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We all knew this was going to be an eventful year. 2024 has had a target on it since 2020. The Presidential election has been the obvious focal point. It still is and will be into November... and beyond. But from a Market standpoint, there have been so many other developments. The S&P 500 hit 31 new, all-time highs. The relentless Bull has stampeded throughout Wall Street in the first half of 2024.



AI enthusiasm is the big story. It's been the indisputable driver of Big Tech strength. There's been an AI mania on Wall Street. Companies keep investing aggressively in Artificial Intelligence which sent semiconductor demand through the roof. Nvidia, the AI leader, has seen its revenue triple in a year.



By Michael G. Frazier

Digital Revolution

Artificial Intelligence has triggered the largest secular growth themes in decades. It's expected to contribute an additional \$15 Trillion to the Global Economy by 2030. Most jobs will be impacted. Some for the better, with increased productivity. Some for the worse. An estimated 300 Million jobs could be replaced around the globe.

These new AI factories take in data and produce intelligence. That's the new prize growth companies covet. Those that have invested heavily have seen their stocks soar. The cash rich, dominant Tech Titans continue to lead the charge.

Tech Titan Dominance

There are now three \$3 Trillion companies: Apple, Microsoft and Nvidia. These three now account for 20% of the S&P 500 index. When you add Amazon, Google and Facebook, it's nearly one-third. These 6 stocks increased the S&P's value by over \$3 Trillion so far this year. That outdistanced the \$2.3 Trillion for the rest of the 494 stocks.

In 2024, the Tech Titans effectively are the Stock Market. These top 6 stocks have accounted for over 60% of the S&P's return this year. Nvidia is responsible for 35% alone. We're certainly invested in AI. We'd like to see leadership broaden out. This record run has not been confirmed by most markets, industries or stocks. This makes the rally vulnerable when Tech ultimately runs out of steam.

Comparisons have been drawn between today and the Dot-com days. We don't see it that way. There are some similarities in terms of bubble-like price action and excessive valuations. But these Mega Cap Tech companies are very profitable and are sitting on mountains of cash. And though richly priced, P/E ratios are much tamer than the Dot-com days. For perspective, Microsoft currently trades at P/E of 32x next year's earnings estimates. It traded at 65x in 1999. The real question is the sustainability of the growth. That's what the Market will key on.

Cooldown Ahead

While spending on Artificial Intelligence exploded, the US Economy has been cooling. Sticky inflation is the biggest culprit. Consumers are slowing spending and proving more selective in how and where they spend. Retail sales reflect it. High prices finally hit the pain threshold. Even bars and restaurants saw weakness. That's new. That said, record travel for the 4th of July weekend is expected by AAA, as Americans continue their desire to be out and about.

America's Economy grew 1.4% in Q1. The growth rate has slowed, but it's growing, nonetheless. The resilience of American consumers is the reason. They continue to spend despite rising prices and high borrowing costs.

Consumer spending accounts for 70% of US GDP. A strong labor market with low unemployment has played a major role. So has the \$2 Trillion in excess savings Americans accumulated during the pandemic. That was then. Those excess savings have since been depleted.

High Prices Have Limits

Inflation is by far the biggest issue for American consumers. It tops the list for election issues. Grocery prices are 26% higher today than they were before Covid. Companies keep trying to pass on the elevated costs to shoppers. Spending has slowed. And here's the thing: Once prices go higher, they seldom fall back down. Remember the days when a Coke was 50 cents in vending machines? No more. They're \$2 these days.

There's a big divide in America between those that own assets and those that don't. Investors and homeowners have benefitted greatly with value increases to all-time highs. That has significantly helped cushion the rise in our daily prices. But most Americans live paycheck-to-paycheck and are struggling to stay above water with inflation. This issue is definitely on the ballot.

The housing market remains tight. At almost 1/3 of the Consumer Price Index (CPI), housing costs matter. Demand continues to be strong as supply remains quite limited. Higher mortgage rates have made buying a house even more

expensive because prices haven't come down. Those that refinanced during Covid, locking in sub-3% loans, are reluctant to sell. It's a big frustration for the younger generation.

