# NEW REPUBLIC PARTNERS

**MARKET COMMENTARY**

**Q2 2024**

NEW REPUBLIC PARTNERS

# Market Commentary

| Market Monitor 2024 | Q2 | YTD |
|---|---|---|
| MSCI All-Country World Index | 2.9% | 11.3% |
| S&P 500 Index | 4.3% | 15.3% |
| Bloomberg U.S. Agg. Index | 0.1% | -0.7% |
| Bloomberg Commodity Index | 2.9% | 5.1% |

## Narrow Leadership Across Equity Markets

One theme that defined equity market performance in Q2 and 2024 YTD was narrow leadership, no matter how one sliced it:

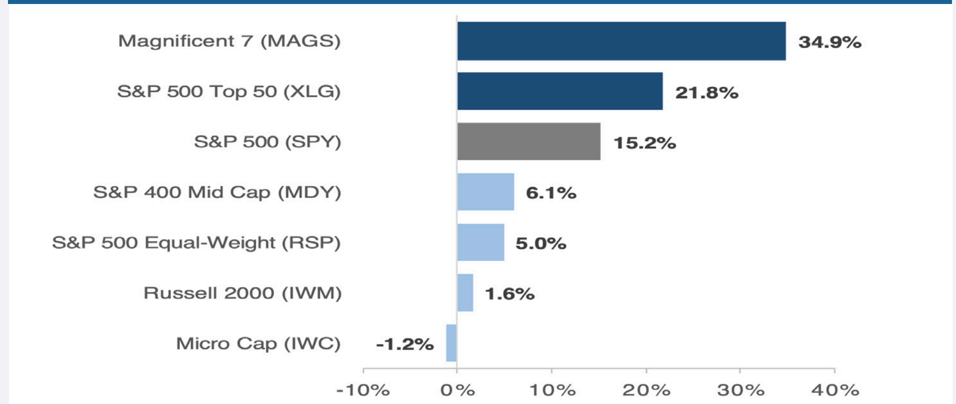
- The S&P 500 index gained +4.4% in Q2. In contrast, the Russell 2000 index of small cap companies fell by -3.3%.
- Even in Emerging Markets, the MSCI EM index (+4.1%) was narrowly driven with over half the returns coming from two stocks, TSMC and Tencent.

And the same applies for the first half of 2024:

- The Equal-Weight S&P was up 3.7% for 1H 2024 vs. 15.5% for the S&P 500.
- The Magnificent 7 was up 33% YTD and drove 60+% of the index's return, while the S&P 500 ex the Mag 7 was up 5%.
- Across the pond in Europe, the top eight names have driven nearly half the index return year-to-date.

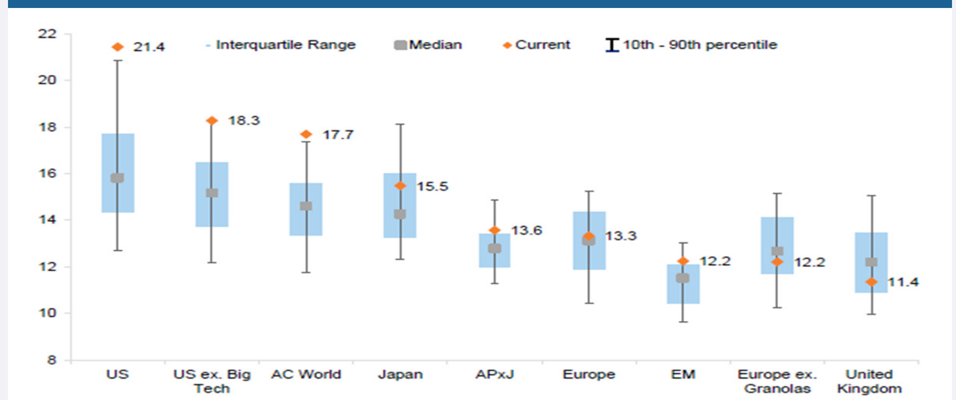
Narrow leadership is not a bad thing when supported by fundamentals as, in part, the market is discerning between winners and losers. However, back in the U.S. in a more troublesome way, the narrow leadership can also be seen in market valuations as U.S. equities ended the quarter at 21x fwd P/E, an eerily similar level to late 2021. Meanwhile, ex the dominant tech companies, the U.S. trades at 18x fwd P/E, which is still elevated relative to history.

