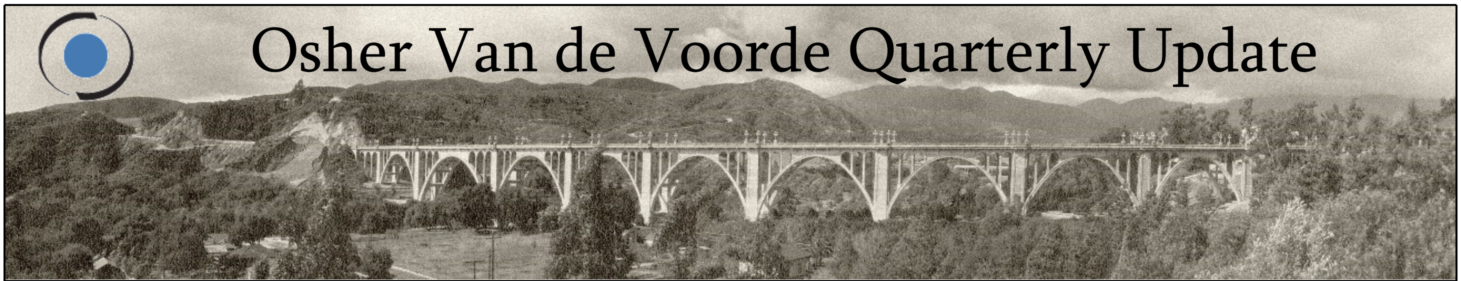


The Magnificent One

July 2024

In our Outlook 2024 newsletter published in January, we predicted a high range of 5,400 to 5,700 for the S&P 500 over the coming year or two. While satisfied that we correctly saw the uptrend, we are surprised by the accelerated pace at which our optimistic threshold has been reached. Indeed, the S&P 500 closed the first half at 5,460, an impressive six-month advance of 14.48%. Indicative of continued lopsided leadership by mega-cap technology, the NASDAQ composite delivered an even more remarkable 18.13% return. Meanwhile, the Dow Jones Industrial Average and Russell 2000 indices languished with returns of 3.79% and 1.73% respectively.

That large-cap technology momentum is driving today's buoyant stock market is an understatement. Last year, the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) accounted for 63.2% of the total 26.3% gain for the S&P 500. In the first six months of 2024, Nvidia alone accounts for one-third of the advance. With an amazing 149% climb that catapulted its market cap north of $3T for the first time and a 10-for-1 stock split to boot, Nvidia has proven to be the dominant force behind the market's momentum. To further illustrate the point, in a market where the S&P 500 is up 14.48% year-to-date, Nvidia is up 149% while the average S&P 500 constituent is up only 4%. This is the largest underperformance of the average stock relative to the overall market since 1990.

Our investment discipline is such that it is common for us to miss such ascendant trajectories of otherwise solid businesses in their early go-go growth phase. We have never professed to be skilled at momentum investing and instead buy high-quality growth companies when the valuation metrics imply a margin of safety. We did not buy Microsoft, Apple, Alphabet or Amazon when the companies were in their early growth phases and trading with lofty expectations. Instead, we initiated positions in these wonderful growth companies when they sold at more reasonable multiples. We first acquired Microsoft in 2012 when the PC era was deemed dead, and the stock had not made a new high for 15 years. We initiated our position in Apple in 2013, shortly after the company experienced its first earnings lull in a decade and the company initiated its first dividend. We first purchased Alphabet during a 20% correction back in 2019. We reestablished our core position in Amazon 21% below its recent all-time high, after it had undergone a painful 55% price correction. We avoid the temptation to chase stock prices higher and always prefer buying best-of-breed businesses on the dip. All these examples proved to be wonderful opportunities.

Momentum investing is beyond the scope of our discipline in that it requires: 1) faith that there will always be a buyer willing to pay an ever higher price (buy high, sell higher); 2) a trader's mentality and quick trigger should bad news surface; 3) confidence in forecasted earnings that may not pan out; and 4) a willingness to suspend long established valuation metrics. Famous examples of momentum trades gone awry include the dot.com bust of the early 2000s, Cathie Wood's ARK Innovation ETF and Bitcoin.

