Client Investment Letter

August 2024

Global financial markets delivered positive returns overall during the second quarter. A resilient U.S. economy, ongoing enthusiasm around generative artificial intelligence, and growing expectations for interest rate cuts were the main drivers of returns for equity and fixed income markets. Throughout the quarter, sectors and styles that had previously done well (e.g., mega-cap technology and consumer stocks) continued to perform well and dominate equity market returns.

In fact, by the end of June, 61% of the year-to-date total return of the S&P 500 Index was attributable to just seven companies, and one-third to Nvidia alone (see Appendix A). This level of concentration is both a function of the index's structure but also relentless investor appetite for companies at the center of the AI trend. In the short term, however, that translates into underperformance for any portfolio or investment strategy that maintained any level of diversification (be it fixed income, international equities, smaller-cap companies, or even other large-cap stocks that just were not part of the "Magnificent Seven"[1]).

However, as we progressed through July and into August, the winds began to shift in equity markets. Earnings season began with high-profile disappointments from several large technology companies (though the bar for their performance had been set impossibly high). Fresh geopolitical uncertainty was injected into the market after President Joe Biden withdrew from the race for the White House and as tensions intensified between Israel and Iran. Additionally, weaker-than-anticipated manufacturing and jobs numbers were published, spooking markets, and raising fears of an impending recession.

We would take this opportunity to remind our clients that volatility is a natural state of financial markets, and while it has risen in recent weeks, it remains well below previous peaks. Volatility provides opportunities for investors to deploy new capital into the markets at more attractive levels, as well as to rebalance portfolio allocations to their long-term, strategic targets. Our core philosophy drives us to remain disciplined and diversified, and to be prudent managers of capital when markets, economies, and politics get turbulent.

[1] The "Magnificent Seven" refers to AAPL, AMZN, GOOG + GOOGL, META, MSFT, NVDA, and TSLA.

Q2 Financial Markets Performance

EQUITIES

Broad-based U.S. stock indices advanced between March and June, but performance among market caps and style diverged in a meaningful way (see Exhibit 1). The Magnificent Seven continued to rise with little resistance amidst strong earnings and outlook statements, despite uncertainty about the economy and interest rates. This dynamic was also a major factor in the significant outperformance of the technology and communication services over all other market sectors, as well as the strong positive returns of large-cap growth stocks vs. all other market caps and styles.

Non-U.S. developed market equity performance was mixed. Despite a 25-basis point interest rate cut by the European Central Bank in June, Eurozone shares declined after the announcement of snap parliamentary elections in France weighed on sentiment. Meanwhile, U.K. equities achieved all-time highs after the local economy posted better-than-expected GDP growth and inflation eased. Japanese stocks were higher in local currency terms, driven by improving corporate profitability, but the precipitous weakening of the Japanese yen turned performance negative for U.S. dollar-denominated investors.

Quarterly gains in emerging market equities outperformed their developed market peers. Low relative valuations of Chinese stocks, optimism about the authorities' support measures for the housing sector, and President Xi's reform rhetoric, helped local stocks advance. Weaker-than-expected results for Prime Minister Modi's party (blocking a supermajority in parliament) provided a boost to Indian shares. Positive AI prospects continued to drive Taiwanese equities higher, while markets in Brazil and Mexico were down the most in U.S. dollar terms. Widespread floods in the former and a newly elected president and legislature in the latter concerned investors and weighed heavily on their currencies.

Financial Markets Performance cont.

