JOURNEY

Journey Wealth

Quarterly Market Commentary

Q3 July 2024

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Journey Wealth Investment Team

Pete Franz, CFA, CFP –
Chief Investment Officer

As the CIO of Journey Wealth, Pete is responsible for establishing, managing, and articulating the firm's investment platform and approach. He collaborates with the firm's investment partners, monitors markets, and conducts portfolio analysis to construct portfolios that align with client objectives.

As the Head of Investments, Jack divides his time between developing solutions for clients and assisting with the curation of the firm's investment portfolios. Jack supports Pete in all facets of developing and monitoring the Journey Wealth investment platform, including working with key asset managers, our advisory team, and conducting ongoing research.

Jack LaLiberte, CFA, CPA -
Manager, Investments

Market Recap

Market Recap

Thus far, 2024 has seen a continuation of recent trends in equity markets, characterized by low volatility and performance that was positive but relatively concentrated in a narrow neighborhood of large US companies. Fixed income markets have been volatile as market participants and the Fed have become more aligned on the future path of interest rates. Fundamentally, the global economic engine has continued to hum along, bolstered by upside growth surprises in the US and China.

Looking Ahead

Before 2020, capital markets experienced extended periods of gradually declining interest rates and low, stable inflation. That dynamic shifted in the wake of the COVID pandemic and generated additional uncertainty in capital markets. The path forward for interest rates remains uncertain, although market expectations for rate cuts are much lower than at the beginning of the year. The Fed's tighter monetary policy regime has had little impact on growth. Markets anticipate one to two interest rate cuts in 2024, although the possibility of none remains. Globally, equity valuations remain divergent. While the top-heavy S&P 500 has continued to outperform small cap and international equities, we believe these represent an intriguing opportunity set. On the fixed income side, long-term investors should focus less on what the Fed is going to do in the short-term than the level of yields, which remain near the top end of the 10-year range.

Asset Allocation

At a strategic level, our primary focus and responsibility is to align your investment allocation with your unique goals and objectives. As markets process and respond to the never-ending glut of new information, we stand ready to make tactical allocation shifts; but only to the extent that they materially improve alignment between your portfolio and your financial plan. With the election news cycle heating up, additional volatility is possible through the end of the year. While volatility can be uncomfortable, we encourage managing risk proactively by ensuring that your investment allocation matches up with your risk tolerance and financial plan. When it comes to elections, we recommend focusing on the components of your financial plan that are more directly tied to political outcomes, including tax and estate planning. Please don't hesitate to reach out to your advisor to schedule time to discuss your financial plan, including your goals and planning assumptions. Letting planning drive the investment approach helps ensure that your portfolio remains aligned with your vision for the future.

*The "Magnificent Seven" includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA and TSLA.

Leading Topics

Equity Breadth

For US equity markets, 2024 has seen a smooth march upward. While indices like the S&P 500 performed well, performance was largely driven by a handful of names. The top 10 companies in the S&P 500 now represent about 37% of the Index's market cap. 61% of the S&P 500's return thus far in 2024 is attributable to the "Magnificent Seven*" stocks, not far off the 63% we saw in 2023. Valuations remain nearly 30% above the 30-year average, which is difficult to justify given the interest rate outlook and potential long-term slowing growth in the US and other developed markets. AI has provided a catalyst, but elevated Federal debt levels and demographic trends are long-term headwinds to growth. We don't advise making investment decisions based solely on valuations and we wouldn't recommend not having domestic equity exposure. However, it's important to be aware of concentration risk if your investment allocation is heavily tilted towards US equities. Markets appear to be pricing in a soft-landing scenario in which the Fed can rein in inflation without causing substantial unemployment or a prolonged period of reduced economic growth.

Federal Reserve/Inflation

Arguably the largest risk coming into the year was the disconnect between the Fed and the market on the trajectory of rate cuts. Inflation remains stubborn, driven almost entirely by housing and services. Shelter remains the hottest component of inflation, accounting for over half of headline CPI. Shelter costs are likely to remain elevated in the near term given limited supply. Currently, there's little impetus for the Fed to cut rates given the low level of unemployment and stable growth outlook.

Fixed Income

Interest rate risk is elevated when the Fed and the market are disconnected in their outlook for rates and when absolute yields are lower. Market expectations for interest rate cuts going forward are minimal, leaving less room for disappointment if rates remain constant. Additionally, yields across fixed income segments are near 10-year highs, providing some protection against unexpected interest rate movements. Fixed income now offers appreciable yield as well as an avenue for capital appreciation if rates decline. Given lofty US equity valuations and reinvestment risk in cash, bonds offer a potentially attractive risk-adjusted return profile.

International

International equities have been a bright spot in 2024. Broadly speaking, US equities have outperformed but the trend has been less one-sided than in recent years. In addition to the attractive growth opportunities present in international markets, they are generally more diversified across sectors and have more reasonable valuations than large cap US equities. While we don't believe in making bets, we see maintaining some meaningful exposure to international equities as valuable for risk mitigation as well as a way to gain exposure to growth opportunities at reasonable valuations.