In looking specifically at Nvidia, while we are impressed with their AI leadership credentials and stunning earnings growth, there are many potential pitfalls that give us pause. Nvidia shares now trade at 40x forward earnings compared to the overall market at 20x and average S&P 500 stock at 15x forward earnings. While Nvidia's premium multiple is well-deserved, its quarter-over-quarter earnings growth has slowed from 88% to 34% to 22% to 18% over the last four quarters. Analyst consensus estimates call for a further slowdown in the current quarter. The law of large number is taking hold.

Many other companies envious of Nvidia's fat margins (including AMD, Intel and Qualcomm) are aggressively deploying their own products at lower prices to undercut Nvidia and better compete. In addition, hyperscaler powerhouses Alphabet, Amazon, Meta and Microsoft are all producing their own AI chips. Even Apple is working with Taiwan Semiconductor to develop proprietary chips to run AI data centers. In the trajectory of all businesses, a point is reached when margins cannot be maintained, and growth inevitably slows. Especially since the AI industry is relatively new and rapidly evolving, we do not have a strong opinion as to when that time may come for Nvidia.

When Nvidia's market cap recently surpassed $3T, less than four months after it surpassed $2T, it briefly became the largest U.S. company by market cap. It was the first time since 2019 that any company other than Microsoft or Apple had claimed that throne. Since 1926, there have only been eleven other companies to have earned the honor of being the largest U.S. company by market capitalization: AT&T, Apple, Cisco, DuPont, Exxon Mobil, General Electric, General Motors, IBM, Microsoft, Philip Morris and Walmart. Of these companies, only Apple, Exxon, Microsoft and Walmart are even in the top twenty today. All others experienced spectacular falls from grace.

(Continued on Page 3)

The Magnificent One (continued)

From a technical perspective, Nvidia is in unchartered territory. The shares recently traded 100% above their 200-day moving average. Since 1990, the widest spread for any U.S. company then reigning as the largest company by market cap was Cisco Systems back in March of 2000, when it sold 80% above its 200-day moving average. Another interesting similarity, Nvidia is up 4,280% in five years to its peak compared to 4,460% for Cisco in the five years leading to its peak. We have never seen a parabolic stock chart that ultimately does not undergo significant reversion to the mean, thus paving the way for opportunity.

Nvidia may do very well in the future and the stock may prove to be a wonderful performer from current levels. One analyst speculates that Nvidia will one day claim a $10T market cap. Another analyst, Dan Ives of Wedbush Securities, has become famous for his bullish technology calls and suggests we are at "9pm in an AI party that lasts until 4am". Ives has a $200 price target on Nvidia. Caveat emptor.

Perhaps unfairly, we are picking on Nvidia as emblematic of what's wrong with this highly concentrated market: lack of breadth. Using Relative Strength Index (RSI) to measure momentum, the market-cap-weighted S&P 500 recently traded with an RSI above 70, while the equally weighted S&P 500 traded with an RSI below 50. RSI is measured on a scale of 0 to 100 and readings above 70 imply overbought conditions. With data going back to 1990, this is the first time in history there has been such a wide performance dispersion between market-cap and equally weighted S&P 500.

In previous episodes where markets were similarly concentrated, investors were rewarded for staying the course with an appropriately diversified portfolio. Buying momentum and chasing performance has never been our forte and we remain confident that your portfolio is well-positioned for worthwhile risk-adjusted returns. The longer this dispersion persists, the more optimistic we become for a sustained period of superior performance.

Meanwhile, the core PCE price index came in at 2.6% in May and is glacially moving towards the Fed's 2% target. Softening retail sales are indicative of a weakening consumer, even as the labor market remains steady. ISM Manufacturing has contracted for three consecutive months while ISM Services remain in expansion mode. Industrial production rose by 0.9% in May, its biggest gain since last July. These mixed economic signals do nothing to alter our view that the next move by the Federal Reserve is a cut, perhaps as early as September of this year.