Exhibit 1 – Equity Market Returns

Benchmark Index	2nd Quarter 03/31/2024 – 06/30/2024	Year-to-Date 12/31/2023 – 06/30/2024	Since Quarter End 06/30/2024 – 08/06/2024	Year-to-Date 12/31/2023 – 08/06/2024
S&P 500	4.28%	15.29%	-3.95%	10.74%
S&P 500 Equally Weighted	-2.63%	5.08%	0.18%	5.27%
S&P 500 Growth	9.59%	23.56%	-7.29%	14.56%
S&P 500 Value	-2.10%	5.79%	0.95%	6.80%
Russell 2000 (*Small Cap*)	-3.28%	1.73%	0.89%	2.63%
Russell 3000 (*Total U.S.*)	**3.22%**	**13.56%**	**-3.63%**	**9.43%**
MSCI EAFE (*Developed Markets*)	-0.31%	5.34%	-2.99%	2.19%
MSCI EM (*Emerging Markets*)	5.29%	7.49%	-4.65%	2.49%
MSCI ACWI ex-U.S. (*Total Int'l*)	**1.11%**	**5.69%**	**-3.27%**	**2.23%**

Source: FactSet. Performance data presented above is total return (price appreciation plus dividend and/or interest income). Non-U.S. equity benchmark returns are presented net of foreign taxes.

FIXED INCOME

Performance of global fixed income markets was mixed in the second quarter, as uneven economic and political developments drove returns (see Exhibit 2). Initial concerns about U.S. inflation and the timing of interest rate cuts were alleviated later in the quarter with the emergence of softer labor market conditions. Political uncertainty in Europe and emerging markets also drove some weakness.

In the U.S., broad-market indices were generally unchanged, as rates rose slightly across the yield curve, driven by the expectation that inflation would take longer to return to the Federal Reserve's target. Shorter duration Treasuries performed better than longer dated securities.

Global investment-grade bonds delivered varied returns. U.S. high grade corporates lost ground as interest rates rose, with higher quality bonds underperforming due to their higher durations. European corporates managed small quarterly gains, while U.K. bonds were slightly down.

Junk bonds performed well mainly due to their high coupons and lower duration profile. Like the investment-grade market, European high-yield corporates were able to outperform the U.S.

Nearly all issuers of developed market sovereign debt performed negatively in the second quarter. Slower-than-expected improvements in inflation dampened investors' mood. Emerging market debt gained ground mainly thanks to its high yielding profile. Currency denomination mattered less, as lower durations drove outperformance of corporates versus sovereigns.

Exhibit 2 – Fixed Income Market Returns

Benchmark Index	2nd Quarter 03/31/2024 – 06/30/2024	Year-to-Date 12/31/2023 – 06/30/2024	Since Quarter End 06/30/2024 – 08/06/2024	Year-to-Date 12/31/2023 – 08/06/2024
Bloomberg U.S. Gov't/Credit	0.05%	-0.68%	3.11%	2.41%
ICE BofAML 1-3 Year U.S. Broad	1.01%	1.52%	1.67%	3.22%
Bloomberg U.S. Aggregate Bond	**0.07%**	**-0.71%**	**3.25%**	**2.51%**
ICE BofAML U.S. High Yield BB-B	1.21%	2.49%	1.33%	3.86%
Bloomberg Global Agg ex-U.S. (Hedged)	0.15%	0.69%	2.30%	3.00%
Bloomberg Emerging Markets USD Agg	0.68%	2.22%	1.86%	4.12%

Source: FactSet. Performance data presented above is total return (price appreciation plus dividend and/or interest income).

Global Economic Update

UNITED STATES

The U.S. economy continues to exhibit signs of both mid- and late-cycle expansion. Second-quarter GDP growth came in at 2.8% annualized, improving on the first quarter's 1.4% figure. On one side consumers, the main driver of the economy, remain in a relatively healthy financial situation. Low debt levels (and locked in at low rates), high interest coverage ratios, rising wages, and strong asset appreciation (be it property or financial assets) provide ample runway for consumers (particularly in higher income brackets) to continue spending.

However, growth in manufacturing has been slowing for several months. High borrowing costs and declining demand are weighing on firms' longer-term investment decisions. In July, even growth in services, which had been enjoying continued expansion as consumers rotated away from spending on goods during the depths of the pandemic, began to contract.

This further complicates matters for the Fed. Inflation remains sticky (see Appendix B) – tight housing supply is keeping shelter prices elevated (even if there were some signs of stabilization in the second quarter). Goods prices have stopped deflating, while services inflation remains elevated (though also showing signs of stabilizing). That might offer defense of a higher-for-longer stance by policymakers. However, if their tight policy stance (which is becoming more of an outlier across developed markets) is beginning to weigh on the manufacturing and services sectors, they may be more inclined to ease.

