PRIVATE ASSET MANAGEMENT, INC.

Managing Locally, **Thinking Globally**.

Staying True to Core Values

Jeff Witt, CFA CIPM CFP®
CEO Private Asset Management

As Private Asset Management (PAM) celebrates its thirtieth anniversary, I am reminded why our founder, Stephen Cohen, initially started the firm – minimizing conflicts of interest prevalent in the industry. At that time, Steve had become disillusioned with our industry, which was selling products that almost ensured clients would lose money but generating large commissions for financial firms. The conflict of interest inherent in these products was galling and Steve's frustration working for a firm that would peddle these products led him to found his own. Steve wanted to make sure that we "always sat on the same side of the table" as our clients, so that we would make more money when they made more money.

Thirty years later, I am happy to report that we have remained true to our founder's vision of always putting the client first and ensuring that we remain on the same side of the table. PAM's fee structure has always remained simplistic, with our investment management services charged a set fee based on assets under management. We do not sell products, nor receive commissions, and we have never shared in any expenses associated with investments (e.g. mutual fund 12B-1 fees). Note that investment management firms are required to report fee and compensation arrangements on a governmental filing called an ADV Part 2. PAM's fee and compensation disclosure runs just over a page, with most of the language covering the items that we neither charge nor receive compensation for.

I have recently been reviewing some of the fee arrangements of other investment firms in our industry and I am appalled at the potential conflicts of interest. For example, while the industry has moved to a zero-commission trading model, some firms have in-house broker-dealer arrangements, where they may charge trading fees. Others might push clients into investment products with higher relative fees, because they receive a commission from these products. Finally, some firms could try to obfuscate these fee arrangements, with lengthy disclosures in their ADV Part 2 and some even needing addendums to this filing to try to explain their fee structure. The result is the clients cannot be sure what they are paying and if their advisor truly has their best interest at heart.

While it can be disheartening to see that these conflicts still exist, I believe they are an anachronism, and the industry is moving to a better place. Professional organizations like the CFA Institute and regulatory bodies like the SEC continue to push the finance industry to better align compensation practices with that of the client's best interest. These efforts appear to be paying off for PAM's clients, as it is easier now to partner with other organizations, such as ETF providers, that are continually lowering fees and offering more services. Thus, we are hopeful the industry will continue to reduce these conflicts of interest. In the meantime, rest assured that PAM will continue to fully embrace its founder's vison of always sitting on the same side of the table as our clients.

David Allen, CFA, CFP®
Chief Economist
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How Concerning Is the Lack of Breadth in the Equity Rally?

US equity markets have performed well so far this year despite challenging circumstances. For instance, the Federal Reserve has continued its fight against inflation by increasing short-term interest rates. In addition, the debate over increasing the debt ceiling introduced unnecessary uncertainty into markets before an agreement was reached earlier this month. We also saw aggregate index earnings per share decline on a year-over-year basis for the second consecutive quarter, suggesting that company fundamentals are weakening. The market has taken all of this in stride.

Through the end of the second quarter, the S&P 500 has generated a total return of 16.9 percent year-to-date and now sits at its highest level in over a year. Along the way, the index has entered a bull market, seemingly turning the page on the COVID-19 bear market. However, the strength of the rally has been extraordinarily concentrated among shares of the largest, tech-exposed companies in the index. Shares of these companies benefitted most recently from investor enthusiasm for generative AI technology and its applications. While we share in this enthusiasm, the lack of breadth suggests that the rally we've enjoyed this year is somewhat fragile.

The reliance on tech is evident in the divergent performance of the three major US equity indices. The NASDAQ Composite Index, which has a tech-heavy membership, has generated a total return of 32.3 percent this year, the best first half for the index in forty years. Meanwhile, the Dow Jones Industrial Average has posted a year-to-date gain of just 4.9 percent. This is the largest spread we have seen between the NASDAQ's and Dow's performance in the first six months of the year dating back to the NASDAQ's debut in 1971.

Sector performance tells a similar story. Just three of eleven S&P 500 Sector Indexes have outperformed this year: Information Technology, Communication Services, and Consumer Discretionary. This year's fourth best-performing sector, Industrials, has underperformed the S&P 500 by 6.7 percentage points. Moreover, of the 362 members of these underperforming sector indexes, just 75 (21 percent) have outperformed the S&P 500 this year.

But the story of the US equity market in the first half of the year is not just tech (and tech-adjacent) versus the rest. It's also the significant outperformance of the mega-cap companies in the index versus the mere large caps. The average return of the ten largest companies in the S&P 500 is over 68 percent, while the rest of the index has seen an average return of 7.7 percent.

One of the impacts of the rally is that valuations look increasingly stretched, which is concerning because, historically, higher multiples are negatively correlated with future returns. The S&P 500 trades with a blended forward PE ratio of 19.3x, close to one standard deviation above the 10-year average. However, the equal-weighted S&P 500 Index, which reduces the influence of the largest sectors in the index, trades with a 15.8x multiple, close to one standard deviation below the 10-year average. Moreover, according to Bloomberg Intelligence, roughly 75 percent of index constituents are trading with a forward PE multiple below the overall index, and 56 percent have a multiple below their own long-term pre-pandemic average.

So, while the overall index may look expensive, there are still large pockets of value available to investors. In the second half of the year, it may be prudent for some investors to shift allocations into these areas. While the possibilities of generative AI are exciting, they cannot sustain a market rally indefinitely. For the current rally to endure long-term, its drivers will need to be less concentrated than what we've seen in the first half of the year. Moreover, at some point, markets will begin focusing more on company fundamentals, and businesses that offer better relative value and consistent, quality earnings will be well positioned.

Tips for Preventing Fraud

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Operations Corner

2023 IRA RMDs

If you have an IRA with us and will be 73 years old or older by December of this year, you should have received a letter in January for your 2023 Required Minimum Distribution (RMD). If you do not have existing instructions on file to satisfy the requirement by end of 2023, please give us a call. We can schedule your RMD for either a one-time future date in 2023, or as a monthly distribution.

Address change: Have you moved or updated contact information?

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All checks for deposit must be made payable either to the name on your account or to "Charles Schwab." They should also be endorsed. We suggest signing and writing "For deposit only" on the back. Checks from a title or insurance company must be endorsed and the signature(s) must match the listed payee(s) exactly, or they will be rejected.

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investment. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors.

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