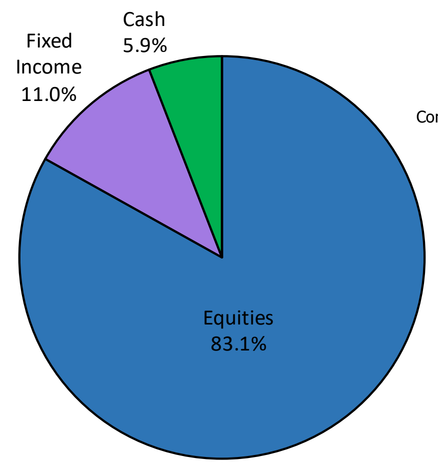
Especially with post-COVID supply chains now functioning, one could make a strong case that stubborn inflation is the Fed's own doing. With high interest rates, cost of capital is such that homebuilders are not increasing supply commensurate with the high demand of millennial homebuyers. Homeowners who bought or refinanced when interest rates were pegged to zero are loathe to sell, further exacerbating supply and forcing would-be buyers to rent at persistently high prices. With owner equivalent rents as the largest contributor to today's above-target inflation, it may take additional economic weakness and subsequent rate cuts to bring the housing market back into equilibrium. Further, with approximately 75% of U.S. wealth in the hands of only 10% of the population, wealthy savers are receiving an estimated $500MM boon on the $6T invested in high-yielding money market funds. Much of this income surplus is undoubtedly driving demand and prices for services.

When the Fed does finally cut interest rates, we expect much of the wide dispersion in stock valuations to close markedly and the equally weighted portfolio to finally have its day. A Fed rate cut will reinvigorate the economy, remove the recession-fear overhang that dogs many cyclicals, increase the allure of more interest-rate-sensitive stocks, and lessen the relative appeal of those Magnificent 7 stalwarts whose premium multiple is predicated on their perceived immunity to the economic cycle. While it may require some patience, our discipline requires that we stay the course with a broadly diversified portfolio of high-quality businesses with proven records of earnings growth, predictable cash flow, and consistent dividend increases. Our approach may be boring, but long-term investors are sure to be rewarded. As Warren Buffet famously quipped: "Beware the investment activity that produces applause; the great moves are usually greeted by yawns."