Valuation & Concentration

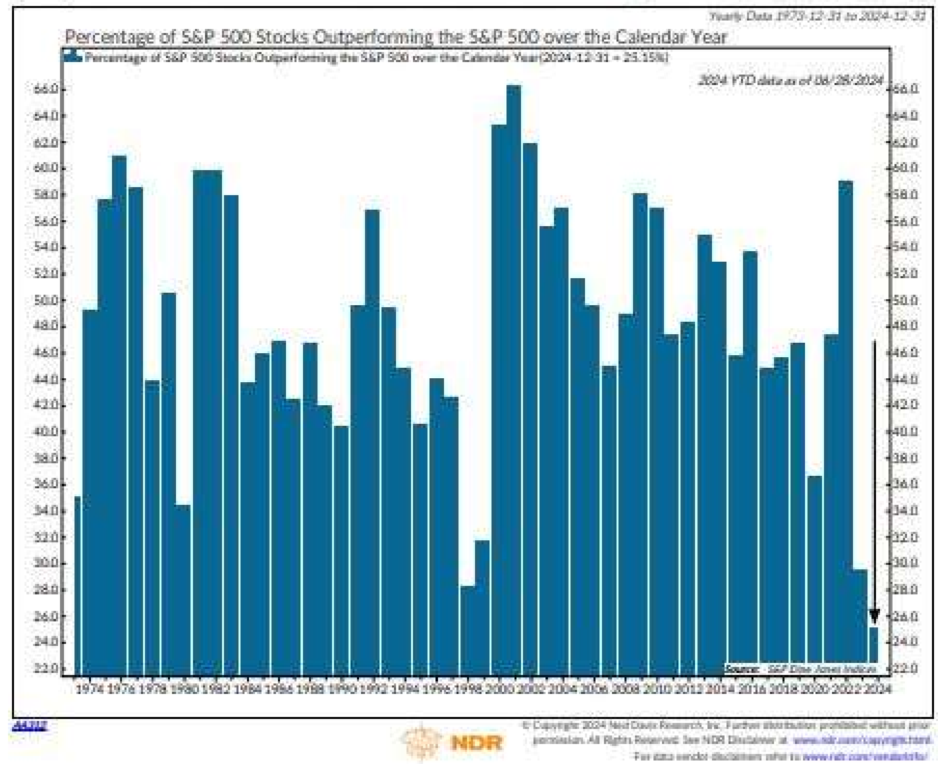
The returns for US equity markets in 2023 and thus far in 2024 have been impressive. While market cap weighted indices like the S&P 500 performed well, both relatively and absolutely, returns were almost entirely driven by a handful of names. In fact, year-to-date, the number of S&P 500 constituents outperforming the broader index is at a record low. At the end of June, the price to cash flow ratio for the S&P 500 was around 16x, well above the 30-year average of 11x. At its root, the objective of equity investing is to purchase a stream of cash flows at a reasonable price. Various metrics indicate that cash flows for US large cap growth equities are expensive relative to the rest of the global equity universe. There are certainly catalysts for further growth, including compelling trends in healthcare and the AI space. However, this is juxtaposed against significantly higher interest rates, which could hamper growth and put pressure on valuations. The impact of higher rates on the largest US companies is debatable as they have the greatest access to inexpensive capital and low debt levels. However, the trade-off between current and future earnings growth has shifted for investors as those future earnings are discounted at higher rates. The current valuation picture in large cap US equities doesn't leave much room for error.

Source: JP Morgan

Valuation & Concentration

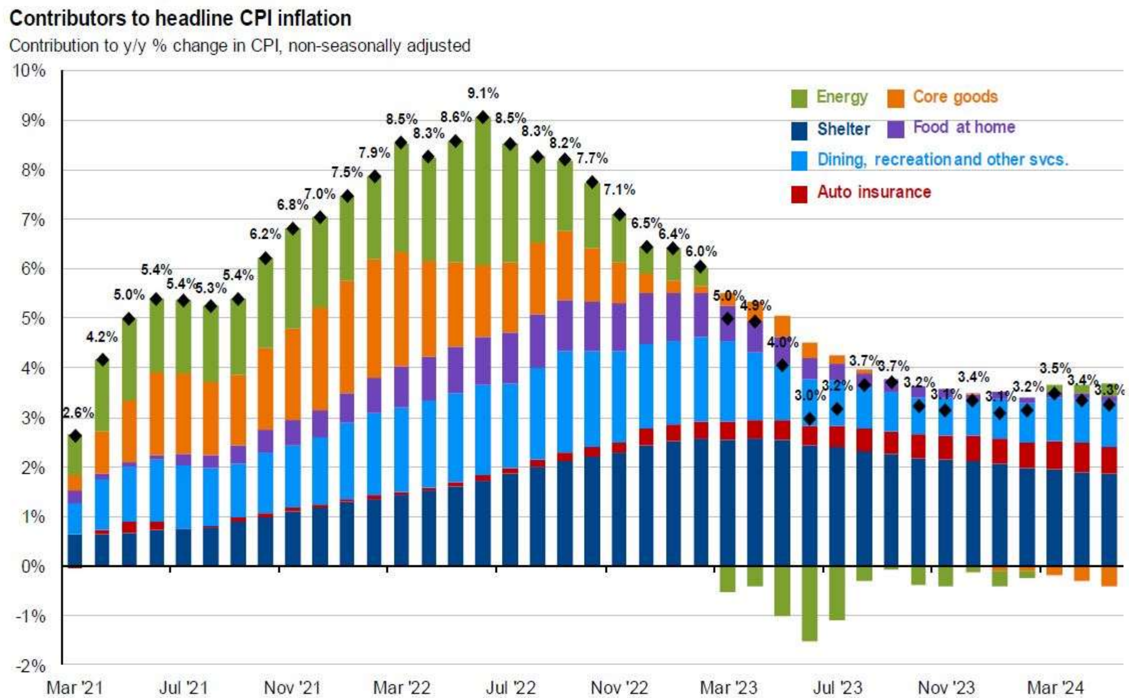
We don't advise making investment decisions based solely on valuations. Market segments can remain above or below long-term averages for extended periods. Regardless of your outlook on valuations, it's critical to be aware of concentration risk, particularly if your investment allocation is heavily tilted towards domestic equities. Investors whose portfolios look a lot like the S&P 500 may be overestimating their degree of diversification. The ten largest stocks in the S&P 500 make up over a third of the index, by far the highest level in the past 30 years. Furthermore, these companies are nearly all in the Technology sector or the highly correlated Communications sector. No one knows for certain if US equities will continue their outperformance over the long term. One of the most important elements of portfolio construction is risk management and we believe that maintaining a meaningful allocation to international equities and small caps is critical to building a diversified portfolio.

