



Mainsail
WEALTH ADVISORS

Quarterly Market Commentary

Another Brick in the **W**all

As we reflect on the first half of 2024, AI has certainly been the predominant theme driving both investor optimism and market performance. Companies like Nvidia, Microsoft, Apple, and the so-called "Magnificent 7" have led the charge, with Nvidia alone accounting for 40% of the S&P 500's Q2 return. These tech giants have contributed nearly two-thirds of the S&P 500's performance year-to-date. The hope of a fundamental change in the earnings trajectory of a wide swath of companies, coupled with growing consensus that the Fed may in fact architect a "soft landing", has led to a bullish environment for investor sentiment. However, our team remains cautiously optimistic as we head into the back half of the year, mindful that elevated investor sentiment, above average market valuations, and geopolitics, could derail the current trajectory of stocks.

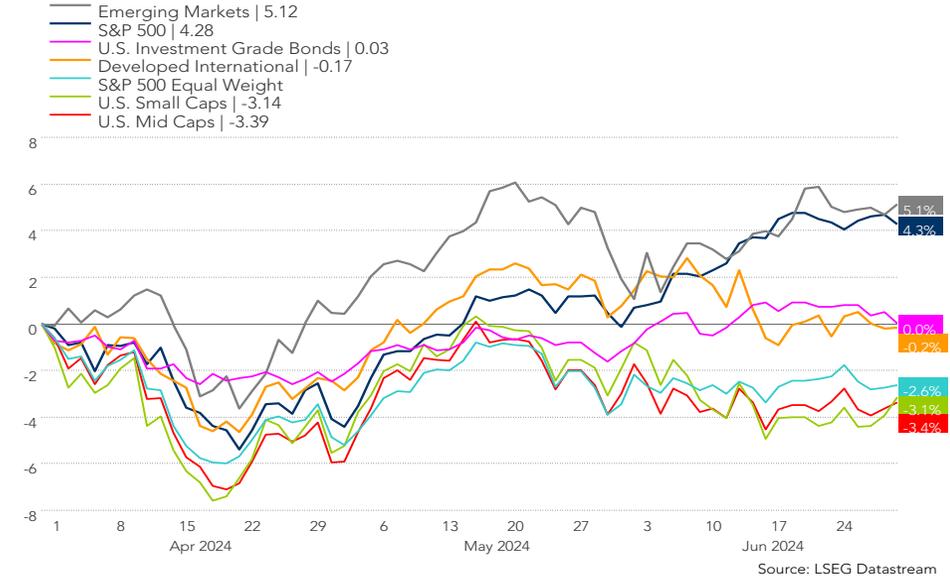
During the quarter, the S&P 500 climbed the proverbial "wall of worry", adding another 4.3% after a strong start in Q1, which saw the index up 7.0%. While the tech heavy S&P has broken out to new highs, Small Caps and the S&P Equal Weight index have yet to eclipse their previous peaks, suggesting a narrow rally. Additionally, measures of investor optimism currently sit at elevated levels, indicating that much of the 'good news' may already be priced in. It would be reasonable for the markets to consolidate some of the recent gains over the summer before potentially moving higher near year-end.

Looking ahead, despite the moderation in U.S. economic growth with the labor market and leading economic indicators showing signs of slowing, there are reasons for optimism. Other developed markets, notably Japan, are experiencing cyclical upturns. Inflation is showing signs of easing, with the CPI hitting its lowest level since 2020. Lastly, we anticipate the Fed may begin gradual rate cuts as early as September, aiming to balance its dual mandate of maintaining stable prices and achieving full employment. With over \$6T of assets built up in U.S. Money Market Funds we believe there is a potential for significant reinvestment into riskier assets as rate cuts reduce the appeal of cash holdings.

