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Chartwell Current Outlook and Investment Strategy

Macroeconomic Update

We've mentioned multiple times over the last two years that monetary policy operates with lags of uncertain duration. Thus far in 2024 it seems that the uncertainty is dissipating as the sharp rise in interest rates over the last two years is beginning to bite. U.S. economic growth has clearly slowed from 2023's robust level. The Atlanta Federal Reserve's GDPNow™ (Federal Reserve Bank of Atlanta, Center for Quantitative Research) estimates annualized second quarter GDP growth of 1.5%, as of July 3, 2024, on par with first quarter 2024 GDP growth of 1.4%. After a fleeting pop into expansionary territory at the end of the first quarter of 2024, the manufacturing sector moved back into contractionary territory for the entire second quarter. The Institute for Supply Management Manufacturing Index (June 2024 Manufacturing ISM® Report On Business®) for June registering 48.5. All the index's sub-components, except for Prices Paid, were sub-50.

The U.S. economy's performance in the second quarter was consistent with the Federal Reserve's policy goals of slowing economic growth and moderating wage pressure without sending the economy into a tailspin. The "Core" Consumer Price Index of 3.4% in June is clearly above their long-range 2% target, but the trend is their friend. A continuation of that trend will lead to the reduction of rates perhaps as early as this Fall. A reversal of that trend will push interest rate reductions into 2025 at the earliest. None-the-less, current fundamentals remain a positive foundation for further economic growth over the near term, albeit at lower levels than we've seen over the last few years.

	QTD	YTD
Equities		
Large Cap	4.3%	15.3%
Large Cap Growth	8.3%	20.7%
Large Cap Value	-2.2%	6.6%
Small Cap	-3.3%	1.7%
Small Cap Growth	-2.9%	4.4%
Small Cap Value	-3.6%	-0.9%
Fixed Income	-0.1%	-0.5%
High Yield	1.1%	2.6%
Cash	1.3%	2.7%

*Please see endnotes for asset definitions

Equity Market Update and Outlook

Equity markets have exhibited robust headline performance this year, highlighted by the S&P 500's 4.3% increase this quarter and culminating in a 15.3% rise for the first six months of 2024. Large-cap technology stocks have been a significant force behind this growth, with the Russell 1000 Growth index up 8.3% for the quarter and 20.7% for the year. Much of this increase can be attributed to investors seeking out companies that benefit from the adoption of artificial intelligence (AI). Within the S&P 500, the technology sector saw a 13.8% increase this quarter and a notable 28.3% for the year. NVIDIA, the producer of graphics processing chips powering artificial intelligence, is the company most often identified as a beneficiary of AI spending and its stock jumped 37% in the second quarter putting it up an impressive 149% in the first half of the year. Other major tech companies like Google, Meta, and Amazon have also contributed significantly, accounting for half of the S&P's total annual return on the year. In contrast, sectors not driven by AI have experienced more modest movements. For example, the R2000 index of small caps decreased by 3.3% in Q2, with only a 1.7% increase over 2024. Additionally, six out of eleven economic sectors have seen declines this year, highlighting the mixed performance. Investor expectations of rate cuts were dampened by higher-than-anticipated inflation, which pushed the U.S. Treasury note yield to 4.34% from 3.86% at the beginning of the quarter. Additionally, the economic growth and corporate earnings outlook remained uncertain, with real GDP expected to slow down slightly from 2023's 2.5% growth rate. Both of these factors played a role in dampening enthusiasm for certain parts of the equity market.

