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COLONIAL TRUST
COMPANY

3RD QUARTER | 2024

COLONIAL TRUST *Quarterly*

Second Quarter Performance

In The Spotlight with Sterling

The Economy

2ND QUARTER PERFORMANCE

THE S&P 500 BEGAN THE SECOND QUARTER WITH A 5.5% SELL-OFF THROUGH APRIL 19TH, ONLY TO SEE THE INDEX RALLY 9.9% FROM THE QUARTER-LOW TO QUARTER-END.

For the quarter, the S&P 500 had a total return of 4.3%, and a year-to-date return of 15.3%. The DJIA posted a negative return for the quarter of 1.3% and trailed the S&P 500 year-to-date, with a total return of 4.8%. The Nasdaq continues to outperform the S&P 500 and DJIA, with a total return for the quarter of 8.5% and year-to-date return of 18.6%.

The strong performance from the Nasdaq and S&P 500 did not benefit small cap stocks, as measured by the Russell 2000, which fell 3.3% for the quarter. International markets were mixed, with developed markets down 0.2%, while emerging markets rose 5.2% The Chinese Hang Seng index returned 9.0% for the quarter. Finally, bonds were up 0.1% for the quarter as measured by the Bloomberg Aggregate Bond index.

Index	Total Return
S&P 500	15.3%
DJIA	4.8%
Nasdaq	18.6%
Russell 2000	1.7%
MSCI EAFE	5.8%
MSCI Emerging Markets	7.6%
Bloomberg Agg Bond Index	-0.7%

Source: Bloomberg, LP

Technology and communication services stocks were the driver of S&P 500 returns, continuing the trend seen in the first quarter. Within the eleven S&P GICS sectors, there were five in the green and six in the red. Technology stocks returned 13.8% and communication services returned 9.4%, accounting for much of the market's performance as these two sectors comprise more than 40% of the S&P's market value. Equity returns remain concentrated in a handful of companies with Nvidia, Apple, Microsoft, and Alphabet (Google) accounting for nearly 25% of the S&P 500's value. These companies outperformed the index for the quarter, with all but Microsoft up more than 20%.

THE ECONOMY

ECONOMIC GROWTH SLOWED IN THE FIRST QUARTER, WITH GDP GROWTH FALLING TO 1.4% FROM 3.4% IN THE FOURTH QUARTER OF 2023.

This was largely due to moderating growth in consumer spending, which fell from 3.3% to 1.5%. The consumer has been the key driver of economic growth due to a tight labor market and rising real wages. Nominal personal consumption expenditures continue to increase; however, the pace of growth has slowed.

The aggregate US consumer remains in good shape financially; however, there is a bifurcation that is worsening. Household net worth reached an all-time high of $160.8 trillion as of March 31st. This wealth is not evenly distributed, with older generations, who typically have real estate and investment assets, seeing their wealth increase. The baby boomer generation comprises 20% of the population but accounts for 52% of net worth. Younger generations are less likely to own their home or have substantial investment assets and are more likely to have higher levels of debt. We have seen an uptick in 30+ days delinquencies on auto loans (7.9%) and credit card debt (8.9%). Inflation-adjusted balances in checking and savings accounts are up 5% from pre-Covid levels, but accounts of those in the bottom quartile of income are down 21%. Most consumers have greater income, with retirees benefiting from higher asset prices and interest rates, while the working population is seeing real wage growth. However, younger and lower-income consumers are feeling financial strain. We expect this divergence to continue. More than three quarters of consumer spending is from the top three quintiles of income, with the bottom two accounting for 22%. At the risk of sounding callous, if the top half of the income spectrum continues to consume at these levels, consumer spending will remain strong.

More cyclical parts of the economy are mixed. The housing market remains weak due to high mortgage rates. New home starts are at the lowest levels since the pandemic and the inventory of existing homes is largely locked up due to existing mortgages having lower rates. Auto sales have remained stable at nearly 16 million units since January 2023. Gross private domestic investment grew 4.4% in the first quarter, with strength in intellectual property and manufacturing structures, thanks to the Chips Act and onshoring. Manufacturing activity remains in contraction territory as measured by the Institute for Supply Management's Purchasing Managers Index but has improved somewhat over the last year.

