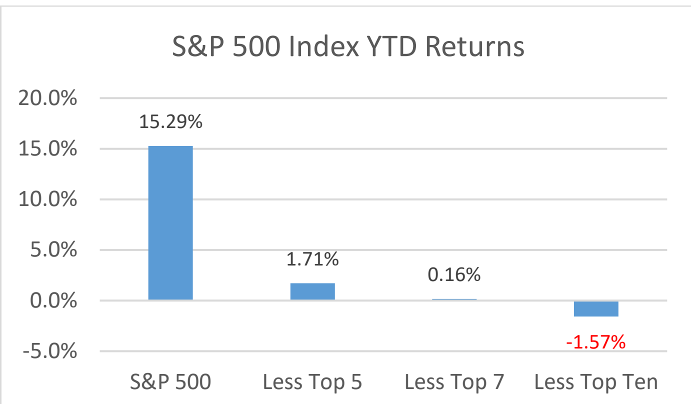
STOKES CAPITAL ADVISORS, LLC

Market Commentary
June 30, 2024

Quarterly Market Review

Global equity markets added to their already impressive gains for the year with the S&P 500 recording 35 record highs. Better than expected earnings from the technology sector (specifically the magnificent seven (MAG7), steady economic growth, healthy labor market trends and a downward trajectory in inflation all contributed to the record gains. However, a deeper look into the broader market gains reveals that almost all the return this year can be contributed to just a hand full of stocks. Indeed, if you back out the top seven names (MAG7), the S&P 500 has gone nowhere this year. (See Chart Below)



Looking back over the last three years, the market cap weighted S&P 500 Index and the Equal weighted S&P 500 index have been tightly correlated until July 2023. The deviation over the last 12 months can be attributed to the Artificial Intelligence boom and the meteoric rise in the MAG7. In fact, the S&P 500 Index is up 36% versus the market cap weighted index gain of 15%. (See Chart Below).

The last time we witnessed such a deviation was the internet revolution or "dot.com craze" of the late 1990s. (See Chart Below) While artificial intelligence or (AI) may very well be the next technological revolution, caution should be exercised when investing in the theme. Security selection will prove to be critical especially when valuations are vaulted into the stratosphere. As with all new technologies," first movers" feast while the market digests and rewards the winners and unmercifully punishes the losers; Capitalism in its purest form.

Surveying the bond market for the quarter, investors appear to be on hold, waiting for the Federal Reserve to provide more evidence on achieving their dual mandate of price stability and full employment. Total return for the Barclays aggregate bond index was flat for the quarter and down -0.71% year to date. Looking at the forward Treasury curve, the market is expecting two ¼ point rate cuts in the back half of 2024.

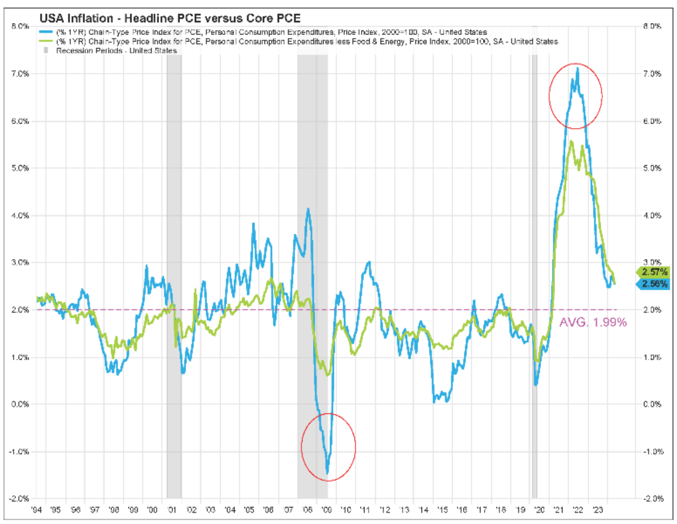
The front end of the Treasury curve, which enjoys a 5% risk free yield, remains an attractive alternative to credit and/or longer dated securities. However the risk on mood across the capital market spectrum has tightened credit spreads and put junk bonds or high yield credit in the winner's circle for 2024.

