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June 2024 Market Commentary

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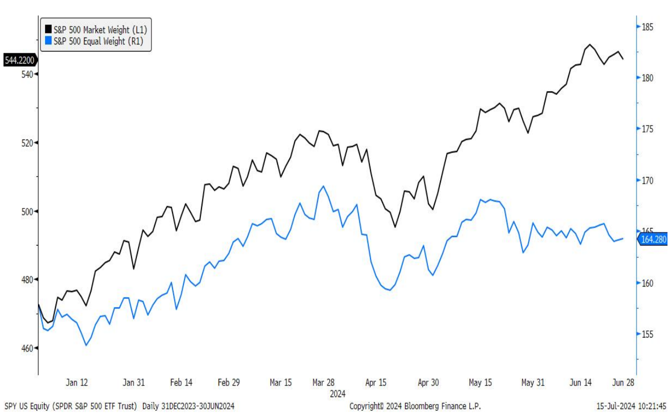
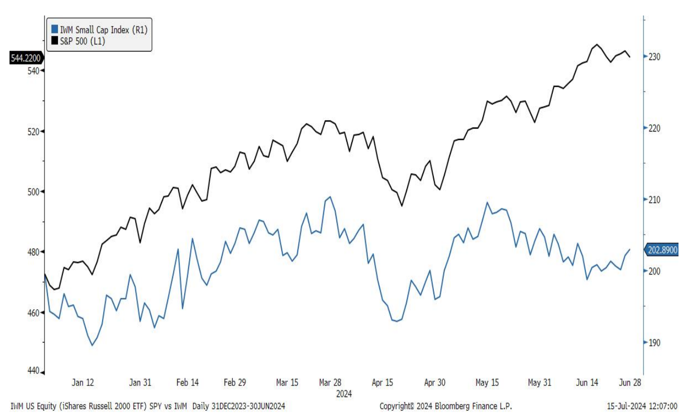
AI or Bust. June was another good month for the major US equity market indexes, driven mainly by mega-cap and AI-related stocks, while the average stock's performance was more subdued. The S&P 500 gained 3.6%, the NASDAQ jumped 6.0%, and the Dow Jones Industrial Average advanced by 1.2%. Meanwhile, the equally weighted version of the S&P 500 was *down* half a percent, and the Russell 2000 index of small-cap stocks *fell* 1.1%, highlighting the narrowness of the latest leg up. The S&P 500 is up 15.3% through the first half, marking the 13th-best start for the index since 1928. Yet just six stocks are responsible for roughly two-thirds of the gain, and the top 5 holdings now make up around 27% of the index, which is the highest concentration for the top names since at least 1980. The equally weighted S&P 500 is up a more modest 5% through the first six months of the year, and the Russell 2000 is up only 1.6%—a historically wide performance gap versus its larger cap peers. These dynamics weighed on our first-half results. While we own a smattering of mega-cap names and AI beneficiaries, we also hold small and mid-cap stocks and promising positions in sectors, including industrials, healthcare, and energy, that are not directly tied to the AI buildout. Looking forward, we expect some of our holdings in these areas that have lagged so far this year may start to outperform over the next few months, particularly given the increasing probability of easing monetary policy coupled with the potential for pick up in earnings growth.

<u>S&P 500 trounced Equally Weighted S&P 500</u>



Source: Bloomberg

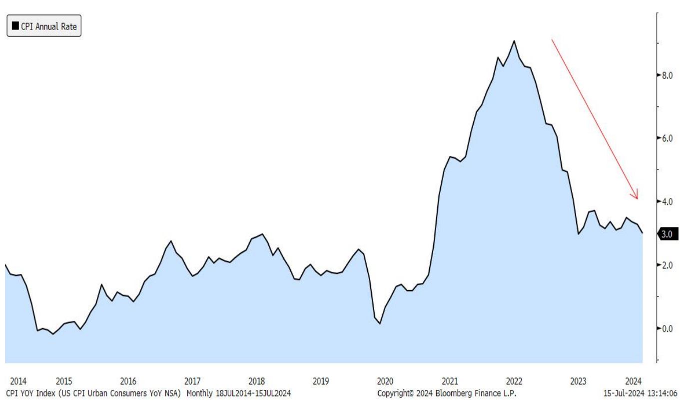
<u>Wide spread between large caps and small caps</u>



Source: Bloomberg

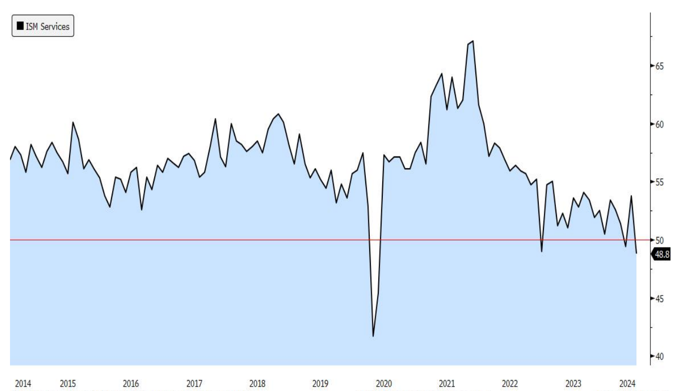
Moderating inflation, easing labor market, and some worrisome growth data bolster the case for rate cut. Inflation data continued to ease in June, with the consumer price index (CPI) falling by 0.1% month-over-month (the first decline in MoM inflation since May 2020) and coming in at a 3% annual rate (the lowest reading since June 2023). Notably, the shelter component, which contributes one-third of total CPI, finally appears to be easing, increasing by a moderate 0.2%. The unemployment rate increased to 4.1% in June, the highest level since 2021 and above the Fed's 4% projection for this year. Several reports suggest cooling growth over the last few weeks, including the latest ISM Services index, which came in well below expectations for June at 48.8, moving into contraction territory with weak underlying employment and new orders data. The non-manufacturing index has been a bastion of strength, while the ISM manufacturing index has been in contraction territory for 19 of the last 20 months. Taken together, the latest economic readings suggest the Fed will likely join other central banks from around the world and begin to cut interest rates before the end of the year.

Inflation continues to moderate



Source: Bloomberg

Non-manufacturing PMI slips into contraction



Source: Bloomberg

We remain constructive but would not be surprised by an increase in volatility or pullback. The major market indices have been remarkably calm, only suffering one 10% pullback over the last 21 months, as investors continually rotated into the safety of the largest stocks. As a result, valuations now look stretched in certain areas, with the S&P 500 trading at 23.5X earnings compared to an average of 18X. Moreover, it is not hard to find large-cap stocks that have AI exposure or are perceived as safety havens trading at well over 30X. At these valuations, stocks may be more susceptible to a pullback driven by unexpected earnings, economic, election, or geopolitical news over the next few months. Still, given the narrow nature of the recent market advance, we continue to find compelling opportunities in stocks that have lagged and are trading at valuations below their pre-COVID levels, have strong growth prospects (some even AI-driven), and may see outsized benefits from easing monetary policy over the coming months.

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