Debt is a 4-Letter Word

America has a debt problem. The Federal budget deficit is expected to swell to nearly \$2 Trillion this year. This, according to the Congressional Budget Office. The previous estimate was \$1.5 Trillion released just in February. The National Debt is fast approaching \$35 Trillion. This exceeds current economic output of \$28 Trillion, which translates to 125% of debt to GDP. The United States has by far the largest and most dynamic economy in the world. There is no question: It is very strong. The issue is the spend beyond the means.

As a general rule, it's not good policy to owe more than you make. We at Bedell Frazier are all about smart money strategies. Washington has not been practicing smart money for a while now. At the current rate, the Federal Debt is projected to exceed \$56 Trillion over the next 10 years. Roughly one-third of America's revenue will go towards paying interest payments on our debt a decade from now. 2 important takeaways: 1. Money is no longer free. 2. Washington is a math-free zone.

US household debt has reached a record. Credit card debt has ballooned over \$1 Trillion and Americans are falling behind on their payments.



One-third of households said it was somewhat or very difficult to pay for usual household expenses. This, in a recent Census Bureau survey. The savings rate has fallen from a multi-year high during Covid to multi-year lows.

Inflation and the Fed

The Federal Reserve has kept interest rates over 5% with the goal of whipping inflation. The Market was pricing in many rate cuts at the beginning of the year. Elevated inflation has prevented it from happening. At one point, it looked as though the next move might be more hikes. That was in the Spring. Things have changed a bit since.

The rate of price increases has certainly slowed. But make no mistake, prices are not falling. They're just not going up as fast anymore. We can see an initial rate cut on the horizon. The Yield Curve remains inverted. In fact, it's the longest inversion in modern history. That's the Bond Market's way of identifying potential problems. An inverted yield curve has long been a signal of pending recession. The recession still hasn't shown up.

The economic slowdown with slowing inflation does provide some cover for the Fed to try to cut. July seems unlikely. Maybe in September. The optics are important here. The Fed aggressively asserts its independence from politics. Cutting just weeks before the Presidential election would certainly garner attention. We'll soon learn if that's something the central bank is willing to do.

Bond Vigilantes to the Rescue

Something's gotta give. The Bond Market has been processing this excessive debt with high inflation. It can be a lethal combination. The level of debt is unsustainable. The Market has ignored it for years. High debt was manageable when interest rates were zero. They're not zero anymore. The Bond Market is very awake to this issue. It's only a matter of time. As James Carville astutely pointed out years ago: The Bond Market can intimidate anyone.

The Bond Market is the Smart Market. It's driven by math, not emotion. The good news is yields have fallen. That means higher prices. The Bond Market is sniffing out the slowdown. It always moves before the Fed. That has been welcome relief to sky-high borrowing costs. We see the yield curve flattening out a bit, with the front-end falling faster with the Fed. The back-end of the curve should stay somewhat elevated reflecting the risk of the continued reckless spending out of Washington. That's where the Bond Vigilantes will ride.



Value in Fixed Income

There continues to be strong, structural demand for shorter-dated securities. The Treasury Department keeps increasing the supply of bills as a share of its total debt load. 2-Year, 5-Year and 7-Year paper keeps getting scooped up. It's the longer dated maturities that are being questioned due to the lack of fiscal discipline in Congress.

We continue to really like the front-end of the curve for Treasuries. We are keeping a short-duration there until there's more clarity out of Washington. We have found value in longer-dated maturities in high-quality Corporate Bonds and select Municipals for tax-free income. It's always essential to know what you own. That's a key value in owning individual bonds.

Race to the White House

In what's shaping up to be one of the most unpopular, yet consequential Presidential elections in American history, there is a rematch from 2020. It's Biden versus Trump, round II. The first debate happened. Few questions were answered. Far more have risen in response.

From a Washington source: *"Regarding policy, last night's debate was superficial and lacked any serious discussion about economic policy. We did not hear any talk on any new policy proposals that might move financial markets."* The race to the White House is still unclear with concerns everywhere.

