Second Quarter 2024

Financial Markets Commentary

DT INVESTMENT PARTNERS

"This Time, it's Different." Aggressive Fed Rate Increases Have Not Led to Economic Recession.

Financial Markets (see page 5 for asset class total returns)

- U.S. Large Cap stocks, led by growth-oriented companies, continued their steady march higher in price during the second quarter. Corporate profits have been stronger than expected and investors seem convinced that the Fed will bring inflation under control without sending the U.S. economy into recession. Technology shares continued to rally on investor enthusiasm over artificial intelligence (AI). The S&P 500 made 31 all-time highs and has not had a one-day decline of at least 2% in 340 days.

- Sectors that are insensitive to higher for longer interest rates such as Technology, Communication Services, and Consumer Staples rose in value during the quarter, while those sectors more sensitive to interest rates (Financials, Energy, Industrials, Materials, & Real Estate) struggled. In addition to the Technology sector, Utilities posted solid returns thanks to the artificial intelligence craze. As technology companies build data centers to power the artificial-intelligence push, these data centers will require more power, and investors believe that Utilities stocks will benefit from this expected surge in demand.

- Emerging Market stocks also rose during the quarter, led by China whose state-linked investors are actively promoting their stock purchases, global investors are returning, and shareholders are being supported by top-down policies. We believe this rebound will be short-lived because nothing of long-term substance is really changing. China's recent economic indicators remain broadly negative. The bursting of the property bubble continues to weigh on their economy. So far, the government has embarked upon a regulatory crackdown and stimulus programs that have been relatively weak, given the magnitude of the real estate crisis. We are still not in favor of making a direct investment in an economy that is so tightly controlled by the government.

- The U.S. economy's resilience has enabled the Fed to delay the start of their easing (reducing interest rates) campaign. As a result, the value of the U.S. dollar has remained strong, rising 1.3% during the second quarter. Once the Fed begins reducing interest rates, the value of the dollar should weaken. This will increase the relative purchasing power of foreign countries, making imports cheaper and exports more expensive. A weaker dollar should also be supportive of global growth and international stock prices along with U.S. multi-national company profits.

- All investment grade bond sectors (Treasuries, Government Agencies, Corporates, Mortgage-Backed Securities, & Municipals) generated positive total returns for the quarter. Credit upgrades continued to outpace downgrades indicating positive ratings momentum. Mortgage-Backed Securities (MBS) rose in price as investors were attracted to the relatively high yields (>5%) offered by these securities. Although Municipal bond prices fell slightly due to a large increase in supply, total returns were positive thanks to high relative coupon rates (income). The bond market may be forecasting that the Fed's 2% inflation target will soon be reached (bond prices rise/yields decline). We believe the inflationary forces of enormous fiscal deficits, green energy transition, and deglobalization should be more than offset by the deflationary impacts of aging populations, high debt service costs, and increasing productivity from technological innovations. Bond yields may be rangebound at 4-5%, until the Fed begins reducing rates.

Global Economy

- The U.S. economy continues to be the straw that stirs the global economy’s drink. While Europe and China struggle with weak economic activity, the U.S., along with India and Japan are showing signs of resilience. ***Despite higher interest rates and elevated inflation, the International Monetary Fund is predicting the U.S. economy will expand this year at more than twice the rate of other major developed countries (2.7% for the U.S. vs. 0.8% for Europe).*** America’s powerful, consumer-led economy is helping to support growth in the rest of the world. Consumers have been able to spend more thanks to plentiful jobs and increasing net worth.

- Over the past two years, those believing the economy was headed for a “hard landing” argued that the Fed’s aggressive (5.25%) interest rate hikes would plunge the U.S. economy into recession. Despite the U.S. economy’s resilience, some forecasters continue to believe their long-held recession call will be proven true. Eventually, they will be correct. However, a lot can happen between now and then. Thus far, the economically bearish forecasters have been wrong. The U.S. economy continues to grow, the labor market remains strong, U.S. consumers continue to spend, and the NASDAQ and S&P 500 are near all-time highs.

- The most dangerous words in investing “this time, its different,” as coined by Sir John Templeton, are proving to be correct. ***This time, things may actually be different.*** Those in the “hard landing” camp accurately cite previous Fed rate hike cycles leading to financial crises that turned into credit crunches and recessions. However, the Fed moved quickly in March of 2023 to prevent the mini regional banking crisis from spreading. The current global economy, led by the U.S., is much different than it was before the COVID-19 pandemic. As a result, many of the historically successful recession indicators such as aggressive Fed policy tightening, an inverted yield curve, and manufacturing and industrial production slowdowns have currently proven to be misleading. ***The U.S. economy has become more service-oriented and digital and less manufacturing-oriented and industrial.*** As a result, the economy is much less sensitive to interest rates. The service sector currently contributes 80% to Gross Domestic Product.

