Q3 OUTLOOK:

THE TORTURED EQUITY INVESTORS DEPARTMENT

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Bill Gates may be rich, but Steve Ballmer is richer. Thanks to Microsoft's surging stock price and Ballmer's concentrated holdings, his net worth has surpassed that of Gates, making Ballmer the 6th richest person in the world. While Bill Gates diversified and donated, Ballmer kept his wealth in Microsoft stock. So far, Ballmer's risky bet has paid off.

This serves as a parallel to the average US equity holder who has seen significant gains in their portfolios due to the prolonged bull market. However, just as Ballmer's wealth is tightly linked to the fortunes of a single company, many investors face the risk of overexposure to an overvalued US equity market. With current stock valuations at historically high levels, it might be prudent for these investors to consider derisking their portfolios.

Diversifying assets and locking in some of their gains can help to safeguard against potential market corrections. Just as Ballmer's strategy worked under specific conditions, individual investors must recognize the importance of balance and risk management in their financial planning. Alternatives to a 60/40 portfolio exist.

With an election looming, we will look at what investors should be watching for during the rest of 2024. But first, a review of Q2 economic and market performance.

Markets*

	As of 6.30.2024	Q2 Return
S&P 500	5,460.48 pts	3.9%
NASDAQ	17,732.60 pts	8.3%
The Dow	39,118.86 pts	-1.7%
Global Equities		8.0%
Emerging Markets		3.7%
Energy		-3.5%
Gas	$3.90/gal	-1.8%
Gold	$2,326.75/oz	4.3%
VIX	12.44 pts	-4.4%
10-Yr Treasury	4.396%	19.6 bps

**See endnotes.*

Alternatives*

	Q2 Return
Direct Lending	3.7%
CLOs	3.4%
Private Equity	-7.4%
Hedge Funds	2.0%
Equity REITs	-2.3%
Residential REITs	6.8%
Industrial REITs	-11.3%
Wine & Cheese	-4.6%
Crypto Market	-16.6%
SPACs	-6.6%

**See endnotes.*

US Economic Performance – GDP Slowing, Inflation Steady, Unemployment Up

- US GDP growth is expected to slow to under 1% over the Q2 to Q3 2024 period, down from the 3.4% growth seen in Q4 2023.
- Are we there yet? US inflation decreased to 3.0% in June, down slightly from 3.3% in May 2024.
- The labor market began cooling in June. The economy added 206,000 jobs, pushing unemployment to 4.1%, up slightly from 4% a month ago.
- The Conference Board forecasts consumer spending growth will slow from 2% to 0.5% in Q2 and Q3 2024 as households adjust to changes in income, debt, savings, and spending patterns.
- The housing market continues to face challenges with existing home sales declining for the third straight month. Sales declined 2.4% in May to the lowest level since June 2020.

Monetary Policy – No Cuts Yet

- The Fed held rates at 5.25%-5.50% for another quarter as their fight against inflation continues, noting "quite a bit of progress" in bringing inflation down.
- Not too fast. Jermone Powell said the US is back on a “disinflationary path,” but the Fed needs more data before cutting rates. The 12-month rate of PCE, the Fed’s preferred inflation measure, has dropped to 2.6%, still above the central bank's 2% target.
- Rate cut bets have not paid off. The bond market sees a 73% chance of at least one rate cut by September and a 95% chance by December, according to the CME.
- Higher for longer. Several FOMC members have emphasized the importance of maintaining a restrictive policy stance to ensure inflation returns to the 2% target, and in June the Fed signaled one cut is expected in 2024.

Credit Market Performance

- The yield curve remains inverted. Investment grade is slightly down YTD, with no change in Q2. High yield is up 2.5% and leveraged loans are up 4.4%, both on a YTD basis.

- Private credit continued to shine in Q1 2024 (the most recent quarter for which data is available), with returns of 2%, outperforming private equity (1.3%) and private real assets (0.8%), according to MSCI index data.
- Overall US leveraged loan activity, including new issuance and repricing, hit a record level of $405 billion in Q2.
- Global private capital dry powder remained high. Data from MSCI shows investors sitting on nearly $2 trillion as they wait for opportunity, stability, and rate cuts.

