From the Helm

APRIL 2024

01

FIRST QUARTER 2024 MARKET REVIEW AND OUTLOOK

The first quarter of 2024 saw the S&P 500 rise 10.6% on a total return basis to an all-time-high of 5,254. This was the first time that the S&P 500 posted double-digit gains in consecutive quarters since late 2011. 40% of all trading days during the quarter were record closing highs for the S&P. Just six stocks accounted for 50% of index gains so far this year. The S&P 500 is up 27% in a straight line since October of last year. International stocks are up 4.6% to begin the year with developed and emerging markets indexes up 6.0% and 2.2%, respectively.

The Bloomberg Aggregate Bond Index is down -0.74% this year as rates continue to grind higher. There is evidence that inflation may be turning higher again,

In this Issue

which is poor timing for a Federal Reserve with a clear bias toward cutting interest rates. Today, the bond market seems anchored around its fair value of 4.00% on the 10-year U.S. Treasury yield. We will be on watch for an eventual Fed rate cut that prompts a rise in the 10-year-Treasury yields, rather than a fall, reflecting sticky inflation and inflation expectations.

Despite a U.S. manufacturing recession in 2022 and 2023, a true recession in major Eurozone economies and Japan, and negative earnings growth in the U.S., the equity market was strong last year. Now, the manufacturing business cycle has turned a corner, major global economies are emerging from recession, and the earnings cycle is inflecting positively.

02

JUST KEEP DANCING

In mid-2007, ahead of the Global Financial Crisis, then-CEO of Citigroup Chuck Price was quoted as saying, "...when the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

As we wrote above, the S&P 500 is up 27% since October of 2023 and 50% from the market bottom of October 2022. Can this go on? The Wall Street Journal recently noted that, when the S&P 500 gains more than 8% in the first quarter of the year, it has finished higher for the remainder of the year 94% of the time, with an average gain of 9.7% over the final three quarters. In short, strength begets strength.

Jurrien Timmer of Fidelity recently wrote, "the soldiers have joined the generals, and there is little question that a cyclical bull market is underway. Like most cyclical bull markets, this one started with skepticism and disbelief, and without any apparent fundamental support. The market never got cheap, bottoming at 16xs trailing earnings in October of 2022, and it took four quarters for earnings to bottom which they did a year later in the third quarter of 2023." The question is, how much higher can the market go from here?

Over the last seven cycles, the shallowest bull market run was 48%, and the strongest was 169%. The gain for the current cycle stands at 50% from the October 2023 low. The median cycle has gained at least 60%, which leaves us some more room to run. Another 10% from here would be 5,780 on the S&P 500. For this cycle and market run to persist, we are going to need to see earnings improve in a material fashion. The Technology sector has seen both earnings and earnings expectations rise over the last 12 months, but that has not been the case for other major sectors or asset classes.

For the bull market to accelerate over the near-term, investors should, ironically, root for weaker growth and employment, because that means that the Fed is more likely to cut interest rates, and this should ensure adequate liquidity, allowing deficit spending to continue. In contrast, two consecutive months of higher-than-expected inflation means that investors have shifted from expecting growth to fade (soft landing) to worrying about too much growth (no landing). "No landing" means that Fed rate cuts are less likely, and that inflation does not slow. A "no landing" scenario would not be favorable for equities absent a dramatic improvement in the outlook for corporate earnings.

Powell and company have a very tight window in which to potentially cut rates without being perceived as interfering with the election. There is no Fed meeting in April. This leaves May, June, and July as the most realistic "live" meetings. From September onward, it will be all about the election. It makes little sense to cut interest rates in the face of quietly rising inflation, but Powell clearly wants to do so.

Of course, investors must be prepared for a market pullback at any time, especially from such extended levels.