On pace for record low % of stocks beating S&P 500



Inflation: Brought to You by Housing

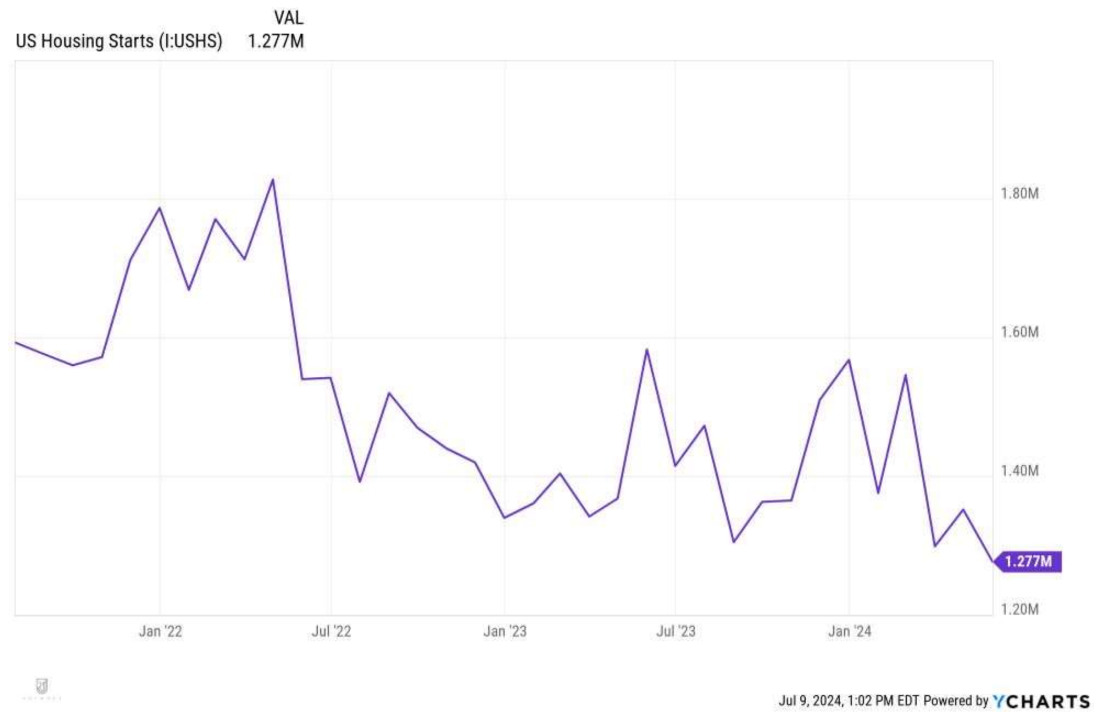
The past year has seen slow but gradual improvement in inflation. While goods inflation has improved drastically, services and shelter costs have remained stubborn. The decline in inflation has been accomplished without a significant increase to unemployment or a dramatic slowdown in economic growth, at least not that we've seen thus far. The monthly pace of inflation is still well above the Fed's target of 2%. The labor market has begun to show signs of loosening and the ratio of job seekers to job openings is now near historical norms. Shelter is now the most critical segment, making up about two thirds of the headline CPI figure.



Source: JP Morgan

Inflation: Brought to You by Housing

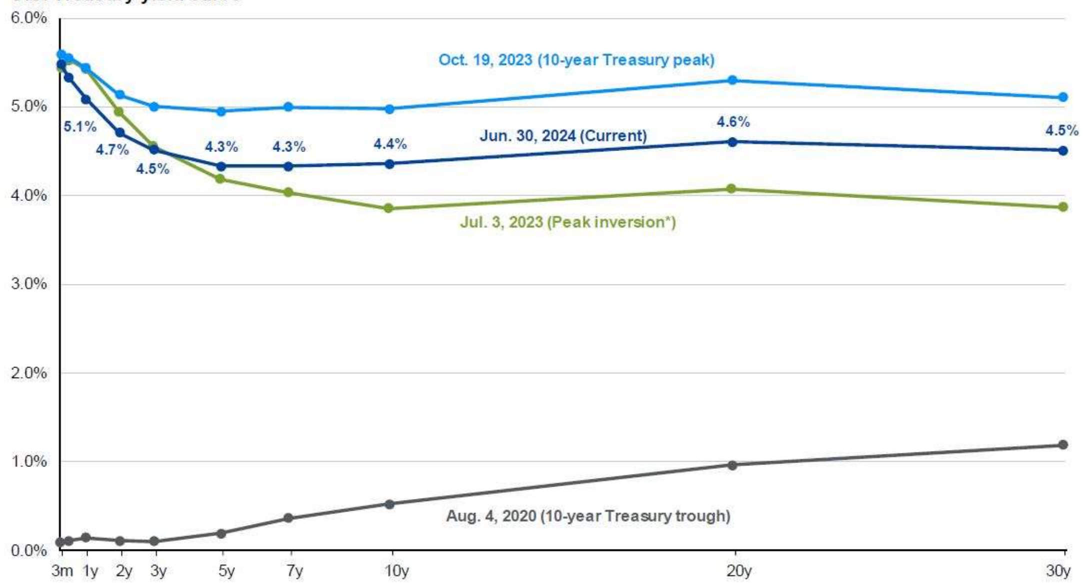
Housing affordability varies regionally, but overall US housing affordability sits near the lowest levels ever recorded, per the National Association of Realtors. Affordability has been under pressure due to higher mortgage rates as well as limited supply. Homeowners with 3% or 4% mortgages now face higher barriers to selling given the current rate environment. These constraints are on top of a housing market that is already under-supplied. Multi-family housing is likely to offer some relief as new multi-family unit completions are expected to hit a record high this year. However, housing starts have plummeted over the past two years as the cost of capital has risen. In effect, higher lending rates are reducing affordability both by constricting supply as well as increasing the effective carrying cost of housing for recent homebuyers. The lack of affordability is evidenced by the sluggish pace of mortgage applications, which have dropped to the lowest levels since 1995. Mortgage rates are more greatly influenced by longer-term Treasury yields than the Fed Funds rate. While the Fed may cut short-term rates, longer term rates are influenced by supply and demand in the Treasury market. Given current fiscal trends, Treasury issuance is likely to remain elevated and mortgage rates are unlikely to shift down dramatically. Ultimately, the future path of inflation hinges on housing and unless something shifts from a supply or mortgage rate perspective, affordability is unlikely to improve dramatically.



