

Q2

Quarterly Market Review

Second Quarter 2024



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This report features world capital market performance and a timeline of events for the past quarter. It begins with an article exploring the impact of passive investing on market dynamics and individual stock prices. It then features the returns of stock and bond asset classes in the US and international markets.

Overview:

Quarterly Topic: Has Passive Investing Gotten Too Big?

Market Summary

World Stock Market Performance

US Stocks

International Developed Stocks

Emerging Markets Stocks

Real Estate Investment Trusts (REITs)

Fixed Income

Global Fixed Income

Commodities

Has Passive Investing Gotten Too Big?

Key Takeaways

- Passive investing has grown significantly in recent years, raising questions about its impact on market dynamics and individual stock prices.
- Passive funds make up just one segment of the stock ownership landscape, which also includes direct holdings by retail and institutional investors.
- Truly passive investments don't affect the relative demand for stocks and, therefore, shouldn't significantly impact relative price movements.

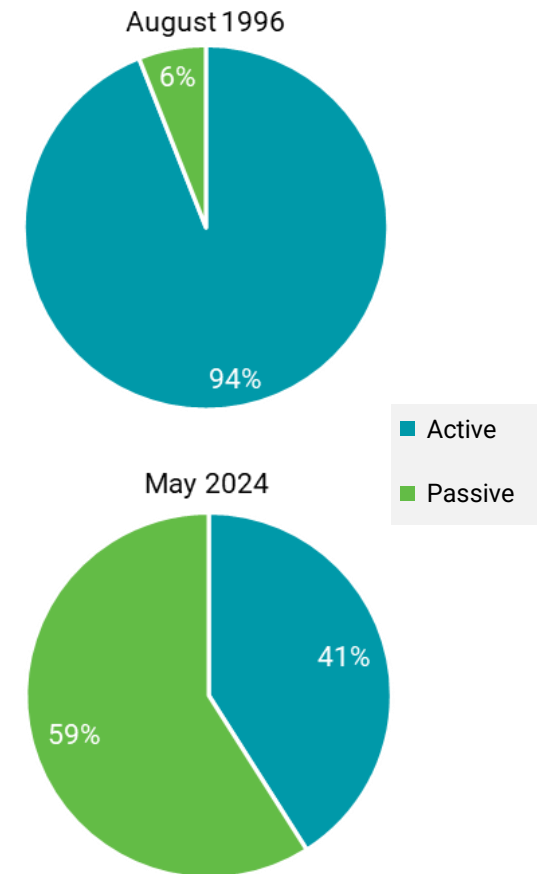
The growing market share of passive investments has been a continuing theme in the fund industry over the past few decades. Passive funds are often thought of as mutual funds or exchange-traded funds (ETFs) that track a periodically rebalanced, market-capitalization-weighted index.

In August 1996, 20 years after the launch of the first publicly available index fund, passive funds represented only 6% of U.S.-domiciled equity mutual fund and ETF assets. Active, non-index tracking funds held 94%. As of the end of May 2024, passive mutual funds and ETF assets have grown to nearly 60% of the equity fund market.

Figures such as these, along with the common perception that all passive investors are buying and holding the market and thereby no longer actively trading in stocks, have brought about questions about the potential impact passive investing may have on market prices. Periods when a subset of companies rise rapidly in price and valuations, such as the Magnificent 7 stocks of late, may also contribute to investor curiosity. Some claim that perhaps more money flowing into index funds that hold these companies is the driving force for the dramatic price increases in those few mega-cap companies with very high prices.

Figure 1 | Passive Fund Assets Have Grown Exponentially Over the Past Several Decades

Share of Equity Mutual Fund and ETF Assets by Active and Passive



Has Passive Investing Gotten Too Big?

While the growth of passive funds has been a remarkable trend to watch, we believe that's all it is. Truly passive investments don't affect relative demand for the ownership of companies and so shouldn't have a significant effect on relative price movements, or in other words, drive price changes in some companies more than others. We explain why.

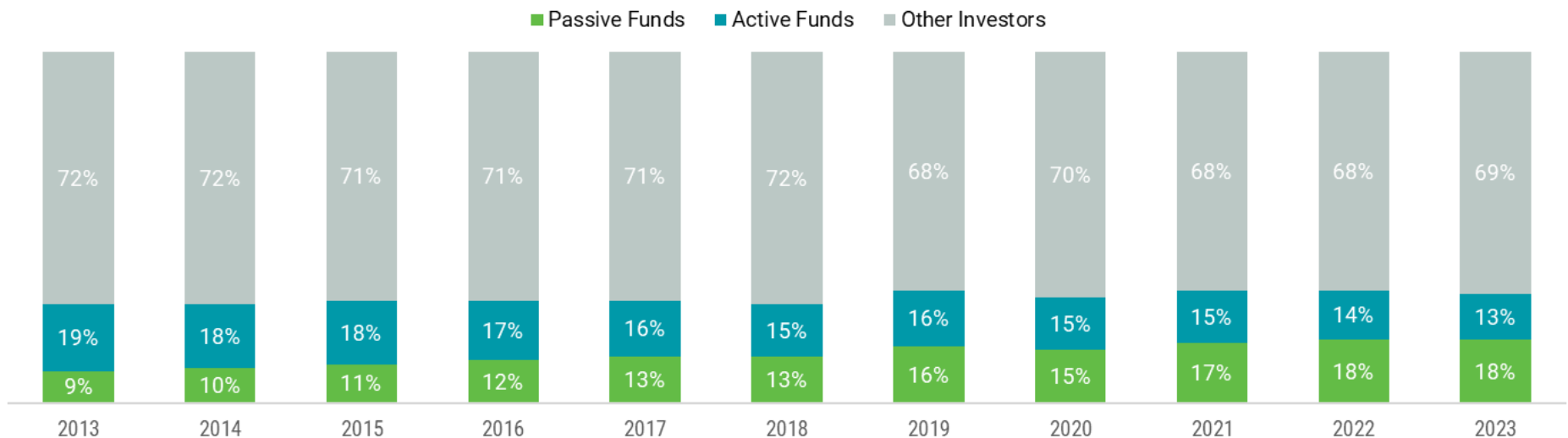
Mutual Funds and ETFs Aren't the Only Owners of Stocks

First, it's important to recognize that all securities are owned by investors, not only through funds but also directly, such as those held directly by retail and institutional investors. Considering the share of index fund ownership of all securities in the market versus just within the fund industry meaningfully changes the picture.

At the end of 2023, index-tracking mutual funds and ETFs were measured to hold only 18% of U.S. stocks. **Figure 2** shows how this has evolved. Index funds have increased their share primarily at the expense of active funds, not direct holdings.

