Capital Markets Commentary and Quarterly Report: 2nd Quarter 2024

Capital Markets Highlights

After a strong first quarter, equity market returns were more mixed in the past 3 months. The S&P 500®, driven by a small group of AI-focused Technology stocks[1]continued higher, while most other areas of the US stock market pulled back, including Small- and Mid-cap[2], the average S&P 500® stock, Value indexes and Dividend stocks. For the quarter, the S&P 500®, in which the largest companies are weighted more, rose +4.29 % bringing its year-to-date (YTD) return through June 30 to +15.29%. The equally weighted S&P 500® was down -2.63% in the quarter and is up +5.08% YTD through June 30.

The market's returns[3] since late 2022 have been led by the Technology & Communications Services sectors, holding many stocks benefiting from the booming interest in artificial intelligence (AI). That trend continued in the second quarter of 2024[4]. What was different from the first quarter is that fewer other sectors participated in the rally. In the first quarter, 10 of the 11 sectors increased, while in the second quarter, more than half of them (6) were down.

Growth strategies have significantly outperformed Value and Dividend strategies YTD and mega-cap stocks outpaced small, mid, and large cap stocks. We expect the broader market and many of these lagging areas to show better relative performance as the year progresses.

The U.S. economy continued to grow but at a decelerating pace, with Q1 GDP up +1.4% versus +3.4% in Q4 2023. Despite the slower pace of economic growth this year, the economy has strong underpinnings with a healthy job market, good consumer and business balance sheets, and inflation trending towards the Fed's goal of 2%.

In his June 12 press conference, Fed Chairman Powell noted that the Committee participants expect GDP growth of 2.1% this year and 2% over the next two years[5]. The unemployment rate in June was 4.1%, and the latest number for the Fed's preferred gauge of inflation, the PCE Price Index, was up just 0.1% in May and up +2.6% for the last 12 months, the lowest since March 2012, and down from 4% one year earlier. Core CPI was up +0.2% in May and +3.4% for the last 12 months, down from a peak of 9.1% in June 2022[6].

Fixed income returns were mixed, with shorter maturities modestly positive for the quarter and year-to-date and longer-term maturities modestly lower for the quarter and year –to-date. The 10-year Treasury yield was 4.40% on June 30 versus 4.20% on March 31 and 3.88% on December 31, 2023.

[1] This and future references to Sector specific returns are from J.P. Morgan Fixed Income Dynamics 2Q/2024 as of June 30, 2024.
[2] This and future references to specific strategies are based on June 30, 2024, Index Returns for those strategies.
[3] All references to the stock market are the S&P 500® unless otherwise noted.
[4] The quarter that split the market in six charts. WSJ June 30, 2024.
[5] Transcript of Chair Powells's Press Conference June 12. 2024.
[6] Reuters, Bureau of Labor Statistics.

Our Thoughts Going Into Q3

Looking ahead, we expect further gains for stocks in 2024, with more volatility as we approach the November elections. As we said in last quarter's letter, we caution against letting your political leanings or thoughts about the election and winners influence your investment strategy. Generally, the state of the economy and the interest rate environment have much more impact on investment returns than elections or which party controls the Presidency or congress[7].

Though the outlook for the economy has modestly slowed[8], it remains good. Consensus expectations are for S&P 500® earnings to grow by more than 10% over the next twelve months. The market's price/earnings ratio (P/E) is above its 20-year average, primarily due to the very high multiples of the 10 most valuable stocks averaging more than 30 times earnings. The multiple on the remaining stocks is 17.6 times[9],which is in line with historical averages especially in a declining interest rate environment. There are parts of the market that are fully priced, but there are also many pockets of undervaluation.

We believe stocks with very high multiples are vulnerable to earnings disappointments or changes in psychology from current levels. According to JP Morgan, the Magnificent 7 have accounted for 61% of the market return in 2024 through June 30[10]. The market action in June that focused almost exclusively on the AI Mega Tech melt up and left most other areas in the dust feels like it is hitting extremes. As the year progresses, we expect that market leadership will broaden to other stocks with good business outlooks and more attractive valuations. This change in psychology should benefit our portfolio holdings. We are already seeing some of the market's leaders pull back.