Federal Reserve & Treasury Dynamics

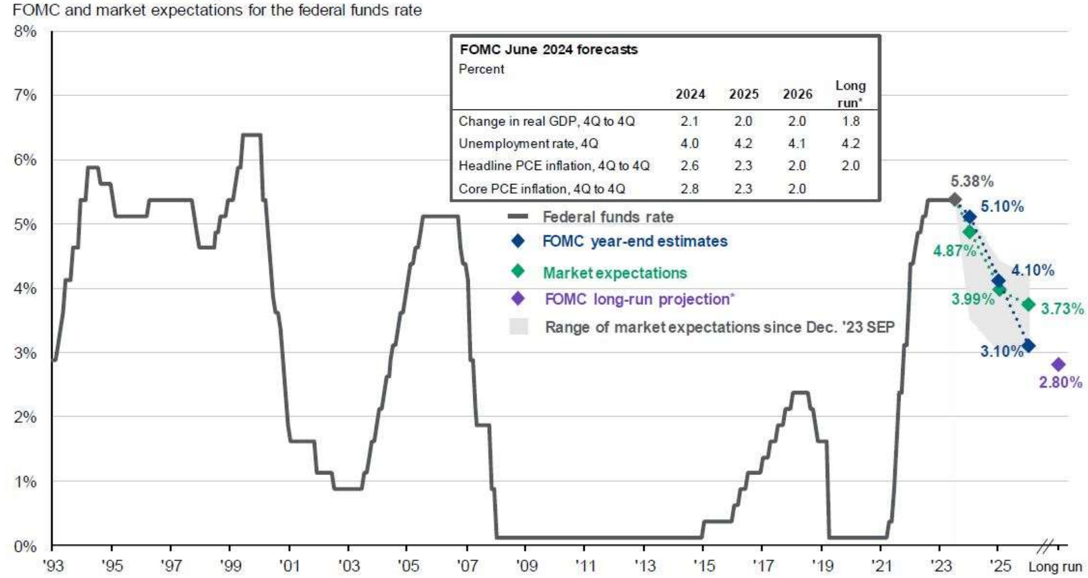
Fed policymakers anticipate 1-2 rate cuts this year, fairly in line with market expectations. Although additional rate hikes are likely off the table, the Fed has been clear with its intent to leave rates higher for longer. Interest rate risk is elevated when absolute yields are low and when the Fed and the market are disconnected on the future path of rates. Neither condition currently exists. Bond-holders now have more substantial yields to insulate against rate volatility and expectations of cuts are lower, leaving less room for disappointment. Over the past year, short-term rates have been almost unchanged while the longer end of the yield curve has shifted upward, reducing the degree of yield curve inversion. The shift is not solely due to the Fed. The longer end of the curve is also driven by Treasury issuance, which has increased markedly over the past few years. Given the stable employment and growth outlook, as well as the slow progress on inflation, there is little impetus for the Fed to cut rates in the near term barring a dramatic improvement in inflation or an economic shock. Treasury dynamics are likely to sustain higher longer-term rates, potentially curtailing corporate investments and delaying or reducing the financing of large consumer outlays.