The puts and takes on the economy illustrate an economy that is continuing to grow, albeit at a slower pace than 2023. The Atlanta Fed GDPNow, a projection of economic growth based on real time economic data, shows second quarter GDP growth of 1.7%. The positive of slower growth is less inflationary pressures to the economy. We have seen that CPI, less food and energy, was 3.4% in May, down from 6.6% in September 2022. Moderating economic growth should further reduce aggregate demand, allowing inflation to moderate. This will give the Fed leeway to reduce interest rates, which is additive to economic growth.

WHAT MIGHT THE SECOND HALF OF THE YEAR HOLD FOR EQUITY MARKETS?

As we have written many times in these pages, equity market performance is a function of earnings growth and valuation ratios. For calendar year 2024, estimates for S&P 500 earnings currently stand at $240/share according to Standard and Poor's. This would represent 12.2% year-over-year earnings growth. Earnings growth is projected to be back-half loaded, with over 19% earnings growth in the last two quarters of 2024. As we prepare for the second quarter reporting season, analysts expect earnings growth of 6.1%, beating the 4.0% growth in the first quarter.

Earnings growth in the first quarter was better than anticipated, with 77.1% of companies beating analysts' estimates. This is greater than the four-year average of 72.6%, according to Standard & Poor's. Earnings growth was concentrated in the technology, communications services, consumer discretionary, and consumer staples sectors. Revenue growth in the first quarter was 4.5%, outpacing earnings growth, while profit margins contracted slightly.

For the remainder of the year, technology and communications services firms are projected to continue to see strong earnings growth. However, earnings growth is forecast to broaden with more cyclical sectors, like industrials, materials, and financials improving in the back half of the year.

S&P 500 Sector Level Returns	1Q	2Q est.	3Q est.	4Q est.	2024
S&P 500	4.0%	6.1%	19.4%	19.6%	12.2%
Consumer Discretionary	21.6%	5.1%	1.7%	23.9%	11.6%
Consumer Staples	26.5%	-3.8%	6.8%	8.7%	9.0%
Energy	-25.7%	11.0%	-5.2%	13.9%	-3.4%
Financials	-5.1%	-13.1%	36.6%	0.1%	1.6%
Healthcare	-14.1%	27.6%	44.1%	44.9%	24.3%
Industrials	-10.6%	-6.9%	15.3%	10.2%	1.5%
Technology	29.1%	27.8%	27.4%	29.6%	28.5%
Materials	-27.7%	-6.4%	17.1%	78.2%	6.2%
Comm. Services	34.0%	18.0%	13.1%	21.8%	21.1%
Utilities	18.8%	-7.6%	11.2%	11.6%	8.8%
Real Estate	9.9%	-18.8%	-5.2%	11.5%	-1.8%

Source: Standard & Poor's

Revenues are projected to accelerate in the back half of the year, with fourth quarter revenue growth projected to be 8.2% compared to 4.5% in the first quarter. More importantly, profit margins are projected to improve, although not reach the record high levels of 2021. This strength is forecast to continue into 2025, with revenue estimates of 6.1% growth and earnings estimates of 15.3% growth. This outlook is consistent with the economy avoiding recession and inflation continuing to moderate.

The S&P 500 appears to be pricing in this constructive earnings backdrop. The price to next year's earnings multiple, or forward P/E, is 21.0x at quarter-end. This is a premium to its 30yr average of 16.7x. This multiple fell below the 30yr average in October 2022, when the current bull market began and has moved higher as economic and earnings growth has been better than expected.

The market is not inexpensive at current valuations. The macro explanation for elevated valuations is the belief that the future path of interest rates is not higher. The Federal Reserve has signaled they don't expect to raise interest rates further and their next move will be to cut. While the timing and magnitude of any rate cuts is unknown, the market and the Fed expect one to two 0.25% rate cuts in 2024 and more to follow next year. Falling interest rates are a positive for asset prices and market valuations have risen in anticipation of a more accommodative monetary policy.