What can stop this move higher? Three things:

- Higher interest rates. Five percent is a critical level for U.S. Treasury bonds. We are at 4.2% today, and our team believes that fair value for the 10-year is about 4.25%. Remember that debt refinancings for both corporations and the U.S. government pick up in earnest next year. Longer-term interest rates should rise if i.) global growth accelerates, which seems likely as China is modestly reflating, and the Eurozone and Japan are emerging from mild recessions. ii.) inflation starts to grind higher.
- Job losses. So far, this has been benign given an era of lower employment supply. Historically, companies have cut jobs only in periods of material earnings and/or margin reduction. We had a mild earnings contraction last year but appear to be out of the woods. Earnings should accelerate from current levels.
- Geopolitical shock. This is nearly impossible to anticipate but is generally always inflationary.

03

DANCE WITH THE ONE WHO BROUGHT YOU?

Much has been written about the size of the "Magnificent 7" stocks – Amazon, Apple, Nvidia, Microsoft, Google, Tesla, and Meta (formerly Facebook). The "Mag 7" makes up 29% of the S&P 500. The top five stocks in the S&P 500 make up 25.6% of the total, higher than we saw during the peak of the Technology bubble in 2000. The question for investors today is, do you "dance with the one who brought you," i.e. stick with the Big Technology theme or tilt positioning toward continued economic strength and a "broadening" of stocks leading the market?

WHAT HASN'T CHANGED... TOP 5 WEIGHTS INFLUENCE

The prospects for a "broadening" market were disappointing out of the gate in 2024 but slowly improved as the quarter went on. Small-cap stocks are up 2.4%, and the equal-weighted S&P 500 is up 7.8% vs. the S&P 500 which rose 10.6%. The beginning of the year felt like a repeat of 2023 with the Technology and "Tech-like" names leading the way. However, that cohort of stocks (as measured by the performance of the Nasdaq 100, or QQQ) gradually fell back and are now underperforming the broad index year-to-date with cyclical sectors like Energy and Financials leading. Thematic individual stocks like Nvidia (up 82% during the first quarter) generate headlines and are on the tip of every market participant's tongue while names like Apple (down -10.9%) and Tesla (down -29%) have underperformed the market in grand fashion. The month of March showed some broadening of small and mid-cap stocks and non-Technology or Technology-enabled sectors, which makes us cautiously optimistic.

04

LAST DANCE

To conclude, we believe that the global economy narrowly avoided a proper recession in 2022 and 2023, and that we have now rounded a corner in terms of economic growth. Today, we should focus on incredibly strong markets, full valuations and what is already "priced in." We believe that both the Federal Reserve and the Treasury want to "smooth the runway" ahead of November elections.

We believe that the chance of "no landing" is higher than the chance of a "soft landing." There is an extreme consensus amongst investors, fixed income specialists in particular, that U.S. and Developed Market consumer price inflation will continue to drift lower. Later this year, we believe that it is likely that we will see another up leg in bond yields, as the global economy regains momentum, and the strongest economies show signs of sticky and still-elevated underlying inflation. Just last week, Federal Reserve Governor Christopher Waller made a speech titled "There's Still No Rush" in reference to interest rate cuts.