U.S. Treasury yield curve



Federal funds rate expectations

FOMC and market expectations for the federal funds rate



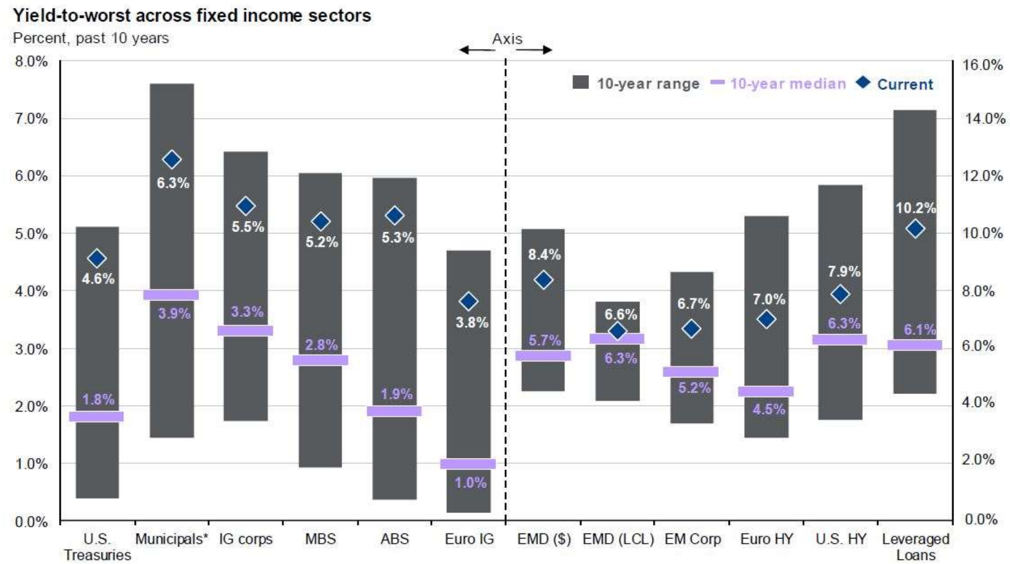
Source: JP Morgan

See disclosures on final page of this document

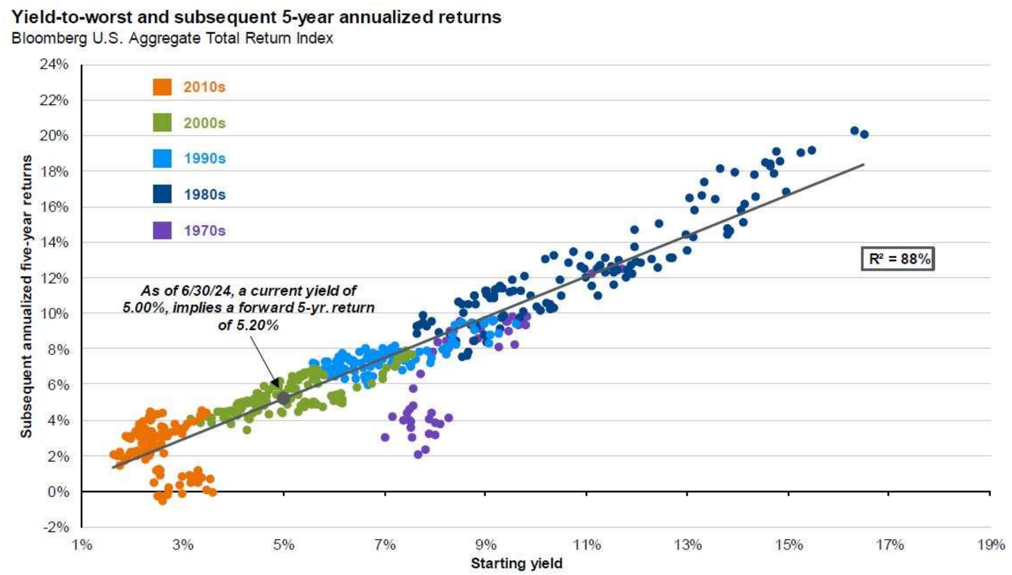
Fixed Income

While interest rate volatility is likely to continue as the Fed's actions and political uncertainty buffet the yield curve, the opportunities available in fixed income appear attractive on a risk-adjusted basis. The opportunity set in fixed income should be evaluated relative to other asset classes. Although yields on cash-equivalents are enticing, the Fed could single-handedly reduce them on a whim, exposing investors to reinvestment risk. Higher rates have shifted the asset allocation dynamic. A few years ago, bonds provided little yield and served primarily to mute volatility, whereas they now offer real yields as well as an avenue for capital appreciation. This shift, in conjunction with lofty US equity valuations, has compressed the equity risk premium.

Historically, the yield to worst of a fixed income portfolio is the best predictor of fixed income returns. While investment timing is not something we advocate, the relative entry point for longer-term fixed income is difficult to ignore. It's easy to fixate on short-term cash yields around five percent. However, these rates typically fall quickly when the Fed cuts interest rates. Both equities and fixed income tend to healthily outperform cash and cash equivalents in the years following the final rate hike of a cycle. We frame our investing process in terms of our clients' financial planning needs and the hurdle rates necessary for clients to achieve their financial goals. Locking in yields in the 5-6% range for the long term can go a long way towards achieving those goals without stretching portfolio risk.



Source: JP Morgan



Source: Bloomberg, FactSet, J.P. Morgan Asset Management

International Equities

International equity valuations look attractive relative to US equities, particularly those in the large cap growth category. The appeal of international equities is broader than just favorable valuations. In an environment where the S&P 500 is arguably more concentrated than ever, international equities offer diversification. At the end of June, ten stocks comprised over one third of the weight of the S&P 500. Seven of those are concentrated in the Communications and Technology sectors. By contrast, the ACWI ex. US Index is far less concentrated, both on an individual name and sector basis. The top ten companies only made up about 14.5% of the index at the end of June and those companies are diversified across five sectors.