### THE BIGGEST COMPANIES ARE OUTPERFORMING YTD




Data From: iShares, State Street, Invesco. Past performance does not guarantee future results. Latest available data as of 6/30/2024.
Source: MarketDesk.

### STRETCHED VALUATIONS IN THE U.S. RELATIVE TO THE GLOBE




Data From: FactSet, Goldman Sachs Global Investment Research.
Source: MarketDesk.

# Market Commentary

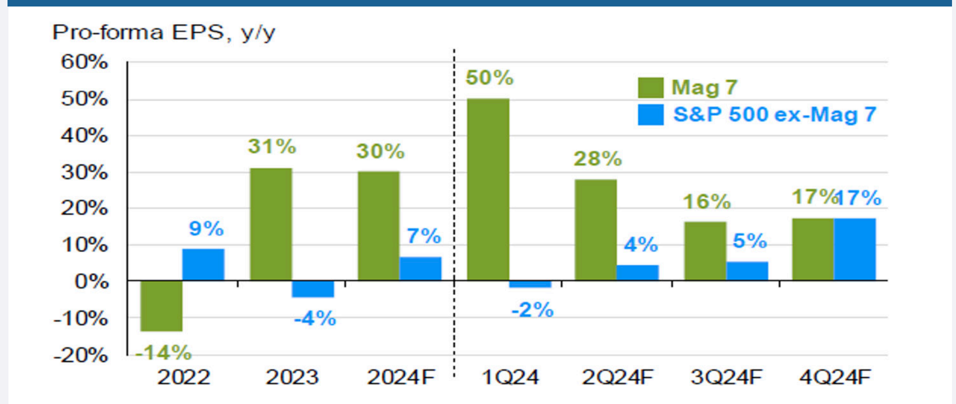
## Narrow Leadership Across Equity Markets continued

Based on earnings growth, one can see the justification for this valuation gap as the Mag 7 delivered 50% year-over-year earnings growth in first quarter and is expected to report 28% earnings growth in second quarter before leveling off in the mid-teens for the back half of the year. The silver lining to all of the above is there is room for the rest of the index to "catch up" as those outside the Mag 7 stocks start to pull their weight and move from flat earnings growth in 1H2024 to 10-11% earnings growth in the second half of the year.

## A Return to Disinflation and Trend-line Growth

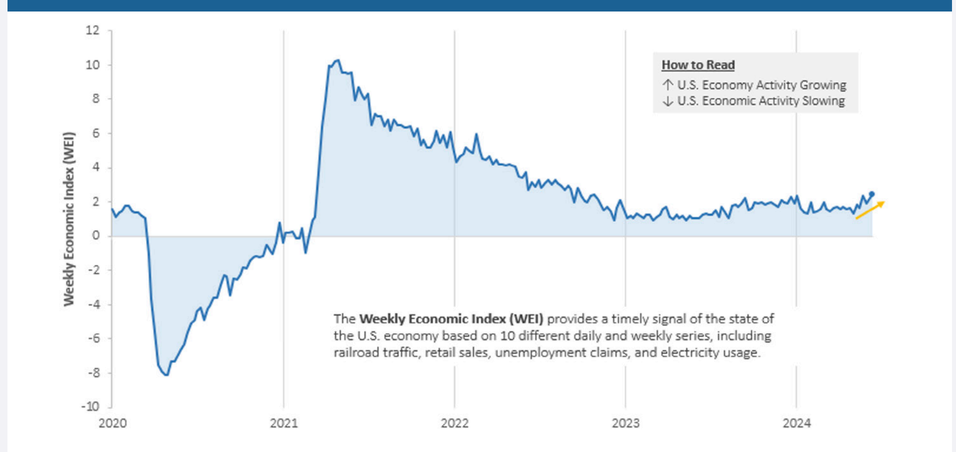
The economic backdrop for the U.S. is supportive of this catch-up narrative as the economy has been resilient, albeit slowing on the margin. We view the recent slowing in aggregate figures for the U.S. economy as reflective of a return to normal growth after a couple years of COVID stimulus infused growth. U.S. GDP growth has decelerated from 4.1% in 2H2023 to an estimated 1.7% in 1H2024, and U.S. unemployment has ticked up from 3.5% to 3.8% on a 3-month moving average basis as reported by Goldman Sachs. Staffing shortages are settling out in sectors such as Leisure & Hospitality where the pain was the most acute. Similarly, after some stickiness in the first quarter, the disinflation trend resumed in second quarter as the Fed's preferred measure of inflation (Core PCE) moved down to 2.6% in May (lowest since March '21), incrementally giving the Fed room to maneuver in the second half of this year. Thus, with our equity exposure, we are emphasizing active management in the U.S. while maintaining equity targets across U.S., International Developed, and Emerging Markets sectors.

