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Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

RETURNS ARE NARROW, BUT POSITIVE

The S&P 500 earned 4.3 percent in the second quarter, bringing the year-to-date gains to 15.3 percent - a remarkable outcome given that only half the year is over.

While that is excellent news, an issue lurks below the surface: a relatively small number of stocks power the return. Indeed, the Magnificent Seven are as magnificent as ever.

Everyone knows these giant tech firms, including Meta (formerly known as Facebook), Amazon, Tesla, and Nvidia, among others. They're all big companies with enormous profits, are growing rapidly, and investors seem willing to pay any price.

So far this year, the Mag 7 (as they're known) are up an astounding 37.0 percent, with nearly half of that in the second quarter.

If we remove the impact of the Mag 7, the S&P 500's return is -1.0 percent, bringing the year-to-date return down to 8.3 percent. That's not a bad result, but it tells you that half of the return this year comes from seven stocks, an effect known as a narrow market.

Outside of the tech boomlet, the big story for the quarter was the hawkish repricing of interest rate expectations. At the start of the year, the bond market was pricing in three cuts by the

"Quick! We need a bigger chart in here."

Federal Reserve this year, well more than what the Fed was indicating.

By the end of the first quarter, the bond market signaled that they still expected three cuts but pushed back the timing to the end of the year. At this point, the bond market expects just one cut by the end of the year.

The good news about the lack of cuts is that the economy is still doing relatively well, and jobs are plentiful. The downside is that inflation is still well above the Fed's target of two percent.

Investors should stay invested but remain cautious, given the potential risks that persist despite the impressive top-line returns for the S&P 500.

STOCK MARKET SUMMARY

By David Ott

As noted on the first page, the Mag 7, and Nvidia in particular, are driving a lot of the excess returns this year.

However, that doesn't mean other sectors aren't enjoying reasonably good returns.

In addition to technology and communications (essentially more technology), energy and financials are up double digits.

Another five sectors are up more than five percent, which, if annualized, would suggest double-digit returns for the year (although it's dangerous to annualize since we don't know what the next six months will bring).

The S&P 500 momentum index is up 34.0 percent this year, which appears to be the best result since the tech bubble in the late 1990s.

Growth stocks are also hot, up 23.6 percent so far this year, but you only have to go back to the pandemic in 2020 to see results that strong.

Value stocks are positive, up 5.8 percent, but that's very muted compared to the abovementioned styles. The last primary style, quality, is also substantially higher, up 18.3 percent.

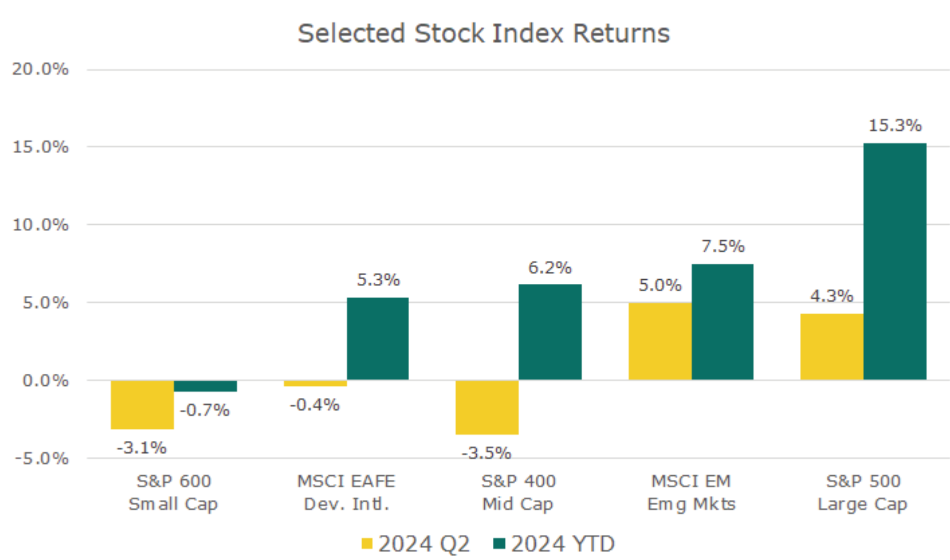
Developed markets stocks did well in the first half of the year, but it's hard to tell because the dollar is so strong. The MSCI EAFE index of developed markets stocks was up 12.4 percent in the first half in local currency terms but fell to 5.3 percent for US investors like us.

The effect was similar albeit less dramatic in emerging markets, with the MSCI EM index up 11.0 percent in local currency terms but 7.5 percent for US-based investors.

