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Redhawk Quarterly Commentary

June 30, 2024

Each quarter, Redhawk's Investment Committee provides a Quarterly Commentary. We look at what is transpiring in the investment landscape and provide our perspective on a variety of topics. These are not predictions, and it represents our perspective on important market and economic information designed to help make decisions affecting your long-term financial strategy. Our goal is to help you understand what is going on in the markets so you can more clearly define investment goals, diagnose unintended risks, and utilize portfolios that can achieve a better financial outcome.

Market Commentary

The strength of the U.S. stock market continued to surprise many investors in the second quarter. The S&P 500 gained 4.3% during the quarter, bringing first-half gains to 15.3%. Artificial intelligence pacesetter, NVIDIA, gained 149.6% during the first half of 2024, setting the tone for a market in which a small number of stocks drove the market higher.

The quarter finished with the S&P and NASDAQ both near all-time highs. The rally took place amidst a dramatic reduction in rate-cut expectations, as inflation remained above Fed targets and job growth stayed strong. Bond prices generally fell year-to-date, as rising Treasury issuance and the Fed staying "higher for longer" served as a recipe for higher interest rates.

The strong performance of the S&P 500 was again driven by a small number of mega-capitalization technology-oriented stocks. The information technology sector accounted for 95% of the Index's gain; NVIDIA led the charge, alone accounting for almost half of the S&P's return. The company is currently the clear leader in chip designs for Artificial Intelligence (AI) computing functions. The rise of this one stock is reflective of how AI has captured the imagination of society, the markets, and of course, the other companies placing orders for NVIDIA's chips, which companies that believe developing AI capabilities will facilitate their own profit growth in the years ahead.

NVIDIA's stock performance has been hyperbolic. Averaging returns of over 90% per year for the last four years, its weight in the S&P 500 has grown from 0.9% to 6.6%, and now constitutes a larger portion of the Index than five of the eleven economic sectors. Many economists are comparing this concentration to Cisco and other top tech companies from the early 2000s (see the high P/E ratio of the top ten stocks in the chart to the right). In fact, the chip designer briefly became the largest publicly traded company, surpassing Microsoft, in mid-June before the stock retraced its gains over the subsequent week. However, the contrast between the technology giants is striking. While NVIDIA has risen sharply and suddenly, Microsoft grew and evolved its business through multiple market, economic, and technology cycles to become the dominant company it is today. Whether NVIDIA can endure as a market leader remains to be seen, as competition in innovative AI chips will certainly heat up, potentially challenging the company's dominance, business fundamentals, and stock valuation[1].

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

Source: J.P. Morgan Asset Management.

S&P 500 Price Index

Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2024.

As for valuations, the S&P 500 traded at 21x earnings (see the chart to the left), which seems high on an absolute basis, but reasonable if estimates for earnings growth hold up. Valuation is heavily influenced by the top ten weightings which traded for 30x earnings and now make up 37% of the index. The other 490 companies traded for an average valuation of around 16x, close to the long-term average. Small and mid-cap stocks also traded near their long-term average valuations, on suppressed earnings[2].

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U.S. Market

The S&P 500 was up 15.3% as of end of June, whereas the NASDAQ has rallied nearly 20%. However, the equal weighted S&P 500 was up only 4.3%, highlighting the concentration of returns in a handful of large technology stocks. Fixed income has had a more difficult first half, with the Bloomberg US Aggregate Index down 0.71%, in spite of a rally since early April on reduced fears of inflation.

Through the first half of 2024, every sector gained except for real estate, with cyclicals such as financials and energy rising over 10% (see the chart below outlined in red). Technology continued to lead the way at 28.2% followed closely by the communication services sector at 26.7%, which was propelled by Meta and Google, and together represent more than 46% of the sector's weight. On the other hand, materials, industrials, energy, and financials sectors underperformed for the quarter.

