One Federal Street, 25th Floor
Boston, MA 02110
(617) 557-7407
www.minotdeblois.com

First Half Review and Investment Outlook

July 2024

We have believed for some time that the odds favored a soft economic landing, which appears to have occurred at least in the United States, where strong aggregate consumer finances, low unemployment, and high labor demand remain supportive of growth, at least in the intermediate term.

Major Asset Class Indices[1]	Total Return First Half 2024	Total Return Last 12 Months
S&P 500 (U.S. Large Cap Stocks)	+15.3%	+24.6%
MSCI EAFE (Foreign Developed Large Cap Stocks)	+5.3%	+11.5%
Bloomberg Aggregate Bond Index (U.S. Investment Grade Bonds)	- 0.7%	+2.6%
US Short-Term Treasury Bills (Money Market Fund)	+2.6%	+5.3%

The first half of 2024 saw positive returns across most asset classes, as shown in the table above, with momentum especially strong for risk assets. Technology, communications and other growth stocks continued their market leadership and, as we write, just six stocks – Microsoft, Apple, NVIDIA, Amazon.com, Meta Platforms (Facebook), and Alphabet (Google) – comprise approximately 30% of the entire S&P 500 index.[2]

Our investment approach considers the goals of individual clients and aims to achieve strong absolute returns while mitigating risk. Where applicable, we implement this strategy via the purchase of individual stocks we believe are reasonably valued relative to their potential growth and financial strength. We believe that our individual stock portfolio construction results in quality-biased, defensive and diversified portfolios designed to ameliorate risk and participate in strong markets while protecting capital in bear periods.

In accounts where it is appropriate to purchase individual stocks, the vast majority of client portfolios hold all six of the securities listed above. Although these may be among an account's largest holdings, for reasons of diversification and risk control their combined value rarely rises to the same concentration these stocks currently command in the S&P 500. As noted in a June 2024 Bloomberg article:

> "Diversification is your best friend on your worst day," said David Kelly, chief global strategist at J.P. Morgan Asset Management. "The right asset allocation is a little bit like home insurance. You never know when you're going to need it, but you should never feel comfortable not having it."

Part of the job of asset managers is to attempt to control risk, and concentrating so much of a portfolio in so few stocks runs counter to that principle. (For example, many diversified mutual funds are not permitted to hold individual stocks in the percentages currently commanded by the largest constituents of the S&P 500 index.) It is the case that broadly diversified portfolios, both within U.S. large cap stocks and across other equity markets, have trailed the S&P 500 for some time.[3] Nevertheless, we continue to believe in the value of diversification, because diversified portfolios have historically

[1] The S&P 500 Index is a broad measure of U.S. large capitalization stocks; the MSCI EAFE Index (Net) is a broad measure of mid-large capitalization stocks in developed international markets; the Bloomberg U.S. Aggregate Bond Index is a broad index of U.S. investment grade bonds; the 90-Day U.S. Treasury Bill represents short-term government money market funds. Returns are provided by sources deemed to be reliable but are subject to change or revision.

[2] While this level of concentration is highly unusual, it is not unprecedented. The top ten stocks in the U.S. stock market made up roughly 30% of the market in the 1930s and early 1960s.

[3] Historically, equal-weighted portfolios have outperformed their market weighted counterparts over the long term and in more than half the calendar years. This advantage has been due to tilts toward positive factors of lower valuation and smaller size, outweighing the strong performance of the few stocks driving the majority of returns.

out-performed concentrated portfolios over time, especially on a risk-adjusted basis. It is important to recall how significantly diversified portfolios won out from 2000 to 2008, a period when stocks saw their values cut in half on two separate occasions.

We would be remiss if we did not note that, in some respects, the U.S. stock market's strong return rests on a solid foundation: The current trajectories of both inflation and economic growth appear to be positive,[4] and we expect the Federal Reserve to cut interest rates at least once by year-end. Expected earnings growth[5] for companies comprising the S&P 500 is now considerably higher than what had been estimated. Longer term, the potential benefits offered by artificial intelligence could also support a broadening of performance beyond the first-movers in this technology and lead to continued productivity gains across a variety of industries.

Despite these positive trends, we would not over-weight equity exposure, as we have become more cautious on the prospects for stock returns. U.S. large cap stocks have performed extremely well, valuations have risen (along with expectations), and the current P/E ratio for the S&P 500 is now over twenty times the consensus earnings per share estimate. Furthermore, we expect market volatility (which has been subdued on an index level but material for individual stocks) to increase throughout the remainder of the calendar year, particularly because of upcoming elections in the United States and continued geopolitical turmoil abroad.

Although many investors understandably attempt to incorporate election outcomes into their market outlooks, doing so is extremely difficult. Not only are the results themselves difficult to predict, but policy changes resulting from elections are as well. Changes in global trade, labor movement, and tax policies may have implications for capital markets, depending upon the election results and decisions made thereafter. One observation that can be made with a high degree of certainty is that neither party appears willing to deal with the rapidly expanding federal deficit, and we will likely see that deficit grow – a chronic issue on its way to becoming acute. In sum, the uncertainty engendered by the domestic political situation is, to us, another reason to be cautious.

Looking at the intermediate to longer-term, we do not believe that the next decade is likely to see a repeat of the 13% annualized return produced by the S&P 500 over the last ten years, nor of the outsized gains by a handful of mega-cap technology stocks that have resulted in the concentrated market we see today. Finally, although valuations are not a good predictor of near-term returns, over longer time periods they often are. Thus, investors with long time horizons should be mindful of how expensive the largest U.S. stocks have become – and that, relative to the recent past, attractive low-volatility alternatives such as U.S. Treasuries and money market funds yielding approximately 5% are available.

Above all, we remain focused on our long-term goal of participating in market rallies while limiting exposure to significant declines. This strategy we implement by regularly rebalancing diversified portfolios of high-quality stocks and bonds, which we believe should compensate investors for the uncertainty ever-present in the economy and capital markets.

Zach — Greg — Adam

Zachary Bourque CFA — Gregory Gullickson CFA — Adam Rutledge CFA

---

[4] There are, however, some indications of financial stress among lower income households and younger consumers. Furthermore, leading indicators continue to signal a slowdown in part due to the impact of higher borrowing costs.

[5] S&P 500 earnings for the 1st quarter rose 6%, which was slightly above the consensus estimate of 5% growth. For 2024, FactSet reports a consensus estimate of 11% growth in S&P 500 earnings. The consensus may be optimistic, but S&P 500 earnings growth approaching 10% seems achievable.