

SC Capital Advisors Investor Insights



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2nd Quarter 2024

2024 2nd Quarter in Review & Outlook

"The most dangerous thing is to buy something at the peak of its popularity." —Howard Marks

Narrow leadership fuels momentum surge

The 2nd quarter of 2024 was lackluster for most broader global equity benchmarks, except for a few in the U.S. large-cap growth space that contained a handful of stocks benefiting from the Artificial Intelligence (AI) theme. According to a Morningstar attribution analysis, without the gains from just Nvidia, Apple, Microsoft, Alphabet, and Broadcom, the broad U.S. market index would have been down for the 2nd quarter as well.

Asset Class Returns 2024 (6-30-2024)								
	US Large	US Mid	US Small	REITs	Intl Large	Intl Small	Em Mkts	Bonds
Q1	10.3%	10.0%	5.2%	-1.2%	5.8%	2.4%	2.4%	-0.8%
Q2	3.6%	-3.5%	-3.3%	-1.7%	-0.4%	-1.8%	5.0%	0.1%
2024	14.2%	6.2%	1.7%	-2.9%	5.3%	0.5%	7.5%	-0.7%

Indexes: US Large, Russell 1000; US Mid, S&P MidCap 400; US Small, Russell 2000; REITs, DJ US Real Estate; Intl Large, MSCI EAFE; US Small, MSCI EAFE SSmall Cap; EM, MSCI Emerging Markets; S&P GSCI TR; Bonds, Bloomberg US Agg Bond. Source: Morningstar.

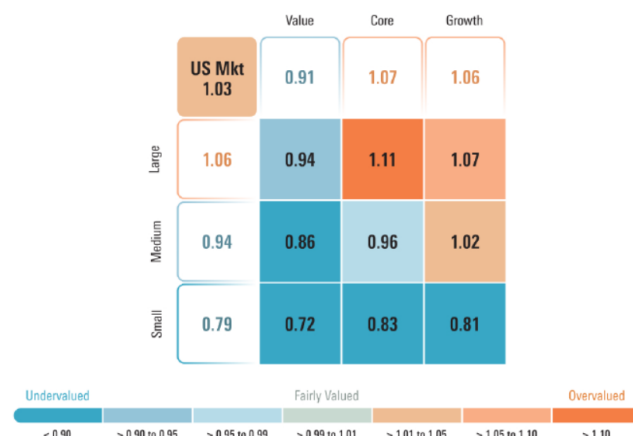
Emerging Markets posted the best gains for the quarter while the broader bond market eked out a small gain but remained in slightly negative territory year-to-date. Real Estate remains the most unloved sector by investors in 2024.

Based on a composite of intrinsic valuations of the approximately 700 stocks covered by Morningstar that trade on US exchanges, as of June 24, 2024, they calculated that the US equity market was trading at a price/fair value estimate of 1.03. This represents a 3% premium to their fair value estimates. Since the end of 2010, the market has traded at this premium or more only 10% of the time, according to Morningstar.

The insatiable demand for a handful of stocks tied to artificial intelligence continues to push the market to a higher premium as compared with a composite of Morningstar valuations. We think AI stocks are at best fairly-valued, and at worst overvalued. Therefore, we expect a widening out of returns across the market to drive further gains. We think this specifically will occur in the value category, which remains the most undervalued, according to Morningstar

US Stock Market Trading Above Fair Value

Valuations of Morningstar's equity research coverage by equity style box.



valuations, as well as down in capitalization into small-cap stocks.

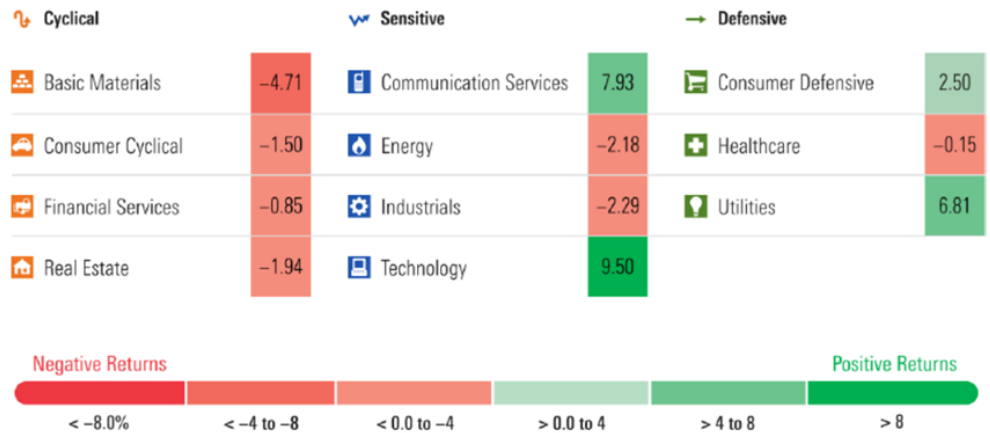
While it may have been a little early to start moving into contrarian plays, we continue to see the best opportunities among those sectors and stocks that have underperformed, are unloved, and—most important—undervalued.

