Quarterly Market Commentary

2Q 2024

For another quarter, the US economy has remained resilient despite high interest rates. The labor market remains tight and significant progress has been made on inflation. While the unemployment rate has trended higher to 4.0%, it is still relatively low and has been supported by an imbalance between the number of job openings and the availability of workers seeking employment. After accelerating in February and March, the Consumer Price Index (CPI) increased at a slower pace in April and was unchanged in May, offering some relief for consumers and providing the Fed with support to potentially begin easing. Gains in the financial markets have led to increases in household wealth, supporting consumer balance sheets and spending.

Economic data in key areas is showing signs of softening, however, as fiscal policy support wanes and the impact of tighter monetary policy reverberates through the economy. Consumer spending, the biggest component of US gross domestic product (GDP), has slowed as pandemic savings have been exhausted and households are spending more of their income to service debt. Auto loan and credit card delinquencies are rising, though still well below pre-pandemic levels, as consumers struggle to find a balance between income, debt, savings, and spending. High mortgage rates, high home prices, and lack of supply have contributed to a frozen housing market and increased home ownership costs. Business investment growth has slowed as high interest rates weigh on financing activities. While the Fed has remained determined to keep interest rates at a higher for longer level until officials are confident significant progress has been made towards its 2% target, economists and strategists are continuing to speculate how long the economy can continue its expansion under this higher interest rate policy regime before the Fed capitulates.

In its two second quarter meetings, the Federal Open Market Committee (FOMC) unanimously voted to keep the federal funds target range unchanged at 5.25%-5.50%. The FOMC has now opted to hold the federal funds target rate unchanged at its highest level since 2001 for seven consecutive meetings. The much-anticipated Summary of Economic Projections (SEP) from the FOMC's June meeting offered little in the way of surprise. Fed officials increased their forecasts for both inflation and the federal funds rate over the next two years. In terms of the federal funds rate, Fed officials expect just one 25 basis point cut by the end of this year and four 25 basis point cuts in 2025. In March, officials had projected three 25 basis points cuts in 2024 and three 25 basis points cuts in 2025. While the Fed has laid out a path for less easing this year, markets aren't fully buying the rhetoric. The fed funds futures market indicates two 25 basis point rate cuts by the end of this year, with the first coming in September and the second in December.

Figure 1: FOMC Summary of Economic Projections – June 2024

FOMC Summary of Economic Projections – June 2024				
	Median			
Variable	2024	2025	2026	Longer Run
Change in real GDP	2.1	2.0	2.0	1.8
March projection	2.1	2.0	2.0	1.8
Unemployment rate	4.0	4.2	4.1	4.2
March projection	4.0	4.1	4.0	4.1
PCE inflation	2.6	2.3	2.0	2.0
March projection	2.4	2.2	2.0	2.0
Core PCE inflation	2.8	2.3	2.0	
March projection	2.6	2.2	2.0	
Federal funds rate	5.1	4.1	3.1	2.8
March projection	4.6	3.9	3.1	2.6

Source: Federal Reserve

US real gross domestic product (GDP) increased at an annual rate of 1.4% in the first quarter of 2024, the slowest quarterly growth rate since the second quarter of 2022. The Q1 2024 GDP growth rate marked a sizable pullback from the 4.9% and 3.4% growth rates in the third and fourth quarters of 2023, respectively. However, two of the biggest contributors to the slowdown in growth from the fourth quarter were a sharp increase in imports and a decline in business inventories, which tend to be volatile. The Atlanta Fed GDPNow model estimates real GDP growth of 2.2% in the second quarter.

FIXED INCOME

New data suggesting the economy may be slowing and progress toward the Fed's 2% inflation target is underway wasn't enough to persuade the FOMC to cut the federal funds target rate, creating further uncertainty about the timing and magnitude of the Fed's easing cycle. US Treasury yields traded in a wide range during the second quarter, ultimately ending the quarter modestly higher than where they started. Yields moved higher in the first half of the quarter on hotter-than-expected inflation data and the prospect of fewer rate cuts from the Fed before retreating in the second half of the quarter as progress on the inflation front reignited optimism for future rate cuts. US taxable bonds, as measured by the Bloomberg US Aggregate Bond Index, posted a total return of 0.07% in the second quarter, bringing the index's year-to-date total return to -0.71%.

