# Portfolio Themes for Q2 2024:

## Introduction

The men's and women's NCAA Basketball Tournament, better known as March Madness, is in the process of winding down. Every year, we see early round upsets, but as the tournament progresses, higher seeded teams tend to best their less talented counterparts. Because of the potential for chaos, the first two rounds tend to be the most exciting, before chalk starts to prevail. March in US sports culture is certainly associated with Madness, and in historical western culture, it is often associated with the 'Ides of March,' symbolizing misfortune and doom.

The financial markets could be described in a similar manner, with equity markets trending positive with minimal volatility and continuing to be led by some of the Magnificent 7 names at the top. Meanwhile, intermediate, and longer-term interest rates have found some stability, while some of the meme stock frenzy we saw in 2021, with Bitcoin, gold, and other alternative or even speculative assets, have re-entered our daily lexicon.

In the spirit of March Madness, it's clear that the investment landscape, much like NCAA Tournament, has the potential for surprises and opportunities. However, just as the top teams with the best fundamentals tend to prevail, so too will the best-run companies.

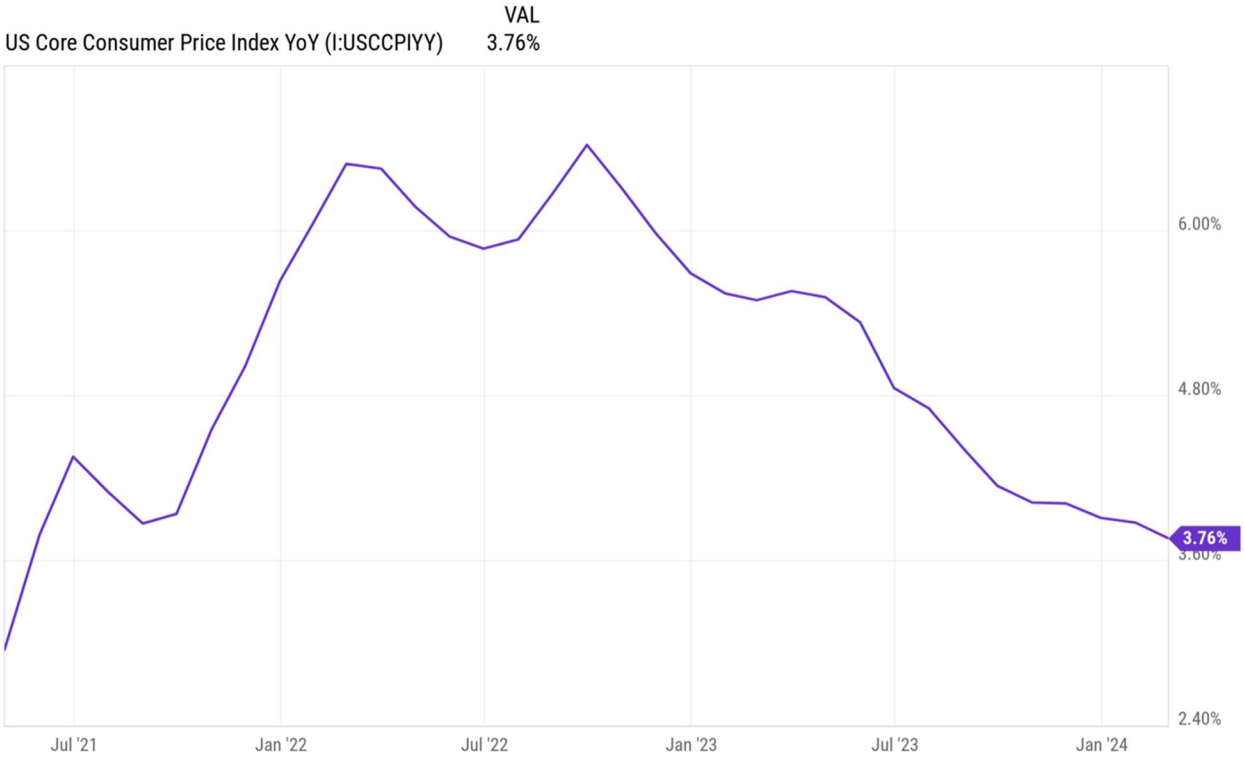
## Fed & the Economy

### Navigating Economic Landscape:

The US economy has continued to expand, led by strong consumer and government spending, and supported by continued strong corporate profits. Until the latest CPI & Employment data, released in Mid-March, the trend of disinflation and robust employment carried over into the 1st quarter. Even the most recent and final GDP estimates for the 4th quarter of 2023 were revised upward at the end of March, from a blistering 3.2% up to 3.4%[1].