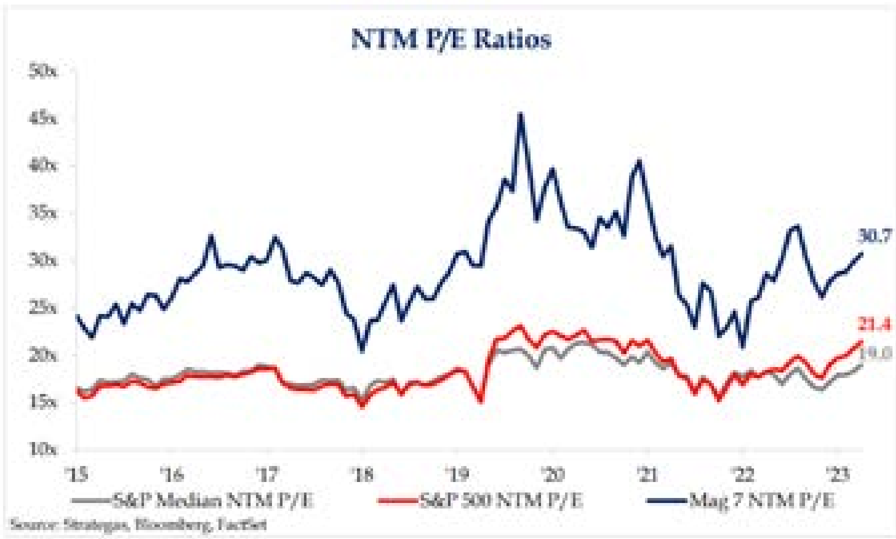
05

THE BULLISH SIDE OF THE LEDGER

- Earnings growth is improving, but only in the Tech + Tech friends' segments. We have not seen material earnings improvement to date out of the remaining sectors of the economy or smaller stocks. Earnings improvement outside of "big Tech" is a crucial factor to keep this market rally going.
- We are on the precipice of beginning a new manufacturing cycle with ISM PMIs set to rise from here and LEIs appearing to have bottomed out.
- An excess $1tr-$1.5tr in money market funds could be re-invested should interest rates begin to fall. This is 17% of total money market assets.
- The Fed is leaning incrementally dovish, but even by its own admission, lacks economic justification to cut interest rates. The Treasury is committed to smoothing the runway ahead of the election. We effectively have a Federal Reserve & Treasury "put" through the presidential election. Aggressive fiscal spending has been powerful.

- China has struggled economically for years and has spread that economic weakness to its largest major trading partner, the Eurozone. The PBOC has been making modest monetary policy adjustments to stimulate the economy which is not particularly effective for a society that does not borrow. If China decides to turn to fiscal stimulus (as it did post the Global Financial Crisis), we could finally see a spark that could catalyze an improvement in global growth overall.

P/E RATIOS: MAG 7 VS. S&P



06

ON THE BEAR SIDE

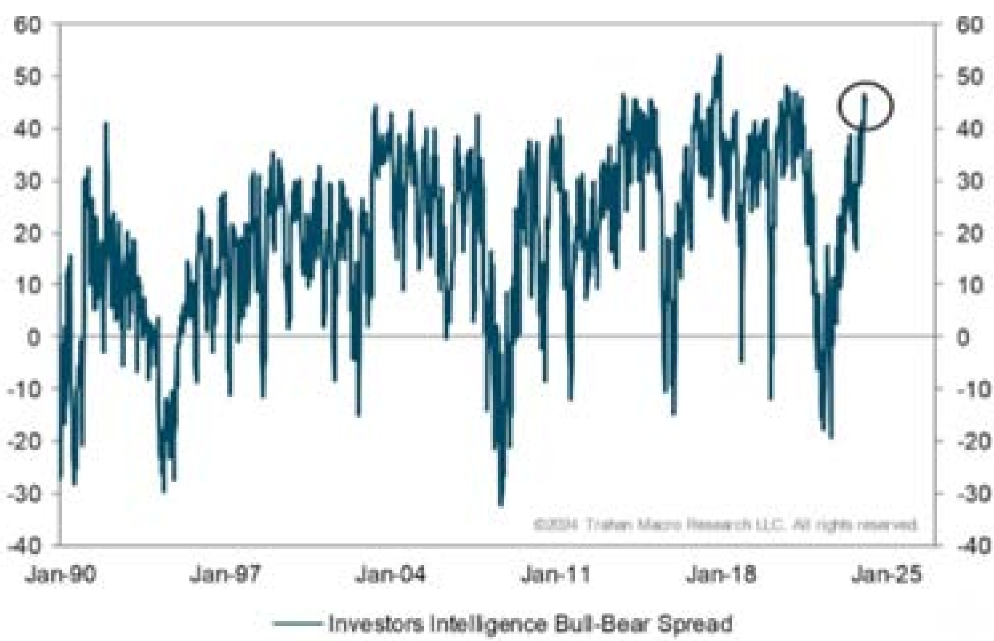
- We have just experienced the most aggressive Fed rate hiking cycle since the Volker era. Will there eventually be a broad impact? We are close to the 24-month window for "long and variable lags" to take hold. We know that companies or economic sub-sectors that borrow using floating rate loans are hurting, but that is a small part of the economy.
- Market sentiment is quite full by our measures. "Fast money" is fully invested.
- Valuations are full. The S&P 500 is trading at a 21xs total market forward P/E multiple, and an 18xs forward P/E multiple on the non-Mag-7 stocks. The inverse-interest-rate justified P/E for this market is 16xs which also happens to be the 15-year average P/E of the U.S. market. For the first time in 20 years, the yield on the 10-year U.S. Treasury bond exceeds the earnings yield of the S&P 500, i.e., the equity risk premium is now zero. This suggests extraordinarily high equity valuations given the relatively high interest rate environment.
- The government and corporate debt refinancing "wall" picks up in earnest in 2025 and 2026. This debt will almost certainly be refinanced at higher interest rates.
- Earnings expectations are too robust for the economic environment. The Street is expecting 10% YoY earnings growth in 2024. We think that it will be closer to 5-7%. As mentioned above, the only place where earnings revisions are rising is in the Technology category.
- Commercial Real Estate problems will trickle through the regional banking complex for the next 3-5 years, as all parties effectively "kick the can down the road."

