the serious investor

SUMMER 2024

THE SERIOUS INVESTOR: SUMMER 2024

Welcome to the summer edition of LVW's *The Serious Investor*.

The second quarter started on a turbulent note. After a series of hotter-than-expected inflation readings, investors anticipated that the Federal Reserve would continue to keep interest rates high. This prospect renewed worries that the Fed's efforts to contain inflation might trigger a recession.

These concerns softened as the quarter progressed, inflationary pressures such as wage growth moderated, and the overall economic outlook held firm. Pricing in the bond markets as of early July implies that investors expected the Fed to cut interest rates once this year, likely in September.[1]

This environment led to a down-and-up quarter for U.S. stocks. The S&P 500 fell more than 5% during the first three weeks of April, then recovered to post a nearly 4% return for the quarter as a whole. That said, gains were concentrated in a small handful of stocks, as investors flooded into shares of companies they expected to benefit from developments in artificial intelligence. Nvidia, Apple, Microsoft and Alphabet (Google) collectively accounted for more than 100% of the S&P 500's gain during the quarter, while seven of the benchmark's 11 economic sectors declined.[2]

Over the first half of the year, the market-weighted S&P 500 advanced 14.5%, but the equal-weighted version of the index returned just 4.1%. That development continues a long-running trend: For the three years through June, the equal-weighted benchmark gained just 8.8%, far below its average return of 33.8% during three-year rolling periods since 1990—suggesting the overall market may not be overheated despite the run-up in market-weighted indexes.[3]

The dominance of AI-related stocks in the second quarter helped growth outperform value and large caps outperform small caps. U.S. stocks beat international markets, as stocks fell in major European economies and Japan.[4] Emerging markets gained, overall, in part because Taiwan's and India's exposure to technology manufacturing helped their markets post strong advances.

Bond prices and yields were volatile. Yields rose and prices fell on intermediate- and long-term securities, while high-yield bonds outperformed investment-grade issues as credit spreads narrowed.[5]

Our investment discipline considers markets through the lens of valuation, growth, liquidity and positioning (sentiment). Halfway through 2024, our analysis leads us to the following perspective:

Valuation: Between average and expensive

In the United States, the S&P 500 is well above historically average valuations and back to levels seen only during the dot-com era of the late 1990s and the post-COVID period of 2021 and 2022.[6] S&P 500 valuations are elevated largely because of the influence of the "Magnificent Seven"—Alphabet, Amazon, Apple, Meta (Facebook), Microsoft, Nvidia and Tesla. These stocks grew earnings more than 50% during the first quarter of 2024, lending some credence to their premium valuations. U.S. small cap, international developed market and emerging market equities appear reasonably priced relative to history.

Growth: A slowing expansion

Year-over-year earnings growth for the second quarter is expected to come in at 8.8%, the highest in two years.[7] Consumer spending slowed a bit but remained solid,[8] and U.S. GDP continues to run above historical trends. These developments are consistent with our view that the U.S. economy remains in expansion mode, but that the expansion may be slowing. Globally, several major developed market central banks have begun lowering rates, while economists' expectations for world GDP growth increased slightly in the second quarter.[9]

Liquidity: Tight but potentially loosening

Cash and money market fund assets remain at multidecade highs, in part because of elevated interest rates. The Fed has slowed the pace of its balance sheet reductions, and real (after-inflation) rates remain restrictive. The probabilities suggest the Fed will begin lowering rates sometime in the second half of the year, but inflation staying stubbornly above the Fed's 2% target could get in the way of rate cuts.

Positioning: A narrow market

The U.S. equity market's recent advance has been exceptionally narrow. If not for the outsized gains of four mega-cap stocks—Nvidia, Apple, Microsoft and Alphabet—the S&P 500's return would have been negative in the second quarter. Given that divergences like these tend to resolve themselves over time, market returns might broaden in the months ahead.

We appreciate your continued trust and confidence in LVW Advisors.

1 Barron's. July 8, 2024
2 J.P. Morgan Asset Management Guide to the Markets. Data as of June 30, 2024.
3 Bespoke Investment Group. Data as of June 30, 2024.
4 Bespoke Investment Group. Data as of June 30, 2024.
5 WSJ.com. July 8, 2024.
6 J.P. Morgan Asset Management Guide to the Markets. Data as of June 30, 2024.
7 Factset. Earnings Insight June 21, 2024.
8 Bureau of Economic Analysis. June 28, 2024.
9 Reuters. July 8, 2024.

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