EST 1913
COLONIAL TRUST
COMPANY

2ND QUARTER | 2024

COLONIAL TRUST *Quarterly*

CAPITAL MARKETS REVIEW

THE FIRST QUARTER WAS ANOTHER OUTSTANDING QUARTER FOR LARGE-CAP DOMESTIC EQUITIES.

The S&P 500 ended the quarter at a new all-time high of 5,254. The total return for the quarter was 10.6%, compared to an average annual return for the S&P 500 since inception of 10.5%. The S&P 500 was not the only index to end the quarter at all-time highs. The DJIA also reached an all-time high of 39,807 on March 28th, while the Nasdaq Composite reached a new high of 16,429 on March 22nd. The equity momentum in the fourth quarter of 2023 continued into 2024, with the S&P 500 returning 28.5% from the October 2023 low.

The market delivered positive returns for domestic small-cap stocks as measured by the Russell 2000, for developed markets in the MSCI EAFE index, and emerging markets in the MSCI Emerging Markets Index. While all three of these indices offered positive returns for the quarter, they remain below their all-time highs – all of which occurred in 2021.

Strong economic data put upward pressure on bond yields, with the 10yr Treasury yield increasing by 0.32% for the quarter to 4.20%. Higher yields caused a negative 0.78% return for the bond market, as measured by the Bloomberg Aggregate Bond Index.

Index	Total Return
S&P 500	10.55%
DJIA	6.14%
Nasdaq	9.32%
Russell 2000	5.17%
MSCI EAFE	5.83%
MSCI Emerging Markets	2.13%
Bloomberg Agg Bond Index	-0.78%

Source: Bloomberg, LP

FRANCES KRYDYNSKI
Client Service Representative

IN THE SPOTLIGHT

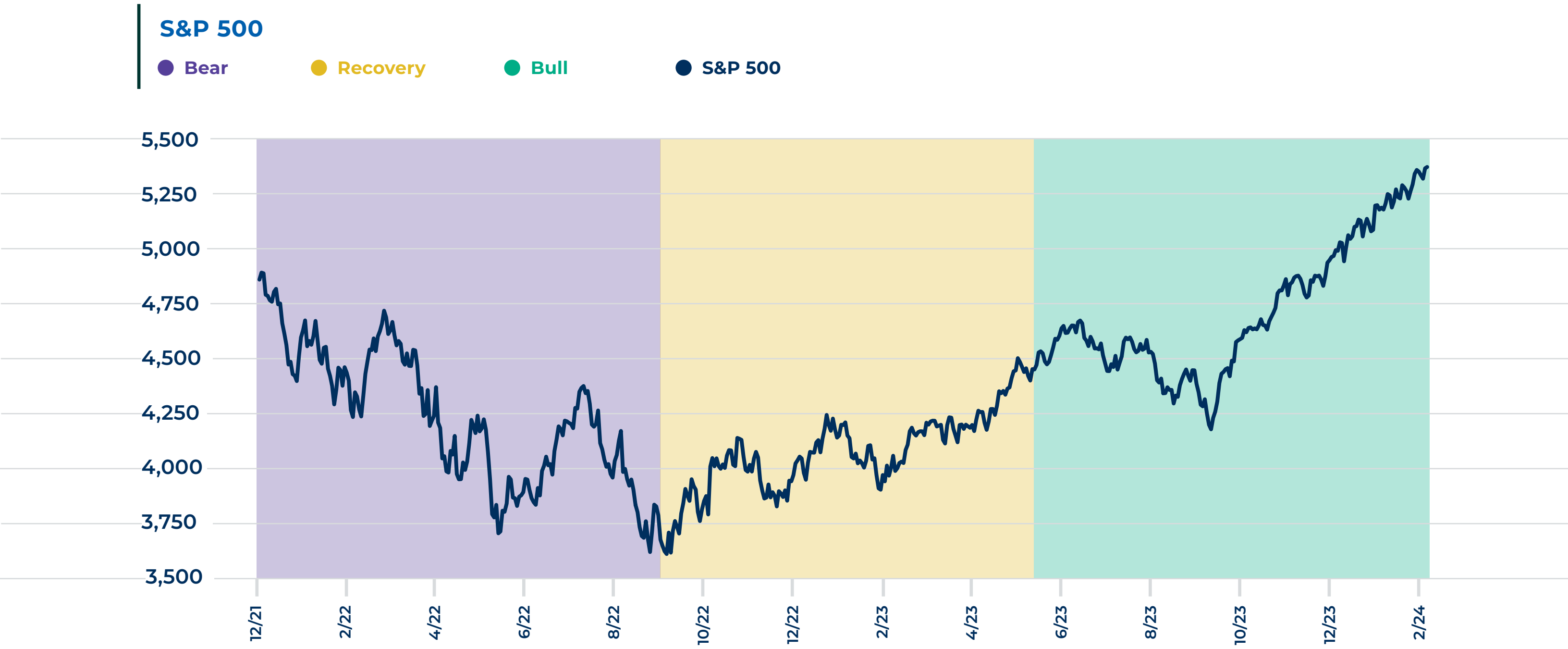
Frances Krydynski, a native of Spartanburg, joined the Colonial Trust Spartanburg office in June 2023. Prior to taking a break from work to raise her family, her career was spent at USC Upstate, where she was responsible for managing special projects and major university events for the Chancellor. While raising her children – now aged 16 and 19 – she spent much of her time volunteering at school as well as the Episcopal Church of the Advent, where she continues to serve. She loves spending time with her family, cooking, and reading a good book.