It's not about whether the Fed does 2, 4, or even 6 rate cuts this year; the real catalyst for price change is whether there is deviation from the path of what market participants are expecting. The marketplace has all but confirmed that the Fed is done raising rates and has shifted to gauging when the Fed will begin cutting rates. However, predicting exactly when the Fed reverses course may not be wise. The messaging around Fed Policy and how markets perceive that will continue to be important. Cutting rates in 2024 while inflation is still above target, could be interpreted as signals of an impending slowdown or recession, potentially triggering unintended market reactions.

[1]BEA: https://www.bea.gov/data/gdp/gross-domestic-product




Source yCharts

**Inflation Dynamics:**
Inflation has continued its slowdown, fueling positive market reactions across many asset classes. Bond investors are experiencing a long-awaited reprieve as higher interest rates, coupled with decreasing inflation, have led to an increase in real yields. This shift marks a significant turning point, offering much-desired relief and more attractive investment opportunities within the bond market.

However, the CPI figures released in March did surprise estimates, coming in higher than expected. The final stretch of cooling inflation may continue to prove difficult. Patience will be imperative, both by the public and the Fed for the following reasons:

1. Energy prices have crept up, and since energy costs are a significant part of consumer expenses, changes in energy prices inevitably influence inflation perceptions and realities.
2. There is no slowdown in sight for fiscal spending, which continues to move against the actions taken by the federal reserve.
3. There is record cash on the sidelines. Consumer & business balance sheets continue to be healthy, with ample, although declining, cash reserves, much of which is held in money markets, treasuries, or CDs, ready to be moved elsewhere.

Once the Fed does begin reducing rates, discussion will shift to what is the neutral rate. Declining interest rates could hurt the US Dollar, and as an import-driven economy, that could make the cost of cheap goods & services from overseas more expensive. Lower rates may also incentivize all the cash on the sidelines to be spent on goods & services or invested elsewhere, pushing up prices.

**What is a Normal? The Myth of Normal.**

Recent headlines describe the current market environment as 'not normal'. The yield curve is inverted while we have record high employment data, strong GDP, relatively high inflation, and high interest rates. We are living in a post COVID, data driven world, with artificial intelligence carving a path for massive change in our world.

As advisors ourselves, we hear questions such as: "maybe I should wait to invest until things normalize?" All the 'what if' scenarios which are brought up are just that: 'what ifs'. It begs the question as to what is a truly 'normal' economy and how that would be measured. If we look at some average economic data points from recent history, let's say the past 80 years following World War 2, then an average US economy may be comprised as follows:

- 5.7% unemployment
- 3.5% inflation
- 3.1% Real GDP Growth
- 5.1% 10 year treasury
- 7.6% S&P 500 returns[2]

Are any of these data points truly normal? Comparing the current US economy to these figures, does this truly tell us whether the US economy is good, bad, somewhere in between, let alone normal? If you know anything about averages, it's that the average is made up of everything, but nothing is truly average.

Here's what is normal: Continuous change.

The reality is there is no such thing as normal. The economy is a dynamic global system made up of billions of individuals, companies that start up and go out of business, innovations and technologies that are born or wither, cultural trends, and demographic shifts. These drivers are continuously reshaping and redefining what normal is. Progress happens in small increments and can be unnoticeable at the surface. Understanding that progress in investing happens in small increments, not in large doses, is one of the keys to being a great investor.

[2] All 5 Data Points From yCharts

Bottom line here, is if you are thinking about putting off investing until 'right after' the next big thing, that isn't the answer. There's always a reason to put off investing, right up until it's too late. Same can be said about how you invest or waiting for the right time or 'normalization' to occur. Sticking with a disciplined approach factoring in your financial plan should be the priority.

## Fixed Income

### Fixed Income Recap

We did see some residual volatility in intermediate and long-term rates during the 1st quarter, as the pendulum swung back, off the late December interest rate lows. Rates ended up settling down in March, leading to a positive return in the US Aggregate Bond Index (Agg) after negative returns in January & February. The Agg had its first positive month of the year, returning 0.92% in March, however the index is still negative on the year, with -0.78%, through the end of the quarter. [3]