Another reason for the elevated valuation multiples is the outsized contribution of market returns, growth expectations, and multiples of a handful of stocks.

A TALE OF TWO MARKETS

The market concentration can be measured by the Magnificent Seven (MSFT, AAPL, NVDA, GOOGL, META, AMZN, TSLA) or the top ten holdings in the S&P 500. No matter the yard stick used, the equity market is more concentrated than at any time in the modern era. The top ten stocks represent 37% of the S&P 500's value and the Magnificent Seven account for 31%. An examination of the top ten stocks in the S&P 500 shows most are participating in massive shifts in technology, particularly around artificial intelligence, aside from Berkshire, Lilly, and JP Morgan.

These companies have strong fundamentals, with superior profitability, growth prospects, balance sheets, and returns on invested capital compared to the broader market or their peers. Moreover, these firms have scale, high switching costs, and the network effect that provide an economic moat around their businesses.

Top Ten Holdings in the S&P 500	MV in Billions	For. P/E	LT EPS Growth	% of S&P 500
Microsoft Corp.	3,370	35.67x	14.8	6.9%
Apple Inc.	3,309	31.26x	12.7	6.8%
NVIDIA Corp.	3,052	42.54x	42.8	6.3%
Alphabet Inc.	2,267	22.68x	15.0	4.7%
Amazon.com Inc.	2,052	33.79x	29.0	4.2%
Meta Platforms Inc.	1,276	23.13x	18.6	2.6%
Berkshire Hathaway Inc.	874	21.69x	NA	1.8%
Eli Lilly & Co.	866	62.30x	40.0	1.8%
Broadcom Inc.	759	29.50x	15.9	1.6%
JPMorgan Chase & Co.	593	12.94x	3.0	1.2%
Top 10	**18,419**	**31.55x**	**21.3**	**37.8%**
S&P 500	**48,724**	**21.00x**	**15.4**	**100.0%**
The Rest of the Index	**30,304**	**17.60x**	**11.8**	**62.2%**

Source: Bloomberg, LP and JPMorgan Chase

The top ten stocks have higher valuation metrics than the other stocks in the index, but their earnings represent 27% of the S&P 500's earnings and they are growing at nearly double that of the rest of the market. For reference, during the dot.com bubble the top ten stocks accounted for approximately 27% of the S&P 500's value and 16% of earnings.

THAT IS NOT TO SAY THAT CONCENTRATION DOES NOT INTRODUCE RISK INTO THE EQUITY MARKET. HOWEVER, THEIR PERFORMANCE HAS SHOWN DISPERSION IN THE SECOND QUARTER AND YEAR-TO-DATE.

Many of these companies are leveraged to artificial intelligence, but serve different aspects of this investment opportunity, from chips to large language models, to hardware making AI accessible to consumers. As AI is integrated into different aspects of the economy, these companies will benefit in different ways.

Our concern with the concentration of the market is not that each of these large firms is doing the same thing for the same customer. Rather, we are wary of performance concentrated in a handful of names. Year-to-date return for the Magnificent Seven was 33%, while the rest of the S&P 500 returned 5%. The Wall Street axiom, "Trees don't grow to the sky" remains applicable and we don't expect this level of out-performance indefinitely. However, these stocks have momentum on their side.

The forecast for improving earnings in the back half of the year is not solely in this handful of names. As we mentioned, more cyclical areas of the market are expected to see improving earnings growth. Many of these companies have been ignored by investors in favor of these high growth tech stocks or makers of weight loss drugs. The bottom 90% of the market is trading at a 44% discount to the top 10% of the market and many are expected to see improving fundamentals. If economic growth continues as forecasted and inflation continues to moderate, we believe there will be attractive return across the broader market and not just a handful of names.

IN SUMMARY

Economic growth is moderating, and the big "C" consumer remains resilient, even with stress in the lower income quintiles. Inflation is moderating along with economic growth, while some cyclical areas continue to hold up. Lower inflation and lower interest rates are a positive for these more cyclical areas of the economy. We don't expect another banner year of economic growth, but we expect growth to continue.

