Vestor Capital
INVESTMENT & WEALTH MANAGEMENT

Economic and Investment Outlook

July 8, 2024

Equity Market Update

Equity indexes have exhibited mixed results thus far in 2024. U.S. large-cap indexes have large weightings in the technology and communications services sectors which have strong secular growth dynamics and have performed well this year. Conversely, U.S. small-cap stocks are essentially flat due in part to heavier weightings in economically sensitive sectors which have been held down by inflationary pressures and continued high interest rates. Developed international indexes have heavier weights in financial, energy and industrials sectors and only a modest weight in technology and other high growth areas of the market. This has resulted in more modest gains. Finally, the emerging market index is up almost 8% due in part to a rebound in Chinese stocks from lows last year, as a handful of large Chinese technology stocks have rebounded off 2023 lows.

There has been much discussion about the fact that only a handful of companies in the S&P 500 are responsible for much of the index's gains, which is posited as unhealthy, with which we would beg to differ. Large companies in the S&P 500 that have performed well this year have superb business fundamentals and investors are recognizing this. Conversely, stocks of companies that have weak fundamentals have fared poorly. This is what a healthy market is supposed to do. The stock market is a meritocracy, and not every stock gets a participation trophy.

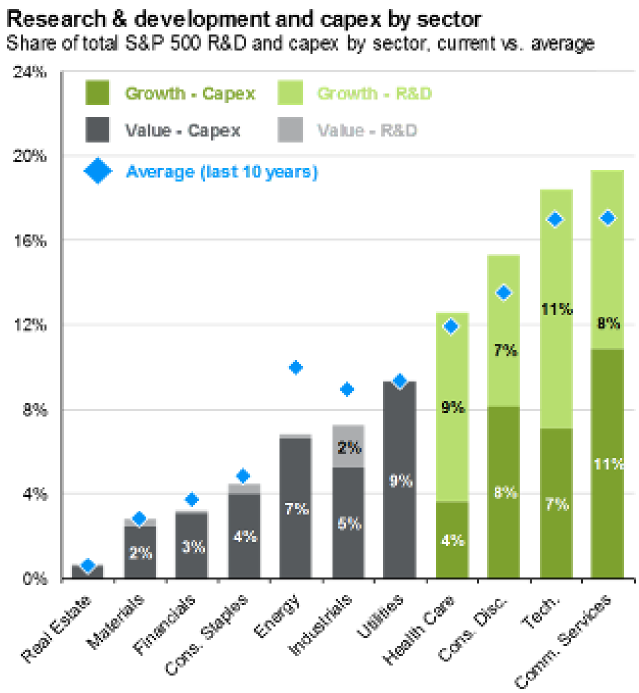
Total Return Performance for the Major U.S. and International Stock Market Indexes

Equity Index	*YTD June 30, 2024*
United States	
Dow Jones Industrial Avg.: 30 Stock Composite	**4.79 %**
S&P 500 Composite: U.S. Large Cap	**15.29 %**
NASDAQ Composite: Technology Heavy	**18.57 %**
S&P 600 Small Cap: U.S. Small Cap	**-0.74 %**
International	
MSCI EAFE Large Cap: Europe, Asia & Far East Large Cap	**5.78 %**
MSCI EAFE Small Cap: Europe, Asia & Far East Small Cap	**0.82%**
MSCI EM Emerging Market: Emerging Market Countries	**7.60 %**

Source: Bloomberg, L.P.

Economy

The graph below highlights the fact that sectors which have performed well in 2024, such as communications services and technology, also have the highest capital expenditures and research & development of any sector of the economy. In addition, current investment levels are above the 10-year average. Conversely, we see much lower investment in "old economy" sectors that are also generally below the average of the last 10 years. This reflects the fact that the U.S. economy continues to transform more toward technology which has been a positive for the U.S. stock market that is populated with large technology companies. This also helps explain why growth stocks have outperformed value stocks over the last decade.



Source: JPMorgan Guide to the Markets 6/30/2024

Thoughts on Stock Valuations

The stock market is always discounting the future which is an important fact to remember. While not infallible, generally rising stock prices indicate that a company's fortunes are improving, and investors are recognizing this. Conversely, falling stock prices usually indicate that a company is exhibiting what we term weakening fundamentals. The secret sauce to investing is being positioned properly in these trends and recognizing turning points.

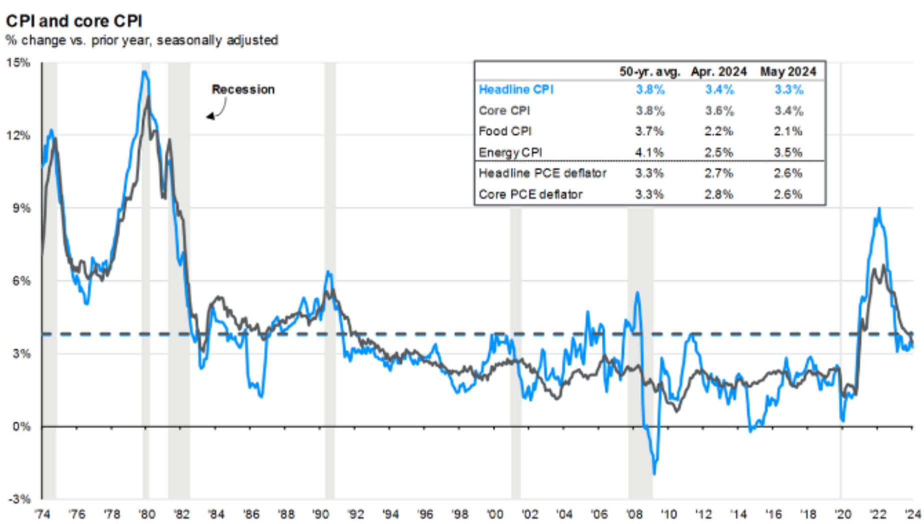
While market pundits continually opine on valuations, we have not found that focusing on valuations improves investment outcomes. For example, The Gap (GPS) clothing company has been a cheap stock for 10 years and yet the stock is down over this period. Conversely, Microsoft (MSFT) has been an expensive stock for the last decade and yet has reported an annualized return of 29% during this period. The difference is that MSFT continues to grow revenues and earnings faster than expected while GPS is earning less today than 10 years ago. The key to investing is to avoid companies whose fundamentals are either weakening or are expected to weaken in the near future. This applies to **ALL** companies regardless of whether they are classified as either a "value" or "growth" stock. When fundamentals weaken the market punishes without regard as to whether the stock is "cheap" or "expensive".