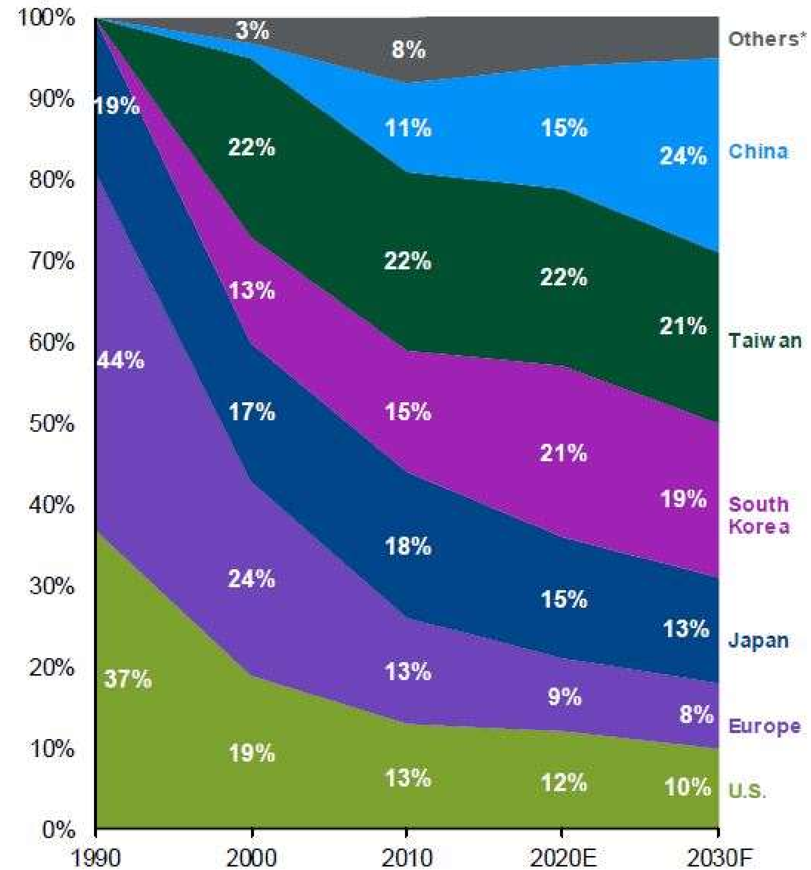
Source: Capital Group

International Equities

International markets also offer appealing growth prospects, particularly in emerging markets. Emerging markets are forecast to have more rapid GDP growth than the US over the next five years* and nearly all of the global middle-class growth over the same period is expected to occur in Asia**. Economic growth is a complex equation with many variables but it's hard to argue that demographic factors, including middle class and population growth, won't play a role. While the AI boom has captured the imaginations of many investors, the AI revolution will likely be built upon a foundation of semiconductor production. Currently, only about 12% of semiconductor production occurs in the US, while over half occurs in China, Taiwan and Korea. One of the headwinds facing emerging markets has been the dominance of China over most indices and its recent economic stumbles. However, China's weight in the MSCI Emerging Markets Index has been reduced from around 40% a few years ago to closer to about 25%. India's weight in the same index has doubled over the past four years. This shift in index composition, along with demographic and technological tailwinds, drives our favorable outlook on the growth trajectory within emerging markets. While making outsized bets runs counter to our investment philosophy, we view maintaining meaningful exposure to international equities as valuable for both risk mitigation as well as an opportunity to gain exposure to growth opportunities at a reasonable price.

Semiconductor production by location

% global share



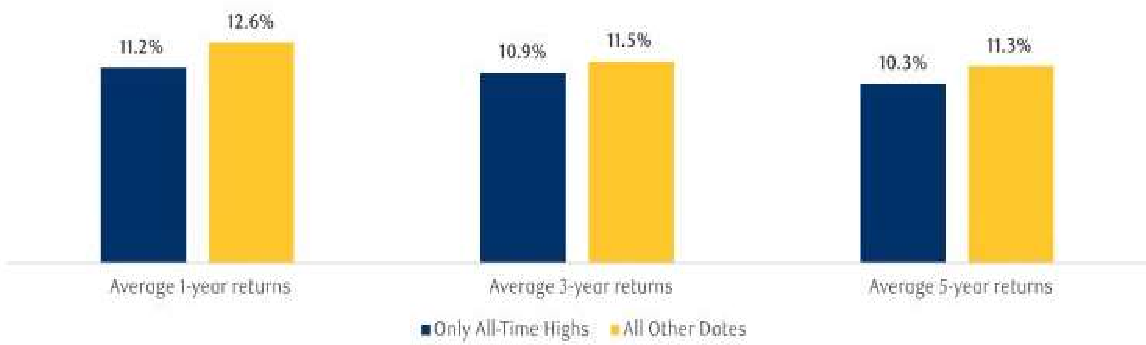
Source: JP Morgan

*Per the Oxford Economics Global Economic Outlook Report (https://www.oxfordeconomics.com/resource-hub/)
**Per World Data Lab, Visual Capitalist (visualcapitalist.com)

Behavioral Finance

With equity indices hitting fresh all-time highs regularly, it can be tempting to try to time markets by holding back on new equity investments. One of the reasons we focus so much on allocation targets and rebalancing is to avoid the natural human temptation to tweak and adjust based on valuations, feelings or headlines. The purpose of rebalancing is to earn better risk-adjusted returns as well as to "buy low" and "sell high" in a systematic way. Vanguard conducted a study analyzing a 60/40 portfolio (with and without rebalancing) and compared those outcomes to an 80/20 portfolio that was rebalanced. The 60/40 portfolio that wasn't rebalanced earned a higher return than the rebalanced portfolio, as one would expect given the increase in the equity weighting over time. The intriguing point is that the 60/40 portfolio that wasn't rebalanced underperformed the 80/20 rebalanced portfolio while possessing a higher standard deviation. In summary, a lower return with a higher level of volatility. As such, we firmly believe in a systematic rebalancing approach to optimize risk-adjusted returns.

