Second Quarter Market Update

July 2024

PLAN WITH PURPOSE.

INVEST WITH CONFIDENCE.

We hope you enjoyed the Fourth of July! Warren Buffett has referred to being born in America as winning the 'ovarian lottery'. We would have to agree. Last week, as we celebrated America's birthday with friends and family, we gave thanks to the founders and the countless individuals that have contributed to this great nation.

In the first half of 2024, the US stock market continued to outperform the rest-of-the-world. While there is no assurance this outperformance will continue, we believe there is something exceptional about America, and that our economic system has been unmatched in its ability to unlock human potential.

Q2’24 Market Performance, Key Drivers, & Go-Forward Outlook

The US stock market increased 13.6% year-to-date, driven in large part by mega-cap tech. Emerging Market stocks increased 8.3%, International Developed stocks increased 4.6%, and the Aggregate Bond Index decreased 0.7%. The US stock market has continued to dominate in 2024.

Figure 1. Market Performance, Total Return

	Q2'24	Year-to-Date
Equities		
US Total Market[1]	3.2%	13.6%
International Developed[2]	-0.7%	4.6%
Emerging Markets[3]	5.8%	8.3%
Fixed Income		
Aggregate Bond[4]	0.1%	-0.7%

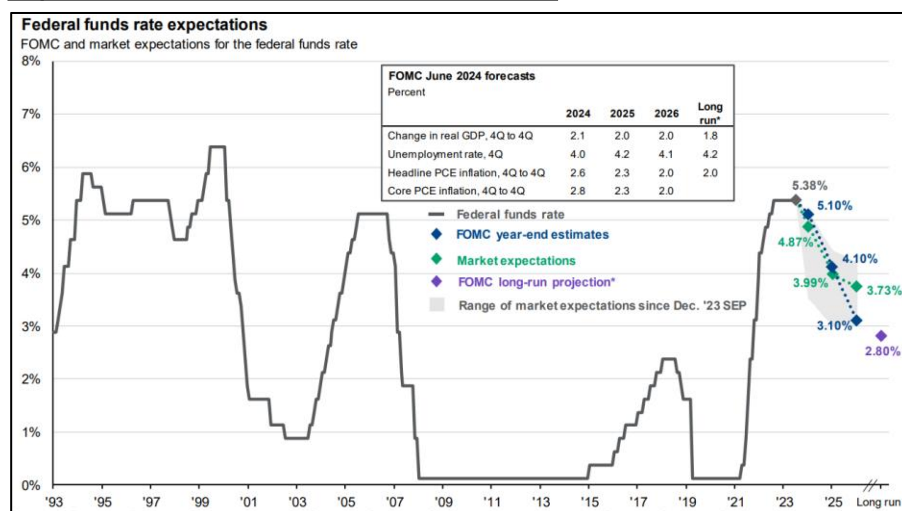
Source: Bloomberg
1. S&P Total Market Index, 2. FTSE Developed ex US Index, 3. FTSE Emerging Index,
4. Bloomberg US Aggregate

Gains in the S&P 500 have been powered by the largest US tech stocks, in part due to exuberance surrounding artificial intelligence. We believe that artificial intelligence has the potential to transform modern life, and a wide variety of personal and business-related tasks. That said, the end-game, or the long-term impact on the size of the markets for data centers, specific chips, large language models, and software that leverages AI, as well as the competitive environment and ultimate profitability of these products, remains highly uncertain. While we’re bullish on the growth of artificial intelligence, we’re also cautious on assets driven by AI hype, given the high-levels of uncertainty, and the risk that over-enthusiasm may be leading to over-valuation. Related to this, we continue to invest in businesses that benefit from AI, but where our thesis is not entirely dependent on it. Throughout the quarter, market prognosticators also continued to focus on the timing of rate cuts at the Federal Reserve. Stickier inflation provided less room to ‘ease’, which was a drag on fixed income securities.