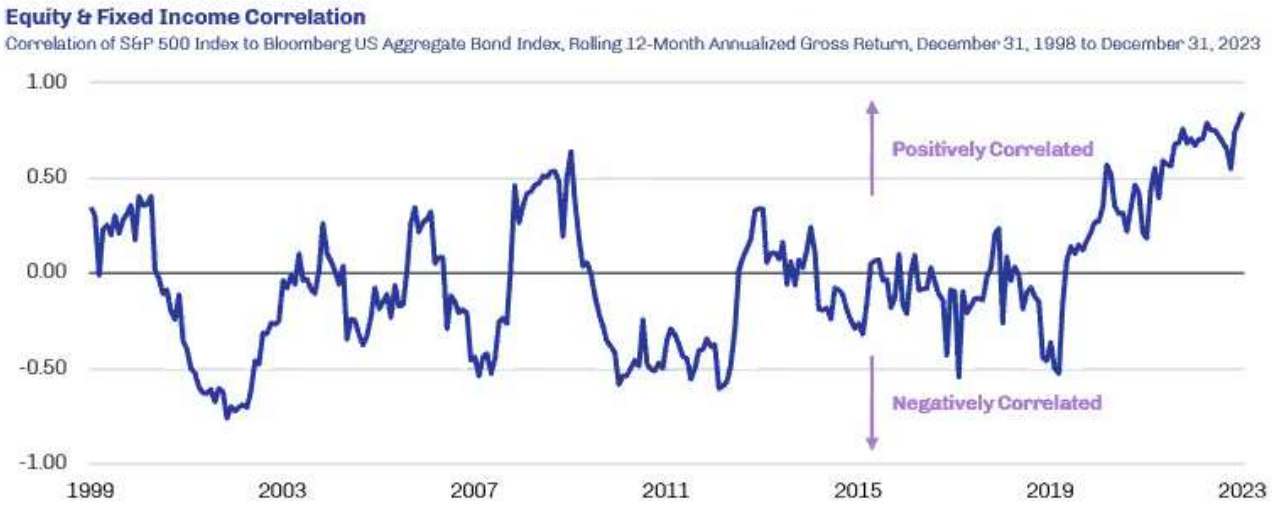

Interest rates continue to tell the story for equity markets. In other words, they are still the tail that wags the dog. If we compare the 10-year treasury to the S&P 500, we see this clearly unfolding in the back half of 2023. The chart on the next page showcases just how correlated equities & fixed income remain. Although not to be reminiscent of 2022, this data further

[3] yCharts: https://tinyurl.com/53t3vt2f

cements that bonds have, and likely still are, providing far less short-term diversification than in prior decades.