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech.	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	**3.6%**	**2.2%**	**12.4%**	**8.1%**	**10.0%**	**32.4%**	**9.3%**	**2.2%**	**11.7%**	**5.8%**	**2.3%**	**100.0%**	Weight
Russell Growth weight	0.5%	0.6%	5.7%	5.1%	14.1%	46.8%	12.7%	0.7%	10.1%	3.8%	0.1%	100.0%	
Russell Value weight	8.0%	4.7%	22.9%	14.3%	4.7%	9.5%	4.5%	4.6%	13.9%	7.9%	5.0%	100.0%	
Russell 2000 weight	7.5%	4.5%	16.0%	17.2%	10.4%	15.3%	2.2%	5.6%	15.2%	3.5%	2.6%	100.0%	
QTD	-2.4	-4.5	-2.0	-2.9	0.6	13.8	9.4	-0.8	-1.0	1.4	4.7	4.3	Return (%)
YTD	10.9	4.0	10.2	7.8	5.7	28.2	26.7	-1.9	7.8	9.0	9.4	15.3	
Since market peak (February 2020)	104.3	60.3	45.1	56.8	47.7	151.0	67.4	9.1	51.2	39.4	12.5	72.9	
Since market low (March 2020)	363.4	150.8	154.2	168.8	116.3	264.6	134.4	75.2	109.7	83.6	74.7	161.2	
Beta to S&P 500	1.2	1.1	1.1	1.1	1.2	1.2	1.0*	0.9	0.7	0.6	0.5	1.0	β
Correl. to Treas. yields	-0.1	-0.6	-0.5	-0.5	-0.6	-0.7	-0.8	-0.8	-0.6	-0.6	-0.6	-0.7	ρ
Foreign % of sales	39.0	51.9	28.1	33.2	33.2	57.4	48.1	16.9	34.4	39.8	1.3	41.4	%
NTM earnings growth	2.5%	7.0%	11.4%	10.9%	14.1%	19.4%	17.8%	2.8%	13.5%	6.4%	9.5%	12.8%	EPS
20-yr avg.	**100.2%**	**13.2%**	**20.6%**	**13.8%**	**16.8%**	**12.1%**	**11.3%***	**6.9%**	**7.9%**	**7.5%**	**4.7%**	**10.9%**	
Forward P/E ratio	12.0x	19.5x	15.1x	20.5x	24.5x	30.4x	19.4x	16.5x	19.0x	20.0x	16.4x	21.0x	P/E
20-yr avg.	**13.5x**	**15.0x**	**12.5x**	**16.3x**	**19.7x**	**18.0x**	**18.7x***	**17.1x**	**15.0x**	**17.5x**	**15.7x**	**15.7x**	
Buyback yield	3.8%	1.1%	2.0%	1.8%	1.5%	1.4%	3.2%	-1.7%	1.0%	0.8%	-0.2%	1.7%	Bbk
20-yr avg.	**1.8%**	**1.0%**	**0.5%**	**2.3%**	**2.5%**	**3.0%**	**1.8%**	**-1.4%**	**1.9%**	**1.8%**	**-0.7%**	**1.8%**	
Dividend yield	3.3%	1.9%	1.8%	1.6%	0.8%	0.7%	0.9%	3.9%	1.7%	2.8%	3.4%	1.4%	Div
20-yr avg.	**2.8%**	**2.4%**	**2.3%**	**2.2%**	**1.4%**	**1.2%**	**1.1%***	**3.8%**	**1.9%**	**2.9%**	**3.8%**	**2.1%**	

Source: FactSet, Refinitiv Datastream, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management. All calculations are cumulative total return, not annualized, including dividends for the stated period. Since market peak represents period from 2/19/2020 to 6/30/2024. Since market low represents period from 3/23/2020 to 6/30/2024. Correlation to Treasury yields are trailing 2-year monthly correlations between S&P 500 sector price returns and 10-year Treasury yield movements. Next 12 months (NTM) earnings growth is the percent change in next 12-months earnings estimates compared to last 12-months earnings provided by brokers. Forward P/E ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates and J.P. Morgan Asset Management. Buyback yield is net of share issuance and is calculated as last 12-months net buybacks divided by market cap. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Beta calculations are based on 10-years of monthly price returns for the S&P 500 and its sub-indices. *Communication Services (formerly Telecom) averages and beta are based on 5-years of backtested data by JPMAM. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2024.

