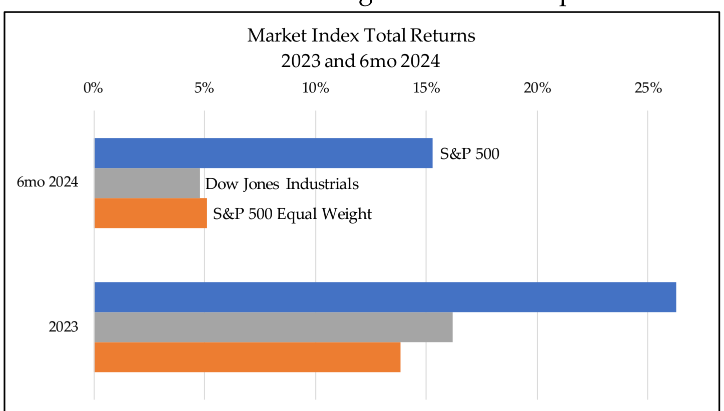
Birch Hill
INVESTMENT ADVISORS

Market View

July 2024

FAVORABLE EQUITY RETURNS CONTINUE

US stocks, as represented by the Standard & Poor's 500 Index, declined in April before resuming a gradual upward trend in May. For the first six months of 2024, the S&P 500 returned +15.3% but most S&P stocks didn't fare as well. A handful of very large technology companies dominate the capitalization-weighted S&P 500, so their returns skew the index's results. If each of the companies in the index is given equal weight, the index returned +5.1% during the six-month period. This wide gap in returns has persisted for much of the last two years, driven largely by enthusiasm about artificial intelligence. This reminds us of how past innovations have ignited unsustainable surges in narrow groups of stocks.



Source: Bloomberg

While attractive opportunities exist in some parts of the stock market, at current valuations, selectivity and caution are advisable in mega-cap technology stocks. The S&P 500's progress this year has been unusually steady, including only one brief period of decline (5.5% in three weeks). Equity markets typically experience multiple declines each year. Intra-year declines greater than 8% are the norm, even when the market produces above-average 12-month returns. Volatility can increase at any time.

HIGHER INTEREST RATES THAN PREVIOUSLY EXPECTED

Interest rates appear to have peaked last October when reports of softening economic growth and declining inflation led investors to conclude that the Federal Reserve would soon begin to reduce short-term interest rates. Since then, stronger than anticipated economic growth and stubborn inflation have delayed the Fed's anticipated rate cuts. As a result, bond values have wavered, and investors in medium to longer-maturity bonds experienced disappointing returns in 2024's first six months. The Bloomberg Intermediate Government Credit bond index returned only +0.5% during the period.

Market Indicators		6/30/2024
TOTAL RETURN		
US Stock Markets	12 Mos	Year-to-Date
S&P 500 Index	24.5%	15.3%
S&P 500 Equal Weight Index	11.8%	5.1%
DJ Industrial Avg.	16.0%	4.8%
S&P 400 Mid Cap	13.6%	6.2%
Russell 2000 Small Cap	10.0%	1.7%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	11.3%	5.8%
Japan (MSCI Index)	12.6%	7.2%
China (FTSE 50)	-1.6%	8.5%
Emerging Mkts Index	10.5%	6.7%
US Fixed Income Yields	12/31/2023	6/30/2024
6 Mo US T-Bill	5.26%	5.33%
2 Yr US T-Note	4.23%	4.71%
10 Yr US T-Note	3.88%	4.36%

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PERSISTENT ECONOMIC GROWTH

Economic indicators look favorable in the near term, but longer-term concerns are bubbling. US economic growth, as defined by gross domestic product, cooled to +1.3% in the first quarter of 2024 and is estimated to have increased in a range of +2% to +3% in the second quarter of the year. The labor market has begun to normalize, but a 4% unemployment rate is still noticeably lower than the 6.2% 50-year average. Consumer auto and credit card loan delinquencies continue to trend unsustainably higher. It is currently estimated that federal tax and other receipts will only cover 76% of government expenditures in 2024. Few politicians express concern.