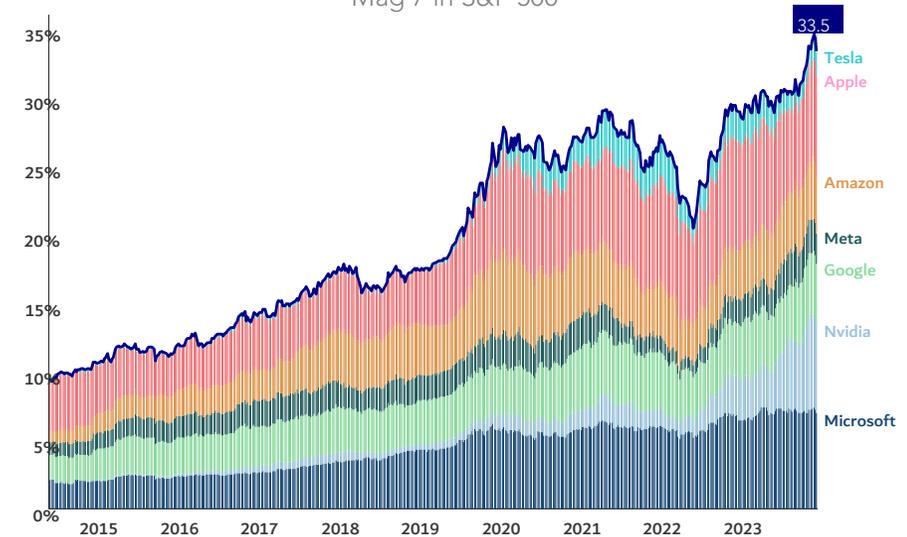
Political uncertainty also looms large with the upcoming U.S. elections, adding a layer of unpredictability to market dynamics. In addition to the U.S., 2024 will see the largest number of global elections ever held in a single year. This could certainly stir market volatility.

Overall, the Mainsail Investment Committee is on balance, cautiously optimistic. Our view is that the pros outweigh the cons and believe equities will likely outperform bonds over the next 12 months. As we look forward, we aim to navigate these twists and turns with a steady hand, ready to capitalize on opportunities as they arise.

Last Quarter Asset Class Returns



Concentration
Mag 7 in S&P 500



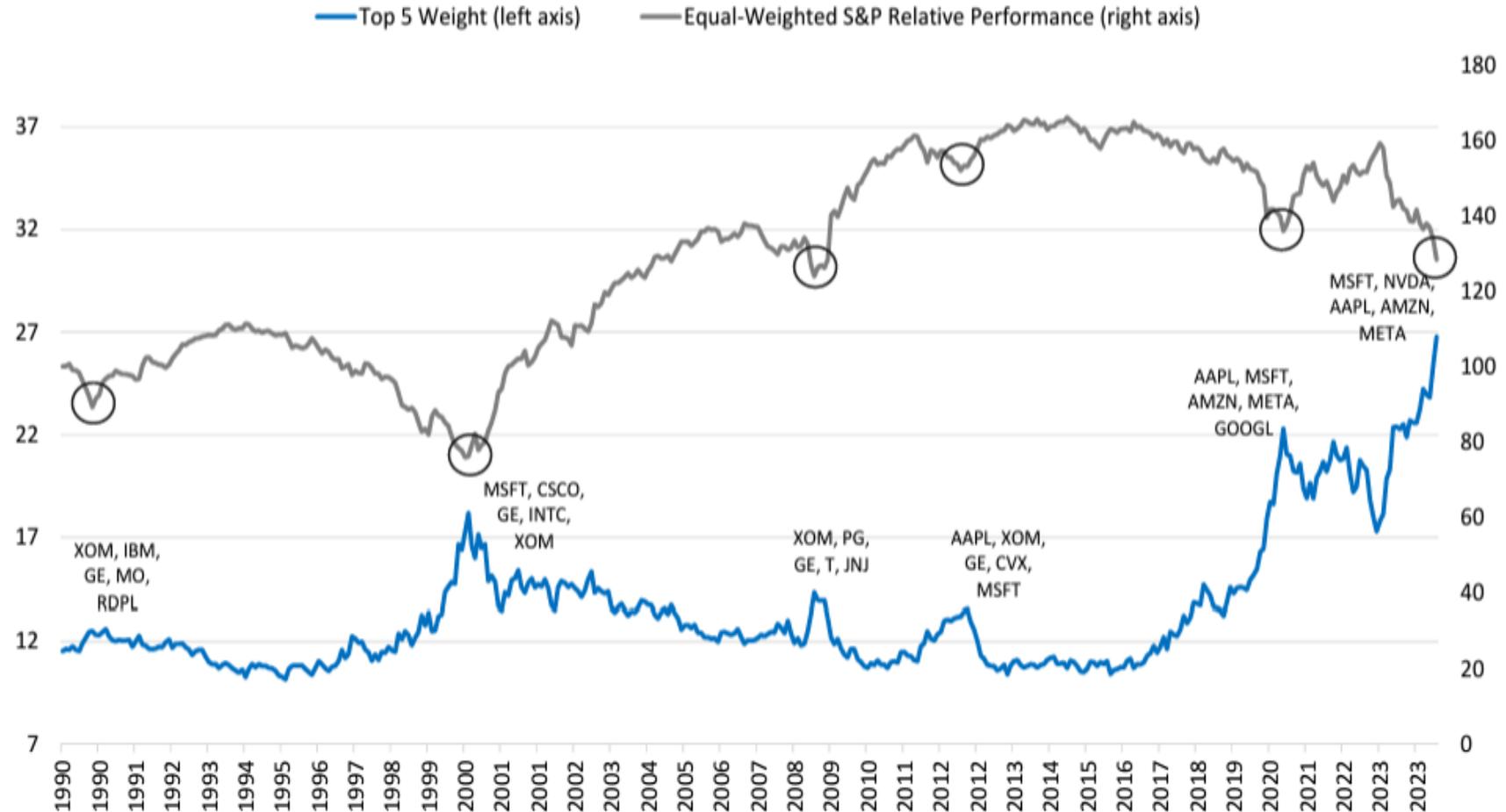
Diversification Still Matters, We Promise!

