2nd Quarter Market Review and Comment
July 2024

Updated Market Performance

Returns	2nd Quarter 2024	YTD 2024	One Year	Annualized 3 Year	Annualized 5 Year	Annualized 10 Year
S&P 500	**4.28%**	**15.29%**	**24.56%**	**10.01%**	**15.05%**	**12.86%**
DJIA	**-1.27%**	**4.79%**	**16.02%**	**6.42%**	**10.33%**	**11.30%**

Performance: April reversed the upward trend set in March, falling -4.08%. April showers brought May flowers with the S&P 500 posting a return of 4.96%. June's returns followed May's lead, rising by 3.59%. This left us with a 2nd quarter 2024 total return of 4.28%.

After the 1st quarter 2024 gave us a gain of 10.56%, the 2nd quarter 2024 continued the positive momentum leaving us with a return of 4.28%. The Dow Jones Industrial Average (DJIA) underperformed the S&P 500, posting a -1.27% loss over the same period. For the previous twelve months the S&P 500 returned 24.56%, outperforming the DJIA which returned 16.02% over the same period. The annualized three-year returns for the S&P 500 were 10.01%, the DJIA three-year returns trailed the S&P 500 posting 6.42%. Over the last five years the annualized returns are well above historical norms (around 10.26%), with the S&P 500 returning 15.05% and the DJIA posting 10.33%. The ten-year annualized numbers are running above long-term averages (around 10.26%), with the S&P 500 returning 12.86% versus the DJIA which turned in 11.30% for the same period.

Breaking down the returns for Q2 2024, we note that there were two outperforming sectors and nine underperformers. **The best sectors were Technology (13.81%), Communication Services (9.37%), and Consumer Staples (1.35%). The underperformers during the quarter were Materials (-4.50%), Industrials (-2.90%), and Energy (-2.42%).** The best sectors over the last year were Consumer Discretionary (12.07%), Industrials (11.29%), and Materials (11.05%). Following behind were Utilities (1.65%), Communication Services (2.58%), and Consumer Staples (3.24%).

Economy: Growth in the economy increased in 2023 by 2.5% compared to an increase of 1.9% in 2022. 2023 continued to leave us with growth below historical trends (Historical growth is ~3.15%). We anticipate growth to modestly decelerate this year. The Fed has pivoted and is now in a holding pattern. They have also telegraphed rate cuts for this year if needed. Recession risks are currently moderate. We had a technical recession in the first half of 2022 which is defined as two negative quarters of GDP. We think a more meaningful recession will occur sometime in 2025. At the current moment, the recession looks to be shallow and short.

The third estimate for the 1st quarter 2024 Gross Domestic Product (GDP) is 1.40%; according to the report released at the end of June by the Bureau of Economic Analysis (BEA). The latest estimate suggests that overall economic growth in the 1st quarter 2024 decreased to 1.40% from the 4th quarter 2023 third estimate of 3.40%. GDP for 2023 came in at 2.5%. While GDP for 2022 came in at 1.90% compared to 5.80% in 2021, -2.20% in 2020, 2.50% in 2019, 3.00% in 2018, and 2.50% in 2017.

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Currently, the Atlanta Fed (Forecast of U.S. GDP Growth) has forecasted 2024 Q2 GDP growth at 2.0%. Blue Chip consensus has forecasted 2024 Q2 GDP growth at 1.7%. By comparison, China says their GDP increased 5.30% in the 1st quarter of 2024. Increasing from 4th quarter 2023 reading of 5.20%. China's 2023 GDP was 5.20%, 3.00% in 2022, 8.10% in 2021, 2.20% in 2020, 6.70% in 2019, and 6.70% in 2018. China's GDP growth rate is forecasted to be 5.00% for the 2nd quarter 2024. Growth rates for the European Union (EU) and the Euro Area were 0.40% and 0.40% respectively in the 1st quarter 2024. For 2023, GDP grew 0.40% for the EU and 0.40% for the Euro Area. For 2022, GDP grew 3.40% for the EU and 3.40% for the Euro Area. For 2021, GDP grew 6.00% for the EU and 5.90% for the Euro Area. For 2020, GDP fell -5.60% for the EU and -6.10% for the Euro Area. For 2019, GDP rose 1.80% for the EU and 1.60% for the Euro Area. This is down from the 2.10% growth achieved by the EU and the 1.80% achieved by the Euro Area in 2018. GDP Growth forecasts for the end of the 2nd QTR 2024 are 1.20% for the EU and 1.00% for the Euro Area.