Small-cap stocks are the only major asset class down for the year due to poor performance in the second quarter. Small-cap stocks have more interest rate sensitivity because they pay higher interest for the same leverage as larger companies, so higher rates hurt.

"I'll tell you what freedom is to me: no fear."

Nina Simone
American Singer
1933 - 2003



Data Source: Bloomberg

BOND MARKET REVIEW

By Ryan Craft, CFA

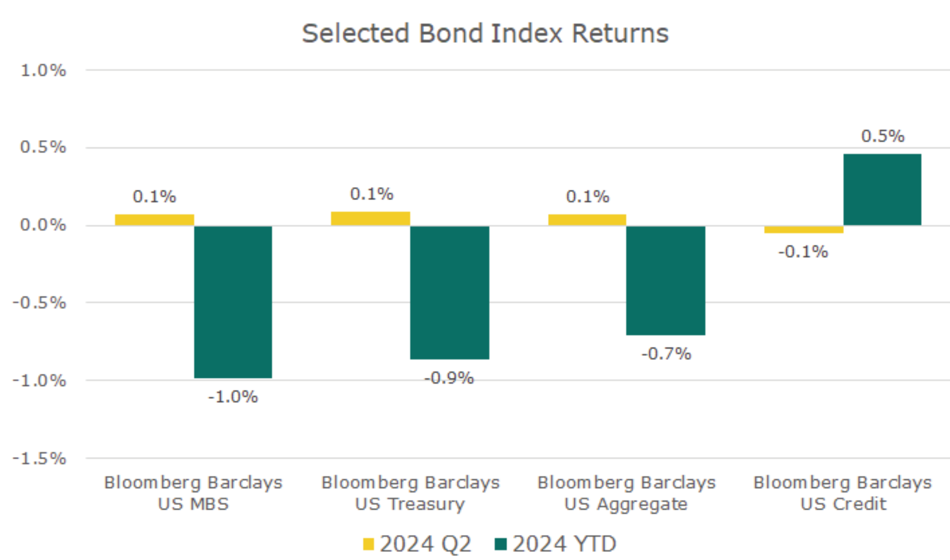
Bonds were volatile throughout the second quarter as the economic data has not given the green light for interest rate cuts. Long-term bond yields jumped another 50 basis points in April before falling in May and June. Despite the volatility in rates, the total return for the broad bond market was relatively flat for the quarter, with a slight gain of 0.07 percent. This story is true for all sectors of the bond market.

The narrative for bonds continues to be driven by the outlook for Federal Reserve policy. At the end of 2023, the market expected the Fed to cut overnight rates by 2-3 percent throughout 2024. This view was supported by an optimistic outlook for falling inflation, allowing the Fed to move rates to a neutral rate compared to the current rate they consider restrictive. Inflation has not cooperated with this outlook; it has remained much higher than expected at the start of the year. Only over the past few months has inflation shown signs of decelerating back to an acceptable level.

With inflation remaining stickier than many anticipated, long-term rates have increased. Some of this increase results from investors expecting inflation to be higher in the future, which can be seen through TIPS breakevens or the difference between an inflation-protected Treasury and a normal Treasury. Breakevens have increased by 35 basis points in 2024, showing that the market expects inflation to be higher for longer. This is a primary reason the Fed has not cut interest rates.

Inflation expectations can drive real behavior. If consumers expect goods to cost a lot more in the future, they may purchase more in the present, driving up demand and increasing prices even more. Expectations can become self-fulfilling (or at least that is the theory). The market still expects the Fed to begin cutting interest rates this year, but it is unlikely until November. The Fed continues to state that it is focused on the data and needs more proof that inflation is headed toward its two percent target.

This means that more than any other economic indicator, inflation will continue to drive the bond market for the rest of the year.



Data Source: Bloomberg

"You know more about a road by having traveled it than by all conjectures and descriptions in the world."

William Hazlitt
English Essayist
1778 - 1830

THE ANXIETY OF PRIVATE MARKETS

By David Ott

> **"Good advice is always certain to be ignored, but that's no reason not to give it."**
>
> *Dame Agatha Christie*
> *English Detective Writer*
> *1890 - 1976*

I'm writing about private markets again, which may seem odd to long-time readers because we don't invest in private markets.

I routinely think about private investments for two reasons. First, they're the hottest topic in our industry—what are you doing about 'privates,' as they are often called? Have you heard of this private or that private?

Second, as I've said many times, I've invested in some to learn more about how they work and see if they make sense for clients. We like to say that we eat our own cooking, and my account is a bit like a test kitchen.

