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Markets continue to post new all-time highs even as uncertainty about Fed rate cuts and the long-term impact on growth persists. The Bulls are in firm control of the narrative for the equity markets even as valuations get stretched to levels not often seen in our lifetimes. For example, the Shiller CAPE (cyclically-adjusted P/E ratio) is currently trading 70% above its long-term average. Today's reading is 34.7 compared to an average of 20.3.

Why are stocks able to withstand the uncertainty about the Fed and economy? It is all about earnings. 1Q24 earnings just completed their reporting cycle and according to FactSet, it was another stellar quarter. For the quarter, 78% reported a positive earnings surprise, slightly ahead of the 77% average over the last 5 years. Sixty-one percent of companies reported higher than expected revenues, just below the long-term average. Q1 earnings came in a strong 6.0% higher than Q1 of 2023, handily beating the forecast for an increase of 3.4%, and the highest year-over-year jump in earnings since 1Q2022 when the comparison was in the midst of COVID closures.

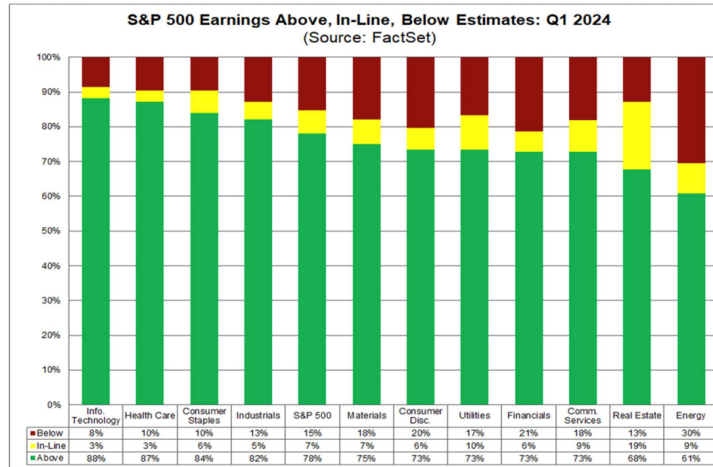
Long-term investors understand that often forward guidance from companies is as important as the current results. For the quarter, 60 companies guided earnings lower for Q2 while 41 increased guidance. Looking at sectors, 8 of 11 sectors reported year-over-year growth with only Energy, Healthcare, and Materials showing a decline. Median estimates for full year 2024 show earnings growth of 11.4% over 2023 that may be the justification for trading at 20.5 times trailing 12-month earnings when the 5-year average is 19.2 and 10-year average 17.8.

AI has become a driving force for equities and not just for the highflyers like Nvidia or Qualcomm. FactSet reported that 199 companies referenced AI in their earnings calls, the highest number in history and included 91% of all technology sector companies. On average, companies made mention of AI a total of 11 times in their latest earnings calls. AI is in the early stages of transforming how companies operate and behind an expected surge in productivity and rising corporate profit margins. Goldman Sachs recently reported that AI is likely to replace 300 million full-time global jobs by the year 2030 and be a source of new job creation for engineers and computer scientists.

Many commentators believe buying, or holding, equities when markets are overvalued exposes investors to greater levels of risk, but the data does not necessarily support that. It is

correct that when valuations get stretched to levels seen today it typically ends in a multi-year bear market but the timing of when the bear market starts may surprise you. Bloomberg data shows that since 1950, investing when markets hit an all-time high resulted in average gains over the next 12 months of 12.7%. A driving force behind this is recency bias where investors get conditioned to believe the stock market will continue to make new highs indefinitely. Valuation metrics like P/E ratio or Shiller's CAPE are historically not reliable indicators of short-term (12-18 months) market direction. Market technicals or momentum tend to be more prescient at predicting the market's short-term trajectory and they look strong right now. The S&P 500 is trading about 140 points over its 50-day moving average and 90 points above the 200-day moving average. It would take more than a 5% correction from current levels to turn the momentum factor bearish for stocks.

Inflation continues to be the greatest threat to the market's persistent climb. Consumer Confidence rose in May after 3 consecutive months of declines but remains at 2016 levels. The survey's questions about future Expectations is probably the most concerning data point as consumers remain rather sanguine about the future. The Expectations index has been steadily declining since late 2018 and shows no signs of reversing that trend. It clearly has not been a market moving data point but suggest weakness could persist if upward momentum is lost.