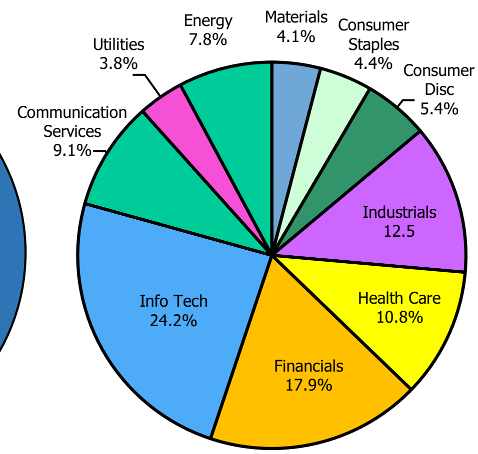
Investment Strategy Summary

As of June 30, 2024

Firmwide Asset Allocation

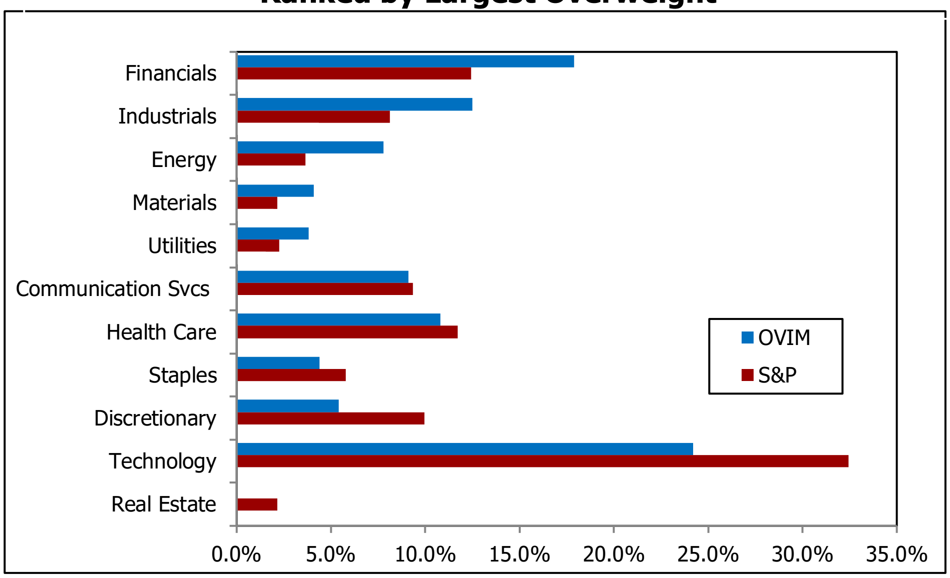


Equity Sector Allocation

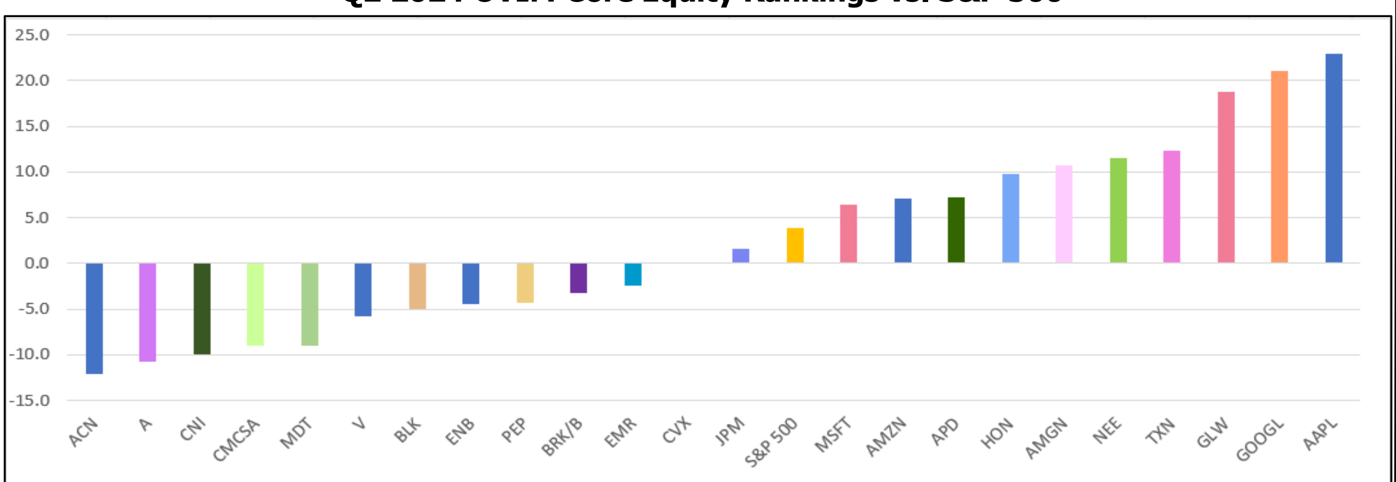


Top Core Global Equity Holdings	
Amazon.com Inc.	AMZN
Microsoft Corp.	MSFT
Apple Inc.	AAPL
Alphabet Inc. Class A	GOOGL
Amgen Inc.	AMGN
BlackRock Inc.	BLK
Visa Inc.	V
Emerson Electric Co.	EMR
Texas Instruments Inc.	TXN
JPMorgan Chase & Co.	JPM
Corning Inc.	GLW
Berkshire Hathaway Inc. Cl. B	BRK/B
Chevron Corp.	CVX
PepsiCo Inc.	PEP
Air Products & Chemicals, Inc.	APD
Honeywell International Inc.	HON
Comcast Corp.	CMCSA
Medtronic PLC	MDT
NextEra Energy Inc.	NEE
Canadian National Railway	CNI
Enbridge Inc.	ENB
Accenture PLC Class A	ACN
Agilent Technologies Inc.	A