I bought a private real estate fund several years ago, and the performance has been good—if you trust the valuations.

Valuations are an issue for any investment, but at least in the public markets, thousands, if not millions, of investors, evaluate nearly every security second by second and are willing to put a price on them and, importantly, trade them at that price.

In private markets, managers usually hire third parties to put a value on the investments, but those relationships can be pretty cozy.

Let's say you're the manager of a private real estate, credit, or equity fund, and you're paid a percentage of the assets under management. Naturally, you want the prices held high for billing purposes. It's an inherent conflict.

Now, let's say you are a third-party valuation firm. Could you be swayed to put a good price on an investment if you thought you'd be fired for putting a bad price on a holding? It's a delicate dance.

A recent New York Times article questioned whether the prices on some of the assets in a popular private real estate fund were fair.

The Times pointed out that the prospectus says, 'these assumptions [about the valuation] are determined by the Advisor, and reviewed by our independent valuation advisor.'

The capitalized Advisor is the manager, so this sentence effectively says the manager sets the price, and the third-party advisor reviews it.

Let's say you're comfortable with the prices the manager and third party use. In a real estate fund, the underlying assets (the buildings) are usually only valued once per year, unlike the continuous valuation in public markets.

Is once a year sufficient? Isn't it reasonable to assume that the value of any asset changes more often than once a year?

Now, I do have to concede that public markets aren't perfect, even though they are priced frequently.

We've all heard the story of Mr. Market, the manic-depressive investor who will offer you vastly different prices over such a short period that the underlying value of the business hasn't had time to change.

If everything is going smoothly, then the issues in the private markets aren't much of a problem. But things can go haywire in public and private markets alike.

According to the Financial Times, a second large private real estate fund is having a hard time.

In this case, investors withdrew their cash from the fund, but the manager thought the withdrawals would die down and didn't start selling underlying real estate. Now, this fund is drawing heavily on its credit lines to meet redemptions, which have grown heavier.

One feature of a private investment fund is that it can block investor redemptions, which means the manager doesn't have to sell the fund's assets at fair prices. A fire sale doesn't benefit anyone.

At the same time, managers know that blocking investors from getting their money back is deeply unpopular. The fund I own began to limit withdrawals at the end of 2022 and stopped limiting withdrawals a few months ago.

The fund that is currently struggling is allowing investors to withdraw less than a half percent of their assets each month, which is paltry.

Stemming withdrawals is good, even if it doesn't feel like it. You could say that it's a feature, not a bug, but whatever it is, for investors in the fund like me, it was also anxiety-provoking.

I don't own the second fund, and I'm relieved. I'm even more relieved that we don't own either of these funds for clients.

In the long run, I suspect they will do fine. Both managers have stellar reputations and are savvy investors with long and attractive track records.

That said, it's pretty clear to me that many of the investors who bought the fund didn't fully understand the risks. They no doubt signed disclosures stating that the fund might put up 'gates' on the fund and disallow withdrawals for an extended period, but I suspect clients didn't fully appreciate what that meant.

That's one of the reasons why we don't invest these funds. I feel like I could tell a client until I'm blue in the face that they might not get their money back when they want it.

But when it hits the fan, I don't think people will remember or care that I told them. That's not a dig on clients – that's how I feel right now with the fund that I own.

I've also heard stories about funds that put up gates and then marked down the fund assets materially when investors couldn't exit quickly. I've also heard stories about funds that wind down after gating the fund.

I'm not saying either of these funds will wind. The managers are excellent real estate investors, and both have said they are committed to this structure.

I will keep holding because I might learn something about how funds like this get through times like this. And, the fund I own is diversified, has relatively low leverage, and I have a sense of the floor based on public markets.

But I know my anxiety will continue as I wait for the other shoe to drop, knowing that it may never fall. I'm just glad that the anxiety is about my own money – I'd be a basket case if it were your money instead.

A version of this article came out in our weekly Acropolis Insights - let us know if you'd like to sign up, and we will put you on the list.

"Genius is eternal patience."

Michelangelo
Italian Renaissance Artist
1475 - 1564

"Given a ten percent chance of a 100 times payoff, you should take that bet every time."

Jeff Bezos
Founder, Amazon
1964 -

INSIDE THE ECONOMY: INFLATION

By: David Ott

Inflation is cooling, even if we don't feel it as much as we might like at the grocery store and the gas pump. The chart below shows three measures of inflation.

Although there are important differences, the story is essentially the same: inflation was low before the pandemic, shot higher in 2021 and 2022, and has slowed since then.

