Market Outlook

Peak Indexing

Q3 2024

What We Got Right and Wrong in Q2

What we Got Right:.

"Recent Divergence in Magnificent 7 will Continue"
Entering 2024 we expected divergence in Big Tech as investor focus on AI turned from "hype" to "results." Winners in Q2 include Nvidia (+36%) and Apple (+23%), while Meta (+4%) underperformed.

"Still Upside Risk to Yields"
We continued to believe longer-term Treasury yields would rise due to stickier inflation and the Fed pushing out rate cuts. The 10-year Treasury yield peaked at over 4.7% in the second quarter.

"Strong Q1 Returns Historically Bullish for Rest of Year"
The S&P 500 rose 10+% in the first quarter for just the 10th time since 1970. In the previous nine years, the S&P 500 had a median return of 3.3% in the second quarter. The S&P 500 followed this trend, finishing Q2 up 4.3%.

"US Large Caps Outperform During a Fed Pause"
A Fed pause has historically led to outperformance of Large Caps. This trend continued in Q2, as Small Caps (Russell 2000 Index) finished the quarter down -3.3%.

What we Got Wrong:

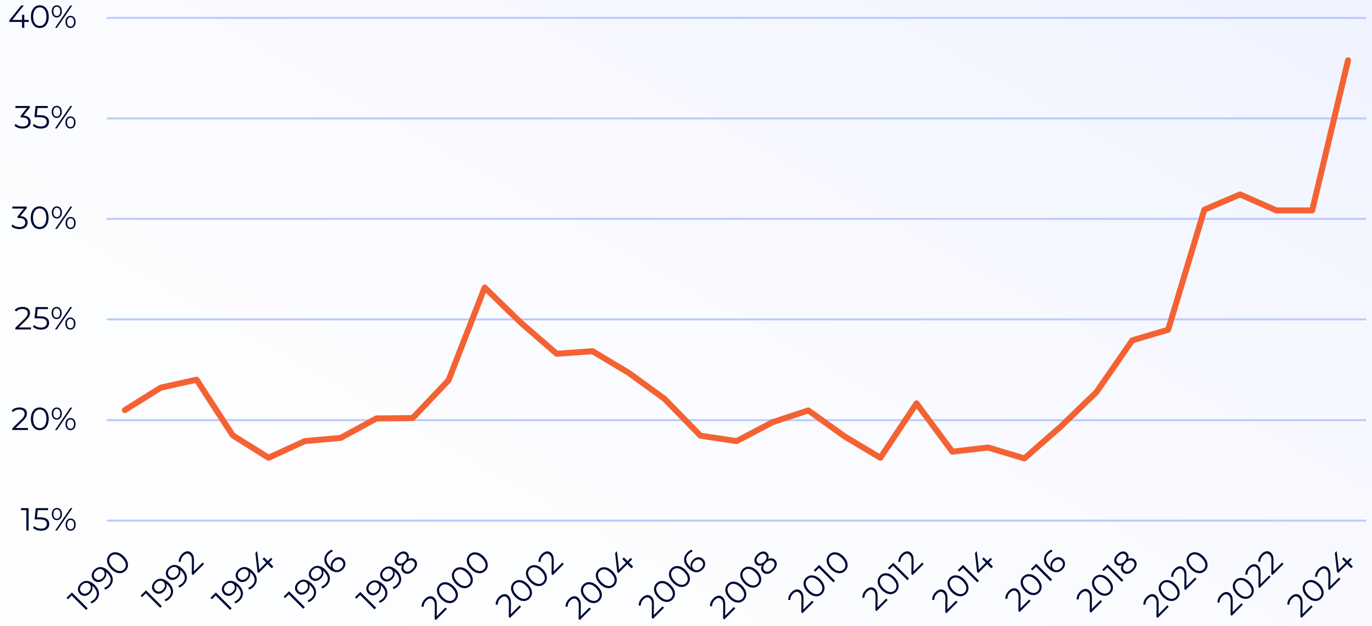
"Core Bonds Outperform During a Fed Pause"
We still expect core bonds to rally as the Fed nears cutting, but stickier inflation and rising yields led to underperformance versus Cash in Q2. The Bloomberg US Agg Bond Index was flat in the second quarter (+0.1%).