Source yCharts

**Stocks and Bonds Are Not Negatively Correlated as They Once Were**




Correlation is a measurement between -1 and 1, which indicates the linear relationship between two variables. If there is no relationship between two variables, the correlation coefficient is 0. If there is a perfect relationship, the correlation is 1. And if there is a perfect inverse relationship, the correlation is -1.

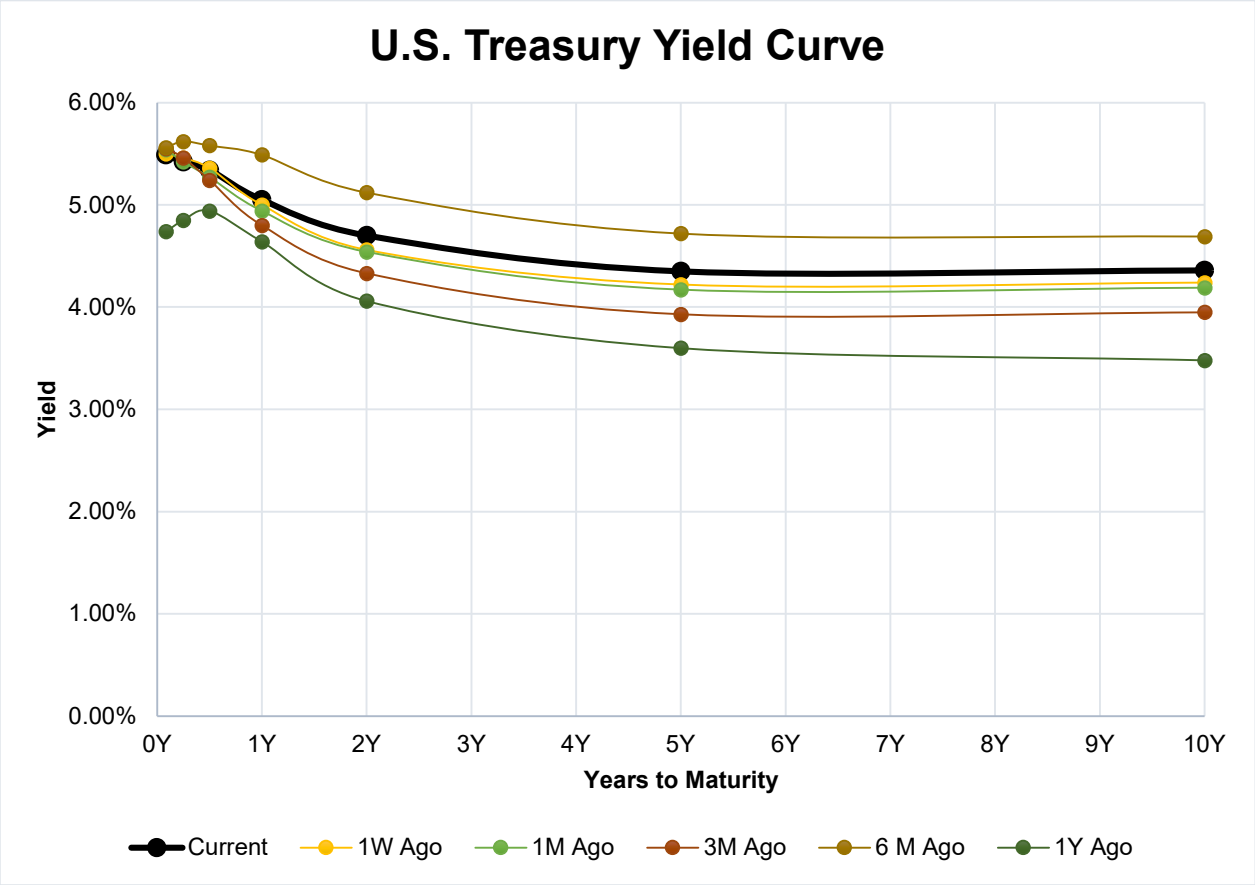
**Past performance does not guarantee future results.**