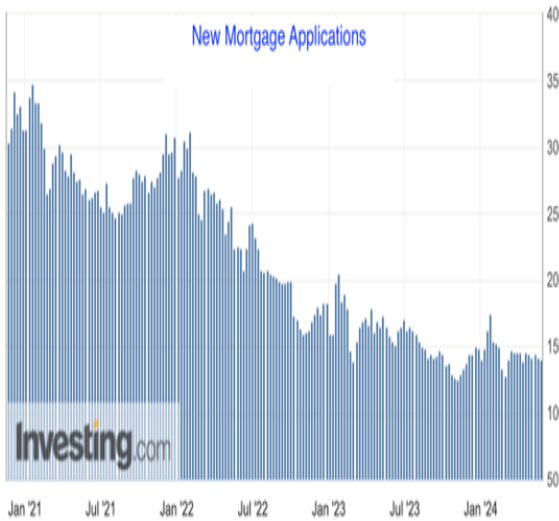
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Quite possibly the best explanation for the market's continued upward trajectory lies in the lack of attractive alternatives. At both the institutional and retail levels, the bond market, even with substantially higher yields than 18 months ago, has little trust with investors. While most investors expected the Fed to be cutting rates by mid-2024 based on prior guidance, there remain many questions about when the Fed will actually feel it is safe to cut short-term rates. Inflation figures continue to suggest the Fed might be forced to hold off on cuts as the Fed targets 2% inflation. The latest PCE remained at 2.84%, down from 4.78% a year ago but slightly higher than February figure. Wholesale inflation just posted the largest monthly gain in a year at 0.5% (6.0% annualized). As bond market uncertainty remains, stocks may be the safest place to park capital.

Rating the Housing Market

The housing market is currently frozen as neither buyers nor sellers are finding attractive real estate options and the thawing process is likely dependent on a single factor: interest rates. The average 30-year mortgage rose back above 7% in April for the first time in 2024 as persistently high inflation keeps the Fed sitting on their hands. April was a dismal month for real estate; sales of New Homes plunged by 4.7%, sales of Existing Homes dropped by 2% and Homebuilder sentiment was sharply lower. Buyers cannot afford the payments at current prices with 7% mortgages and sellers are hesitant to sell and lose their existing 3% mortgages. Home prices have not declined sufficiently to correspond with wages making home affordability very difficult for many.

- Many buyers are turning to creative ways to make purchasing a home work financially such as renting part of the house on Airbnb to generate income to make mortgage payments.
- International purchasers of US real estate are concentrated in only a dozen or so cities but have seen substantial decline with YTD purchases 9.6% lower than last year.
- According to the National Assoc of Realtors, mortgage rates need to drop to approximately 5% to spur necessary activity in the housing market which may take as many as 8 Fed rate cuts.



Gold Continues to Shine

Investors should not be surprised by gold's recent surge, given the inflation outlook and the Federal Reserve's interest rate policy. Go back to the end of last year and the expectation was that by now, the Fed would be poised to cut interest rates as CPI approached the central bank's 2% target. Fast forward six months and the inflation outlook is less certain. The higher-for-longer scenario seems more likely now, with rate cuts perhaps not coming until 2025. As the chart to the right illustrates, investors have hedged inflation with gold, thus sending the precious metal higher by roughly 13% for the year.