Source: Bloomberg, Morningstar Direct and Dynasty Financial Partners. As of 6/30/2024

Peak Indexing? Concentration Near Historic Levels

A decade ago, the ten largest companies in the S&P 500 accounted for less than 15% of the index. Today the top ten is over 35% and consists mostly of Big Tech – raising valuation concerns. Companies trading near their highest valuations in the past 5 years include Apple (32x) and Microsoft (34x). Although Nvidia (41x) is less expensive versus prior years, it will face pressure to continue growing to justify its $3.1 Trillion market cap.

Share of Top 10 Companies in S&P 500
(by market cap)



Big Tech Valuations
(Forward P/E)

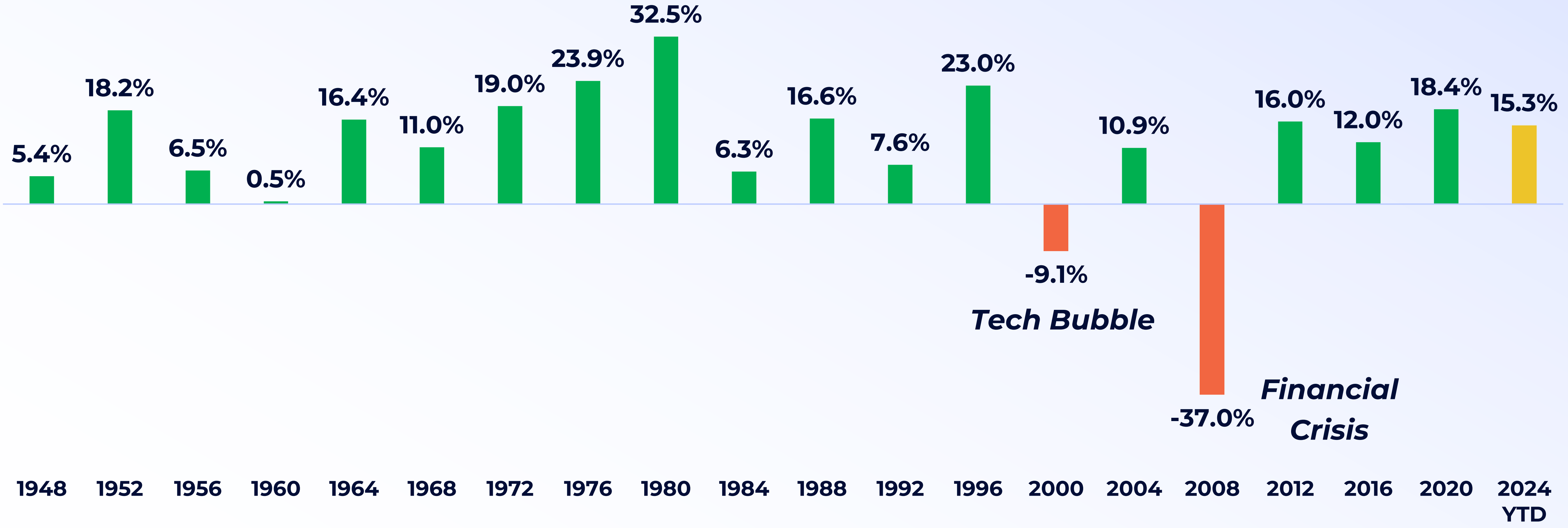
NVIDIA	41x
amazon	37x
Microsoft	34x
Apple	32x
Meta	24x
Alphabet	24x

Source: Morningstar Direct, Bloomberg and Dynasty Financial Partners
Data points are annually. As of 6/30/2024. Forward P/E is as of 7/8/2024

Stock Performance in Presidential Election Years

US stock performance has historically been strong in Presidential Election years. In fact, the stock market has only experienced two negative calendar years in a Presidential Election year, dating back to 1948. Those two negative years were in 2000 when the Tech Bubble burst and in 2008 during the Global Financial Crisis.