See important disclosures and index definitions at the end of end of this presentation.

Source: FactSet; data as of December 31, 2023. Equities are represented by S&P 500, Fixed Income is represented by the Bloomberg US Aggregate Bond Index. Correlations are calculated using monthly total returns on a rolling 12 month basis.

## Yield Curve

Towards the end of March, the US treasury market made history for the longest continuous inversion of the US yield curve, measured by the 10-2 year spread. The yield curve has now been continuously inverted since July 5th, 2022, passing the 624-day inversion from August of 1978 through April 1980, which previously held the record.




Source yCharts

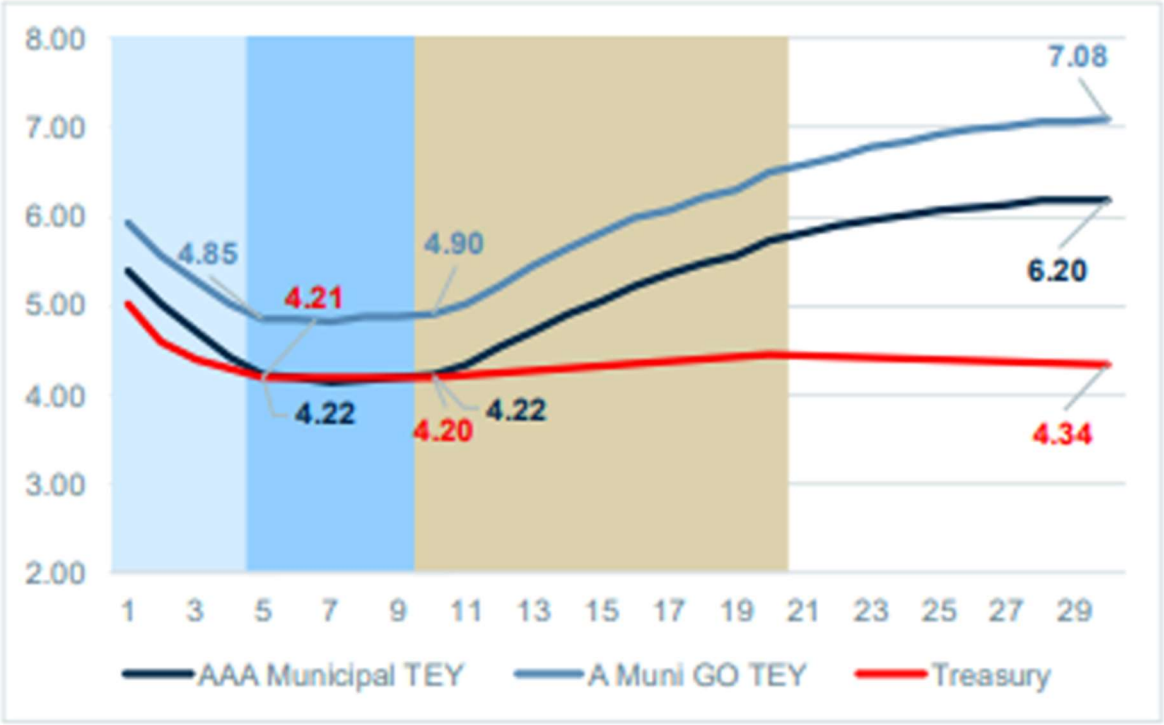
### US Treasury Yield Curve Data

| | | | Date | 4/2/2024 | 3/26/2024 | 3/2/2024 | 1/2/2024 | 10/2/2023 | 4/2/2023 |
|---|---|---|---|---|---|---|---|---|---|
| | Label | Ticker | Name | Current | 1W Ago | 1M Ago | 3M Ago | 6 M Ago | 1Y Ago |
| Years to Maturity | 0.083 | I:1MTCMR | 1 Month Treasury Rate | 5.49% | 5.50% | 5.54% | 5.55% | 5.56% | 4.74% |
| | 0.25 | I:3MTCMR | 3 Month Treasury Rate | 5.42% | 5.46% | 5.42% | 5.46% | 5.62% | 4.85% |
| | 0.5 | I:6MTCMR | 6 Month Treasury Rate | 5.34% | 5.36% | 5.27% | 5.24% | 5.58% | 4.94% |
| | 1 | I:1YTCMR | 1 Year Treasury Rate | 5.05% | 5.00% | 4.94% | 4.80% | 5.49% | 4.64% |
| | 2 | I:2YTCMR | 2 Year Treasury Rate | 4.70% | 4.56% | 4.54% | 4.33% | 5.12% | 4.06% |
| | 5 | I:5YTCMR | 5 Year Treasury Rate | 4.35% | 4.22% | 4.17% | 3.93% | 4.72% | 3.60% |
| | 10 | I:10YTCMR | 10 Year Treasury Rate | 4.36% | 4.24% | 4.19% | 3.95% | 4.69% | 3.48% |
| | 30 | I:30YTCMR | 30 Year Treasury Rate | 4.51% | 4.40% | 4.33% | 4.08% | 4.81% | 3.67% |
| 10-2 Spread | | | | -0.34% | -0.32% | -0.35% | -0.38% | -0.43% | -0.58% |

Source:yCharts

**Municipal Bonds**

Given the current economic landscape, municipal bond investors have a compelling case for considering longer-duration bonds. Indicators such as a slowing economy, tightening credit conditions and declining inflation suggest that interest rates could decrease moving forward. This environment creates an attractive opportunity for investors to lock in higher yields available in the intermediate and long segments of the municipal bond curve. Although the Municipal curve remains inverted from 1-10 year stretch, the curve is spoon shaped, and increases if we move beyond 10 years.




*Taxable equivalent yield (TEY) @ 40.8% tax rate

Source: https://www.raymondjames.com/

The market dynamics of municipal bonds, characterized by limited supply and robust demand, particularly during the summer months, strengthen the case for investing in this asset class. This imbalance, driven by a seasonal decline in bond issuance and a concurrent need for investors to reinvest maturing bonds or interest payments, typically enhances municipal bond valuations. The strategic positioning within the municipal curve, especially in the longer end, can help investors manage reinvestment risk amid recessionary threats, making this an opportune moment to consider municipal bonds for portfolio diversification and yield enhancement. Such conditions are particularly enticing for investors in the top three tax brackets seeking favorable tax-adjusted returns.