The Bloomberg US Treasury Index logged a total return of 0.10% in the second quarter. US Treasury Inflation Protected Securities, or TIPS, outperformed nominal Treasuries during the second quarter, with the Bloomberg US TIPS Index delivering a total return of 0.79%

Municipal bonds underperformed their taxable counterparts in the second quarter, with the Bloomberg Municipal 1-10 Year Index returning -0.40%. Similarly to US Treasuries, municipal bond yields moved higher during the quarter. However, intermediate maturity municipal bond yields rose in excess of 30 basis points, compared to 12 to 15 basis points for Treasuries, as heavy supply and rich ratios hit that segment of the yield curve particularly hard. The Bloomberg Municipal 1-10 Year Index delivered a total return of -0.77% in the first half of 2024.

Solid corporate fundamentals, strong corporate earnings, and resilient economic activity have continued to support the corporate credit market, keeping both default rates and credit spreads contained. Investment grade corporate bonds, as measured by the Bloomberg US Corporate Bond Index, declined 0.09% in the second quarter, bringing the index's year-to-date total return to -0.49%. High yield corporate bonds were once again a top-performing fixed income sector, supported by high coupon payments and being less sensitive to rate movement. The Bloomberg High Yield Corporate Index advanced 1.09% in the second quarter, bringing the index's year-to-date total return to 2.58%.

Contrary to expectations, fixed income yields have risen since the start of the year as market participants adjust their prospects for the timing and magnitude of Fed rate cuts. The 10-Year US Treasury yield has increased from 3.88% on December 31, 2023, to 4.36% on June 30, 2024. The yield on the Bloomberg US Aggregate Bond Index has increased from 4.53% to 5.00% over this same time period, contributing to a -0.71% total return through the first half of the year. The rapid change in the outlook for Fed policy has been reflected in elevated levels of fixed income volatility. We expect volatility to remain elevated, with FOMC policy predictions steering yields and fixed income returns, until the Fed offers a clear path forward on its interest rate policy stance.

Returns	2Q24	YTD
Bloomberg US Aggregate Bond	0.07	-0.71
Bloomberg 1-10 Yr Municipal	-0.40	-0.77
Bloomberg US Treasury	0.10	-0.86
Bloomberg TIPS	0.79	0.70
Bloomberg US Corporate Bond	-0.09	-0.49
Bloomberg High Yield Corporate	1.09	2.58
FTSE WGBI nonUSD	-2.84	-6.17

Source: Morningstar

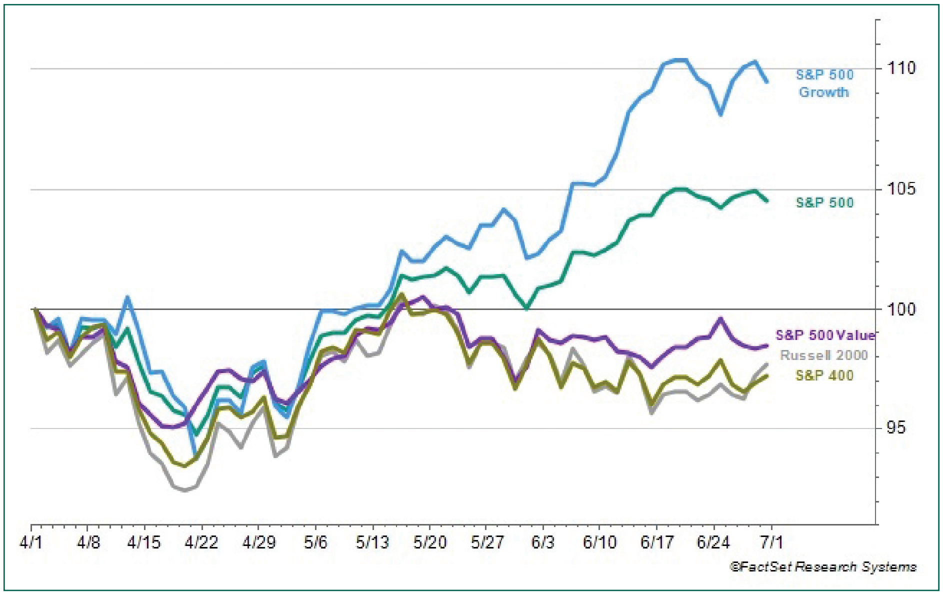
Past performance is not indicative of future performance. It is not possible to invest in an index.

