MARKET PERSPECTIVES

PREPARED BY SMITH GROUP ASSET MANAGEMENT

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Market Summary

U.S. Equity Markets (%)	2Q'24	1 Year	3 Years	5 Years	10 Years
S&P 500	4.3	24.6	10.0	15.1	12.9
Russell 1000 Growth	8.3	33.5	11.3	19.3	16.3
Russell 1000 Value	-2.2	13.1	5.5	9.0	8.2
Russell 2000	-3.3	10.1	-2.6	6.9	7.0
Russell 2000 Growth	-2.9	9.1	-4.9	6.2	7.4
Russell 2000 Value	-3.6	10.9	-0.5	7.1	6.2

Top/Bottom Sectors (%)	2Q'24 (sorted)	1 Year
Info. Technology	13.8	41.5
Comm. Services	9.4	44.9
Utilities	4.7	8.1
Energy	-2.4	15.8
Industrials	-2.9	15.6
Materials	-4.5	8.4

Price Comparison (in USD)	June 30, 2023	June 30, 2024
Oil (WTI spot)	$70.45	$81.46
Natural Gas	$2.76	$2.60
Gold	$1,928	$2,337
Fed Funds Rate (Upper Target)	5.25%	5.50%
10-Yr Treasury	3.84%	4.40%
VIX	13.59	12.44

Non-US Equity Markets (in USD) (%)	2Q'24	1 Year	3 Years	5 Years	10 Years
MSCI AC World Ex-U.S.	1.0	11.6	0.5	5.6	3.8
MSCI EAFE (Developed)	-0.4	11.5	2.9	6.5	4.3
MSCI Emerging Markets	5.0	12.6	-5.1	3.1	2.8

Non-US Regions (in USD) (%)	2Q'24	1 Year
Developed Americas	3.8	24.0
Developed Asia	-2.9	10.6
Developed Europe	0.4	12.1

Non-US Regions (in USD) (%)	2Q'24	1 Year
Emerging Americas	-12.4	-5.3
Emerging Asia	8.4	15.5
Emerging EMEA	1.4	9.1

Source: MSCI, S&P Global, LSEG; Refinitiv, St. Louis Federal Reserve Bank; Periods greater than one-year have been annualized; EMEA: Europe, Middle East, Africa

Market Highlights

- US equity markets continue to look through inflation pressures, rising unemployment and uncertainty over potential Fed rate cuts and extended their march upwards in 2Q'24. Led by mega-cap outperformance, the S&P 500 rose 4.3% and the S&P 500 Top 50 shot up 8.8% for the quarter. The average stock in the S&P 500 significantly trailed the mega-caps as the S&P 500 Equal-Weight fell 2.6% for the quarter.
- Market breadth for the S&P 500 was the worst in at least the last 30-years as only 25.4% of stocks outpaced the cap-weighted index return of 4.3%. The previous low breadth figure was 30.6% in fourth quarter 1999. The thirty-year average is 49.4%.
- The combined market capitalization of Microsoft, Apple and Nvidia exceeds the combined market capitalization of all listed German, French and UK companies. The combined profits of Microsoft, Apple and Nvidia are approximately half that of the German, French and UK companies.
- Nvidia has added more than $2 trillion in market cap in 2024 and makes up almost 35% of the S&P 500's YTD gain. The 35% return contribution is over 6-times Nvidia's average 4.8% weight in the index.
- The ten largest companies in the S&P 500 now account for over 37% of the index weight (vs. 26% at the height of the dot-com bubble), but only 23% of earnings weight, the largest divergence in at least the last 30-years. These companies have an average forward P/E of 38 (median of 33) and next calendar year expected earnings growth of 21%. The remaining 490 stocks in the index have an average forward P/E of 20 (median of 17) and next calendar year expected earnings growth of 14%.
- Equity markets are 12-months removed from a cyclical trough in earnings growth and are poised for a fourth straight YoY gain. 2Q'24 YoY earnings for the S&P 500 are expected to be up 9.1%. If the recent pattern of earnings beats is any guide, 2Q'24 YoY earnings growth rates should push into the low to mid-teens.
- Based on current bottom-up consensus estimates the S&P 500 will report year-over-year earnings growth of 10.3% in 2024 and 14.2% in 2025 - both of these figures are higher than estimated at the beginning of the year. If accurate, it will mark the second time in the past 10-years that the S&P 500 has reported consecutive years of double-digit earnings growth. The last occurrence of back-to-back years of double-digit earnings growth was in 2017 (11.8%) and 2018 (22.7%). Note in 2015 and 2016, S&P 500 YoY earnings growth was –1.1% and 0.5%, respectively.

