withum WEALTH MANAGEMENT

Summer, 2024

Investment Commentary

Q2 Review

Major US equity indices put in a mixed performance in Q2, with the Dow falling (1.7%), while major performance contributions from some of the Magnificent 7 stocks helped drive the S&P and Nasdaq 3.9% and 8.3% higher, respectively. Many commentators aired concerns about market breadth as the official market cap-weighted S&P bested its equal-weight variant by nearly seven percentage points in the quarter.

Not only has optimism about a broadening rally failed to materialize, but things seem to have moved in the opposite direction – while more than 78% of S&P constituents traded above their 50-day moving averages at the end of Q1, that proportion shrank to ~46% near the end of Q2.

The spring quarter saw a continued repricing of Fed rate-cut expectations in the face of somewhat stubborn inflation and still-robust job growth. Central bank officials continued to voice a need for "greater confidence" that inflation is moving sustainably back towards their 2% target before cutting rates. This hawkish shift was made more tangible by the Summary of Economic Projections from the June FOMC meeting, which showed a median policymaker forecast for just one rate cut in 2024, down from three in the March SEP.

We are certainly glad that we aren't economists at the Federal Reserve tasked with trying to read the muddled, ever-shifting tea leaves of economic data. As far as we can tell, Q2 saw continued disinflation accompanied by some signs of a gradual economic slowdown. May core CPI printed at its lowest level since August 2021, while May core PCE saw its smallest annual gain since March 2021. Meanwhile, jobs growth has continued to defy expectations for weakening, with June payrolls notably stronger than consensus. Despite this, attention on the health of the consumer continues to grow given weaker retail sales reports and corporate commentary about an uncertain macro environment.

Regarding the corporate picture, Q1 earnings remained resilient, but with a few caveats. S&P constituents booked earnings growth of 5.8%, and while that bested expectations of 3.4%, big tech distorted this figure significantly – strip out the Magnificent 7 names, and the remaining S&P components saw earnings decline by 1.75% on average. Nevertheless, consensus still calls for double-digit index earnings growth for 2024 and a robust increase of over 14% for 2025. That's a bit at odds with some recent corporate updates that have voiced concerns about cautious client behavior and value-conscious customers trading down or delaying big-ticket expenditures.

Debt and Politics

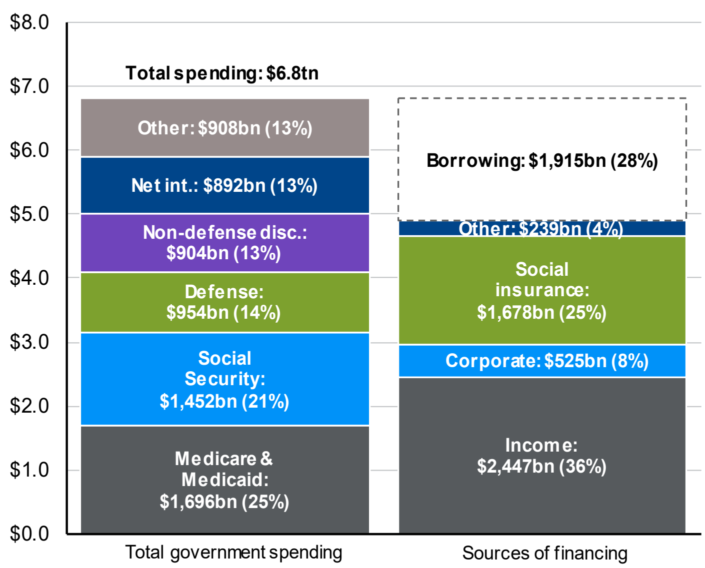
We often field questions from clients about the state of Federal finances. Are our Social Security and Medicare programs sustainable? Are US Treasuries truly risk-free? While we don't see these items as short- or even medium-term concerns, their viability as long-term concerns is legitimate. The Congressional Budget Office puts out a pretty easy-to-understand forecast of where the federal budget is headed, and it doesn't paint a pretty picture.

Consider the charts below. The one at the top right shows that even without the extension of the tax cuts from the Tax Cuts and Jobs Act of 2017 (set to sunset next year), the budget deficit as a share of GDP is expected to increase steadily towards 7%, causing total debt as a share of GDP to increase from 99% today to about 124% by 2034. Put another way, even without the TCJA extension, debt as a share of GDP will be rising well above the levels that we experienced right after World War II.