S&P 500 Performance in Presidential Election Years (Post-WWII)

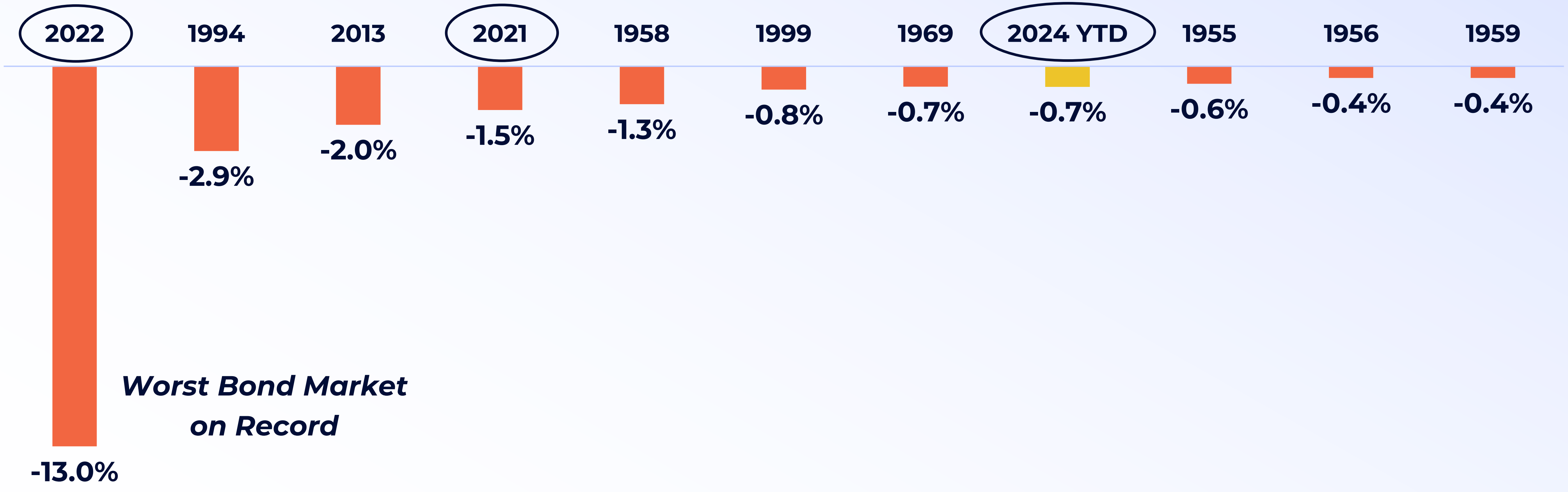


Source: BlackRock, Morningstar Direct and Dynasty Financial Partners. As of 6/30/2024

Bond Market Rout Continues

Negative calendar year performance for US Bonds are rare but have become more common in recent years. The Fed's fight against inflation, which peaked at 9.1% in June 2022, resulted in the worst bond market year on record. The hope is the next Fed easing cycle will boost bond returns going forward.

Worst Bond Market Years (Post WWII)



Source: Morningstar Direct and Dynasty Financial Partners. As of 6/30/2024
US Bonds represented by Bloomberg US Agg Bond Index (1976-2024) and IA SBBI US IT Govt Index (1945-1975)