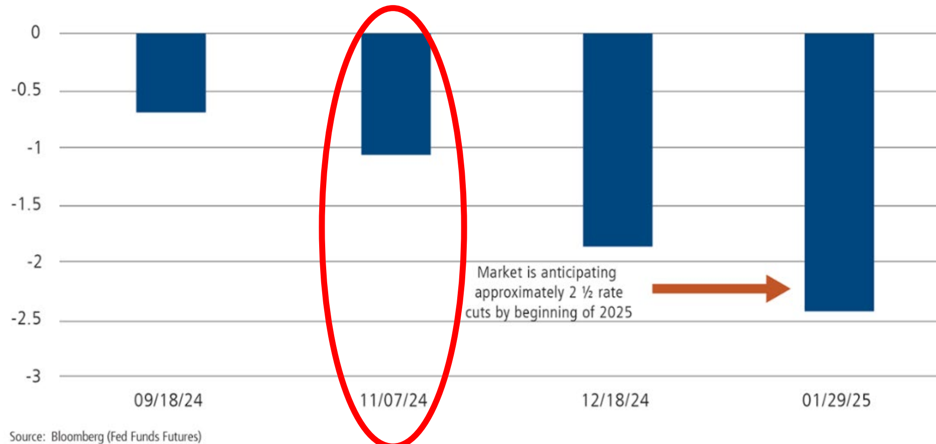
The top performing index for the quarter was the NASDAQ at 8.47%. The S&P 500 was up 4.28%, bringing its return to 15.29% for the year. The Russell 3000 was up 3.22% for the quarter. The Dow Jones Industrial Average fell 1.27% for the quarter and was up 4.79% for the year. The Mid Cap S&P 400 lost 3.45% for the quarter, bringing its return to 6.15%for the year. The Small Cap Russell 2000 was down 3.28% in the second quarter and up 1.73% for the year (see the chart to the right)[3].

Broad Market	Q2 2024	2024
S&P 500	4.28%	15.29%
Russell 3000	3.22%	13.56%
Dow Jones Industrial Average	-1.27%	4.79%
Nasdaq	8.47%	18.57%
Size	**Q2 2024**	**2024**
Mid Cap (S&P 400)	-3.45%	6.15%
Small Cap (Russell 2000)	-3.28%	1.73%

Source: S&P Dow Jones.

Market expectations for potential rate cuts by the Federal Reserve have been on a roller-coaster ride throughout the year, fluctuating from six expected cuts coming into the year to as low as one cut at one point in the spring. The Fed's expectation had been for three rate cuts this year. This outlook changed in June, when the median expectation in the Fed's dot plot was updated to just one cut anticipated the year. For 2025, the Fed now sees four rate cuts, more than the three previously expected. However, Chair Powell was quick to note that markets should not hold forecasts with high confidence.

While inflation remained above the Fed's 2% target, fears of a second wave of inflationary pressures have failed to materialize. Many economists believed that the Fed would like to get a rate cut in before the U.S. election in November (see the red circle in the chart below)[4].

