TUCKER ASSET MANAGEMENT®

MARKET DEEP-DIVE

Q2 2024

Despite conflicting data points, the U.S. economy continued to perform well in the second quarter. S&P 500 earnings reports for the first quarter demonstrated robust earnings surprises with 79% of S&P 500 constituents reporting actual earnings above Wall Street consensus estimates. The S&P 500 reported 6.0% year-over-year earnings growth in the first quarter (vs. expectations of 3.1% heading into the quarter), the highest since Q1 2022. The market currently estimates second quarter and full-year EPS growth of 9%. Small business optimism rose to a year-to-date high in June on better economic prospects. Some slight cracks in the labor market are appearing with continuing jobless claims hitting 1.86 million, the most since November of 2021.

The unemployment rate unexpectedly climbed to 4.1% in June, tied for the highest level since October 2021. Consumers displayed resilience; even though quarterly retail sales figures showed signs of fatigue, spending on services remained healthy. Consumer spending was driven by both the wealth effect of rising home equity and stock portfolios, and solid increases in income growth. Housing, while somewhat inhibited by high prices and mortgage rates, remains healthy as resilient demand continues to face low levels of supply. Corporate bond credit spreads linger near all-time lows, reflecting strong corporate balance sheets and earnings consistency. GDP increased 1.4% (annualized) in the first quarter and is on track to grow at a 2.0% pace in the second quarter, according to the Atlanta Fed.

Despite firm performance from both businesses and consumers, concerns regarding elevated inflation and interest rates remain. Inflation has proven stickier in the last mile to the Fed's 2% target. The Fed's preferred measure of inflation, PCE, posted its smallest rise in May since March 2021 bringing the year-over-year number to 2.6%. Economic risks are becoming more two-sided: inflation is moving closer to target levels and the labor market is reflecting more stable supply and demand conditions.

The Fed's meeting in June saw officials dialing back their expectation for rate cuts this year. Relative to projections in March, the median estimate for interest rate cuts has fallen from three quarter-point cuts to one by the end of the year. Back in March, 10 of 19 Fed officials were projecting at least three rate cuts in 2024. Currently, eight officials expect two cuts, seven expect one, and four are predicting none. The futures markets are currently implying at least two rates cuts are likely this year.

As stock valuations have climbed, concentration risk in capitalization-based indices have continued to worsen. Ten stocks currently comprise 37% of the S&P 500 index and account for 77% of the S&P 500's return so far this year, according to FactSet data. The 1-year forward P/E ratio of these ten stocks is currently 30.3x, whereas the remaining stocks in the index have a forward P/E of 17.6x. Despite the index's 15%+ return year-to-date, over 35% of constituent stocks are negative this year.

Constructive Observations

- Current yields offer compelling income opportunities across a myriad of asset classes.
- Corporate profits and balance sheets appear generally healthy.
- Consumer spending is likely to remain supported by a steady labor market and wage gains exceeding the rate of inflation.
- AI-related productivity boom could positively impact GDP going forward.
- Future monetary policy is likely to have an accommodative bias

Cautious Observations

- Economic growth is slowing and/or turning negative around the globe.
- Interest rates are likely to stay higher for longer as progress on lowering inflation has been slow and uneven.
- Labor market data has been showing signs of weakness.
- Property sector woes and weak consumer sentiment in China likely to have spillover effects.
- Divergent monetary policy paths globally are likely to increase volatility.

MACRO OVERVIEW

The U.S. economy grew at an annualized pace of 1.4% in the first quarter, beating expectations of 1.3%. U.S. economic data has softened over the second quarter and has generally been coming in below consensus since early May. The Labor Department reported the average number of monthly jobs added during the second quarter declined to 177,000 vs. the 267,000 monthly pace of the first quarter. The unemployment rate ticked up from 3.8% in March to 4.1% in June, indicating slack and gradual slowing in the labor market. Other indications the job market is cooling were average hourly earnings growth dropping from 4.1% to 3.9% in June from a year earlier, the smallest gain since 2021, although still above the Fed's 3.0% - 3.5% target. Additionally, the nonfarm payroll counts were revised lower for both April and May.

May headline CPI was slightly lower than expected: 3.3% from a year ago vs. 3.4%, a welcome outcome after several firmer than expected reports to start 2024. The monthly reading was unchanged, at 0% in May, down from 0.3% in April and 0.4% in March. To obtain the Fed's 2% target, economists suggest the monthly reading should consistently be in the range of about 0.2%. June headline CPI declined 0.1% from May, the first time it has fallen in more than four years, putting the 12-month rate at 3.0%, its lowest level in more than three years. U.S. gasoline prices fell 3.6% in the month of May, after increasing in each of the prior three months. Consumers paid an average pump price of $3.70 per gallon at the end of May, and $3.56 per gallon at the end of June.

