

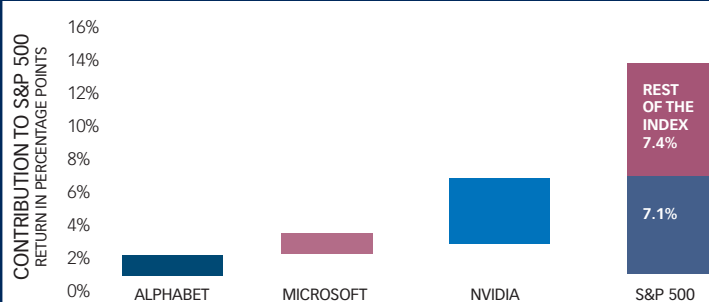
MONTIS Financial

Quarterly

2024 Second Quarter Investment Market Report

For the past two quarters, we have started this newsletter writing of “euphoria,” although the number of companies that are the focus of this euphoria is shrinking. In fact, in the second quarter, small cap stocks declined, mid cap stocks declined, and S&P 500 large cap stocks not related to artificial intelligence (A.I.) declined. The shining focus of the U.S. stock market was large cap stocks related to A.I., which gained 14.7% vs. -1.2% for the rest of the S&P 500ⁱ. Last year, we spent much of this space discussing the “Magnificent 7.” In our first quarter newsletter, we explained how the focus was down to the “Fab Four,” and this quarter, all that seems to matter is Nvidia, which is up almost 150% so far this year and has accounted for approximately 35% of this year’s total gain in the S&P 500. Add in Microsoft and Alphabet, and now we’ve accounted for almost half of the S&P 500’s return.

3 STOCKS ACCOUNT FOR NEARLY HALF OF 2024 S&P 500 RETURNS



Source: The Carlyle Group, June 25, 2024

Does this mean the stock market is becoming overly fragile? Are we due for a correction? Possibly. Possibly not. The stock market has always had boom-bust cycles and most likely always will. Despite all the excitement around A.I., chasing the recent source of gains has generally not proven to be a great strategy. Investors look back on the dot.com crash now as if it was so obvious that paying 1000x revenues for profitless companies was certain to end in disaster; yet most market commentators were busy at the time saying how different it was and that the internet would usher in a new industrial revolution...and it did. It was just an almost entirely different set of companies that led us there as the internet changed life

as we knew it. The early market darlings are mostly gone – America Online, Netscape, Lycos...does anyone remember the Super Bowl commercials for Pets.com? As with all market cycles, there are times when investors wish they owned more, and there are times when they wish they owned less, but it is essentially impossible to know when we switch from one part of the cycle to another until we are well past those times.

Exciting new technologies almost always see early exuberance leading to overvaluation. That is typically followed by a period of investor disillusionment when valuations fall, and then a long-term period of adoption across a wide audience that sees a much broader market impact with many firms benefiting from implementation of that technology. That pretty well sums up the last 25 years of life with the internet, and I suspect it will be the course we follow with A.I. Investors who have enjoyed the most successful outcomes over those last 25 years are likely to have relied on a well-diversified portfolio. Many investors have forgotten that it wasn't until March of 2013 when the S&P 500 Index fully recovered and moved meaningfully beyond its March 2000 peakⁱⁱ. That's 13 years of no gains!! (28% total cumulative return over those 13 years if we include dividends.)

INDEX	Q2 2024	YTD 2024
S&P 500	4.3%	15.3%
Equal-Weighted S&P 500 Index	-2.6%	5.1%
Dow Jones Industrial Average	-1.3%	4.8%
Nasdaq Composite	8.5%	18.6%
Russell 2000 (Small Caps)	-3.3%	1.7%

Source: Morningstar Direct

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Meanwhile, the MSCI Emerging Markets Index saw a total return of 195% over those same 13 yearsⁱⁱⁱ. Since then, we have had a spectacular period for the S&P 500, but here we find ourselves again – at historically high valuations talking about exciting new technologies. But the market leaders are actually very profitable this time around. Who will those market leaders be in 10 years? Diversification is not only key to containing the damage from the “bust” periods, but also in trying to capture exposure to the emergence of the long-term success stories (I suspect most readers had never heard of Nvidia 2 years ago, long before it was the highest-weighted stock in the S&P 500 and “only” valued at about 10% of its current market capitalization. Now everyone who owns an S&P 500 index fund owns a healthy chunk of Nvidia as it represents almost 7% of that fund!)

International developed markets are seeing plenty of headlines about elections, as is much of the world this year. Amid those headlines, developed markets largely treaded water in the second quarter after a strong Q1. Emerging Markets saw a strong index performance in the second quarter and for the first half, and much as was the case in the in the U.S., it was largely driven by a single A.I.-related chipmaker, Taiwan Semiconductor, which is up nearly 70% year-to-date^{iv}.

INDEX	Q1 2024	YTD 2024
MSCI EAFE (Developed Markets)	-0.4%	5.3%
MSCI Emerging Markets	5.0%	7.5%

Source: Morningstar Direct; See disclosures for important benchmark information

THE FEDERAL RESERVE AND INTEREST RATES: STILL WAITING!

