ICR® 2nd Quarter Newsletter – July 2024

After a modest sell-off in April, markets rallied in May and June to finish the quarter up almost 4%, as measured by the S&P 500. Yet again, technology stocks led the way with a 13.8% gain while six of the eleven sectors posted negative returns. Energy, materials, financials, industrials, real estate, and health care were all drags on the market in the second quarter. Given those sector returns, it should come as no surprise that large cap growth stocks far outpaced small cap and value stocks. The Russell 2000 Value Index actually lost 4.2% in the second quarter, underscoring the recent bifurcation within the market.

Foreign stocks also lagged the U.S. market with the MSCI EAFE index for developed foreign stocks losing 1.5%. The emerging markets index, however, managed a 5.1% gain in the quarter, largely led by strong performance in Indian stocks and a high allocation to Taiwan Semiconductor which has benefited from its ties to AI.

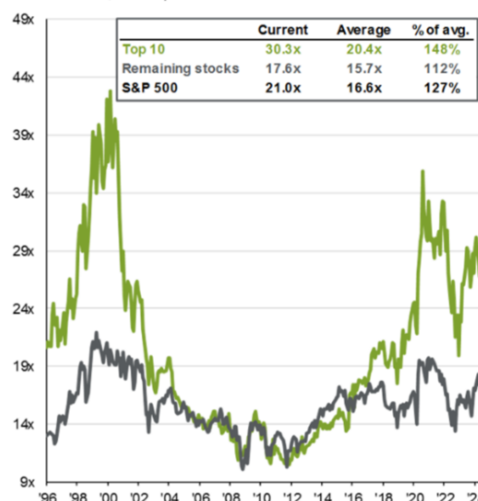
Interest rates crept up slightly with the ten-year Treasury yield ending the quarter at 4.40%, up from 4.20% at the end of March. The latest inflation numbers from June showed the first monthly drop in headline CPI in 23 months, and the annual rate of 3.0% is finally getting close to the Federal Reserve's long-term goal of 2%. That report significantly increased the odds of a rate cut at the Fed's September meeting from around 70% to now over 90%, according to the CME Group's FedWatch Tool. (CME Group provides the world's leading derivatives marketplace. It includes the Chicago Mercantile Exchange - CME.)

Indeed, the conversation is turning to whether the Fed is waiting too long to lower rates and putting the relatively strong economy at risk. While the unemployment rate is still historically low, it has begun to creep higher, recently rising above 4% for the first time since January 2022. A 4.1% unemployment rate is nothing to be concerned about, but the Fed needs to be careful not to let that figure start to rise quickly.

In the stock market, we're once again seeing a handful of large (mostly tech) stocks drive the market higher while the rest of the market has been only slightly positive this year. This environment has drawn comparisons to the Dotcom Bubble – and its ensuing meltdown – of the late 1990s and early 2000s when we saw a similar increase in stock concentration in the S&P 500. The chart to the right shows that we've reached an even more extreme level of concentration now, with the top ten stock making up 37% of the index.

This may be a bit different than the Dotcom Bubble, though. Whereas the leaders during that time where not terribly profitable, the current leaders are actually seeing their earnings surge, as seen in the chart to the left. It seems clear that the current leaders are in a stronger financial position than their counterparts of the Dotcom Era. But, how long they can sustain those strong earnings is what will determine whether this outperformance can continue.

There's also the very real possibility that these strong companies will continue to be profitable but have simply been bid up too much. NVIDIA, the poster child for the artificial intelligence investing craze, has seen its stock price soar in recent years. It's hard not to draw comparisons between NVIDIA now and Cisco in the late 1990s, which was viewed as being at the center of the internet revolution. At one point, Cisco became the most valuable company in the world, but then the bubble popped and its stock price still hasn't fully recovered, over 20 years later. And it wasn't that Cisco - the company - did anything wrong. Their revenue remained steady throughout the bursting of the bubble. It was just that the desire of investors to pile into anything internet-related began to fade and the sky-high valuations of those companies lost their appeal. Will the same thing happen to AI-related stocks like NVIDIA? It's obviously impossible to know for sure, but there is historical context for a strong company like NVIDIA continuing to be profitable while its stock price comes back down to earth.



One question we've been asked a few times recently is whether we're currently in a bubble. As we've said before, valuations matter, but not that much in the short run. Once we start looking out five or ten years, valuations tend to be a pretty good guide for future stock performance. And that is concerning for the longer-run prospects of the companies that are dominating the S&P 500. The P/E ratio of the top ten stocks in the index isn't quite as high as it was during the Dotcom Bubble, but still within shouting distance of what might be considered bubble territory. The rest of the index, however, is actually reasonably valued by historical standards. Of course, if the prices of those top ten stocks revert to more "normal" levels, anyone invested in market-cap-weighted indices is going to feel like a bubble is popping, since those ten make up 37% of the index.

We probably sound like a broken record, but this once again leads us back to our commitment to diversification and non-concentrated portfolios as the most effective ways to mitigate risk – in the absence of a crystal ball. Let us know if you have any questions, thoughts, or concerns, and thank you for partnering with us on your financial journey.

Sincerely,

James A. Heine　　　　James L. Cobb

Market Report (as of 6/30/24)

Index	2024 (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	14.5	8.3	13.2
Dow Jones Industrial Average	3.8	4.3	8.0
U.S. Aggregate Bond Index	-0.7	-3.0	-0.2
MSCI EAFE (Foreign Index)	3.5	0.1	3.8

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