Market volatility should create attractive pricing for investing new money in good companies that have short-term disappointments, while also allowing for the sale of other holdings at favorable prices.

The Fed has made it clear that they will keep interest rates high until they are comfortable that inflation is no longer a threat[11]. The timing of a cut in interest rates is unpredictable but becomes more likely with each passing month of improving inflation data and a slowing job market. Based on a slowing economy and declining inflation, the Fed is expected to start an interest rate decrease cycle at some point later this year that will likely continue into 2025. While the timing of an interest cut is uncertain, what is clear to us is that at some point in the upcoming months the Fed will start lowering rates. When that happens, it should boost the housing market with very positive spillover effects on the overall economy and the stock market.

We believe that our portfolios are well-positioned to navigate the current economic environment and provide favorable stock market returns for the balance of this year and beyond. Our investments have solid financial positions, stable and growing businesses, and strong management teams.

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[7] Historical data shows markets have tended to rise in Presidential election years, with the S&P 500® recording positive returns in 20 of the 24 election years since 1928, or 83.3% of the time. According to figures from First Trust, the average return for those election years was 11.58%. That's well above the S&P 500® average return of 9.81% for all years since 1928. Source: Investopedia December 31, 2023. Economic and inflation trends have demonstrated a stronger relationship with market returns than election results.

[8] As measured by Q1 2024 GDP

[9] Source: FactSet. Standard & Poor's, J.P Morgan Asset Management.

[10] Economic and Market Update J.P. Morgan Asset Management as of June 30, 2024.

[11] Fed Chair Powell's Press Conference June 12, 2024

Large Cap Value Strategy

Matrix's Large Cap Value portfolio (LCV) was up low single digits in Q2 2024 and up low double digits YTD through June 30[12]. The gains trailed the S&P 500® but were ahead of the Russell 1000® Value's results for the quarter and six months.

In Q2 2024, Technology and Communications Services stocks added the most to the portfolio's gain. For the six months through June 30, those two sectors plus Financials, Consumer Discretionary, and Industrials accounted for most of the portfolio's performance. Healthcare was the biggest drag on results for the quarter and six months.

Looking forward, we anticipate that the contribution to portfolio results will shift from those sectors that have led performance for the last 18 months to some other sectors. Our Healthcare stocks have solid fundamentals and are at very attractive valuations. Similarly, we think our large position in Financials has significant additional upside. Our Financials are well capitalized with strong business franchises and positioned to grow earnings and dividends[13]. They should see a nice uptick in business and profits when the Fed starts cutting rates, and the yield curve moves towards a positive slope (lower short-term rates versus longer-term rates).

In Q2, we started new positions in Lowe's Corp and Medtronic.

Lowe's (LOW) is the second largest home improvement chain, with a strong #2 market share of 20%,behind the industry leader Home Depot with a 29% market share. The home improvement industry continues to grow and consolidate around Home Depot and Lowes due to large selections, low prices, and high levels of service. Lowe's has a long history of double-digit revenue and earnings growth with high returns on capital. The company was a significant beneficiary during COVID-19 when low interest rates, rising housing prices, and living/working from home were major themes leading to an acceleration in its core home remodeling business. Since then, Lowe's shares have dropped from a high of over $260 in 2021 to a recent price of $215, where we started purchasing the shares. The valuation is attractive at 15 to 16 times earnings as Lowes shares typically trade for 20+ times earnings[14].

Medtronic (MDT) is the world's largest manufacturer of implantable biomedical devices, with sales in over 150 countries. Cardiovascular (cardiac rhythm disease management and cardiovascular) accounted for 37% of '24 sales; Neuroscience 29%, Medical Surgical 26%, and Diabetes 8%. International revenues were 49.0% of '24 sales[15]. The company's business was impacted during COVID-19 when medical procedures declined. Earnings peaked in 2018; five years later, they are still around $5 per share. Recent results have improved, leading us to believe the company is back on track, and a higher stock price should follow. The share price is down from $135 in 2022. We think the shares have a significant upside at their current price around $80. We have owned the stock in our Dividend strategy since early 2022 and added it to our Value Portfolio now as we think the valuation is compelling. With reaccelerating earnings growth, the stock should be very timely.

