

2024 Second Quarter Update

Review: The S&P 500 delivered a positive return again in Q2 and is up 15.3% year to date. The S&P 500 continues to outpace international equities in 2024, though emerging markets did have a strong Q2, returning 5.4%. Persistent inflation has delayed the much-anticipated start of interest rate cuts by the Federal Reserve, which led to slightly higher bond yields in the quarter and roughly flat bond index returns.

	2Q24	1Q24	2023
S&P 500	4.3%	10.6%	26.3%
MSCI EAFE^{1,2}	-0.1%	5.8%	18.9%
MSCI Emerging Markets²	5.4%	2.2%	10.3%
Bloomberg U.S. Aggregate Bond	0.1%	-0.8%	5.5%
Bloomberg Municipal Bond	0.0%	-0.4%	6.4%

¹Europe, Australasia, Far East

²MSCI returns are in U.S. Dollars

Are Tech sector gains masking signs of market stress?

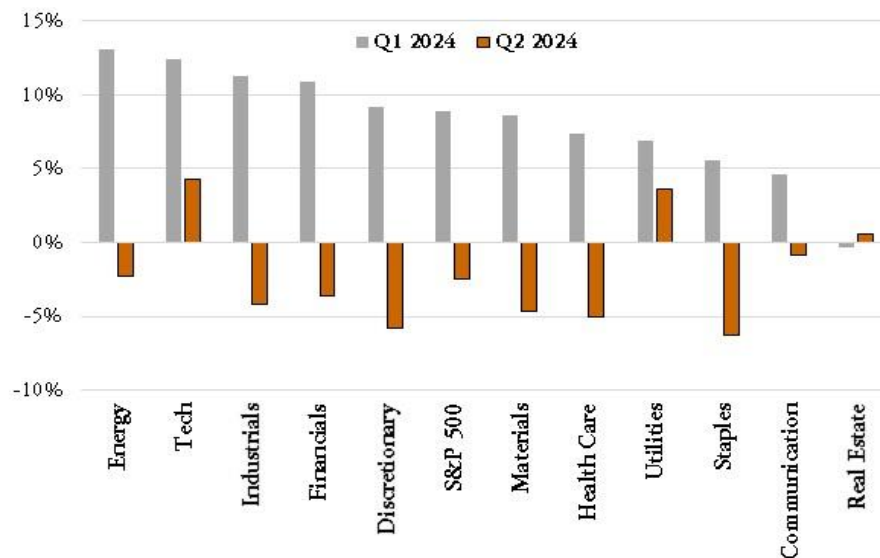
The S&P 500 Tech sector now comprises almost 1/3 of the total S&P 500 index, making it a key driver of index returns. In the first half of 2024, the sector's 28.2% total return was responsible for over half of the S&P's 15.3% return, and even though there are some mega cap companies boosting the sector's return, which is market cap weighted, the average Tech sector stock has delivered a 17% return year to date. These returns are impressive and are partly supported by strong earnings growth, with current Bloomberg consensus estimates implying an expected 24% earnings growth in 2024 for the sector. The other significant driver of Tech stock returns has been the optimism (exuberance?) about adoption and potential monetization of artificial intelligence (AI).

That said, the strong return from the Tech sector in Q2 (+13.8%) masked declines in other sectors. The average S&P 500 stock returned -2.5% in Q2, and excluding Tech stocks, that average return was -3.5%. The chart on the next page shows the average return by sector in Q1 and Q2. Almost all sectors had positive returns in Q1, continuing the broad rally that started in late 2023 when investors started to anticipate rate cuts. However, most sectors had negative average returns in Q2. These negative



returns were driven by declining valuation multiples, with the average S&P 500 stock's price-to-earnings (P/E) ratio declining 6%. In fact, all sectors had declines in average and median P/E ratios, except for the Tech sector, which had a median P/E increase of 2%. Declining valuation multiples should not be surprising, given the higher for longer rate environment. Therefore, it will be important to continue to monitor valuations in the Tech sector in the near term, particularly as companies report earnings over the next two months.

Average Total Return by S&P 500 Sector, Q1 and Q2 2024



Outlook: The US economy has continued to surprise on the upside. The current consensus estimate for 2024 real GDP growth is 2.4%, which is double what the estimate was as of year-end 2023. A relatively robust, albeit slowing, job market has enabled consumers to continue to spend, supporting economic growth. However, there are still reasons to be cautious about the state of the consumer, as we have pointed out in recent Investment Updates, particularly growing debt delinquency rates and excess savings built up during the pandemic that are now depleted for many households. The downside risk to the consensus economic outlook is that a gradual weakening of the job market turns into something worse before the Fed starts to cut rates.

International growth has been mixed. There have been some signs of modest improvement in developed markets, but generally, growth still significantly lags that of the United States. Growth estimates in most key emerging markets have gone higher, despite a relatively strong US Dollar.

Strategy: The higher for longer interest rate environment leaves us cautious on equity valuations in the near term, particularly heading into Q2 earnings season. We continue to prefer quality growth stocks at reasonable valuations and traditionally defensive sectors, given the relatively elevated market multiple as well as potential economic risks. Volatility in bond yields has continued due to shifting expectations for the start of rate cuts as well as potential economic uncertainty. However, the risk-reward in higher quality fixed income securities continues to appear relatively attractive.