Capital Markets Review | 2nd Quarter 2024

June 30, 2024

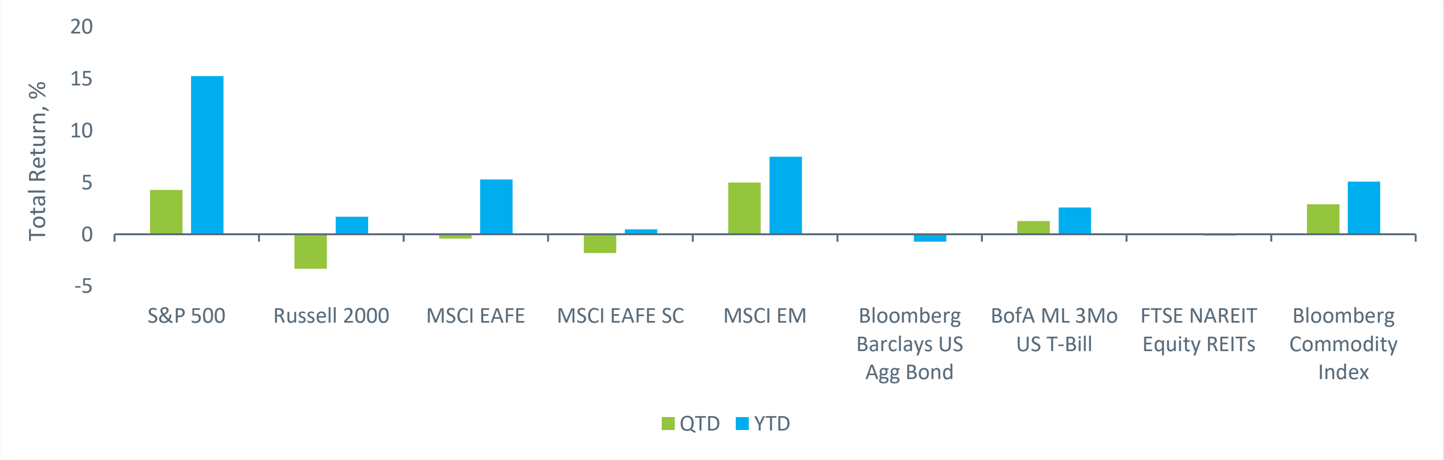
Overview

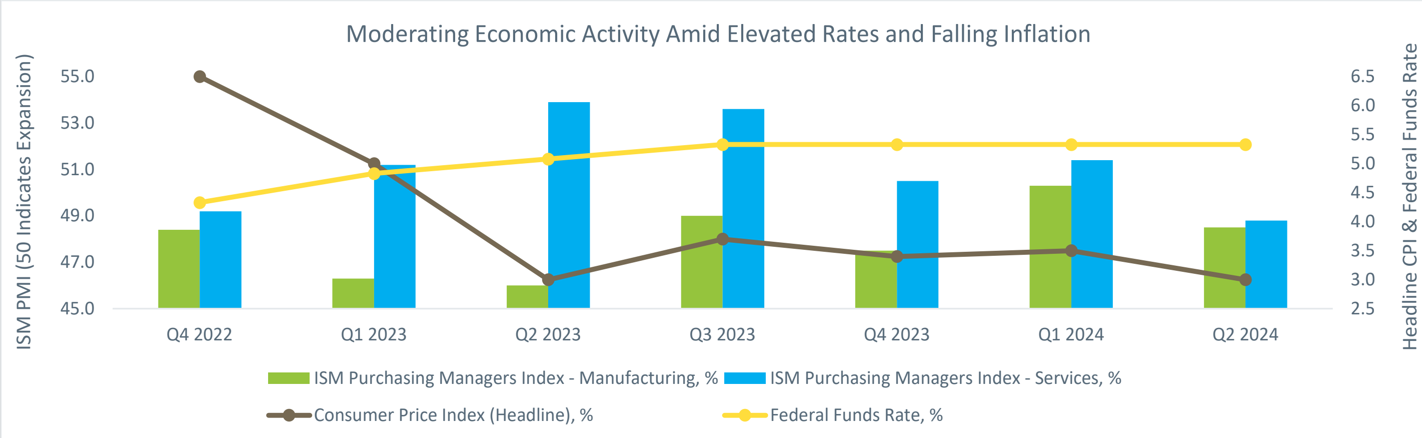
During Q2, broad global equity markets experienced subdued volatility and continued appreciation, while aggregate fixed income returns were flat. Within equity markets, results were once again driven by mega cap growth stocks, including Nvidia and other stocks expected to benefit from further adoption of artificial intelligence (AI). Results for stocks beyond this small cohort were more mixed, with many segments within the smaller cap and developed international equity asset classes delivering flat to negative returns. Emerging markets equity experienced a positive quarter driven by a rebound from China and continued strong results in India.