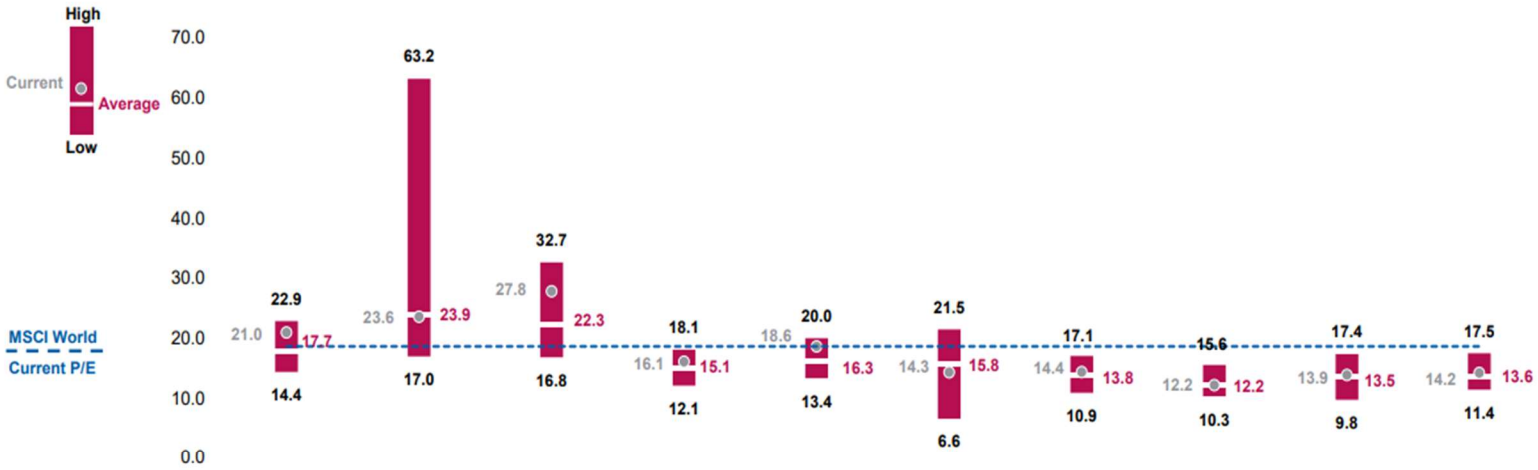
## Equities

### Valuations & Earnings

Market dynamics and earnings have continued to be favorable, but there continues to be a distinct divergence in asset class returns and valuations, namely between US growth and just about everything else. The below chart provides a 10-year lookback on relative asset class valuations. Nearly all equity asset classes are in line, or even cheaper than their 10-year historical averages, except US Growth stocks. Important to note: this analysis compares each asset class to it's *average* valuations over the past *10 years*, and growth has had a tremendous 10 year run. In other words, this is not comparing the valuation of growth stocks of today, versus their valuations of 50 years ago. That type of analysis would showcase growth stocks at even higher valuation metrics!

# Valuation Analysis

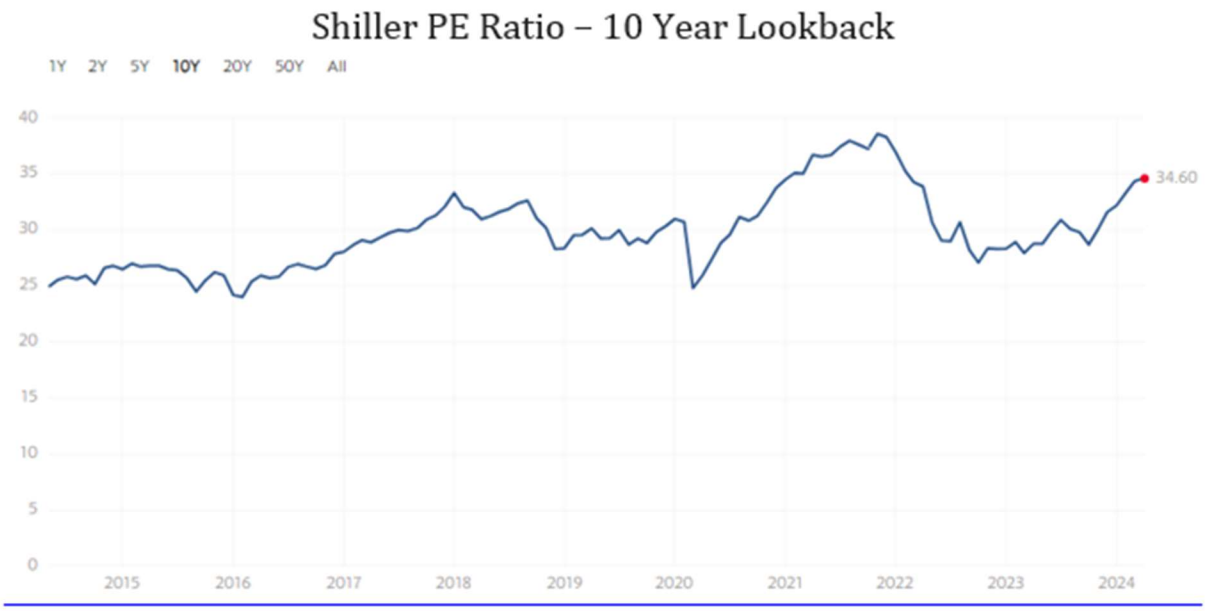
**Regions/Styles: Current NTM P/E vs. 10-Year High, Low, Average**




| | S&P 500 | Russell 2000 | Russell 1000 Growth | Russell 1000 Value | MSCI World | MSCI World ex USA Small Cap | MSCI EAFE | MSCI EM | MSCI Europe | MSCI AC Asia Pac |
|---|---|---|---|---|---|---|---|---|---|---|
| High Date | 8/20 | 6/20 | 8/20 | 3/21 | 8/20 | 8/20 | 8/20 | 1/21 | 6/20 | 1/21 |
| Low Date | 12/18 | 9/22 | 2/16 | 9/22 | 12/18 | 9/22 | 9/22 | 10/18 | 9/22 | 12/18 |

