INVESTMENT STRATEGY UPDATE

MARKET REPORT
JULY 2024

ASCENTIAL
WEALTH ADVISORS

OPTIMISM PROPELS EQUITY MARKETS

Equity markets continued to rise in the first half of 2024, fueled by optimism over a soft economic landing and the anticipated productivity and profitability benefits of Artificial Intelligence (AI). Big technology companies continued to dominate returns, lifting the S&P 500 and NASDAQ indices to new all-time highs. The divergence in performance over the first six months of the year was pronounced with the Russell 1000 Growth Index returning +20.7% compared to the Russell 1000 Value Index up +6.6%.

The contradictory fears of recession and hyperinflation have faded. Unemployment in the US has remained around 4%. Economic growth has slowed from the post-pandemic frenzy but remained steady at just under 3%. At the same time, inflation figures have been gradually easing downward toward the Federal Reserve's 2% target. This economic resilience has caused the Federal Reserve to hold interest rates steady, indicating any rate cuts later in 2024 would be data dependent. Outside the US, central banks are dealing with similar circumstances. However, the European Central Bank implemented its first rate cut at the beginning of June and is expected to make at least one more in the near term. International equity markets have posted mixed results, but overall were positive and in line with the broader, non-technology concentrated US indices.

Bonds were down slightly over the first half of the year as the prospects for multiple interest rate cuts by the Federal Reserve lessened. Coming into the year, markets had priced in around six rate cuts for 2024, and as of the end of June that expectation had fallen to one to two rate cuts. As a result of the higher rates for longer expectation, the yield on the 10-year US Treasury closed on June 30th at 4.4%, up from 3.9% at the end of 2023. The yield curve has remained inverted, with short-term interest rates still exceeding long-term rates.

Index	*2024 (through 6/30)*
S&P 500	+15.3
Dow Jones Ind. Avg.	+4.8
MSCI EAFE	+5.3
BC US Aggr. Bond	-0.7
Dow Jones Relative Risk Benchmarks	
Conservative	+2.4
Moderate	+3.6
Aggressive	+7.8

It would not be surprising to see markets pause after the strong rally of the past nine months, coupled with the impending US presidential election this fall. Election years generally carry higher than average volatility. Although this did not materialize in the first half of the year, it could be on the horizon as the political cycle heats up. While volatility is a concern, absent a major economic shock, we think that markets can ultimately withstand the political discord. We favor embracing current attractive income opportunities and remaining flexible in positioning, while not shying away from equities.

OUR VIEW

FIXED INCOME:
Historically bonds have experienced a period of strong returns following peak interest rates. Based on this the current risk return profile on fixed income is compelling. While cash and short-term fixed income remain attractive for liquidity purposes, there is likely a better future opportunity in slightly longer duration bonds. With rate cuts in the US likely to start later this year, investors should consider locking in higher rates at longer maturities for a portion of their fixed income allocation. We are positive on fixed income in general, and favor gradually shifting away from cash and short-term bonds for long-term portfolios.

US EQUITY:
US equities have become bifurcated, and the S&P 500 has grown highly concentrated as the big technology companies have soared on the enthusiasm over AI. The top 10 companies now account for 37% of the 500-company index. The equally weighted S&P 500 returned 4.1% in the first half of the year, compared to the 15.3% return on the market cap weighted index. This left the top 10 companies trading

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US EQUITY (CONT:

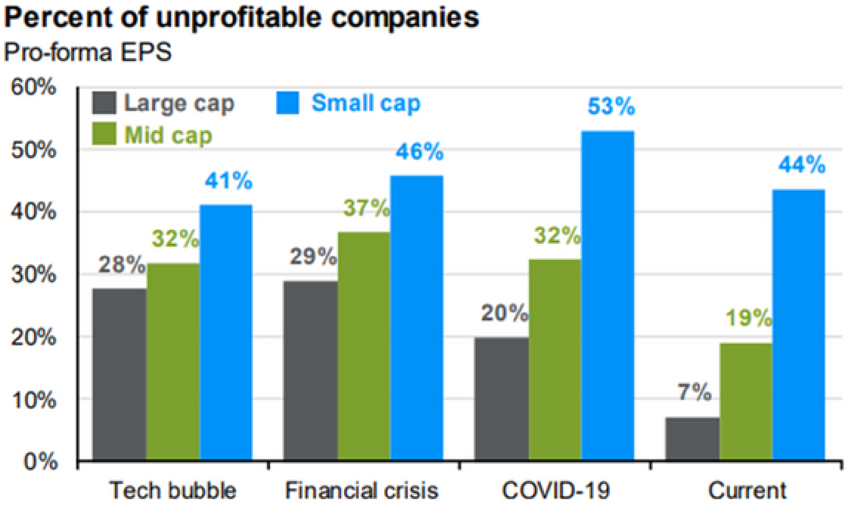
at a price to earnings multiple of 30.3x earnings, whereas the other 490 companies were valued at 17.6x earnings. (JP Morgan Guide to Markets, June 2024) The upward price trajectory for the top companies has been supported by earnings. Projections are for earnings growth to accelerate more broadly, which may lead to a period of stronger performance across a wider spectrum of companies. Overall, we remain positive on US equities, but feel the current environment dictates flexibility and selectivity. US elections may increase market volatility and the outcome could impact stocks at the sector and industry level. As result we are in favor of investments that offer higher income, a quality bias, and flexibility to respond more rapidly to changing market conditions.

INTERNATIONAL EQUITY:

Foreign stocks also produced positive returns, and with overall lower exposure to technology, performance in foreign equities has been in line with non-tech segments of the US market. However, results have been somewhat mixed, with countries such as Taiwan and India excelling, while China has continued to underperform. We view this divergence as a trend that is likely to continue in the near term, particularly given the tariff situation between the US and China and the potential for heightened global geopolitical tensions. As a result, we are currently in favor of a slight reduction to emerging markets exposure and a reduced allocation to China. We continue to see long-term opportunity in foreign equities due to attractive valuations and the growth potential in some emerging economies but feel slightly more caution is warranted in the near term.

QUALITY IN TIMES OF UNCERTAINTY

In the short term, markets can be volatile and influenced by headlines and world events, but over longer periods of time the fundamentals of companies and the overall economy are the actual drivers of returns. Company fundamentals reflect financial health; companies with good balance sheets, cash flow, and profitability are considered higher quality. These factors also offer these firms the ability to better withstand economic downturns. Owning investments with a quality bias in a portfolio can help to mitigate downside risk, particularly in times of heightened uncertainty. In the US market there are currently many large and mid-sized companies that are considered high quality. Smaller companies are generally more likely to be unprofitable and carry higher debt loads, and as a result can be more volatile and sensitive to changing market conditions. During periods of uncertainty, focusing on quality may be a way to reduce volatility and stay invested for the long term.



Source: Compustat, FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management.
The S&P 500 is used for large cap. The Russell Mid Cap is used for mid cap. The Russell 2000 is used for small cap. Data for the percent of unprofitable companies in each index are from the following quarters: Tech bubble = 4Q01, Financial crisis = 4Q08, COVID-19 = 1Q20 and Current = 1Q24.
Guide to the Markets – U.S. Data are as of June 30, 2024.

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