated gains, particularly in value stocks, small-cap companies, and international markets, offering potential for robust long-term growth amidst shifting global dynamics.

TMG has and will continue to deploy its sophisticated technology and trading systems to add value during periods of market volatility by conducting tax loss harvesting, strategic rebalancing, and accelerating Roth conversions, when appropriate. We appreciate your trust and confidence in managing your investments. Our team remains committed to monitoring the markets and making informed decisions to ensure your portfolios are well-positioned for future opportunities.

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Index Definitions

- Standard & Poor's (S&P) 500: A stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.
- The CBOE Volatility Index (VIX): A calculation designed to produce a measure of constant, 30-day expected volatility of the US stock market, derived from real-time, mid-quote prices of S&P 500 Index call and put options. On a global basis, it is one of the most recognized measures of volatility—widely reported by financial media and closely followed by a variety of market participants as a daily market indicator.
- Dow Jones Industrial: A stock market index that measures the stock performance of 30 large companies listed on stock exchanges in the United States.
- Nasdaq 100: A stock market index of the common stocks and similar securities listed on the Nasdaq stock market, which has more of a growth focus.
- Russell 2000: A small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index.
- Russell 2000 Value: A small-cap stock market index of the value-oriented companies within the Russell 3000 Index.
- PMI Manufacturing Index: Based on monthly questionnaire surveys of selected companies, the Purchasing Managers' Manufacturing Index (PMI) offers an advance indication on month to-month activity in the private sector economy by tracking changes in variables such as production, new orders, stock levels, employment, and prices across manufacturing industries.
- ISM Manufacturing Index: The manufacturing composite index from the Institute for Supply Management is a diffusion index calculated from five of the eleven sub-components of a monthly survey of purchasing managers at roughly 300 manufacturing firms nationwide. The survey queries purchasing managers about the general direction of production, new orders, order backlogs, their own inventories, customer inventories, employment, supplier deliveries, exports, imports, and prices. The five components of the composite index are new orders, production, employment, supplier deliveries, and inventories (their own, not customer inventories). The five components are equally weighted. The questions are qualitative rather than quantitative; that is, they ask about the general direction rather than the specific level of activity. Each question is adjusted into a diffusion index which is calculated by adding the percentage of positive responses to one-half of the unchanged responses.
- PMI Services Index: US Services Purchasing Managers' Index (PMI) is based on monthly questionnaire surveys collected from over 400 US companies which provide a leading indication of what is happening in the private sector services economy. It is seasonally adjusted and is calculated from seven components, including New Business, Employment and Business Expectations.
- ISM Services Index: The Institute for Supply Management surveys more than 375 service-providing firms from 16 industries (construction and mining are included). The services composite index has four equally weighted components: business activity (closely related to a production index), new orders, employment, and supplier deliveries (also known as vendor performance). The first three components are seasonally adjusted, but the supplier deliveries index does not have statistically significant seasonality and is not adjusted. For the composite index, a reading above 50 percent indicates that the services economy is generally expanding; below 50 percent indicates that it is generally declining. The supplier deliveries component index requires extra explanation: a reading above 50 percent indicates slower deliveries and below 50 percent indicates faster deliveries.
- Consumer Confidence Index: The Conference Board compiles a survey of consumer attitudes on the economy. The headline Consumer Confidence Index is based on consumers' perceptions of current business and employment conditions, as well as their expectations for six months hence regarding business conditions, employment, and income. Three thousand households across the country are surveyed each month. In general, while the level of consumer confidence is associated with consumer spending, the two do not move in tandem each and every month.
- Consumer Price Index (CPI): The CPI is a measure calculated monthly by the Bureau of Labor Statistics that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living.
- Consumer Sentiment Index: The University of Michigan's Consumer Survey Center questions 600 households each month on their financial conditions and attitudes about the economy. The Consumer Sentiment Index is directly related to the strength of consumer spending. Consumer confidence and consumer sentiment are two ways of talking about consumer attitudes. Among economic reports, consumer sentiment refers to the Michigan survey while consumer confidence refers to The Conference Board's survey.
- MSCI EAFE: Index of large- and mid-cap companies of 21 Developed Market countries in Europe, Australasia, & the Far East.
- MSCI Emerging Markets: Index of large- and mid-cap companies of 26 Emerging Market countries in Europe.
- Bloomberg Barclays US Aggregate Bond Index: A broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. In addition to investment grade corporate debt, the index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria.