Global equity markets posted another quarter of solid gains and added to a dramatic 18-month performance rebound. A continued rally in the stock prices of the largest U.S. companies by market capitalizations (mostly Technology stocks) once again drove the U.S. equity market's gain. The S&P 500 index was up 3.9% in the quarter and is now up nearly 14.5% for the year, excluding dividends. The stocks of smaller U.S. companies (Russell 2000) and foreign companies (MSCI ACWI Ex USA) continue to lag the S&P 500 by a wide margin. The Russell 2000 index was down during the quarter and is up only 1% year-to-date, while the MSCI ACWI Ex USA index was flat for the quarter and is up only 4% for the year. Meanwhile, a rise in U.S. Treasury yields continued to weigh on bond prices, offsetting the income bonds have generated so far this year. Through the end of June, the Bloomberg Barclays U.S. Aggregate Bond Index (the benchmark for U.S. bonds) is down 0.7%, although our bond portfolios have beaten the benchmark and are slightly positive in that time frame.

Equity Indexes	Q2, 2024	YTD	2023
S&P 500	3.9%	14.5%	24.2%
Russell 2000 (Small Cap)	-3.6%	1.0%	15.1%
MSCI EAFE (Developed)	-1.5%	3.5%	15.0%
MSCI Emerging Markets	4.1%	6.1%	7.0%
MSCI ACWI Ex USA	0.0%	4.0%	12.6%

Note: All returns exclude dividends

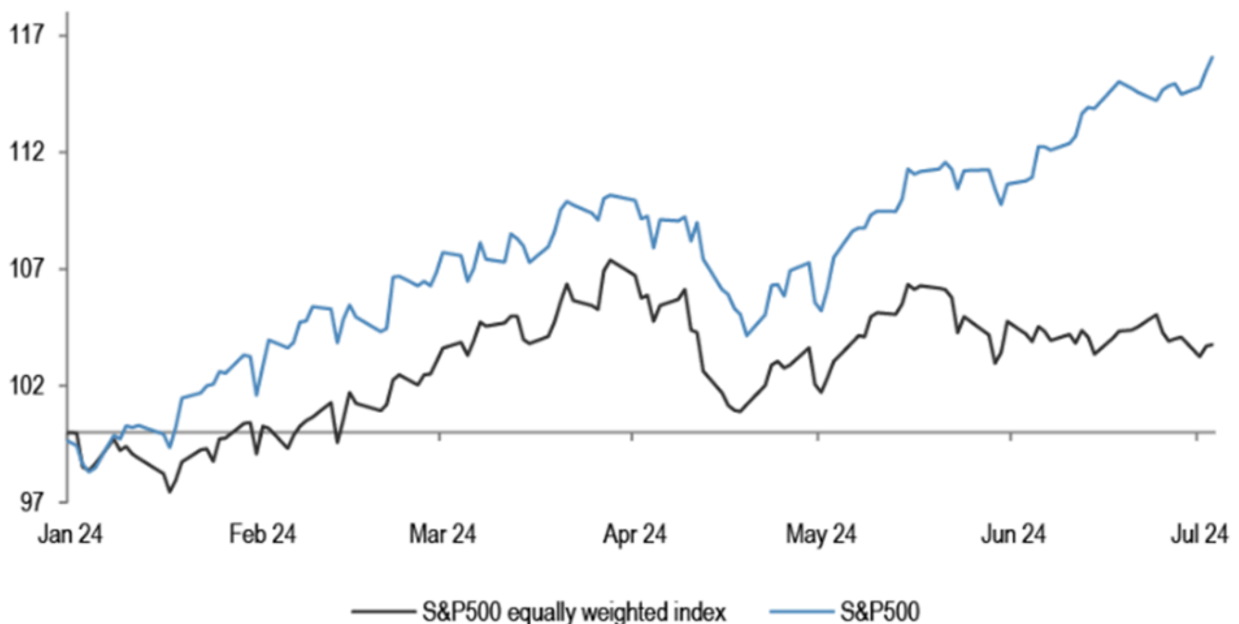
Fixed Income Indexes	Q2, 2024	YTD	2023
Bloomberg Barclays US Agg Bond	0.1%	-0.7%	5.5%
Bloomberg Barclays Municipal Bond	0.0%	-0.4%	6.4%

Source: Orion

For the past few quarters, market breadth has been a concept we have been monitoring and discussing in our quarterly letters. Market breadth is a measure of how many stocks are participating in a given move in an index or on a stock exchange. One easy way to measure market breadth for the S&P 500 is to calculate the percentage of stocks in the index that are outperforming the overall index. For example, in 2023, only 29% (145) of the S&P 500 companies outperformed the index. For context, over the past 35 years the median number of stocks outperforming the index is 49%, which is a level we consider more indicative of healthy market breadth. So, 2023 was a very strong year for returns in the S&P 500 but it was largely driven by a small group of technology stocks that became known as the 'Magnificent Seven' – Apple, Microsoft, Amazon, NVIDIA, Alphabet, Meta (Facebook) and Tesla.

In our last quarterly letter, we noted that breadth for the S&P 500 began to improve (meaning more companies in the index began to outperform) in December 2023 and continued to improve throughout the first quarter of 2024. We viewed this improving market breadth as a positive development, as it indicated that gains in equity markets were less dependent on a small group of companies. Moreover, when markets are rising, and breadth is improving it often strengthens the case for the current trend to continue.

However, since the end of March, the divergence between the market's relatively small group of winners and everything else has kicked into high gear. Nowhere is this more obvious than in the returns seen by Nvidia Corp. (NVDA). The company's stock is up nearly 150% since the beginning of the year, as the company has added nearly $2 trillion to its market capitalization! In fact, Nvidia alone has contributed more than 30% of the S&P 500's nearly 15% advance in 2024. Through the first six months of 2024, only 25% (125) of the S&P 500 stocks have outperformed the index. In the chart below, we show a comparison of the S&P 500 index (which is weighted based on the size of each company) to an equal weighted version of the same 500 companies. As shown, the equal-weight version of the S&P 500 peaked in March and is up only 4% for the year, dramatically lagging the traditional market-weight S&P 500 index due to the heavy influence of just a few stocks. So, the concentration of market returns now appears to be getting worse, not better as we observed last quarter.



So, what are the implications of this heavy concentration of market returns? It is not unusual for the dispersion between winners and losers to widen during a bull market. However, the extreme level of dispersion has us somewhat concerned. The cumulative effect of 18 months of concentrated returns has resulted in a situation where the top 10 stocks in the S&P 500 index now account for over 37% of the overall index. We haven't had this level of concentration among the top-10 companies in the S&P 500 since the 1970s. Moreover, eight of the top 10 stocks are in some way tied to the same AI/data center investment theme, and the technology sector (including communication services and Amazon) currently accounts for over 45% of the S&P 500. In a nutshell, our concern is that 'the market' is becoming increasingly less diversified and more of a bet on a single segment of the market/economy.

Some investors would say that this is not a big deal. After all, these are great companies with strong competitive positions that operate in a segment of the economy that is poised to grow for years to come. We currently own eight of the top 10 members of the S&P 500 and seven of the eight technology companies, so we share that view to some extent. However, we would also point out that four tech giants – Amazon, Meta, Google and Microsoft – have pledged to spend a total of $200B on AI-related infrastructure in 2024, a 45% increase compared to the prior year and exceeding the total capital investments and expenses of the other 90 Technology & Communications companies in the S&P 500. The big four are obviously leveraging their huge financial resources to obtain a big lead in the AI arms race, but what happens when they are finished with this investment cycle? It is not clear to us what would fill this potential $200 billion void, much less produce the kind of spending required to perpetuate a growth rate from this very high level of spending. To be sure, we don't have all the answers when it comes to forecasting the future of AI/Data center spending. However, we do think there is a lot of hype at the moment, and there is a risk that we will enter an 'overbuild' phase in the next year or two. We only need to look back to 2022 when many of these same technology companies led the market through a major correction, to understand how quickly things can change. In 2022, the Magnificent 7 stocks as a group were down 40% while the S&P 500 excluding the Magnificent 7 was down 8%. We also point out that the last time we had two consecutive years with such a low percentage of S&P 500 stocks outperforming the overall index was during the late 90's Dot-com bubble. The promise of the internet in the late 90's has certainly been realized over the past 20+ years, but if you bought the Nasdaq in 1999, it went down 80% before that all came to fruition.

One of the key tenets of our investment philosophy is to maintain appropriate diversification of our investment portfolios. This includes investing in asset classes other than equities, particularly bonds, which tend to do well when equities are doing poorly. We continue to think the current yields now offered by investment grade bonds are quite attractive in the 5%-6% range, and if rates were to fall it is not unreasonable to expect bonds could generate double-digit returns for a period of time. Suitable diversification also includes maintaining appropriate diversification within equities (and other asset classes). For the past 6-12 months, we have been slowly transitioning our equity portfolio

by trimming our positions in some of the big winners and buying some of the high-quality companies that have not participated in the recent market rally. Recent buys include stocks in traditionally defensive sectors like consumer staples and healthcare, as well as two very strong consumer brands (Lululemon and Nike) that have recently been hit hard on fears of slowing consumer spending. The net result of these changes is that while the S&P 500 has 37% of its weight in the top 10 stocks, we have less than 30%. As a fiduciary of your hard-earned money, we believe it is prudent to fade this level of hype and momentum, to maintain proper diversification, and to position our portfolios for the long term in consideration of the inevitable cyclical risks to current technology spending.

As always, please do not hesitate to reach out with any questions or concerns you may have regarding your individual investment portfolio.

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