**OUTSIDE THE MAG 7 TO PULL ITS WEIGHT**




Source: J.P. Morgan.

**U.S. ECONOMY ON STABLE FOOTING FOR NOW**




Source: MarketDesk. | Disclosures: Data is sourced from Federal Reserve. Latest available data as of 6/21/2024.

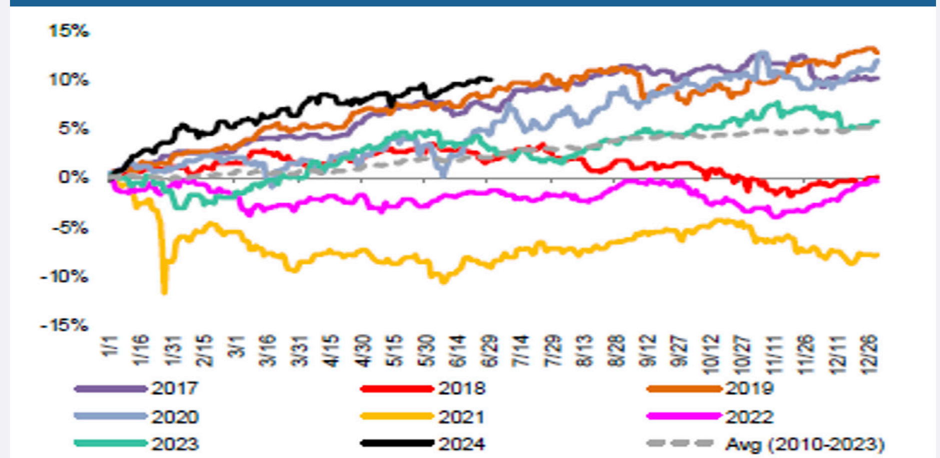
NEW REPUBLIC PARTNERS

# Market Commentary

## It's a New Day for Hedged Equity

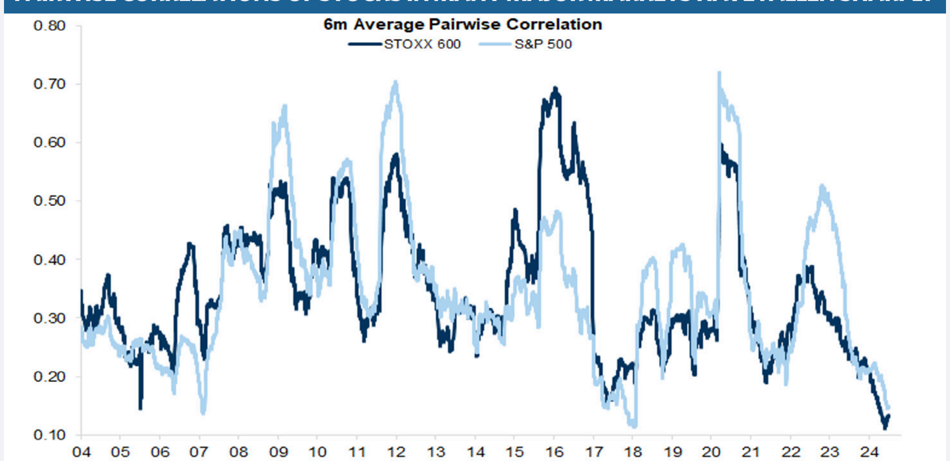
In first quarter, we highlighted the strong setup for Hedged Equity strategies with the renewal of short rebates, less competition, and increased stock dispersion. As highlighted by a recent Morgan Stanley report, long/short alpha had its sixth straight positive month in June and alpha generation in the first half of the year has been the strongest since Morgan Stanley began tracking it in 2010. Of note, nearly all the positive alpha has been driven from the short side. Therefore, with all the consternation around narrow market leadership and top-heavy equity indices, we believe Hedged Equity provides a great alternative equity exposure in a diversified portfolio.

