Second Quarter 2024 Letter

Figure 1 – S&P 500

Figure 2 – U.S. 10-Year Treasury Yield

As we begin the third quarter of 2024, I have exciting news to share about our firm. Deanna Harless, our Director of Financial Planning, has become a shareholder in Bernard Wealth Management Corp. Deanna's experience and expertise in all areas of financial planning serve our clients well. Moreover, her care, compassion and diligence embody the values that we share here. Deanna joins me and Andy Niedermeier, our Chief Investment Officer, in leading and improving our firm. I hope you'll join me in congratulating Deanna on this important milestone.

Market Recap

Stock returns were mixed in the second quarter of 2024. The large cap S&P 500 continued its strong run, rising 4.3%, and is now +15.3% for the year. Other indices struggled. The S&P Midcap fell -3.5% and the Russell 2000 Small Cap lost -3.3%. Overseas results were also mixed. Emerging markets, led by India, surged in the quarter, gaining 5% while other developed markets fell slightly (-0.4%). Growth stock performance in the U.S. posted strong returns as investors focused on positive earnings surprises, especially from technology companies. U.S. bond returns were also mixed. The Treasury-heavy Bloomberg U.S. Aggregate Bond index eked out a 0.1% gain, while shorter maturity sectors posted slightly stronger returns.

Stocks dipped in April as a rise in bond yields precipitated profit taking. Investor sentiment weakened as inflation remained above the Federal Reserve's 2% target. Declines in large cap stocks were modest, and stocks stabilized and climbed to new heights as long-term interest rates retreated, supported by solid earnings reports. Towards the end of the quarter, some economic readings, including initial jobless claims, weakened. In contrast to the first quarter's broad participation, 6 of 11 S&P sectors and 60% of S&P 500 stocks posted losses for the quarter.

S&P 500 earnings rose 7.0% in the first quarter on 4.4% revenue growth, a small improvement over the prior quarter's 6.4% earnings growth. Results were substantially better than the 2.2% growth expected at the beginning of earnings season, as companies maintained stronger margins than projected. 77% of companies topped analysts' expectations, an improvement over the prior quarter's 73% and in line with the 5-year average. Communication services and information technology were among the top growers again, while energy and health care posted substantial earnings declines. For 2024 Q2, S&P 500 earnings are expected to be up +8.6% from the same period last year on +4.7% higher revenues. This would be the highest earnings growth rate since the +9.9% growth rate in the first quarter of 2022, just before the earnings recession began.

Economic Perspective

U.S. growth continued to slow in the first quarter of 2024. Gross Domestic Product (GDP) rose 1.4%, a noticeable drop from the prior quarter's +3.4% clip. Consumer spending, which comprises about 2/3 of the U.S. economy, grew but at a slower rate. Housing starts also slowed, a further sign that higher interest rates may be impacting the economy. Purchasing manager surveys for both the services and manufacturing sectors in June suggested contraction, a disappointment after stronger, expansionary readings in March.

The employment picture softened in the second quarter, possibly giving the Federal Reserve impetus to cut interest rates. The economy added jobs in the quarter, but at a slower pace than the previous 12 months. The unemployment rate rose to 4.1%, the highest level since November 2021. Wages rose at an annual rate of 3.9%, slightly lower than the +4.1% reading at the end of the first quarter. In addition, job openings continued a steady decline since hitting a late pandemic peak in March 2022. Taken together, this data may point to further slowing in the economy, particularly in consumer spending, which is already showing the impact of higher interest rates.

Inflation moderated slightly in the second quarter as the consumer price index (CPI) inched towards the Fed's target of 2%. Prices in May rose 3.3%, slightly lower than economists' projections. Both new and used automobile prices fell, another sign of the effect of higher interest rates. The producer price index (PPI) was also lower than expected, rising 2.2% over the prior year. As of this writing, Federal Reserve governors have expressed a need for additional data confirming lower inflation before reducing interest rates. However, the slower price growth, along with the weaker employment numbers, should move the Fed closer to the first rate cut.

Looking Ahead

The technology sector (**Figure 3**) led the market higher in the second quarter. While valuations of some of these growers may look rich, robust earnings growth has sustained momentum. We continue to emphasize these stocks in our portfolios. Overseas, emerging markets rallied in the quarter. These stocks, led by India, have high expected earnings growth and attractive valuations. We have shifted our exposure to the emerging markets, effectively removing China from our investments. The current regime, focused primarily on control and maintaining power, has acted capriciously repeatedly against businesses and entrepreneurs, shaking investor confidence in markets and corporations there.

As noted last quarter, long-term Treasury yields (**Figure** 2) remain lower than those offered by similar quality short-term debt. We continue to overweight shorter maturities in our fixed income models, reducing interest rate risk and locking in higher coupons. We note that, when the Federal Reserve does finally cut rates, longer duration bonds should rally strongly. Consequently, we maintain some allocation to intermediate maturity bonds.

Figure 3 – Technology Sector SPDR Fund

Figure 4 – MSCI Emerging Markets ex-China

If the economy continues to slow, volatility may increase, and investors may look to the exits. Rather than trying to time market corrections, we'll stick to long-term client-specific financial plans. After the rally of the past 18 months, we'll be reviewing asset allocation targets and trimming stocks where appropriate. If you have questions about your portfolio, we encourage you to contact us.

We hope you're enjoying the summer!
Best regards,

Kenneth M. Bernard, CFA

Index returns taken from Morningstar.com