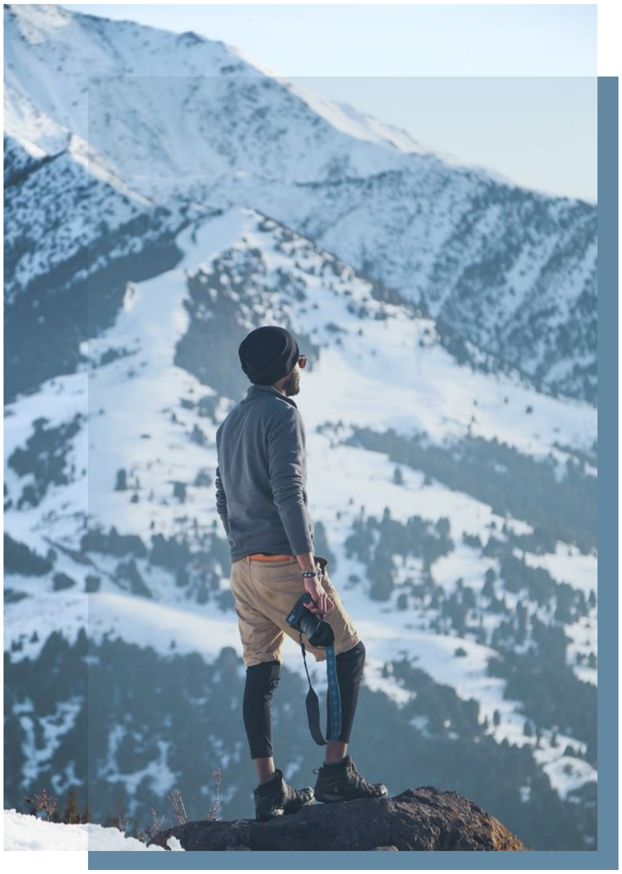
PERSPECTIVES

Benefit Financial Services Group Newsletter

Quarter Ending June 30, 2024



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Market Recap

Brent Miller, CFA® (Senior Portfolio Manager)

The U.S. stock market continued its upward ascent in the second quarter (Q2) of 2024, once again led by the S&P 500 Index.[1] The quarter did not begin smoothly, however, with the S&P 500 Index declining by (4.2%) in April before rising by 8.4% over the last two months of the quarter. Mega cap technology stocks were at the tip of the spear once again, with the Nasdaq-100 Index[2] appreciating by 7.8% in the quarter, led by generative AI darling NVIDIA Corporation (NVDA), which was up 36.7% in Q2 2024. Despite forecasts calling for a broader market rally in the quarter, the market narrowed considerably in the quarter, with the S&P 500 Equal Weight Index[3] declining by (3.1%) in the quarter compared to a 3.9% increase in the market-cap weighted version of the index.[4]

International stocks lagged their U.S. counterparts with the MSCI World ex USA Index[5] declining by (0.5%) in Q2 2024. In advanced economies, European stocks were adversely impacted by slower economic growth and tighter monetary policy in the Eurozone. In Japan, equities continued to reap the benefits of corporate governance reform and a shift towards an inflationary economy after years of deflation. Emerging market returns flipped the script in Q2 2024, exceeding developed international market returns in the quarter as strong tech sectors in Taiwan and South Korea benefited from AI-related enthusiasm. In addition, India continued to be a bright spot among developing economies, buoyed by strong GDP growth and continued inflows from overseas investors.

The most recent Federal Open Market Committee's projections for rate cuts imply one 25 basis point rate cut by the end of 2024, down from market expectations of three 25 basis point cuts at the end of Q1 2024. Consequently, after outperforming the S&P 500 Index in Q4 2023, the small cap Russell 2000 Index[6] continued to underperform the broader market, declining by (3.6%) in Q2 2024 as the "higher for longer" interest rate environment took a firmer hold.[7]

10-Year Treasury yields climbed for most of the first month of the quarter, reaching a Q2 high of 4.74% on April 24th. A pullback in yields resulted in the 10-Year Treasury Yield bottoming out at 4.19% on June 13th before rising once again to close out the quarter at 4.39%. From a performance perspective, the Bloomberg Aggregate Bond Index[8] fell by (0.9%) in the quarter as changing rate cut expectations and rising yields at the beginning and end of the quarter exerted downward pressure on bond prices. The biggest losses came from long-term bonds, which tend to be more sensitive to changes in interest rates and interest rate expectations.