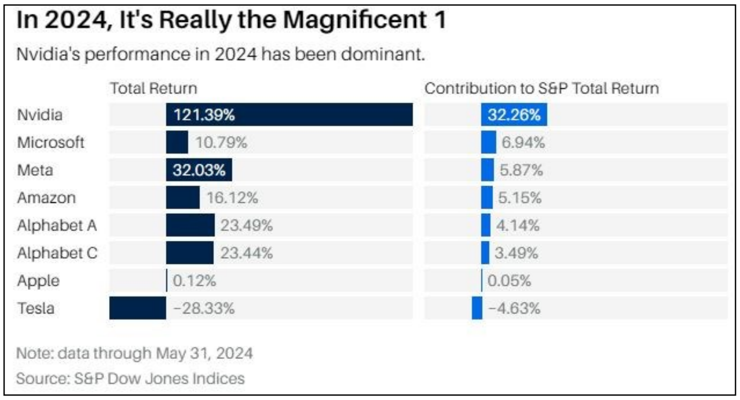
Sector Weightings Relative to S&P 500
Ranked by Largest Overweight

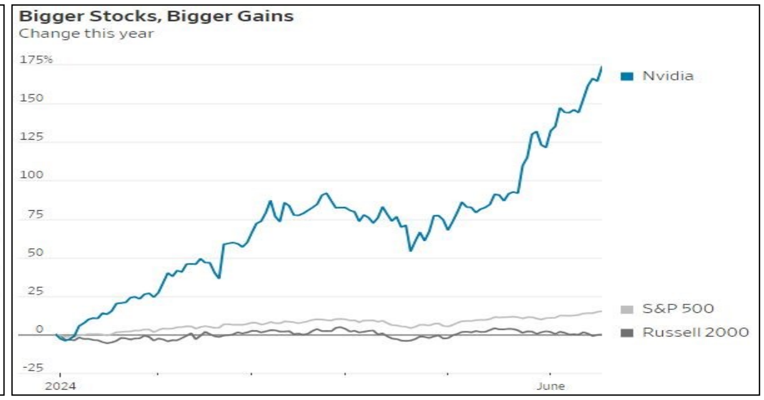


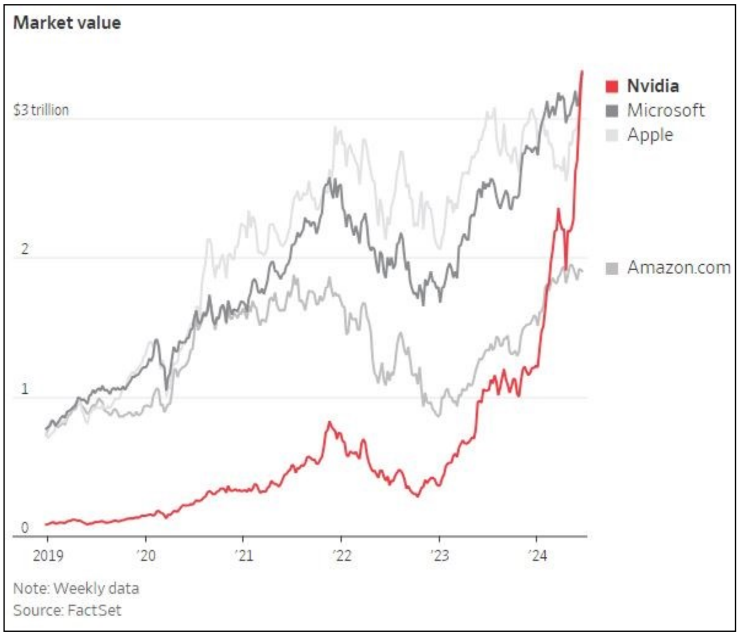
Q2 2024 OVIM Core Equity Rankings vs. S&P 500