The ongoing surge in AI-related stocks, along with positive returns in defensive sectors, was enough to push the broad market index into positive territory, but that hides the losses seen elsewhere.

The technology and communications sectors surged as AI plays remain hot. Even though the utility sector is considered a defensive sector, it too has been caught up in the demand for AI-related plays. Computing for AI requires multiple times more electricity than traditional computing and investors have increasingly begun to price in that higher electric usage.

Returns by Sector: Quarter to Date (%)

Widespread losses as investors flock to artificial intelligence plays or look to play defense.



As the rate of economic growth slows, consumer defensive stocks have caught a bid as investors become increasingly nervous that macroeconomic risk could pressure earnings elsewhere. Losses were widespread across the cyclical sectors as well as economically sensitive sectors such as energy and industrials.

Value/Growth disparity increases

The AI phenomenon has caused an even greater disparity of returns between Growth and Value, or “style,” indexes, particularly in U.S. asset classes. The data show that this phenomenon is largely a U.S. trend and predominantly among large-cap technology-driven companies. The style disparity is much narrower in the international (MSCI) indexes. We think the disparity is also a result of some investor overexuberance, as it could be quite a long time before all the AI capital investment boom translates into profitability and productivity enhancement. We have seen a rebalancing from large-cap growth into value and small- and mid-cap stocks at the beginning of the third quarter.

Style Indexes

Total Returns through 6-30-24

Name	YTD	1 Month	3 Months	6 Months	12 Months	3 Years	5 Years	10 Years
Russell 1000 Growth TR USD	20.70	6.74	8.33	20.70	33.48	11.28	19.34	16.33
Russell 1000 Value TR USD	6.62	-0.94	-2.17	6.63	13.06	5.52	9.01	8.23
S&P MidCap 400 Growth TR USD	11.70	-1.28	-3.38	11.70	18.82	4.04	10.49	9.71
S&P MidCap 400 Value TR USD	0.45	-1.90	-3.52	0.45	8.17	4.65	9.54	8.18
Russell 2000 Growth TR USD	4.44	-0.17	-2.92	4.44	9.14	-4.86	6.17	7.39
Russell 2000 Value TR USD	-0.85	-1.69	-3.64	-0.85	10.90	-0.53	7.07	6.23
MSCI EAFE Large Growth NR USD	7.49	-0.20	-0.17	7.49	10.03	1.45	7.28	5.95
MSCI EAFE Large Value NR USD	5.34	-2.48	0.42	5.34	14.46	6.79	6.75	3.03
MSCI EM Growth GR USD	8.58	4.56	5.01	8.58	11.33	-8.48	3.41	3.76
MSCI EM Value NR USD	6.46	3.33	5.08	6.46	14.13	-1.09	2.91	1.96

Data source: Morningstar

Risk builds in capitalization-weight indexes

Yet another way to see the AI influence among U.S. Large Cap stocks is to compare a capitalization-weighted index like the widely-known S&P 500 versus its equal-weighted counterpart. A capitalization-weighted index assigns a larger proportion to companies with higher market values, meaning bigger companies have more influence on the index’s performance. In contrast, an equal-weighted index gives each company the same importance, regardless of its market size, leading to a more balanced representation of all constituents.

Below, the shorter-term returns strongly favor the cap-weighted methodology, displaying the massive influence of the few mega-cap technology-oriented stocks that have driven returns. Yet, the long-term inception returns favor the equal-weighted index. This data reinforces the importance of periodically rebalancing portfolios based on valuations.