US and Global Market Summary

- Megatech stocks pushed US equities to all-time highs as the S&P 500 gained 3.47%. Stocks are up 23.78% over the past 12 months. Equity returns remain concentrated in big tech.
- The AI trade showed no sign of slowing down. NVIDIA was up 36.74% in Q2, which contributed 1.6% to the market's return.
- Crypto winter in June? Bitcoin ended the quarter around $60,000, down 13.5% from its all-time highs of $73,000 at the end March.
- What election? The VIX, known as "Wall Street's fear gauge," remained relatively low, suggesting investor complacency, despite geopolitical tensions, upcoming elections, and domestic uncertainties.
- Since 1952, the S&P 500 has experienced an average gain of 7% during presidential election years, as reported in US News & World Report, with this figure rising to 12.2% in years when a president is seeking re-election.

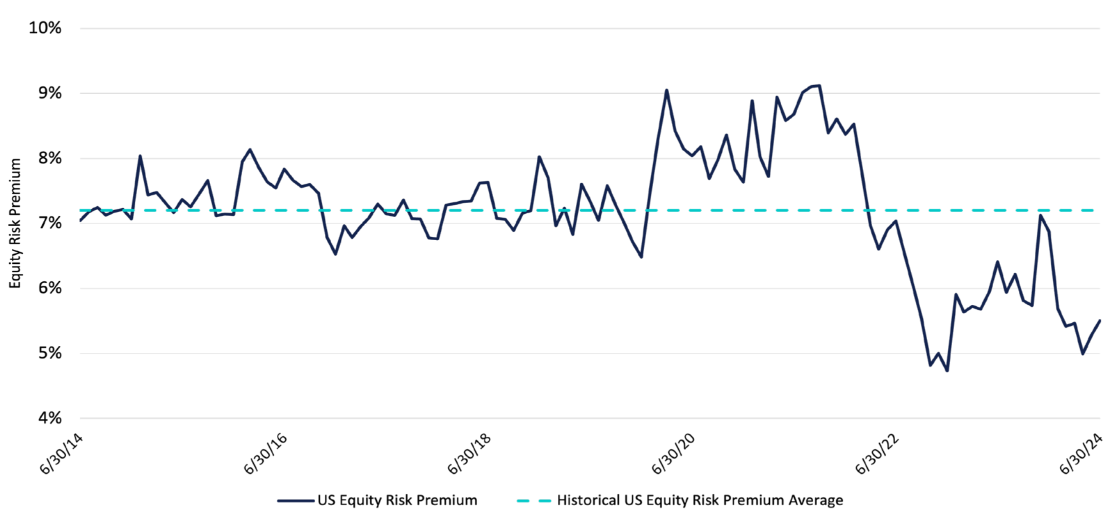
A strong first half of the year with some rocky roads ahead. All eyes are on the US election. Where should US stockholders look for diversification, inflation hedging and alpha? We first look at what makes the equity market look toppy and suggest options in international markets, alternative investments, and even cash.

US Equity Risk Premiums are Low

Equity risk premium (ERP) is the excess return that the stock market provides over a risk-free rate. This premium compensates investors for taking on the higher risk associated with equity investments compared to risk-free assets, such as government bonds.

Currently the ERP is near a ten-year low. In other words, equity investors are getting lower compensation for investing even as stock prices get higher.

