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June 7, 2024

Earnings Season Was Fun, Now What?

Major Equity Indices	Value (5/31/24)	Total Return (includes reinvested dividends) May 2024	YTD 2024 (through May)	Q2 2024 (April & May)	Q1 2024
NASDAQ Composite	16,735.02	7.0%	11.8%	2.3%	9.3%
S&P 500	5,277.51	5.0%	11.3%	0.7%	10.6%
S&P 500 Equal-Weight	6,707.28	2.8%	5.6%	-2.2%	7.9%
Dow Jones Industrial Average	38,686.32	2.6%	3.5%	-2.5%	6.1%
Russell 2000	2,070.13	5.0%	2.7%	-2.4%	5.2%

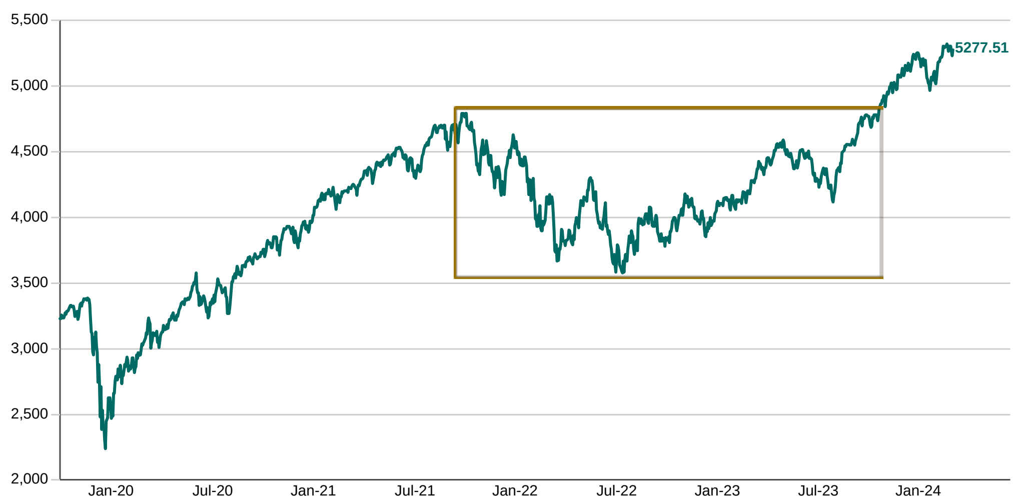
Data Source: FactSet as of 5/31/24. Total return includes reinvested dividends. Calculations use closing prices.

U.S. equity indices rallied in May, recovering most (if not all) of April declines, and solidifying solid year-to-date (YTD) performance. While many factors often contribute to higher equity prices, a key driver in May, in our view, was better-than-expected year-over-year (Y/Y) earnings growth for the year's first quarter (1Q24). While a strong start to the year boosts the outlook for continued earnings growth over the balance of 2024, we believe investor attention will now shift to economic trends, inflation data, and changes in interest rates. If those trends move in a positive direction, equity gains from current levels can continue, but risks remain and elevated valuations, along with ongoing narrow gains, could limit upside and lead to volatility. Our S&P 500 fair value estimate remains 5,000, which is about 5% below current levels, and the 5/31/24 level is about 2% below the upper end of our 4,600 to 5,400 fair value range. As of 5/31/24, the S&P 500 traded at 21.7x the 2024 S&P 500 earnings estimate (FactSet consensus) and 21.0x the estimate over the next four quarters (2Q24 to 1Q25). With modest return expectations ahead, we advocate managing portfolios to prioritize holdings of high-quality companies and broad sector diversification.

S&P 500 has moved to all-time highs. When the S&P 500 moved above 4,800 on 1/19/24, the index closed at a new all-time time high for the first time in more than two years. During the two-year period from January 2022 to January 2024, the S&P 500's closing price ranged between 3,600 (3,577 on 10/12/22) and 4,800 (4,796 on 1/3/22), but since that breakout day in January of this year, the index has rallied an additional +9.0% (as of 5/31/24) over more than four months. Other indices have rallied as well, with both the Dow Jones Industrial Average and Nasdaq Composite indices establishing new highs in the first quarter and extending those gains in May. But after closing March at an all-time high, the Equal Weight S&P 500, which in our view represents the "average" large company stock, has not participated in second quarter gains, and through 5/31/24 was down -2.2% (including dividends) in 2Q24 (the Equal Weight index assigns the same weight to all S&P 500 companies; the S&P 500 index weights by market capitalization, giving the larger companies greater influence). In addition, the Russell 2000 index, the most widely followed U.S. small company index, was also lower in 2Q24 through May (-2.4%) and its last all-time high was in November 2021. YTD index gains remain narrow. While the Nasdaq Composite and S&P 500 delivered total returns of +11.8% and +11.3% through the end of May, respectively, the Equal Weight's total return was +5.6% and the Russell 2000's was +2.7%. We would like to see better relative participation from the average stock to support sustained equity market gains from current levels, and that has not happened in 2024 despite new highs. While equities could indeed trade higher if economic and earnings growth continues to exceed expectations, we believe that increased volatility and unpredictable market returns are likely.