**GLOBAL YTD TOTAL ALPHA (Long Appreciation – Short Appreciation)**



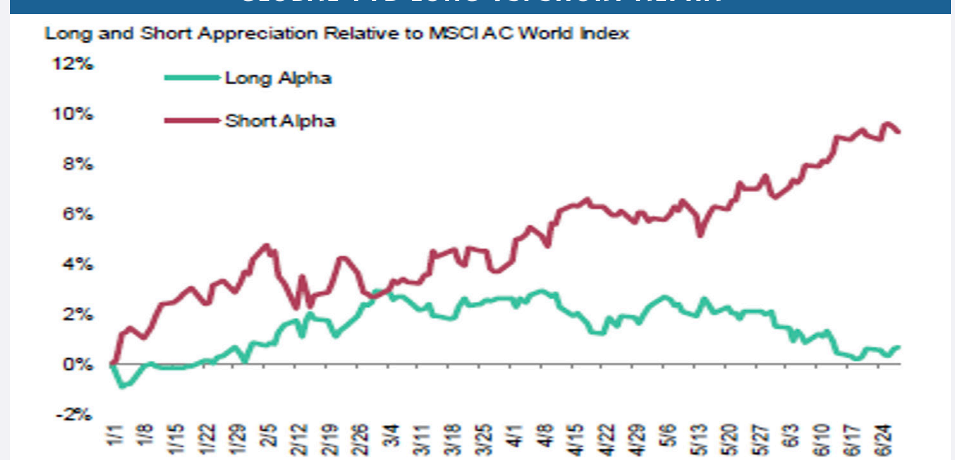

Source: Bloomberg, Morgan Stanley Prime Brokerage, data as of June 28, 2024. | Alpha metrics include global cash and swap positions held by global Equity L/S funds.

**PAIRWISE CORRELATIONS OF STOCKS IN MANY MAJOR MARKETS HAVE FALLEN SHARPLY**




Source: Bloomberg, Goldman Sachs Global Investment Research.

**GLOBAL YTD LONG VS. SHORT ALPHA**




Source: Bloomberg, Morgan Stanley Prime Brokerage, data as of June 28, 2024. | Alpha metrics include global cash and swap positions held by global Equity L/S funds.