We acknowledge that this still may not provide a complete picture of the ownership of companies attached to passive strategies, given that there may also be passive approaches managed in institutional and retail separate accounts. A recent study considered this reality and estimated the actual ownership of passive strategies between 30% and 35%.¹ So, while it's difficult to determine the total share of passive investing, we know it becomes much smaller when we expand our view beyond mutual funds and ETFs.

Figure 2 | Index Funds' Share of the Total U.S. Stock Market Is Small
Percentage of U.S. Stock Market Capitalization at Year-End



Data from 2013 – 2023. Source: Investment Company Institute (ICI), 2024 Fact Book.

¹ Alex Chinco (Baruch College, Zicklin School of Business) and Marco Sammon (Harvard Business School), "The Passive-Ownership Share Is Double What You Think It Is," (April 2024). Available at SSRN.

Has Passive Investing Gotten Too Big?

Redefining Passive Investments

The definition of passive investments also bears redefining. A truly passive investment makes no security selection decisions. For example, a total market index, such as the Russell 3000® Index, is designed to capture essentially all companies in the U.S. market at their market capitalization weight with very little security selection. This is a passive investment. While larger companies will have a higher dollar allocation than smaller companies, no companies are held disproportionately more or less than in the market.

In contrast, many other indexes tracked by funds today select subsets, or asset classes, of the market or even more customized indices that are even closer to traditional active stock picking. Think of the Russell 1000® Growth Index, representing U.S. large-cap growth stocks, or the Russell 2000® Value Index, representing U.S. small-cap value stocks.

With asset class indexes, someone – typically the index provider – makes security selection decisions about which companies to hold. These active decisions include which companies will be classified as large or small, value or growth and at what weight to hold them. Different index providers tend to make different choices when defining asset class indexes and when and how often to rebalance them. These aren't truly passive investments.

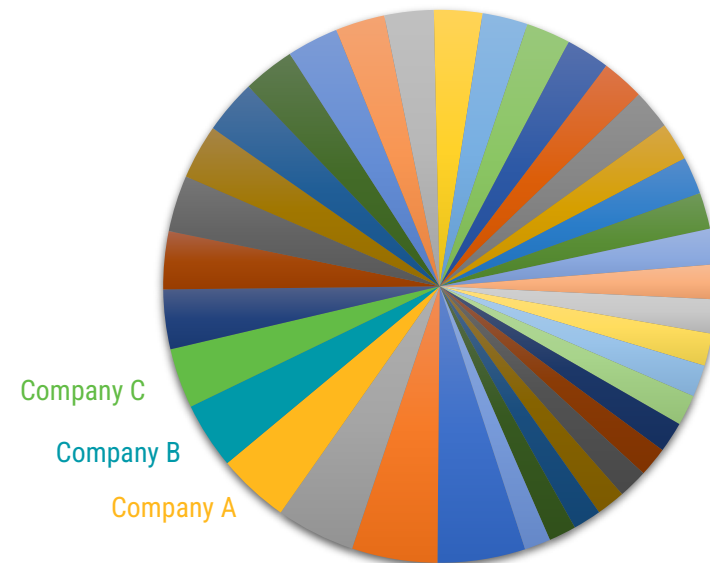
The active decisions underlying asset class indexes can be viewed similarly to those made in traditional active stock-picking strategies, but portfolio managers don't make these decisions. With funds tracking asset class or custom indices, portfolio managers are tasked with simply

following the holdings selected by the index provider (e.g., FTSE Russell, S&P, CRSP, MSCI).

A Sharpe Perspective

Following the logic of renowned economist and Nobel laureate Bill Sharpe, we can get an idea of the effects of truly passive strategies buying the market (i.e., those without security selection decisions). To start, the market is the aggregation of all company shares owned by all investors, as depicted in **Figure 3**.

Figure 3 | The Market Is the Aggregation of All Companies

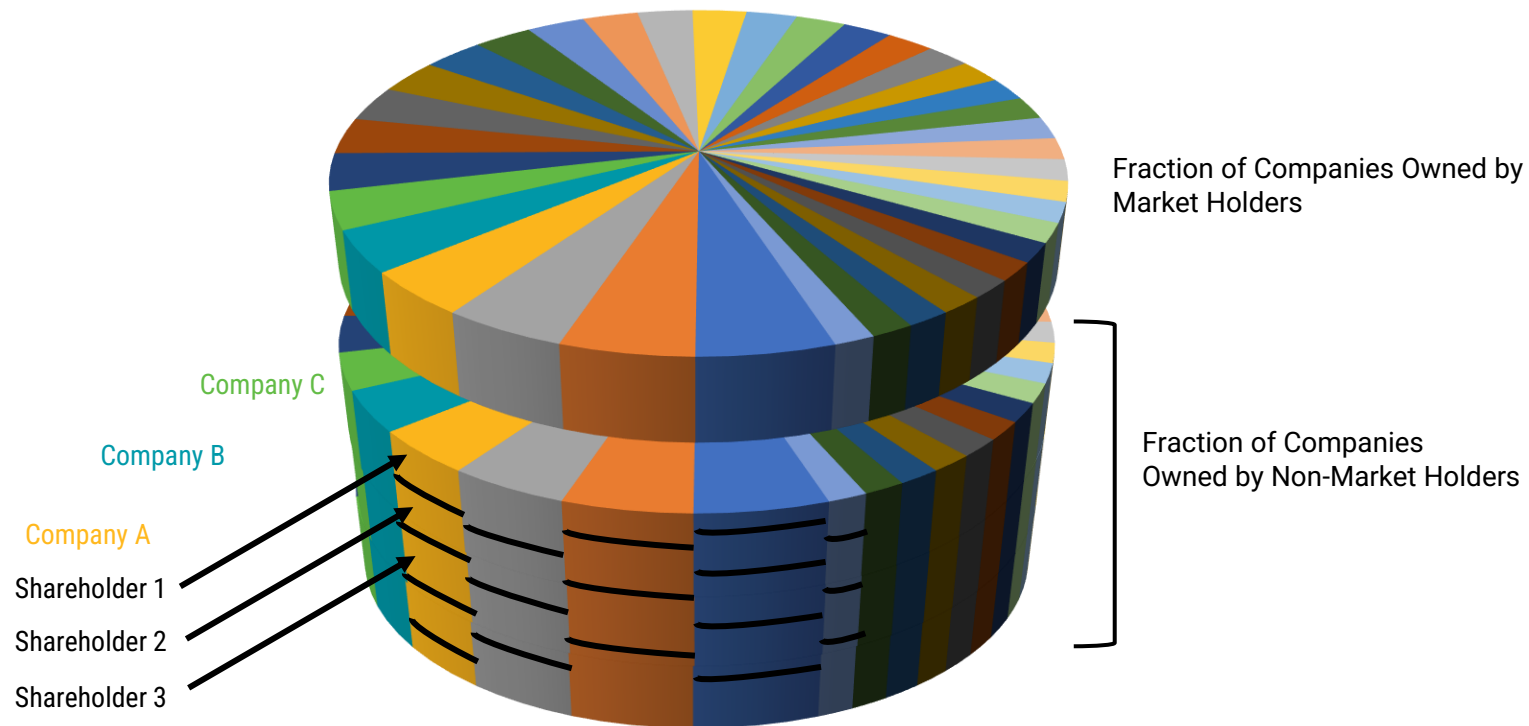


Has Passive Investing Gotten Too Big?

