

COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

MARKET RECAP

The U.S. Equity market had a good second quarter, recording a 4.3% gain as measured by the S&P 500 Index. The Technology and Communications sectors accounted for the bulk of this positive return, which was not as impressive as the breadth of sectors that accounted for the positive return in Q1. While the S&P 500's 15.3% return in the first half of this year and the break through all-time highs paint a picture of market strength, the durability of that strength is yet to be tested. Equity investors continue to allocate to Growth equities, which were up 9.6% in the quarter and up 23.6% in the first half of the year as measured by the S&P 500 Growth Index. Value stocks, as measured by the S&P 500 Value Index, were down 2.1% in the quarter and up 5.8% in the first half. The NASDAQ's 8.5% return in the quarter and 18.6% return year-to-date was on top of the leaderboard among the flagship indices, with Dow Jones Industrial Average down 1.3% in the quarter and up only 4.8% in the first half. Smaller-capitalization stocks, as measured by the Russell 2000 Index, were down 3.3% in the quarter and up only 1.7% in the first half. Overseas markets did not fare much better, with the MSCI EAFE Index of international developed market equities down 0.2% in USD terms in the quarter. Japan's Nikkei 225 Index, which was the standout performer in Q1, retrenched by 7.7% in Q2. The MSCI Emerging Markets Index was up 5% in the quarter.

The Information Technology sector was the best performer in Q2, up 13.8%. It was closely followed by Communication Services, which was up 9.4% in Q2 on the back of GOOGL's 33% gain. Utilities also had a good quarter, up 4.7%. Cyclical sectors, including Materials, Industrials, Energy, and Financials, all recorded low single-digit negative returns during the quarter, with Materials down the most (-4.5%). Still, ten out of eleven S&P 500 sectors had a positive return through the first half of the year, with Real Estate being the only one down (-2.4%).

The commodity complex had mixed performance during the quarter, with WTI Crude Oil down 2%, Gasoline down 8.4%, and Agricultural commodities down 4.7%, but Natural Gas (47.5%), Silver (17.3%), and Copper (9.6%) were all up meaningfully.

Investors' anticipation of a lower Fed Funds rate in the second half of the year did not do much for Fixed Income assets in Q2. The Bloomberg Global Aggregate Index was down 0.6% in the quarter. The Bloomberg Intermediate Treasury Index was up 1.1%, Intermediate Government/Credit was up 1.3%, and High Yield was up 2.3%. The Bloomberg 5-Yr Municipal Index was down 0.5%. The U.S. Dollar registered a 1.9% appreciation in the quarter vs. other currencies as measured by the DXY Index.

MARKET RECAP AND OUTLOOK THIRD QUARTER 2024

KEY POINTS

Note: All returns include invested cash flows expressed in U.S. dollar terms

MARKET SCORECARD as of 06/30/2024	TOTAL RETURN IN USD	
	Q2	2024 TR
DOW JONES IND AVG	-1.3%	4.8%
S&P 500	4.3%	15.3%
NASDAQ	8.5%	18.6%
MSCI EAFE EQUITY <small>(GROSS)</small>	-0.2%	5.8%
RUSSELL 2000 INDEX	-3.3%	1.7%
MSCI EMERGING MARKET EQUITY <small>(GROSS)</small>	5.0%	7.6%
BLOOMBERG GLOBAL AGG BOND INDEX	-0.6%	-3.2%
BLOOMBERG INTERM. TREASURY	1.1%	0.2%
BLOOMBERG INTERM. GOVT/CREDIT	1.3%	0.5%
BLOOMBERG 5 YEAR MUNI INDEX	-0.5%	-0.8%
BLOOMBERG HIGH YIELD CORP INDEX	2.3%	2.6%
ishares S&P GSCI COMMODITY TR INDEX	0.4%	10.5%

- Inflation and growth have come down in tandem this year, opening the window for easier monetary policy by the Federal Reserve in the second half of the year.
- The key question for investors remains whether the expected Fed rate cuts can mitigate further slowdown in the economy. We remain more cautious than the consensus and expect inflation could remain stickier than many forecast.
- Our focus is on the defensive and undervalued parts of the equity market. We also have a preference for international equities and commodities.
- Structural concerns in the economy, which include debt and deficits, keep us cautious on the trajectory of long-term interest rates. Upcoming U.S. elections in November could provide a fresh opportunity to address some of those issues.

