



BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, JULY 2024

Enthusiasm for the "Magnificent 7" mega-technology stocks and AI has driven remarkable gains in the equities market. The Magnificent 7 stocks have shown resilience too, continuing to rise even when the markets do not. The stock market has registered more than 35 record closes this year—an exceptional number for the first half of the year. However, without Nvidia, Alphabet, Microsoft, and Apple, the S&P 500 index's 4.28% second-quarter gain would have been erased.

Despite the focus on AI-driven technology stocks, many of your Blue Granite portfolio holdings have also performed quite well. Year-to-date, Walmart has gained 30%, Costco 32%, Bank of America 20%, JP Morgan 20%, Eaton 31%, Applied Materials 46%, RTX Corp 21%, and Qualcomm 39%. One-year returns are even more impressive for these stocks and other holdings in your portfolio.

Currently, stocks are trading at some of the highest valuations seen in the last twenty years, raising questions about potential market risk. However, robust economic growth is essential to sustain the market's momentum. Despite stocks reaching new highs, we see signs of slowing growth. Consumer spending is weakening, and government reports on manufacturing and services may be signaling an economic correction, with new and existing home sales and building permits turning negative. Both manufacturing and services have declined for the first time since May 2020, a pattern that has historically preceded recessions in 15 out of 17 instances. While we do not predict an imminent recession, caution is warranted, especially following the market's spectacular 25% run over the past year.

Investor confidence remains high, driven by potential interest rate cuts by the Fed. However, Fed Chair Jay Powell's recent Senate testimony highlighted that while the labor market has cooled and inflation has moderated, more data is needed before lowering rates. The risk is that delaying too long could jeopardize economic growth. Additionally, stocks tend to perform well in election years due to campaign promises, but any euphoria should be tempered by current economic conditions.

Conditions are positive for the rest of the market to rally while the AI and tech sectors consolidate. The gains in AI and tech have stretched valuations excessively, and history shows that such concentrated rallies can lead to significant selloffs. Your portfolio holds companies with strong financials, clear long-term growth prospects, and dominant industry positions. While there has been some lag compared to recent big tech returns, your portfolio is well positioned for long-term success. Decades of market history remind us that overheated sectors often cool off, while high-quality, established, and profitable companies drive long-term performance.

Unemployment has been rising steadily since April last year, from a 54-year low of 3.4% to a recent 4.1%. Rising unemployment and reports of an economic slowdown are recessionary

indicators that invite caution. Given the significant stock market rally over the past year, Blue Granite will continue to exercise caution and adhere to our investment strategy. We are confident in your portfolio's blend of high-quality stocks and bonds, designed to protect your assets, grow them conservatively, and generate increasing cash through dividends and bond interest.

Final observation. On July 11th, a significant market trade occurred with mega-cap stocks, particularly big tech and the Mag 7, declining while the rest of the market rose substantially. This "reversion to the mean," where stocks converge to their long-term averages, may signal a shift from the overly concentrated rally and excessive enthusiasm for tech and AI stocks. The AI trend has led to underperformance in global portfolios by overshadowing other sectors in the S&P 500 Index, might now begin to level the playing field for all stocks, reflecting our earlier commentary.

Wishing you the best for the rest of your summer!

Warmest regards,

Scott, John & Dave