Federal Finances

The 2024 federal budget

USD trillions

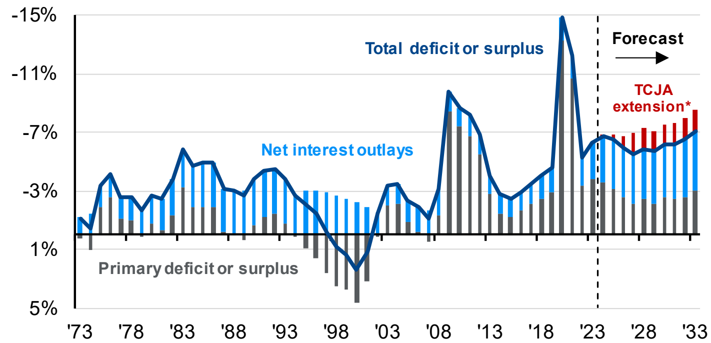


CBO's Baseline economic assumptions

	2024	'25-'26	'27-'28	'29-'34
Real GDP growth	2.9%	2.0%	1.7%	1.8%
10-year Treasury	4.5%	4.0%	3.6%	4.0%
Headline inflation (CPI)	3.2%	2.4%	2.2%	2.2%
Unemployment	3.8%	4.0%	4.3%	4.5%

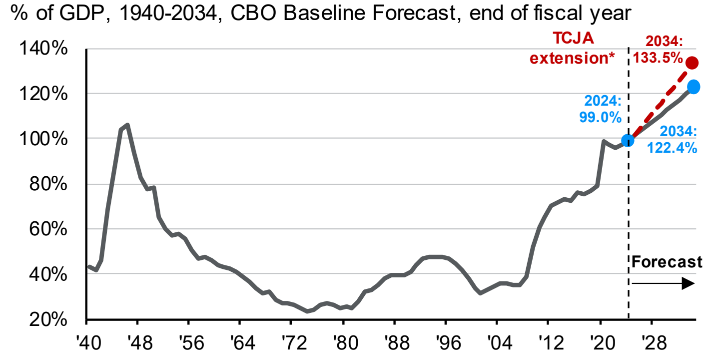
Federal deficit and net interest outlays

% of GDP, 1973-2034, CBO Baseline Forecast



Federal net debt (accumulated deficits)

% of GDP, 1940-2034, CBO Baseline Forecast, end of fiscal year



Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department. Estimates are from the Congressional Budget Office (CBO) June 2024 An Update to the Budget Outlook: 2024 to 2034. "Other" spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. *Adjusted by JPMAM to include estimates from the CBO May 2024 report "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues" on the extension of TCJA provisions. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. J.P. Morgan Guide to the Markets – U.S. Data are as of June 30, 2024.

How does the outcome of the presidential election affect the fiscal outlook? It is fairly certain that if Trump is elected president again and Republicans have a majority in the House, all of the Tax Cuts and Jobs Act would be extended. Not only would this put upward pressure on debt and the deficit, it could potentially push long-term interest rates higher than they otherwise would have been. This outcome appears to have become incrementally more likely of late, given the reaction to President Biden's recent debate performance. As of this writing, several Democrats in Congress have called for Biden to withdraw from the race.

Concentration Redux

In an ideal world, our quarterly commentary would examine fresh topics every quarter, lest we risk boring our readers. However, sometimes, certain themes are so prevalent in the market's overarching narrative that they require continuous examination, updating, and expansion. Recall that in our **Winter Commentary**, we discussed the unprecedented degree of market concentration, with the top 10 market capitalization stocks in the S&P 500 accounting for over 90% of the index's returns in 2023. Something that looked extreme from a historical perspective has only gotten more dramatic this year, with those top ten stocks now representing a staggering 37% of the index. Even in the last days of the dotcom bubble that figure never crested 28%.

There are many ways to view market concentration, and there is a case to be made that it isn't such a bad thing. The earnings contribution of these top ten stocks has been rising, signaling that their outsized growth isn't merely smoke-and-mirrors AI-driven over-exuberance. On the other hand, valuations for these ten companies have also been rising, and they are now about 150% of the average S&P 500 valuation over the

S&P 500: Index Concentration, Valuations and Earnings

P/E ratio of the top 10 and remaining stocks in the S&P 500
Next 12 months, 1996 - present

	Current	Average	% of avg.
Top 10	30.3x	20.4x	148%
Remaining stocks	17.6x	15.7x	112%
S&P 500	21.0x	16.6x	127%

Weight of the top 10 stocks in the S&P 500
% of market capitalization of the S&P 500

Earnings contribution of the top 10 in the S&P 500
Based on last 12 months' earnings

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. The top 10 S&P 500 companies are based on the 10 largest index constituents at the beginning of each month. As of 6/30/2024, the top 10 companies in the index were MSFT (7.0%), AAPL (6.3%), NVDA (6.1%), AMZN (3.6%), META (2.3%), GOOGL (2.3%), GOOG (1.9%), BRK.B (1.7%), LLY (1.5%), JPM (1.3%) and AVGO (1.3%). The remaining stocks represent the rest of the 492 companies in the S&P 500.

