



2Q2024

The S&P 500 made new highs during the second quarter, closing up 4.28% qtd and up 15.29% ytd on a total return basis.ⁱ Much of this was driven by the concentration of performance in the Information Technology sector and the Communications Services sector where both earnings gains and multiple expansion fueled by the AI boom led to higher prices. The market capitalization of those two sectors combined now account for 40.7% of the S&P 500 which is as high as it got before the tech bubble burst in 2000 per Yardeni Research.ⁱⁱ However, the valuation multiple at approximately 30x forward earnings is much lower than during the tech bubble. As we wrote in last quarter's letter, the Artificial Intelligence era could have long lasting impacts on both market performance and productivity gains for the foreseeable future.

With the market at these levels, much of investors' attention has turned to the Federal Reserve's policy on interest rates. At the Fed's mid-June press conference, Chair Powell reiterated the Fed's commitment to an inflation target of 2.0%. From the transcript:

"My colleagues and I remain squarely focused on achieving our dual mandate goals of maximum employment and stable prices for the benefit of the American people. Our economy has made considerable progress toward both goals over the past two years. The labor market has come into better balance, with continued strong job gains and a low unemployment rate. Inflation has eased substantially from a peak of 7 percent to 2.7 percent but is still too high. We are strongly committed to returning inflation to our 2 percent goal in support of a strong economy that benefits everyone."ⁱⁱⁱ

At the beginning of the year, the market was expecting the Fed to cut rates five to seven times, and it now expects one cut sometime before year-end. The 10-year Treasury rate spiked in mid-May to almost 4.60%, but it has now dropped to 4.39%.^{iv} The Fed has done a good job of bringing inflation down without triggering a widespread financial crisis and tipping the economy over into a recession. As Chair Powell notes though, it is still too high and many consumers are unhappy with the prices of food, energy, insurance (both home and auto), and housing. Unemployment hit a low of 3.4% in early 2023 and has gradually climbed to its most recent reading of 4.0%.^v The trend in unemployment will be a key factor to watch in order to remain confident in the strength of the economy.

While the Federal Reserve can directly impact the short end of the yield curve, by design it has no input on fiscal policy. We think that one of the reasons that inflation got so high during the pandemic was due to the unprecedented amount of fiscal stimulus injected into the economy. While this stimulus did keep the 2020 pandemic recession very short lived, the additional spending from the Inflation Reduction Act of 2022 could be one of the factors that kept inflation higher for longer. This spending is also contributing to the U.S. running the largest budget deficit during a peacetime economic expansion.^{vi} The Congressional Budget Office just raised its estimate of the federal budget deficit for 2024 to \$1.9 trillion. Much of this increase was due to student debt relief (+\$145 billion), FDIC bank resolutions (+\$70 billion), aid to Ukraine, Israel, and other allies (+\$60 billion), and Medicaid (+50 billion).^{vii}

These kind of deficits are not sustainable over the long term. For now, there is enough interest in U.S. government debt issuance to fund the deficit. Democrats are already discussing large tax increases for 2025, but without some reduction

in government spending, the deficit will continue to grow until Congress is forced to act. As the focus turns to the Presidential election in the fall, the market could experience more volatility as these policy discussions unfold.

On a personal note, we hope for the safe return of the hostages held by Hamas and that the Israeli conflict with Hezbollah on the border between Israel and Lebanon does not turn into a wider regional war. Thank you for your confidence in us, and we look forward to speaking with you over the summer.

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ⁱ S&P Dow Jones Indices, <https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf>

ⁱⁱ Yardeni Research Morning Briefing, June 17, 2024

ⁱⁱⁱ Federal Reserve Board, Transcript of Chair Powell's Press Conference, June 12, 2024, <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20240612.pdf>

^{iv} [cnn.com/quotes/US10Y](https://www.cnn.com/quotes/US10Y)

^v Bureau of Labor Statistics, [bls.gov](https://www.bls.gov), Seasonal Unemployment Rate

^{vi} Yardeni Research Morning Briefing, June 25, 2024

^{vii} Yardeni Research Morning Briefing, June 25, 2024

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