THE EQUITY MARKET APPEARS TO BE RICHLY VALUED ON THE WHOLE; HOWEVER, MARKET VALUATION METRICS ARE BEING DISTORTED BY A CONCENTRATION OF GROWTH AND EQUITY MARKET RETURNS IN A HANDFUL OF STOCKS LEVERAGED TO ARTIFICIAL INTELLIGENCE.

The promise of AI has not yet come to fruition, but we don't see this as a flash in the pan, rather a technology that can revolutionize our economy and our lives. More attractive valuations can be found in the rest of the equity market, particularly if economic growth remains positive and inflation moderates.

We look forward to hearing about the second quarter financial results of our holdings and to a broadening out of the market in the back half of the year. We value the confidence you place in Colonial Trust, and we hope all our clients and friends had a wonderful 4th of July. Please reach out to us if you have questions about our outlook or your accounts.

TAX OUTLOOK

FOR A COUPLE OF WEEKS IN JUNE TAX RATES RECEIVED MORE COVERAGE THAN USUAL.

Markets began contemplating a growth slowdown while at the same time fearing the Fed would not begin cutting rates quickly enough. Slow growth means lower tax collection and high rates mean servicing the national debt is expensive. All of a sudden the commentators began contemplating what a higher debt means for tax rates. This isn't an academic exercise. On December 31, 2025, most of the personal income tax code reverts to 2017 rates.

Unless Congress passes a renewal of the tax rates all the income tax brackets will receive higher tax rates, with the highest bracket going from 37% to 39.6%. The standard deduction would be halved (though the SALT cap would be lifted), child tax credits would decrease, and lastly the estate tax exemption would be halved.

This newsletter does not make political predictions on who will win elections but it does seem unlikely there will be a wave election sweeping the White House and both sides of Congress to the same party. The likelihood grows that there will be no consensus to pass a broad renewal. Both parties are claiming to support keeping the current income tax rates and avoiding an increase, but it is unclear what the appetite is to save the current estate tax exemption. Currently a married couple can exempt $27.2mm from estate taxation. If the rates are not renewed the exemptions will be divided in two and the married couple will only be able to pass $13.6mm without taxation, with individuals only a $6.8mm exemption.

STASIS AND GRIDLOCK WITH NOTHING PASSING MEANS EVERYTHING WOULD REVERT TO 2017 RATES WITH TAX INCREASES ACROSS THE BOARD.

While past performance is not indicative of future results, Congress has not shown itself to be nimble or forward thinking in quite a long time. If the easiest thing is doing nothing, your taxes will go up. For those with inherited IRAs it may make sense to take higher withdrawals the next couple of years in case rates go up. Converting IRAs to Roths would make sense while rates are lower.

As the end of 2025 approaches it will be important to monitor the estate tax conversation. It may take the entire next year for Congress to reach a resolution and if proper estate planning is not done it may be too late to accomplish. It may well be appropriate on an individual basis to go ahead and make irrevocable gifts early in 2025 recognizing that there is a chance that ultimately the gift may prove unnecessary because the rates were extended at the last minute. High net worth individuals need to be deliberate. They need to examine their net worth and their tolerance for volatility from Washington. If their net worth is high and their tolerance for uncertainty low, they need to see their attorney and investment advisor soon to begin contemplating gifting and what form it will take.

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IN THE SPOTLIGHT

Sterling Ivey, a native of Thomasville, GA, joined Colonial Trust as an Operations and Compliance Analyst in June 2024. Sterling has worked in operations and client support roles in the trust industry for over seven years. He previously worked as a Trust and Operations Assistant with TNB Financial Services. He holds a Bachelor of Arts from Presbyterian College and a Masters in Public Administration from Valdosta State University. Sterling has also attended Cannon Financial Institute's Trust Schools and earned a postgraduate Certificate in Financial Planning from the College for Financial Planning.

He currently lives in Greenville and serves on the board of Habitat for Humanity of Greenville County. Sterling enjoys watching baseball and fly fishing, but most of all, he enjoys spending time with his girlfriend, Marianne, and English Cocker Spaniel, Charlie.

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