# Making Sense of Finance

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## Second Quarter 2024 Review

### STOCK MARKET

The U.S. stock market continued its upward trend in the second quarter with the S&P 500 increasing 4%. The market suffered a major pullback in April before rallying in May and June. The tech laden Nasdaq Composite index gained over 8% as the focus reverted to large cap growth stocks and Artificial Intelligence (AI) themed stocks continued to gain popularity. After the stock market rally appeared to be broadening earlier in the year, the last quarter's rise for the most part was driven by a few mega cap stocks as corroborated by an actual decline in the Dow Jones Industrial index of close to 2% last quarter. In addition, the average stock in the S&P 500 declined 3% in the second quarter as measured by the equal weighted S&P 500 index, in contrast to the 4% gain in the market cap weighted S&P 500 index. According to Dow Jones Market Data, the average stock in the S&P 500 lagged the broader index by over 10% year to date so far this year; the largest underperformance since at least 1990. The mid-cap and small cap stock indexes also lost 3% last quarter. In the aggregate, corporate earning projections continue to rise along with the market as valuations such as the forward price/earnings multiple have changed little from the end of the March quarter.

As mentioned previously, the technology stock sector led the way in the second quarter, the only sector with a double-digit percentage gain. The correlation of the technology sector and the broader market is statistically very high, 0.92, when measured on a monthly basis over the past ten years. Other standouts in the last quarter were the communications sector, continuing outperformance from earlier in the year, and surprisingly the utility sector, after flat returns in the first quarter. Some investors are thinking of utility companies as an adjacent way to participate in AI demand, since AI requires a lot of

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Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

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computing power (hence increased electricity demand). Sectors that underperformed in a noticeable way were basic materials, industrials, and energy. The latter group responding to the price of oil; although its price was volatile, finished the quarter at basically the same price it had started.

Foreign stock markets again fell behind in performance relative to their US counterpart. The MSCI EAFE index of developed country stock markets in US dollar terms had a negative return of -1% in the second quarter. This was due in part to the ongoing strength of the US dollar as well as the foreign markets not having the same concentration of mega-tech stocks as present in the US markets. The UK market however fared well when measured in British pounds as their primary index the FTSE 100 reached an all-time high. Most large, developed country economies globally have not kept up with the growth in our domestic economy. Already the European Central Bank, the Swiss National Bank and the Bank of Canada have initiated rate cuts of 25 basis points. Emerging market country stocks in contrast fared better. The MSCI Emerging Market Index rose over 4% last quarter both in US dollar terms and when measured in the local currency. Chinese stocks rallied after a poor first quarter performance. Indian stocks also had a strong quarter attracting many foreign investors.

**BOND MARKET**

After some interest rate volatility in the second quarter, bonds in general had basically flat returns as measured by the Bloomberg Barclays US Aggregate Bond Index. Longer term corporate and Treasury bonds had negative returns as well as global bonds. With high yield bond spreads near record lows, taking risk in fixed income paid off as this bond sector had the best returns last quarter. Short-term corporates and Treasuries also had positive returns. The Federal Reserve continued to hold the Fed Fund target rate steady with a wait and see approach as investors envision a possible cut in September, although it has been difficult to time when the Fed will lower the interest rate. The yield curve is still inverted with short term bonds having a higher yield than longer term bonds.

**OUTLOOK**

While traditional “Blue Chip” stocks, like those in the Dow Jones Industrials Index have lagged tech; historically, this is a good sign that investors may rotate into more traditional sectors soon. In addition, even with interest rates holding steady, despite earlier expectations of a Federal Reserve interest rate cut, we think this looks like a win-win situation. The stock market has continued to advance despite no cut in rates and corporate profits continue to improve, overall. If the economy continues to improve on its own, the stock market should follow suit. Given the pressures on the Fed to lower rates, we think a nominal rate cut will likely happen in the second half of 2024.

Investing in Utilities, as a theme seem to have merit with many positive attributes. Historically, utilities have about half the volatility of the broader markets. Larger-than-average dividend yields add to this stability. Because power plants are often financed with debt, lower interest rates in the future could be advantageous, as well. And finally, with more technology consuming more and more electricity, there is an added growth component.

The outlook for bonds looks promising too. With the increased odds of a rate cut, bond prices have some upside potential. Short-term bonds (under 5 years duration) are yielding over 4%, which is not a bad return compared to the past decade of about half that amount.

The political environment could cause some additional volatility in the market. Given President Biden’s withdrawal as the Democratic nominee, we are assured of a change in leadership in 2025. Investors should not panic, regardless of which political party wins as historically, it’s a virtual tie in stock market performance.

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