George McAuliffe – Second Quarter 2024 Commentary

Dear Clients,

The market in the second quarter of 2024 was a bit of a mix. Seemingly decent Q1 earnings reports were greeted with slowing and broadening amidst continued talk of rates "higher for longer", followed by prior leadership re-emerging towards the end of the quarter. With a soft landing still in the cards (if not already achieved), and geopolitics not creating any new crisis, the path of least resistance for the market seems to remain a slow melt up on incremental progress.

Looking back at the markets, much of the last year or two has seemed like the Funhouse at the amusement park. A regular stream of scary, startling, and sometimes amusing surprises popping out at one. But the only way one really got hurt was by trying to dodge them or stepping off the ride. Rather, if one kept one's cool, didn't blink, and kept on the chosen path, one emerged on the other side without much spilling one's drink. And here we are today, where at this writing with June CPI numbers taking another step down, the markets are now back to considering three rate cuts before the end of the year in a seemingly still ok economy. Remember a year ago when even one rate cut looked iffy, and there were good odds we would be entering a global slowdown?

But some things are worth further discussion. Take the first seven, aka "The Magnificent Seven," which mostly continue to push the market higher. Indeed, Microsoft, Apple and Nvidia are each over 7% of S&P500 weight, whereas in towards 50 years of data, only even one doing so was fairly rare (eg IBM in the 1980's). One should always beware such index distortion, and if one remembers the film of the same name, four of the heroes eventually end up dead (and I do not own all of them in any portfolio). But on the other hand, these are currently stocks with real earnings, not 1999 Internet stocks being valued on clicks. And if an argument can be made that today's Seven are truly creating value, inventing useful new things, and increasing productivity for everyone, then it seems normal that such stocks should perform better. A market where all stocks are similarly valued and all see similar modest appreciation would imply civilization is not doing much advancing. But nothing stays the same, competition eventually comes, and things rotate. Recently "the other 493" have been doing a bit better, and such market broadening is healthy. But is this because appreciation has fully ended for the first Seven, or is it more because some of this productivity is starting to filter down, and along with the nearing of rate relief, is easing valuation concern for many of these smaller companies? I believe more of the later.

So whither the markets and our stocks? For some of the more popular names, I would not be surprised by a little slowness at this point, and growing into some of the current valuations. Perhaps a pause, but as long as competitive moats remain and innovation continues, this is not, in my mind as a long-term investor, indicative of a reason to sell. And the rate and payroll squeeze easing on smaller companies is only good, as these will invest in what larger firms sell. And if some rate easing will de-block M&A levels that might be at 20-year lows, this should be good for the entire market both in terms of increased efficiencies, and clearing out some markets that need clearing (eg Real Estate and some Private Equity). This leaves geopolitics, where we can only continue to hope no one does anything egregiously deleterious. So back to our investments, where I remain cautiously optimistic, and continue to look for quality companies worthy of being added to your portfolios. Thank you for your continued confidence.

As always, I would be happy to discuss further with anyone interested.

Thank you,

George B. McAuliffe III
Portfolio Manager
+1 (212) 698-0807
gmcauliffe@tocqueville.com