There are more signs of weakness forming in the labor market (the central bank's other mandate), where the unemployment rate has risen half of a percentage point from its cycle low. That said, there has not been an increase in layoffs, instead much of the rise in unemployment stems from high immigration rates, a normalization of job growth, and some frictional unemployment as job openings shift from industries focused on goods to those focused on services.

Currently, markets are predicting (with near certainty) that the first interest rate cut will arrive in September (though the magnitude of said cut is up for debate). July's weak CPI print, coupled with a slowdown in PMI numbers, and rising volatility in markets may give the Fed enough cover to do so, lest they risk finding themselves "behind the curve."

ELSEWHERE AROUND THE WORLD

The Eurozone, U.K., and Canada are all seeing increased signs of recession risk. Europe saw a sizeable contraction in industrial production in May and a disappointing PMI reading in July. The region is facing increasing pressures from global trade, from the continued slowdown in China, potential tariffs if a second Trump administration is elected, as well as political uncertainty closer to home.

Nevertheless, the European consumer continues to benefit from strong wage growth boosting real household incomes. Furthermore, credit conditions are improving, removing some of the sting from the industrial slowdown.

In larger emerging markets (e.g., India, Mexico, Brazil), economic growth conditions are better, though consumers are still suffering under high real interest rates and heightened political instability. China, meanwhile, is the economic outlier. Policymakers have pivoted to a more supportive stance, but the economy is still not seeing enough positive momentum to pull it out of its recent growth recession. Export volume is accelerating, but export prices are falling, leading to weaker profits. Structural imbalances in the property sector and chronically weak consumption continue to plague the economy.

Investment Strategy

EQUITIES

While earnings expectations for the mega-cap names at the center of the AI trend were overly optimistic, earnings across the board are growing, nonetheless. We have been anticipating a broadening of that earnings growth beyond the Magnificent Seven into the rest of the market.

The remaining 493 constituents of the S&P 500 Index are expected to significantly improve their earnings-per-share over the coming quarters (see Appendix C). While EPS for the Magnificent Seven are also expected to grow over the same period, it is the *rate of change* that could drive the share prices of both groups.

Positive but decelerating growth may cause the market to challenge the lofty valuations of the Magnificent Seven and instead bid up the shares of companies that are accelerating their earnings growth. To that end, we continue to add to value, quality-focused, as well as equally weighted strategies to reduce the idiosyncratic and valuation hazards at the top end of the U.S. equity market, without over-risking portfolios by diving headfirst into small- and micro-cap stocks.

Valuation discounts in international markets meanwhile continue to defy expectations of mean reversion. While we want to maintain exposure to that potential price appreciation, we continue to right-size our allocation to non-U.S. stocks in favor of large-cap U.S. stocks. Furthermore, we are also continuing to reduce our overall exposure to emerging markets (and within the region, shifting some exposure away from China).

FIXED INCOME

For the last several quarters, there has been higher-than-usual volatility in rates markets as investors react to new economic data and policymaker rhetoric, trying to gauge the Fed's next move. From a portfolio management perspective however, we do not attempt to time nor fight the Fed. Instead, we are positioning bond allocations prudently.

Should the Fed begin cutting overnight rates and yields along the curve follow suit (perhaps if the economy continues to cool down), then longer-duration investments should do well. However, there are structural challenges that may keep inflation above the central bank's preferred target. Additionally, fiscal indiscipline may lead to upward pressure on longer-term rates (particularly 30-year Treasuries), which pose severe downside risks to bond investors' portfolios.

We take both risks seriously and must manage them accordingly. Since bond allocations (for most investors) are there first and foremost to protect capital, we err on the side of caution. For that reason, we continue to focus on short-term, high-quality bonds, and utilize active managers to find attractive opportunities in credit markets where spreads are tight.

