Stock market returns in June were mixed – the S&P 500 rose 3.6 percent and the Dow increased by 1.2 percent. Midcap and Small cap stocks both fell about a percent, as measured by the Russell Midcap and Russell 2000 indices. The MSCI World ex-Us also fell 1.6 percent for the month, though the MSCI Emerging Markets index rose 5 percent. The US Aggregate bond index gained 0.9 percent in June.

For the first six months of this year, the mega-cap growth stocks were the big gainers – the Russell 1000 Growth is up 20.7 percent through June 30th. In contrast, the Russell 1000 Value gained 6.6 percent and the Dow Jones gained 4.8%. Smaller capitalization stocks underperformed the mega-caps with returns more in line with the average stock – the equal weighted S&P 500 is up 5.1 percent year to date. Through June 30th, the Bloomberg US Aggregate bond index declined 0.7 percent.

Moving into the latter half of the year, we have some concerns but remain optimistic. On the one hand, as Lisa Shallot reminded us again this month, "rarely have markets been so expensive—absolutely and relative to US Treasuries—or so disconnected from economic surprises and the level and direction of interest rates. Rarely has a bull market experienced such an uninterrupted string of all-time highs amid severely deteriorating breadth and limited participation from small-cap stocks. And rarely have the top-10 stocks accounted for more than 35% of total S&P 500 market cap."

On the other hand, our team sees tremendous opportunity in market segments outside the magnificent 7. As Daniel Skelly, our Senior Investment Strategist wrote recently, we think there are "two primary reasons why markets will eventually broaden out this year and into 2025: 1) Federal Reserve rate cuts amid economic growth (consistent with the base case view of Morgan Stanley & Co.'s chief US economist, Ellen Zentner) should drive interest in more cyclical and value-oriented sectors; 2) according to consensus estimates, during the second half of 2024, the earnings growth of the "Magnificent Seven" should start to slow versus that of virtually all other stocks, i.e., the S&P 493. This dynamic will shine a light on the idea that companies outside the AI-centric names also offer earnings growth."

To understand what we think is happening, it's important to consider that stocks (and other investments) sometimes trade based on simple scarcity – the same way a rookie Mickey Mantle baseball card might trade. Sometimes, considerations about earnings, dividends, payback periods, and valuations just don't bear on the price. In the case of a rookie Mantle card, there are only 2,628 or so to go around, and the value is derived not from the card's ability to produce future income for its owner but entirely from the belief that the underlying scarcity of the card will entice future buyers to pay an even higher price. Right now, we think the magnificent 7 stocks trade that way. There are simply more people wanting to own and hold the stocks than there are shares to go around. In the current environment, valuations as high as 75 times earnings and 38 times sales do not inhibit their performance. As long as liquidity remains abundant and the number of people desiring those shares continues to grow or stay the same, the prices are likely to continue to rise. We believe history shows this happens repeatedly. Markets are not perfectly efficient for this reason.

But in the event of a liquidity run, the price declines of securities trading based on scarcity rather than valuation can be furious. Securities trading away from intrinsic value are the ficklest of investments historically because when their prices fall, new purchasers remain difficult to entice. It's rather easy to find a new buyer when the income from an investment will repay him or her in short order; but it can be quite difficult if no income is immediately forthcoming. Consider the famous Dutch Tulip bubble, the internet bubble of the late 90s, and the housing bubble of the late 2000s as examples of when liquidity dried up and things that had been trading on scarcity had difficulty finding a price floor. In fact, if economists and investors apply the word bubble in retrospect, it's because three things happened: 1) an abundance of liquidity led to massive gains in an investment that was trading on scarcity rather than intrinsic value, 2) the liquidity dried up, and 3) someone got left holding the security as the price rapidly declined when no new buyers could be found. In retrospect, that always looks quite foolish; but never seems so in the present.

Our team remains focused on intrinsic value because we always focus on risk. If we were forced to become speculators, we would argue that we don't see liquidity drying up anytime soon. In fact, as Lisa Shalett wrote this month , "despite 550 basis points of rate hikes and more than $1 trillion in quantitative tightening, US financial conditions remain as accommodative as ever, raising genuine questions about the policy transmission mechanism and whether the Federal Reserve really has control in a world characterized by extreme wealth concentration, shadow banking and fiscal predominance." Furthermore, we expect rate cuts later this year and into 2025 – which will increase liquidity all else held equal. It's not that we are certain there is a bubble in the magnificent 7; nor are we predicting an imminent market crash. Simply put, we are not speculators and have no desire to chase momentum or returns. As long-term investors focused on intrinsic value, we see a tremendous number of securities trading below fair value while also providing accelerating earnings growth – in many cases, earnings growth that is likely to exceed the magnificent 7 stocks. It's extremely important to us that those securities would also likely better shield our clients' portfolios in the event that we misjudge future liquidity. The chance an unexpected event suddenly saps liquidity as happened in March of 2020 is never zero. We care very much about both return and risk, not just return alone.

Moving into the back half of 2024, we continue to expect what we have expected since January. Interest rates will remain higher for longer (we are not going back to zero-percent rates anytime soon); inflation, while declining, will remain above the Fed's target of 2 percent; and both bonds and the average stock will provide good returns in 2024. We continue to predict high single digits for the average stock and mid-single digits for bonds for the full year – with the majority of the bond returns and the broadening of stock performance oriented around the beginning of Fed rate cuts which we now anticipate this fall.

We hope you had a happy 4th of July and as always, if you need anything at all, please don't hesitate to reach out to any member of the team.