US Equity Risk Premium (June 2014 - June 2024)

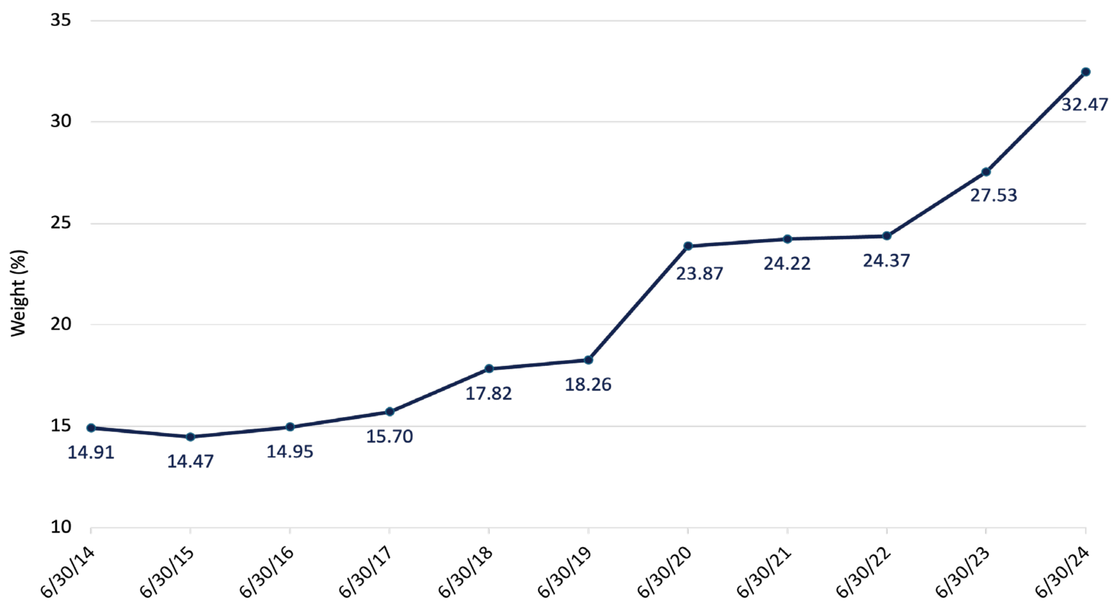


Source: Bloomberg

US Equity Gains Are Top Heavy

The S&P 500 is concentrated. Over the last ten years the concentration of the largest eight stocks has gone from 15% of the index to now over 30%. Index holders don't get full benefit from holding 500 separate stocks since the S&P is a market-cap weighted index dominated by big tech. As the largest stocks have surged in value, passive stock investing has become a more concentrated bet. Like Ballmer's holding of Microsoft, this bet has, so far, paid off. But what are investors' other options?

Weight of Top 8 Stocks in the S&P 500 (June 2014 - June 2024)



Source: Bloomberg

Option #1: Increase International Diversification

US investors are typically overweight US exposure in general. But now the US equity market has reached unprecedented heights relative to the rest of the world (ROW). US stocks now account for 70% of the overall world market capitalization vs 50% in 2014. This significant share highlights not only the strength of the US market but also raises concerns about relative overvaluation. Historically, such a disproportionate weighting suggests that investors might be ignoring more reasonably valued opportunities in other markets.

US Equities Market Cap as a % of World Equities Market Cap (June 2014 - June 2024)