In Conclusion

While investors should not extrapolate market performance over short periods of time, the last several weeks have served as a healthy refresher course. Not all trends are unstoppable. Valuations, earnings, and corporate fundamentals matter. However, at the same time, risk management is critical. Diversification, while it may hold back returns in some periods, can protect them in others. Volatility is uncomfortable but offers opportunity.

We would advise our clients to expect more market volatility (both in stocks and bonds) in the lead up to the U.S. presidential election, especially now that the top of the Democratic ticket has changed. However, election results in the U.S. and the balance of power in Washington have not been shown to have a statistically significant impact on the longer-term returns of stocks or bonds.

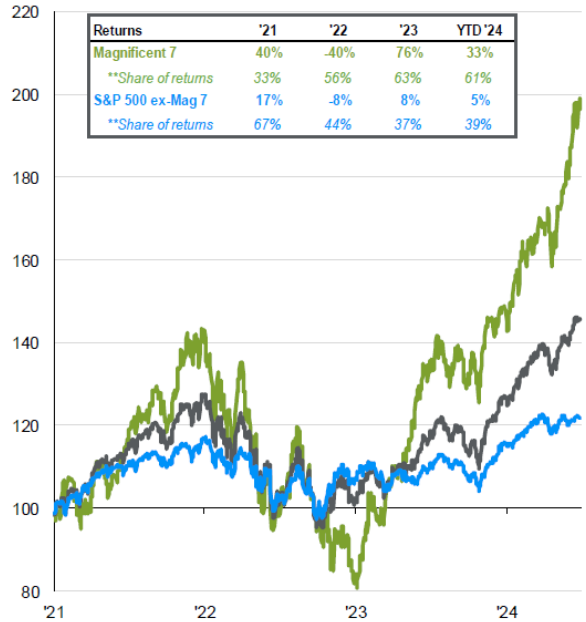
If you are unsure if your current portfolio targets are still appropriate for you, or if there have been any changes in your risk tolerance, liquidity needs, and/or investment goals, please contact us so we may discuss your investment strategy in more detail and decide if any changes are warranted. Additionally, if you have any questions or concerns about financial markets, please never hesitate to call us at +1 (301) 881-3727 or email us at client.services@sol-capital.com.