Frances is a graduate of the University of Georgia. She serves as a Client Service Representative and has enjoyed greeting clients and assisting them and the firm in any way she can.

ANATOMY OF A BULL MARKET

A BULL MARKET IS A PERIOD WHERE SECURITY PRICES RISE CONTINUOUSLY, AND THE MARKET ACTION OVER THE LAST SIX MONTHS IS CONSISTENT WITH A BULL MARKET.

The accepted distinction when a market moves from a recovery to a bull market is after markets rise more than 20%. The lows of the most recent cycle occurred October 12, 2022, when the S&P 500 reached 3,577. The recovery began the following day; it took the S&P 500 164 trading days to rise 20% on June 8, 2023. The market continued this momentum, and the index has risen 22.4% since June 8, 2023, and 46.9% since the October 12, 2022 lows. While the shellshock of the 2022 bear market can leave investors with trepidation, the S&P 500 finished the 1st quarter 9.5% above the previous market highs of January 3, 2022.



According to Forbes, the average post-war bull market lasts 5.25 years and the median lasts 3.87 years. When compared to these averages, this bull market is in the early innings.

As this chart illustrates, while the bull market began in the summer of 2023, the move from October has been meteoric and consistent. Since the October low to quarter-end, the market has been positive 63% of the trading days, with 14 days of a greater than 1% increase compared to only four with more than -1% declines. At no time since October 27th has the market fallen more than 1.6% with the longest losing streak being just four days.

The foundation of this bull market has been the Magnificent Seven Stocks of Amazon, Google, Apple, Telsa, Nvidia, Microsoft, and Meta. While many of these stocks remain important pillars of the market, the bull market has broadened out. These seven stocks have dramatically outperformed the S&P 500 over the last year; however, in March, the broad market topped these mega-cap stocks. Within the S&P's 11 sectors, the Magnificent Seven reside in the technology, communication services, and consumer discretionary sectors. While these sectors were leaders for the quarter, only communication services bested the market in March. The returns in March were led by energy, utilities, materials, and financials.

as of 3/28/2024	1yr	1Q24	March
S&P 500	32.10%	10.16%	3.10%
Mag-7 Price Index	73.91%	17.14%	2.66%

Source: Bloomberg, LP

S&P 5oo Sector Level Returns	1Q24	March
Energy	12.69%	10.43%
Materials	8.44%	6.22%
Industrials	10.57%	4.32%
Consumer Discretionary	4.75%	0.01%
Consumer Staples	6.81%	3.17%
Healthcare	8.40%	2.23%
Financials	11.97%	4.67%
Technology	12.48%	1.93%
Communication Services	15.57%	4.33%
Utilities	3.59%	6.30%
Real Estate	-1.36%	1.12%

Source: S&P Global

THAT IS NOT TO DOWNPLAY THE IMPORTANCE OF THESE STOCKS, WHICH REPRESENT 28.7% OF THE MARKET VALUE OF THE S&P 500.

But it does indicate the other 71.3% of the index is showing bullish signs. At quarter-end, there were 370 stocks on the NYSE that reached new 52-week highs, including JP Morgan, Procter & Gamble, and Caterpillar – none of which are developing artificial intelligence chips or weight loss drugs.