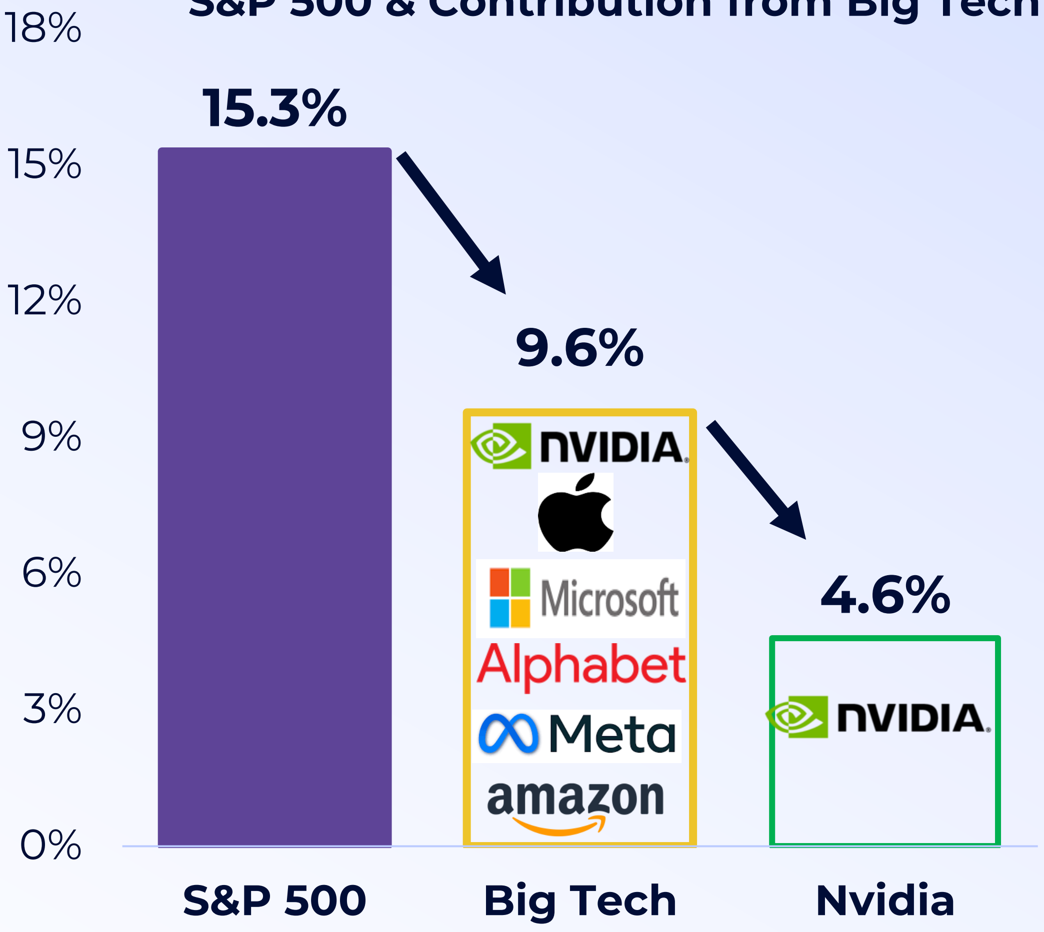
Narrow Market Leadership Continues

Big Tech's strong earnings and dominance in AI has led the market higher. Without the major Big Tech stocks shown to the right, the S&P 500 would only be up roughly 6% YTD. Nvidia alone accounted for 30% of the S&P 500's returns.

Below we highlight new products or features that will allow these companies to capitalize on AI:

- **Nvidia:** New GPU Chips: Blackwell (2024) & Rubin (2026)
- **Apple:** New "Apple Intelligence" features in future iPhones
- **Microsoft:** "Copilot" AI; partnership with OpenAI (Chat GPT)
- **Alphabet:** "Gemini"; AI-driven responses in Search
- **Meta:** AI generative assistant tool in social media apps
- **Amazon:** AI Features for cloud (AWS) and shopping

