PATHSTONE
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Market Flash Report

June 2024

Key Takeaways

- Market News: The divergence in market performance became more pronounced in Q2, with mega-cap stocks driving the S&P 500's gains while the broader market struggled. The top 10 companies by market capitalization now represent an unprecedented 38% of the total index, up from 34% at the end of Q1. This shift reflects investors' growing optimism about the growth prospects of these industry giants, particularly as enthusiasm for AI technologies continues to fuel market sentiment and drive valuations higher.
- Small Caps: Q2 performance was disappointing for US small caps, marking their worst first half of the year compared to the S&P 500 on record. As interest rates have remained higher for longer, earnings for smaller and less growth-oriented businesses have been more heavily impacted.
- Bonds: The bond market faced headwinds in Q2 as Treasury yields rose early in the quarter due to higher-than-expected inflation prints leading to weak overall performance. Short-duration bonds outperformed their longer-term counterparts, while high-yield bonds continued to show strength with near multi-decade high yields balancing out shifts in the yield curve.
- Emerging Markets: Despite China's economic struggles, EM equities were one of the top performers for Q2. Taiwanese and South Korean equities are benefiting from the AI push due to their exposure to chip and component makers like TSMC and Samsung.

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Index Performance (as of 6/30/2024)

Equity	Q2 2024	One-Year	Three-Year
U.S. Large Cap	4.3%	24.6%	10.0%
U.S. Small Cap	-3.3%	10.1%	-2.6%
Developed Non-U.S.	-0.2%	12.1%	3.4%
Emerging Markets	5.1%	13.0%	-4.7%
Real Assets			
Real Estate	-1.9%	6.6%	-3.9%
Commodities	2.9%	5.0%	5.7%
Natural Resource Equities	-1.4%	17.0%	17.1%
Fixed Income			
Core Plus			
U.S. High Yield Debt	1.1%	10.4%	1.6%
Emerging Market Debt	-1.7%	1.5%	-2.4%
Core Bonds			
U.S. Aggregate Bonds	0.1%	2.6%	-3.0%
U.S. Treasuries	0.1%	1.5%	-3.3%
U.S. Municipal Bonds	-0.4%	2.3%	-0.4%

Month-End Values/Yield	Current	Prior Month	One-Year
CBOE Volatility Index	12.4	12.9	13.6
10-Year Treasury Yield	4.4%	4.5%	3.8%

Sources: Bloomberg, Pathstone

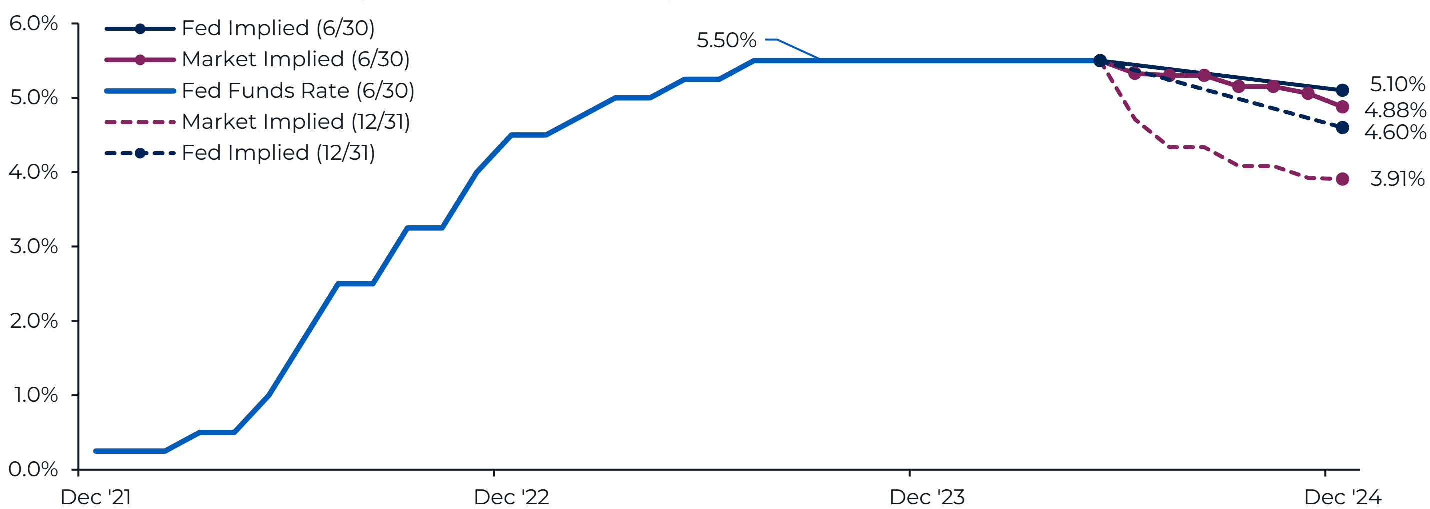
You cannot invest directly in an index; therefore, performance returns do not reflect any management fees. Returns of the indices include the reinvestment of all dividends and income, as reported by the commercial databases involved. Returns over one year have been annualized.