US EQUITY

US equity indices experienced significant price divergences across market capitalizations in the second quarter. Large-cap stocks continued their positive momentum, while small and mid-cap segments faltered. It was a tale of two markets: the S&P 500 pushed to new record highs, driven by mega-cap tech and the fervent artificial intelligence (AI) investment narratives. In contrast, a Federal Reserve committed to maintaining higher interest rates and weakening macroeconomic data, weighed on the more economically and rate-sensitive mid and small-cap segments. The concentration in the S&P 500, with the top 10 stocks representing 37.0% of the index, is a persistent concern for passive and active investors alike. The mega-cap stocks, characterized by high quality, market leadership, strong balance sheets, and robust cash flow, coupled with secular growth opportunities, continue to attract investment capital from a wide range of investors. However, with the S&P 500 being so top-heavy and much of the performance directly tied to the AI buildout, the index's reliance on these few highly correlated stocks may increase market volatility. This also heightens susceptibility to a shift in investor sentiment or a slowdown in AI investment.

Market performance in the second quarter varied across capitalizations and style (see Figure 2). Large-cap stocks, represented by the S&P 500, posted a 4.28% gain in Q2, following a 10.46% gain in the first quarter. Large-cap growth continued to significantly outpace large-cap value, with growth stocks outperforming by 11.69% in the quarter, expanding the year-to-date gap to 17.77%. At the sector level, information technology led with a 13.81% increase for the quarter, while communication services and utilities were the only other sectors to outpace the S&P 500. The laggards were the more cyclical segments, with materials, real estate, and industrials down low single digits for the quarter. Smaller companies finished lower for the quarter, with the S&P 400 and Russell 2000 declining 3.49% and 3.28%, respectively. The price divergence between US equity segments has pushed large-cap stocks to an increasingly higher price multiple, while small and mid-cap stock price valuations have moved lower since the end of the first quarter. Large caps are now trading at a forward P/E of 21x, well above their 20-year average of 15.7x. Mid-caps at 17.0x and small-caps at 21.7x are both near long-term averages. Investors continue to pay a premium for higher quality businesses and those associated with the AI ecosystem. At the same time, lower valuations are not enough to broadly lure investors to the more cyclical and interest rate-sensitive small and mid-cap segments.

Figure 2: US Equity Performance (Q2 2024)



Source: FactSet

Earnings reported in the second quarter were stronger than expected, with 79% of S&P 500 companies posting positive earnings surprises and 61% reporting positive revenue surprises. Aggregate S&P 500 earnings grew well above expectations, registering a 6.1% year-on-year increase compared to the 3.5% increase expected at the start of the quarter, marking a third consecutive quarter of growth. Revenues also exceeded expectations, growing at 4.3% compared to the 3.6% expected. The top earnings growth sectors mirrored the price performance leaders, with communication services, information technology, and utilities all growing earnings over 25% year-over-year. Meanwhile, the energy, health care, and materials sectors all saw aggregate earnings fall over 20% year-over-year. Net profit margins were steady at 11.8%, up marginally from a year ago. Earnings commentary was divided on consumer behavior, with low-income consumers showing signs of weakness, constraining purchases, and trading down amidst the continued higher prices, while high-income consumers remained resilient. Investors continued to favor the primary players in the AI buildout as well as the second-level beneficiaries of the AI investment spending. The increasing appetite for exposure has been the primary reason for the divergence between growth and value segments. The upcoming Q2 S&P 500 earnings season is expected to show even higher rates of aggregate growth, with analysts predicting an 8.8% increase in earnings on 4.4% revenue growth. Q3 and Q4 earnings growth are expected to be 8.2% and 17.4%, respectively. Full-year 2024 expectations have risen from the prior quarter, with 11.3% earnings growth and 5.0% revenue growth now anticipated.

As we look to the third quarter, the continued momentum and price swings of the AI buildout beneficiaries are likely to dictate short-term price movements in the large-cap segment. The concentration of the largest companies, all linked to the AI secular growth theme, presents elevated risks to passive and active investors alike. While the expectation of AI being a multi-year disruptive and transformational technology is promising, investors with elevated expectations and a short time horizon may face a longer path to tangible returns on this invested capital. Once again, the focus on the risk vs. reward tradeoff remains paramount, and diversification is key to maintaining exposure to these exciting secular growth opportunities while also reducing idiosyncratic risk.