Investing at all-time highs vs. all-dates

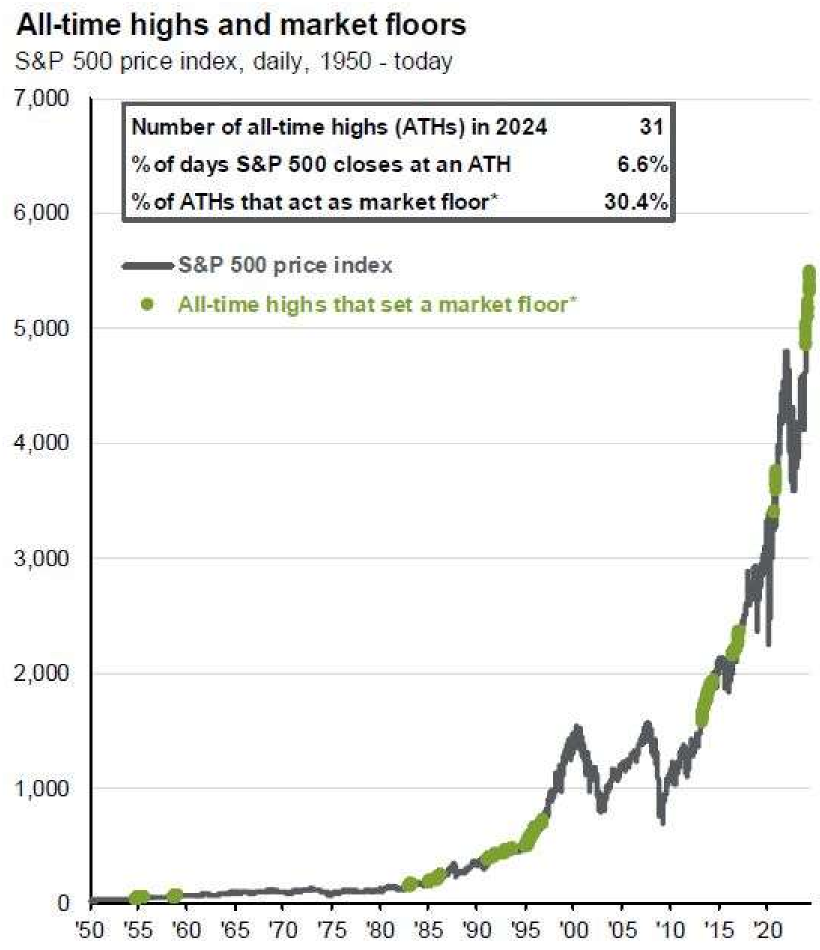


Source: RBC

Time & the Markets

While we believe valuations are a factor in the attractiveness of various market segments, picking and choosing market entry points has proven to be a fruitless exercise for investors. It is certainly true that some all-time highs are followed by crashes. However, those tend to be short-lived when they do occur. Furthermore, approximately 30% of S&P 500 all-time highs established new market floors where the Index didn't fall more than 5% below that level, per JP Morgan. According to RBC, investing at all-time highs typically results in slightly lower long-term returns as compared to days that are not market highs, but the difference is smaller than you may expect (about 1% over a 5-year period).

Market timing runs counter to our fundamental investment philosophy, largely because it's so difficult to do on a consistent basis. The only reason to change your investment allocation target is a change in your financial goals or circumstances, not market movements. Periodic rebalancing, by definition, allows investors to take gains off the table and "buy low, sell high" in a disciplined and systematic way.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
(Left) *Market floor is defined as an all-time high from which the market never fell more than 5%.

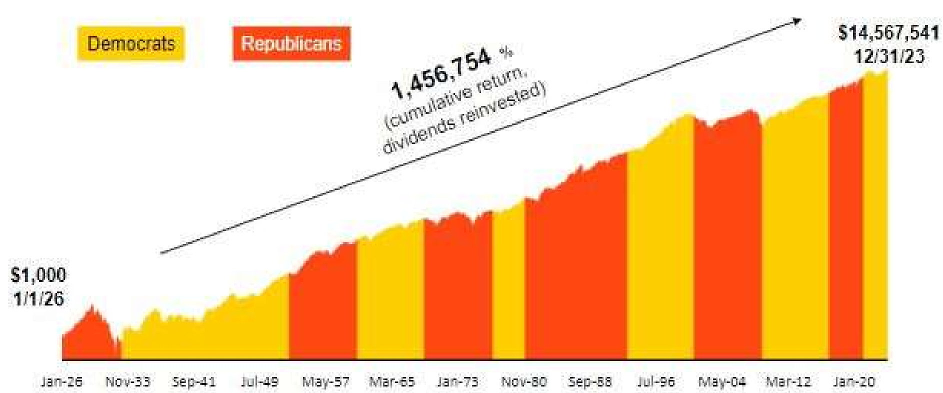
The Election

Elections can generate volatility, which can make otherwise rational market participants question their exposures. The tough part about elections is that even if you know the outcome, it's difficult, if not impossible, to predict how markets will react to it. For example, during the 2016 election, pre-FTX Sam Bankman Fried was hired to design a computer system to predict the outcome of the election. His system predicted the Trump win before the race was called by the news networks. The firm that hired him, Jane Street Capital, bet big that the Trump win would rattle markets. However, markets rallied the following day and the firm lost approximately $300 million. The bottom line is that even if you knew how the election will shake out, you don't know how markets will react to that outcome.