Post pandemic, tech has led the way in a dramatic fashion. So much so that many are tempted to abandon any sense of prudence and chase returns that have already occurred. After all, AI is going to change the world and you don't want to miss out....right?

We are reminded of the same sentiment that doomed so many investors at the dawn of the internet age and caution against this approach to investment management. We ran across this description from Raymond James' Mike Gibbs and think its worth a read:

"Overall, diversification remains paramount, and any broadening out should favor active management in the coming years. Currently, the narrow outperformance from Tech mega-caps has resulted in a spike in market concentration with the top 5 constituents accounting for ~27% of the S&P 500. Historically, spikes in market concentration have typically presented opportunity for the "average stock" to gain relative performance—thus favoring active management. Additionally, it is important to note that leadership can change over time, so it is important not to get complacent."

S&P 500- Top 5 Constituent Weighting & Relative Performance



Fed's Balance Sheet Returns to Pre-Pandemic Levels

- Don't look now, but the Federal Reserve has been slowly tightening policy behind the scenes with their current Quantitative Tightening campaign.
- This coupled with the sharp rise in the S&P 500 has sent the Fed's Balance Sheet, relative to the overall US Market Cap, back to levels not seen since February of 2020 right before the Fed launched its aggressive response to the pandemic.

Government Debt is High, but the dollar is somehow strong

- With exploding U.S. deficits, the U.S. now stands only behind Italy, Greece and Japan as the largest amount of government debt relative to domestic GDP. This is our preferred way to look at debt as it takes into account the income level of the borrowing country.
- Despite this increase in debt, the dollar has done surprising well relative to other currencies.