The housing market weakened since last quarter with existing home sales down to 4.1 million from 4.4 million in February, and down 3% from year ago levels. Median home prices rose 2% in the quarter and 6% year-over-year. New home sales declined from 662,000 in February to 619,000 in May.

The University of Michigan Consumer Sentiment Index dropped to 68.2 in June from 79.4 in March, a 7-month low, resulting from the impact of a slower economy, higher rates, and persistent (albeit falling) inflation. Similarly, the Conference Board's Consumer Confidence Index dropped in June to 100.4, down from 101.3 in May.

MARKET OVERVIEW

Equities

The S&P 500 returned 4.3% in the second quarter, bringing its year-to-date return to just over 15%: a respectable half-year outcome by almost any standard. Sector and style positioning dictated a great deal in terms of investors' ability to capture the headline index return, however. Large-cap growth stocks returned over 9.5% this quarter, whereas large-cap value stocks declined by just over 2.0%. The top six IT stocks in the S&P rose 17% on average primarily due to EPS revisions and multiple expansion, while the remaining 494 stocks saw a slight upward EPS revision and larger multiple compression driving a 1% decline on average. Six of eleven S&P sectors posted negative returns this quarter and only three outperformed the overall index. Info. Tech (13.8%), Communication Services (9.4%), and Utilities (4.7%) were the top-performing sectors in the second quarter. Mid-cap and small-cap stocks declined 3% in Q2.

Returns in the developed international markets were generally negative this quarter, with European markets concerned about the elections in France (-7%), and Yen weakness causing Japanese stocks to stumble (-4%). The MSCI EAFE index was down less than 1% this quarter and has returned just over 5% year- to-date. The U.S. dollar has appreciated in 2024 against most other currencies. As a result, returns in local currency terms are much higher: MSCI EAFE is up over 11% year-to-date in local currency terms.

Within emerging markets, the overall index returned 5% in the second quarter, delivering stronger performance than the S&P 500, but was characterized by dramatic decoupling across the asset class. Asia generally advanced while most Latin American markets pulled back. Although real estate woes and slowing GDP continues to beset the Chinese market, stocks there rose 7% this quarter as confidence continues to grow after four straight quarters of negative returns (the reason China remains negative on a trailing twelve-month basis). China's Third Plenum, one of the most important political meetings of the Chinese Communist Party will be held later in July and is expected to focus on deepening economic reforms to address a wide range of issues. Brazil and Mexican markets suffered double-digit declines this quarter as both countries face political headwinds that could stifle economic growth.

Fixed Income

U.S. Treasury yields ended the second quarter slightly higher by 10 to 20 basis points, with larger increases concentrated in longer maturities. Early in the quarter, yields rose due to elevated inflation and robust economic growth but later reversed due to downward revisions and new data pointing to a declining trend. The 10-year Treasury yield rose from 4.2% to 4.4% during the quarter (after reaching 4.74% mid-quarter) and the 30-year went from 4.34% to 4.56%. Fed minutes indicate an eagerness to cut rates in September, driven primarily by concerns about the employment outlook. The market is pricing in an 80% probability of a rate cut in September, which will ultimately depend on inflation and employment trends remaining on their current stable to slowing track. Globally, June was the first month since the beginning of the post pandemic cycle during which no major central bank raised interest rates. While the Fed's monetary policy has been on hold, relative weakness in other economies and better progress on inflation have allowed the EU, Canada, Switzerland and Sweden to embarking on easing paths, although the risk of sticky inflation has led each to avoid fully committing to meaningful further cuts.

We have passed the two-year anniversary of U.S. Treasury yield curve inversion, exceeding the prior record of 623 days set back in 1978 and dwarfing the average 92-day inversion of the past half century. 3-Month Treasury Bills currently yield about 90bps more than 30-year bonds. Yield curve inversion is usually resolved by falling short-term rates as some type of economic shock requires swift policy easing. Short rates continue to reflect expectations for a slow and steady easing cycle. Longer-term rates are balancing the eventuality of lower short-term rates with the need to increase future supply of longer- dated bonds to finance large fiscal deficits. Investors are currently paying a premium to lend to the U.S. government for a longer time. That bodes well for the market's ability to absorb the large amounts of bonds the U.S. plans to sell, at least in the immediate future. The current yield curve inversion embodies two fundamental principles: economic uncertainty remains high, and short- end rates are heavily influenced by a government institution (the Federal Reserve) that focuses on relatively few short-term factors, whereas longer- term yields are set by open-market forces pricing in a wide range of longer- term scenarios. Eventually, investors will return to normal behavior and demand higher yields for longer maturities, but when that might occur is highly debatable.