Within fixed income, the lack of movement in monetary policy and persistently tight spreads among corporate debt led to marginally positive returns for broad fixed income indexes, but longer duration asset prices declined modestly as long-term Treasury yields rose in Q2. As with past quarters, the yields of shorter-dated Treasuries remained higher than longer-dated issues as the inverted yield curve persisted. Investors remained attuned to the potential policy changes by the US Federal Reserve, but expectations for sudden or sharp actions have abated amid stable economic conditions and stubborn inflation levels. There has been improvement in inflationary conditions as highlighted by the personal consumption expenditures deflator reading of 2.6% in May (the preferred inflation measure of the US Federal Reserve). The headline Consumer Price Index release also came in below expectations at 3.0% according to the June reading. Also notable, breakeven levels of inflation, as indicated by the difference by nominal and real Treasury yields, declined over the quarter after a measured increase in Q1. However, commentary from members of the Federal Open Market Committee (FOMC) have generally aimed to temper expectations for a rapid or substantial shift toward a more accommodative monetary stance with the Federal Funds Rate target range remaining at 5.25% – 5.50%.

Minutes from the June meeting of the FOMC indicated that "greater confidence" was necessary with regard to the downward path of inflation prior to considering major policy changes. The "dot plot" released by the FOMC indicated dispersion in rate forecasts among the group with the median member indicating that the Federal Funds Rate would be lower by 25 basis points by the end of 2024, which represents significantly less movement than projected in prior quarters. In contrast, the European Central Bank (ECB) announced that their policy rate *(continued on next page)*

2nd Quarter and Year-to-Date Performance



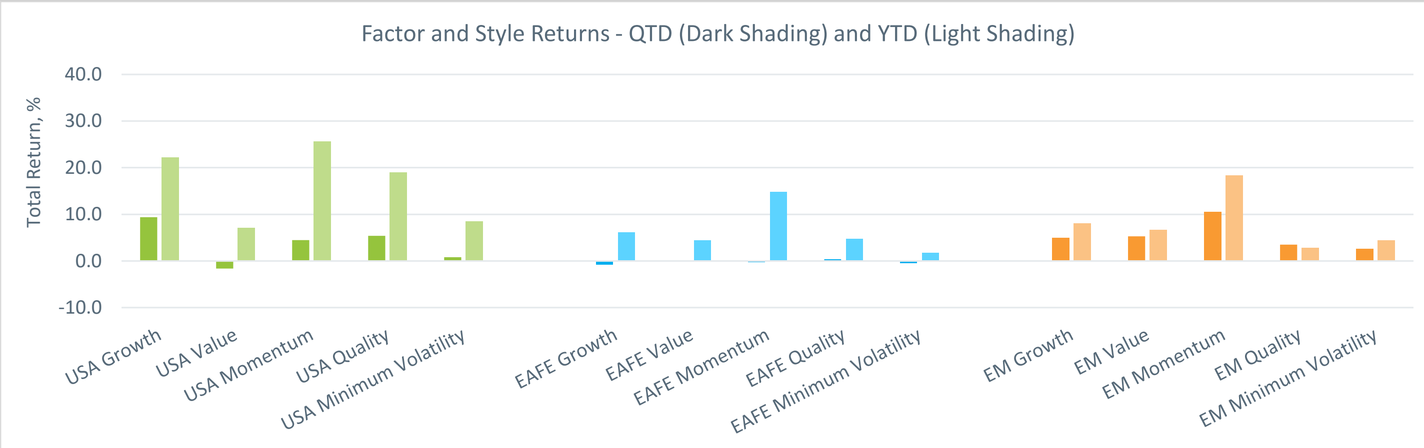


would be reduced from 4.0% to 3.75% amid slowing regional inflation while there has been continued commentary around the potential for the Bank of Japan to increase policy rates following the announcement that it would shrink its bond purchasing program.