NEW REPUBLIC PARTNERS

# Market Commentary

## Continued Rough Waters in Fixed Income

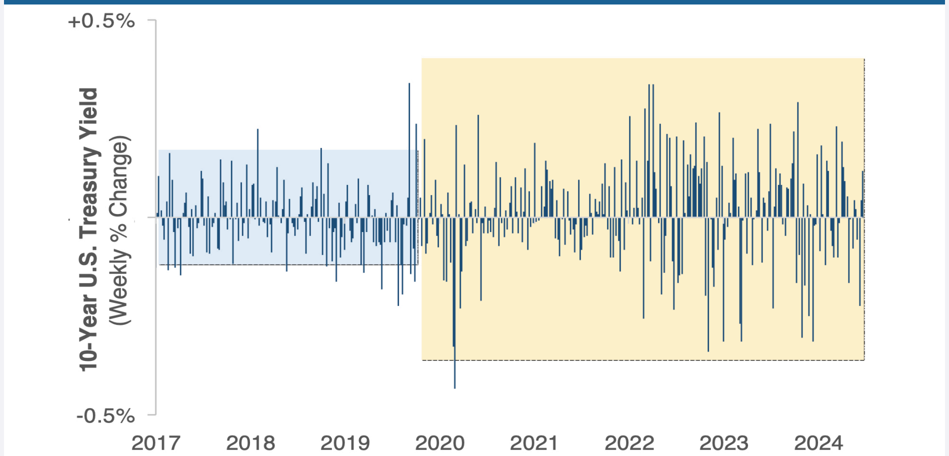
In Fixed Income, a persistent theme has been increased volatility, particularly in Treasury yields, as market participants try to discern the Fed's next move. On the surface, yields ended the quarter marginally higher, but it was a bumpy ride. The 10-year Treasury yield started the quarter at 4.20%, rose to 4.70% by late April, and dropped back to 4.37% by the end of June. Despite the intra-quarter yield volatility, bonds posted relatively flat returns. Corporate investment grade generated a -0.5% total return, lowering its 2024 return to -1.4%. High yield gained +0.7%, increasing its 2024 return to +2.2%.

As noted in the chart on the right, treasury yields have been volatile in both directions since the Fed began raising interest rates in March 2022. Today, Treasury yields are the most volatile they have been in eight years as the market navigates a complex transition from rate hikes to rate cuts. Thus, as Rick Rieder of BlackRock recently pointed out, "Duration isn't much of a hedge in today's environment. Consider that in each of the last 12 CPI prints where there has been a surprise, upside or downside, the reactions of the S&P 500 and the 30-year [U.S. bond] were positively correlated. Unless you have some long-dated liability to match, owning the long bond potentially just adds unnecessary volatility to your portfolio."

We echo Rieder's sentiments, and while the absolute yields for different types of Fixed Income look attractive on a relative and historical basis, taking on more duration and moving out the curve has simply not worked. The Fed has yet to embark on the much-anticipated rate cutting cycle, and we still favor strategies such as Private Credit and Absolute Return that can serve the dual purpose of providing enhanced yield and diversification that many have looked to traditional Fixed Income for in the past.

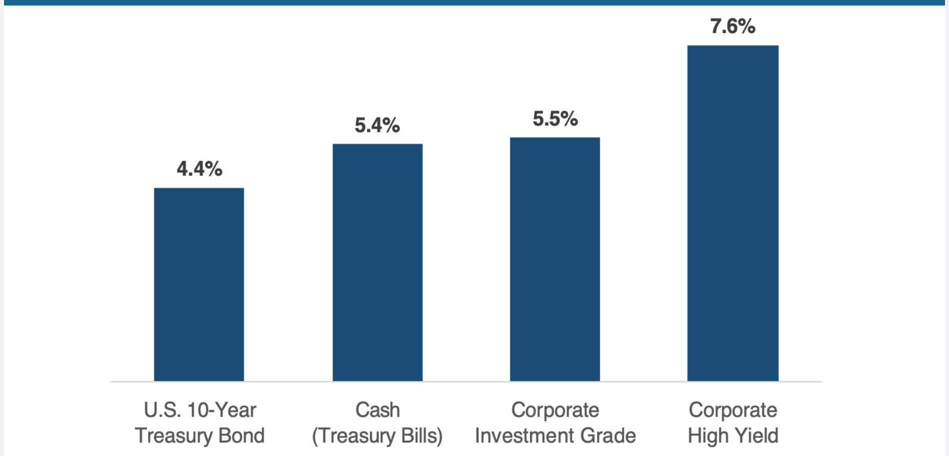
Being patient on not extending duration also ties to where we do have concern: federal finances. Running budget deficits of nearly 7% of GDP is unheard of at a time when the country is near full employment. And, elevated annual budget deficits are forecasted to worsen in a Trump election victory scenario and extension of the Tax Cuts and Job Act tax cuts. The supply/demand imbalance to support such deficits in treasury issuances would then keep treasury yields and the long end of the curve elevated even if the Fed begins a rate cutting cycle in September as widely anticipated.