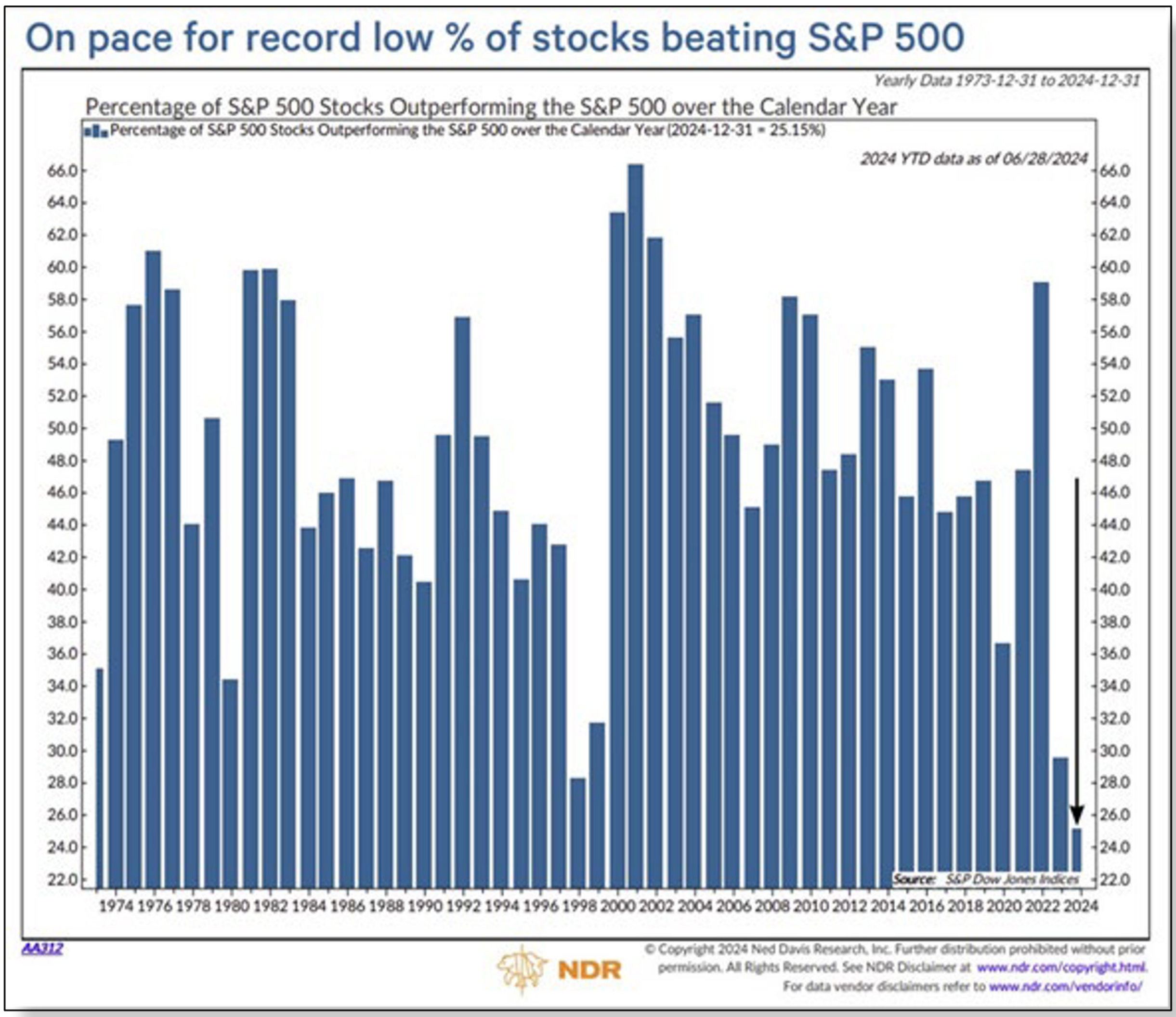
Uncertainty over Fed policy has led to record-breaking rate volatility for core aggregate bonds. Core bonds have had a -3.0% annualized return over the last three years. The U.S. Aggregate Bond index was up 0.1% this quarter and down 0.7% year to date. Short and intermediate Treasuries were flat for the quarter, whereas maturities of 10-years and longer declined 1-2%. High yield bonds were up 1% this quarter and leveraged loans returned 2%.