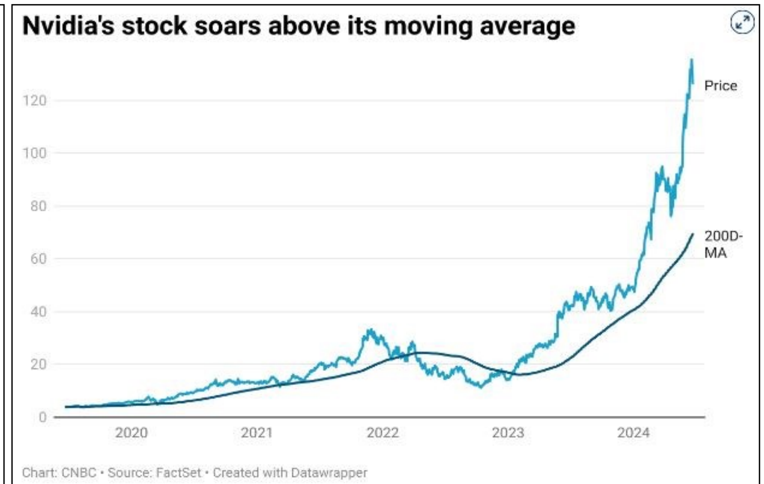


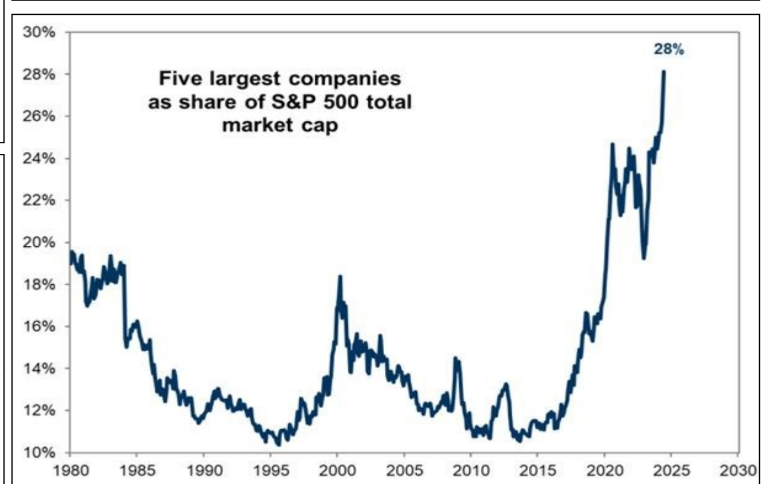
Charting the Markets

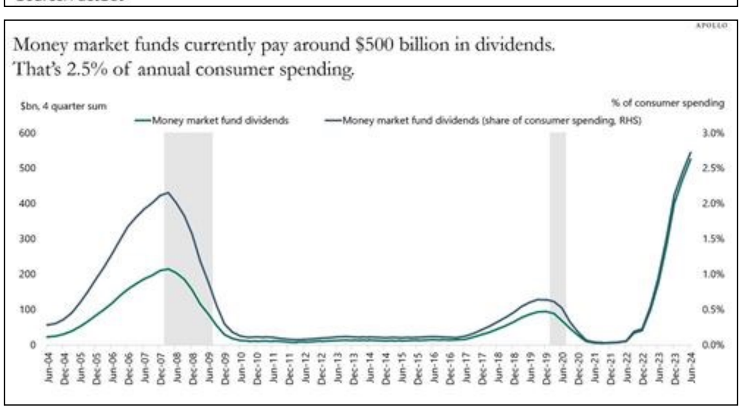


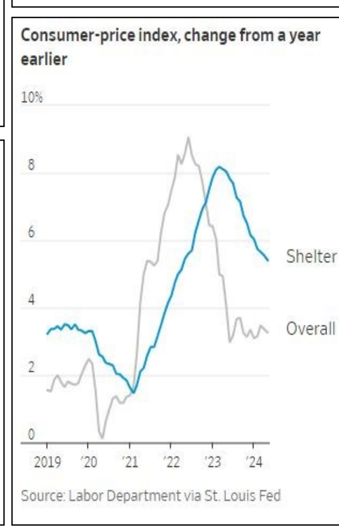


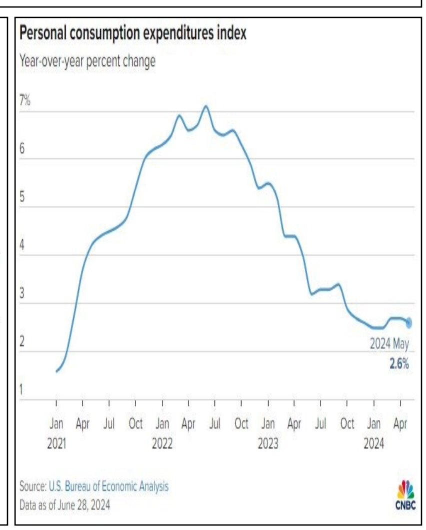












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Using the Annual Gift Tax Exclusion

For many, there is a true joy in gifting and seeing loved ones benefit from the improvement a gift can make in their lives. It may come as a surprise that gifts, which may be made in cash, stock, property, or forgiveness of debt, are taxed by the federal government. While there is no limit on the amount you can gift, there is a limit on the amount you can gift *tax-free*. The recipient typically owes no tax, but gifts may be taxable to the donor.