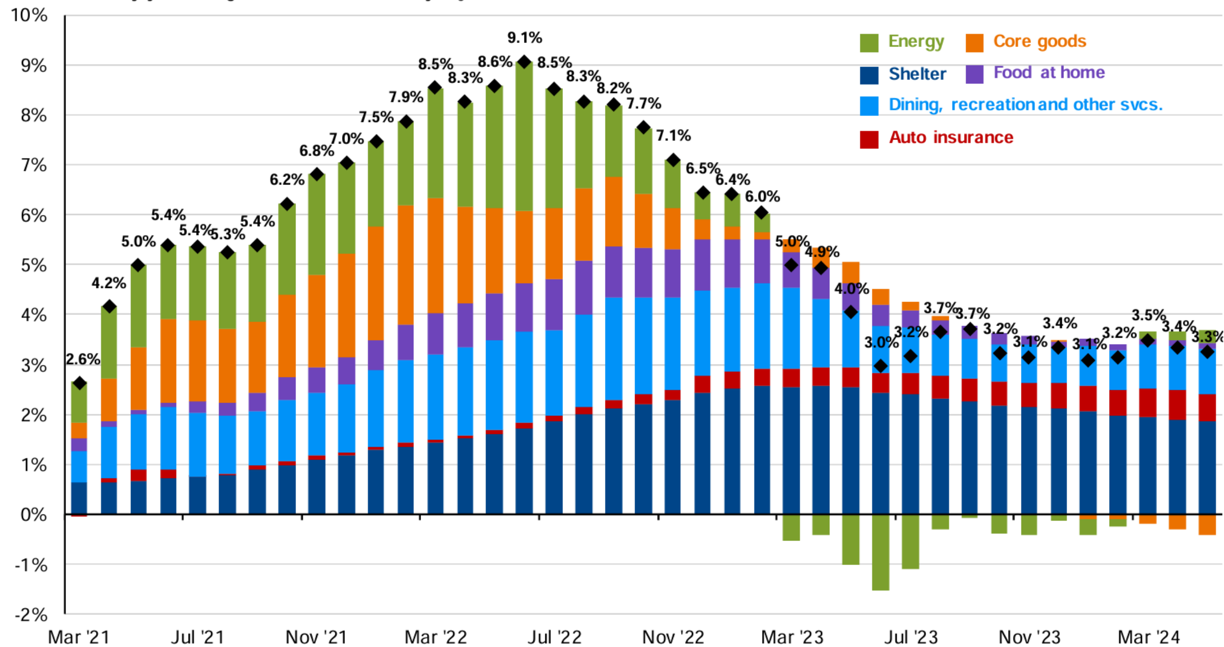


Inflation remained above the Fed's 2% target, but, unlike recent economic growth, its drivers are not so widespread. Shelter and auto insurance, which together account for just under 40% of the Consumer Price Index (CPI) basket, contributed almost 80% of the latest 3.3% year-over-year inflation print (see the chart below). Importantly, however, these two inflationary forces have become the "sticky" components of inflation while other factors such as energy and core goods have subsided over the past year. Shelter-related inflation readings, which alone count for over a third of the headline CPI, are notoriously lagging rather than reflective of current moves in housing prices, so their elevated levels are indicative of the rental statistics catching up with the reality of the real estate market.

Meanwhile, auto insurance rates, which account for less than 3% of consumers' spending basket, have risen by 20% over the past year and have contributed 0.6 percentage points to the CPI. The surging rates are being driven by several unique factors, including a higher incidence of collisions and more expensive car repairs (primarily because of the advanced technology in vehicles). With the recent elevated inflation numbers largely accounted for by these unique factors, sustained elevated levels of broad inflation may be less of a risk to the economy than it has been in recent years[1].

Contributors to headline CPI inflation

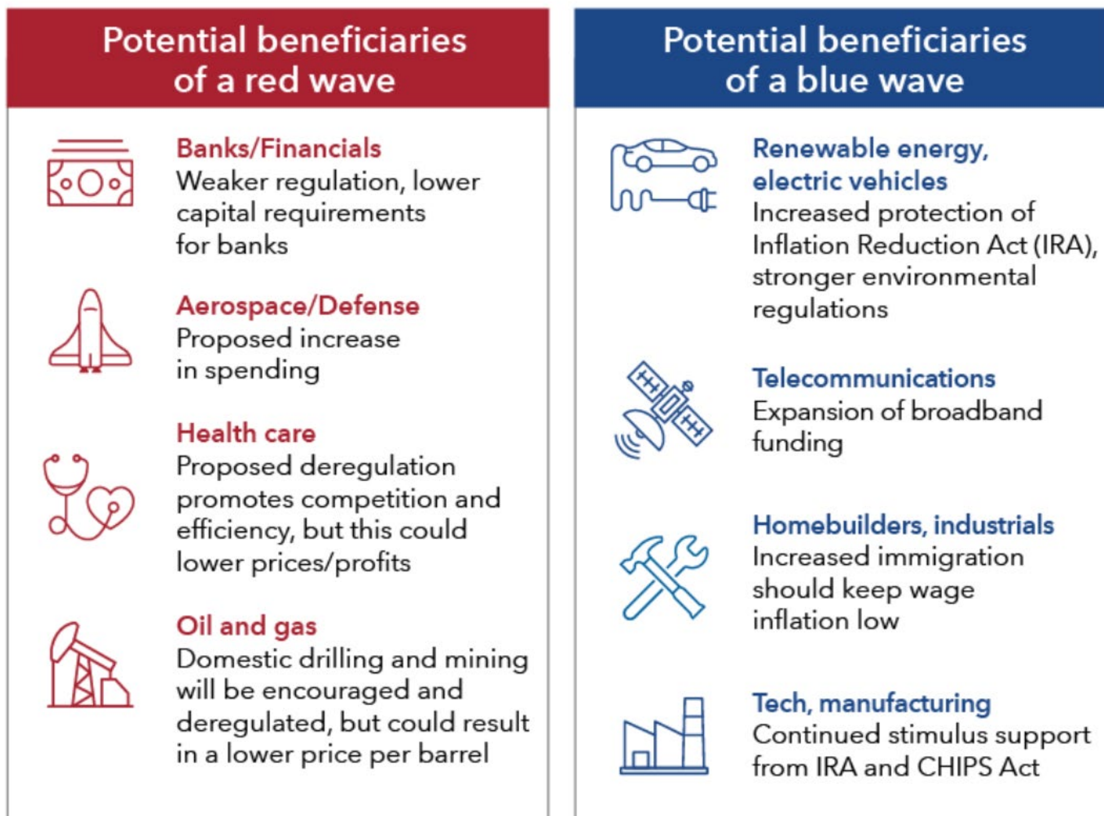
Contribution to y/y % change in CPI, non-seasonally adjusted