Inflation and the policy responses of the Federal Reserve to combat that inflation continue to be the preeminent concern among the financial markets (especially the fixed income market), although the surprising strength of the U.S. economy is not far behind. Last quarter we commented that the excessive optimism at the beginning of the year that we would see six Fed interest rate cuts in 2024 had been pared back to three cuts. In this most recent quarter, we have seen those expectations trimmed even further to likely just one rate cut, with many market strategists predicting that there will not be any rate cuts this year as inflation remains stubbornly above target and the economy continues to perform.

As the markets have adjusted to account for a longer wait to see that first Fed rate cut, fixed income has largely treaded water, with interest income and price movements essentially offsetting each other.

INDEX	Q1 2024	YTD 2024
Bloomberg US Aggregate Bond Index	0.1%	-0.7%
Bloomberg Global Aggregate Bond Index	0.0%	-0.8%
Bloomberg Municipal 5-Yr Index	-0.4%	-0.8%

Source: Morningstar Direct; See disclosures for important benchmark information

LONGER-TERM INTEREST RATE CONCERNS

There is a common refrain, “markets tend to focus on what’s right in front of them,” meaning shorter-term issues over longer-term issues. However, there is a longer-term issue which is starting to get more attention in the bond markets, and that is the explosive growth of the U.S. federal debt.

Budget deficits have been a chronic issue in the U.S. and around the world for many decades; however, since the massive borrowing that occurred during the pandemic, both sides of the aisle have adopted fiscal policies that have the U.S. borrowing at a rate that is unprecedented during peacetime or during a period of low unemployment. Our accumulated federal debt is now equivalent to 100% of our GDP^v (or as big as our entire economy for one year). In addition, that statistic is already projected to grow at least 6% more next year and even more in the ensuing years. Those numbers are likely to increase further with the likely legislative agendas (regardless of who wins the election) and with a world that seems likely to require increased defense spending (neither of which is currently included in those figures).

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This leads to many potential issues, including:

- Greater upward pressure on inflation because the government is pumping trillions of dollars of fiscal stimulus into an economy at full employment that is already fighting inflation.
- Increased supply of U.S. Treasuries in a market where large rate-insensitive, foreign borrowers such as China and Japan are no longer buying large amounts of U.S. treasuries, meaning U.S. investors will need to digest most of the treasury auctions (and they are much more demanding of competitive rates of return to other investment options).
- If the economy starts to stumble, the government will have significantly less “dry powder” to stimulate the economy through fiscal policy because it would already be starting from such a stretched fiscal position.
- In the not too distant future, Congress will have to start choosing between either higher taxes or reduced spending on entitlement programs like Social Security and Medicaid (which is addressed further in our Financial Planning News section).

We have recently seen the bond market begin to react to these issues, so it may become much more prevalent in the headlines in the coming year as legislative agendas come more into focus.

ARE WE STILL SEEING A “SPLIT ECONOMY”?

For the last couple of quarters, we’ve been discussing three possible scenarios for the U.S. economy:

- The “Goldilocks” case (not too hot, not too cold) for an economic “soft landing”
- The recession case (too cold!)
- The stubborn inflation case (too hot!)

For the entire past quarter, we have continued to straddle the Goldilocks case and the stubborn inflation case, and fears of a recession (which was considered a near certainty early last year) have severely waned. With its surprising resilience in the face of higher interest rates than we had seen in 15 years and low unemployment, the U.S. economy is possibly the strongest major economy in the world right now. That might come as a surprise to many people who still have not adjusted to the higher prices we are seeing from re-emergence of inflation. Another segment of the population who might find it hard to believe that the overall economy is prospering would be those with lower incomes who are very much feeling the impact of higher interest rates over the last couple of years. Credit card and auto loan delinquencies continue to rise for people in their 20s and 30s, and rents are continuing to climb^{vi}.

Therefore, we continue to see a “split economy,” where the upper income levels drive a disproportionate amount of consumer spending, and those upper income consumers have experienced very little impact from the Fed’s interest rate hikes. Meanwhile, lower income consumers have very much felt the impact and are struggling, but their impact on the economy is far less than the former group. This will continue to be a challenging balance for the Fed as they chart the future path of monetary policy.

WHAT ABOUT THE 2024 ELECTION?

I think the most frequent question I’ve been asked by clients over the last couple of months is what impact I think the Presidential election could have on the markets. As much as intuition would tell us that the markets could be significantly impacted by differing taxation and economic policies, history would tell us that they really have not made a difference in terms of stock market gains. In fact, the concerned voters and the financial press have actually been terrible predictors of how the stock market would react to different Presidential administrations.

As the table below shows, conventional wisdom about the likely market impact of Presidential policy goals has not borne out. Going back to the Reagan administration, some of the Presidents who many would have considered least market-friendly saw the largest stock market gains and vice versa. Historically, it seems the sitting President simply does not have much influence over markets, or even the economy – those are driven by more powerful global and economic forces that are years in the making.