US Economic Trends

Inflation and short-term interest rates were two key themes in the first half of 2024. As a reminder, at the beginning of the year, the market was calling for the Federal Reserve to cut rates approximately six times. Stickier inflation provided less room to 'ease', though more recently, two softer Consumer Price Index (CPI) prints have bolstered the case that the Fed will begin to lower rates prior to year-end. In our view, the reason for cuts will be important, and investors should be 'careful what they wish for'. If cuts are a result of a more severe economic slow-down, we think this sets up negatively for stocks, as well as riskier segments of the fixed income market. On the other hand, non-recessionary cuts should be a meaningful positive. We also think that too little attention is paid to estimates of long-run rates. We suspect rates will move meaningfully lower over a multi-year period, but will remain well-above pre-pandemic levels. See **Figure 1.** for a chart of historical fed funds rates and go-forward expectations.

Figure 2. The Fed and Interest Rates



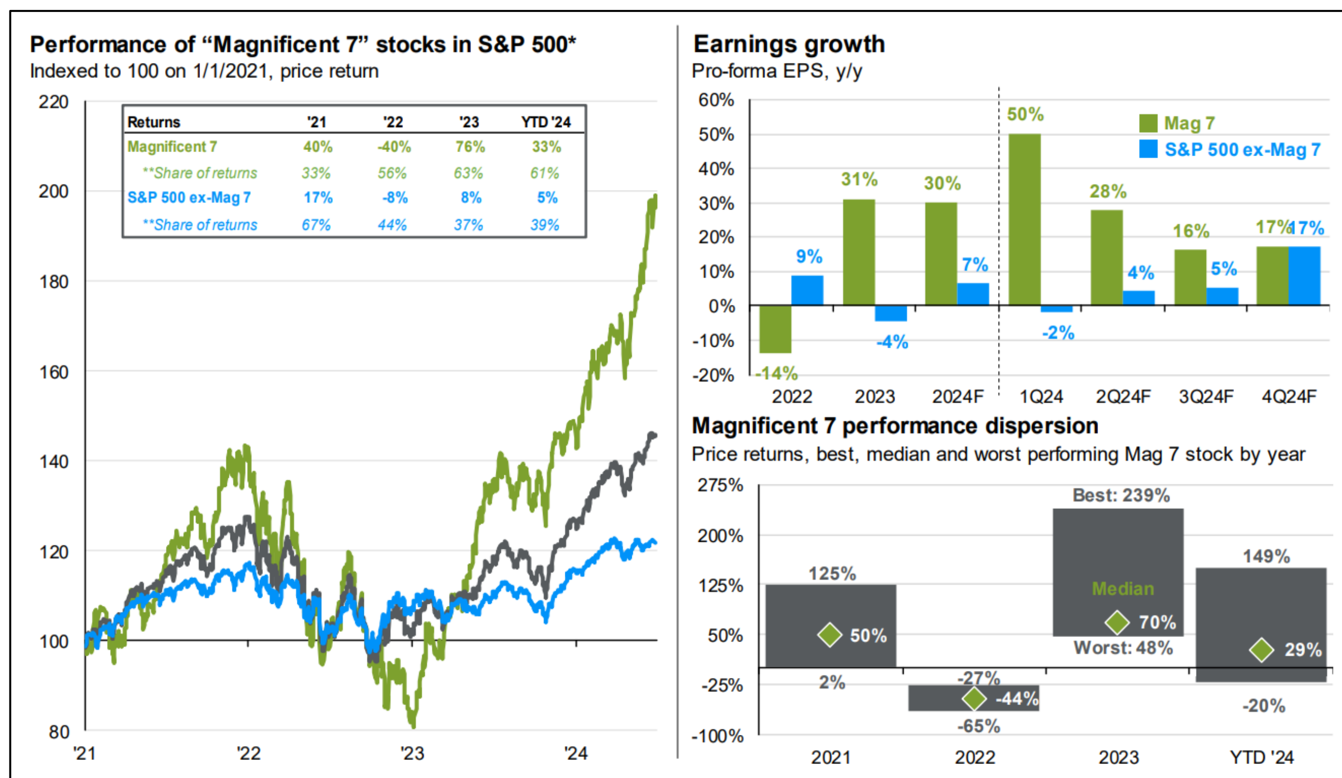
Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management
*Market expectations are based on USD Overnight Index Swaps. *Long-run projections are the rates of growth, unemployment, and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy.*

Many market participants also continue to call for a 'soft-landing', whereby the Fed can rein in inflation without causing a recession. While the labor market has been softening somewhat (e.g., rising jobless claims), wages continue to increase, and the unemployment rate is at low-levels. Importantly, the consumer makes up ~2/3rds of US GDP, and employment supports spending. Key risks to a 'soft-landing' would include a re-acceleration of inflation, a weaker consumer as excess savings from the COVID period dwindles, or a meaningfully weaker job market. We also continue to monitor geopolitical events and potential economic policies resulting from the US presidential election.