YTD Returns:
S&P 500 & Contribution from Big Tech

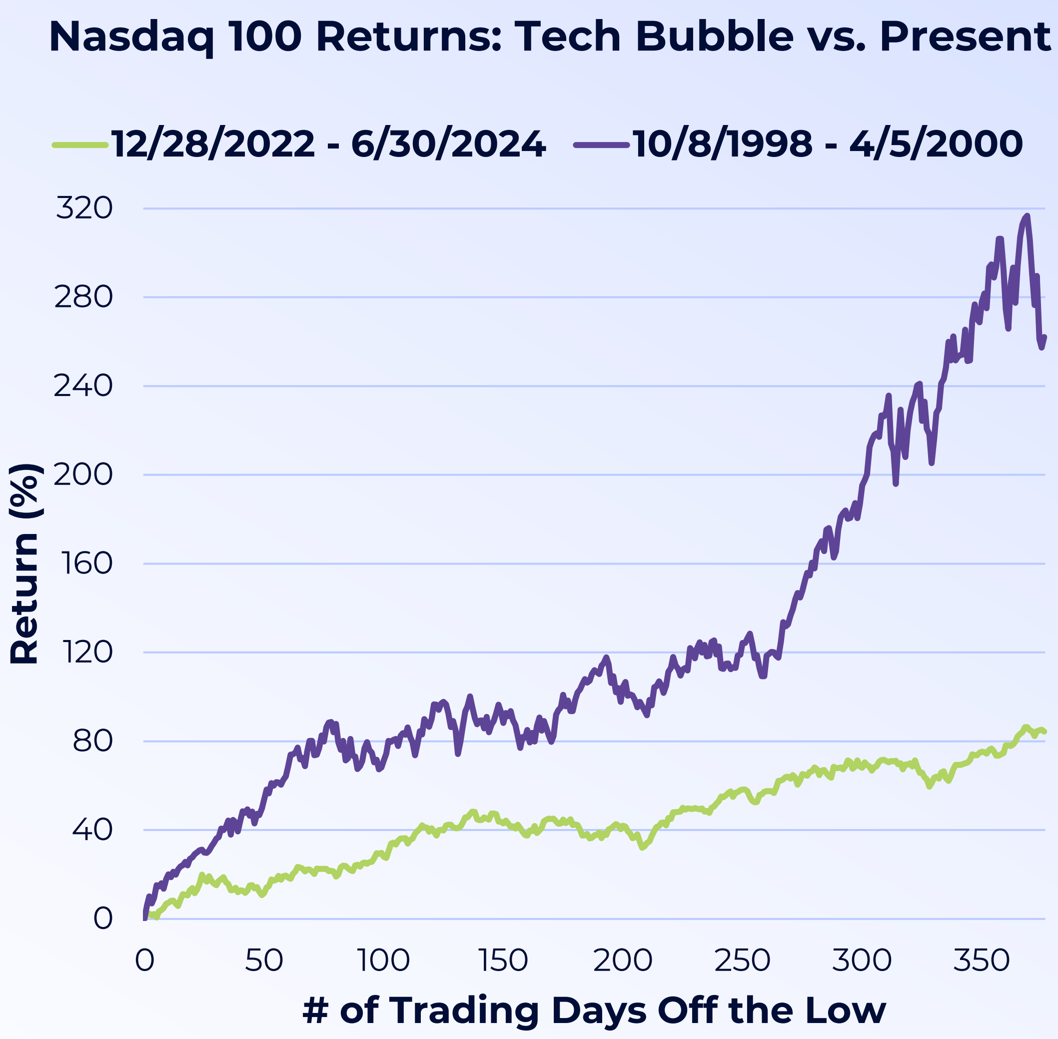


Source: Morningstar Direct, Bloomberg and Dynasty Financial Partners
The SPDR S&P 500 ETF (SPY) is used as a proxy for the S&P 500 Index. As of 6/30/2024

Echoes of the Tech Bubble? Not so Fast

The buzz around Artificial Intelligence has garnered comparisons to the Tech Bubble in the late-1990s. The most obvious comparison is Cisco's rise in the late-1990s versus Nvidia today. Cisco's networking equipment was vital to powering the internet, while Nvidia's GPU chips are key to powering AI applications. Both companies also became the most valuable company in the world at one point.

An important distinction, however, is the <u>level</u> of euphoria back in the late-1990s. Many Tech companies outside of Cisco experienced high returns despite having little-to-no profit or earnings. To help illustrate, we highlight the recent rally in the Nasdaq 100 (off the lows in late-2022) versus the rally off the lows in late-1998 (in leadup to the Tech bubble). Despite a recent rally of roughly 85% since late-2022, the Nasdaq 100 surged over 300% before the Tech Bubble burst.



Source: Bespoke Investment Group, YCharts and Dynasty Financial Partners. As of 6/30/2024

Historically How Long Until the Fed Cuts?

The market remains focused on when the Fed will begin cutting interest rates. In looking back over the past 30 years, **the Fed has averaged roughly 10 months between the last hike and first cut.** It's important to note the Fed has historically cut as early as 5 months after the last hike, and as late as 18 months (dating back to 1995). Given stickier inflation and a resilient labor market, **it's more likely the Fed waits until late-Summer to begin cutting rates**.