Unemployment is continuing to trend below historical norms (~5.705%). According to the Bureau of Labor Statistics, June unemployment remained little changed at 4.10%. Unemployment for 2023 came in at 3.63%, nearly unchanged from 2022. Unemployment for 2022 came in at 3.65% which is 1.71% below 2021's rate of 5.36%. Unemployment was 8.11% and 3.67% in 2020 and 2019, respectively. The number of unemployed was essentially unchanged at 6.8 million for June. The labor force participation rate held at 60.1% in June. In June, job gains occurred in healthcare, government, social assistance and construction.

Inflation decreased to 3.00% in June, running below the average long-term trend. After averaging 3.27% in the 1st quarter 2024, inflation as measured by the Consumer Price Index (CPI) decreased to an average of 3.23% for the 2nd Quarter 2024. The average rate of inflation for 2023 decreased by 3.88% to 4.13% from 2022's 8.01% and was above average by historical standards (~2.63% over last 30 years and 3.28% from 1914-2023). Indexes which increased in June include shelter, motor vehicle insurance, household furnishings and operations, medical care, and personal care. The indexes for airline fares, used cars and trucks, and communication were among those that decreased over the month. The energy index fell 2.0% over the month, as it did the preceding month. The index for food increased 0.20% in June. The food away from home index rose 0.40% over the month, while the food at home index increased 0.10%.

Consumption is an important driver of the economy as it represented 67.7% of the 1st quarter 2024 nominal GDP. The U.S. Census Bureau announced in June that retail sales for May 2024 were virtually unchanged from April and were up 2.3% above May 2023. Non-store retailers were up 6.8% from last year, while the Food and Beverage Industry was up 3.8% from May 2023.

The manufacturing economy contracted in June. Economic activity in the manufacturing sector contracted for the month of June for the third consecutive month and the 19th time in the last 20 months. The Purchasing Managers Index (PMI®) registered 48.5; a decrease of 0.20 from May's reading of 48.7. The eight manufacturing industries reporting growth in June in order are Printing & Related Support Activities, Petroleum & Coal Products, Primary Metals, Furniture & Related Products, Paper Products, Chemical Products, Miscellaneous Manufacturing and Nonmetallic Mineral Products. The nine industries reporting contraction in June in the following order are Textile Mills, Machinery, Fabricated Metal Products, Wood Products, Transportation Equipment, Plastics & Rubber Products, Food, Beverage & Tobacco Products, Electrical Equipment, Appliances & Components, and Computer & Electronic Products. A reading above 50 indicates that the manufacturing sector is generally expanding while below

50 indicates that it is generally contracting. Based on historical relationships between PMI and GDP, a PMI of 48.5 corresponds to a 1.70% increase in real gross domestic profit (GDP) on an annualized basis.

Home prices continued to increase in February. According to the S&P Case-Shiller Home Price Indices home prices in April increased 6.30% over the last 12 months, which is down 0.20% from the previous month's 6.5%. San Diego continued to report the highest year-over-year gain with an 10.3% increase in April, followed by New York and Chicago, with increases of 9.4% and 8.7% respectively. According to the National Association of Realtors, the year-over-year change in existing home sales was 1.0% in May for Single family homes between $250,000-$500,000. Housing supply continued to remain tight in May with 2.9 months of supply.