J.P. Morgan Guide to the Markets – U.S. Data are as of June 30, 2024.

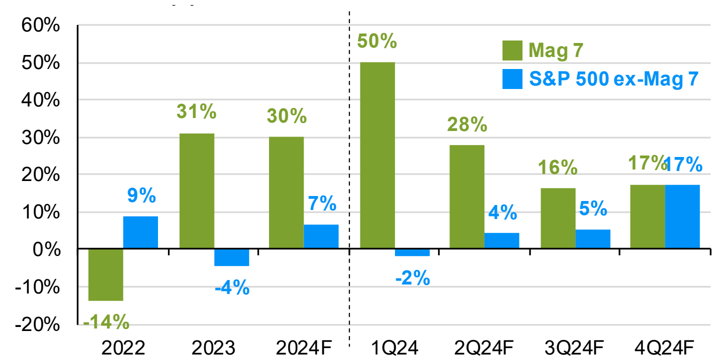
past three decades. However, this too can be spun positively – the other 490 companies aren't cheap, but they do carry much more reasonable valuations.

Is a market broadening still in the offing? Maybe. Consider the chart above showing the earnings broadening that analysts expect to happen over the rest of this year. This already started in the first quarter earnings season, with eight out of 11 sectors registering positive earnings growth. Some of this could come from other, more tangential AI beneficiaries like energy, utilities, and the industrial companies that are going to build datacenters. Other sectors like healthcare could also be beneficiaries of innovation themes (see: GLP-1 weight loss drugs).

Market concentration comes in other flavors besides that occurring in the S&P 500. The current 64% representation of the U.S. within global equities is perhaps just as staggering. This doesn't portend a U.S. stock market crash, but it is likely that this condition will eventually revert towards its historical mean as other markets catch up. It's worth noting that there was some very strong performance in a handful of major overseas markets last year, with Japan, Taiwan, India, and Europe ex-UK returning 29%, 31%, 22%, and 17%, respectively, on a local-currency basis. The takeaway here is simple: despite longstanding underperformance, maintaining healthy international exposure in portfolios remains as prudent as ever.

Earnings Growth

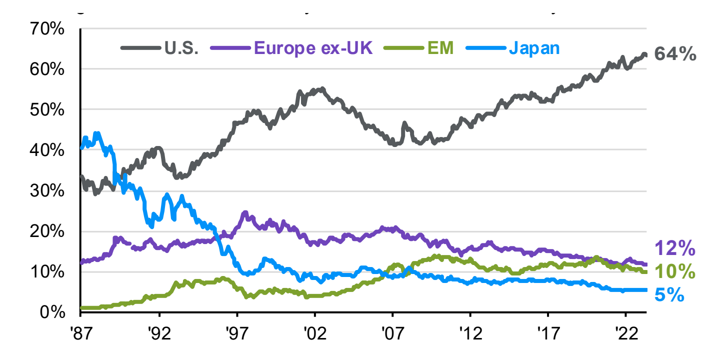
Pro-forma EPC, y/y



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

Share of Global Market Capitalization

% weight in the MSCI All Country World Index, USD, Monthly



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

Closing Thoughts

We continue to believe that diversified portfolios help to minimize risk and that market timing is extremely difficult. Moderate and conservative portfolios outperformed significantly in the down market of 2022 but have underperformed more aggressive and tech-heavy portfolios in 2023 and so far in 2024. Regardless, investors have enjoyed a higher stock market and more robust yields.

While we do not like to predict the direction of the market, we would expect some increased volatility as we approach the election, particularly if there is a new Presidential candidate selected by the Democrats. Volatility has been low for some time and, like everything in life and the markets, the likelihood is that there will be movement in the other direction at some point. ▪

Please do not hesitate to reach out to us if you have a question or need assistance with anything. We hope you are all enjoying the summer thus far.

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WEALTH MANAGEMENT

Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management team with any questions or concerns:

T (732) 450 0147
infowwm@withumwealth.com
withumwealth.com