The June outlook released by the World Bank forecasted global GDP growth of 2.6% in 2024 followed by a slight uptick to 2.7% in 2025. Global inflation levels were forecasted to be 3.5% this year with expectations that reductions will be more gradual than in prior projections. Given the inflationary outlook, uncertainty around the growth forecasts were primarily centered around the need for a higher-for-longer interest rate environment, further trade fragmentation given the upcoming US presidential elections and heightened risk around existing and potential military conflicts. Specific to the US, data indicates stable hiring activity, reduced job openings, and a deceleration in wage growth. Signs of moderation include the manufacturing and services purchasing managers indexes being in contractionary territory and declining levels in the consumer confidence index. The unemployment rate remains below long-term averages at 4.1%, but has increased since a low of 3.4% reported in early 2023. Forecasts for US GDP growth in 2024 were generally stable in Q2 with many projections falling in a range of 2.0% – 2.5%.

Expanded Review of Key Economic Indicators

	Q2 2024	Q1 2024	Q4 2023	10 Year Average
Federal Funds Rate	5.33%	5.33%	5.33%	1.53%
Treasury (2-Year)	4.71%	4.59%	4.79%	1.82%
Treasury (10-Year)	4.36%	4.20%	3.88%	2.39%
Treasury (30-Year)	4.51%	4.34%	4.03%	2.86%
Breakeven Inflation (5-Year)	2.28%	2.44%	2.14%	1.93%
Breakeven Inflation (10-Year)	2.29%	2.32%	2.17%	1.98%
Breakeven Inflation (30-Year)	2.30%	2.28%	2.16%	2.03%
BB US Corp: Hi Yld Index - OAS	3.09%	2.99%	3.23%	4.23%
Capacity Utilization	78.17%	78.41%	78.73%	77.45%
Unemployment Rate	4.10%	3.80%	3.70%	4.75%
ISM PMI - Manufacturing	48.50%	50.30%	47.40%	53.53%
Baltic Dry Index - Shipping	2,050	1,821	2,094	1,405
Consumer Confidence (Conf. Board)	100.40	103.10	108.00	109.74
CPI YoY (Headline)	3.00%	3.50%	3.40%	2.86%
PPI YoY - Producer Prices	2.60%	1.90%	0.10%	2.70%
US Dollar Total Weighted Index	124.52	121.41	118.77	114.25
WTI Crude Oil per Barrel	$82	$83	$72	$63
Gold Spot per Ounce	$2,333	$2,230	$2,068	$1,535



US Equity

In Q2, US equities posted mixed results across the style spectrum, with broader market cap-weighted indexes delivering low single digit gains, as demonstrated by the Russell 3000 return of 3.2%. In contrast, returns from equal-weighted broad market indexes were negative highlighting the lack of market breadth in Q2. There was continued dispersion between the “Magnificent Seven” and the broader US market. Apple and Nvidia both were strong contributors, returning 23.0% and 36.7%, respectively.

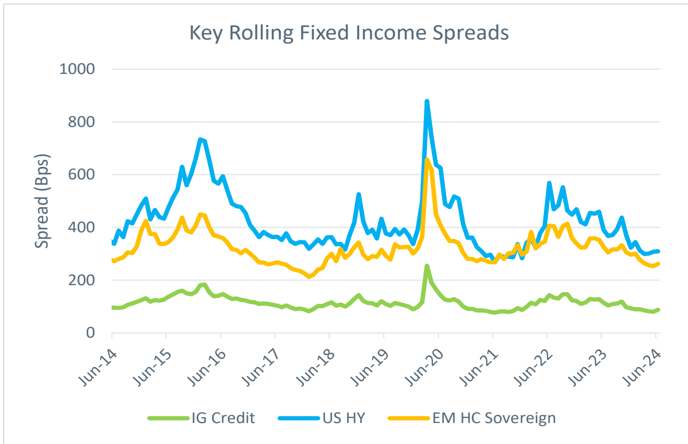
By sector, technology and communication services stocks delivered positive results while energy and industrials stocks were generally laggards. During the quarter, large-cap equities significantly outperformed small-cap equities, and value underperformed growth, particularly in the large-cap space, with the Russell 1000 Value and Russell 1000 Growth delivering -2.2% and 8.3%.