As we begin the second quarter, it is prudent to consider the drivers of a bull market. At their core, markets are driven by earnings, investor sentiment, and valuation ratios/interest rates.

Companies reported 4Q23 earnings over the last two months and according to Bloomberg, LP earnings grew 4.2% over 4Q22, ending the earnings recession that occurred in the first three quarters of 2023. For the quarter, 74.0% of companies beat Wall Street earnings expectations. This is down from 79.6% in 3Q23, but above the 10yr average of 72.3%.

Markets are forward-looking and therefore are focused on future earnings growth. Expectations are for 3.3% growth in 1Q, 7.0% growth in 2Q, and approximately 20% growth in the last two quarters of 2024. This would result in 2024 S&P 500 earnings growth of 12.5% and estimates for 2025 are slightly higher at 13.9%.

These estimates are based on mid-single digit sales growth and improving margins. Continued sales growth requires continued economic growth, which seems to be the path of least resistance. We began the year with economists forecasting 1Q GDP growth of 0.5%, and those estimates are now 2.0%. Estimates for the full year GDP growth have likewise increased from January, from

1.3% to 2.2%. Estimates of GDP growth have underestimated economic performance for four consecutive quarters, and we will soon learn if 1Q24 marks the fifth.

THE INCREASE IN THESE ESTIMATES OVER THE LAST 90 DAYS IS THE RESULT OF CONTINUED STRENGTH IN THE CONSUMER SECTOR AND IMPROVEMENTS IN THE MANUFACTURING SECTOR.

According to the Non-Farm Payroll (NFP) report, the economy added over 500 thousand jobs in January and February. The unemployment rate increased from 3.7% to 3.9% but has been below 4% for 25 consecutive months. Initial claims for unemployment insurance averaged 210 thousand per week for the quarter, which is the exact number of the final read we received in March. Employees have seen wage gains outpace headline CPI inflation for ten consecutive months, allowing consumers to continue to spend. Personal consumption expenditures have increased by 4.5% and 4.9% in the first two months of 2024, on a year over year basis. While this is a downshift from the YOLO spending of 2022 and 2023, it is higher growth in spending than we saw from 2010 through 2019.

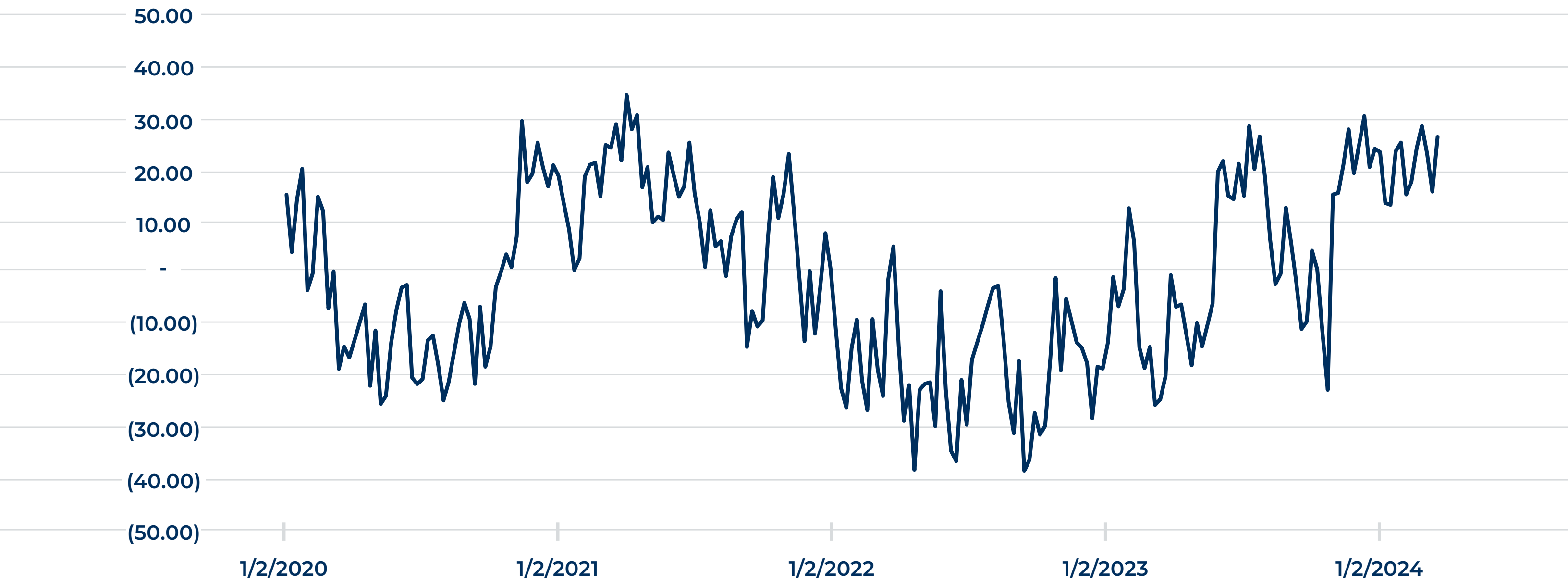
The manufacturing sector is also improving from the nadir seen in 2023. We highlighted on these pages three months ago the renaissance in manufacturing construction occurring in America. Onshoring and new chip plants have been a boon for electrical and HVAC manufacturers, but also all the companies that make inputs and tools involved in this construction. Other areas of manufacturing seem to be improving as well. The Purchasing Managers Index (PMI) for manufacturers as measured by the Institute for Supply Management (ISM) and S&P Global have improved. The ISM measure for March increased to 50.3, its first print in expansion territory after 16 months of contraction. The S&P measure of manufacturing moved into expansion territory in January and is at levels last seen in June 2022.