- ***The likely U.S. economic scenario moving forward may be a cross between a “no landing” and a “soft landing.”*** Fed rate hikes have caused inflation to slow, while unemployment remains low, and no recession has materialized. Interest rates may stay higher for longer without a significant rise in unemployment and an economic slowdown. ***In this stronger for longer economy, bond yields may stay elevated relative to the past 15 years and the potential for higher stock prices remains good.***

Jobs, Inflation, & Fed Policy

- The unemployment rate in the U.S. currently sits at 4%, which is low by historical standards. The rate has been at or below 4% for the past 30 months. Although, it has been creeping up in recent months from as low as 3.4% last year. Job growth in May of 272,000 jobs was considerably higher than economists' estimates of 190,000. The boost in monthly job gains further illustrates how resilient the U.S. economy has been despite higher borrowing costs and persistent inflation.

- The Consumer Price Index (CPI) on a year-over-year basis peaked in June 2022 at 9.1%, fell to 3% by June 2023, and then crept higher to 3.5% in March. It currently sits at 3.3%. The Fed's preferred inflation measure, the Core Personal Consumption Expenditure Index sits at 2.6% through May. The Core (ex. food & energy) CPI excluding Shelter over the past 3 months, on an annualized basis is 1.9%. So, it appears that shelter costs are the stickiest component of inflation, keeping CPI elevated above the Fed's 2% target.

- High shelter costs are primarily the result of a shortage of housing. According to Zillow estimates, the U.S. housing deficit has reached 4.5 million per the most recent data from 2022. Housing supply remains depressed, especially in the single-family housing segment. As high mortgage rates persist (the 30-year mortgage rate topped 7.5% in May) and permits remain historically low, the rebound for housing is far from imminent. The U.S. also has a large percentage (90%+) of mortgages that are fixed rate. This makes housing turnover difficult when owners are locked in below 5% and the current mortgage rate sits above 7%. Elevated borrowing costs are keeping new home construction levels depressed. ***The irony is that by keeping rates higher for longer, the Fed is contributing to higher housing costs which is contributing to higher inflation readings. The Fed's desire to keep rates higher for longer until they are fully confident that inflation is falling towards 2% is working against their desire for a 2% inflation target.***

- After concluding 5.25% of interest rate hikes that began in March of 2022 and stopped in July of last year, Fed officials appear to be unified in their belief that making no more rate moves is the best course of action for a growing economy with inflation running slightly above their 2.00% target. At their June 12th meeting, the Fed held rates steady for the seventh consecutive meeting and offered little notion that they would begin reducing rates soon. Most officials forecast they might lower rates once or twice during the four remaining meetings of the year. In his post meeting press conference, Chair Powell said the Fed is looking for something that gives them confidence that inflation is moving sustainably lower. ***The Fed's continued reliance on past economic data almost ensures that they will be behind the curve in their monetary policy moves.***

Outlook and Portfolio Strategy

- ***Over the past 80 years, the Fed has never managed to bring down inflation without causing an economic recession.*** The current U.S. unemployment rate of 4.0% is near historical lows (3.4%). The May Core PCE on a year-over-year basis was 2.6%, down from a peak of 5.4% early last year and slowly trending towards the Fed’s 2% target. ***While a soft-landing scenario in which Fed rate hikes cause inflation to slow, while unemployment remains low, and no recession occurs seems possible, it feels like we are currently in a no-landing scenario in which rates stay higher for longer without a significant rise in unemployment and economic slowdown, while bond yields stay elevated and the potential for higher stock prices is good. We believe that it is possible to have a strong economy and good stock market performance in a rate environment that is relatively high compared to the past 15 years.*** The stock market is experiencing a melt up in prices led by technology stocks, particularly Artificial Intelligence-related companies. The rally in the S&P 500 Technology sector has been led by both earnings and valuations. For Q2 2024, the estimated (year-over-year) earnings growth rate for the S&P 500 is 8.8%. ***This rally may broaden out to additional sectors as the customers of technology companies use new technology to boost their productivity.***

- While the U.S. economy has proven more robust than just about anyone thought, there remains a high level of uncertainty going forward regarding future Fed policy and geopolitics. Elevated stock market valuations raise the potential for a near-term correction. The Fed signaled that they expect to lower interest rates once (0.25%) by year-end, while traders are forecasting two rate reductions beginning in September. Geopolitical factors could weigh on the market over the summer as we move closer to a U.S. Presidential election in November while wars wage on in Ukraine and the Middle East.

- We believe that investors should continue to embrace the benefits of balance and diversification in their portfolios to help mitigate the risks associated with the highs and lows of economic and market cycles. We continue to be slightly overweight bonds and slightly underweight risk. The Fed’s response to reduce inflation has resulted in the highest bond yields since September 2007. Municipal bond supply should remain elevated as most municipalities will need to issue debt because they have depleted their COVID-19 stimulus funds from the federal government. This should provide investors with attractive opportunities to earn tax-free income.

