Palisade CAPITAL MANAGEMENT | Private Wealth

Q2 2024 REVIEW AND OUTLOOK

Broad Market Indices	INDEX LEVEL	2Q 2024 RETURN (%)	YTD 2024 RETURN (%)
S&P 500® Index	5,460.48	4.28	15.29
Dow Jones Industrial Average	39,118.86	-1.27	4.79
NASDAQ Composite Index	17,732.60	8.47	18.57
Russell 2000® Index	2,047.69	-3.28	1.73
MSCI ACWI ex US Index	468.70	1.11	5.69
Barclays U.S. Aggregate Bond Index	89.96	0.07	-0.71
VIX Volatility Index	12.44	-4.38	-43.61
Baltic Dry Index – Spot (Ocean Cargo Shipping Rate)	2050	12.58	42.44
Gold ($ per ounce) – NY Spot	2,327.7	4.28	12.78
Oil ($ per barrel – West Texas intermediate)	81.52	-2.91	13.40
Bitcoin ($)	60,329	-14.73	43.67

U.S. Treasury Yields	6/30/24	3/31/24	Change over Quarter
3-Month	5.36	5.35	0.01
2-Year	4.72	4.62	0.10
10-Year	4.37	4.20	0.17

Source: FactSet Research Systems, Inc.

What Just Happened? The U.S. equity market (S&P 500® Index) notched a gain of nearly 4% in the June quarter. Considering the challenges of the quarter, the market's "good-but-not-great" Q2 June performance deserves respect. Those challenges included (1) higher-than-hoped inflation – still above the Federal Reserve's 2% goal – and, thus, (2) no interest rate relief from the Fed. The bank's base interest rate has been 5.25-5.50% for a full year. At the start of this year many economists predicted the Fed would cut rates four or five times in 2024. Now, most Fed watchers expect the bank to cut rates just once or twice in the second half, if even that.

So, given these challenges, what can we expect of markets in the second half of the year?

The Trouble with Averages. Indices like the S&P are only averages. They don't tell the story of the turbulence that often occurs *within* the average. Case in point: the quarter's performance was led by just a few white-hot technology shares like artificial intelligence (AI) chip maker NVIDIA whose 37% jump in the period accounted for *nearly half (44%) of the total gain in the S&P Index in the quarter*. **But most other S&P sectors, like consumer, financial, energy, and health care struggled in the quarter and actually lost ground.**

Technology: The Whale in the Pool. The technology segment today constitutes 32% of the S&P's market value – slightly more than the *combined* financial, health care, and industrial sectors. Lopsided? Yes. Unprecedented? No. Twenty-four years ago, in the first quarter of 2000, technology shares then accounted for 33% of the S&P 500® Index. In that heady era the convergence of new technologies, especially the internet and the world wide web, made everything seem possible and brilliant – at least until the realities of overcapacity and overvaluation crashed the party. Two years later, at end-March 2002, the technology sector's weight in the S&P 500® Index had been cut in half to just 16%.

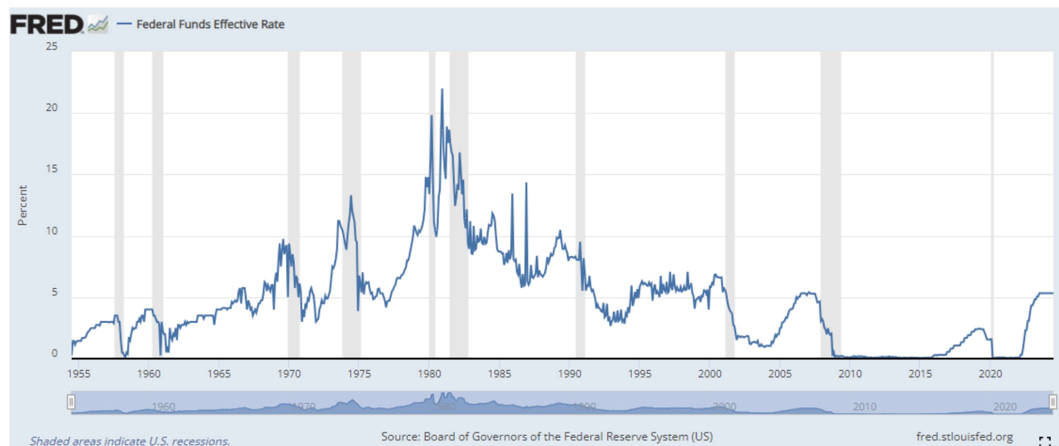
Could that happen again? There's no denying the similarity between investors' love affair with AI now and their prior infatuation with the new technologies of that era. But there are major differences between the periods.
First, today's tech sector is dominated by a handful of very profitable companies. Just three multi-trillion dollar valued companies – Apple, Microsoft, and NVIDIA – make up approximately 68% of the S&P technology sector versus 45% as of March 2020. And their products touch many more aspects of our personal and professional lives (and more

deeply so) than ever. Imagine living without a smartphone, for example. Most of us would be unable to do everyday tasks: work, bank, shop, take and send photos, engage with social media, and communicate generally.

