Continued Progress in Q2 2024

Quarterly Insights by Peter G. Carolan

The S&P 500 experienced its first real dose of volatility early in the second quarter, with a negative April, but expectations for interest rate cuts by the Federal Reserve, solid economic growth and continued strong financial performance from AI-related tech companies ultimately pushed the S&P 500 to new highs and the index finished the quarter with strong gains.

While the S&P 500 hit new highs in the second quarter, the month of April was decidedly negative for markets as fears of no rate cuts in 2024 (or even a rate hike) pressured stocks. The catalyst for these concerns was the March Consumer Price Index (CPI), which rose 3.5% year over year, higher than estimates. That hotter-than-expected reading reversed several months of declines in CPI and ignited fears that inflation could be "sticky" and, if so, delay expected Fed rate cuts. Those higher rate concerns were then compounded by comments by New York Fed President John Williams, who stated rate hikes (which investors assumed were over) were possible if inflation showed signs of re-accelerating. The practical impact of the hot CPI report and William's commentary was to push rate cut expectations out from June to September and that caused the 10-year Treasury yield to rise sharply, from 4.20% at the start of the quarter to a high of 4.72%. Those higher yields pressured the S&P 500 in April, which fell 4.08% and completed its worst month since September.

On the first day of May, however, the Fed largely dispelled concerns about potential rate hikes and ignited a rebound that ultimately carried the S&P 500 to new highs. At the May 1 FOMC decision, Fed Chair Powell essentially shut the proverbial door on the possibility of rate hikes, stating that if the Fed was concerned about inflation, it would likely just keep interest rates at current levels for a longer period instead of raising them. That comment provided immediate relief for investors and both stocks and bonds rallied early in May as rate hike fears subsided. Then, later in the month, the April CPI report (released in mid-May) rose 3.4% year over year, slightly lower than the 3.5% in March and that resumption of disinflation (the decline in inflation) further increased expectations for rate cuts in 2024. Additionally, employment data moderated in May, with the April jobs report coming in below expectations (but still at healthy levels). The practical result of the resumption of disinflation, the supportive Fed commentary and moderating labor market data was to increase September rate cut expectations, push the 10-year Treasury yield back down below 4.50% and spark a 4.96% rally in the S&P 500 in May.

The upward momentum continued in June thanks to more positive news on inflation, additional reassuring commentary from the Fed and strong AI-linked tech earnings. First, the May CPI (released in mid-June) declined to 3.3% year over year, the lowest level since February. Core CPI, which excludes food and energy prices, dropped to the lowest level since April 2021, further confirming ongoing disinflation. Then, at the June FOMC meeting, Fed Chair Powell reassured markets two rate cuts are entirely possible in 2024, reinforcing market expectations for a September rate cut. Economic data, meanwhile, showed continued moderation of activity and that slowing growth and falling inflation helped to push the 10-year Treasury yield close to 4.20%, a multi-month low. Finally, investor excitement for AI remained extreme in June, as strong AI-driven earnings from companies integrating AI technology into future products pushed tech stocks higher and that, combined with falling Treasury yields and rising rate cut expectations, sent the S&P 500 to new all-time highs above 5,500.

In sum, markets impressively rebounded from April declines and the S&P 500 hit a new high thanks to increased rate cut expectations, falling Treasury yields and continued robust earnings growth from AI-linked tech companies.

Second Quarter Performance Review

The second quarter produced a more mixed performance across various markets than the strong return in the S&P 500 might imply, as AI-driven tech-stock enthusiasm again powered the Nasdaq and S&P 500 higher while other major indices lagged. The Nasdaq was, by far, the best performing major index in the second quarter while the S&P 500, where tech is the largest sector weighting, also logged a solidly positive gain. Less tech focused indices didn't fare as well, however, as the Dow Jones Industrial Average and small-cap focused Russell 2000 posted negative quarterly returns.

By market capitalization, large caps outperformed small caps in Q2, as they did in the first quarter of 2024. Initially, higher Treasury yields in April weighed on small caps, while late in the second quarter economic growth concerns pressured the Russell 2000.

From an investment style standpoint, growth massively outperformed value in the second quarter, as tech-heavy growth funds once again benefited from continued AI enthusiasm. Value funds, which have larger weightings towards financials and industrials, posted a slightly negative quarterly return as the performance of non-tech sectors more reflected growing concerns about economic growth.

On a sector level, performance was decidedly mixed as only four of the eleven S&P 500 sectors finished the second quarter with positive returns. The best performing sectors in the second quarter were the AI-linked technology and communications services sectors. Utilities also logged a modestly positive quarterly return, as the high yields and resilient business models were attractive to investors given rising concerns about future economic growth, while declining Treasury yields made higher dividend sectors such as utilities more attractive to income investors.

Turning to the sector laggards, the energy, materials and industrials sectors closed the quarter with modestly negative returns. Their declines reflected growing anxiety about future economic growth as those sectors, along with small-cap stocks, are more sensitive to changes in U.S. and global growth.

US Equity Indexes	Q2 Return	YTD
S&P 500	4.28%	15.29%
DJ Industrial Average	-1.27%	4.79%
NASDAQ 100	8.05%	17.47%
S&P MidCap 400	-3.45%	6.17%
Russell 2000	-3.28%	1.73%

Source: YCharts

Internationally, emerging markets outperformed the S&P 500 in Q2 thanks to optimism towards a rebound in Chinese economic growth and as falling global bond yields late in the quarter boosted the attractiveness of emerging market investments. Foreign developed markets, meanwhile, lagged both emerging markets and the S&P 500 and posted a fractionally negative quarterly return. Concerns about the timing and number of Bank of England and European Central Bank rate cuts, along with French and German political concerns later in the quarter, acted as headwinds for foreign developed equities.