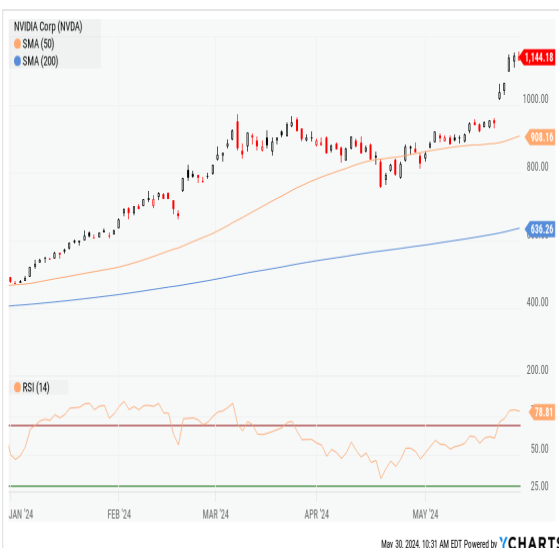
- If we don't see a downward trend in year-over-year core CPI, gold likely has further upside as investors will continue to hedge anticipated inflation. A weaker dollar over the past month has also supported gold's move higher.
- Gold has exhibited a low return correlation to equities. Its allure as an equity diversifier is bolstered by the fact that Treasuries, since 2022, have offered no cover from equity volatility as rates accelerated higher. However, if longer-term rates drift higher the opportunity cost of holding gold – which pays no interest – will increase and thus be a headwind for the current rally.



AI Powerhouse

If you've paid any attention to markets over the last year, you've likely heard of the truly remarkable run Nvidia Corp (NVDA) has been on since the lows of October of last year where the stock has appreciated by more than 190%. Year-to-date, the stock is up by more than 130% and is quickly approaching a \$3 trillion market capitalization. After reporting yet another blowout quarter, set the stage for record future performance with a solid second-quarter outlook and announced a 10-for-1 stock split. Nvidia's blockbuster earnings report appears to signal that the AI spending boom shows no signs of abatement. Additionally, with a 10/1 stock split that is set to take place later this month, current investors could be looking to capitalize on what could be an opportunity for the broader investor community to access and own shares of the company.

- The Relative Strength Index currently sits at 80 signaling a rally that is potentially overdone.
- While stock splits have no impact on the underlying fundamentals of a company, nor do they impact a company's market value, they are a historically bullish signal as average returns one year later are 25% vs. around 12% for the broad market according to an analysis from Bank of America.
- NVDA is set to undergo a 10/1 stock split on June 10th. The last stock split occurred in July of 2021 and subsequently saw shares rise more than 78% before falling 65% over the next 12 months.



Quinn VandeKoppel

Macro View – New Fed President

Last week, the Federal Reserve Bank of Cleveland announced that Beth M. Hammack, a former long-time executive at Goldman Sachs, would be the new President following Loretta Mester's retirement at the end of June due to the Fed's mandatory age and length-of-service policies. Hammack, who was most recently the co-head of global financing at Goldman, is set to join the Federal Reserve during a critical time as the Fed weighs whether to cut rates from more than a 23-year high before year end. There is much debate amongst Fed Officials as many expect rates to stay elevated for longer than originally expected following hotter than expected inflation reports over the first half of this year. Mester was amongst those who were particularly cautious about rate cuts this year and added that she wanted to see "a few more months of falling inflation data" before voting to cut rates.



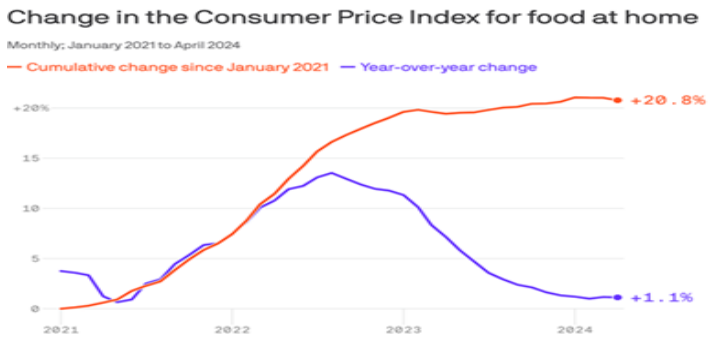
Fixed Income – Less than optimistic

As economic data continues to emerge, it appears increasingly likely that investors will have to wait at least until the end of the summer before any near-term policy changes are made by the Federal Reserve. According to the CME's Fed Watch Tool, the probability of a rate cut during the next two upcoming FOMC meetings is 0% and 10.2%, respectively. Minutes from the last Federal Open Market Committee meeting also indicate that central bankers still lack the confidence to cut rates, with a few even suggesting they could be open to hiking if inflation worsens. Markets are predicting the first 25 basis point rate cut of the year in September's meeting, but the probability of this happening is only 41.7%. As inflation remains above the Fed's stated goal of 2%, investors who initially anticipated as many as six interest rate cuts this year are now beginning to consider the possibility of no rate cuts at all.