Economic Highlights

- In the post-WWII era there have been only two periods in which the US unemployment rate rose by 0.5% or more in a 12-month period for which the economy was not either entering, in the midst of, or exiting a recession. These years were 1951 and 1962. The unemployment rate has increased from 3.5% to the current reading of 4.0% over past 11-months.
- Unemployment of 4.0% is still a relatively tight labor market number; however, 1) job openings have been declining since March 2022 and are down by over 1/3rd from their peak; and, 2) the rate of growth of non-farm payrolls has been slowing and at current pace will fall below the rate of the prior decade by year-end.
- Productivity growth has been above 3% for three of the last four quarters, relative to a historic average of 1.5%. The last extended productivity boom was the PC cycle of the mid '90s. At the time, that period became the longest expansionary cycle of the post-WWII era. The productivity boom lifted wages while allowing earnings to accelerate well above trend.
- According to CBO forecasts, over the next four-years, the US national debt is forecast to exceed its all-time high after WWII. Additionally, interest on the federal debt will broach 3.5% of GDP, a level that proved painful enough in the early 1990's to drive a bipartisan effort to reduce the debt.

Earnings & Valuation Highlights

After reporting YoY earnings growth of 1.5% in 2023, the S&P 500 is now poised for double digit earnings growth in 2024 and 2025. Additionally, a broadening of earnings growth across the economy appears to finally be taking hold, although is by no means yet being reflected in a broadening of stock market returns. For 2024, five sectors are forecast to deliver double digit earnings growth and eight sectors are expected to grow by double digits in 2025, this compares with just three sectors in 2023. Exhibit 1 examines the earnings outlook for the S&P 500 by sector over the next two years. The largest variance between sector weighting in the index and the earnings contribution is Information Technology which accounts for 32.5% of the index weight but only 22.1% of

Exhibit 1: Source: Factset, S&P Global, Bloomberg

S&P 500 Earnings Outlook and Valuation

Sector	Index Weight	Est. CY 2024 Earnings Weight	Variance	Est.CY 2025 Earnings Growth	Contribution to Index Earnings Growth	Median P/E
Communication Services	9.5%	10.2%	0.8%	12.3%	9.0%	11.1
Consumer Discretionary	10.1%	8.5%	-1.5%	14.9%	9.1%	16.4
Consumer Staples	5.8%	6.2%	0.4%	7.6%	3.4%	17.5
Energy	3.6%	6.5%	2.9%	10.8%	5.0%	11.8
Financials	12.3%	17.7%	5.4%	10.2%	12.9%	12.3
Health Care	11.7%	12.8%	1.1%	18.6%	15.4%	17.8
Industrials	8.1%	8.2%	0.1%	15.4%	8.9%	20.8
Materials	2.1%	2.3%	0.2%	17.1%	2.1%	18.6
Information Technology	32.5%	22.1%	-10.4%	20.1%	31.7%	25.6
Utilities	2.3%	3.0%	0.7%	8.5%	1.4%	16.0
TOTAL (excl'g Real Estate)	**97.9%**	**97.6%**		**14.4%**		**17.8**
Healthcare excl'g Merck				-1.3%		
Technology excl'g Nvidia				6.6%		

earnings; however, the sector accounts for 31.7% of the earnings "growth" in the index. Healthcare looks like an extremely attractive sector based on current valuations, earnings weight and growth potential; however, the earnings growth of the sector is heavily influenced by the rebound in Merck's earnings following the companies write-off from the acquisition of Prometheus, which resulted in a $10.2 billion charge in 2023. If Merck's results had been excluded from Health Care sector results in 2023, earnings would have risen by 5.4% instead of a 19% decline.

Conclusion

Current expectations are for second quarter S&P 500 earnings to rise 10-11% Y/Y, with most of the gains attributable to Technology, Health Care and Communication Services. As noted, US employment remains strong but some cracks are starting to show and the unemployment rate has risen by 0.5% over the past year, traditionally a very good predictor of an impending recession. The earnings outlook for corporate America is certainly not signaling a recession but earnings were in a cyclical slowdown through 2022 and 2023 so at least some portion of the current growth is a rebound from depressed levels. A significant upward vector to productivity is also expanding margins and providing strong support to earnings. Productivity typically moves in long-term cycles and we are likely at the early stages of a multi-year up-cycle which will drive earnings growth well above trend levels. With a median P/E ratio of 17.8x for the S&P 500, double digit earnings growth expected for the next two years and a secular uptick in productivity likely underway there appear ample attractive opportunities for equity investments.

Source: Bloomberg, S&P Global, St. Louis Federal Reserve Bank, Deutsche Bank

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