Real Assets

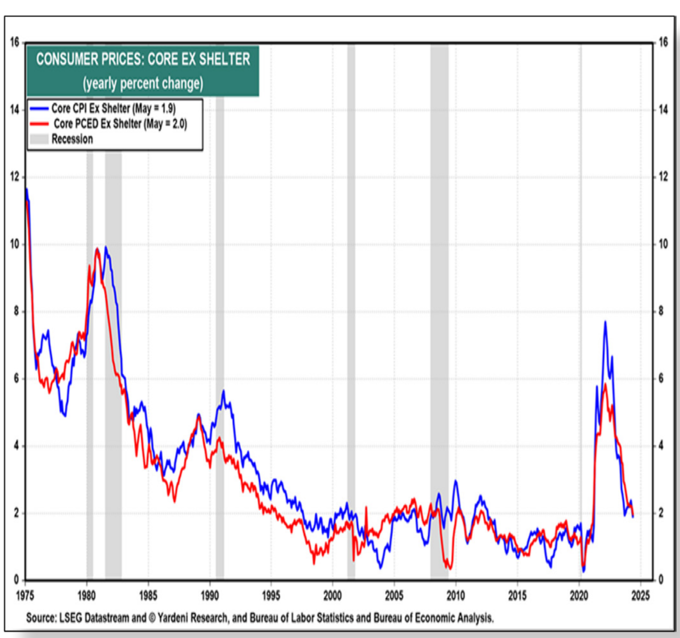
Commodities have erased most of their 2023 losses in just the first half of this year. The more diverse Bloomberg Commodity Index increased 3% overall in the second quarter, whereas the energy-tilted Goldman Sachs Commodity Index was up 0.7%. These two indices are up 5% and 11% respectively, year- to-date. Crude oil was up a modest 1% this quarter, whereas heating oil (- 2.4%) and gasoline (-4.2%) both fell. Natural gas has been very volatile, declining almost 30% in the first quarter amid mild weather and record production, and bouncing back 14% in the second quarter. On a trailing twelve month basis, natural gas has declined 44%.

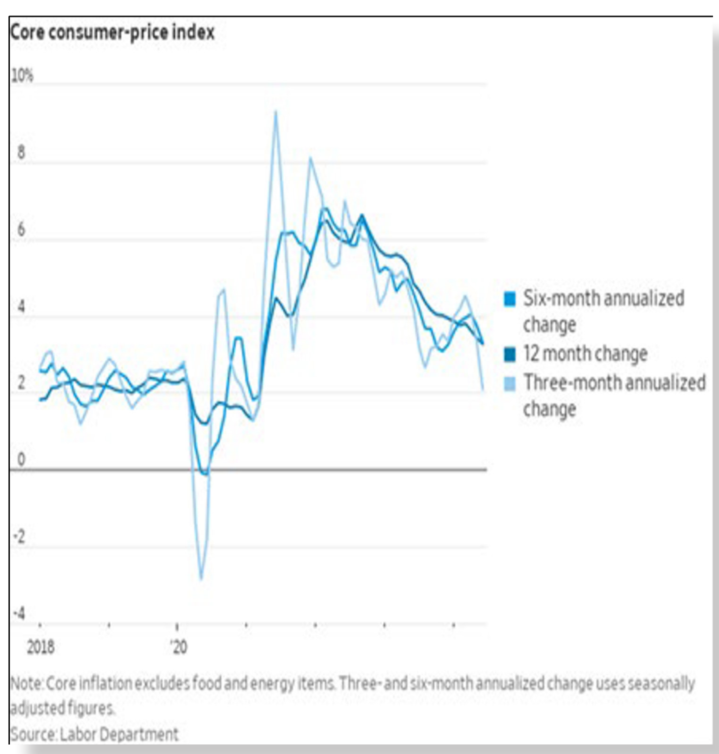
Gold appreciated 5% in the second quarter and is up 13% through mid-year. At the beginning of April, gold was $2,250 per troy ounce. The price was supported from investors betting on a June interest rate cut from the Federal Reserve, as well as strong central bank buying. The highest percentage of central bankers in at least six years expect their holdings of gold to increase, according to the World Gold Council's annual survey released in June. The survey found that 29% of the central bank respondents plan to increase their gold reserves in the next 12 months, the highest since the survey began in 2018. The precious metal found further support in May as geopolitical and sovereign debt concerns weighed on investors in China and the Middle East. In the short-term, demand for gold is likely to increase from Chinese buyers, as they eschew their real estate and stock markets. On May 20, gold hit a record intraday high of $2,454.20, its highest price ever. Platinum rose 10% in the second quarter. Silver, which is "quasi-precious" and "quasi- industrial", rose almost 18% this quarter and is up 22% for the year-to-date. Industrial metals also rose this quarter by almost 10%, as a group. Individual metals rose this quarter, as follows: aluminum +7.4%, copper +10.6%, nickel +3.2% and zinc +20.4%.