Source: BLS, FactSet, J.P. Morgan Asset Management. Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owners' equivalent rent, rent of primary residence and home insurance.
Guide to the Markets – U.S. Data are as of June 30, 2024.

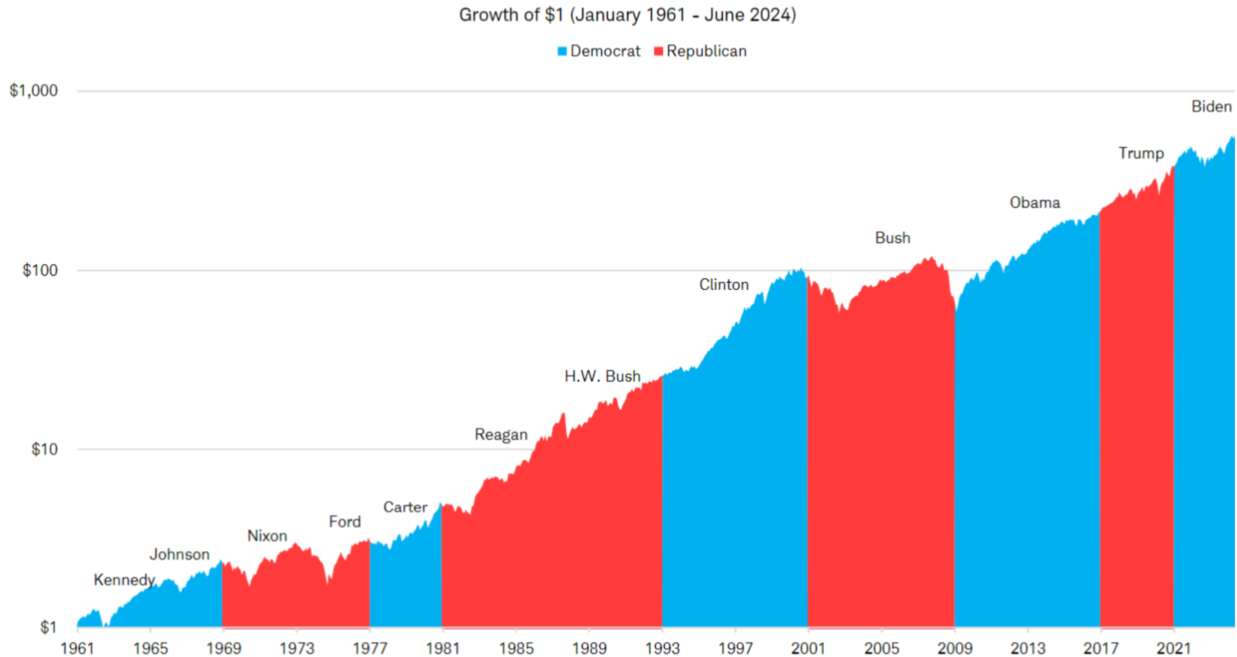
The U.S. presidential election result could produce a significant shift in political leadership, potentially triggering policy changes that could affect the investment environment, both in the U.S. and globally. A great deal depends on whether the winning presidential candidate will muster enough support to propel other candidates in their party to victory, taking control of the U.S. Senate and the House of Representatives in a red wave or blue wave scenario. Otherwise, gridlock could prevail, with little change expected. However it plays out, investors should expect occasional bouts of market volatility in the months leading up to Election Day.