Japan's market has broken out to new all-time highs after decades of stagnation

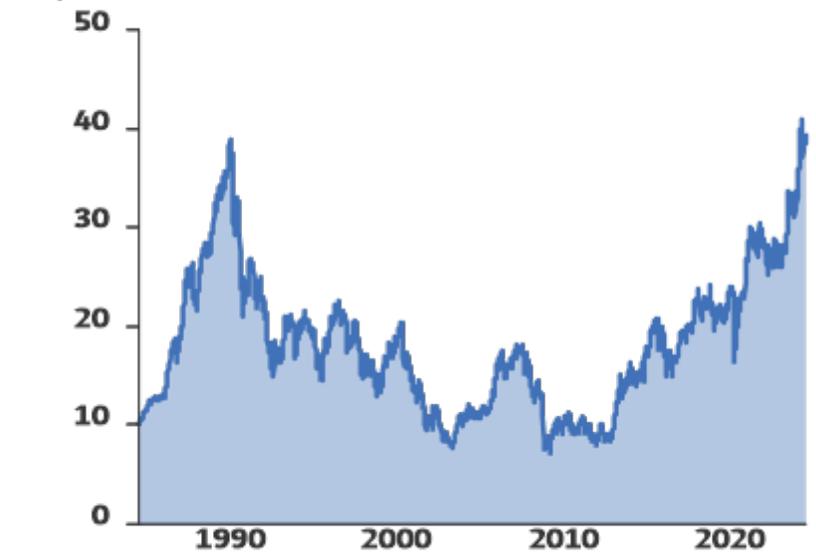
- After spending the last 30 years struggling to overtake previous all-time highs from the '80s, Japan's stock market has had a massive and notable resurgence this year. A falling Yen and improved growth prospects seem to be the catalyst.

Federal Reserve Balance Sheet



Source: LSEG Datastream

Nikkei 250 Stock Index



Source: LSEG Datastream

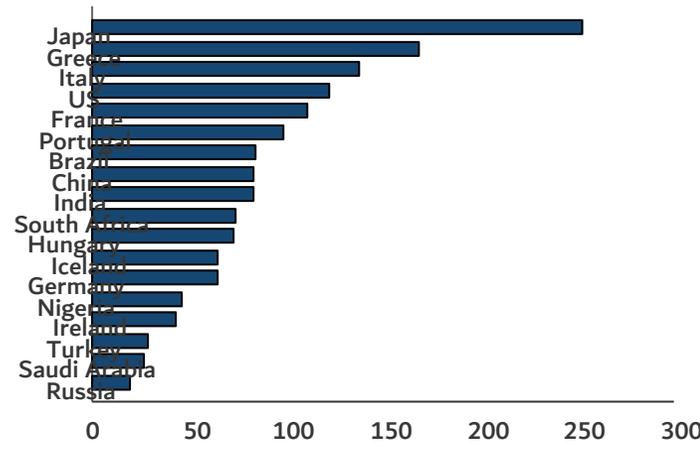
US broad trade weighted dollar



Source: LSEG Datastream

Gross government debt

Per cent of GDP, 2023



Source: LSEG Datastream



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Equity Market Outlook

Valuations and Market Breadth

- Despite high valuations in mega-cap stocks (27.8x), the broader market, as represented by the S&P Equal Weight index, shows reasonable PE ratios (21.1x). Recent increases in market breadth suggest a more inclusive rally, with small caps showing strong performance.

Earnings Growth Outperforming Expectations

- 2024 Consensus S&P 500 earnings are stable with double digit growth expected, and 2025 earnings have been moving higher as well. While PE's may be elevated as long as earnings growth continues at a healthy clip, downside risks should be limited.