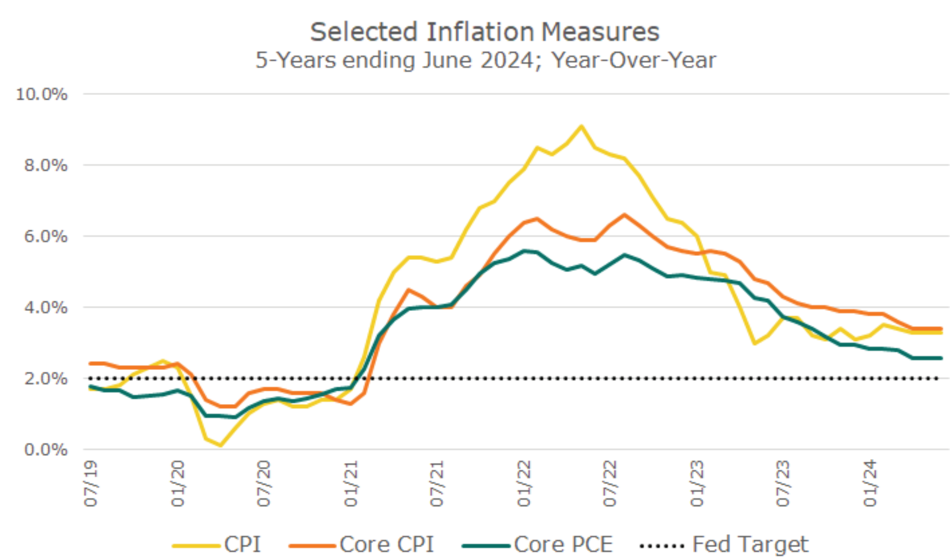
The primary measure we consider is the Consumer Price Index (CPI), which measures consumers' everyday costs (in yellow). You can see that it peaked at more than nine percent in 2022 and was 3.3 percent in the 12 months that ended in June, 2024.

The orange line is the 'core' CPI, which excludes food and energy. Both measures are important, and over the long run, both measures produce almost identical results. But you can see that including food and energy makes for a more volatile reading: lower lows in the pandemic, higher highs at the peak, and crossing below the core rate in the last few years. We all encounter food and energy in our lives, but those items are so noisy that it's also helpful to look at inflation without them to get a better sense of overall prices.

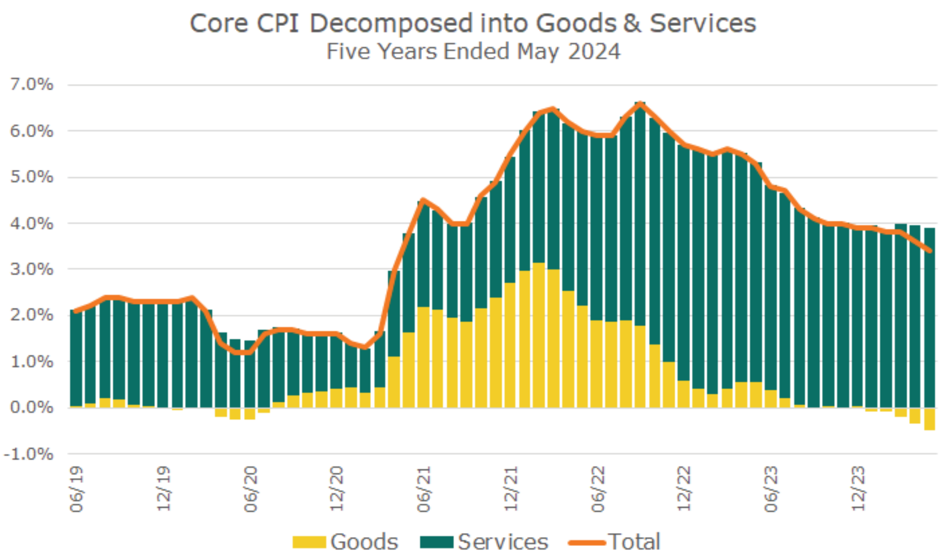
The third green measure is the Core Personal Consumption Expenditure or Core PCE. Like Core CPI, it strips out food and energy but measures parts of the economy that aren't part of the CPI. Medical costs, for example, aren't a big part of CPI because consumers don't see them directly (although we see them through our health insurance, which is part of CPI).

Core PCE matters because the Federal Reserve targets this rate at two percent (the dotted black line in the chart). The Fed absolutely pays attention to CPI, Core CPI, and a whole host of other measures, but Core PCE is the rate to focus on when you think of their target rate of two percent.