Taking Stock – Just as Bad as you Might Think

While inflation has decreased from its peak of 9% in mid-2022 to approximately 3.4%, the impact of high prices continues to affect many Americans daily. A trip to the grocery store serves as a constant reminder that inflation is still a pressing issue. As shown in the chart below, since President Biden took office in 2021, the inflation rate for "Food at Home" (basic necessities purchased at the supermarket) has increased by 1.1% year-over-year, according to the Bureau of Labor Statistics. Although this might not seem significant on an annual basis, the cumulative increase of 20.8% over the same period is far more concerning. In addition to the rising cost of groceries, dining out has also become more expensive, with prices increasing by 4.1% over the last year and 22% cumulatively since 2021. With the presidential election approaching later this year, inflation has become a crucial issue for voters and could be a decisive factor in the outcome.



Technical – Seasonality

As we head into the last few days of May, it seems the seasonal adage "sell in May and go away" will not apply this year. After a decline of more than 4% in April, markets quickly rebounded, with the S&P 500 (SPX) now set to finish the month up by over 5%. If the seasonal stock market theory did not hold true for May, could we potentially see a pullback next month as we approach the second half of the year? The large-cap index surpassed its previous all-time high just a few days ago and has been on an impressive run since the lows of October 2023. Since setting a new high, markets have pulled back and are now sitting at a critical support level of 5264. If this level fails to hold, the next downside support can be seen at 5100, representing about a 3% decline from current prices. However, if economic data begins to show positive improvements toward inflation, markets could continue to climb higher from here.



Performance Update

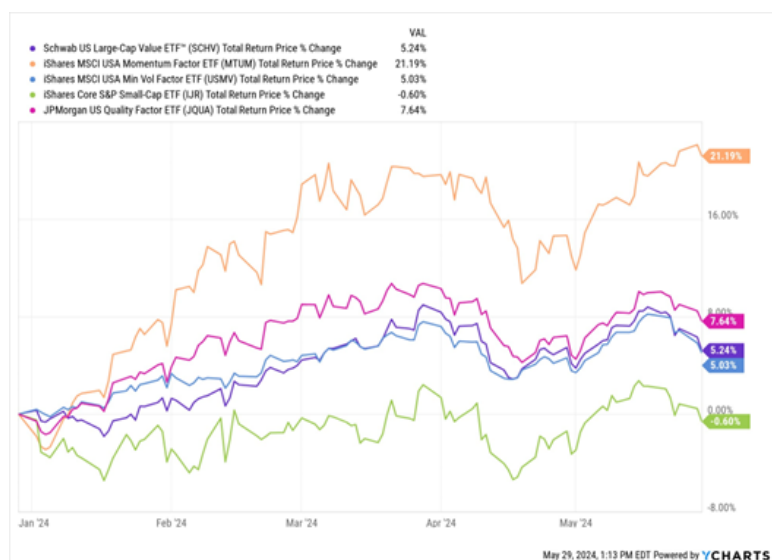
Clint Pekrul, CFA

Returns this year have been somewhat of a mixed bag. Domestic large cap stocks, as measured by the S&P 500 Index, stormed out of the gate in the first quarter but have leveled off entering the end of May. We've seen a similar pattern from developed and emerging markets overseas, as measured by the MSCI EAFE and EEM Indexes, respectively.

Unlike equities, which are generally higher for the year, fixed income, as measured by the Bloomberg Aggregate Bond Index, has drifted lower in 2024 as yields have risen. One exception is high yield, as measured by the ICE US High Yield Index, which is modestly higher for the year.

Given the inflation backdrop, commodity prices have surged in 2024, as measured by the GSCI Commodity Index. By sector, agriculture and base metals have led the way. Gold has also surged higher for the year as investors look for a store of value.