On the commodity front, the price of Brent Oil fell by (4.7%) during Q2 2024 but was down as much as (12.4%) on June 4th before a strong close to the quarter stemmed the decline. The sharp decline in April and May was primarily attributable to fears of a global economic slowdown's dampening effect on demand and a temporary easing of geopolitical tensions in key oil producing regions of the world. By contrast, June brought optimism about rising fuel demand during the Northern Hemisphere's driving season along with renewed fears about conflict in the Middle East curtailing global supply.

We look forward to the rest of the year and are hopeful that the Federal Reserve will be able to keep rates higher most of 2024 without triggering a recession, resulting in a "soft landing" scenario for the domestic economy.

Forecast

Steven Yamshon, Ph.D. (Managing Principal)

I am confident by now that most investors have either heard of artificial intelligence (AI), experienced it, or considered investing in it. Investors are expecting great possibilities from AI, like eliminating mundane tasks, making work more efficient, and the possibility of eliminating many routine occupations. Is AI hype or real? Have AI stock prices gotten ahead of themselves just like in the dotcom boom and bust cycle of the early 2000's?

For AI stock prices to stay at these levels and to increase further will greatly depend on their ability to contribute to economic productivity. The benefit of AI is not debatable by most economists, but the question lies in how much AI will contribute to productivity. Looking back at productivity growth from the information technology boom that occurred from the late 1980's to the early 2000's, approximately 2% was added to productivity growth. Considering it is unlikely that AI will add much more than that, 2% improvement in productivity will add approximately $3-$10 trillion in economic impact by 2035. According to the Bank Credit Analyst, multiple expansion of AI related growth stocks has already seen a $4.5 trillion increase in stock prices since 2022. This could suggest that AI Stocks have gotten ahead of themselves. In my opinion, there is no question that AI will be a productivity enhancer; the question is at what price does the AI Investor have to pay to be part of it?

The primary drivers of long-term returns in the stock market are the future cash flows of the underlying companies and the prices that investors pay for those cash flows. Expecting the mega cap technology stocks to outperform the broader market is to bet on them further exceeding the market's expecations. Simply meeting expectations may result in returns more in line with the market, consistent with the history of top U.S. stocks. However, if prices are higher than assets' discounted cash flows, those assets won't be able to deliver on their required rates of return, leading disappointed investors to sell out of them. When stock prices get ahead of themselves, it usually takes a long time, if ever, for them to fully recover. For example, Cisco Systems (CSCO), a market darling of the dotcom boom era, peaked in 2000 and although its earnings and revenues have increased since then, the stock price has not recovered to its prior highs.

I believe market breadth will expand as large-cap stocks outside the AI ecosystem narrow the performance gap. In my view, this broadening will take place outside of U.S. large-cap equities traditionally classified as growth stocks.

Portfolio Management

Michael Allbee, CFP® (Principal/Senior Portfolio Manager)

At some point, we've all felt FOMO (Fear of Missing Out). Why do many people tend to have FOMO and end up following the crowd? Here is a quote from Warren Buffett from a few years ago that explains why it happens in the stock market:

"People start being interested in something because it's going up, not because they understand it or anything else. But the guy next door, who they know is dumber than they are, is getting rich and they aren't," he said. "And their spouse is saying can't you figure it out, too? It is so contagious. So that's a permanent part of the system." [9]

This herding behavior can create market bubbles or market crashes via panic buying and panic selling. The dotcom bubble of the late 1990s and early 2000s and the COVID-19 induced market crash in March 2020 are prime examples of the effects of herd behavior. Check out our BFSG Short on *"What is Herding Bias"* for a quick primer.