It follows that the market comprises all passive investors who hold a pro-rata slice of all companies in the market (market holders) and active investors with holdings that differ from the market (non-market holders). Non-market holders include active fund investors, asset class index fund investors and other investors who hold stocks outside of funds that don't match the market.

Critically, Sharpe's logic points out that if some investors buy the market, non-market holdings must also add up to the market in aggregate. **Figure 4** illustrates this point.

Figure 4 | Market and Non-Market Investor Holdings Add Up to the Total Market

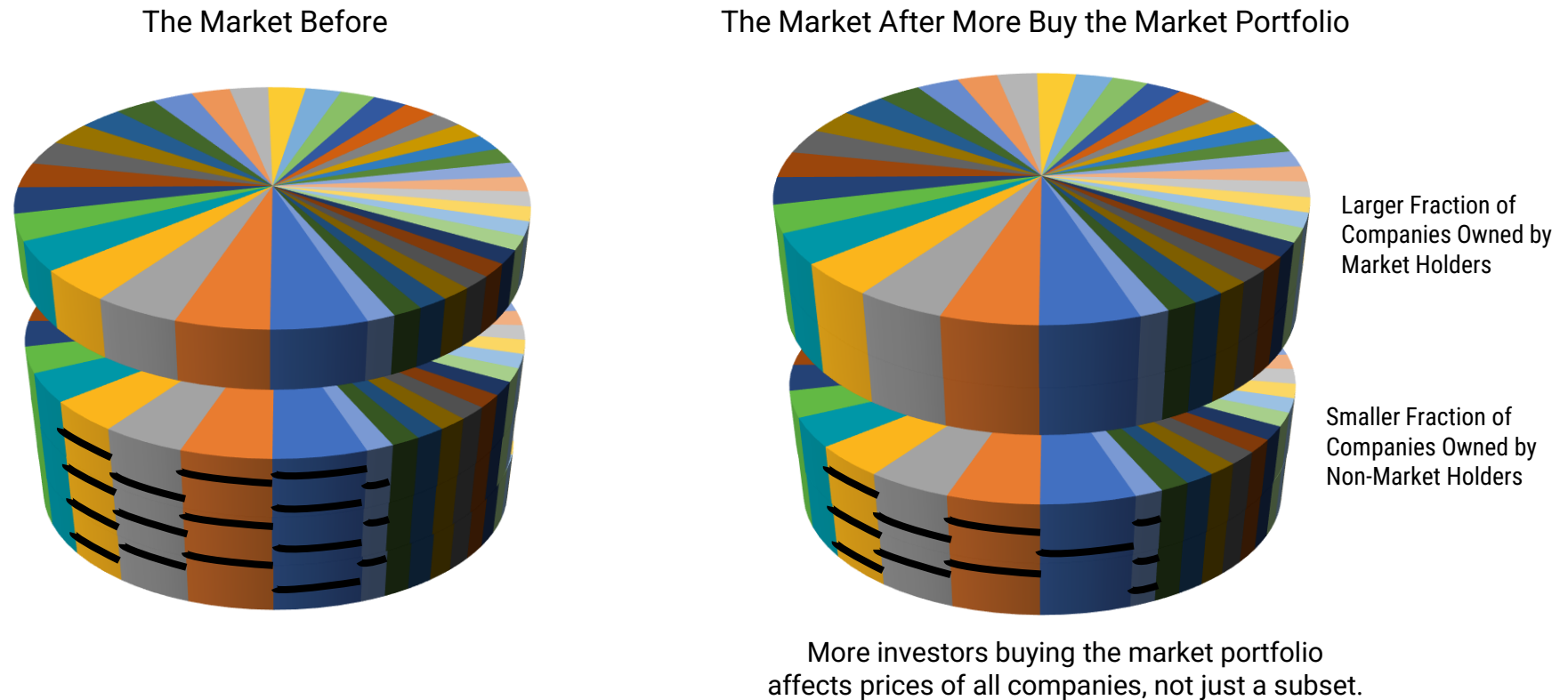


Has Passive Investing Gotten Too Big?

So, what happens when more investors become market holders (i.e., by buying total market index funds)? Let's imagine that market holders own 30% of the market, and now, new investors have decided to move from cash to buy an additional 1% of the market. These new market holders need to buy an equivalent share of each company from a diversified group of non-market holders to increase the share for market holders.

In this scenario, the demand for the ownership fraction of each company is the same. While this activity may push prices (price incentivizes sellers), there is no clear reason why a small subset of companies (e.g., mega caps) will be bid up significantly more than the rest of the market. **Figure 5** demonstrates this example.

Figure 5 | More Investors Buying the Market Portfolio Should Affect Prices of All Companies Equally



Has Passive Investing Gotten Too Big?

Who Drives Relative Price Changes?

In contrast to market holders, non-market investors are more likely to push the prices of some companies more than others. This is because non-market holders will prefer a subset of companies in the market and will buy them from other non-market investors who hold them. Again, the incentive for the seller is price. Market holders are only spectators to this activity and play no role in the trades.

This same effect can occur from non-market, asset class fund investors, whether from an actively managed fund, index-tracking fund or a strategy buying just a few stocks. If many investors come to prefer a particular asset class, those preferred securities can be pushed up in price more than other companies in the market. This is particularly true of funds tracking growth indexes that tend to continue to hold securities despite rising prices, whereas value indexes tend to sell securities as prices go up.

What About Non-Market Holders Converting to Market Holders?

In the scenario that many non-market holders decide to become market holders (i.e., rather than coming from cash, as in the first example), the distribution of the non-market holders matters when it comes to price effects. We can think of this as biased and non-biased cohorts of non-market holders.