**TREASURY BOND YIELDS REMAIN VOLITALE**




Source: U.S. Treasury. Latest available data as of 6/30/2024.

**TEMPTING YIELDS IN CREDIT MARKETS**




Data From: U.S. Treasury, Federal Reserve. Latest available data as of 6/30/2024.
Source: MarketDesk.

# Market Commentary

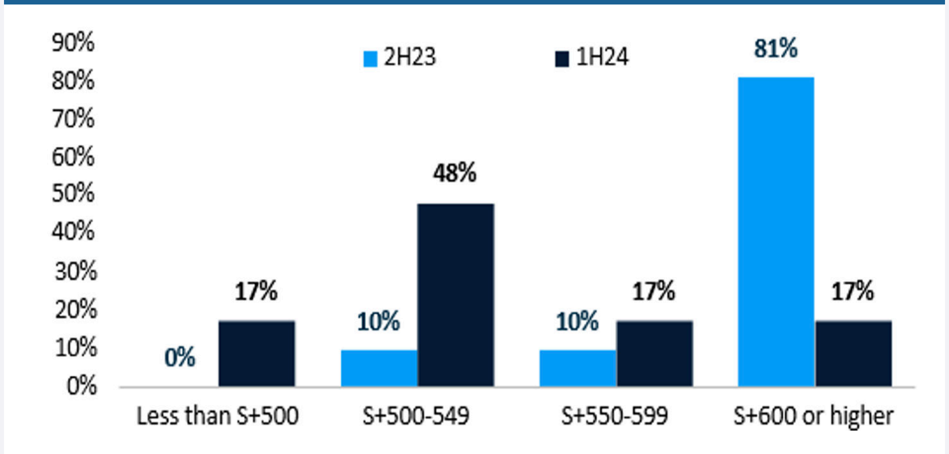
## Private Credit Maintaining the Upper Hand

While Private Credit is not subject to the same market swings that can impact the broadly syndicated loan and high yield markets, direct lending has also experienced a significant inflow of capital year-to-date, as the all-in financing terms remain attractive to investors in an environment of higher for longer rates. This inflow of capital has caused spreads on Private Credit direct lending securities to compress. As seen in the chart on the right, 81% of loans made in the first half of 2023 had rates of S+600 or higher, while 65% of loans made during the first half of 2024 had rates of S+549 or below.

The tightening of spreads in both the Public and Private Credit markets has been amplified by a slower pace of M&A throughout 2023 and into 2024. This reduction in M&A is most prevalent in the large cap Private Equity market where the majority of Private Credit capital is focused.

As Private Credit continues to evolve, we have positioned our Private Credit portfolios to reflect our views of the best risk-adjusted returns in the broader Private Credit sector. First, we have shifted our focus away from larger-cap direct lenders, which have been most impacted by the tightening in spreads mentioned above. Second, we continue to focus on niche Private Credit strategies, where we believe attractive risk-adjusted returns lie. Lastly, we continue to be active on the direct and co-investment fronts, which we believe provide investors access to high-quality securities in a fee-efficient manner.

**SPREAD DISTRIBUTION OF NEW ISSUED SPONSORED DIRECT LENDING LOANS**




Source: Pitchbook, LCD.