While anything can happen in the short-term during a momentum led market, the investment strategy that outperforms in the long run is one that is hurt minimally when things do not go as expected and benefits greatly when things work out in our favor. According to Charles D. Ellis, who wrote the seminal book “Winning the Loser’s Game”, the distinctive characteristic of effective portfolio management is the elimination of *unintended* risk associated with an individual stock (i.e., Enron) or group of stocks (i.e., tech stocks) and the deliberate assumption of intended market risk.

As we navigate complex and uncertain market environments, we carefully craft each portfolio with a diverse mix of investments spread across a variety of companies, industries, and asset classes, such as stocks, bonds, and alternatives to manage risk and promote long-term capital growth. We also pay acute attention to your time horizon, which for some of you may be a few years and for others may be 30 years. It’s time *in* the market that counts, not *timing* the market.

Finally, most investors are at greater risk for herding behavior when they are uncertain about their current situation. If you haven’t put together a financial plan or if it needs to be updated, now is the time to reach out to us to see if you are well positioned to reach your financial goals.

Talk With Us!

Arash Navi, CPA, CFP® (Wealth Manager)

As financial advisors, the topic of estate planning comes up quite frequently when we speak to our clients regarding their financial goals. Simply put, estate planning allows individuals to decide how their assets are distributed, who cares for their dependents, and who makes medical decisions on their behalf in case of incapacity or death. As such, this topic can create anxiety for some and lead many to procrastinate on estate planning. There is also the fact that many believe estate planning is only for the wealthy with large estates and it would be a costly matter to address. Shockingly, a 2024 study by Caring.com[10] revealed that only 32% of Americans have a will, the most fundamental estate planning document. This lack of preparedness leaves loved ones navigating a complex and costly legal process during a difficult emotional time.

Estate planning doesn't have to break the bank. While consulting an attorney for a complex estate is wise, there are ways to keep costs down. Here, I will discuss the essential documents that are included in a comprehensive estate plan, and I have also included additional resources where you can learn more about each document. We do, however, highly recommend consulting an attorney and many offer a free consultation. Over the years, we have built a network of attorneys that we have worked with, and we can help you find one!

Essential Estate Planning Documents:

Will: This document outlines your wishes for the distribution of your assets after your death. It names an executor, the person responsible for managing your estate and carrying out the instructions in your will. You also appoint a guardian for minor children in the will.

Check out: https://www.fivewishes.org/ for more information on wills.

Living Trust: A trust allows you to transfer ownership of assets to a trustee who manages them for the benefit of beneficiaries named in the trust. Trusts can offer probate avoidance, disability planning, and potentially some tax advantages.

Durable Power of Attorney (DPOA): This document allows you to designate a trusted individual to handle your financial affairs if you become mentally or physically unable to do so yourself.

Advance Healthcare Directive (Living Will): This document expresses your wishes regarding medical care in the event you are unable to make decisions for yourself. It may include preferences for life support, pain management, and organ donation.

Beneficiary Designations: Assigns a person(s) or party (i.e., non-profit) to receive the benefits from specific accounts and products, including life insurance policies, annuities, brokerage and retirement accounts. Beneficiary designations can override your intentions stated in your will. You should ensure your beneficiary designations within your will align with the designations of your life insurance policy and other financial accounts.

While the emotional comfort of knowing your loved ones are cared for is priceless, estate planning also offers significant financial advantages. For example, for those of us living in the beautiful state of California (where you are taxed to death!), leaving behind loved ones without proper estate planning documents can be very costly. The state steps in, triggering probate, a lengthy court process to determine how your estate is divided. This can be a financial nightmare for your family. Probate fees in California can devour 4-7% of your estate's value. Let's say your estate is valued at $200,000. Probate could cost your family a staggering $8,000 to $14,000! In contrast, a basic estate plan with a will and power of attorney might cost around $1,500-$2,500. The cost-benefit is clear: a few thousand dollars upfront for an estate plan can save your family tens of thousands during probate, not to mention the emotional stress of navigating a complex legal system while grieving.