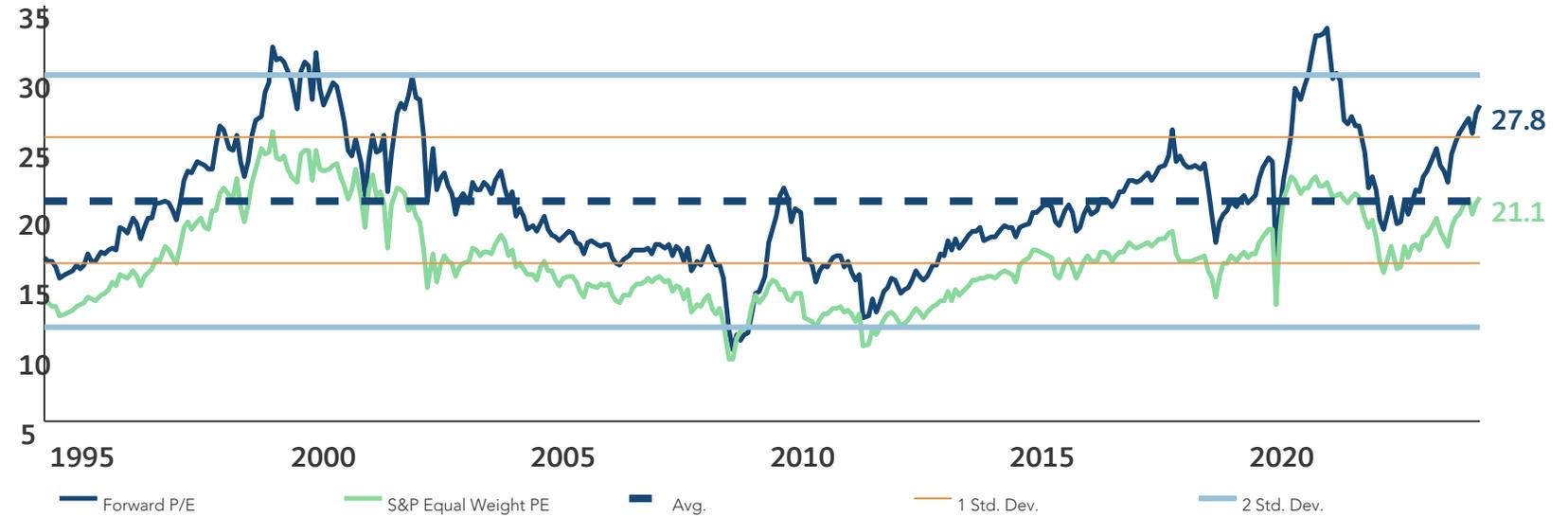
AI & Productivity:

- The AI-driven bull market may very well be in its infancy with significant productivity gains expected across various industries.
- Identifying key winners remains challenging but this “revolution” could provide a catalyst for earnings growth and/or margin expansion for years to come across a wide swath of industries.

Cash on Sidelines

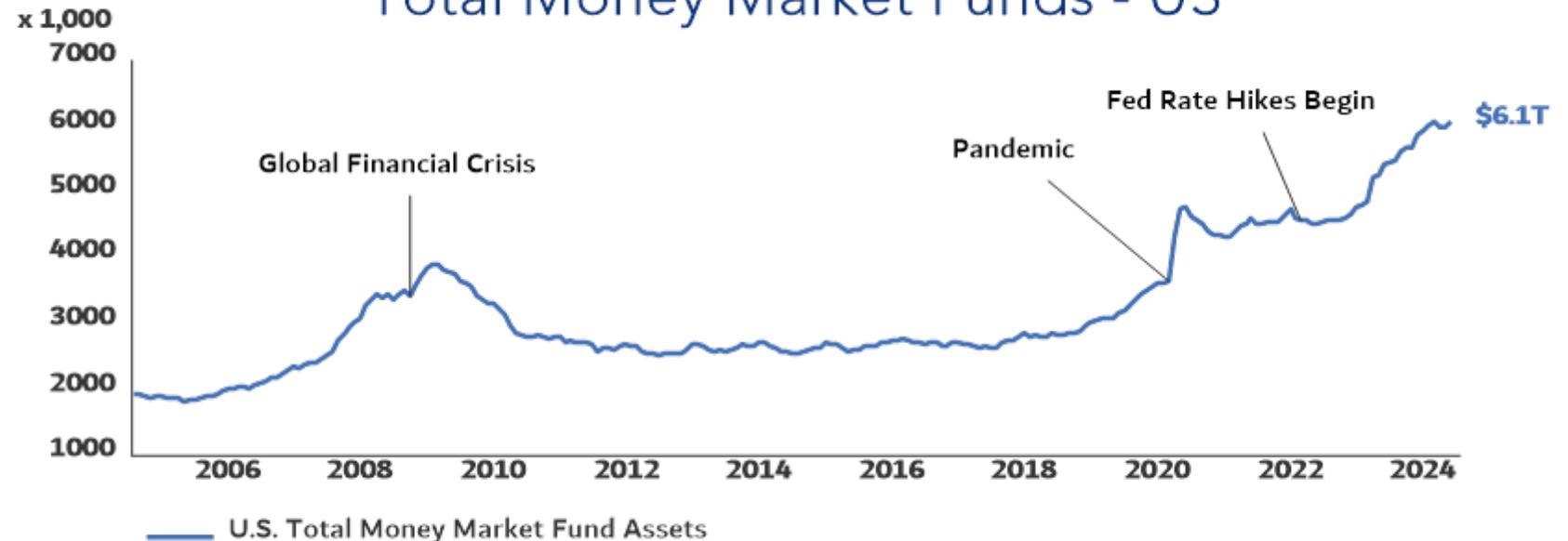
- As investors navigated the post-pandemic era and money market rates rose to levels not seen since the early 2000s, investors piled into these “safe assets”. As rates begin to fall, investors are likely to redeploy some of the record assets held in Money Market funds to equities.