NEW REPUBLIC PARTNERS

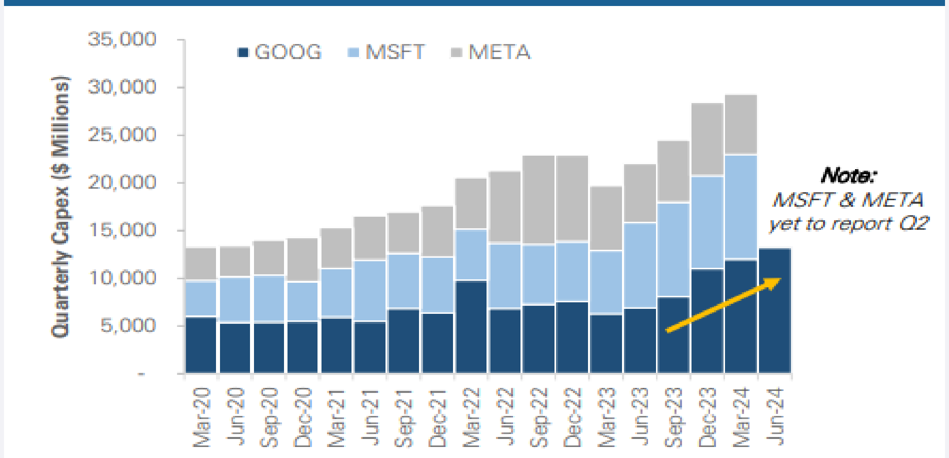
# Market Commentary

## Final Spotlight on AI: Opportunities and Pitfalls

Major computing cycles typically come along every ten to fifteen years: from mainframes in the '50s -'60s, minicomputers in the '70s, PCs in the '80s, the internet in the '90s, and the mobile internet beginning in '07… to Generative AI, which is now taking the stage as the next innovative platform. We believe AI adoption is entrenched as the AI hyperscalers are set to spend $183B in AI-related capex after two successive years of ~$125B in capex (JPM). There are naysayers who doubt the ROI on the massive capex spend that is occurring and note the lack of game changing AI applications that have come to market. Some skepticism is warranted as Warren Buffet once quipped, "The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money." By that same token though, the lack of AI applications to-date should not be surprising as every computing cycle to-date has followed an "IPA" progression of infrastructure first, platforms next, and applications last. The market is also being sensical to-date in only rewarding those firms that can tie a dollar of AI spending back to revenues as many AI application companies suffered setbacks in Q2 when AI-revenues did not match up with the spend.

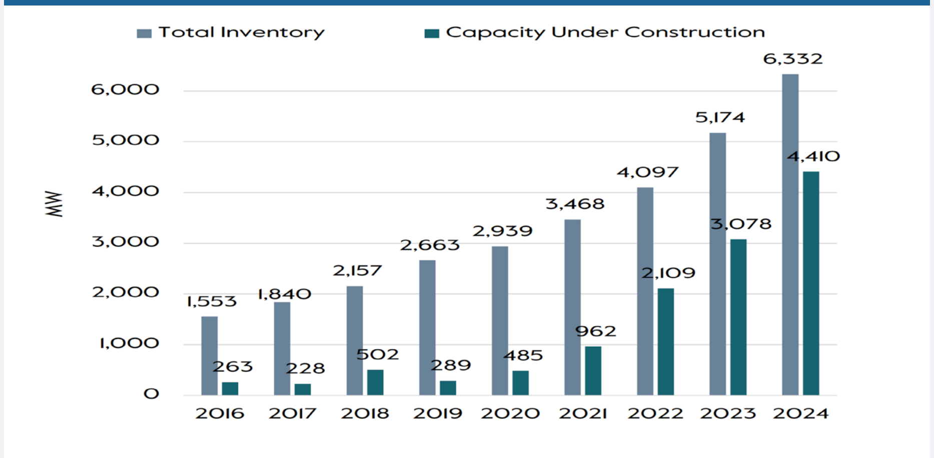
Nevertheless, we believe this theme will carry on. In a recent note by the venerable venture firm, Andreessen Horowitz, the authors make the case that "as [large language models] continue to advance, AI is working its way into everything, from marketing to voice agents to professional services at large. Whether it's PwC announcing a $1 billion investment into AI solutions, or Reuters setting aside $8 billion for AI dealmaking and development, firms are eager to establish themselves as market leaders in implementing this new technology."

**CAPEX CLIMBS AS AI BUILDOUT CONTINUES**




Source: MarketDesk, Google, Microsoft, Meta.

**DATA CENTER INVENTORY AND CAPACITY UNDER CONSTRUCTION**




Source: Apollo.