Returns	2Q24	YTD
Large Cap		
S&P 500	4.28	15.29
S&P 500 Value	-2.10	5.79
S&P 500 Growth	9.59	23.56
Small Cap		
Russell 2000	-3.28	1.73
Russell 2000 Value	-3.64	-0.85
Russell 2000 Growth	-2.92	4.44

Source: Morningstar

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INTERNATIONAL EQUITY

International developed equities were unchanged for the quarter, exhibiting resilience amidst shifts in central bank monetary policy and election uncertainty in France. In June, the European Central Bank (ECB) leapfrogged the Federal Reserve and reduced policy rates by 25 basis points. Headline inflation in the Eurozone declined from 10.6% in October 2022 to 2.6% in May 2024, showing considerable progress towards the ECB's 2% target level, prompting policymakers to act. The Bank of England is expected to follow suit and reduce rates in the summer, while the Bank of Japan has signaled further rate hikes are in the cards. The resulting divergence in monetary policies among major economies intensified volatility in currency markets, leading to a resurgence in the strength of the US dollar.

Following the European Parliament elections, where populist parties made substantial gains, French President Macron dissolved the National Assembly, calling for snap elections. Investors grappled with the implications of potential policy changes, specifically the impact of unfunded tax cuts resulting in growing deficits. Following the first round of voting, the right-wing National Rally party is leading and aims to secure a majority in the next round in July. There is a possibility of political deadlock in France, foreshadowing the potential risks to financial markets due to the upcoming election results worldwide. The MSCI EAFE Index (gross) declined 0.17% during the second quarter but remained firmly in positive territory for the year. Currency effects, though less pronounced than in the previous quarter, posed a headwind for US-based investors. Currency weakness was most pronounced in Japan, where the yen declined to 160 against the US dollar, marking a 38-year low. Modest improvements in economic activity across Europe, particularly within the service sector, have contributed to positive earnings revisions for corporations. Analysts are projecting 4% earnings growth for MSCI EAFE constituents for 2024, bolstered by higher profit margins. However, corporate earnings growth is subdued compared to US equity markets, where a handful of mega-cap technology companies have delivered impressive earnings results for shareholders.

The outlook for the rest of the year will be influenced by expectations of more accommodative monetary policy globally. Other major central banks are widely projected to cut policy rates like the ECB, which has historically been favorable for risk assets. Valuations for the MSCI EAFE have remained steady over the quarter, trading near long-term averages and maintaining a substantial discount relative to their domestic counterparts. Diversification remains an essential tool for investors that is more prudent than ever given the concentration risks that have emerged within US equity markets, which are less prevalent for international markets.

EMERGING MARKET EQUITY

Emerging markets were the top-performing equity segment for the quarter, as sentiment recovered from depressed levels on positive developments in China. In recent years, China's property sector has struggled with significant oversupply and falling prices, a major concern for the government. In May, The People's Bank of China provided funding that enabled local authorities to purchase unsold property, reduce mortgage rates, and lower down payment requirements. While the size of the program is not very impressive, the change in direction of the policymakers is significant and demonstrates their commitment to addressing one of the key issues affecting the economy.

The MSCI Emerging Markets Index (gross) increased by 5.12% in the second quarter, bringing year-to-date gains to 7.68%. There was significant performance dispersion among economic sectors. Information technology led the way with an 11.26% increase for the quarter, benefiting from strong earnings growth related to the AI ecosystem buildout. Taiwan Semiconductor's dominance in producing components for all major players in the semiconductor space has earned its reputation as one of the most important companies in the world. The company has enjoyed significant outperformance and has grown to become a high concentration within the MSCI EM Index at nearly 10%. This exceeds the concentration of any one company in the S&P 500. On the other hand, real estate was the worst-performing sector, declining by 10.23% for the quarter due to high interest rates and regional oversupply issues. Policy support in China may help the real estate sector in the future, but less restrictive monetary policy would be a more meaningful catalyst.

Emerging markets equities have experienced a period of prolonged underperformance relative to US equity markets. Restrictive monetary policy by the Federal Reserve has contributed to higher funding costs and capital flight out of emerging markets. As the Federal Reserve gradually cuts rates, emerging markets should benefit, as they historically perform well during easing cycles. However, improving sentiment is also necessary for price multiples to recover. On a positive note, corporations have been driving earnings growth, with a projected growth rate of over 20% this year. Volatility will likely persist through the remainder of the year as the US presidential elections and potential shifts in trade policy emerge.