S&P 500 Equal Weighted Index
Total Returns ending 6-30-2024

Name	YTD	3 Mo	6 Mo	12 Mo	Annualized				
					3 year	5 Year	10 Year	15 Year	Incep*
S&P 500 Equal Weighted TR USD	5.08	-2.63	5.08	11.79	4.84	10.94	10.04	14.00	12.24
S&P 500 TR USD	15.29	4.28	15.29	24.56	10.01	15.05	12.86	14.82	11.07

Data source: Morningstar
*1-8-2003

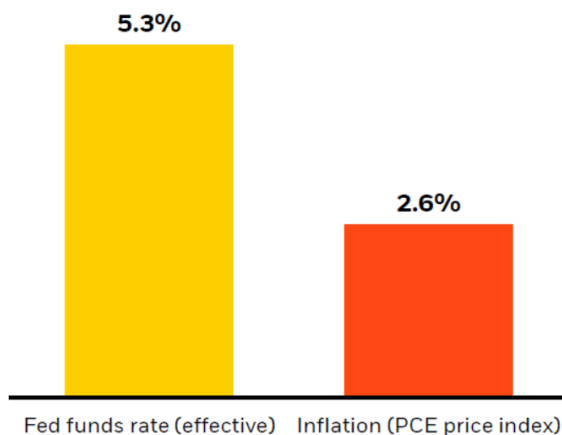
According to Morningstar, value stocks trade near their lowest valuations relative to the broad market valuation over the past 14 years while Blackrock reports that Large Cap stock outperformance over small cap stocks is the largest since 1999. Blackrock also reports that the gap between the Fed Funds rate and the current inflation rate is the largest since August of 2007, which bodes well for a central bank rate cut later this year.

Inflation lower than the Fed funds rate by the largest amount since 2007

Along with moderating economic growth and decelerating inflation might allow the Fed to bring rates down

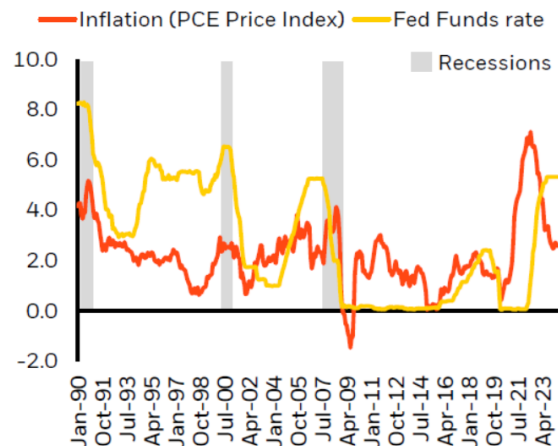
The Federal Reserve’s preferred inflation gauge is well below the Fed funds rate

As of May 2024 PCE report



This is the largest gap between the Fed funds rate and inflation since August 2007

Since 1990, 1/1/1990 – 6/30/2024



Source: Federal Reserve, NBER as of 6/30/24. Federal Funds rate and PCE as reported by the Federal Reserve. Recession time periods are as reported by the NBER. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

Uncharted territory in presidential race

As the presidential race heats up, the political landscape continues to reflect deep divisions and significant challenges. Former President Donald Trump remains a polarizing figure, with his policies and rhetoric eliciting strong reactions from both supporters and detractors. Meanwhile, President Joe Biden faces scrutiny over concerns related to his age and cognitive health, with some questioning his ability to manage the rigorous demands of the presidency. Voters are weighing these and other factors as they consider their options in the upcoming election, underscoring the complexity and high stakes of this electoral season. Many in the Democratic party are even questioning at this late stage on whether Mr. Biden should even be the nominee at this point.

It's important for investors to maintain a long-term perspective and avoid making drastic changes to their portfolio based solely on the results of a presidential election. Historical data has shown that markets have experienced ups and downs under both Democratic and Republican administrations. Instead of reacting to short-term political events, investors should focus on their overall financial goals, risk tolerance, and investment strategy. Staying diversified and adhering to a well-thought-out plan is generally a more effective approach than making hasty decisions based on election outcomes.



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Strategic Roth conversions

We have been conducting quite a bit of strategic Roth conversion analysis for clients lately, particularly those who have recently retired and find themselves in the Roth conversion “sweet spot.” A Roth conversion involves transferring assets from a traditional IRA or 401(k) into a Roth IRA, which can result in taxable income at the time of conversion but allows for tax-free withdrawals later in retirement. The sweet spot occurs when someone is recently retired, their household income is potentially lower than when they were working, and they are in the years before Required Minimum Distributions begin, which is currently at age 73.