INVESTMENT OUTLOOK

There are three key factors that will affect investors' outlook for the rest of this year and going into '25. In the short term, the key variable remains the never-ending tug of war between economic growth and inflation in the U.S. and how it could affect the direction of the Federal Reserve's monetary policy. In the intermediate term, the U.S. Presidential election this November has the potential to more meaningfully impact the economy through the changes in regulation and enactment of key reforms, ultimately impacting long-term productivity and sustainable growth. Permeating through all of that is geopolitical risk that keeps investors on edge and brings into the spotlight some longer-term issues, such as energy independence and government spending priorities.

For now, it looks like the trend of weakening inflation and growth has opened the door for the Federal Reserve to potentially lower its key Fed Funds rate. The market currently assigns more than 90% probability that the Fed will lower the rate by 25bps at its September meeting. On top of that, investors see a more than 66% probability that rates will be lowered again at the Fed's November meeting, with at least two more rate cuts priced in for '25. The key question for investors is whether the Fed's serving of monetary stimulus comes in such a portion that it boosts growth enough to prevent a recession but does not reignite inflation. According to the most recent global asset manager survey by Bank of America, 68% of investors see a "soft landing" scenario for the economy, meaning slower growth accompanied with a timely arrival of monetary stimulus and avoidance of a recession. Another 18% see a "no landing" scenario, which would imply an acceleration of growth without accompanied acceleration in inflation. It is that optimism that has fueled the S&P 500's 15.3% return in the first half of the year and allowed it to climb to historical levels of valuation. A failure by the Fed to deliver such rate cuts would significantly disrupt the existing consensus with negative consequences for risk assets.

The looming Presidential election in the U.S. has the potential to change the odds for asset returns in the intermediate term. A lighter regulatory burden accompanied by an extension of The Tax Cut and Jobs Act ('17) may offer a more fertile environment for growth. However, we continue to remain cautious on the U.S. equity market for reasons that include extreme levels of concentration and an almost non-existent equity risk premium, signifying excessive optimism and stretched valuations. We are underweight in large-cap growth equities in favor of defensive sectors and value equities, including small-caps. We also continue to like the risk and reward presented to us by International equities. Notwithstanding equities, we like commodities, which should benefit from potentially easier monetary conditions, but have gone through a significant period of underinvestment that should limit any downside in case economic growth deteriorates. Structural issues in the economy, highlighted by the U.S. government's budget deficit, keep us cautious on the trajectory of long-term interest rates. We sold our high-yield bond position and replaced it with a combination of mortgage-backed (MBS) and inflation-protected (TIPS) securities, where we see better value.

GLOBAL MACROECONOMIC REVIEW & OUTLOOK

Inflation continued to decrease in Q2. The Consumer Price Index (CPI) for June was up 3% year over year, which compared favorably to the March CPI of 3.5%. On the other side of the inflationary coin, however, is economic growth. The U.S. economy has weakened meaningfully in the first half of this year, partially contributing to the pullback in inflation. Some of the most reliable measures of current and future economic activity continue to point to an extended period of potential economic weakness. Manufacturing in the U.S. has been in contraction ever since Q2 of '22, with a brief respite in March of this year. The services part of the economy also showed weakness in June, when the ISM Services PMI recorded its deepest contraction since April of '20. The Conference Board's Leading Economic Indicators have now been weakening for 23 consecutive months, signaling further headwinds for the economy. The lone bright spot for the U.S. economy recently has been job creation, which has been upwards of 200,000 per month for the better part of twelve months. However, there are signs that things have been slowing even by that measure. The U.S. economy added 206,000 jobs in June, which was a decline from 310,000 created in March of this year. Job openings, as measured by the Fed's preferred Job Opening and Labor Turnover Survey (JOLTs) statistic, have also declined through the year, with May's reading of 8.14 million significantly below January's 8.75 million. The Unemployment Rate ticked up to 4.1% in June, which was a 31-month high.

We continue to be cautious on the U.S. economy. We have previously discussed some of our structural concerns in terms of the twin deficits (federal budget and current account), and their sustainability. Those two historical tailwinds to growth could turn into headwinds when taken in the context of a 125% Debt/GDP ratio. The U.S. consumer, which has historically been the engine behind economic growth, accounting for 68% of the U.S. GDP, has been stretched. Retail Sales grew only 2.3% in June after growing 2.6% in May, 3.6% in March and 5.5% in December of last year. Moreover, while inflation has come down, it continues to be sticky, as evidenced by the Core CPI (ex-food and energy), which has been running above 3%, and Super Core CPI (ex-goods), which has been running at 5%. The implications of such economic conditions have potentially negative consequences for long-term growth prospects. When combined with elevated expectations in the market, they give us a pause in terms of our willingness to take on a more aggressive posture with respect to risk within our asset allocation.

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