With major equity indices trading at or near all-time highs, but with outperformance concentrated among narrow leadership in large-company, growth sectors and indices, many areas of the market (both individual companies and sectors) have lagged. In our view, this creates rebalancing opportunities by following portfolio allocation objectives and trimming positions that are overweight relative to targets and adding to positions that are underweight. While this can be difficult in the near-term if the best performers continue to outperform, we believe it to be a prudent strategy for long-term investors. Rebalancing allows portfolios to remain invested during periods of market volatility but can reduce risk by improving diversification.

S&P 500 Price: 12/31/2019 - 5/31/2024



First quarter earnings growth exceeded expectations. With first quarter corporate financial results largely reported (among S&P 500 constituents), earnings have exceeded expectations. Through the end of May, 98% of S&P 500 companies had reported quarterly financial results covering the calendar first quarter, and Y/Y earnings growth was +5.9%, above estimated growth of +3.4% on 3/31/24. In addition, 78% of S&P 500 companies have exceeded expectations (according to FactSet's Earnings Insight), which is modestly better than an average of 74% over the past ten years. Earnings per share (EPS) percentage growth in 1Q24 was the best in two years and adds to investor confidence that S&P 500 2024 full-year EPS will grow +11.6% (FactSet consensus estimate, as of 6/4/24). To reach that estimate, the EPS growth rate must accelerate over the next three quarters. That is possible if earnings growth improves for a few sectors. According to FactSet data, in 1Q24, both the S&P 500 Health Care and Energy sectors posted Y/Y earnings declines exceeding -25% and, combined, took away 6.1% from reported earnings growth. This means that excluding those two sectors, 1Q24 earnings growth was a solid +12.0%, and earnings growth for both Health Care and Energy is expected positive in 2Q24 so will likely not be a drag in the quarters ahead. On the other hand, the S&P 500's six largest stocks by market capitalization contributed 7.8% to 1Q24 S&P 500 earnings, so excluding those six companies, 1Q24 earnings declined -1.9%. Earnings growth for the six largest companies is expected to remain solidly positive in 2024 but at a slower growth rate, especially in the year's second half. For the S&P 500 estimated EPS growth rate to achieve those double-digit estimates in 2024 and 2025, accelerating earnings growth from a broader swath of the index is needed. That earnings growth, in our view, will be dependent upon the strength of the U.S. economy and how inflation trends could impact the level of interest rates.

Economic trends, inflation and interest rates. U.S. economic growth, measured by gross domestic product (GDP) as reported by the Bureau of Economic Analysis (BEA), has slowed from above-trend levels in the second half of 2023, but has remained positive. Recent data suggests softer consumer spending that, although somewhat expected, creates uncertainty for consumer-facing companies. U.S. GDP (inflation-adjusted annualized rate) slowed to +1.3% in 1Q24, well below above-trend growth of +4.9% and +3.4% in 3Q23 and 4Q23, respectively. The 1Q GDP report missed consensus estimates that had drifted higher during the quarter, but ultimately the consumer spending (which comprised 68% of total GDP) contribution disappointed and was below second half of 2023 levels. The culprit of a weaker consumer was spending on goods (think vehicles, appliances, furnishings, etc..), which declined on an annualized basis, while spending on services (travel, entertainment, household expenses, insurance, health care, etc.…) continued with solid growth. The FactSet consensus estimate for 2Q24 GDP growth was +1.6% as of 6/5/24, slightly better than the pace in the first quarter but below the +2.0% level that we consider "on trend." In addition, that second quarter estimate has firmed since the end of March when the consensus estimate was +1.0%. Government data for April (reported in May) revealed weakness in the housing market (housing starts, existing home sales, and new home sales all missed estimates) and consumer spending growth (personal consumption expenditures), while positive, was well below rates in February and March. Other data was weaker as well, including the Conference Board's Leading Economic Index and manufacturing surveys. Not all the data was negative, however. Surveys on services spending accelerated and the labor market has remained robust. In fact, the most recent jobs report (Bureau of Labor Statistics) covering May showed an increase of +272 thousand nonfarm payrolls, significantly above expectations, and Y/Y wage growth (average hourly earnings) up +4.1% (better than inflation). Slowing, but positive, growth could be enough to provide a backdrop for sustained earnings, especially if it helps the Federal Reserve Bank (Fed) to begin an orderly process of reducing its fed funds interest rate target (interest rates charged to banks for overnight borrowing and lending) and inflation continues to settle lower. The risk to that scenario is more consumer weakness that creates GDP headwinds and a U.S. economy that slows more rapidly than expected.