- In risk markets, we continue to favor U.S. stocks, particularly Large Cap. As long as the economy grows while the jobs market stays strong and inflation remains contained, U.S. Large Cap stocks can continue to perform well. Particularly if the market rally broadens to include more sectors besides technology as AI leads to a productivity boom for all types of businesses. We are also overweight U.S. Small Cap and International Developed Market stocks. An eventual rate cut by the Fed will reduce interest expense for Small Cap borrowers. It should also weaken the value of the U.S. dollar, benefitting international companies and economies. We remain overweight government bonds while avoiding direct exposure to Emerging Market stocks, Real Estate, Gold, and High Yield bonds.

Total Rate of Return Performance as of 6/30/2024

Stock Indices	Asset Class	QTD Return	YTD Return
MSCI AC World Daily TR N	Global Equities	2.87%	11.30%
DOW JONES INDUS. AVG	U.S. Large Cap Equities	-1.27%	4.79%
NASDAQ COMPOSITE	U.S. Large Cap Equities	8.47%	18.57%
S&P 500 INDEX	U.S. Large Cap Equities	4.28%	15.29%
RUSSELL 1000 GROWTH INDX	U.S. Large Cap Growth Equities	8.33%	20.70%
RUSSELL 1000 VALUE INDEX	U.S. Large Cap Value Equities	-2.17%	6.62%
S&P 400 MIDCAP INDEX	U.S. Mid Cap Equities	-3.45%	6.15%
RUSSELL 2000 INDEX	U.S. Small Cap Equities	-3.28%	1.73%
MSCI EAFE	International Developed Market Equities	-0.20%	5.78%
MSCI EM	Emerging Market Equities	5.03%	7.60%
DJUSslct REIT Trust	Real Estate	-0.16%	-0.55%
S&P 500 Sector Indices	**S&P 500 Stock Sectors**	**QTD Return**	**1 Year Return**
S&P 500 ENERGY INDEX	U.S. Large Cap Equities - Energy	-2.42%	10.93%
S&P 500 HEALTH CARE IDX	U.S. Large Cap Equities - Health Care	-0.96%	7.81%
S&P 500 CONS DISCRET IDX	U.S. Large Cap Equities - Consumer Discretionary	0.65%	5.66%
S&P 500 CONS STAPLES IDX	U.S. Large Cap Equities - Consumer Staples	1.35%	8.98%
S&P 500 INFO TECH INDEX	U.S. Large Cap Equities - Information Technology	13.81%	28.24%
S&P 500 UTILITIES INDEX	U.S. Large Cap Equities - Utilities	4.66%	9.44%
S&P 500 INDUSTRIALS IDX	U.S. Large Cap Equities - Industrials	-2.90%	7.75%
S&P 500 COMM SVC	U.S. Large Cap Equities - Communication Services	9.38%	26.68%
S&P 500 MATERIALS INDEX	U.S. Large Cap Equities - Materials	-4.50%	4.05%
S&P 500 FINANCIALS INDEX	U.S. Large Cap Equities - Financials	-2.03%	10.16%
S&P 500 REAL ESTATE IDX	U.S. Large Cap Equities - Real Estate	-1.91%	-2.45%
Commodity ETF/Index	**Type of Commodities**	**QTD Return**	**1 Year Return**
ISHARES GOLD TRUST	Gold	4.57%	12.55%
S&P GSCI Tot Return Indx	Broad Commodities	0.65%	11.08%
Bond ETFs/Index	**Fixed Income Sectors**	**QTD Return**	**1 Year Return**
ISHARES CORE U.S. AGGREGATE	Core Bonds	0.03%	-0.71%
ISHARES INTERMEDIATE GOVERNM	Intermediate Government & Corporate Bonds	0.59%	0.41%
SPDR PORTFOLIO HIGH YIELD BO	High Yield Debt	0.99%	2.71%
ISHARES 3-7 YEAR TREASURY BO	U.S. Treasuries	0.49%	-0.16%
ISHARES MBS ETF	Mortgage-Backed Securities	0.29%	-0.86%
ISHARES 5-10Y INV GRADE CORP	Corporate Debt	0.44%	0.35%
ISHARES NATIONAL MUNI BOND E	Municipal Debt	-0.23%	-0.49%
TREASURY BILL	Cash	1.85%	10.19%

Notes

Total Rate of Return Sources on page 3: *MSCI, Standard & Poor's, Dow Jones, NASDAQ, Russell, & Blackrock IShares. Investors cannot invest in a market index directly; the performance of an index does not represent any actual transactions and its performance does not reflect the deduction of any fees or expenses associated with actual investing. Market performance information is included on this slide solely to demonstrate the potential benefits historically associated with long-term investing in a portfolio of well-diversified asset classes and does not represent or suggest results DT Investment Partners would or may have achieved when managing client portfolios*

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