Populism continues to make inroads in both political parties. Republicans have transitioned from the traditional free market party to a more working-class party under Trump. Our Washington sources argue neither of the Presidential candidates would address the Federal debt, both having track records of excess spending. Trump wants to extend the tax cuts he put in place in his first term, while Biden would most likely raise taxes, targeting Big Business and the rich. The Congressional Budget Office estimated that extending the tax

cuts will cost \$4 Trillion over 10 years. The corporate tax rate is not scheduled to reset until after 2025.

International – India the Standout

The United States is not the only nation holding elections in 2024. In fact, half the world's population will have headed to the ballots before year-end. India held the largest democratic election in history. The population of 1.4 Billion made a statement. Prime Minister Neandra Modi won re-election, but it was not the runaway victory he expected. Modi has proven to be one of the most effective leaders around the globe, but now he will have to lead with a coalition. The message was sent: Too much power is not a good thing.

India has the fastest-growing economy in the world. With the largest population, 65% of which is under the age of 35, India is also proving to be one of the most stable democracies in the world. We are invested there.





European Struggles

Europe is doing some soul searching of its own. This has been going on for a while; Rooted in Brexit in 2016. The people are tired of the establishment. They want change. They're struggling economically, battling inflation and are angry about their borders. Sound familiar? The population of Euro skeptics is on the rise.

The British people are pushing back on government. The criticism is on how government manages the nation with excess spending and poor results. It's evident in Health Care. Roads. Infrastructure. Immigration. Education. The British Government is struggling to support its society. The people are fed up. The Prime Minister has just a 19% approval rating heading into the July 4th election.

France is holding a snap election. This was unexpected. President Macron has lost support. Both the right-wing and the left-wing are jockeying for power. The French Stock Market was rattled, suffering its worst week in over 2 years. Bond yields jumped, sending prices lower, reflecting stress in the system. The Euro currency dropped, sending a clear message: Extremes of political parties threaten stability. Neither side is committed to fiscal responsibility, free markets and even the Euro currency. Like everyone else, France suffers from rampant inflation with political and social unrest.

Wars: Cold and Hot

Planet Earth has clearly entered a dangerous new phase as the nations of the world pick sides in what appears to be becoming a precarious decade. It's not as simple as East versus West like the Cold War days. It's far more complicated. Free Markets and Democracy have lost much support. Ukraine is caught in the middle. The situation comes at a time when the West is struggling with diminished military recruitment, as well as pressure from higher interest rates and mountains of debt.

Russia seeks to challenge what it calls the "hegemonic and imperial West." Alliances are being strengthened to create a more formidable anti-US axis. Russia has found friends in China, Iran, Cuba, Venezuela, and North Korea, who all share distrust of American might.

Moscow has relied on others to keep the Russian war machine going in Ukraine. Vladimir Putin and Xi Jinping formed an alliance with a no-limit friendship between Russia and China in 2022. That was just before the invasion of Ukraine.

A new pact between Moscow and Pyongyang was signed pledging military cooperation and outlined a new mutual defense pact that would assist either nation if one was attacked. That may include the export of Russian consumer goods and energy supplies to North Korea, and other economic relationships that often prove to be advantageous in a long, drawn-out war.

The G7 approved \$50 Billion in funding to Ukraine by using interest income from frozen Russian assets. NATO Allies are increasing defense spending by 18%, and 23 allies are going to spend 2% of GDP or more on defense. Allies are buying more and more equipment from the United States.

The war between Israel and Hamas is showing few signs of ending anytime soon. It's dividing populations the world over. Iran-backed Houthi militants keep threatening attacks on ships in the Red Sea, disrupting global trade. This has led to higher costs in fuel and insurance. It has contributed to the sticky inflation, particularly in Europe.

These wars, both cold and hot, have not derailed the Bull Market from running. In fact, it has run fast in the face of the fighting. The Market has basically ignored geopolitics for years. At some point, it won't be able to. Making money often masks underlying problems. There are quite a few challenges out there around the globe.