Markets: The S&P 500 has hit 22 new closing highs year-to-date. At this time, the market will continue to be driven by dovish monetary policy, inflation, slowing economic growth, and geopolitical risks.

What will move the markets moving forward:

- **Earnings: Earnings growth for the S&P 500 is expected to increase 9.70% for the 2nd quarter of 2024. If 9.70% is the actual increase for the quarter, it will mark the highest earnings growth since Q4 2021.** Looking at future quarters, analysts project earnings growth for the 3rd QTR 2024 to be 7.4% and 4th QTR 2024 to be 17%. Earnings growth for 2024 is projected to be 11.0%.
- **Valuations: Valuations rose meaningfully last year.** The Price to Earnings at the beginning of 2023 was 16.7. It has increased to 21.0 through the 2nd quarter 2024. The 20 Year average P/E is 15.7, which is 5.3 below our current levels. There is not a lot of room for P/E expansion currently without meaningful earnings growth.
- **Interest Rates/Monetary Policy: Short Term Interest Rates have been stable since September and are right above historical averages. The average effective Federal Funds rate since July 1954 is 4.61%. The average over the last 10 years is 1.53%.** The Federal Reserve left rates unchanged at a range between 5.25%-5.50% in its latest meeting in June and it is anticipated that they will lower rates by .25 in September. The Fed will continue reducing its holdings of Treasury securities, agency debt, and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet. The Committee is strongly committed to returning inflation to its 2 percent objective. The spread between the 2-year and 10-year Treasury yields is -0.14% as short-term rates have risen faster than long-term rates. The yield curve is currently inverted (2-year yield is higher than the 10-year yield) and financial conditions are currently tightening. **Eight of the last Nine recessions since 1955 have occurred during a rising interest rate environment when short term rates were higher than long term rates (Inverted Yield Curve).**
- **Inflation: Inflation meaningfully decreased in 2023.** Currently the Fed has paused interest rate increases. Currently, we do not see the Fed needing to raise rates to continue to fight inflation. Slower economic growth should allow inflation to continue to slowly decrease.
- **Russia-Ukraine Conflict and other Geopolitical risks: The current conflict is continuing to weaken the European economy more than the US economy, with some speculation of a recession in some countries (especially Germany) as soon as the 1st quarter 2024.** At this time, it is hard to determine the total impact this conflict will have on the US. US-China relations remain tense. The conflict Israel and Gaza is continuing to drag on with no cease fire in sight. US-Iran relations remain tense.

- **Election Year:** Since 1952, the S&P 500 has averaged a 7% gain during U.S. presidential election years. While a 7% gain is far from disastrous, it is also well short of the 17% average S&P 500 gain in the year prior to an election year. It's also below the roughly 10% average annual total return for the S&P 500 in a typical year. Of course, it's important to remember that past performance does not guarantee future returns, and there have only been 17 presidential elections since 1952. The good news for investors heading into 2024 is that the S&P 500 has not declined during a presidential re-election year since 1952 and has averaged a 12.2% annual gain in re-election years. President Biden recently announced that he will step down as the Democratic Nominee and endorsed Vice President Kamala Harris. It is looking like Kamala will be the nominee, but we will find out for sure in August's democratic national convention. Also, we had the assassination attempt on Donald Trump. This election is interesting, and we still have time before the general election. The markets usually get a little volatile in October before the election, but usually settle down in December after the election.

Forecast:

We think the biggest threats to the stock market are elevated interest rates, economic contraction, and geopolitical risks. We think the S&P 500 will end Q3 2024 between 5300 and 5400. At this juncture, we venture a guess that stocks will end the year somewhere between 10% and 12% for the year.

For the next six to twelve months, the Federal Funds rate will most likely decrease from its current range of 5.25%-5.50% to 4.75-5.00%. **The 10-year Treasury, which is currently priced at ~4.21% and should remain in a range between 4.00%-4.30% throughout the end of the 3rd quarter.**

As always, we appreciate your continuing confidence in our firm. Please let us know if you have questions.

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