Suppose the investors wishing to buy the market currently hold investments in aggregate similar to the market (non-biased cohort). In that case, the effect on prices should also be reasonably distributed across companies; in other words, there should be no significant difference in impact between companies.

If, instead, there is a bias to a particular area of the market among the non-market converters (biased cohort), such as holding only small-caps, then moving to the market portfolio would likely push down prices of small-cap stocks and push up prices of large-cap stocks. Importantly, that effect would not be limited to only the largest companies, such as the Magnificent 7 stocks. The effect would be across all large-cap companies.

Has Passive Investing Gotten Too Big?

Takeaways

In our view, this logic from Sharpe provides a powerful framework for understanding relative stock price movements from investor activity. While the details come with some complexity, we believe the critical takeaway is that there is a sound theory to address the common investor questions about the effects of continued growth among index funds.





The theory is clear that passive market holders shouldn't have any significant effect on relative stock prices. It's the non-market holders, including asset class investors (index or active) and, in particular, growth-oriented investors, who are more likely to push prices. This is just one reason we think all asset class strategies (index-based or otherwise) must be evaluated based on their methodology for selecting and weighting securities and overall expected implementation costs and results.

While some index-based strategies may look attractive based on expense ratios alone, when considering overall implementation costs, the low-cost advantage may be eliminated due to their prioritization of tracking the index on top of all other implementation costs.

The fact that market, or large-cap blend, index funds are allocating a large fraction of their assets to a few mega-cap companies with very high prices today, disregarding their expected returns or valuations, is caused by the high prices of these stocks. It's not the reason why they have high prices. We think strategies that consider market capitalization and valuations should produce better outcomes for investors.

Quarterly Market Summary

Index returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q2 2024	STOCKS				BONDS	
	3.22%	-0.60%	5.00%	-1.48%	0.07%	0.11%
						
Since Jan. 2001						
Average Quarterly Return	2.4%	1.6%	2.5%	2.2%	0.9%	0.9%
Best Quarter	22.0%	25.9%	34.7%	32.3%	6.8%	5.4%
	2020 Q2	2009 Q2	2009 Q2	2009 Q3	2023 Q4	2023 Q4
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-5.9%	-4.1%
	2008 Q4	2020 Q1	2008 Q4	2008 Q4	2022 Q1	2022 Q1

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net dividends]), Emerging Markets (MSCI Emerging Markets Index [net dividends]), Global Real Estate (S&P Global REIT Index [net dividends]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2024, all rights reserved. Bloomberg data provided by Bloomberg.

Long-Term Market Summary

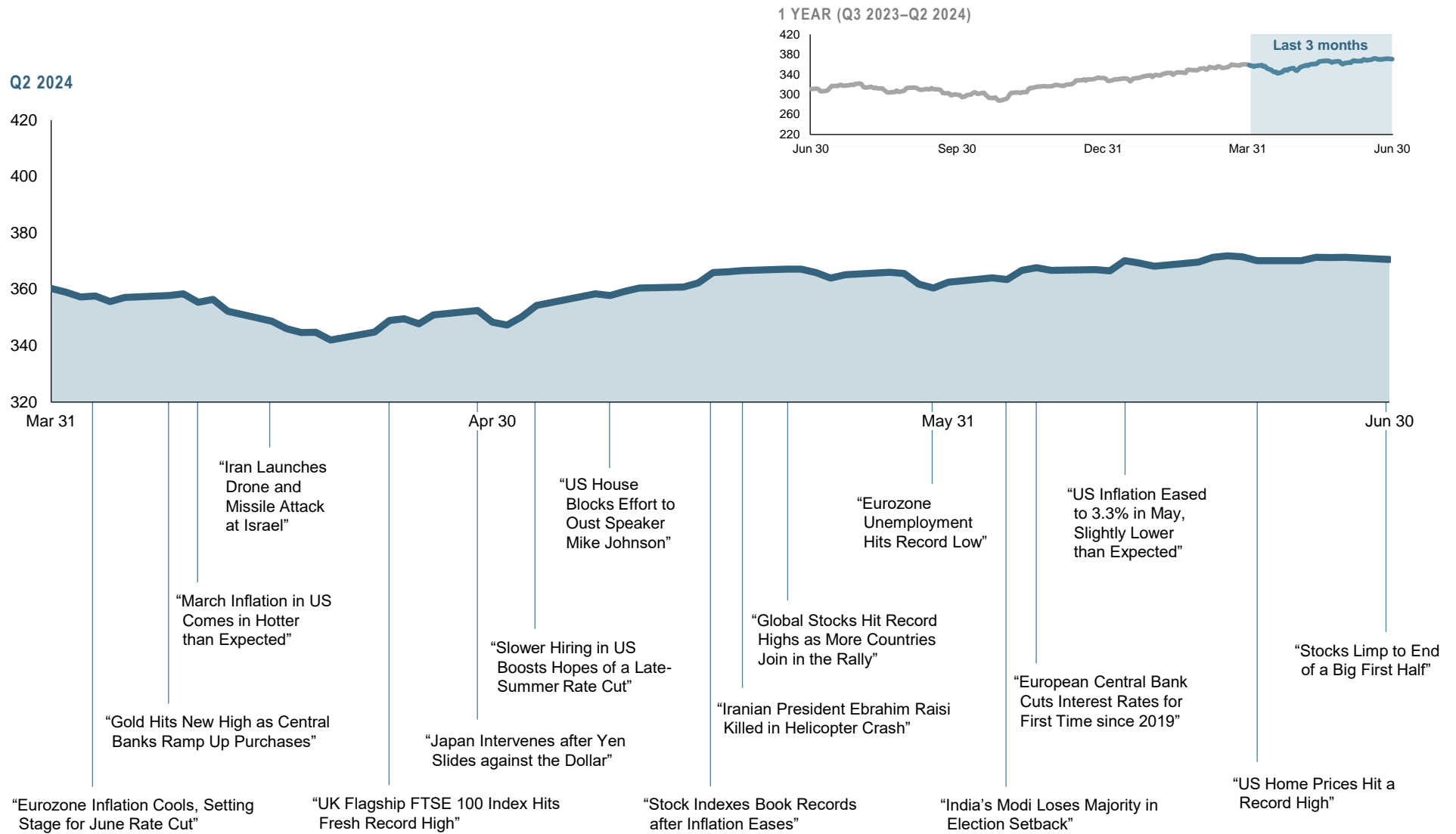
Index returns as of June 30, 2024

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1 Year	STOCKS				BONDS	
	23.13%	11.22%	12.55%	5.10%	2.63%	5.26%
						