Second, the productivity benefits of AI are likely to show up sooner than they did with 1990-2000 era technologies. This is critical. In 2001, the National Bureau of Economic Research wrote "[c]hanges in technology are the only source of permanent increases in productivity". And the principal ways that healthy economies expand are through productivity and/or population growth (ideally both). AI-driven productivity gains will likely be faster and more "democratic" than older innovations. By that we mean that in the old days one had to purchase a personal computer or buy a smart phone to benefit from the devices' innovative technologies. But the benefits of AI will likely radiate *outward* from, say, a datacenter to an organization's customers and clients. Thus, users may benefit from AI without having to make personal investments in AI. Rather, that will be the job of hyper-scalers like Google and Amazon. Some pundits say that there are no good "use cases" for AI now, but this super-technology is just in its infancy. To judge by the $100 billion capital investment in AI that Amazon alone recently announced, big things are coming.

As the benefits of AI become commercially tangible, we expect productivity to jump in many downstream industries, which ironically might lead to a broadening of AI's benefits across the stocks of many *non*-technology industries and overlooked equity groups, including value stocks as well as mid-cap and small-cap market segments, all of which have recently lagged large cap growth shares.

And Those Fed Rate Cuts? Be Careful What You Wish For. At least in theory, we would all like to see lower interest rates. But the long history of Federal Reserve rate cuts is complicated – and not encouraging. As the chart to the right shows, cuts in the Fed's "policy rate" from 1955 to the present mostly have occurred *during or after* the start of a recession (recession years are marked in the gray vertical bars). Perhaps the Fed is no better than the rest of us in predicting downturns. It may not be such a bad thing for the Fed to keep rates "higher for longer" as that might mean the economy is performing well, and the central bank is at or near its dual mandate of price stability and full employment.



Source: Federal Reserve Bank of St. Louis; Board of Governors of the Federal Reserve (US), June 2024.

Our Outlook. In this U.S. presidential election year, the punditry is in overdrive to explain how Messrs. Trump and Biden would drive the economy in one direction or another. The polls have been unreliable in recent years, and we are not certain that the "presumptive" nominees will *be* their parties' candidates after their conventions this summer (more so for the Ds than the Rs). In an era of divided government, we are not sure that either party's leader would want to (or be able to) take the economy on a different path than the one which has worked well in recent years. Inflation is falling, though slowly, unemployment has been below 4% for some time, and real economic growth has been around 2% per quarter since the end of the pandemic.

This has been a rewarding environment for stocks – at least the stock *averages*. But we think the tight concentration of market value in a handful of technology stocks will begin to loosen, because of the productivity benefit we believe AI will unleash broadly throughout the economy – even if the Fed keeps interest rates "higher for longer."

Thank you for allowing us to manage your investments. We aim to reward your faith in us for years to come.

Sincerely,
Palisade Capital Management

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The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance, based on the market capitalizations of 500 large companies having common stocks listed on the NYSE or NASDAQ. The S&P 500® Index does not have a defined investment objective, nor does it charge fees and expenses.

The Dow Jones Industrial Average (The Dow), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock market.

The Russell 2000® Index (the "Index") measures the performance of the small-cap segment of the U.S. equity universe. It consists of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Source: London Stock Exchange Group plc and its group undertakings (collectively, the “LSE Group”). © LSE Group 2024. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trade mark(s) of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group, nor its licensors, accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor, or endorse the content of this communication.

The MSCI ACWI Ex-U.S. is a stock market index comprising of non-U.S. stocks from developed and emerging markets. The Index is made up of constituents which make up approximately 85% of the global equity market aside from the U.S.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500® Index options.

The Bloomberg Barclays U.S. Aggregate Bond Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

The Baltic Dry Index (BDI), is issued daily by the London-based Baltic Exchange. The BDI is a composite of the Capesize, Panamax, and Supramax Timecharter Averages. It is reported around the world as a proxy for dry bulk shipping stocks, as well as a general shipping market bellwether.

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing and is the underlying commodity of the New York Mercantile Exchange’s oil futures contracts.

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