Returns	2Q24	YTD
MSCI EAFE	-0.17	5.75
MSCI Europe	0.92	6.36
MSCI Japan	-4.24	6.45
MSCI China	7.16	4.82
MSCI UK	3.70	6.92
MSCI Emerging Markets	5.12	7.68

Source: Morningstar

Unhedged, Gross Dividends Reinvested

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REAL ESTATE

The FTSE Nareit All Equity REITs Index was down 0.90% in the second quarter, bringing its year-to-date return to -2.19%. For the second consecutive quarter, real estate investment trusts (REITs) have underperformed the broader US equity market. Real estate is the only sector of the S&P 500 that is down in 2024, and that is a function of Fed policy and yields as the market continues to adjust expectations for a higher for longer interest rate environment. The market has been preoccupied with the Fed's next policy action, with expectations on the timing of rate cuts being pushed back and the magnitude of rate cuts being slashed. The result has been higher real yields, and while REITs are more than just a play on interest rates, the volatility of interest rates and expected impact of Fed policy do play a role in short to intermediate term returns as sentiment, rather than fundamentals, drive market prices.

As shown in the table below, property sector returns were mixed in the second quarter, with eight of the twelve sectors posting negative returns. Amongst REIT property sectors, health care, residential, and specialty REITs were the leaders, while timber, lodging/resorts, and industrial REITs were the laggards.

Property Sector	2Q24	YTD
Industrial	-10.58	-12.82
Office	-5.10	-5.56
Retail	-0.40	0.22
Residential	7.62	7.94
Diversified	-1.66	-11.92
Lodging/Resorts	-11.30	-6.30
Health Care	11.53	10.27
Self Storage	2.69	-2.28
Timber	-18.64	-16.29
Infrastructure	-3.42	-11.90
Data Centers	-2.61	1.99
Specialty	6.67	18.90

Source: Morningstar

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Despite negative year-to-date returns, REITs remain nearly 20% above their October 2023 lows. While REIT performance and sentiment have been hindered by concerns over higher financing costs, tighter lending standards, and secular shifts in demand, commercial real estate company balance sheets remain generally strong and fundamentals remain solid in most property sectors. Additionally, REITs are trading at an earnings multiple discount to the S&P 500, which is a historical anomaly. Since January 1, 2005, the FTSE Nareit All Equity REITs Index has traded at a 2.7x earnings multiple premium to the S&P 500, on average. As of March 31, 2024, it was trading at a -1.7x discount. These factors suggest REITs have the opportunity for outperformance, which could be amplified in a Fed rate cutting cycle.

Returns	2Q24	YTD
FTSE NAREIT All Equity REITs TR USD	-0.90	-2.19

Source: Morningstar

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COMMODITIES

Commodities carried over their strong performance from the first quarter, with the Bloomberg Commodity Index advancing 2.89% in the second quarter. The Bloomberg Commodity Index posted a solid 5.14% in the first half of the year, keeping pace with other risk assets.

Commodity sector returns were mixed for the quarter, with four sectors advancing and two sectors declining. Industrial metals and precious metals were the biggest gainers, while livestock and grains were the biggest laggards.

Commodity Sector	2Q24	YTD
Energy	2.99	7.98
Grains	-5.73	-13.24
Industrial Metals	9.78	8.98
Precious Metals	7.94	15.03
Softs	1.37	11.15
Livestock	-1.24	9.60

Source: Morningstar

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WTI and Brent crude oil prices were down 1.73% and 2.14%, respectively, in the second quarter. Oil prices peaked in early April as Israel and Iran threatened war, unleashing concerns that a wider conflict could engulf the Middle East and interrupt oil supplies. Oil prices subsequently pulled back in late April and May as geopolitical tensions eased and the market experienced weaker-than-expected demand. Oil prices once again surged in June on optimism for an increase in demand during the US summer season, re-escalation of geopolitical tensions in the Middle East and Europe, and an extension of voluntary cuts from OPEC+. While crude oil prices declined, natural gas prices increased 49.71% in the second quarter. After bottoming in late April, natural gas prices surged higher on geopolitical tensions, lower US production, supply disruptions in Norway, and growing demand expectations.

Industrial and precious metals stood out in the second quarter, leading the commodity complex higher. Gold hit a new all-time high in May as the precious metal benefitted from optimism for Fed rate cuts, safe haven demand amid mounting tensions in the Middle East and Europe, and central bank buying. However, diminishing expectations for Fed rate cuts and an end to China's 18-month buying spree resulted in a June pullback for gold. Silver, copper, aluminum, zinc, lead, and nickel all hit year-to-date highs in late May. Copper prices rallied 9.48% in the second quarter, fueled by supply concerns and improving demand prospects for metals used in the green energy transition. Copper prices also received a boost from several notable support measures announced by the Chinese government to prop up the country's slowing property sector.

Returns	2Q24	YTD
Bloomberg Commodity TR USD	2.89	5.14

Source: Morningstar

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