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-0.06%	5.75%
MSCI EM TR USD (Emerging Markets)	5.40%	7.68%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	1.32%	6.04%

Source: YCharts

Commodities saw slight gains in the second quarter thanks to aforementioned optimism on Chinese economic growth and as geopolitical concerns rose throughout the quarter. Gold rallied solidly on the uptick in geopolitical risks, following the tit-for-tat strikes between Israel and Iran, along with the growing chances of a direct Israel/Hezbollah conflict. Oil, meanwhile, logged a small loss on signs of slipping OPEC+ production discipline and concerns about future global growth and demand.

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	0.65%	11.08%
S&P GSCI Crude Oil	-2.07%	13.68%
GLD Gold Price	4.47%	12.60%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a slightly positive return for the second quarter, as rising expectations for a September Fed rate cut and moderating U.S. economic growth boosted bonds broadly.

Looking deeper into the fixed income markets, shorter-duration bonds outperformed those with longer durations in the second quarter, as bond investors priced in sooner-than-later Fed rate cuts. Longer-dated bonds, meanwhile, were little changed on the quarter despite the return of disinflation and moderating U.S. economic growth.

Turning to the corporate bond market, lower-quality, but higher-yielding “junk” bonds rose modestly in the second quarter while higher-rated, investment-grade debt logged only a slight decline in Q2. That performance gap reflected continued investor optimism towards corporate profits despite some disappointing economic reports, which led to bond investors taking more risk in exchange for a higher return.

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	0.07%	-0.71%
BBgBarc US T-Bill 1-3 Mon	1.34%	2.68%
ICE US T-Bond 7-10 Year	-0.05%	-1.40%
BBgBarc US MBS (Mortgage-backed)	0.07%	-0.98%
BBgBarc Municipal	-0.02%	-0.40%
BBgBarc US Corporate Invest Grade	-0.09%	-0.49%
BBgBarc US Corporate High Yield	1.09%	2.58%

Source: YCharts

Third Quarter Market Outlook

Stocks begin the third quarter of 2024 riding a wave of optimism and positive news as inflation is declining in earnest, the Fed may deliver the first rate cut in over four years this September, economic growth remains generally solid and substantial earnings growth from AI-linked tech companies has shown no signs of slowing down.

Those positives and optimism are reflected in the fact that the S&P 500 has made more than 30 new highs so far in 2024 and is trading at levels that, historically speaking, are richly valued. That said, if inflation continues to decline, economic growth stays solid and the Fed delivers on a September cut, absent any other major surprises, it's reasonable to expect this strong 2024 rally to continue in Q3.

However, while the outlook for stocks is undoubtedly positive right now, market history has shown us that nothing is promised. As such, we must be constantly aware of events that can change the market dynamic, as we do not want to get blindsided by sudden volatility.

To that point, the market does face risks as we start the third quarter. Slowing economic growth, disappointment if the Fed doesn't cut rates later this year, underwhelming Q2 earnings results (out in July), a rebound in inflation and geopolitical surprises (including the looming U.S. elections) are all potential negatives. And, given high levels of investor optimism and current market valuations, any of those events could cause a pullback in markets similar to what was experienced in April (or worse).

While any of those risks (either by themselves or in combination with one another) could result in a drop in stocks or bond prices, the risk of slowing economic growth is perhaps the most substantial threat to this strong 2024 rally. To that point, for the first time in years, economic data is pointing to a clear loss of economic momentum. So far, the market has welcomed that moderation in growth because it has increased the chances of a September rate cut. However, if growth begins to slow more than expected and concerns about an economic contraction increase, that would be a new, material negative for markets. Because of that risk, we will be monitoring economic data very closely in the coming months.

Bottom line, the outlook for stocks remains positive but that should not be confused with a risk-free environment. There are real risks to this historic rally and we will continue to monitor them closely in the coming quarter.

To that point, at Stelvio Wealth Partners, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain focused on both opportunities and risks in the markets, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

Peter G. Carolan
Managing Partner

Index return information is provided for illustrative purposes only. Index returns do not represent investment returns or the results of actual trading nor are they forecasts of expected gains or losses a fund [portfolio] might experience. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses or taxes applicable to an actual investment. Comparisons to benchmarks have limitations because benchmarks have volatility and other material characteristics that may differ from those of the fund [portfolio]. Because of these differences, benchmarks should not be relied upon as an accurate measure of comparison. There is no guarantee that any of the securities invested in by the fund [portfolio] are included in the Index. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The NASDAQ 100 Index is an unmanaged group of the 100 biggest companies listed on the NASDAQ Composite Index. The list is updated quarterly and companies on this Index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology and retail/wholesale trade.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P SmallCap 600 Index in size: between $1-4 billion.

The MSCI All Country World ex USA Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the USA. The Index consists of 45 country indices comprising 22 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

The MSCI Emerging Markets Index is designed to represent the performance of large- and mid-cap securities in 24 Emerging Markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg U.S. 1-3 Year Government Bond Index is composed of all publicly issued, non-convertible domestic debt of the U.S. government and its agencies. The Index also includes corporate debt guaranteed by the U.S. government. Only notes and bonds with a minimum maturity of one year up to a maximum maturity of 2.9 years are included.

The Bloomberg Mortgage Backed Securities Index is an unmanaged index of mortgage pools of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation and Federal National Mortgage Association.

The Bloomberg Corporate High Yield Municipal Bond Index covers the universe of fixed rate, non-investment grade debt.

The Bloomberg Municipal Bond Index is an unmanaged index of a broad range of investment-grade municipal bonds that measures the performance of the general municipal bond market.

The Bloomberg Corporate Bond Index is an unmanaged market value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.