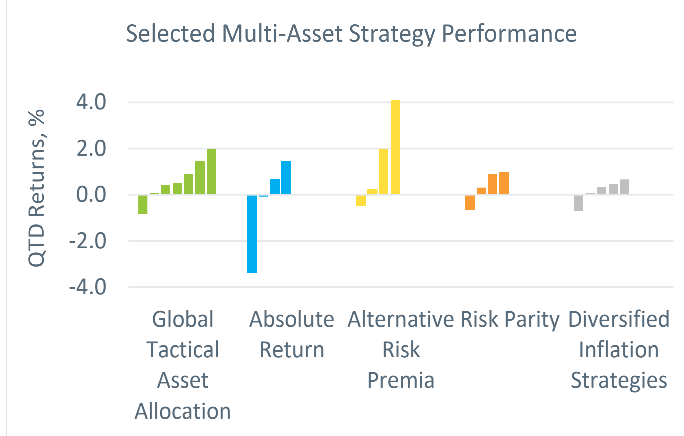
Median manager excess returns were mostly negative in Q2, except for the small-cap space. The largest dispersion in manager median excess returns occurred in large-cap, with growth managers, in particular, struggling to keep pace with strong benchmark returns compared to value managers, who delivered modest excess returns, on average. This trend of underperformance by median growth managers was consistent in the mid-cap space, but not in the small-cap space, where managers fared better relative to the benchmark.

Non-US Equity

Developed international markets continued to trail their US counterparts in Q2 with the MSCI EAFE Index returning -0.2%. As with the US Market, large-cap stocks again outpaced small-cap stocks however, in a reversal from the prior quarter, value stocks outperformed their growth counterparts with the MSCI EAFE Value Index providing the one broad area of positive return, finishing up 0.4% in Q2. Developed markets were particularly influenced by election results in the European Parliament and the ECB’s first interest rate cut since 2019 following the easing of year-over-year inflation. Most developed active managers struggled to beat their index in Q2 with the exception being the small-cap value space.

Emerging market equities significantly outperformed developed markets in Q2 reversing a recent trend with the MSCI Emerging Markets Index finishing the quarter up 5.0%. Emerging market value stocks narrowly outperformed growth while small-cap outperformed large-cap. The majority of active emerging market managers underperformed for the quarter. Taiwan Semiconductor singlehandedly contributed over a quarter of the gains experienced within broad emerging markets equity, but there were additional contributors including strength across India, China, Taiwan, and Turkey. One particular area of market weakness was Mexico due to expectations for upcoming reforms following its presidential election results.





Fixed Income

In Q2, while policy rates were unchanged, the fixed income market experienced volatility due to uncertainty around rate cuts and inflation data. The latest Summary of Economic Projections released by the FOMC indicated only one expected rate cut in 2024 compared to a median forecast of three in the March release. FOMC members continued to stress the need for more confidence in economic data before adjusting policy.

In Q2, US Treasury yields experienced a steady increase across the curve, with the 10-year yield rising by 16 basis points to end at 4.4%. The yield spread between 2- and 10-year Treasury remaining negative, marking a record duration of 24 months since the start of the inversion. Against this backdrop, the Bloomberg US Aggregate Bond Index posted modestly positive returns of 0.1% in Q2. Risk assets weathered rising rates, with lower-rated bonds outperforming the broad market. The Bloomberg US Corporate Investment Grade Index returned -0.1%, while the Bloomberg US Corporate High Yield Index returned 1.1%.

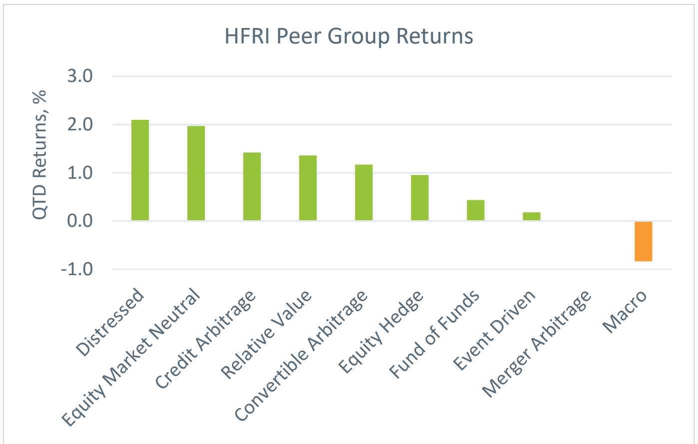
Emerging market debt delivered mixed results. The JPMorgan EMBI Global Diversified Index—tracking hard currency bonds in emerging markets—posted a 0.3% return in Q2. However, the strength of the US dollar put downward pressure on foreign exchange rates, leading the JPMorgan GBI-EM Global Diversified Index, which tracks local currency bond markets, to deliver negative returns of -1.6% in Q2.