We also opportunistically added to existing holdings in Comcast and Tyson Foods.

We sold the portfolio's positions in CVS Health and Gilead Science to provide funds for the recent purchases.

[12] All LCV & MDI performance results are net of fees.
[13] Based on Federal Reserve Stress Test results June 2024 and Matrix Asset Advisors research.
[14] Based on internal Matrix Asset Advisors research report and analysis.
[15] Source: Medtronic FY 2024 reports.

CVS was a position we owned for many years and has been a disappointing holding. The company has faced many industry headwinds and although they have made progress and the stock continues to be attractively priced, we had increasing concerns that their management has not been up to the challenge resulting in deteriorating business performance. In the face of our increasing concerns, our patience ran out and we decided there were more attractive opportunities.

Gilead was another disappointing position that was sold to free up funds for more timely investments in the Healthcare sector. The company has a great HIV franchise and many life-saving medicines, but in the short term they have been less successful with its M&A strategy to buy and develop other successful drugs. We still like Gilead and believe the investment will do well in time. We continue to hold it in the Dividend portfolio but prefer to hold Medtronic because we think it is timelier.

We are optimistic about the portfolio's positioning and prospects for the balance of 2024 and beyond. In the Q1 2024 earnings season, the portfolio's companies posted much better results than the market, with 93.5% of our companies beating on earnings vs. 80.7% for the S&P 500®. The strong fundamentals of our holdings should eventually be reflected in their stock prices.

We believe the LCV portfolio can continue to build on its gains, as our companies' corporate performance and positioning are favorable, yet they sell at reasonable valuations. On June 30, the average P/E multiple of the LCV portfolio was 15.3x 2025 estimated earnings, which is attractively discounted vs. the S&P 500's 19.7x.

Dividend Income Strategy

The Matrix Dividend Income (MDI) portfolio had a modest decline in Q2 2024 and is up mid-single digits for the six months through June 30. The portfolio trailed the Technology-heavy S&P 500® for the quarter and YTD but outperformed the Russell 1000® Value Index in the quarter and modestly lagged this Index for the six months through June 30.

In the first half of 2024, the portfolio's performance faced similar headwinds to 2023, when large, low/no-dividend Technology stocks dominated market performance. These headwinds should lessen in upcoming periods. We believe valuation disparities between sectors and styles have reached unsustainable levels. Businesses are doing well, cash flows and dividend streams continue to grow, and the stocks are simply too cheap.

The MDI strategy continues to deliver on its three objectives: generating high current and growing income, downside protection, and capital appreciation. We expect the portfolio to continue adding to its gains as the year progresses and to be more protective in the choppy environment we anticipate.

Portfolio performance in the quarter was led by stocks in the Technology and Utilities sectors. Utilities have joined the AI party this year, rising on industry executives' predictions that data centers and new semiconductor facilities will significantly increase electricity demand. For the six months through June 30, shares in the Technology, Utilities, and Financial sectors generated most of the portfolio's gains. Consumer Discretionary and Healthcare were lagging sectors for both periods.

In Q2, we exited the position in CVS Health. As discussed above, CVS faces many industry headwinds, and we have had increasing concerns that their management has not been up to the challenge resulting in deteriorating business performance. In the face of these concerns our patience ran out and we decided there were more attractive opportunities. We also trimmed positions in General Dynamics and Qualcomm as they approached fair value.

We used the funds raised from these sales to add to existing holdings in Cisco Systems, Home Depot, PepsiCo, and Starbucks.

Quarterly reports for the portfolio's holdings were above expectations by a greater degree than the market, with 84% beating earnings estimates versus 80.7% for the S&P 500®. Revenues significantly outpaced expectations at 72% vs. the S&P 500's 54.4%. Solid business performance has allowed the companies to continue to reward shareholders with higher dividends.