Inflation, Interest Rates & Fixed Income

While the media continues to harp on inflation levels that are higher than we experienced over the past decade, it is interesting to note that the most recent inflation figure of 3.3% is below the 50-year average of 3.8%. We continue to believe that the past decade of inflation below 2% was a historical anomaly caused in large part from importing deflation from Chinese goods. We are concerned that the Federal Open Market Committee (FOMC) continues to anchor their rhetoric on getting inflation down to 2% which will likely not happen short of a recession.

Interest rates have recently declined due to weaker economic reports and falling inflation levels. The prospect of the FOMC cutting interest rates this Fall and into next year has large implications for fixed income investors in terms of the length of bond maturity they should hold. While investors are enticed by high short-term interest rates, in the event of interest rate cuts they will be forced to reinvest in lower coupon instruments. It is for this reason that we believe holding a blend of bonds with varying maturities is preferable to focusing solely on short-term bonds or money market instruments.

Fixed income investing has proven challenging in the past few years as interest rates have risen from artificially low levels to what would be expected in a normally functioning economy. If interest rates continue to fall this will be welcome news for patient fixed income investors.



Source: JPMorgan Guide to the Markets 6/30/2024

Election

While the election is still four months away, given all the media attention to the most recent presidential debate we wanted to share a few quick thoughts. Our founding fathers were brilliant in how they formed our government with numerous checks and balances as they foresaw the dangers of government tyranny throughout history. Having a legislative, executive and judicial branch of government has essentially put sand in the gears of any one faction gaining too much sway. The biggest contributors to our country's success have been property rights, rule of law and divided government. While there be ebbs and flows amongst the players in the various branches of government, we believe that the indomitable spirit and creativity of our citizens will continue to build and sustain a robust business environment which ultimately is the source of our freedom and wealth.

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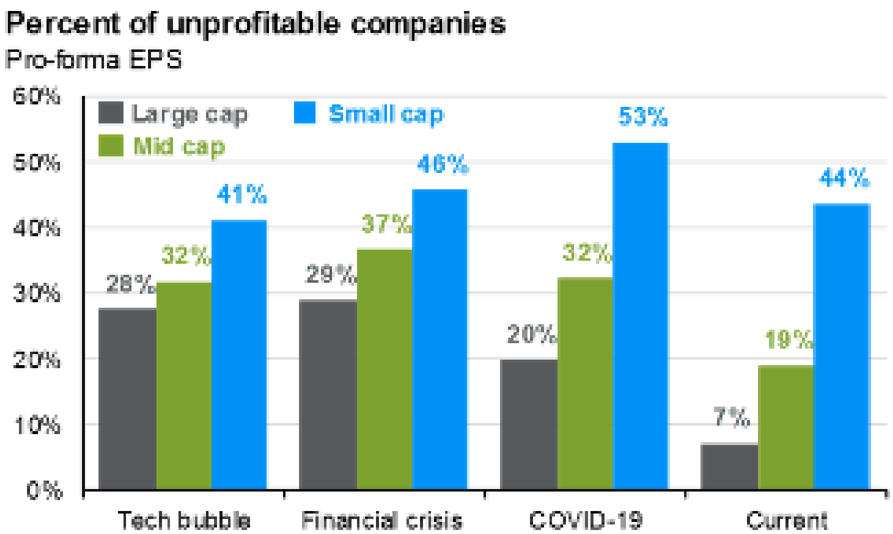
Summary

An interesting chart from JPMorgan below highlights the profitability levels of companies by market capitalization today versus the three market drawdowns we have experienced over the last 25 years. Unquestionably we see a healthier corporate environment today which is comforting. We are particularly impressed with the fact that only 7% of large companies are unprofitable today vs. much higher levels during the technology bubble that many commentators are comparing today's market to.



Source: JPMorgan Guide to the Markets 6/30/2024

We have seen a slight weakening in the economy of late and this has our attention. This is being reflected in the stock market which has seen a wide variety of return profiles between companies depending on how their business is performing, which is healthy. Given the economic uncertainty, investors have gravitated to companies that can perform well in the event the economy weakens. Examples would include technology, communications and select consumer and healthcare stocks.

Outside of the brief economic slowdown associated with COVID, the U.S. has not experienced a recession since the 2007-2008 financial crisis. This is not to suggest that we are "due" for a recession, only to point out that it would not be surprising to see some form of economic softening going forward. Given the vibrancy and diversification of our economy we would expect any economic slowdown to be short lived. Investment timing around the economy has proven fraught with peril and we always look at short-term market weakness as a long-term opportunity and we encourage the same for our clients. We wish you a happy and healthy summer!