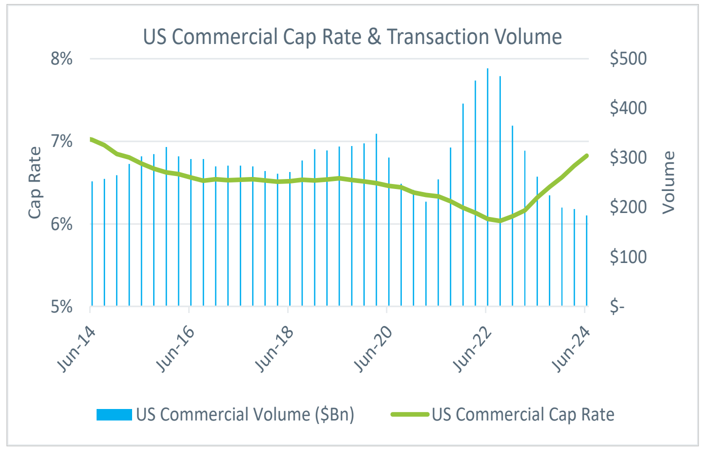
Multi-Asset

Global Tactical Asset Allocation (GTAA) strategies that RVK follows closely posted modest positive returns with limited dispersion in Q2. Generally, active managers providing significant diversification underperformed a US-centric blend of 60% equity and 40% fixed income (60/40 blend) as US stocks continued to trend higher. Relatedly, long-biased GTAA strategies featuring higher allocation to US stocks tied to information technology and communication services sectors outpaced peers.

Multi-asset managers that target reduced correlations, low volatility, and limited market sensitivity posted mixed returns. Among this group, the best performers benefitted from exposure to consumer and health care equities, and commodities, specifically to precious metals. Alternative risk premia strategies that RVK tracks closely tended to produce positive returns in Q2 as market volatility provided the opportunity to take advantage of short-term dislocations.

Diversified Inflation Strategy managers tracked closely by RVK underperformed a US-centric 60/40 blend over the quarter. While results were relatively muted, managers with higher allocations to treasury inflation protected securities (TIPS), especially in cases where shorter duration TIPS were targeted, and exposures to commodities, specifically precious and base metals, outperformed peers. Notably, managers with higher allocations to real estate investment trusts (REITs) tended to lag peers.





Diversified Hedge Funds

In Q2, the HFRI Asset Weighted Composite Index finished the quarter up 0.4% resulting in a year-to-date return of 5.4%. Risk market volatility remained subdued amid uncertainty surrounding the anticipated interest rate policy pivot and the upcoming US presidential election.

The long technology trade continues to perform well as Nvidia and other "Magnificent Seven" stocks continue to push higher even as concentration among hedge fund managers reaches record levels. Long biased tech-oriented hedge funds were top performers during the quarter, with the HFRI Technology Sector Index up 3.7%, and the HFRI Fundamental Growth Index up 2.2%.

Quantitative strategies were another strong performer in Q2 with the HFRI Quantitative Directional Index up 3.6% on the quarter, and 12.9% year-to-date. Activist strategies saw a sharp pullback during the quarter, returning -5.8% in Q2, finishing the first half of 2024 roughly flat.

Macro strategies were mixed, with the HFRI Systematic Macro Index declining -2% while the HFRI Discretionary Macro Index finished up 1.3%. Ongoing trends in the industry include hedge fund managers continuing to engage in a "war for talent", spurred by new fund launches and the elevated popularity of the multi-manager model. Another key theme observed across manager meetings are efforts to integrate AI technology into various business functions.

Real Estate

Core private real estate generated a negative total return -0.5% in Q2 (on a preliminary and gross of fee basis), as reported by the NFI-ODCE Index, with the total return comprising 1.0% from income and -1.5% from price appreciation. Income returns improved slightly on a percentage basis compared to prior quarters, but this quarter marks the eighth consecutive quarter of negative price appreciation for the NFI-ODCE.

Investors of publicly traded real estate underperformed their private market counterparts, though both were negative. Publicly traded real estate delivered a second quarter total return of -0.9%, as measured by FTSE/NAREIT All REITs Index.

Negative price appreciation in institutional real estate, driven by rate expansion, continues to show a slowing pace. Coupled with stabilizing transaction markets and expectations of an interest rate cut in the near-term there is some anticipation from real estate investors that an eventual market inflection point could be nearing.

These positive developments and indicators, albeit early and incremental, are starting to emerge in discussions with managers. A fair number of managers that RVK tracks closely are reporting modest positive total returns while a few others appear as outliers with high single digit negative total returns.

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