- There is some subtle deterioration in labor statistics; nearly all the jobs that have been added over the last 6-9 months come in the government and healthcare categories. Private employers have not added jobs in a year. Further, many of the new jobs added are part-time, not full-time, which is a negative indicator. The trajectory of the unemployment rate is THE most important data series in terms of forecasting the health of the economy. We will continue to watch this category very closely.

GOVERNMENT & HEALTH CARE MONTHLY JOB GAINS AS % OF THE NONFARM PAYROLLS

Monthly change 12-month moving average as of February 29, 2024

IT'S NOT OFTEN WE SEE INVESTOR SENTIMENT THIS BULLISH



07

THANK YOU, SARA!

This June we will bid farewell to Sara Lewis, Principal, Executive Vice President, and Director of Client Service, who will retire after 23 years at Spinnaker Trust.

Sara has played an integral role in the firm since its earliest days in 2001, back when Spinnaker Trust was six people, two dogs, and advising just a handful of clients. Sara has provided invaluable leadership as we have grown to meet our clients' evolving needs. We now have a team of forty-five and serve hundreds of families and institutions nationwide.

She is a trusted advisor to clients— known for her sharp ability to distill complex concepts into easy-to-digest insights — and a cherished mentor to members of the Spinnaker Trust team. With her sage counsel and steadfast demeanor, Sara has played a key role in Spinnaker Trust's maturation from a small startup into an advisor of choice for families, foundations, small businesses, and individual investors. She has led the way for Spinnaker to become an employer of choice for the industry's top talent, enabling us to attract professionals with a wide range of skills and expertise to manage our comprehensive services.

Back in 2012, Sara led the development of a Fossil Fuel Free Portfolio on behalf of Unity College — the first college in the country at the time to divest its endowment of fossil fuels. Since then, hundreds of other institutions have followed suit, and the FFF Portfolio has performed in-line with the S&P 500.

08

WELCOME TO SPINNAKER!

We welcomed Eugenio (Geno) Figarella to our Portfolio management team in January. Geno is originally from Puerto Rico and moved to Maine from Miami. Geno has more than 20 years of experience in the asset management industry. During his career, he has had many titles including advisor, relationship manager, trader, senior analyst, and portfolio manager at institutions like Citigroup and Wells Fargo.

09

HAVE YOU HEARD ABOUT AI?

Artificial Intelligence can be found in several services that people use throughout the day, for instance, when you use a language translator on-line, or a chatbot for customer service conversations on a website. AI is being used to enhance operations in areas such as marketing, website content, customer service, personal assistance, inventory management, and cybersecurity.

We can use AI to help humans do what they are already doing faster and more accurately. AI-powered tools can generate consistent content but lack personal touch. AI can also be used maliciously. Be careful of deep fakes, spoofing, and advanced phishing e-mails that deliver malware.

Spinnaker will blend both AI content and human expertise to produce favorable outcomes. We are training and educating our employees on strict adherence to the privacy of our information and its relationship with AI tools.

Please direct any questions concerning AI at Spinnaker Trust to your relationship manager or e-mail cworonoff@spinnakertrust.com

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