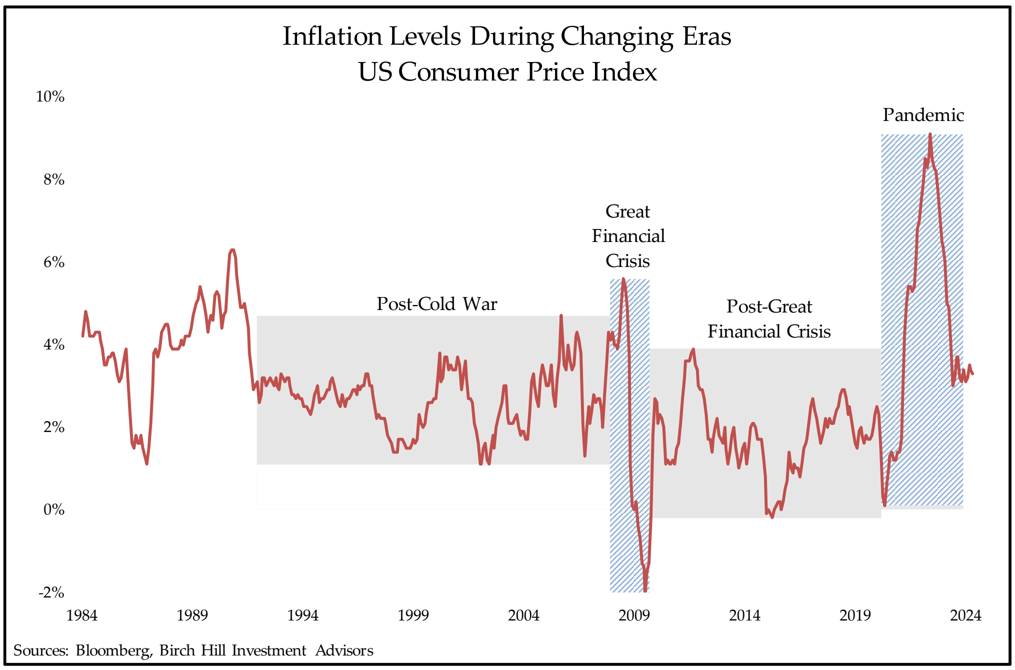
STRUCTURALLY HIGHER INFLATION?

Many bond investors believe the Federal Reserve and other central banks will soon win the inflation fight, returning inflation rates to the zero to 2% range. There are good reasons to believe this consensus is wrong. Inflation has been suppressed for much of the last 40 years, due to major factors that are now reversing. Those factors include:

- The globalization of manufacturing shifted a portion of world production to low-cost economies. Supply chain concerns and higher tariffs are now partially reversing this trend, raising costs.

- Hundreds of millions of workers joined the world's productive economy in the last four decades due to the disbanding of the former Soviet Bloc and the opening of economies in China, India and many smaller nations. Now, with the possible exception of India, no major economies can add significant numbers of workers. Unless technology rapidly increases worker productivity, labor costs will rise.

- Increasingly transparent and politically independent central bank policies have given global businesses and investors a clearer view of upcoming economic conditions and allowed central bankers to take politically unpopular actions that are effective in fighting inflation. However, political changes in many countries have begun to threaten central bank independence.



For these and other reasons, we may now be in an era when US inflation is typically above 3% and central banks around the world will combat occasional periods of higher inflation. Businesses and consumers will need to adjust to higher inflation and lower predictability. Bond investors should be patient and opportunistic.

A BUMPY ROAD AHEAD

US equity markets have moved higher in 2024 with significant help from a handful of very large technology companies. Overall conditions remain favorable for equities, but relatively calm markets are not common over extended periods, and greater volatility could surface at any time. A resilient economy and sticky inflation have kept interest rates higher than anticipated six months ago. Selectivity and quality are particularly important at this point in the market cycle.

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