Source: FactSet as of 3/31/24. NTM P/E is market price per share divided by expected earnings per share over the next twelve months. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

In other words, the price multiple, or price-to-earnings (P/E) ratio, has expanded near historic levels. Historically, stock prices have experienced a pendulum effect due to fluctuations in the P/E ratio, with momentum and other factors exacerbating movements both upwards and downwards. Taking a broader view, we acknowledge that today's P/E ratios may not ever match those from 50 years ago. However, we find it easy to see today's valuations as expensive in the short term, primarily due to the expansion of multiples led by stocks at the top of the indices.




Source: https://www.multpl.com/shiller-pe

## International

### Currencies and US Dollar Headwinds

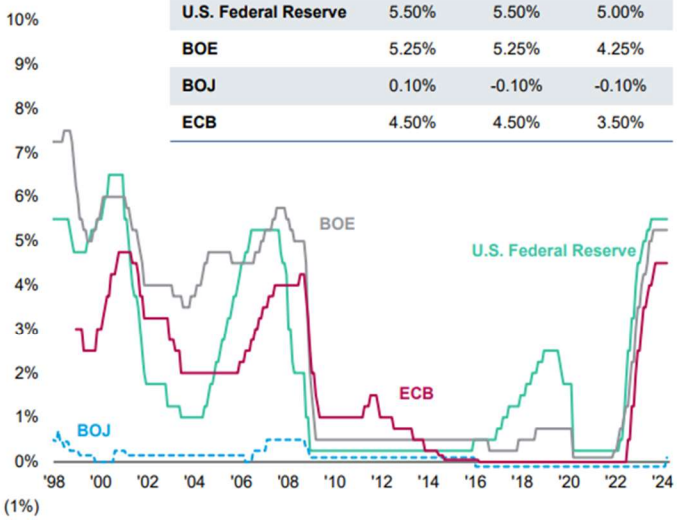
There are compelling reasons to diversify internationally, especially as US equities have sustained their outperformance streak. International equities offer attractive relative and historical valuations, along with higher average dividend yields. Additionally, Chinese equities have shown two consecutive months of positive performance in February and March, after a significant downturn. While we remain cautious about China, this is undeniably a positive indicator for the global economy.

The US dollar remains strong and continued to appreciate against most currencies in the first quarter. Globally, interest rates will continue to act as a catalyst for equity markets. The Bank of Japan raised interest rates in March, ending a prolonged period of negative policy rates. While other developed nations have yet to start reducing interest rates, slower economic growth in Europe suggests that the first rate cuts in the developed world may originate there rather than in the US. Conversely, if the US Federal Reserve leads the way with rate cuts, it could prompt a weakening dollar, especially if other countries do not follow suit.

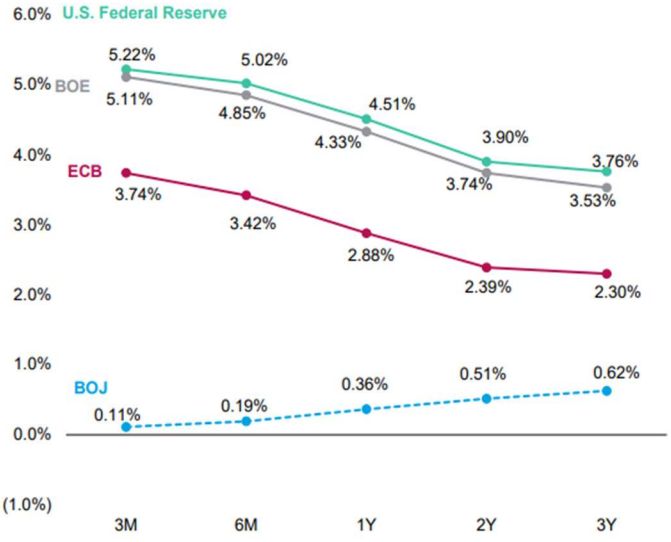
## Monetary Policy

**Central Bank Policy Rates**

| | Current | 1-Mo. Ago | 12-Mo. Ago |
|---|---|---|---|
| U.S. Federal Reserve | 5.50% | 5.50% | 5.00% |
| BOE | 5.25% | 5.25% | 4.25% |
| BOJ | 0.10% | -0.10% | -0.10% |
| ECB | 4.50% | 4.50% | 3.50% |