THE NARROWEST MARKET IN 50 YEARS



INFLATION PRESSURES CONTINUE TO EASE





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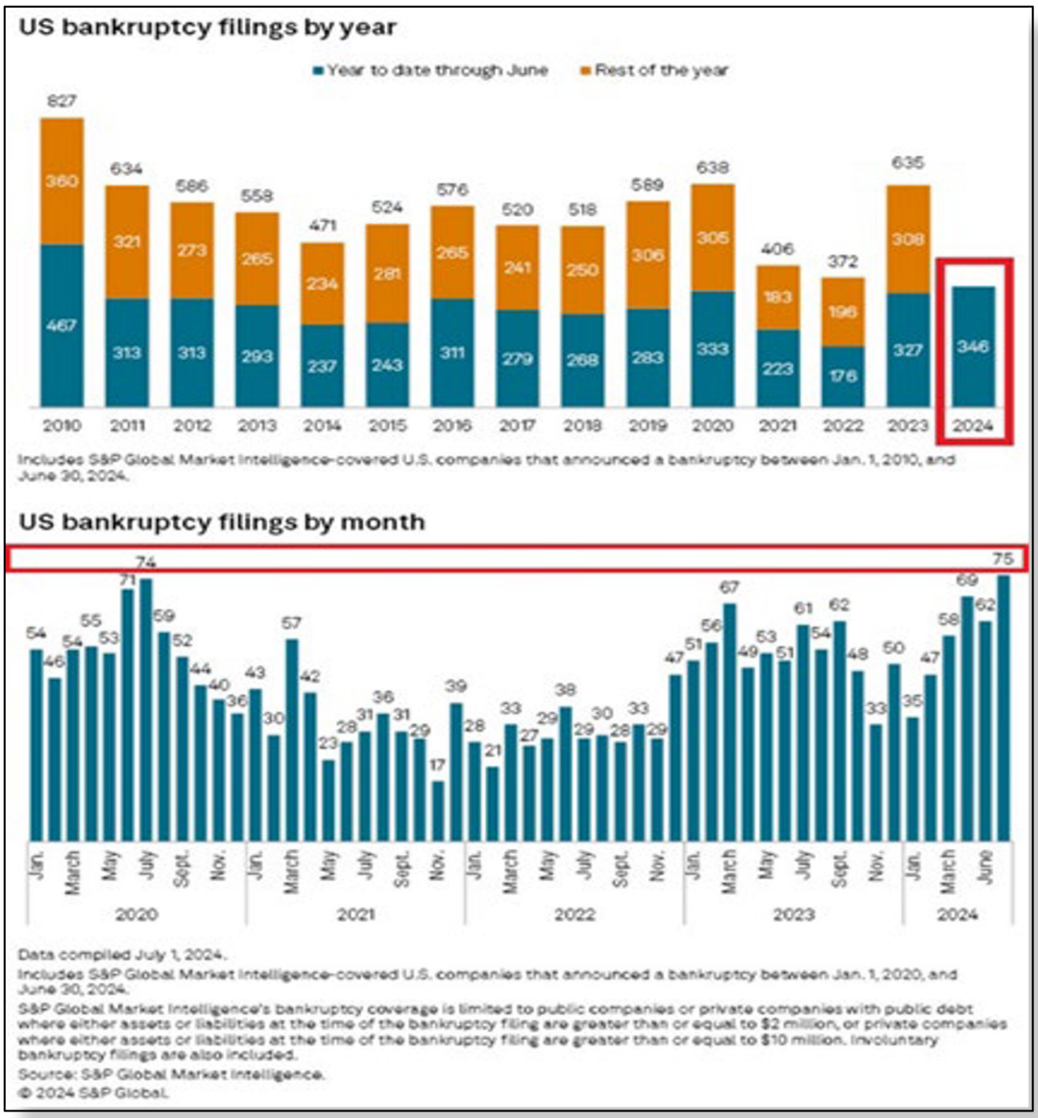
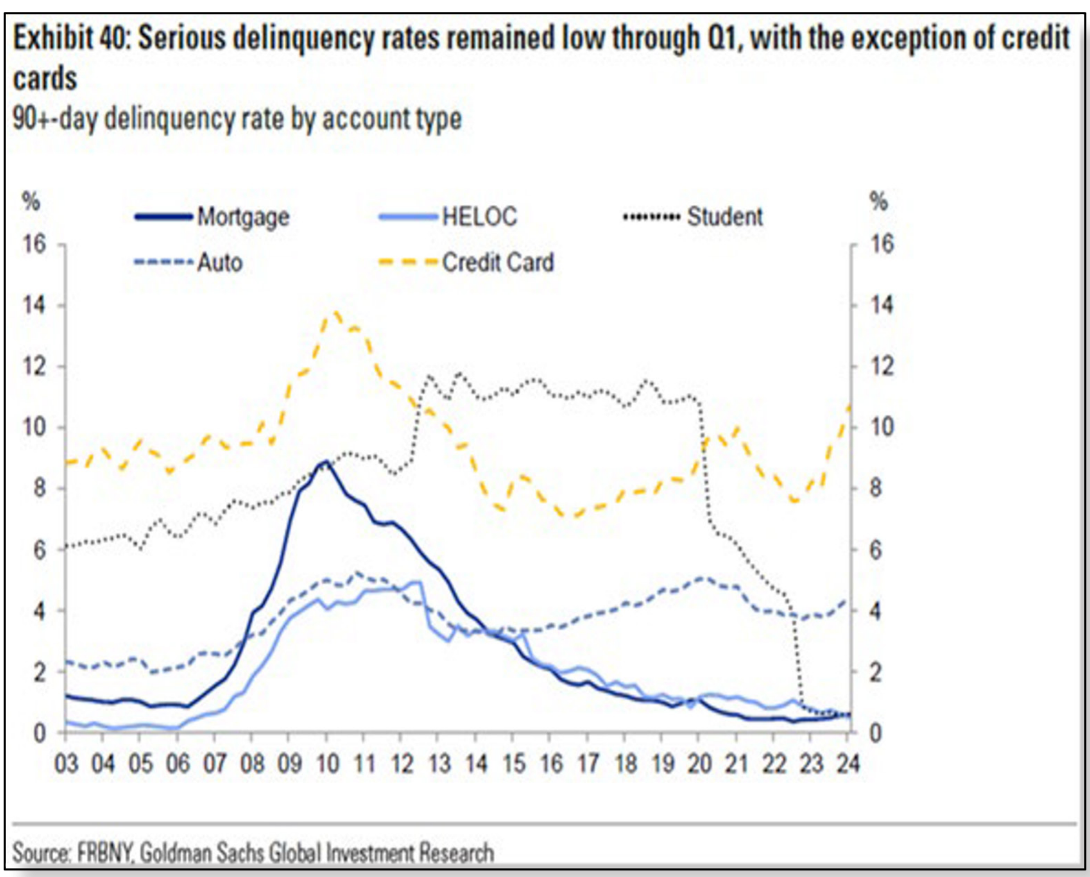
HIGHER RATES TAKING A TOLL