S&P 500 PE vs. S&P Equal Weight PE



Source: LSEG Datastream

Total Money Market Funds - US



Source: LSEG Datastream



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Fixed Income Outlook

Fed Rate Cuts

- As the FOMC attempts to balance its dual mandate of stable prices and full employment, markets are anticipating a series of Fed rate cuts starting in September. The expected cumulative cuts of 75 basis points by year-end have already influenced short-term and long-term yields. It will be important to monitor the markets' reaction to this shift in policy to identify any emerging trends or opportunities.

Inflationary Pressures

- While global CPI has continued to moderate (see chart to the right), historically, the final push to get back to trend inflation has been slow. Given the inevitable change in Washington come November, new policy decisions may impact the trajectory of inflation, further complicating the Fed's job.

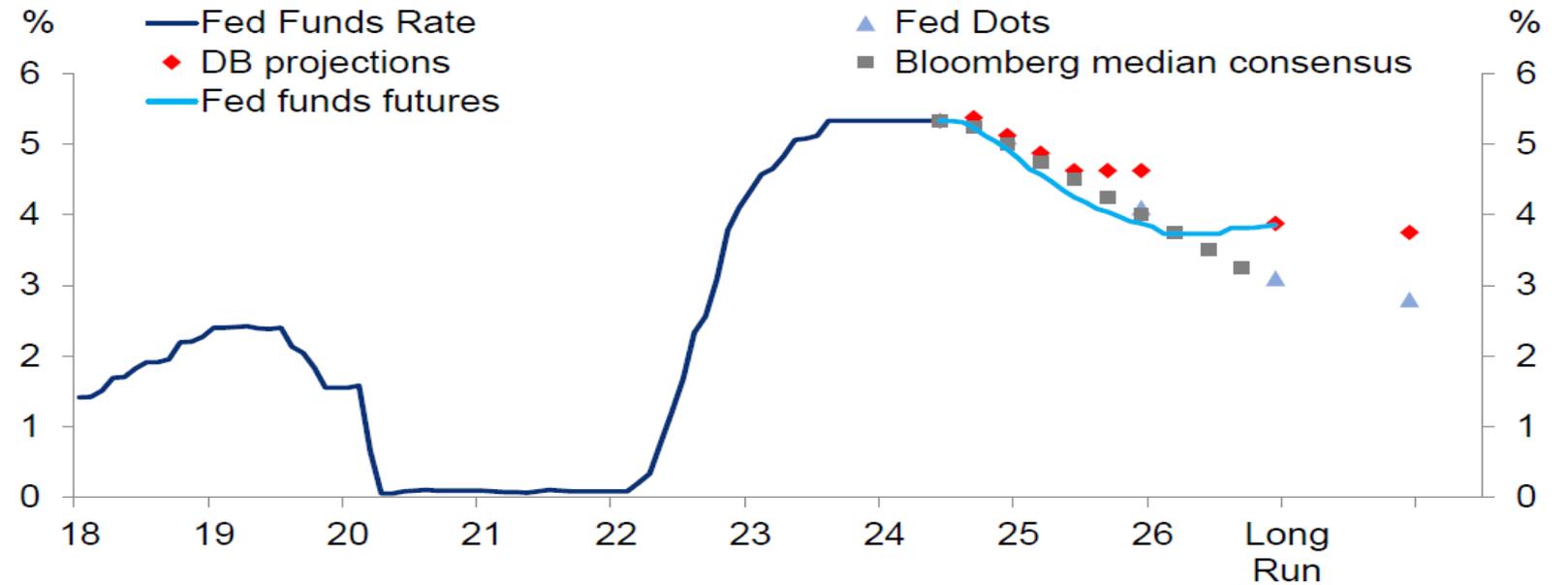
Credit Spreads

- Current spreads for high-yield bonds remain near historic lows, indicating market stability. The expected gradual rise in defaults, rather than a sudden spike, suggests that credit spreads will remain tight.

Sector Specific Insights

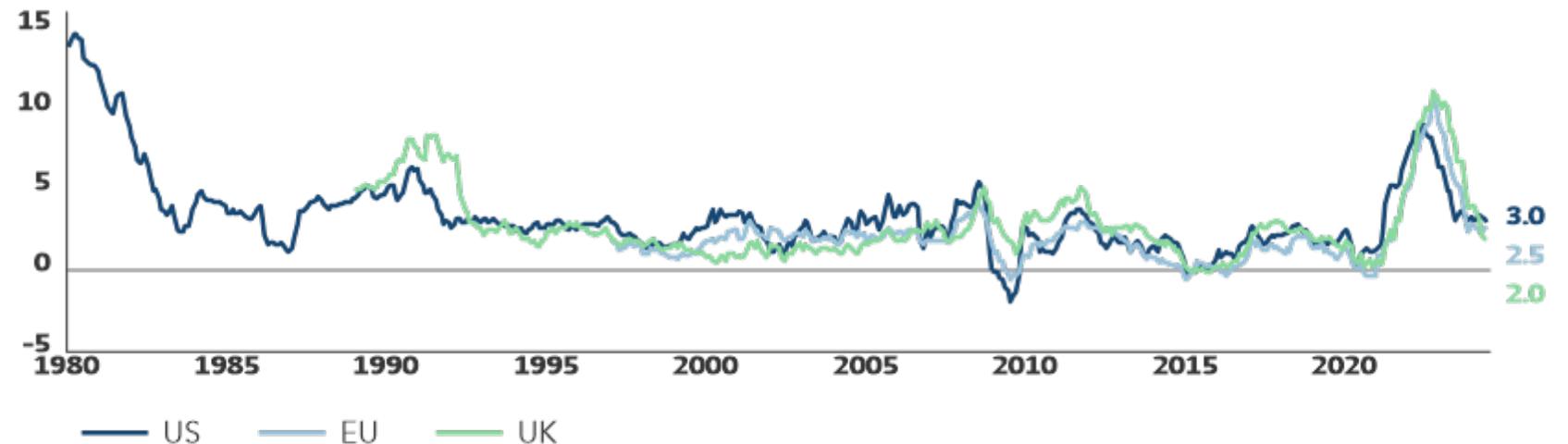
- Corporate bond spreads in A-rated and BBB-rated segments are tight, signaling investor confidence in the economy. Municipal bonds remain attractive in our view with elevated spreads over Treasuries. As we head into 2025, we believe demand for tax free income is likely to remain strong as investors weigh the possible end to the Trump era tax cuts and supply remains limited.

DB Fed forecast versus alternative expectations



Global CPI

Twelve-month percentage changes



Source: LSEG Datastream

Disclosures

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INDEX DEFINITIONS

Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Barclays Capital US Aggregate Index is an unmanaged market value weighted performance benchmark for investment grade fixed rate debt issues, including government, corporate, asset backed, mortgage backed securities with a maturity of at least 1 year.

The S&P SmallCap 600[®] measures the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable.

The S&P MidCap 400[®] Index provides investors with a benchmark for mid-sized U.S. companies. The index, which is distinct from the large-cap S&P 500[®], measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment.

MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indexes. The index's three largest industries are materials, energy, and banks.

MSCI World Ex-U.S. (Net Div) Index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries excluding the United States. With 1,023 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.