Consumer inflation progress stalled in the first quarter but appeared to improve (lower) in April. The consumer price index (CPI, from the Bureau of Labor Statistics) showed a year-over-year (Y/Y) increase in prices of +3.4%, below the +3.5% increase in March. Core CPI, which excludes food and energy prices, increased +3.6% in April (vs. +3.8% in March). Inflation data for the first quarter of 2024 (1Q24), a 3-month period, was modestly higher than 4Q23, creating concerns that inflation could remain stubbornly above +3.0% for an extended period. An alternative consumer inflation measure from the Bureau of Economic Analysis (BEA), the personal consumption expenditure (PCE) price index (PI), which is the Fed's preferred indicator, increased +2.7% year-over-year (Y/Y) and the core PCE PI increased +2.8%. Both numbers were unchanged from March and in-line with estimates. Although the PCE PI, like CPI, remains above the Fed's +2.0% inflation goal over time, it has been running lower and is closer to the target. The discrepancy between the two inflation measures is due to housing costs (rent and owners' equivalent rent) which have larger weighting in the CPI model. Many economists expect increases in shelter costs to recede as annual leases are renewed, but in recent months higher prices have also reflected consumer spending patterns that have shifted to services. The month-to-month (M/M) inflation data is also used to assess near-term inflation trends and is valuable to compare to the Y/Y data. In the April data, this reflected the change in prices in April compared to March for the same basket of goods. In both the PCE PI and CPI, the M/M increase was lower in April compared to March, suggesting perhaps some relief from no M/M improvement in the first quarter. If inflation moves lower from April levels for more than a few months, the Fed, in our view, will be more comfortable with an orderly decrease in the fed funds rate (current target is 5.25% to 5.50%) that starts with two, 0.25% (50 bp total) interest rate cuts in the second half of 2024.

While Fed commentary supports "higher interest rates for longer," Treasury yields have fluctuated. According to Fed minutes released from the most recent (5/1/24) monetary policy meeting, committee members discussed the possibility that elevated inflation trends could extend the timeline for when the Fed could begin to orderly implement interest rate cuts. The 2-year U.S. Treasury yield (a market-traded yield that we view as a proxy for short-term interest rates) was 4.87% on 6/7/24, down from 5.05% in early May, but well-above its 4.25% yield at the end of 2023 (12/31/23). The 10-year U.S. Treasury yield (a proxy for long-term interest rates) was 4.42% on 6/7/24, down from its 2024 high level (in April) of 4.70%, but up from 3.88% at year end. While we expect the 2-year yield to fall over time as the Fed reduces its fed funds target, the 10-year yield, if economic growth remains positive, is likely to remain elevated (4.50% or higher). In our view, a substantially lower 10-year yield from current levels would reflect fears of a more severe economic slowdown, requiring immediate rate reductions from the Fed (to stimulate growth).

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Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publicly traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, exchange-traded companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market. Today the NASDAQ Composite includes over 3,000 companies. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada.

The S&P 500 Equal Weight Index is compiled by S&P Dow Jones. It is an equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization-weighted S&P 500, but each company is allocated a fixed weight, or 0.2%, of the index total at each quarterly rebalance.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members--the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining eleven Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and in this way alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. The U.S. Bureau of Economic Analysis reports inflation adjusted (real) GDP as annualized percentage growth from the previous quarter. The BEA also reports data on a year-over-year percentage change from the same period one year prior. The most recent GDP report can be found at www.bea.gov.

The consumer price index (CPI) is a measure of average change over time in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics.

PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE). The index is published monthly by the U.S. Bureau of Economic Analysis.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet Consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

S&P 500 earnings growth reflect the year over year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index.

Fair value refers to a valuation method based on our view of the intrinsic value of an asset or index, determined by macroeconomic factors and earnings expectations rather than current market prices. This is our view of intrinsic value as of the date of this report. Our fair value estimate of 5,000 as of 6/7/24 reflects 20x the FactSet consensus S&P 500 earnings estimate of $252 for the next four quarters beginning Q2 2024.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity.

The Bureau of Labor Statistics (a division of the U.S. Department of Labor) publish a monthly employment report, The Employment Situation. It presents statistics from two monthly surveys to report labor force status, including unemployment and demographics. The unemployment rate is the number of unemployed as a percent of the labor force.

We define a Bear Market as a peak-to-trough decline (using closing prices) of 20% or more. We generally use the S&P 500 index as a proxy for the broad market for large, leading U.S. companies.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

The U.S. Personal Consumption Expenditures (PCE) Price Index is an indicator of the growth in consumer spending and measures the value of goods and services purchased by persons who reside in the U.S. It is reported monthly by the Bureau of Economic Analysis. PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE).

Volatility looks at to what degree and how quickly prices move over a given span of time. In the stock market, increased volatility, in the form of rapidly falling prices, is often a sign of rising uncertainty.

The Conference Board Leading Economic Index® (LEI) for the U.S.: The composite economic indexes are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components.

The U.S. Census Bureau conducts monthly surveys to assess residential construction activity. New housing construction data are collected in two surveys: The Building Permits Survey (BPS) produces estimates of the number of permits issued for new housing units each month. This is done through a mail survey of a sample of permit offices. Permit offices not in the monthly sample report annual numbers at the end of each year. Monthly data for States, Regions, and the U.S. are weighted, sample-based estimates reflecting the total building permit universe. New home sales are provided from the U.S. Census and Department of Housing and Urban Development. Existing Home Sales comes from data provided by the National Association of Realtors.

When we discuss “growth stocks” we are referring to companies that generate expected earnings growth (over a multi-year period) that is above expected earnings growth for the overall market (typically the S&P 500 index).