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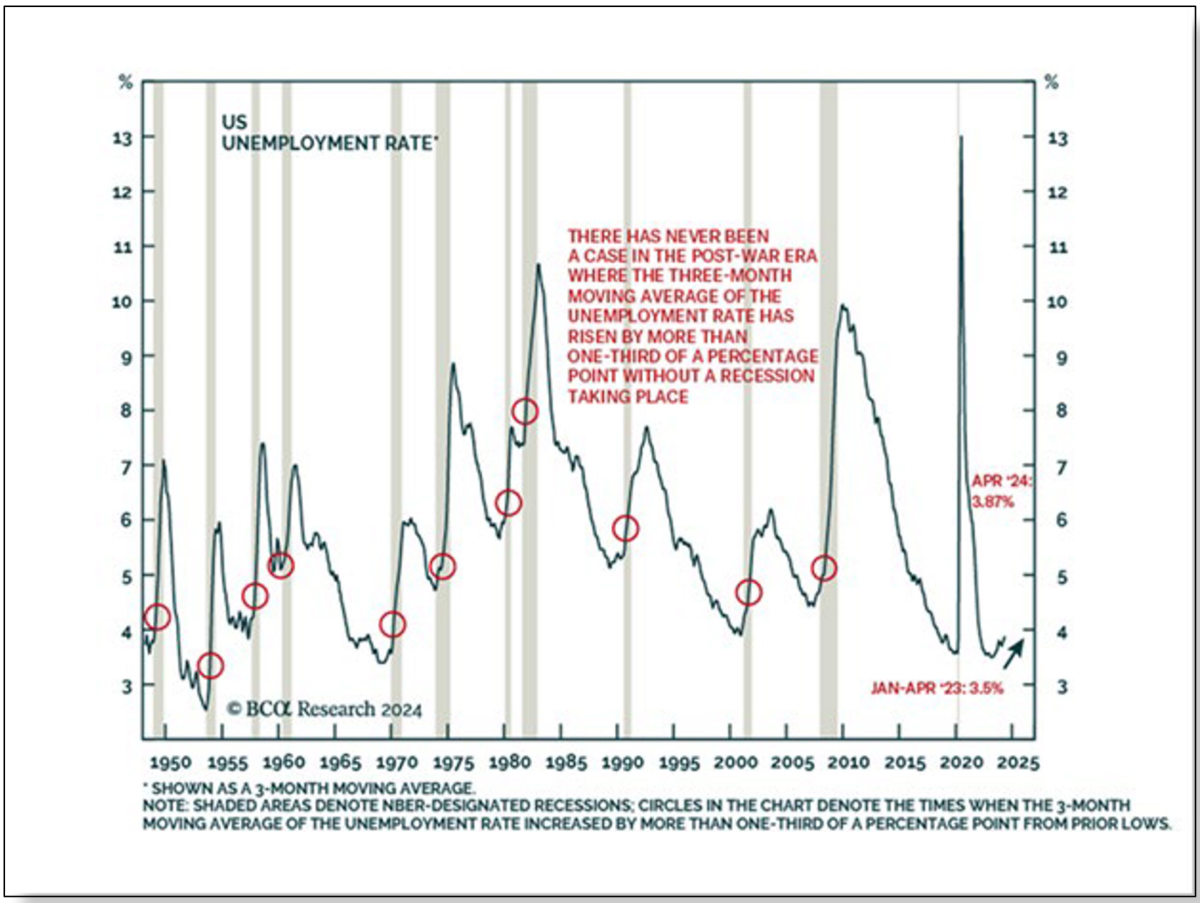
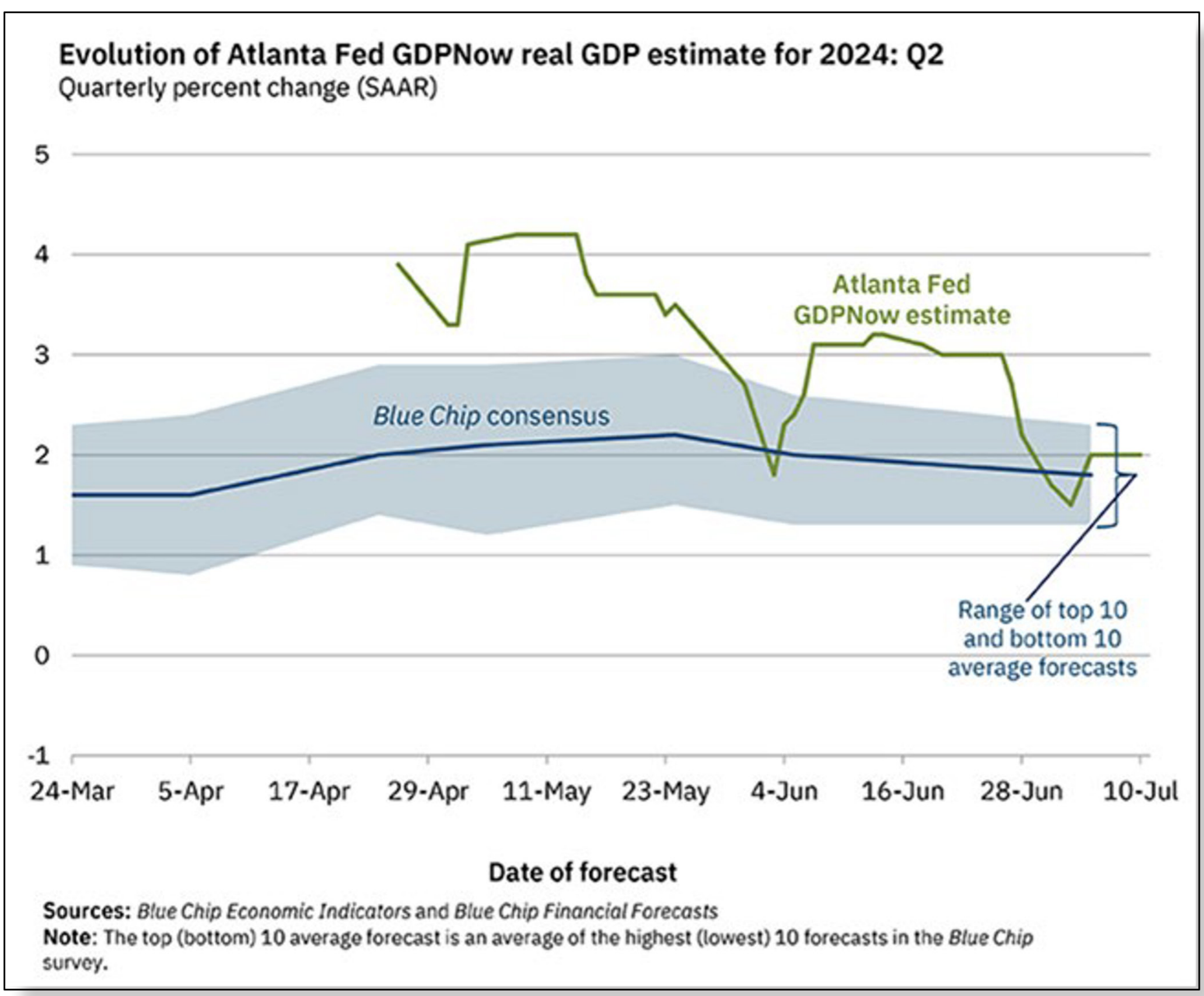