President		S&P 500 Index Return During Time in Office
Bill Clinton (2 terms)	Democrat	210%
Barack Obama (2 terms)	Democrat	182%
Ronald Reagan (2 terms)	Republican	118%
Donald Trump (1 term)	Republican	70%
George H.W. Bush (1 term)	Republican	51%
Joe Biden (less than 1 term)	Democrat	42%
George W. Bush (2 terms)	Republican	-40%

Source: CNBC.com, YCharts

WHAT DOES ALL THIS MEAN FOR CLIENT PORTFOLIOS?

There are no “crystal balls” in investing to foretell the future, and when investment decisions are made as if there are, then eventually there are typically costly consequences. There is no shortage of uncertainty in the markets. Will “A.I.-mania” follow a similar course to the dot.com-mania? Will new players emerge to dominate the A.I. landscape? With a strong economy, will we see the rest of the U.S. stock market catch up? When will the Fed start cutting interest rates? What will be the market impact of increasing global geopolitical strife? What will fiscal policy look like for the next four years?



We discussed in our opening section that we went through a 13-year period where you would have been better off investing almost anywhere except the S&P 500, then for the last 13 years, there has probably been no better place to invest. What will the next 13 look like now that we are back to historically high market valuations?

These are all important questions that will eventually have answers, but our job is to prepare client portfolios to continue to make progress toward successful outcomes regardless of the answers. Therefore, we will continue to look for opportunities to bring new sources of diversification to client portfolios – continually looking to reduce portfolio volatility while still generating the returns needed to achieve the financial goals we set with clients.

A stylized, handwritten signature in black ink.

-Dennis Follmer
Chief Investment Officer, Montis Financial
July, 2024

FINANCIAL PLANNING NEWS: WHAT IS HAPPENING WITH SOCIAL SECURITY?^{vii}

Will the Social Security trust fund run out of money? Estimates vary, but the latest from Social Security suggests that the trust fund will run dry by 2035.

That doesn't mean that we will witness the abrupt termination of Social Security benefits for seniors who qualify. The program receives its revenues from two sources: the money paid in by workers through FICA contributions, and from the trust fund to make up the difference. Approximately 20% of Social Security payments come from the trust fund annually. The most recent estimate is that, if nothing is done and the fund is depleted, the Social Security Administration will pay 83% of the benefits outlined in your benefits statement.

It is unlikely that Congress will ignore the problem; the more relevant question is which proposals will be acted on. One raises the full retirement age from 67 to 68 immediately, then

bumps it up progressively by two months each year thereafter. That would fill 44% of the funding gap and represent a 13% reduction in benefits to future retirees. A second proposal would index the Social Security retirement age to rising lifespans, which addresses 20-25% of the gap.

Another set of proposals would lower the annual inflation adjustments for retirement benefits by switching to a different (less generous) inflation measure. This would fill an estimated 23% of the gap, but could raise political hackles, since most economists believe the current benefits increases don't keep up with inflation as is.

There are several proposals to change the tax cap on FICA payroll taxes - the maximum amount of income that is subjected to FICA assessments. One raises the cap from \$110,100 to \$215,000 of personal income, which fills 35% of the funding gap. Another proposal subjects all earnings to Social Security

taxes, which would fill 86% of the gap. This might be politically popular, since only 6% of American taxpayers are affected. Alternatively, there is a proposal to raise the 6.2% payroll tax rate to 7.2% and leave the cap where it is. That would reduce the gap by 64%.

Yet another proposal would reduce benefits for the highest-earning 25% of Americans, addressing only 7% of the funding gap. Another would tax contributions to retirement plans such as 401(k) programs; yet another would bring all newly hired state and local government workers into the Social Security fold. That would address 8% of the funding gap.

The solution? Look for Congress to consider all these ideas in the coming sessions, and a combination of them to reach the House and Senate floor. The solution is likely to be whatever is most politically expedient, as opposed to the most logical.



Bob Whelan



Cameron Gast

MONTIS COMPANY NEWS:

We are delighted to introduce and welcome two new members to the Montis team! **Bob Whelan**, our new Senior Financial Advisor, brings over 40 years of experience in comprehensive planning and wealth management. His expertise and commitment to personalized client service will be invaluable as we continue to grow and enhance our offerings.

Joining him is **Cameron Gast**, CFP®, our new Financial Advisor, who brings a fresh perspective and a passion for helping clients achieve their financial goals. Their combined knowledge and dedication will strengthen our team and ensure we continue providing the exceptional service you expect from us. Please join us in welcoming Bob and Cameron to the Montis family!

ⁱ The Wall Street Journal, July 1, 2024

ⁱⁱ Source: YCharts

ⁱⁱⁱ Source: YCharts

^{iv} Source: YCharts

^v The Apollo Group, June, 2024

^{vi} The Apollo Group, June, 2024

^{vii} Source: CNBC.com, "Will Social Security run out? Here's what could happen to your benefits"

Important Disclosure Information

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