A Republican sweep, or red wave, could benefit banks, health care companies, and oil and gas companies, primarily through deregulation. A Democratic sweep, or blue wave, could provide a boost to renewable energy initiatives, industrial stimulus spending, and telecommunications projects through additional funding for nationwide broadband access (see the chart below)[5].



Source: Capital Group. CHIPS Act refers to the Creating Helpful Incentives to Produce Semiconductors Act, passed by U.S. lawmakers in 2022 to encourage domestic manufacturing of computer chips.

Elections are stressful and can create uncertainty and a lot of noise. Historically, markets have rewarded long-term investors regardless of the presidential party (see the chart below).



Source: Schwab Center for Financial Research, with data provided by Morningstar, Inc. The chart above shows the growth of $1 invested in a hypothetical portfolio that tracks the Ibbotson U.S. Large Stock Index starting on January 1, 1961. January returns in inauguration years are assumed to be under the party that is being inaugurated. Returns include investment of dividends and interest. For illustrative purposes only. The policy analysis provided by the Charles Schwab & Co., Inc. does not constitute and should not be interpreted as an endorsement of any political party. Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly. Investing involves risk, including loss of principal. **Past performance is no guarantee of future results.**

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Fixed Income Markets

During the quarter, yields increased across most of the Treasury yield curve after rising in April and then pulling back in May and June as several inflation indicators began to moderate. For the year, the 2-Year Treasury increased by 0.47% and the 10-Year rose by 0.48% (see the chart to the right). The increase in yields created a headwind for the fixed income markets as bond prices move inversely to interest rates and credit spreads. Consequently the 2-Year Treasury was up 1.10% and the 10-Year Treasury was down by 2.03% for the year.

	Yield		Return			
U.S. Treasuries	6/30/2024	12/31/2023	2024 YTD	Avg. Maturity	Correlation to 10-year	Correlation to S&P 500
2-Year	4.71%	4.23%	1.10%	2 years	0.76	0.00
5-Year	4.33%	3.84%	-0.42%	5	0.94	-0.03
TIPS	2.08%	1.72%	0.70%	7.1	0.72	0.33
10-Year	4.36%	3.88%	-2.03%	10	1.00	-0.08
30-Year	4.51%	4.03%	-6.20%	30	0.93	-0.12
Sector						
U.S. Aggregate	5.00%	4.53%	-0.71%	8.4	0.89	0.25
IG Corps	5.48%	5.06%	-0.49%	10.7	0.67	0.48
Convertibles	7.01%	7.26%	1.87%	-	-0.06	0.86
U.S. HY	7.91%	7.59%	2.58%	4.9	0.06	0.78
Municipals	3.72%	3.22%	-0.40%	13.4	0.71	0.26
MBS	5.22%	4.68%	-0.98%	7.7	0.80	0.26
ABS	5.78%	5.65%	3.09%	3.6	0.36	0.24
Leveraged Loans	10.16%	10.59%	4.62%	4.6	-0.22	0.62

Source: J.P. Morgan Asset Management.

Short-term bonds have closer maturities and are consequently less interest rate sensitive than intermediate or long-term fixed income securities. Short-term Treasury yields, including, the 3-Month (5.4%), 6-Month (5.3%), and 12-Month (5.1%) are still at their highest levels since the early 2000s. Once the Fed starts cutting the federal funds rate, short-term Treasury yields should also decline[6].

Despite the quarter, yields were extremely volatile, bonds posted relatively flat returns. High yield bonds gained 1.1%, increasing its first half 2024 return to 2.6%. Aggressive fixed income asset classes, bank loans at 4.4% and preferred stock at 4.9%, had the best gains for the year.

International Markets

Strength in some Asian markets helped emerging market equities outperform developed markets in Q2. Stocks related to the artificial intelligence (AI) theme continued to perform strongly. The European Central Bank (ECB) cut interest rates, but sticky inflation kept other major central banks on hold.