Gifts are defined by the IRS as "any transfer to an individual, either directly or indirectly, where full consideration is not received in return." Congress permits donors to gift a certain amount tax-free each year without reporting the gift to the IRS. This per-recipient limit is referred to as the annual gift tax exclusion and is employed strategically to reduce the value of large taxable estates.

The two factors that determine whether gift tax is owed are the lifetime gift tax limit, referred to as the lifetime federal estate and gift tax exclusion, and the annual gift tax limit, referred to as the annual gift tax exclusion. Taxable gifts are those that exceed the annual gift tax exclusion and are subject to the lifetime federal estate and gift tax exclusion, the amount that can pass to heirs tax-free. The 2024 lifetime federal estate and gift tax exclusion is $13,610,000 for an individual or $27,220,000 for a married couple. If your gift to any one person in the tax year exceeds the annual gift tax exclusion ($18,000 per recipient in 2024), you must file a gift tax return in addition to your federal tax return. The amount of your gift exceeding the annual exclusion will be subtracted from your lifetime federal estate and gift tax exclusion.

Gifts below the annual gift tax exclusion are not required to be reported to the IRS. In addition, gifts to spouses (certain rules may apply if the spouse is not a U.S. citizen), gifts of tuition paid directly to an educational institution, and gifts of medical bills paid directly to a hospital are generally not subject to tax. Once your lifetime federal estate and gift tax exclusion has been exhausted, you will begin to owe gift tax. If no gifts are made during your life, you will have your entire lifetime federal estate and gift tax exclusion ($13,610,000 per individual or $27,220,000 for a married couple in 2024) to pass to heirs tax-free.

The annual gift tax limit ($18,000 in 2024, up from $17,000 in 2023) is usually adjusted for inflation. To qualify for the annual gift tax exclusion, a gift must be of present interest, a gift the beneficiary can access and use immediately. The value of all gifts made to an individual during the year, whether those gifts are cash, stock, or property, count toward the annual gift tax exclusion.

Gifts of appreciated stock prevent the donor from having to pay capital gains tax that would have been incurred if the stock was sold and converted to cash. The recipient of appreciated stock will receive the donor's cost basis and may incur capital gains tax upon sale. However, this may be a great strategy for a recipient who is in a lower tax bracket than the donor. The value of gifted stock for gift tax purposes is the fair market value of the stock on the date the stock is gifted.

Gifts to minors qualify for the annual gift tax exclusion. While a minor cannot have their own bank account, gifts to a custodial account or a 529 tax-advantaged college savings account qualify. In addition, a special rule referred to as "superfunding" allows 529 donors to spread one-time gifts across five years of gift tax exclusions. Assuming no other gifts to a specific beneficiary, a 529 college savings plan can be superfunded by a single contributor up to $90,000, or a married couple up to $180,000, in 2024. However, a gift tax return must be filed, five-year gift tax averaging must be elected, and the entire 529 contribution is spread over five years.

In determining potential gift or estate tax due, a taxpayer needs to consider both the federal and state gift and estate tax. While California does not have an estate tax there are 12 states plus Washington D.C that do (including Washington, Oregon, Minnesota, Illinois, Maryland, Vermont, Connecticut, New York, Rhode Island, Massachusetts, Maine, Hawaii, and Washington D.C.).

Please contact us if you would like to discuss and illustrate how annual gifting may be incorporated into your personal financial plan.

DeLynn Russell and James Van de Voorde

Sources: irs.gov, smartasset.com, schwab.com, Kiplinger.com, savingforcollege.com