Last Fed Hike	First Fed Cut	Time Between Last Hike & First Cut	Reason for Cut
Feb 1995	Jul 1995	5 Months	Soft Landing
Mar 1997	Sep 1998	18 Months	Asian Financial Crisis
May 2000	Jan 2001	7.5 Months	Tech Bubble
Jun 2006	Sep 2007	15 Months	Housing Bubble
Dec 2018	Jul 2019	7 Months	Slowing Global Economy
Jul 2023	?	11 Months (currently)	?
Average		10.5 Months	

Source: US Federal Reserve, Bloomberg and Dynasty Financial Partners. As of 6/30/2024

Equity Performance Around the First Rate Cut

To the right we show 12-month forward returns for the S&P 500 around the start of a Fed cutting cycle. The strength or weakness in equities were largely dependent on 1) Why the Fed cut rates and 2) If a Recession was avoided.

In both 1995 and 1998, 1-year forward returns were strong as the Fed managed to avoid an initial Recession (until the Tech Bubble burst).

In both 2001 and 2007, 1-year forward returns were weak as the Fed began cutting rates in response to the Tech Bubble and Global Financial Crisis.

In 2019, the Fed initially cut rates in response to slowing growth. Forward returns were strong despite the Covid pandemic in 2020.

12-Month Forward Returns: S&P 500

First Fed Rate Cut	3 Months Before	First Rate Cut
July 6th 1995	32.9%	23.0%
Sept 29th 1998	20.9%	22.6%
Jan 3rd 2001	(24.4%)	(8.0%)
Sept 18th 2007	(11.0%)	(16.5%)
July 31st 2019	1.0%	10.7%

Source: Bespoke Investment Group, Morningstar Direct, Bloomberg and Dynasty Financial Partners As of 6/30/2024

Risks in Waiting Too Long to Cut Rates

The Fed has acknowledged the risks to inflation in cutting too early. But it's also worth noting the risk to the economy in waiting too long. The Fed has a "dual mandate" for both maximum employment and stable prices.

Going forward we will be monitoring key indicators around the 1) labor market, 2) growth and 3) inflation:

Labor Market	Growth	Inflation
Key Indicators & Current Levels: Weekly Jobless Claims: 238,000 Unemployment Rate: 4.1% **Key Levels to Watch:** Jobless Claims (people filing for unemployment insurance) nearing 300,000 would signal a slowdown. A 4.1% Unemployment Rate is the highest since 2021. The Fed will watch this closely, as its year-end forecast is 4.0%.	**Key Indicators & Current Levels**: Atlanta Fed GDPNow Model: 1.5% **Key Levels to Watch:** Second quarter GDP estimates below 1.5% would be concerning, as original estimates for Q2 were roughly 4.0%. The GDPNow model frequently updates its projections based on incoming data.	**Key Indicators & Current Levels**: CPI: 0.0% (MoM) and 3.3% (YoY) Shelter: 5.4% (YoY) **Key Levels to Watch:** Monthly CPI remaining flat (0.0%) or barely positive (0.1-0.2%). Shelter is a heavily weighted category of CPI (36%) and lags other categories. Rent prices, which remain high, reflect contracts signed months or a year ago.

Source: US Federal Reserve, US Bureau of Labor Statistics, Atlanta Fed GDPNow, Bloomberg, Bespoke and Dynasty Financial Partners. As of 6/30/2024