In Q2, eight of our portfolio holdings raised their dividends by an average of 5.9%. In the first six months of the year, fifteen of the portfolio's holdings have raised their dividends by an average of 6.7%. On June 30, 2024, the portfolio had a 3.03% dividend yield, which compares favorably with the 1.33% yield on the S&P 500® and the 2.16% yield on the Russell 1000® Value.

The MDI portfolio is attractively priced, with average P/E multiples of 15.7x 2025 earnings on June 30, compared to the S&P 500's 19.7x. This wide gap demonstrates the market's lack of attention to dividend-focused stocks, even though we believe their lower volatility and strong income generation make them an attractive investment class.

The disconnect between the fundamentals, valuations, and stock price performance of companies in the Dividend Income portfolio is notable and unlikely to continue. Though the timing for closing this gap is uncertain, we are confident it will happen.

Bonds

In Q2 2024, Fixed income returns were mixed, with shorter-term maturities modestly positive and longer-term maturities negative. The 10-year Treasury yield was 4.40% on June 30 versus 4.20% on March 31 and 3.88% on December 31, 2023.

With economic growth moderating and inflation [16]heading towards the Fed's 2% target, we think the Fed will cut rates later this year. When that happens, short-term rates should decline, and the yield curve will likely steepen. Based on this outlook, we continue to be upbeat about the upcoming return prospects for short-term bonds. We are also comfortable investing at the shorter end of intermediate term bonds and remain wary of longer-term bonds, as we think that as the yield curve steepens, rates on the long end might be stable or move modestly higher.

Matrix's fixed income positioning has been cautious in recent years, focusing on high-quality Corporates, U.S. Treasuries, Agencies, and Municipals (where appropriate) with nearer-term maturities. As rates moved higher in the past 18 months, we modestly extended our maturities, purchasing some bonds in the 2–5-year range and when we believed rates were nearing the higher end of their likely range, selectively purchased some bonds out to 5-7 years. We are now mainly investing in bonds with maturities in the 1–6-year area. They offer excellent current income and a nice cushion against portfolio volatility if the economy falters unexpectedly.

[16] As measured by 1Q 2024 GDP and May 2024 Core CPI and PCE data.

With our conservative shorter-term positioning, our taxable and municipal bond portfolio performance in Q2 2024 was modestly positive and in-line to slightly better than their benchmarks.

Balanced Accounts

In the first half of the year balanced accounts benefited from our overweight to equities. Bonds provided good income and stability during the short-lived equity market sell off in April.

For the past few years, we thought it was an easy call to favor equities over bonds, but with the strong stock market rally over the last 18 months, combined with attractive fixed income yields near 5%, the call is much closer. Depending on the stock and bond market progress over the upcoming months, we would likely use a continued stock market rally to modestly reduce our overweight to equities. We expect to move from the upper end of our targeted range to an overweight in the middle of the band while being mindful of the tax implications of any adjustments.

At current interest rates and our portfolio's stock appreciation potential, we still believe that stocks offer better returns than bonds but that high-quality short to intermediate-term bonds are also attractive investments on their own and should provide stability, modest growth, and a healthy income stream for balanced portfolios for the rest of 2024, a period when we expect more volatility as we get closer to the November election.

Interest rates are now at levels where we believe Fixed Income can meaningfully contribute to diversified portfolio returns, in addition to their traditional role of offsetting volatility from equities. We are very comfortable with shorter-term bonds, with a preference for maturities in the 1–6-year area. We are still cautious about long-term bonds, where we think there is more interest rate risk.

Looking forward, after the strong rally in stocks over the past 18 months, we anticipate more modest gains from equities and more volatility.

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We thank you for your trust in us. Please get in touch with us with any questions about this commentary or your account.

Disclosure:

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All data is through (or as of) 06/30/2024 unless otherwise noted.

For more information about Matrix Asset Advisors, please visit our website at www.MatrixAssetAdvisors.com. Our website includes our firm's Client Relationship Summary document.