AN EMPLOYED CONSUMER, WITH GROWING WAGES, AND IMPROVEMENTS IN THE MANUFACTURING SECTOR IS A RECIPE FOR CONTINUED ECONOMIC EXPANSION AND THEREFORE CORPORATE REVENUE GROWTH.

The margin improvement is predicated on continued moderation in inflation and improvements in productivity. Inflation has moderated from the high level of 2022 and wage growth has also tempered. The Fed's preferred inflation measure of Core PCE has fallen from 5.6% in February 2022 to 2.8% in February 2024. We don't expect the move from these levels to the Fed's target of 2.0% to be a straight line. However, we do expect continued progress on inflation. One reason for this is productivity growth. The Bureau of Labor Statistics measures output per hour to gauge productivity, which is the mother's milk of profit growth. Over the last three quarters, productivity growth has averaged 3.7%. This compares to an average of 1.7% in the 44 quarters from 1Q09 to 4Q19, just before the pandemic. This could be the beginning of a lasting productivity expansion led by technology and specifically artificial intelligence (AI). As AI improves and adoption increases, this may allow companies to offset a tight labor market with increased productivity and higher profits. Continued economic growth will drive revenue growth and a combination of lower inflation and increased productivity can drive earnings growth in 2024, an important contributor to a bull market.

Investor sentiment, both in the near term and future, also impacts market returns. Investor sentiment, as measured by the American Association of Individual Investors has been in the bullish camp after the most recent rally began. Their reading of sentiment showed the percentage of bullish investors was twice as high as those who were bearish. The bulls minus bears were positive 27.6 at quarter-end and has been elevated since mid-November, coinciding with this move higher. This measure is a contrarian indicator and when the last investor in the room turns bullish, the markets typically go through a consolidation period to arrest market excesses. We don't see any significant deterioration in underlying fundamentals but would not be surprised if the market took a breather in the next few months to digest the last two quarters' gains. Consolidations and corrections are a normal aspect of the market, particularly when sentiment becomes too exuberant. Since 1980, the average intra-year decline in the S&P 500 has been 14.2%, but the market offered positive returns in 33 of the last 44 years.

AAII BULL MINUS BEAR SENTIMENT



THE EARNINGS PICTURE SEEMS REASONABLE, THOUGH SENTIMENT MAY BE STRETCHED. THIS BRINGS US TO VALUATION RATIOS.

This is what investors are willing to pay for a dollar of earnings in the future. This is determined by a variety of factors, but none is more important than interest rates. In 2017, Warren Buffett said if he could pick one statistic to ask about future valuations it would be what is the interest rate going to be over the next 20 years. The equity sell-off in 2022 coincided with an increase in interest rates and the increase in equity prices since October has coincided with a fall in interest rates. On a year-to-date basis, interest rates have moved higher, but remain below the highs seen in October 2022.