US Stocks

The S&P 500 increased 15.2% year-to-date, in large part, driven by the "Magnificent 7". The Magnificent 7 has been responsible for 61% of the S&P 500's return. Excluding these seven names, the S&P 500 would have been up just 5%. We also don't view these names as a monolith, and there's been a wide divergence in performance. The top performing name, NVIDIA (NVDA), was up an astounding 150% year-to-date, while Tesla (TSLA), the worst performing name, was down 20% year-to-date. We believe that the S&P 500 is increasingly looking like a concentrated growth fund, and we emphasize diversification as a tool to prudently manage risk. Encouragingly, as we look at analyst estimates going forward, the 'remaining 493' are expected to see similar earnings growth by year-end, which may contribute to a broadening-out of stock performance (see **Figure 3).**

Figure 3. Magnificent 7 Performance & Earnings Dynamics



Returns	'21	'22	'23	YTD '24
Magnificent 7	40%	-40%	76%	33%
**Share of returns	33%	56%	63%	61%
S&P 500 ex-Mag 7	17%	-8%	8%	5%
**Share of returns	67%	44%	37%	39%

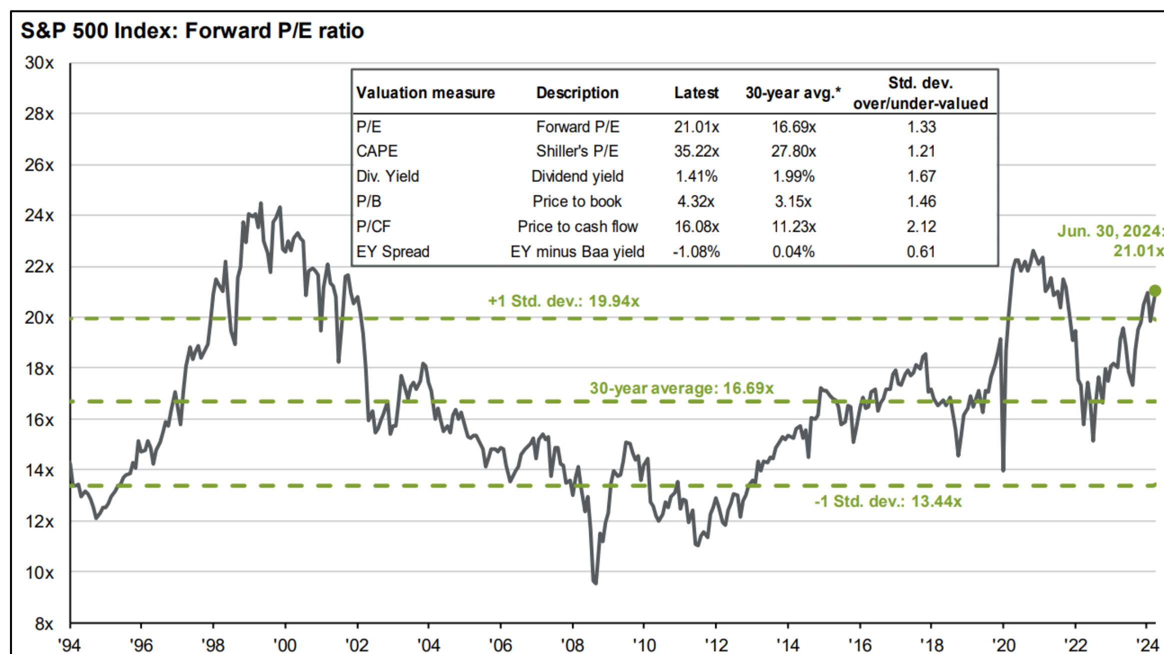
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management
Magnificent 7 includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA, and TSLA. Earnings estimates for 2024 are forecasts based on consensus analyst expectations. Share of returns represents how much each group contributed to the overall return. Numbers are always positive despite negative performance in 2022.