Eurozone shares moved lower in Q2 and finished the quarter at 6.2% (see the red circle in the chart below). Equities fell amid uncertainty caused by the announcement of parliamentary elections in France and dwindling expectations for steep interest rate cuts. The information technology sector gained with semiconductor-related stocks performing particularly well. The consumer discretionary sector saw declines amid weakness in automotive and luxury goods stocks. The ECB cut interest rates by 0.25% in early June. However, the scope for further cuts may be limited by sticky inflation.

UK equities rose and the FTSE 100 achieved fresh all-time highs. Performance of small and mid-sized companies was also helped by a flurry of new bids. This segment was further supported by expectations of a possible turning point for UK focused companies following a decade of underperformance. On a much shorter time horizon, small and mid-sized companies gave back some of their gains towards the end of the quarter as markets pushed back against hopes for imminent interest rate cuts. Having suffered a mild recession over the second half of 2023, it was confirmed the UK economy rebounded strongly in the first quarter of 2024, recording GDP growth of 0.7%[7].

Returns	YTD 2024		2023		15-years	
	Local	USD	Local	USD	Ann.	Beta
Regions						
U.S. (S&P 500)	-	15.3	-	26.3	14.8	1.0
AC World ex-U.S.	11.0	6.0	14.7	16.2	6.7	1.0
EAFE	11.5	5.7	16.8	18.9	7.3	1.0
Europe ex-UK	10.3	6.2	17.3	22.7	8.1	1.2
Emerging markets	11.2	7.7	10.3	10.3	5.3	1.0
Selected Countries						
Japan	21.5	6.5	29.0	20.8	6.4	0.7
United Kingdom	7.8	6.9	7.7	14.1	6.5	1.0
France	1.6	-1.4	18.1	22.3	7.8	1.2
Canada	6.0	2.2	13.3	16.4	6.8	1.1
Germany	9.6	6.3	19.8	24.0	7.0	1.3
China	5.2	4.8	-10.6	-11.0	2.8	0.9
Taiwan	37.0	29.6	31.1	31.3	13.8	1.0
India	17.4	17.1	22.0	21.3	9.0	0.9
Brazil	-6.9	-18.6	22.7	33.4	0.9	1.3

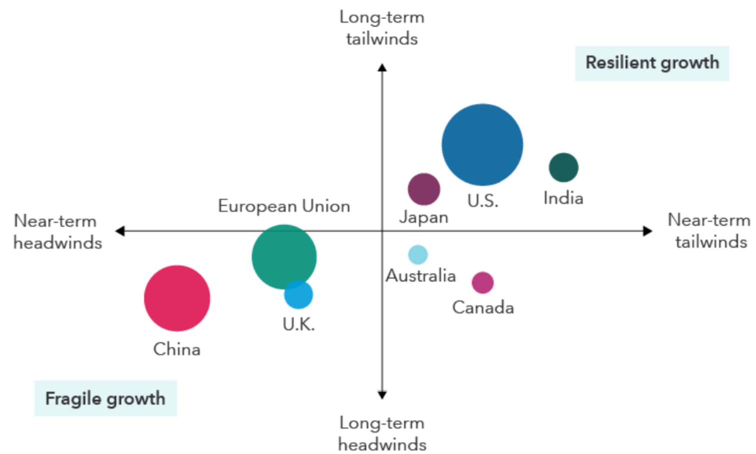
Source: J.P. Morgan Asset Management.

The Japanese equity market generated a positive return of 6.5% for the year (see the blue circle in the chart above). However, due to the continued depreciation of the Japanese yen, the foreign currency-based return turned negative. The yen weakness was primarily driven by the strength of the U.S. dollar, which was supported by a stronger U.S. economy and the expectation of a "higher for longer" interest rate scenario[7].

Asia ex Japan equities achieved solid gains in the second quarter. Taiwan at 29.6% and India at 17.1% (see the green circles in the chart above) were the best-performing markets in the MSCI AC Asia ex Japan Index at the end of Q2, while Indonesia, the Philippines, and Thailand were the worst-performing markets. Shares in China also achieved strong gains in the quarter.

Emerging market (EM) equities finished ahead of developed peers in Q2. Softer U.S. macroeconomic data helped ease concerns about the timing of U.S. interest rate cuts and a rebound in China also supported EM returns. Turkey was the best performer over Q2 helped by optimism that economic policy will remain orthodox.