America's Election and The Market

Both candidates have taken credit for the Stock Market at all-time highs. Biden naturally claims it's a reflection of his administration's success, while the Trump camp says the Market has rallied with anticipation of his return to the Oval Office. Regardless, these are areas we believe will come into focus:

Defense:

Both candidates support higher defense budgets. The fiscal situation will likely constrain how much defense budgets will actually rise. A return to the White House could see Trump push for significant increases in defense spending. The realities of the Federal budget mean he probably would not get as much as he wants. He would also likely push foreign leaders to spend more on defense too. Either way, in this geopolitical environment, we see significant growth in the Defense industry. It's very investable.

Energy:

A Trump Presidency would no doubt commit to increased domestic Oil & Gas supplies by opening up additional Federal property for exploration and drilling. Trump would likely end the temporary pause on liquefied natural gas (LNG) export applications. If Biden wins, we would expect a continuation of the limits on domestic exploration and production as well as the possible extension of the LNG moratorium.

The Republicans have proposed the elimination of clean energy tax credits that were passed or expanded as part of the Inflation Reduction Act (IRA). However, some of the tax credits are going to support construction of facilities in Republican states and districts which are reaping the benefits. Despite the rhetoric, we think there is more Republican support for clean energy tax credits than meets the ears and eyes.

Health Care:

Health care is always a political hot button issue ahead of elections. Over 10,000 people turn age 65 every day in America. Spending on health care now accounts for 17% of America's GDP. The health care industry is very sensitive to policy changes. That's one reason that the sector can see increased Market volatility in an election year.

Donald Trump has continuously criticized the Affordable Care Act, commonly referred to as Obama Care. But he has yet to propose an alternative to the legislation. Both Presidents have pushed to lower drug pricing. President Biden passed legislation that allowed Medicare to negotiate some drug prices. Since both candidates have records in the White House, no major changes are expected regardless of the election outcome. That should be good for Health Care stocks.

Health care is political, but not economically sensitive. Novel therapies to treat and cure life threatening diseases continue to emerge. Weight loss drugs have been the biggest winner in 2024. Next stage treatments continue to be in

trials. Last year, the Food and Drug Administration approved a record 73 novel medicines. These drugs represent new product cycles that could drive growth for the foreseeable future. They address large disease categories, such as Alzheimer's, immunology, cancer, and diabetes. We're invested there.

America on the Move

Though the Economy is cooling, the American people are still willing to spend on experiences. Summer vacations are atop the list with record bookings for cruises and trips to Europe. It's an Olympic year, and Millions will be converging on Paris to see the games. Billions will be watching on televisions, phones and other devices.

Air travel is expected to break more records this Summer. Barbecues and beverages will be plenty at the beach and by the lake. Theme Parks, Ballparks and concerts will have more crowds. Movie theaters are showing signs of activity, making for a relatively affordable time out with the family. Wallets will be open. Never bet against the American consumer. It's been investable for decades.

Powering the Planet

Energy demand is exploding. Supply simply can't keep up. AI is driving that too. Over the last decade, American power demand growth was basically flat, even though the population and its economic activity have increased. No more.

Innovation comes with great costs. A ChatGPT query requires nearly 10X as much electricity to process as a simple Google search. In that difference lies a sea change in how the world will consume power, and how much it will cost. Data center power demand is expected to grow 160% by the end of the decade. Currently, data centers worldwide consume less than 2% of overall power. It's expected to double by 2030. It's expected to triple in the United States.

Fuel sources are many. Renewables have grown in use over the years. Costs have gone down and they're certainly cleaner for the planet. But they still don't have all the reliable characteristics of traditional energy. One thing the Russian invasion of Ukraine reminded us; The World still runs on crude.

The United States is the largest producer of Oil. It tops both Saudi Arabia and Russia. It's also a large producer of Natural Gas, which has been a savior for Europe, freeing its independence from Moscow. Natural Gas is considered a bridge fuel between traditional and renewables. It's 50% cleaner than crude and coal, with strong characteristics in reliability and cost. Natural Gas is powering American data centers and factories. We see it not only continuing but increasing. We're invested there.

Nuclear energy has re-emerged as a viable if not necessary solution for our energy needs. Between the implications of climate change, the limits on solar and wind energy, the high cost of hydrogen and decades of data that support nuclear energy as safe, there are good reasons



to support this carbon-free source of energy. 20% of America's electricity is already produced by nuclear power. We are looking for innovative and responsible investments in nuclear energy as a growing part of our nation's power needs.