While there is no right or wrong answer regarding Roth conversions, there are a few rules of thumb to follow: 1) Convert over time, 2) Stay within your current marginal tax bracket, 3) Pay the taxes with non-qualified (after tax) money, if possible. This allows for putting all of the converted qualified money to work tax-deferred in the Roth account.

One does not have to be in the sweet spot to convert. It can make sense to do Roth conversions while you are still working or after you have reached RMD age. If you would like to have a conversation about it, please give us a call or send us an email.

Please let us know if you have any questions. We look forward to talking with you soon.

—Dana L. Crosby, CFA, CFP®

ETF Returns

For the period ending 06-30-2024

Name	Ticker	YTD	1 Month	3 Months	12 Months	3 Year	5 Year	10 Year
U.S. Large Cap								
iShares Russell 1000	IWB	14.08	3.26	3.56	23.74	8.61	14.48	12.37
iShares Edge MSCI USA Momentum Factor	MTUM	24.44	4.54	4.12	36.06	5.35	11.76	13.29
iShares Edge MSCI USA Quality Factor	QUAL	16.55	3.24	4.11	28.13	10.15	14.94	13.19
PowerShares S&P 500 Low Volatility ETF	SPLV	4.78	-0.28	-0.90	5.94	4.42	5.63	8.54
Vanguard High Dividend Yield ETF	VYM	7.76	-0.32	-1.13	15.38	7.52	9.75	9.37
VanEck Vectors Morningstar Wide Moat	MOAT	2.05	-0.02	-3.66	9.49	6.49	13.87	12.45
U.S. Mid Cap								
SPDR® S&P MidCap 400 ETF	MDY	6.05	-1.67	-3.47	13.16	4.22	10.00	8.87
PowerShares S&P MidCap Low VolatI ETF	XMLV	5.05	-1.46	-1.54	9.14	3.24	3.67	8.01
PowerShares DWA Momentum ETF	PDP	14.50	1.31	-0.93	20.98	3.30	10.45	9.98
PowerShares High Yld Eq Div Achiev™ ETF	PEY	-4.94	-2.42	-3.86	7.50	2.83	6.27	8.67
U.S Small Cap								
iShares Russell 2000	IWM	1.62	-1.12	-3.25	9.84	-2.69	6.85	6.96
PowerShares S&P SmallCap Low VolatI ETF	XSLV	-0.17	-0.46	-0.93	11.97	-0.13	-0.51	5.61
REITs								
iShares US Real Estate	IYR	-3.04	1.88	-1.78	4.49	-2.28	2.87	5.40
International Large Cap								
iShares MSCI EAFE	EFA	5.79	-1.81	-0.18	11.34	2.95	6.56	4.32
iShares Edge MSCI Intl Momentum Factor	IMTM	14.33	-0.62	-0.06	19.34	3.71	8.31	-
PowerShares DWA Developed Mkts Mom ETF	PIZ	13.37	1.22	4.22	18.80	0.06	7.25	4.55
iShares Edge MSCI Intl Quality Factor	IQLT	5.63	-0.72	0.03	12.57	3.16	7.83	-
PowerShares S&P Intl Dev Quality ETF	IDHQ	7.95	-0.65	-0.10	14.97	2.28	7.82	6.33
iShares Edge MSCI Min Vol EAFE	EFAV	2.07	-1.22	-0.15	6.13	-0.01	1.87	3.56
iShares International Select Dividend	IDV	2.30	-3.82	1.26	12.44	1.60	4.42	2.08
International Small Cap								
iShares MSCI EAFE Small-Cap	SCZ	1.02	-3.10	-1.26	7.48	-3.30	4.13	4.21
WisdomTree International SmallCp Div ETF	DLS	1.82	-3.08	-1.00	10.97	-0.95	3.50	3.37
Emerging Markets								
iShares MSCI Emerging Markets	EEM	6.65	2.62	4.39	10.49	-6.01	2.15	2.06
PowerShares S&P Em Mkts Low VolatI ETF	EELV	-0.08	0.95	-0.09	4.83	3.31	3.22	1.78
PowerShares DWA Emerging Markets Mom	PIE	9.79	0.72	3.64	16.07	-5.31	6.24	3.37

Data source: Morningstar

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