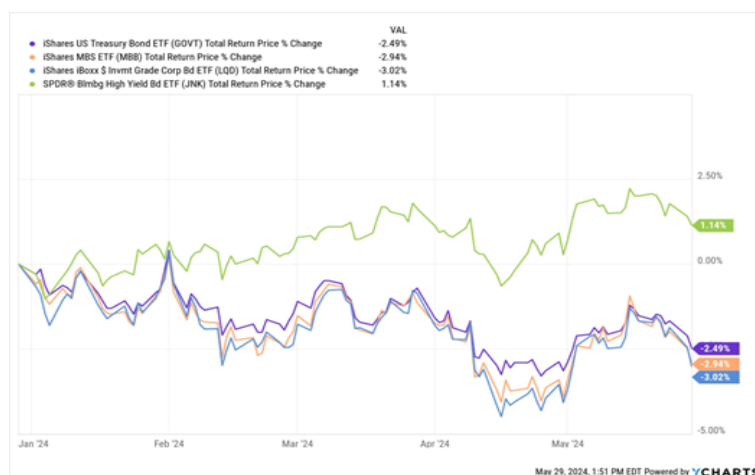
Equity Factor Performance – Bifurcation Continues



The momentum factor has captured much of the domestic equity returns for the year. The MSCI Momentum Index has surged just over 20% year-to-date, driven in large part by Nvidia, Broadcom and Meta Platforms. Likewise, high-quality stocks are higher by roughly 8%, as measured by the JPM High Quality Index.

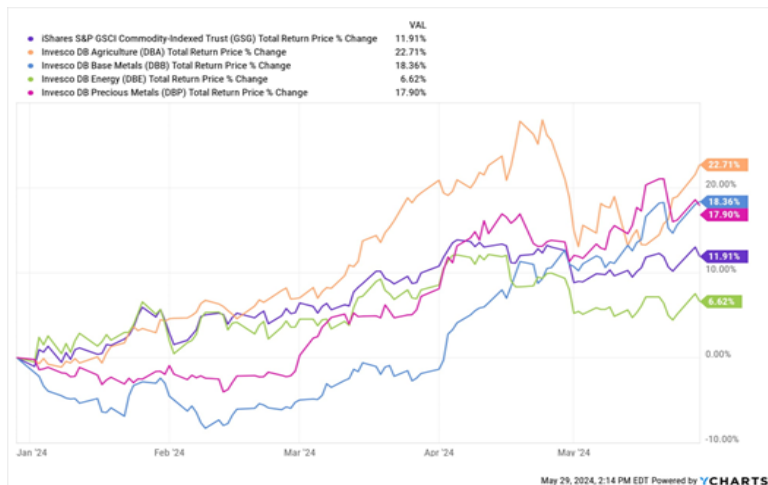
Low volatility stocks, which are generally more defensive than the overall market, have edged higher by roughly 5% in 2024, as measured by the MSCI Minimum Volatility Index. Investors continue to shun value stocks in a trend that extends back to 2020. The Schwab US Value Index is modestly higher by roughly 5% this year but lags the overall market. Meanwhile, small cap stocks, which face significant headwinds from higher interest rates, have more-or-less been flat for the year as measured by the S&P 600 Small Cap Index.

Fixed Income – Headwinds Remain



The benchmark 10-year Treasury yield has risen by about 0.75% this year. Consequently, many sectors of the bond market have pushed lower in 2024. Investment grade bonds are down by roughly -3% as measured by the iBoxx Corporate Bond Index. Likewise, mortgage-backed and US Treasury Bonds are lower by roughly -3% for the year as measured by the Bloomberg Mortgage-Backed and Treasury Bond Indexes, respectively. High-yield bonds, however, have managed a modest gain of roughly 1% based on the Bloomberg High Yield Bond Index.

Commodities – Inflation Surge



Commodities are generally higher for the year. The agriculture sector has surged 22% as measured by the DB Agriculture Index. Likewise, base and precious metals are higher by roughly 18% in 2024, as measured by the DB Base and Precious Metals Indexes. Energy prices, as measured by the DB Energy Index, are higher by approximately 7% for the year. The inflation theme is transparent considering that input costs are higher across all commodity sectors.

Q: Should stock splits matter to investors?