Earnings Season

Earnings drive stock prices. July will bring quarterly report cards for Corporate America. The Street expects earnings to grow 9% in Q2, which ends June 30th. That would be the fastest growth rate in 2 years. Revenues are expected to grow 4.6%. It would mark the 15th consecutive quarter of revenue growth. It's been a strong recovery since Covid.

The Communication Services sector is expected to report the highest growth rate of all eleven sectors. Earnings there are estimated to grow 18.4% from a year ago. Google and Meta, the company formerly called Facebook, account for the vast majority of earnings growth in this sector. If you excluded these 2 stocks, earnings growth rate for the Communication Services sector would fall to just 3.1%.

Tech earnings are expected to grow 16.1%. If Nvidia was excluded, the growth rate would fall to just 6.6%. You can see how just a handful of stocks have driven the Market this year. Growth is the driver, and the driver is AI. As I stated earlier, the Tech Titans effectively are the Stock Market in 2024.

What's more, the Market expects this fast rate of growth to continue over the Summer and further accelerate into the Holidays. The Street estimates earnings to grow 8.2% in Q3 then jump 17.6% in Q4. That would translate to 11.3% growth for the year 2024. Earnings are expected to grow at a faster, 14.3% rate in 2025. The Market has priced in some lofty expectations.



A Bit of Euphoria

Sentiment studies tend to be contrarian indicators. There's a simple reason: Wall Street chases. There tends to be a herd mentality. There has been a bout of new Bullishness across the Street as a number of strategists have raised outlook on US stocks. Goldman has raised its 2024 target for the S&P 3 times now and Evercore ISI went from Bear to Bull, switching its year-end target from 4700 to 6K. It is the Street high. It was the Street low prior.

It's no wonder "Buy Low and Sell High" consistently gets turned upside down with "Buy High and Sell Low." The public buys the most at the top and the least at the bottom. This type of behavior is consistent with top formations. Overbought tends to last longer than oversold. As Warren Buffett wisely points out, he gets greedy when people are fearful and he gets fearful when others are greedy. Fear is a stronger sensation than greed.





A Tech Titan Breather?

Europe is doing some soul searching of its own. The biggest companies are the fastest growers and the most defensive, sitting on mountains of cash. Interest rates don't matter to them. These Tech Titans are massively spending on Artificial Intelligence where others are unable. These companies maintain a substantial amount of customer data to utilize. Data is the fuel for the Digital Age.

Heading into the second half of the year, investors love Nvidia and the Magnificent 7. These are the Tech Titans. Make no mistake, the Tech Titans are fundamentally sound. The Market has rewarded their dominance. They have been and will continue to be core holdings in our portfolios. They just seem stretched at the present.

The S&P 500 hit a fresh high in June while only 2% of index was at a 52-week high. What's more, the number of stocks above their 200-day

moving average kept falling. Half are down 15% or more from their highs. It's not the healthiest situation to have so few stocks participate in rallies.

Our Bull case for the Summer into Fall would be for a Fed easing cycle, and boost other sectors that haven't seen significant appreciation this year. While a pause may be warranted, we can't dismiss the staying power of Tech. The enthusiasm surrounding Artificial Intelligence has been driving these stocks which have been generating the earnings growth.

Seasonally Strong

Sell in May and go away? Not in a Presidential year. The Market has defied traditional seasonality with some strong Summer sessions. In fact, the S&P has been positive in the month of July for 9 straight years with an average return of 3.6%. What's more, the first 2 weeks of July have been the strongest stretch for stocks

on the calendar the last decade. Tech has been the leader throughout. The Tech-heavy Nasdaq has been positive for 16 straight Julys with an average return of more than 4.6%.

This is already the best start to an election year ever. The big question, can it last? We expect a very bumpy road to November. A broadening out of Market leadership would go a long way to smoothing out those bumps. The concentration in just a handful of stocks leading the overall Stock Market can't last forever. Trees don't grow to the sky. A healthy correction with a rotation into cheaper areas that haven't participated would put a stronger foundation under the Market. We think it happens over the Summer and into Fall.



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