Definitions:

***The S&P500® Index** is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. You cannot invest directly in an index.*
***The Russell 1000® Value Index** measures the performance of those Russell 1000 Index® companies with lower price-to-book ratios and lower forecasted growth values.*
***Fixed Income** type of investment security that pays investors fixed interest or dividend payments until their maturity date.*
***Inflation** is a sustained increase in the general level of prices for goods and services.*
***Financials** a section of the economy made up of firms and institutions that provide financial services to commercial and retail customers.*
***Health Care** all businesses involved in the provision and coordination of medical and related goods and services.*
***Information Technology** businesses that sell goods and services in electronics, software, computers, artificial intelligence, and other industries related to information technology (I.T.).*
***Consumer Discretionary** an economic sector classification of non-essential consumer goods and services.*
***Communication Services** includes companies that sell phone and internet services via traditional landline, broadband, or wireless. The communications sector also includes companies that create and produce movies, television shows, and other content.*
***Growth Strategy** is a collection of business initiatives that seek the maximization of a company's value within a period.*
***Federal Reserve** is the central banking system of the United States. It was created on December 23, 1913, with the enactment of the Federal Reserve Act, after a series of financial panics led to the desire for central control of the monetary system in order to alleviate financial crises.*
***Economic Growth** an increase in the production of economic goods and services, compared from one period of time to another*
***Dividend Income Large Cap Core** - the largest U.S. companies, or those with market capitalizations of $10 billion or more, where neither growth nor value characteristics predominate.*
***Value Strategy** investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.*
***Balanced Accounts** combines asset classes in a portfolio in an attempt to balance risk and return. Portfolios are divided between stocks and bonds, either equally or with a slight tilt, such as 60% in stocks and 40% in bonds. Balanced portfolios may also maintain a small cash or money market component for liquidity purposes.*
***Utility Sector** companies that provide electricity, natural gas, water, sewage, and other services to homes and businesses.*
***Manufacturing** the making of goods by hand or by machine that upon completion the business sells to a customer.*
***Corporate Profitability** is a measure of an organization's profit relative to its expenses.*
***IPO** a company's ownership is transitioning from private ownership to public ownership. For that reason, the IPO process is sometimes referred to as "going public."*
***Volatility** is the degree of variation of a trading price series over time, usually measured by the standard deviation of logarithmic returns.*
***U.S. Governments** (Treasuries) are debt obligations issued by the United States Government and secured by the full faith and credit (the power to tax and borrow) of the United States.*
***Agencies** a low-risk debt obligation that is issued by a U.S. government-sponsored enterprise (GSE) or other federally related entity.*
***Municipal Bond** is a bond issued by state or local governments or entities they create such as authorities and special districts. In the United States, interest income received by holders of municipal bonds is often, but not always, exempt from federal and state income taxation.*
***10-year Treasury Yield** the yield that the government pays investors that purchase the specific security.*
***Net Rate of Return** is the total rate of return on an investment after the deduction of any fees, commissions, or expenses. Often quoted as the rate of return on an investment in strategy marketing materials. Returns for more than a year are often annualized, which provides the geometric average return of an investment for each year over a given time period.*
***Interest rates** are the amount a lender charges a borrower and is a percentage of the principal—the amount loaned.*
***Operating Results** show what the company has earned in connection with its business activities before deduction of interest and taxes.*