**Market Expectations for Future Central Bank Rates**




Source: Bloomberg, Factset as of 3/31/24. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

## Portfolio Changes:

During the first quarter of 2024, we made several portfolio revisions, continuing to focus on adding duration and implementing hedged equity alternatives, such as structured products, to discuss with clients in certain risk profiles.

## Discovery Stock Changes:

February:

1. Sold Toyota Motor Co (TM). Purchased Amazon.com (AMZN)
2. Reduced Meta Platforms Inc (META). Added to PNC Financial Services Group Inc (PNC) & Air Products & Chemicals Inc (APD)

**Rationale #1:** Toyota shares have had a nice run over the last 13 months, beating the S&P 500 over that time period. Some of the catalyst to their performance have been a weakening Yen, lower correlation to China, and low impact towards union demands. Amazon on the other hand has a diverse set of revenue streams, covering a multitude of sectors. Amazon continues to have strong growth, and is improving their cash flow position, which should allow them additional capital to deploy towards profitable ventures.

**Rationale #2:** We continue to hold META but are trimming to reduce weight in the portfolio after strong relative outperformance that continued through the Q1 earnings announcement.

Continuing to favor PNC for its geographic diversification, small average account size, and robust branch network. PNC's top-tier loan-to-deposit ratio of 76% vs. the regional banking average of 84% also gives the bank optionality, ultimately giving the bank room to grow loan balances and relieving the bank from relying on expensive sources of funding (e.g., CDs).

Continue to favor APD as the best basic materials sector option due to their strong balance sheet with minimal debt, strong record of pro shareholder management, and diversification across geography, revenue streams, and projects.

## Terrapin Fixed Income Changes:

February:
Eliminated VGSH (Vanguard Short Term Treasury ETF) and added proceeds towards intermediate & long-term bonds, specifically SCHR, MTGDX, & VLGSX.

**Rationale:** We've been looking for some time to slowly close the gap on our duration underweight versus the benchmark, as we believe we are closer to the peak in rates, rather than the trough. Mid-February allowed for a good entry point, as rates spiked following the middle of the month CPI prints.

## Asset Class Positioning

| | Short View | Long View | Trend | Fund |
|---|---|---|---|---|
| **Domestic Equity** | | | | |
| Large Blend | | | Neutral | FXAIX |
| Large Value | | | Neutral | VTV |
| Mid Blend | | | Neutral | FSMDX |
| Small Blend | | | Neutral | JDSCX FSSNX |
| Real Estate | | | Neutral | CSRIX |
| **International Equity** | | | | |
| Foreign Large Blend | | | Neutral | FSPSX |
| Foreign Small/Mid Growth | | | Neutral | FIXIX |
| Diversified Emerging Mkts | | | Up | ABEMX |
| **Short Term Bonds** | | | | |
| Short Government | | | Down | EILDX |
| Short-Term Corp | | | Down | LUBYX |
| **Core Bonds** | | | | |
| Intermediate Government | | | Neutral | SCHR |
| Inflation-Protected Bond | | | Neutral | STIP |
| Long Government | | | Up | VLGSX |
| Investment Grade Corp | | | Neutral | FGBPX AGG |
| Securitized | | | Up | MTGDX |
| **High Yield Bond** | | | | |
| Bank Loan | | | Down | EIBLX |
| High Yield Bond | | | Neutral | BGHIX |
| Preferred Stock | | | Up | CPXIX |

**Disclosures**

We believe the sources to be reliable, however, the accuracy and completeness of the information is not guaranteed.

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Indices mentioned are unmanaged and cannot be invested into directly. The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. The Bloomberg U.S. Aggregate Bond Index is an unmanaged index comprised of U.S. Investment grade, fixed rate bond market securities, including government agency, corporate and mortgage-backed securities. The Russell 1000® Value Index measures the performance of those Russell 1000 Companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000 Companies with higher price-to-book ratios and higher forecasted growth values. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The Nasdaq 100 Index is a basket of the 100 largest, most actively traded U.S. companies listed on the Nasdaq stock exchange. The index includes companies from various industries except for the financial industry, like commercial and investment banks.