Quarterly Commentary

- Monetary Policy: The Federal Reserve held interest rates at an upper bound of 5.5% in June and has indicated that they only expect to cut rates once in 2024. Fed Chair Jay Powell said the Federal Reserve needed "greater confidence" that price pressures were easing before cutting interest rates. The Federal Open Market Committee has indicated that there has not been enough progress towards its 2% goal in recent months, and has delayed rate cuts until the second half of this year at the earliest. Loretta Mester, president of the Cleveland Federal Reserve, raised her estimate of the longer-run federal funds rate to 3.5% from 2.5% due to the resilience of the US economy in the face of higher rates.
- Labor Market: The labor market presents a complex picture, with unemployment remaining low at around 4% and robust nonfarm payroll growth suggesting continued strength. However, beneath the surface, signs of weakness are emerging. The household survey indicates that many new jobs are part-time or secondary positions rather than full-time roles, while job openings and quit rates are trending downward, suggesting diminished opportunities for significant pay increases through job changes. Notably, continuing unemployment claims have risen for nine consecutive weeks, reaching their highest level since November 2021. While soft data from surveys points to potential weakness in employment, leading labor market indicators are mixed. Generally, the labor market tends to follow earnings expectations, which currently remain positive, adding another layer of complexity to the overall employment landscape.
- Inflation: Recent inflation data for April and May have shown a return to expectations, suggesting a path back toward target levels after months of higher-than-anticipated figures driven by oil prices. However, signs of weakening consumer demand are emerging in retail sales and GDP data, with consumers increasingly relying on credit to maintain spending. The Federal Reserve now faces a crucial decision: whether to look beyond sticky housing-related data and recognize the broader trend before unemployment rises significantly. Complicating matters further, base effects could cause year-over-year inflation prints to increase toward the end of the year, potentially making the Fed's decision-making process even more challenging.
- Housing Market: The impact of higher interest rates on the housing market has been profound, leading to a significant reduction in both demand and supply of existing homes. This shift has driven increased demand for new homes and rentals, resulting in relatively stable national prices that have risen about 4% annually since the first rate hike, in line with headline inflation. However, existing home sales have plummeted by nearly one million per month compared to the previous decade's average, with pending home sales hitting a record low. Given that homes represent a substantial portion of consumer balance sheets, a downturn in prices could have far-reaching economic consequences. Furthermore, residential construction jobs, often a harbinger of overall labor market trends, may face increased layoffs if demand continues to decline, potentially signaling broader economic challenges ahead.

Fed Funds expectations have moved higher throughout the first half of the year

FED FUNDS RATE UPPER BOUND, FED IMPLIED = "DOT PLOT", MARKET IMPLIED = FED FUNDS FUTURES



Sources: Bloomberg, Pathstone

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U.S. Large Cap Equity is represented by the S&P 500 Index, with dividends reinvested. U.S. Small Cap Equity is represented by the Russell 2000 Index. Developed Non-U.S. Equity is represented by the MSCI EAFE Index. Emerging Market Equity is represented by the MSCI EM Index. Real Estate is represented by the S&P Global Property Index. Commodities are represented by the Bloomberg Commodity Index. Natural Resource Equities are represented by the S&P North American Natural Resources Index. U.S. High Yield Debt is represented by the Bloomberg Barclays U.S. Corporate High Yield Index. Emerging Market Debt is represented by the JPM GMI-EM Global Diversified Index. U.S. Aggregate Bonds is represented by the Bloomberg Barclays U.S. Aggregate Bond Index. U.S. Treasuries is represented by the Bloomberg Barclays U.S. Treasury Index. U.S. Municipal Bonds is represented by the Bloomberg Barclays Municipal 1-10yr Index.

Sources: Bloomberg, Pathstone

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