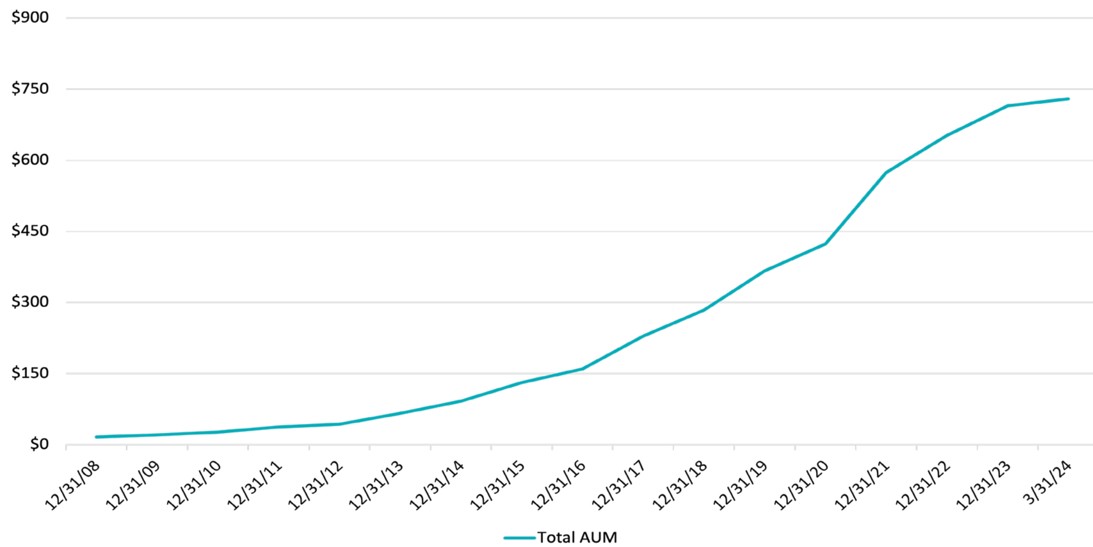
Source: Bloomberg

Option #2: Seek Out Alternative Investments

Investing in alternative investments can provide significant benefits for derisking US equity exposure. By diversifying into assets such as real estate, private markets, hedge funds, commodities, and infrastructure, investors can reduce their reliance on the stock market's performance, potentially lowering portfolio volatility.

Institutional investors are ahead of the curve here. According to Macquarie, they hold 23% in alternative investments vs 6% for advisors—meaning that retail investors have a long way to go to catch up. Large institutions are increasingly turning to private markets, in particular private credit and direct lending. The floating rate nature of private credit loans offers a hedge when rates rise, a consistent valuation premium when rates fall, and a steady stream of income.

Direct Lending Total AUM (2008 - 2024)



Source: Pitchbook

Option #3: Hold More Cash (For a Time)

Holding cash can be a smart short-term move when stocks are overvalued. Cash preserves capital and optionality, by providing liquidity for future opportunities. If election turmoil roils the market, cash can act as a buffer in volatile markets. We are on the cusp of rate cuts, it seems. Dry powder could give investors the opportunity to buy undervalued assets later. Rates are now high enough that sitting in cash isn't nearly as painful as it used to be. When in doubt, a large cash holding will reduce overall portfolio risk.

Shifting from a concentrated US equity holdings to either international stocks, alternative investments, or cash can be a prudent strategy in times of market decline or turmoil. Diversifying your portfolio across global markets and asset classes not only can reduce risk but also presents new opportunities for growth. Alternative investments have the ability to provide a unique return potential and may help reduce volatility, while holding cash ensures liquidity and flexibility. By considering these proactive steps, you can better safeguard your investments against volatility and position yourself for stability regardless of the market environment.

Endnotes

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“Crypto Market” represented by the Bloomberg Galaxy Crypto Index. “NASDAQ 100” represented by the NASDAQ 100 Index. “S&P 500” represented by the S&P 500 index. “Private Equity” represented by the Invesco Global Listed Private Equity ETF. “Direct Lending” represented by the DLX Direct Lending Index. “US Residential REITs” represented by the MSCI US Residential REIT Index. “CLOs” represented by the Palmer Square CLO Debt Index. “Leveraged Loans” represented by the S&P/LSTA Leveraged Loan Total Return Index. “High Yield Bonds” represented by the Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged. “Gold” represented by the SPDR Gold Shares. “Emerging Markets” represented by the iShares MSCI Emerging markets ETF. “Investment Grade Bonds” represented by the Bloomberg US Corporate Bond Index. “Hedge Funds” represented by the Bloomberg All Hedge Fund Index. “Equity REITs” represented by the MSCI World Equity REIT Index “Financials” represented by the Financial Select Sector SPDR Fund. “Telecom” represented by the iShares US Telecommunications ETF. “Utilities” represented by the Utilities Select Sector SPDR Fund. “Commodities” represented by the Invesco DB Commodity Index Tracking Fund. “Oil” represented by the United States Oil Fund LP. “VIX” represented by the Chicago Board Options Exchange’s CBOE Volatility Index. “Natural Gas” represented by the United States Natural Gas Fund LP.

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