5 Years						
	14.14%	6.55%	3.10%	0.65%	-0.23%	0.51%
						
10 Years						
	12.15%	4.27%	2.79%	2.94%	1.35%	2.45%
						

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World Stock Market Performance

MSCI All Country World Index with selected headlines from Q2 2024



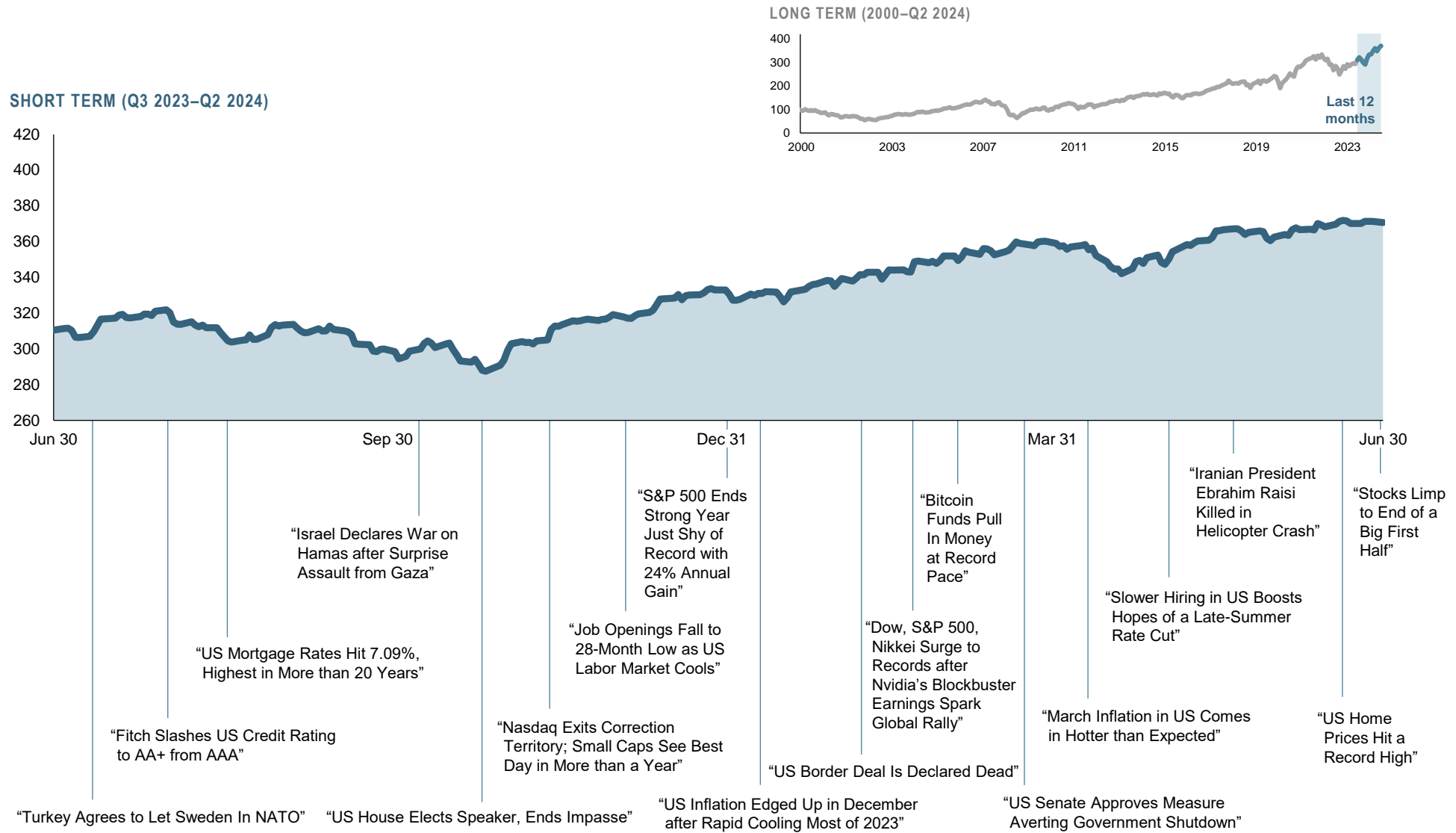
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2024, all rights reserved. Index level based at 100 starting January 2000.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2024, all rights reserved. Index level based at 100 starting January 2000.

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US Stocks

Second quarter 2024 index returns

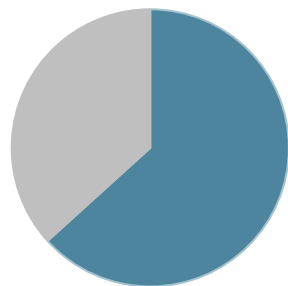
The US equity market posted positive returns for the quarter and outperformed non-US developed markets, but underperformed emerging markets.

Value underperformed growth.

Small caps underperformed large caps.

REIT indices underperformed equity market indices.

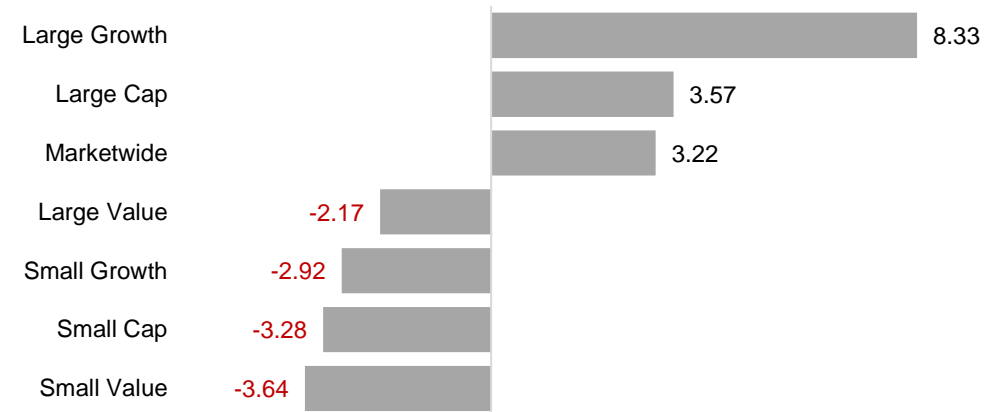
World Market Capitalization—US



63%

US Market
\$52.1 trillion

Ranked Returns (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
Large Growth	8.33	20.70	33.48	11.28	19.34	16.33
Large Cap	3.57	14.24	23.88	8.74	14.61	12.51
Marketwide	3.22	13.56	23.13	8.05	14.14	12.15
Large Value	-2.17	6.62	13.06	5.52	9.01	8.23
Small Growth	-2.92	4.44	9.14	-4.86	6.17	7.39
Small Cap	-3.28	1.73	10.06	-2.58	6.94	7.00
Small Value	-3.64	-0.85	10.90	-0.53	7.07	6.23

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International Developed Stocks

Second quarter 2024 index returns

Developed markets outside of the US posted negative returns for the quarter and underperformed both US and emerging markets.