Investment Implications

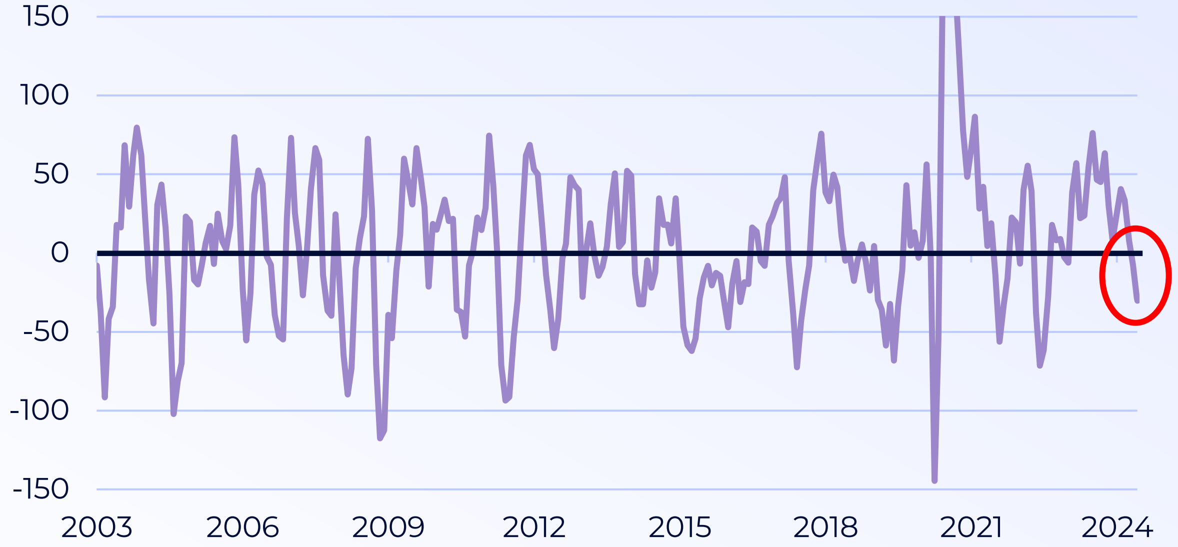
1. **Our Base Case is the Fed Begins Cutting in September:** The Fed has seemed eager to cut since its "pivot" in late-2023 but has also acknowledged the risks of doing so too early. Stickier inflation and a resilient economy delayed the start of the Fed's easing cycle. Going forward, we believe slowing inflation and softer economic data, along with an Unemployment Rate above 4.0%, is enough ammunition for the Fed to begin cutting at the September meeting. Current market odds seem to agree.

2. **Expect Softer Economic Data:** We expect a catalyst for the Fed to begin cutting in September is softer economic data. This is not a call for a Recession in 2024. Instead, we believe the lagged effects of higher rates will slow the economy. Already we are seeing softer economic data. The Citi Economic Surprise Index measures if economic data has been coming in stronger or weaker than expected. A positive index means economic data is beating market expectations. This index recently turned negative and we expect similar results going forward.

Market Probability of a Fed Rate Cut (via CME FedWatch Tool)

JULY	SEPT	NOV
9%	69%	80%

Citi Economic Surprise Index



Source: Bloomberg, CME FedWatch Tool and Dynasty Financial Partners. As of 7/2/2024

Investment Implications (continued)

3. Strong Q1 Returns (+10%) Historically Bullish for Rest of Year:

This is just the 10th time since 1970 the S&P 500 had 10+% returns in the first quarter to start a year. In the previous nine occurrences, the S&P 500 had a median return in the second quarter of 3.3%. The S&P 500 closely followed this trend, finishing the second quarter up 4.3%.

In looking at full year returns, the S&P 500 had median returns of roughly 28%. In fact, none of these years produced a single negative calendar year return. It is important to note that third quarter returns were more muted in these years, with a median return of just 1.9%.