The U.S. as the world's largest economy, once again served the critical role of the global growth engine during the first half of 2024. As Europe and China struggle with weak economic activity, the U.S., India and, to a lesser extent, Japan showed signs of resilience as the major players in the world economy diverged (see the chart to the right)[5].



Source: Capital Group. Country positions are forward-looking estimates by Capital Group economists as of April 2024 and include a mix of quantitative and qualitative characteristics. Long-term tailwinds and headwinds are based on structural factors such as debt, demographics and innovation. Near-term tailwinds and headwinds are based on cyclical factors such as labor, housing, spending, investment and financial stability. The size of the bubbles are used to approximate the relative size of each economy (in USD) and are for illustrative purposes only.

Despite higher interest rates and elevated inflation, the International Monetary Fund (IMF) is predicting the U.S. economy will expand this year at more than twice the rate of other major developed countries. The IMF recently raised its forecast for U.S. growth to 2.7%, compared to 0.8% for Europe. Moreover, the power of America's consumer-driven economy is helping to support growth in the rest of the world as well[5].

Economic Outlook

The U.S. economy in 2024 has shown signs of resilience and growth, driven by a strong labor market, increasing consumer spending, and rising GDP estimates. However, concerns about sticky inflation, the potential impact of the upcoming election, and shifts in consumer credit behavior suggest that challenges lie ahead.

The labor market remains robust, with steady job growth and low unemployment rates, although some indicators, such as declining temporary workers and a softening in job openings, point to potential weaknesses. Inflation has proven to be more persistent than anticipated, with recent upticks in consumer and producer prices raising concerns about the Fed's ability to reach its 2% target.

Shifting inflation expectations, as evidenced by rising breakeven rates, suggest that the Fed may need to hold rates steady for longer than initially expected. While GDP growth estimates have improved and the odds of a recession have decreased, consumer confidence has dipped slightly, and concerns about the political and economic impact of the upcoming election are growing.

As consumers increasingly turn to credit cards to support their spending, the sustainability of this behavior remains uncertain. The overall health of the U.S. economy in the coming months will largely depend on the resilience of the labor market, the persistence of inflation, and the ability of consumers to maintain their spending power in the face of potential headwinds.

For the most part, companies have surpassed earnings and revenue expectations, and there is a renewed focus on growth through capital expenditure and investor returns via buybacks. However, concerns about potentially inflated stock valuations, particularly among the "Magnificent 7" tech companies, have been raised. Investors should balance optimism with the potential risks posed by elevated valuations and the importance of earnings growth in maintaining market momentum.

The bond market in Q1 2024 has been influenced by the Fed's monetary policy, economic indicators, geopolitical events, and inflation concerns. The anticipation of upcoming rate cuts has created a more favorable environment for fixed income investments. Investors may find attractive returns in Treasury notes and bonds, as well as quality corporate bonds. However, the persistence of inflation and geopolitical factors may impact the timing and magnitude of future rate cuts.

To conclude, the current economic environment appears favorable for both stocks and bonds. The prospect of continued earnings growth suggests that stocks may continue to trend higher

throughout the year. Meanwhile, bond yields have reached levels that provide attractive returns for investors seeking stability and income, marking a significant shift from the past few decades. However, it is crucial to keep the fundamental principles of investing in mind. Geopolitical risks remain a significant factor, and election years have the potential to introduce volatility and uncertainty into the markets. Moreover, while the outlook for stocks is bright, valuations are particularly expensive.

We continue to focus on managing both risks and return potential. We understand the risks facing both the markets and the economy and are committed to helping you effectively navigate this challenging investment environment.

Acknowledgements

1. Boston Trust Walden, "Q2 2024 Investment Commentary," https://www.bostontrustwalden.com/insights/2q-2024-investment-commentary/
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7. Schroder Investment Management, "Quarterly Market Review – Q2 2024," https://www.schroders.com/en-gb/uk/individual/insights/quarterly-markets-review---q2-2024/

It is not enough to own a portfolio personalized for your situation, based on your comfort with risk and long-term financial goals. You must be patient and disciplined, too. With Risk-Guard™, our risk management process, our investment committee is reviewing the market conditions and underlying investments on a weekly basis. Please contact your Redhawk financial advisor to learn more.

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