As you can see from the chart, Core PCE is now 2.6 percent, which is still meaningfully above the Fed's target but



Data Source: Bloomberg



also well below its peak of 5.6 percent in March 2022.

While this is good news, digging deeper into the inflation data shows how sticky it has become, which is why the Fed hasn't started to cut rates yet. The chart above breaks Core CPI into two components: goods and services. Before the pandemic, most core goods prices were stable, and most inflation was related to services.

You can see from the yellow part of the chart that goods inflation spiked as the pandemic caused supply chain disruptions and shortages across a wide range of goods. As the pandemic restrictions eased and supply chains returned to normal, goods inflation withered away.

However, inflation around services is relatively steady at around four percent. The recent deflationary effect in goods is responsible for the decline of the overall rate because services have largely stayed the same.

This dynamic could imply that the Fed's efforts with interest rates don't have as much impact as we all might think since the goods inflation would probably have fallen without higher rates, as congestion from the pandemic loosened.

Services account for about 75 percent of the US economy, so sticky inflation in services will have a much more significant impact on household spending. Services also tend to be labor intensive, so high service inflation will impact wages and a large portion of corporate expenditures.

Some worry that sticky service inflation could increase overall inflation expectations, causing a wage-price spiral where prices continually push each other higher.

Fortunately, there is no sign of that in markets at this point. The five and ten-year breakeven rates, which measure expected inflation by comparing the yield on regular and inflation-linked bonds, have held steady in recent years.

While the inflation picture is certainly better, it's not over either.

"Every day is a journey, and the journey itself is home."

Matsuo Basho
Japanese Poet
1644-1694

Major Indexes	2024 YTD
Dow Jones	4.8%
S&P 500	15.3%
S&P 400 Mid-Cap	6.2%
S&P 600 Small-Cap	-0.7%
MSCI EAFE (Intl)	5.3%
MSCI Emerging Mkt	7.5%

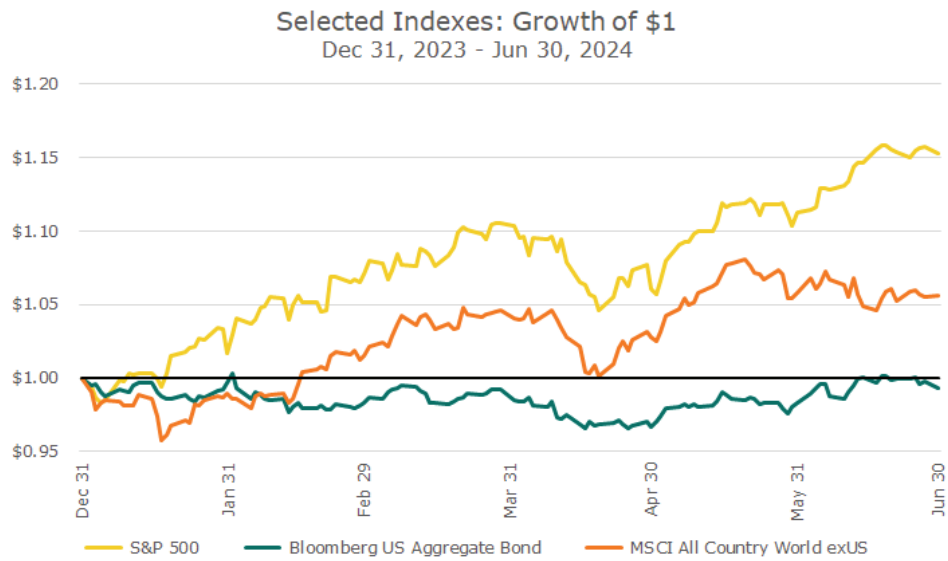
Equity Styles	2024 YTD
S&P 500 Growth	23.6%
S&P 500 Value	5.8%
S&P 500 Quality	18.3%
S&P 500 Momentum	34.0%

S&P Sectors	2024 YTD
Basic Materials	4.1%
Communications	26.7%
Consumer Discretion.	5.7%
Consumer Staples	9.0%
Energy	10.9%
Financials	10.2%
Healthcare	7.8%
Industrials	7.8%
REITs	-2.5%
Technology	28.2%
Utilities	9.4%

Interest Rates	2024 Q2
Fed Funds	5.4%
Prime Rate	8.5%
3-mo. Treasuries	5.4%
2-yr. Treasuries	4.8%
5-yr. Treasuries	4.4%
10-yr. Treasuries	4.4%

All Data as of 06/30/24

THE BIG PICTURE



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