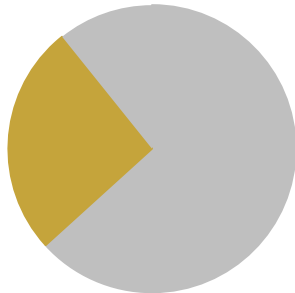
Value outperformed growth.

Small caps underperformed large caps.

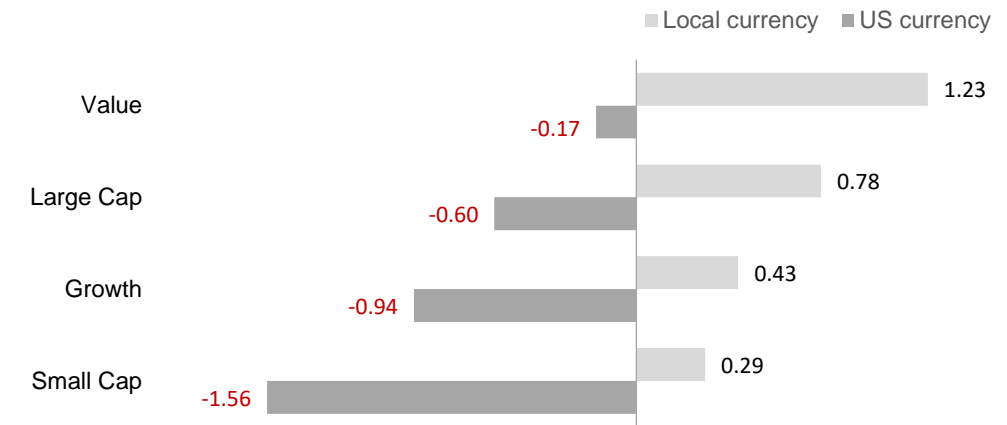
World Market Capitalization—International Developed

26%

International
Developed Market
\$21.4 trillion



Ranked Returns (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
Value	-0.17	4.03	13.17	5.45	6.21	3.06
Large Cap	-0.60	4.96	11.22	2.82	6.55	4.27
Growth	-0.94	5.91	9.36	0.02	6.46	5.23
Small Cap	-1.56	0.98	7.80	-2.98	4.69	4.04

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Emerging Markets Stocks

Second quarter 2024 index returns

Emerging markets posted positive returns for the quarter and outperformed both US and non-US developed markets.

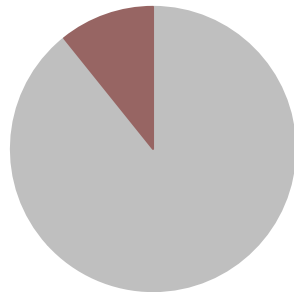
Value outperformed growth.

Small caps outperformed large caps.

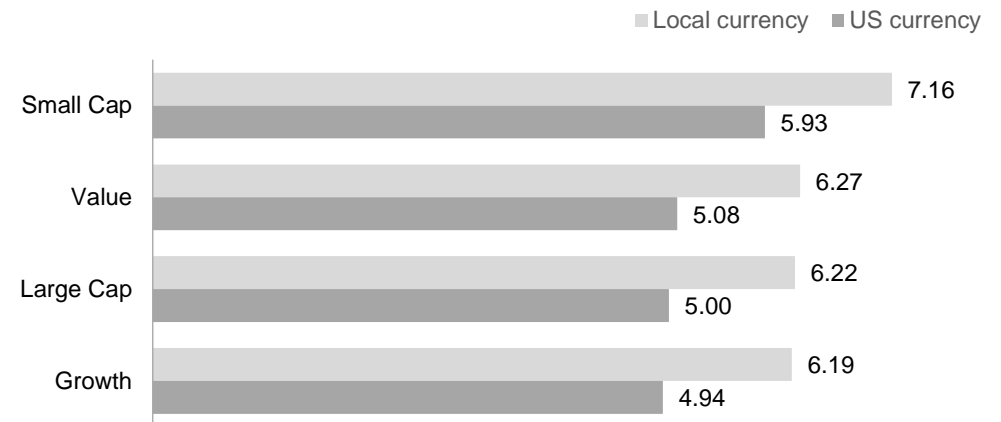
World Market Capitalization—Emerging Markets

11%

Emerging Markets
\$8.9 trillion



Ranked Returns (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
Small Cap	5.93	7.04	20.04	2.54	9.99	5.15
Value	5.08	6.46	14.13	-1.09	2.91	1.96
Large Cap	5.00	7.49	12.55	-5.07	3.10	2.79
Growth	4.94	8.45	11.08	-8.70	3.18	3.51

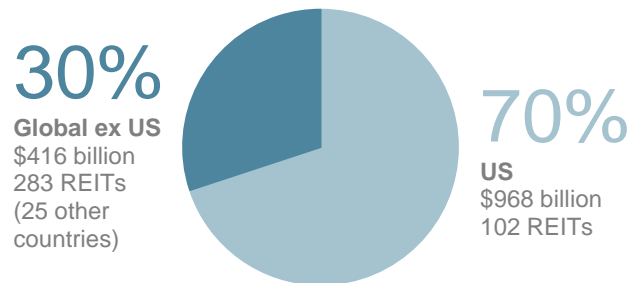
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Real Estate Investment Trusts (REITs)

Second quarter 2024 index returns

US real estate investment trusts outperformed non-US REITs during the quarter.

Total Value of REIT Stocks



Ranked Returns (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
US REITS	-0.16	-0.55	7.15	-0.14	2.78	5.17
Global ex US REITS	-4.39	-6.72	2.45	-7.80	-3.59	-0.05

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones and S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Fixed Income

Second quarter 2024 index returns

Interest rates generally increased in the US Treasury market for the quarter.