Related to this dynamic, the equal-weighted S&P 500 was up just 5% year-to-date. While this performance is solidly 'in the green', the first half gap between the average stock and the market cap, or size-weighted, S&P 500 index was the widest since at least 1990. Concentration risk in the S&P 500 remains a concern.

We continue to invest in businesses that benefit from AI, but where our thesis is not entirely dependent on it. Examples include businesses able to leverage AI to improve productivity within their operations, industrials that benefit from the build-out of data centers, utilities that benefit from increases in power usage, and software businesses that are working to incorporate AI-related functionality, creating additional value for their customers.

In regards to valuation, the S&P 500 continues to look expensive on a variety of different metrics. The forward P/E multiple, defined as the price relative to the expected earnings over the next 12 months, is trading 1 standard deviation above average. See **Figure 4.** We think this underscores the need to be selective, and for active management.

Figure 4. S&P 500 Valuation Measures



Valuation measure	Description	Latest	30-year avg.*	Std. dev. over/under-valued
P/E	Forward P/E	21.01x	16.69x	1.33
CAPE	Shiller's P/E	35.22x	27.80x	1.21
Div. Yield	Dividend yield	1.41%	1.99%	1.67
P/B	Price to book	4.32x	3.15x	1.46
P/CF	Price to cash flow	16.08x	11.23x	2.12
EY Spread	EY minus Baa yield	-1.08%	0.04%	0.61

Source: FactSet, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management
Price-to-earnings is price divided by consensus analyst estimates of EPS for the next 12 months as provided by IBES since March 1994 and by FactSet since January 2022. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies.

We continue to advocate for two key ingredients of investment success: diversification and patience. We remain bullish on well-diversified portfolios, which we believe, over the long-run, will provide growth with lower-levels of volatility. Historically, the stock market has been a compounding machine, and as the old adage states, "'it's not about timing the market, it's about time in the market'.

International Stocks

The All Country (AC) World Index, excluding the United States, was up 6.0% year-to-date, measured in USD. A stronger USD was a drag on results, and in local currencies, the index was up 11.0% year-to-date. The top contributors to performance were Taiwan, Japan, and India, while the top detractors from performance were Brazil, Hong Kong and Mexico. See **Figure 5.**

Figure 5. Global Equity Markets

Returns	YTD 2024		2023		15-years	
	Local	USD	Local	USD	Ann.	Beta
Regions						
U.S. (S&P 500)	-	15.3	-	26.3	14.8	1.0
AC World ex-U.S.	11.0	6.0	14.7	16.2	6.7	1.0
EAFE	11.5	5.7	16.8	18.9	7.3	1.0
Europe ex-UK	10.3	6.2	17.3	22.7	8.1	1.2
Emerging markets	11.2	7.7	10.3	10.3	5.3	1.0
Selected Countries						
Japan	21.5	6.5	29.0	20.8	6.4	0.7
United Kingdom	7.8	6.9	7.7	14.1	6.5	1.0
France	1.6	-1.4	18.1	22.3	7.8	1.2
Canada	6.0	2.2	13.3	16.4	6.8	1.1
Germany	9.6	6.3	19.8	24.0	7.0	1.3
China	5.2	4.8	-10.6	-11.0	2.8	0.9
Taiwan	37.0	29.6	31.1	31.3	13.8	1.0
India	17.4	17.1	22.0	21.3	9.0	0.9
Brazil	-6.9	-18.6	22.7	33.4	0.9	1.3

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management
All return values are MSCI Total Return Index (Gross) data. 15-year history based on USD returns.