BUT ECONOMIC GROWTH REMAINS RESILIENT



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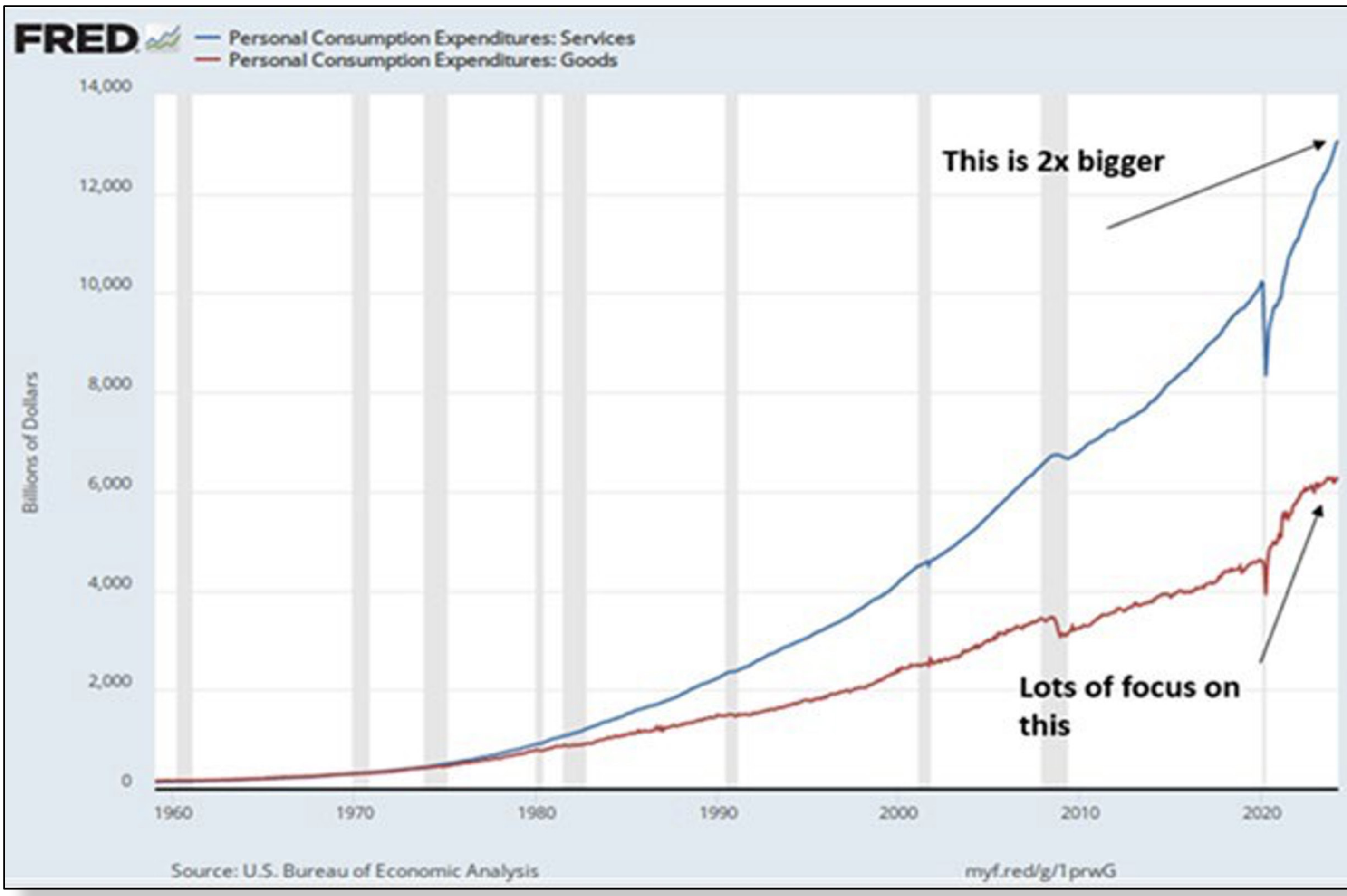

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