# Market Commentary

## Final Spotlight on AI continued

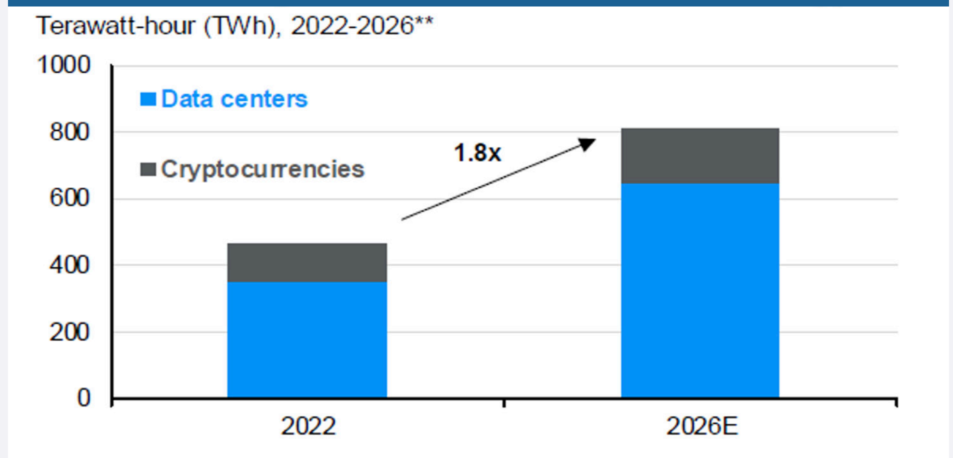
AI is also incredibly energy intensive. Per a recent J.P. Morgan "Webcast," the global electricity demand from data centers and cryptocurrencies is well on its path to nearly double (1.8x) between '22-'26 up to 800 terawatt hours. The total capacity of power projects waiting for a grid connection grew by nearly 30% last year with wait times ranging from 40-70 months as noted in Goldman Sachs' "AI Viewpoint." With continued AI adoption, scarcity in grid capacity looks to be on the horizon — but scarcity also presents opportunity.

Thus, while the infrastructure layer of AI (e.g., Nvidia, TSMC, and the semiconductor value chain) has been the winner over the past 18 months, our technology fund managers have been focused on the next phase of the AI adoption S-curve as winners start to emerge in AI-enabled smartphones, PCs, and AI applications. We are also seeking ways to prudently invest in this theme across Hedged Equity managers (for there are winners and losers in any major computing cycle), Venture Capital, and even Real Assets (namely data centers and power). As with any S-curve adoption cycle, there are bound to be boom and bust cycles along the way giving astute investors the chance to sort out the opportunities from the pitfalls.

*—NRP Investment Committee*

July 31, 2024

**GLOBAL ELECTRICITY DEMAND FROM DATA CENTERS AND CRYPTO**




Source: J.P. Morgan.

## Disclosure

This communication is not a "research report" as defined by the SEC. All discussion is limited to commentary on economic, political or market conditions, and statistical summaries. No investment decision should be made in reliance on this material, which is condensed, not comprehensive, and does not include all risk factors or other matters that may be material. This is not a recommendation or investment advice or an offer or solicitation.

This document may contain certain information that constitutes "forward-looking statements" which can be identified by the use of forward-looking terminology such as "may," "expect," "will," "hope," "forecast," "intend," "target," "believe," and/or comparable terminology. No assurance, representation, or warranty is made by any person that any of New Republic Partners' assumptions, expectations, objectives, and/or goals will be achieved. Nothing contained in this document may be relied upon as a guarantee, promise, assurance, or representation as to the future. NRP LLC shall have no liability for its contents.

There is no guarantee of the future performance of any New Republic Partners portfolio. All investments involve risk, including loss of principal and there is no guarantee that investment objectives will be met.Material presented has been derived from sources considered to be reliable, but accuracy and completeness cannot be guaranteed. The opinions expressed are those of New Republic Partners. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass.

New Republic Capital, LLC (d/b/a New Republic Partners) is an investment adviser registered with the U.S. Securities and Exchange Commission. Registration does not imply a certain level of skill or training. More information about New Republic Partners' investment advisory services can be found in its Form ADV Part 2 and/or Form CRS, both of which are available upon request.

NEW REPUBLIC PARTNERS

704.626.1526

NEWREPUBLICPARTNERS.COM