On the equities side, each Presidential election outcome could favor different market sectors. A Republican White House could buoy confidence for sectors such as financials, energy and healthcare providers with the hope of reduced regulation. A Democratic government could boost companies in the renewable energy space as well as those who are dependent on immigrant labor, such as construction. Historically, long-term equity performance (the only kind that matters if you're a long-term investor) has been far more correlated with employment, inflation and GDP growth trends than with which party is in power

Stocks have continued higher regardless of party holding the presidency

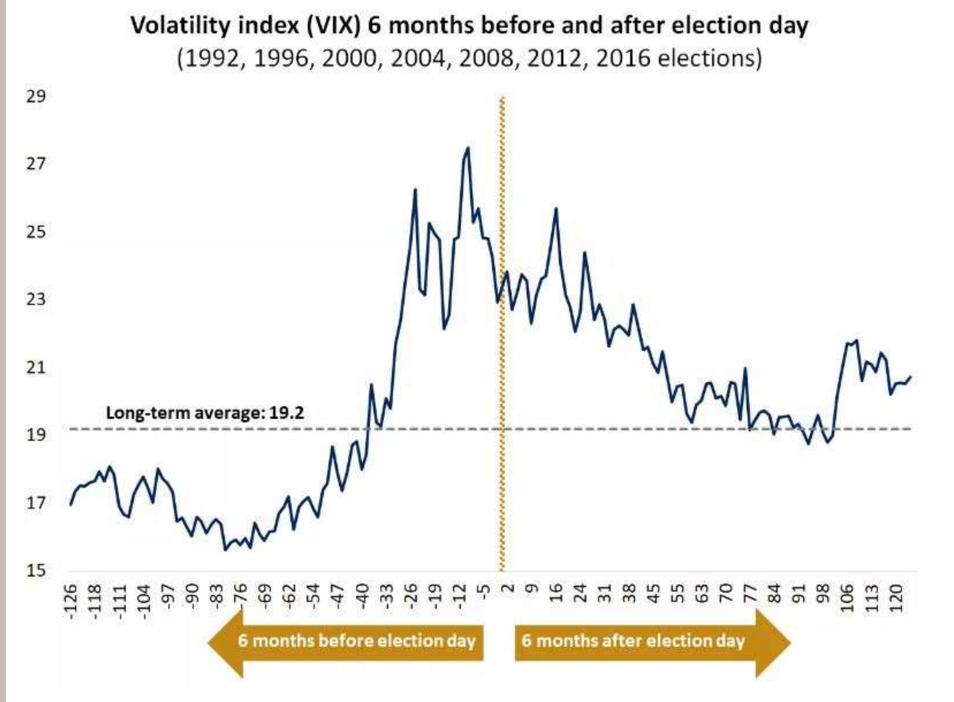
Growth of $1k, 1/1/26 – 12/31/23



Source: Morningstar as of 12/31/23. Stock market represented by the S&P 500 Index from 1/1/70 to 9/30/23 and IA SBBI U.S. large cap stocks index from 1/1/26 to 1/1/70. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

The Election

The impact of election outcomes on fixed income markets is perhaps even murkier. After the first Presidential debate, longer-term Treasury yields ticked up slightly as markets recalibrated the odds of a second Trump term. While there are many factors that determine yields, market participants seem to believe that a second Trump term would come with an extension of some components of the Tax Cuts & Jobs Act, likely increasing the magnitude of the already substantial Federal deficit. Market participants likely believe that the TCJA extension would result in higher interest rates as the Treasury continues to increase debt issuance to fund the deficit. While that may or may not prove true, the trajectory of the deficit is unlikely to change regardless of who sits in the White House. Interest rate volatility is likely to continue as market participants express their views on how the election outcome may impact the Federal fiscal situation. We believe the larger near-term driver of rate volatility is a disconnect between markets and the Fed on the path of rates and the two have become far more aligned over the course of the year.



Source: Bloomberg, Edward Jones.

What's It All Mean

Equity Valuations & Concentration

US equity markets performed well over the past year but valuations are pricing in a path free of any significant bumps in the economic road. Additionally, US equity markets are historically concentrated in a handful of companies and sectors. Be aware of concentration risk if your portfolio is heavily tilted towards domestic equities.

Inflation: The Housing Problem

Progress on inflation has stagnated over the past six months. Housing makes up about 2/3 of the total CPI figure. Shelter costs are likely to be the key to the inflation equation going forward. Elevated mortgage rates and minimal supply are likely to make affordability an uphill battle.

Interest Rates & The Yield Curve

The Fed has made its intent clear: to be slow to reduce short-term rates barring an economic shock. Long-term rates are partially driven by dynamics in the Treasury market as well as the Fed's actions, with larger Treasury issuance likely to support higher long-term rates than we've seen in the recent past.

Asset Allocation Dynamics

The entry point for fixed income appears favorable given current yields and elevated equity valuations. Fixed income offers attractive yields with a lower level of reinvestment risk than cash and equivalents. Interest rate volatility is likely here to stay, but with the Fed and the market on a similar page, wild swings are less likely.

What's It All Mean

Global Opportunities

US growth equities have driven markets over the past decade, but we believe there are opportunities outside of this narrow neighborhood. In addition to more favorable valuations, international equities offer better diversification prospects than their more concentrated US counterparts.

Behavioral Finance

Historically, investors are poor market timers. As such, we recommend adjusting your allocation based on changes to your planning needs and not simply valuations. Historically, investing at market highs has not been punitive for long-term investors. Elections tend to increase uncertainty. Keep in mind that even if you could predict an election outcome, it's impossible to predict how markets will react to that outcome. Markets are complex aggregators of opinions, and it can be difficult to dissect what expectations are built in. As such, it's critical to have a long-term allocation target and to stick with it. We believe that your planning needs should dictate your investment allocation choices rather than short-term uncertainty.

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Relevant Disclosures

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