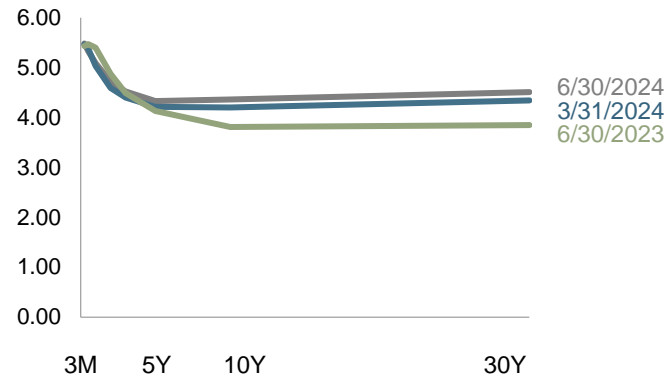
On the short end of the yield curve, the 1-Month US Treasury Bill yield decreased 2 basis points (bps) to +5.47%, while the 1-Year US Treasury Bill yield increased 6 bps to +5.09%. The yield on the 2-Year US Treasury Note increased 12 bps to +4.71%.

The yield on the 5-Year US Treasury Note increased 12 bps to +4.33%. The yield on the 10-Year US Treasury Note increased 16 bps to +4.36%. The yield on the 30-Year US Treasury Bond increased 17 bps to +4.51%.

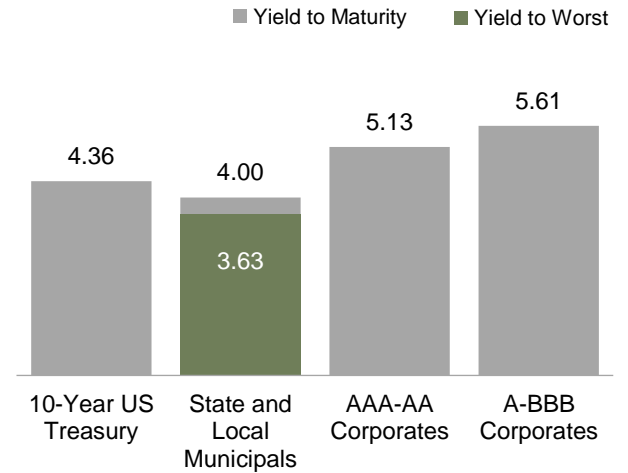
In terms of total returns, short-term US treasury bonds returned +0.77% while intermediate-term US treasury bonds returned +0.58%. Short-term corporate bonds returned +0.96% and intermediate-term corporate bonds returned +0.74%.¹

The total returns for short- and intermediate-term municipal bonds were +0.35% and -0.92%, respectively. Within the municipal fixed income market, general obligation bonds returned -0.30% while revenue bonds returned +0.07%.²

US Treasury Yield Curve (%)



Bond Yield Across Issuers (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
ICE BofA US 3-Month Treasury Bill Index	1.32	2.63	5.40	3.03	2.16	1.51
ICE BofA 1-Year US Treasury Note Index	1.11	1.95	5.02	1.80	1.69	1.36
Bloomberg U.S. High Yield Corporate Bond Index	1.09	2.58	10.44	1.64	3.92	4.31
FTSE World Government Bond Index 1-5 Years (hedged to USD)	0.87	1.13	4.84	0.38	1.03	1.43
Bloomberg U.S. TIPS Index	0.79	0.70	2.71	-1.33	2.07	1.91
Bloomberg U.S. Aggregate Bond Index	0.07	-0.71	2.63	-3.02	-0.23	1.35
Bloomberg Municipal Bond Index	-0.02	-0.40	3.21	-0.88	1.16	2.39
FTSE World Government Bond Index 1-5 Years	-0.06	-1.41	2.43	-2.73	-0.79	-0.78
Bloomberg U.S. Government Bond Index Long	-1.80	-4.99	-5.55	-10.45	-4.24	0.60

1. Bloomberg US Treasury and US Corporate Bond Indices.

2. Bloomberg Municipal Bond Index.

One basis point (bps) equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds and the Yield to Worst are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the ICE BofA US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA Corporates, BBB-A rated. Bloomberg data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (S&BBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). FTSE fixed income indices © 2024 FTSE Fixed Income LLC, all rights reserved. ICE BofA index data © 2024 ICE Data Indices, LLC. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Bloomberg data provided by Bloomberg.

Global Fixed Income

Second quarter 2024 yield curves

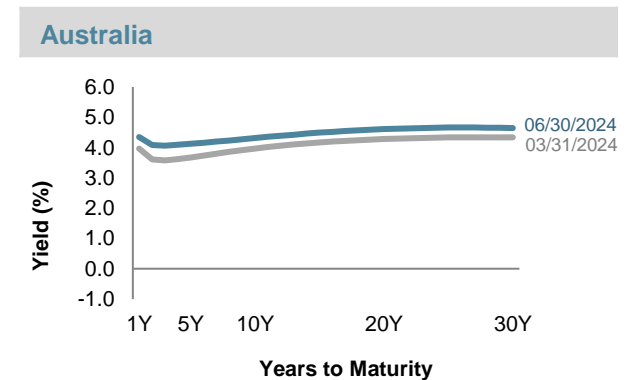
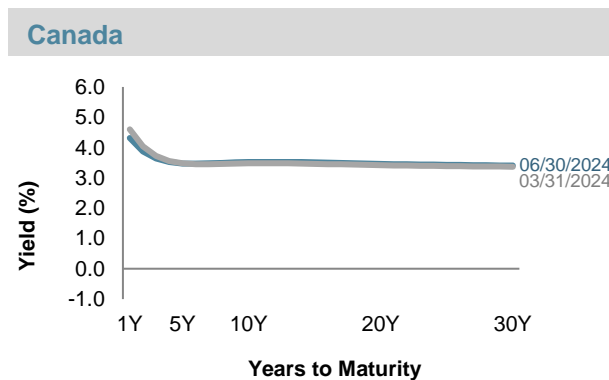
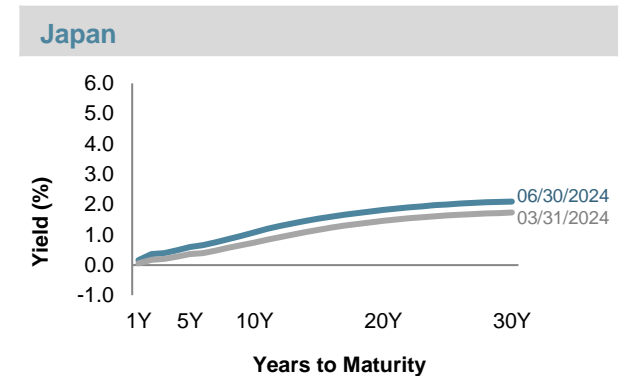
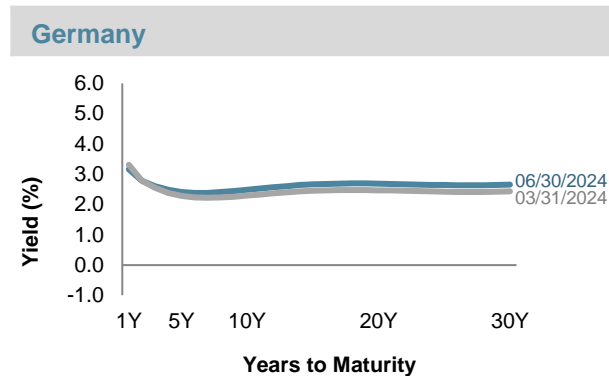
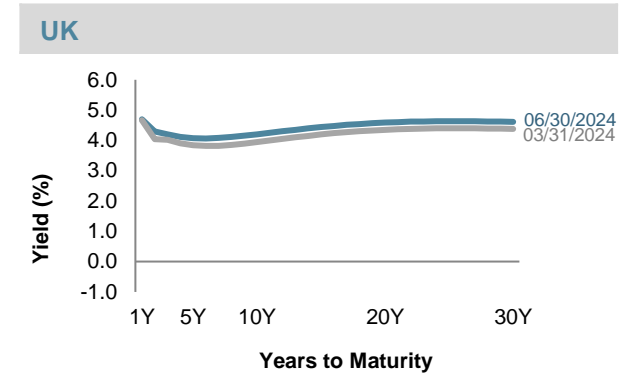
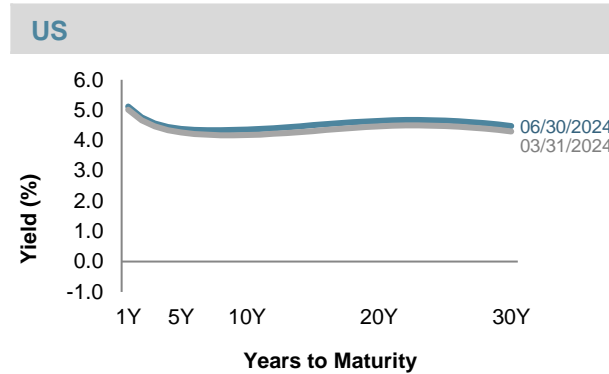
Interest rates generally increased across global developed markets for the quarter.