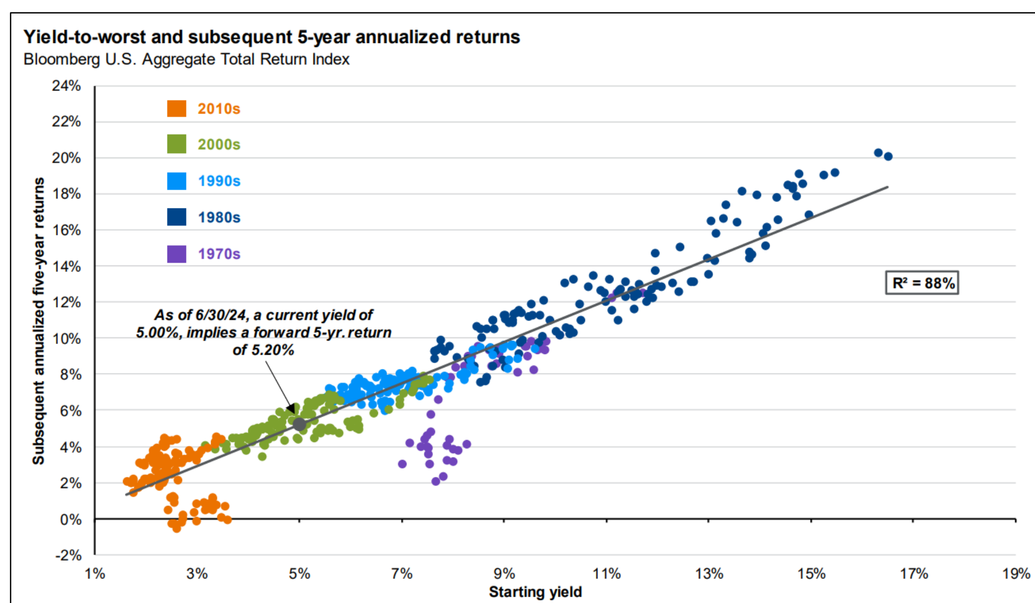
International stocks continue to be cheaper than domestic stocks, though to some extent, we think this makes sense, given a greater percentage of growth and tech stocks in the United States. Should global economic growth accelerate, we would expect international stocks to do relatively better, since they tend to be more cyclically-oriented.

The European Central Bank (ECB) has already started to cut rates, providing a boost to European equities, and the European economy is rebounding after recessions in Germany and the United Kingdom. Additionally, France, in their snap election, avoided the far right winning an outright majority, which from a market perspective, would have been viewed as a negative, contributing to increased budget deficits. In Asia Pacific, Japanese stocks are benefitting from stronger earnings growth and more shareholder friendly management teams. Most importantly, we continue to view international stocks as an important part of a well-diversified portfolio.

Fixed Income

The Aggregate Bond Index was down 0.7% year-to-date. Bond prices and rates move inversely to one another, and the 10-year US Treasury yield increased 52 basis points, or 0.52 percentage points, to 4.40%. This was influenced by stickier inflation and fewer rate cuts than previously anticipated. Going forward, our expectations for fixed income is positive, especially given higher yields relative to several years ago. See **Figure 6.** for a scatterplot of starting yields and subsequent annualized five-year returns. Higher starting yields lead to better returns with a fairly high-level of consistency.

Figure 6. Fixed Income Yields and Go-Forward Returns



Source: FactSet, Bloomberg, J.P. Morgan Asset Management
Returns are 60-month annualized total returns, measured monthly, beginning 1/31/76.
R-squared represents the percent of total variation in total returns

In riskier segments of the fixed income market, spreads (i.e, the extra yield offered to investors for accepting additional risk vs. US Treasuries) continue to be tight. We are positioning fixed income sleeves conservatively, with the view that narrow spreads are not adequately compensating investors for additional credit risk. Going forward, should the economy weaken more than anticipated, we'd expect spreads to widen, which may provide a better entry point.

Fixed income continues to play an important role within portfolios, including 1) ballast in the event of an economic downturn, 2) capital preservation, 3) liquidity, 4) income, and 5) the potential for capital appreciation.

As always, we continue to monitor financial markets and invest on your behalf, with a long-term orientation, consistent with the PWM investment philosophy. We continue to emphasize financial planning, and take a holistic approach to helping you manage your wealth. We consider it a privilege to help our clients reach their financial goals.

Thank you for your continued trust, and as always, we remain available to address any questions or concerns.

Sincerely,

Power Wealth Management

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