Going forward, markets expect the Fed to lower the Fed Funds rates and expect long-term interest rates to remain flat or slightly fall. The Fed's March Summary of Economic Projections (SEP) forecasts three 0.25% rate cuts in 2024. The CME's FedWatch Tool has a 61% chance of the first rate cut beginning in June. It is clear the Fed does not expect any further rate hikes and hopes to begin reducing interest rates in 2024. Their SEP calls for an additional 0.75% cuts in both 2025 and 2026. This signals their belief that inflation will continue to moderate, and their intention to return to neutral monetary policy. This does not mean we will return to sub 1.0% 10yr Treasury yields or sub 3.5% mortgage rates, but it does mean that neither the Fed nor the market expects higher rates going forward.

The S&P 500 ended the quarter trading at a forward price-to-earnings ratio of 20.96x, compared to a 30yr average ratio of 16.62x. This puts the market at a rich valuation compared to historical trends. The evaluated valuation ratios are most acute in the large tech companies, with the forward price-to-earnings ratio of the Mag-7 of 30.87x. The high valuation ratio for these stocks is predicated on 36.8% earnings growth for the group in 2024. Essentially, these companies traded at double the valuation of the rest of the market and are expected to grow earnings in 2024 at three times the rest of the market. We believe they are uniquely positioned to benefit from the transition to AI and the tremendous spending on infrastructure and software needed to bring it online.

IN ADDITION TO THE IMPACT OF THESE LARGE TECH COMPANIES ON MARKET VALUATIONS, ANOTHER DRIVER OF VALUATIONS IS THE EXPECTATIONS OF LOWER INTEREST RATES.

Markets prefer cheap capital. Lower rates increase what investors are willing to pay for future earnings. In our humble opinion, herein lies the rub with the current market. The economy has outpaced growth expectations for over a year, and we believe is likely to continue to do so. While this is a positive for the economy, it reduces the likelihood the Fed will be able to lower interest rates by 0.75% in 2024. Strong employment, wage gains, and improvements in manufacturing are all good news for the revenue and earnings lines of income statements. But strong economic growth may result in inflation declining at a slower pace. The Fed's dual mandate is employment and price stability. If unemployment remains below 4.0% and the economy is growing north of 2.0%, the Fed will focus on price stability and may delay interest rate cuts. While this is good news for the economy, the equity markets will be forced to compare an improving economic backdrop with the prospect of higher for longer interest rates.

The earnings input of the price to earnings ratio may improve in this scenario, but investors will want lower valuation ratios to compensate for higher interest rates. If given the choice between higher growth and higher rates or lower growth and lower rates, we will gladly trade the latter for the former. But we think this could result in some churn in the market while the earnings growth catches up with lower valuation ratios.

Long-term investors are aware markets do not go up in a straight line indefinitely. The move over the last two quarters has been both powerful and consistent. We were not surprised to see the markets sell off a bit in the first days of the second quarter. Sentiment was bullish and the quarter opened with economic data outpacing expectations. This caused interest rates to tick higher to begin the quarter and equity prices to fall. As we mentioned above, this is not unexpected after the last few quarters, but the underlying fundamentals of the economy and corporations are positive. That is a backdrop we prefer and will offer opportunities for new capital as markets digest the combination of higher growth and interest rates higher for longer.

As always, we appreciate your confidence and support as we continue to navigate the markets. We are optimistic about the long-term prospects and excited about the possibilities for AI and other new technologies creative and inventive companies and entrepreneurs are bring to market. We look forward to seeing the benefits for our clients and the world.

OUR LEADERSHIP

H. Walter Barre

Bert D. Barre, CFA

Barry D. Wynn

Camp R. Wynn, CFA

Lorie L. Barton

Henry E. Batts III, AWMA®

Charles W. Clementson

James C. Fiske, CFP®

Jamison W. Hinds, JD

Thomas S. Ledbetter, Jr., CFA

Karen H. Longhurst, ATFA, CTFA

Pamela G. McCauley

Ansley J. Mitcham

Matt Van Name, CFP®, CRPS®, AIF®

Kathryn A. Smith, CPA/PFS, CFP®

Jordan R. Taylor, CPA

W. Charlton Wieters, CTFA

LOCATIONS

SPARTANBURG

233 S. Pine St.
Spartanburg, SC 29302

864.582.3356

GREENVILLE

101 E Washington St.,
Suite 200
Greenville, SC 29601

864.370.0737

COLUMBIA

6 Calendar Ct.,
Suite 1
Columbia, SC 29206

803.782.7646

CHARLESTON

578 East Bay St.,
Suite B
Charleston, SC 29403

843.577.0444

COLONIALTRUST.COM