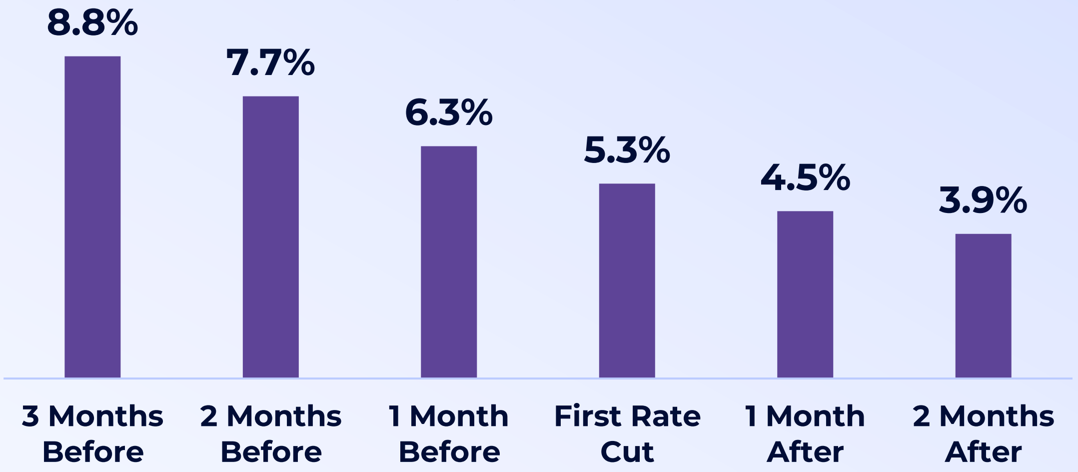
Previous Years with 10+% Returns in Q1 (Since 1970)					
Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
1975	22.9%	15.3%	(10.9%)	8.6%	37.2%
1976	15.0%	2.4%	1.9%	3.2%	23.9%
1986	14.0%	5.9%	(7.0%)	5.6%	18.7%
1987	21.3%	5.0%	6.6%	(22.5%)	5.2%
1991	14.5%	(0.2%)	5.3%	8.4%	30.5%
1998	13.9%	3.3%	(9.9%)	21.3%	28.6%
2012	12.6%	(2.7%)	6.3%	(0.4%)	16.0%
2013	10.6%	2.9%	5.2%	10.5%	32.4%
2019	13.6%	4.3%	1.7%	9.1%	31.5%
2024	10.6%	4.3%	?	?	?
Median			**1.9%**	**8.4%**	**28.6%**

Source: Morningstar Direct and Dynasty Financial Partners. As of 6/30/2024

Investment Implications (continued)

4. Short/Intermediate Bonds > Cash Before Fed Cuts:
A Fed easing cycle is historically bullish for fixed income, as yields decline and prices rise. To take advantage of the beginning of a rate cutting cycle, investors should consider short/intermediate bonds over Cash before the Fed begins cutting rates. This allows investors to lock in some duration along with higher yields. As shown to the right, US Bonds forward 12-month returns are higher 3-months before the Fed begins cutting. We would avoid longer-term bonds due to risks of US deficits and increased Treasury issuance.

Average 12-Month Forward Bond Returns Around Start of a Fed Cutting Cycle (Since 1995)



5. Yield Curve Disinverts:
We expect the yield curve to disinvert after two years of inversion, led by lower two-year yields. The two-year yield reflects market expectations of where the Fed Funds rate could be in a couple years. As of quarter-end the two-year yield was roughly 4.75%. We expect the two-year yield to decline as the Fed cuts earlier than expected and the market prices in additional cuts for 2025.

Yield Curve: 10-Year and 2-Year Treasury

Source: US Federal Reserve, Bloomberg, Morningstar and Dynasty Financial Partners
As of 6/30/2024
Data includes the following dates for the first cut in a Fed Cycle: July 6th 1995, September 29th 1998, January 3rd 2001, September 18th 2007, July 31st 2019

PUREfi FOUNDING TEAM

POWERED BY DYNASTY

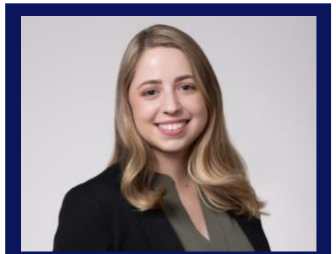
PAUL M. SIMONS
Founder & CEO

CHARLES CORKERY
Chief Administrative Officer & CCO

SANDY GALUPPO
Partner, Senior Wealth Advisor

TIMOTHY JONES
Partner, Senior Wealth Advisor

BILL NICHOLS
Partner, Business Development



NICOLE BOGERT
Client Service Manager

AMELYA REDMAN
Client Associate

BOB SHEA
Chief Investment Officer
Dynasty

JUSTIN WEINKLE
Chief Financial Officer
Dynasty

GORDON ABEL
Chief Marketing Officer
Dynasty

CAITLIN DOUGLAS
Managing Director, Transition Services
Dynasty

HARRIS BALTCH
Investment Banking & Capital Markets
Dynasty

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