Realized term premiums were negative across global developed markets, as longer-term bonds generally underperformed shorter-term bonds.

In Germany and Canada, short-term interest rates decreased while longer-term interest rates generally increased. The short-term segment of the yield curve remained inverted in Australia, UK, Germany, and Canada.

Changes in Yields (bps) since 03/31/2024

	1Y	5Y	10Y	20Y	30Y
US	11.1	12.2	18.1	18.2	18.5
UK	2.7	23.5	25.9	23.6	23.5
Germany	-15.0	13.2	19.0	21.9	22.3
Japan	10.9	23.2	33.9	35.6	36.9
Canada	-28.4	-0.8	4.5	4.4	3.6
Australia	38.3	44.6	34.8	32.5	30.4



Commodities

Second quarter 2024 index returns

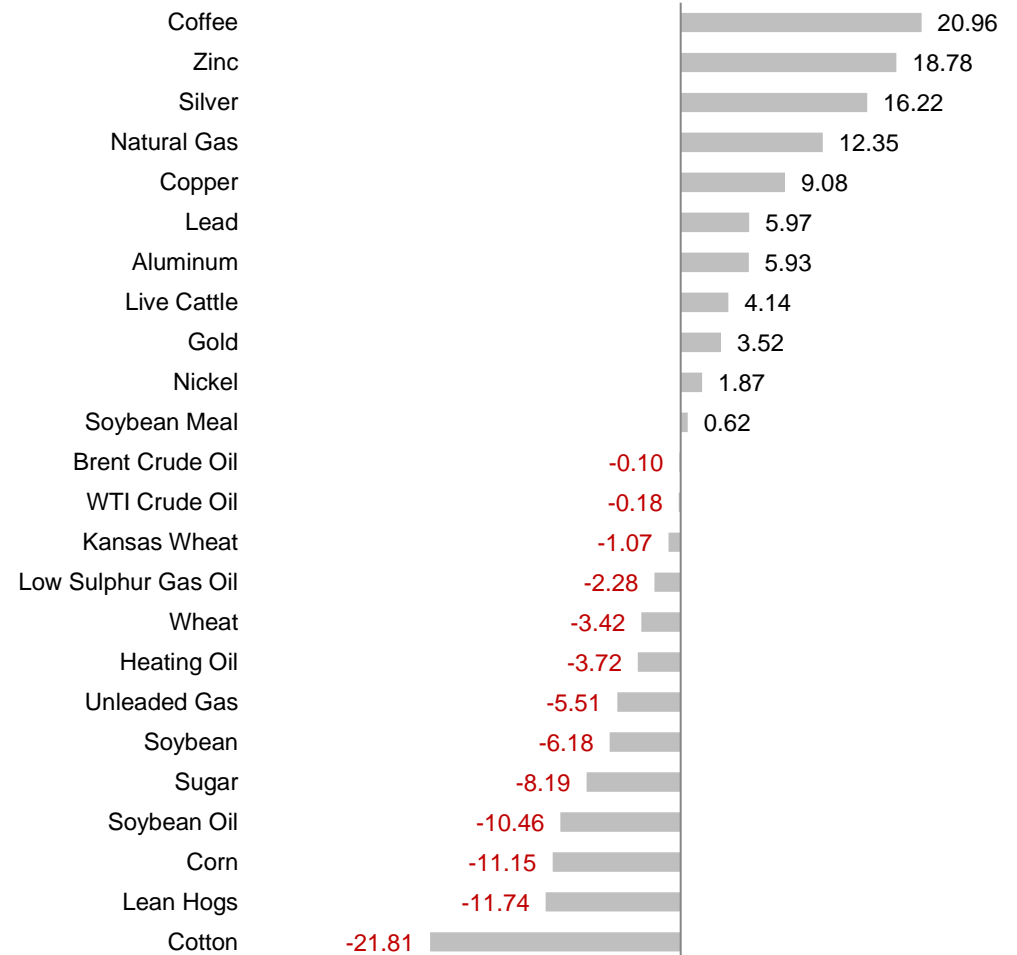
The Bloomberg Commodity Total Return Index returned +2.89% for the second quarter of 2024.

Coffee and Zinc were the best performers, returning +20.96% and +18.78% during the quarter, respectively. Cotton and Lean Hogs were the worst performers, returning -21.81% and -11.74% during the quarter, respectively.

Period Returns (%)

Asset Class	QTR	YTD	1 Year	Annualized		
				3 Years	5 Years	10 Years
Commodities	2.89	5.14	5.00	5.65	7.25	-1.29

Ranked Returns (%)



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