As we look ahead, the economic landscape presents a promising outlook for equities. Economic growth is normalizing at a 2% trend and with inflation showing signs of easing, the stage is set rate cuts by the Federal Reserve. In this climate, we recommend maintaining exposure to leading companies like those included in the so-called the Magnificent 7.[1] Their pioneering efforts in artificial intelligence are not just buzzwords but are expected to drive real productivity gains in the workforce. Indeed, the capabilities of such technology are exemplified by tools like Microsoft's CoPilot, which was extremely helpful in drafting this very communication. In addition, we are broadening our investment opportunity set by increasing exposure to companies poised to benefit from a lower interest rate environment. Recent portfolio additions have been selected for their potential to outperform in such conditions, reflecting our proactive approach to capturing growth opportunities. As always, we remain committed to investing your capital behind companies that we expect will grow their earnings power at a superior rate over a multi-year time horizon.

[1] Magnificent Seven- Alphabet (Google), Amazon, Apple Inc., Meta (FaceBook), Microsoft, Nvidia, and Tesla.
Holdings are subject to change. A full listing of portfolio holdings is available upon request.

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Fixed Income Market Update and Outlook

The high-grade bond market posted relatively flat returns during the quarter. Interest rates rose approximately 20 basis points across various points of the yield curve. Given this uniform rise, longer duration bonds underperformed. An additional headwind for longer duration bonds was the inverted yield curve, which creates an environment where shorter-dated bonds yield more than longer maturities. With high grade corporate credit and mortgage spreads remaining relatively stable over the quarter, duration and carry were the main determinants of relative performance across different fixed income markets.

Going forward, the winds of economic change appear to be shifting, creating opportunities in fixed income. While some service-related areas of the economy remain firm, retail spending, manufacturing and homebuilding are important areas of activity that have recently slowed. In prior economic cycles, these may have already been sufficient catalysts for the Federal Reserve to lower interest rates. In the current cycle, while inflation is trending lower, it is not yet in the eyes of the Federal Reserve reliably trending lower towards their stated target. Consensus is for one or two rate cuts before year end, but at this point that is far from certain as we believe several unique factors are underpinning inflation, including a shrinking workforce, energy transitions, loose fiscal policy, and resultant large budget deficits. If or when the economy weakens further, we are reassured that on average, corporations have conservatively managed their credit profiles over the last few years. While risk premiums in corporate credit (i.e., spreads) may not look particularly appealing in a historical context, the high-grade market's absolute yield of 5.6% and relatively strong corporate credit profiles warrant continued investor consideration.

Chartwell News

With the transition to a more diversified equity approach now largely complete, we are pleased to note that there are no significant announcements to share this quarter. We thank you for the continued confidence you've placed in Chartwell Investments. As always, please do not hesitate to call your Chartwell Investment Team; Pete Schofield (610.407.4858) or Mark Tindall (610.407.4835).

Bloomberg US Aggregate Bond Index or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors frequently use the index as a stand-in for measuring the performance of the US bond market.

Bloomberg US Corporate Index Average Option-Adjusted Spread (OAS) are the calculated spreads between a computed OAS index of all bonds in a given rating category and a spot Treasury curve. An OAS index is constructed using each constituent bond's OAS, weighted by market capitalization. The Corporate Master OAS uses an index of bonds that are considered investment grade (those rated BBB or better).

Dow Jones Industrial Average is the DJIA or "The Dow" is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The Nasdaq Composite Index is the market capitalization-weighted index of more than 2,500 common equities listed on the Nasdaq stock exchange.

Russell 1000 Growth Index measures the performance of the US large-cap companies whose earnings are expected to grow at an above-average rate relative to the market. It is a subset of the Russell 1000 Index. To refl ect the growth style characteristics, the index selects the companies that exhibit growth characteristics, i.e. higher price-to-book ratios and higher forecasted growth. Like other growth indexes, the index is largely biased toward the Information Technology sector which represents more than 40% of the index.

Russell 2000 Growth Index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small-cap stocks.

Russell 2000 Index: London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). ©LSE Group 2023. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trade mark of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

Russell 1000 Value Index measures the performance of the large-cap value segment of the US equity universe. It includes the Russell 1000 companies with lower price-to-book ratios and lower expected growth values.

S&P 500® Index: (registered trademark of The McGraw-Hill Companies, Inc.) is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.

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