So far, I have only discussed simple aspects of estate planning. For those lucky individuals with substantial assets, estate planning is an essential aspect of their finances to ensure their assets are passed on to their loved ones in the most tax efficient manner. Estate taxes currently offer a generous exemption, with individuals able to shield up to $13.61 million and married couples up to $27.22 million in 2024 from federal taxation. However, this benefit is set to expire at the end of 2025. With potential tax rate increases looming, now is a prime time to take advantage of the Tax Cuts and Jobs Act (TCJA) provisions. By strategically utilizing annual gift exemptions and exploring estate planning strategies, individuals can minimize their future tax burden and ensure a smoother transfer of wealth to their heirs.

If you'd like to learn more about estate planning be sure to check out our upcoming Summer Webinar Series, where we have dedicated a webinar covering "Estate Planning". As always, Talk With Us if you would like us to review your current estate planning documents or learn more about what strategy would be best for you and your family's needs.

In the News

- BFSG Named one of Barron's "Top 100 Institutional Consulting Teams" for 2024.*

**Registered Investment Advisors complete a 102-question survey about their practice. Barron's verifies the data with the advisors' firms and with regulatory databases and then they apply their rankings formula to the data to generate a ranking. The formula features three major categories of calculations: (1) Assets (2) Revenue (3) Quality of practice. In each of those categories they do multiple subcalculations. Barron's measures the growth of advisors' practices and their client retention. They also consider a wide range of qualitative factors, including the advisors' experience, their advanced degrees and industry designations, the size, shape, and diversity of their teams, their charitable and philanthropic work and, of course, their compliance records. BFSG was ranked 82nd out of 100 firms for 2024 based upon information submitted for the prior year. BFSG did not pay a fee to participate in this award.*

The Score Board

	06/30/2024	YTD Change
Dow Jones Industrial Average	39,118.86	4.79%
S&P 500*	5,460.48	14.48%
NASDAQ Composite*	17,733.60	18.13%
MSCI EAFE (USD)*	2,314.63	3.51%
Bloomberg Commodity Index	100.99	2.37%
U.S. Aggregate Bond Index	2146.63	-0.71%
10 Yr U.S. Treasury Bond Yield	4.39%	52 bps
30 Yr Fixed Mortgage Rate	7.26%	27 bps
Prime Rate	8.50%	UNCH
Crude Oil ($ / Barrel)	$81.54	15.86%
Gold ($ / Oz.)	$2,326.75	13.01%
U.S. $ / Euro €	$0.93	3.09%
Core Inflation (excluding food / energy)**		3.4%
Inflation (including food / energy)**		3.3%

**Without Dividends; **Unadjusted 12-Months ended February 2024; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The Nasdaq-100 Index is the U.S. stock market index comprised of the largest 100 non-financial companies listed on the Nasdaq stock exchange. The index is dominated by technology companies and is commonly used as proxy for U.S. large cap technology performance.
3. The S&P 500 Equal Weight Index (EWI) is the equal-weight version of the S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight of 0.2% of the index total at each quarterly rebalance.
4. By comparison, the market cap weighted S&P 500 Index was up by 10.2% in Q1 2024 compared to 7.4% increase in the equal weight index, resulting in a performance gap of 277 basis compared to the Q2 divergence of 701 basis points. A narrower performance gap between these two indices indicates greater market breadth in the large cap space.
5. The MSCI World ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets countries (excluding the U.S.) and 24 Emerging Markets countries.
6. The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell Index. The index is commonly used as proxy for U.S. small cap stock market performance.
7. Small cap companies tend to carry higher relative levels of variable rate debt and usually underperform large cap stocks in high interest rate environments due to their higher carrying costs of debt.
8. The Bloomberg U.S. Aggregate Bond Index is a broad-based index that is commonly used as a proxy for the U.S. bond market.
9. Source: CNBC (September 12, 2018). https://www.cnbc.com/2018/09/12/warren-buffett-on-why-the-next-financial-crisis-is-unavoidable-greed.html
10. Source: Caring.com. https://www.caring.com/caregivers/estate-planning/wills-survey/

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