With our best regards,

SOL Capital Management Company

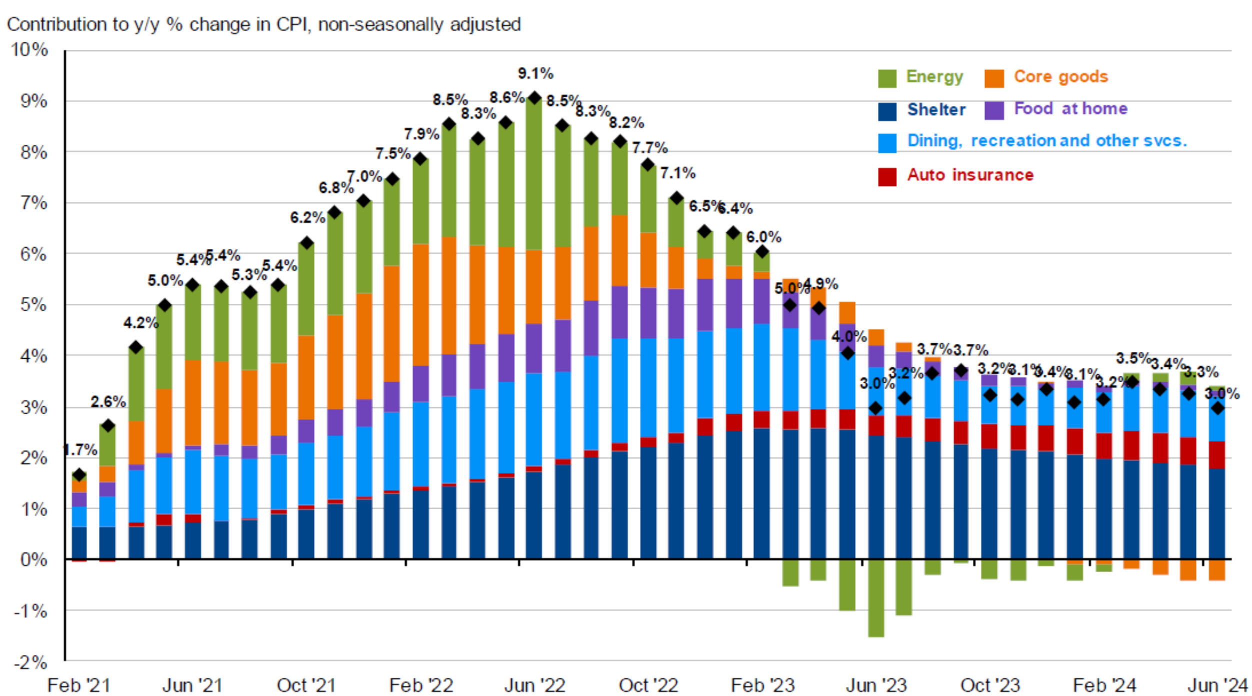
Appendices

APPENDIX A: The "Magnificent 7" Stocks vs. the S&P 500 Index



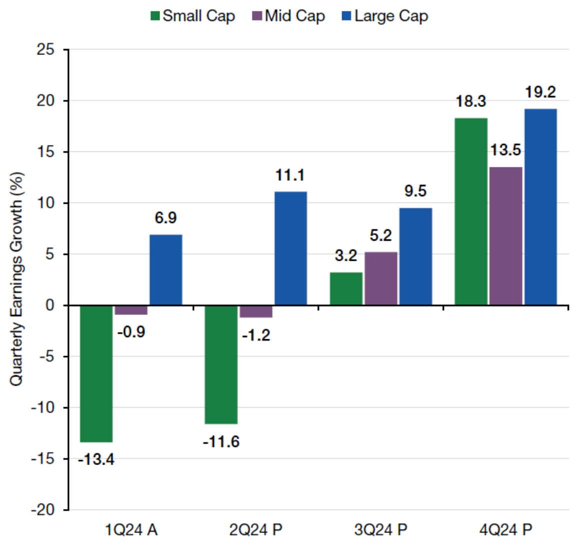
Note: indexed to 100 on 1/1/2021, price return only. Source: JPMorgan Asset Management. Data as of 6/30/2024.
"Magnificent 7" includes AAPL, AMZN, GOOG + GOOGL, META, MSFT, NVDA, and TSLA.

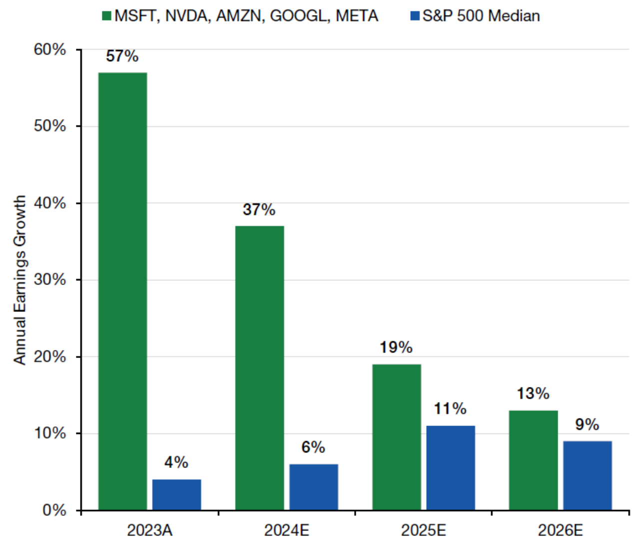
APPENDIX B: U.S. Inflation Components



Source: JPMorgan Asset Management. Data as of 7/31/2024.

APPENDIX C: Earnings Growth Across the S&P 500 Index





Source: Lord Abbett & Co. LLC. Data as of 5/24/2024 (left) and 6/17/2024 (right).

Disclosures

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