Turning to commodities, Gold continued its record setting ascent to close at 2,339 $/ozt and has extended gains into Q3 as well. The energy complex witnessed mixed results for the quarter while Brent Crude Oil was range bound to close at $87 compared to the March 31 close of $86.

Investment Strategy & Outlook

This quarter I will take a deeper look into the current inflation challenge and provide some evidence on how to best manage your money so that your purchasing power is not eroded. After all it's NOT what you earn, it's what you keep that's important.

Historically, inflation as measured by the Personal Consumption Expenditure Index (PCE), which is the inflation gauge the Fed prefers, has averaged around 2.0% over the last 30 years with the deflation collapse of 2009 and the 2020 COVID induced inflation being the outliers. 2% is also the Fed target and the Central Bank does not consider food or energy, instead they prefer the Core PCE which excludes food and energy. The last reading was 2.57%.



To gain more insight on the future trajectory for inflation, the U.S. Treasury market offers breakeven Treasury yields which is the difference between the Inflation Protected Treasury (TIPS) and Constant Maturity Treasury securities. The current breakeven yields are as follows: 5 Year 2.21% and the 10 year 2.25%. Observation: The market has a high degree of confidence that the Federal Reserve will reach its goal of 2% over the long run. Questions remain however: (1) What is the correct monetary policy prescription that achieves their goal and (2) What is the cost, i.e. higher unemployment and/or recession?

In my opinion, we are likely to see a higher level of inflation in this decade compared to the last. Monetary policy mistakes, needless stimulus, runaway deficits, real estate demand, to name a few reasons. In any event, long-term investors may need to position their investments for lower real returns across the capital market spectrum.

Asset allocation policy is the first and most critical decision for all investors and represents the building blocks for portfolio construction. In its simplest form we have Cash, Bonds, and Equities. Here is a summary of the three asset classes and their past performance against inflation.

Asset Class	Index	Nominal Return	Real Return
Inflation	PCE Inflation	2.1%	N/A
Cash	3 Month T-Bill	1.6%	-0.6%
Bond	U.S. Aggregate Bond	3.1%	1.0%
Equity	S&P 500 Index	10.6%	8.5%

Note: Data as of June 30, 2024. 20 Year annualized compound growth rate

Cash currently enjoys a 5% yield but historically cash has provided almost no inflation hedge as interest rates are highly correlated to inflation rates. Bonds are typically fixed instruments which provide current income but no growth of income and very little real return net of inflation. Equities are the most diverse group and cover everything from large to small, dividend to non-dividend payers, growth to value, domestic to foreign, etc.

In our opinion this is where investors should focus. Consider investing in companies that pay and growth their dividends every year. This is a simple yet highly effective way to build and protect wealth over the long run. If your dividends (think income) are growing by 7 to 10% per year and dividends are generated from earnings, then over the long run you have a much better chance of defeating the inflation monster than owning the other assets classes.

Capital Markets Scorecard

Benchmark Description	Q2	YTD
U.S. Treasury 3 Month T-Bill	1.33%	2.65%
Barclays Aggregate Bond Index	0.07%	-0.71%
Bloomberg US High Yield Bond	1.09%	2.58%
S&P 500 Index Total Return	4.28%	15.29%
S&P 500 Equal Weight Index Total Return	-2.63%	5.08%
NASDAQ Composite Total Return	8.47%	18.57%
S&P U.S. Dividend Growers Total Return	0.42%	8.18%
Russell 2000 Index Total Return	-3.28%	1.73%
Alerian MLP Index Total Return	3.35%	17.71%
MSCI Emerging Markets Index	6.34%	11.20%
China SCI 300 Index Local Currency	-0.53%	1.62%
U.K. FTSE 100 Index Local Currency	3.75%	7.88%
Japan Nikkei 225 Index Local Currency	-1.81%	19.34%