Contrary to what many advisors or analysts suggest, yes, investors should take note of stock splits as data suggests it does make a difference in expected returns. To be clear, a stock split does not in any way change the fundamentals of the company whose shares split. Their EPS or earnings per share are unchanged as is their market cap. Having ten \$1's is no better than a single \$10 bill. It is the reason behind why stocks split and what it does to their potential liquidity profile that tends to move the needle. Seldom will you see a company announce a stock split when their shares are in a consistent decline. This means the potential universe of companies announcing a stock split are typically seeing strong earnings growth and rising stock prices. In the case of Nvidia's recent announcement of a 10-for-1 split on June 10, a single share of NVDA will fall from approximately \$1,000 to around \$100. This makes the stock easier to purchase for employees and retail investors thus potentially increasing demand for the stock and creating upward pressure on its price. Historically, stocks that split generate 12-month returns that are more than double the average stock in the index but little data exists to pinpoint the driver of the excess returns. I expect several additional stock split announcements this year as 36 S&P 500 companies stock price is above \$500 and 8 companies have stock over \$1,000 per share.



Publicly traded companies that have experienced considerable share value appreciation often split their stock. For example, if a company with one million shares outstanding split their stock two-for-one, the available shares would increase to two million. Consequently, the price of each share would be cut in half. An investor who owned one share for \$100 prior to the split, for example, would subsequently own two shares of stock valued at \$50 per share. No economic value is created or destroyed through the split transaction. So, why do companies initiate stock splits?

Generally, the primary catalyst is to generate trading volume so that a company's shares can be more easily bought and sold in the secondary market. Trading in \$50 share increments, for example, will likely attract more trading volume than \$1000 share increments, particularly among retail investors. Many of the world's largest companies – Apple, Microsoft, etc., – have undergone stock splits over the years, and the process has not impacted their bottom-line profitability. Conversely, some stocks have never split. Most notably is the A share class for Berkshire Hathaway, which trades at roughly \$610k. The bottom line is that stock splits don't create shareholder value. Investors should be more concerned with a company's long-term profitability.

Q: How much should climate change impact investment decisions?



If you are an ESG (environmental, social, governance) investor it probably impacts your decision making a lot. Investors with no ESG mandate probably will fare best not making bets based on climate change in their portfolios. Every multi-national corporation today has a policy about climate change and what they are doing to be good global citizens suggesting climate change does impact almost all levels of investing albeit indirectly. While the data is somewhat mixed, according to Morningstar, 82 of the 146 ESG indices underperformed their equivalent non-ESG counterparts in 2023 and the results were worse for ESG indices in 2022. Many investors have speculated that the attention given to climate change by governments and potential spending to offset carbon footprint should benefit stocks that help facilitate those goals. In reality, a lot of the companies spawned to facilitate carbon neutral have failed despite massive levels of government subsidy. Most famously, solar power manufacturer Solyndra received more than \$529 million from the US government yet went bankrupt. Just recently, electric car maker Fisker, filed for bankruptcy even after receiving more than \$200 million in government subsidies. Other notables include Sun Power, VPG and ECOtality, all received massive amounts of government funding before going broke. Investors should do far better in their decision making by sticking to company fundamentals and technical indicators like moving averages, rather than esoteric criteria like climate change.



Investors shouldn't underestimate the economic ramifications of climate change over the coming decades. Its impact is felt across most industries, from agriculture to insurance and construction. According to Aon, a business consulting firm, damage from global natural disasters in 2023 totaled \$380 billion. Climate change will likely impact frontier and emerging market countries more so than developed market economies. Companies will have to adopt new technologies and adhere to new regulations in response to climate change initiatives. The consequence is additional costs that will ultimately impact the bottom line and shareholder returns.

But with the challenges come new opportunities, particularly with new technologies. For example, according to the World Economic Forum, research indicates that the climate solutions enterprise value could add \$5-\$11 trillion by 2030. Capital expenditures in climate change solutions continues to rise, reaching \$1.7 trillion in 2023, according to the International Energy Agency (IEA). These investments made today will likely pay dividends down the road. Likewise, based on a study by FTSE Russell, the green economy has the potential to expand from roughly 8% of today's global listed market capitalization to approximately 12-17% by 2030. According to the IEA, the fastest growing opportunities to net-zero emissions are in biofuels and electricity storage. For investors willing to take the risk, the payoff could be substantial.



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