Dividend Yield a financial ratio that tells you the percentage of a company's share price that it pays out in dividends each year.
Industrials *Companies that manufacture machinery, handheld tools, and industrial products. This sector also includes aerospace and defense firms as well as companies engaged in transportation and logistics services.*
GDP (Gross domestic product) *is a monetary measure of the market value of all the final goods and services produced and sold in a specific time period by countries. Due to its complex and subjective nature this measure is often revised before being considered a reliable indicator.*
High Grade Corporate Bonds *that are believed to have a lower risk of default and receive higher ratings by the credit rating agencies, namely bonds rated Baa (by Moody's) or BBB (by S&P and Fitch) or above. These bonds tend to be issued at lower yields than less creditworthy bonds.*
Maturities *are the agreed-upon dates on which the investment ends, often triggering the repayment of a loan or bond, the payment of a commodity or cash payment, or some other payment or settlement term.*
Consumer Spending *the value of the goods and services purchased by, or on the behalf of, U.S. residents.*
2 Year Treasury Yield *is the yield received for investing in a U.S. government issued treasury security that has a maturity of 2 years.*
5 Year Treasury Yield *is the yield received for investing in a U.S. government issued treasury security that has a maturity of 5 years.*
30 Year Treasury Yield *is the yield received for investing in a U.S. government issued treasury security that has a maturity of 30 years.*
Short Term Bonds *are bonds that will pay back your principal, or mature, quickly, typically within four years.*
Intermediate Term Bonds *issued with maturity dates that are between two and 10 years.*
Long Term Bonds *maturities of between 10 years and 30 years.*
Taxable accounts *are accounts where the normal IRS tax rules apply. In a taxable account, you pay taxes on interest, dividends, and capital gains, in the year in which you earn them.*
The Bloomberg Intermediate U.S. Government/Credit Bond Index *is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index with less than 10 years to maturity.*
Core inflation *the change in prices of goods and services, except for those from the food and energy sectors.*
Invesco S&P 500®® Equal Weight ETF *is based on the S&P 500®® Equal Weight Index (Index). The Fund will invest at least 90% of its total assets in securities that comprise the Index. The Index equally weights the stocks in the S&P 500®® Index. The Fund and the Index are rebalanced quarterly.*
Artificial Intelligence *the ability of a digital computer or computer-controlled robot to perform tasks commonly associated with intelligent beings.*
Unemployment Rate *represents the number of unemployed people as a percentage of the labor force.*
Consumer Income *the money that a consumer earns from either work on investment, such as dividends distributed by companies to its shareholders and the gain realized on the sale of an asset, such as a house.*
Downside Protection *occurs when techniques are employed to mitigate or prevent a decrease in the value of the investment. Downside protection is a common objective for investors and fund managers to avoid losses, and several instruments or methods can be used to achieve this goal.*
Capital Appreciation *is an increase in the price or value of assets.*
Yield Curve a line that plots yields, or interest rates, of bonds that have equal credit quality but differing maturity dates.
Net Rate of Return *is the total rate of return on an investment after the deduction of any fees, commissions, or expenses. Often quoted as the rate of return on an investment in strategy marketing materials. Returns for more than a year are often annualized, which provides the geometric average return of an investment for each year over a given time period.*
Small-Cap *public companies whose total market value, or market capitalization, is about $300 million to $2 billion.*
Mid-Cap *companies with a market capitalization (or value) between $2 billion and $10 billion.*
Large Cap Core *the largest U.S. companies, or those with market capitalizations of $10 billion or more, where neither growth nor value characteristics predominate.*
Mega cap *is a designation for the largest companies in the investment universe as measured by market capitalization.*
The Magnificent Seven *Large tech-oriented companies. The group includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta.*
Earnings Revenue- *Revenue is the income a company generates before deducting expenses. Earnings, on the other hand, represents the profit a company has earned; it is calculated by subtracting expenses, interest, and taxes from revenue.*
Mergers & Acquisitions (M&A) *transactions in which the ownership of companies or their operating units — including all associated assets and liabilities — is transferred to another entity.*
Unemployment Rate represents the number of unemployed people as a percentage of the labor force.
CPI *The Consumer Price Index (CPI) consists of a family of indexes that measure price change experienced by urban consumers. Specifically, the CPI measures the average change in price over time of a market basket of consumer goods and services. The market basket includes everything from food items to automobiles to rent.*
P/E Multiples the ratio for valuing a company that measures its current share price relative to its per-share earnings.
Balance Sheet *a statement of the assets, liabilities, and capital of a business or other organization at a particular point in time, detailing the balance of income and expenditure over the preceding period.*
Covid-19 *a global outbreak of coronavirus – an infectious disease caused by the severe acute respiratory syndrome.*
Semi-Conductor *the memory modules, microprocessors, and other chips found in electronic devices and other products.*
Core CPI *the CPI- Energy and Food prices.*

PCE Price Index *Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by people of the United States. According to the Bureau of Economic Analysis (BEA), a U.S. government agency, PCE accounts for about two-thirds of domestic spending and is a significant driver of gross domestic product (GDP).*