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Dear Atherean Wealth Management client:

Enclosed is your portfolio summary report for the quarter ending March 31, 2024, a summary of your investment objectives and target asset allocation as per our records, and an investment advisory fee statement for the second quarter of 2024. It is important that you review your investment objectives and target asset allocation and let us know if any of it is incorrect or if there are any changes to your financial profile or liquidity needs. For a full report of the holdings in your accounts we encourage you to refer to your statements generated by the custodian.

Market and Economic Environment

The U.S. economy grew at a 1.6% annualized rate in the first quarter of 2024[1] with the sequential slowdown primarily attributable to an increase in the the trade deficit and inventory destocking. Many other measures of economic growth in the U.S. suggest that the economy is in stronger shape than these figures imply[2] and that inflation is alive and well. Regardless of whether or how much the Fed cuts rates in the short term we continue to believe that we will be in a high-growth, high-interest rate, above 2% inflationary environment over the longer term.

Equity and Fixed Income Markets – Recent Performance and Valuation

Global equity markets had mixed performance in the first quarter of 2024 with the U.S. large-cap (S&P 500) index up 11%, the U.S. mid-cap (S&P 400) index up 10%, the U.S. small-cap (S&P 600) index up 2%, and the Europe, Australasia, and Far East (EAFE) index up 6% on a total return basis. Bond markets have had a lackluster year with the Barclays Aggregate Bond index down about 1% for the quarter[3] due to rising interest rates across most maturities. The S&P 500 is currently trading at a forward price-to-earnings multiple of just under 20[4] and its corresponding earnings yield remains close to that of the short-term treasury yield. Equity market performance has been dispersed and uneven with large-capitalization U.S. equities outperforming

[1] Estimated real (inflation-adjusted) annualized GDP rate as of 4/26/2024. Source: U.S. Bureau of Economic Analysis

[2] For example, Final Sales to Domestic Private Purchasers, a cleaner measure of aggregate output than GDP, grew at a 3.1% annual rate for the quarter, in line with the previous few quarters. Source: MRB Partners, *U.S. Q1 GDP: Once Again, Sounder Than It Seemed*, April 25, 2024

[3] All return figures are total return (price return plus dividends and interest)

[4] As of 4/19/2024. Source: FactSet

small-capitalization equities by eight percent for the quarter and “growth” stocks outperforming “value” stocks by nine percent for the quarter[5]. Much of the outperformance of large-cap stocks over small-cap stocks and growth stocks over value stocks has been driven by the performance of a select group of mega-cap U.S. growth stocks. While there has been talk of the overvaluation of these stocks, the reality is that the majority of the outperformance of this group over the past five or so years is a result of earnings per share growth as their valuation multiples[6] have been flat to slightly down over this time period. While we are skeptical that the double-digit earnings growth which this cohort has produced over the past few years can continue to occur indefinitely, the valuation multiples of the group, while in some cases close to their historical highs, are not as absurdly high as the multiples of “new economy” stocks were in the internet bubble of the late 1990s[7].

Portfolio Management and Investment Philosophy

While we did not take any new positions in the first quarter, we want to spend some time discussing our investment philosophy as relates to the terms “growth” and “value” as these words are frequently used in a casual manner by many in the financial world, including many of the index constructors. We will also discuss how our private wealth portfolios are constructed and the ways in which these portfolios differ from the broad-based indices (such as the S&P 500). Much of this discussion is geared toward our newer clients as many of our clients who have been with us for many years are already well-acquainted with our investment philosophy.

When we say that we are value investors, what we mean by this is that we seek to purchase securities at prices which are favorable and advantageous in relation to their valuation. We typically utilize earnings or cash flow models or book or net-asset value models in our valuation and analysis, and our assessment of the intrinsic value of a stock or other security depends very much on our assessment of the long-term quality and growth of earnings or cash flow or long-term return on book value or net asset value per share. Qualitatively, quality and growth of earnings and cash flow is a function of the economic moat and competitive advantage that the company has, the quality of the management team, and the effectiveness of the management’s capital allocation practices. In contrast, the way that many growth and value indices are constructed is that growth in earnings per share or revenue is considered a growth characteristic while a lack of growth in earnings per share is considered a value characteristic, regardless of that stock’s valuation[8].

Another way that our equity portfolios differ from the indices is with respect to concentration and turnover[9]. The S&P 500, for example, is an all-inclusive index which attempts to capture the performance of the entire U.S. large-capitalization equity market. While the S&P 500 index is frequently referred to as a passive index, the reality is that an index committee is responsible for adding and removing companies to and from the index on a quarterly basis. As such the index has on average turned over 3.2% of its portfolio annually on a market-cap

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[5] The S&P 1000 growth index which is comprised of U.S. small and mid-capitalization growth equities, was up 12% in the first quarter on a total return basis versus a 3% total return year to date for its value counterpart, the S&P 1000 value index, a performance gap of 9%

[6] The price to cash flow and price to earnings ratio of each of the members of this group (GOOGL, NVDA, MSFT, AMZN, META, AAPL, TSLA) are flat or down over the past five years

[7] For example, Cisco Systems, one of the bellwether new economy stocks of the late 1990s, had a price-to-earnings ratio of over 200 at one point in 2000, and the price-to-earnings ratio of Oracle reached 125 at one point that year. Currently the price-to-earnings ratios of many of the “magnificent seven” stocks are still below 30.

[8] We can illustrate this with a simple example where we take two stocks: stock A which has a PE ratio of X and an EPS growth rate of 10% a year, and stock B which also has a PE ratio of X but has an EPS growth rate of 0% a year. Clearly stock A is a better deal (and hence a better value, and according to our definition of value, more of a value stock than stock B), because we are getting an EPS growth rate of 10% a year for the same price that we would be paying for stock B, which has a growth rate of 0%. However according to the index contruction methodology, while stocks A and B have the same value score, stock A would have a higher growth score than stock B and would hence be less likely to be included in the value index (and more likely to be included in the growth index), despite the fact that is is clearly a better value.

[9] There are some situations where we would utilize an investment in the S&P 500 (or other) index in a particular client account in addition to and sometimes in lieu of our core equity portfolio when the particular situation warrants it, for example for tax management purposes or when the account size is too small to effectively implement our equity strategy in

weighted basis since March of 1995[10]. And the factor-based indices such as those that describe themselves as "value" and "growth" indices have even higher turnover as they are not really passive indices at all, but rules-based actively-managed indices[11]. While we do not have target turnover ratios in our private wealth accounts, our core equity portfolios are concentrated, with between fifteen and twenty-five individual stocks at any given time, and have had a tendency toward low turnover in the past as we seek to act as long-term owners of the companies in which we invest. Historically, this turnover ratio of this portfolio has been higher than that of the plain-vanilla indices such as the S&P 500 but lower than that of the value and other factor-based indices described above.

Thank you for entrusting us to manage a significant portion of your wealth. As always, we are available to discuss your investment portfolio, discuss your financial plan, or address any other questions or concerns which you may have. Please feel free to reach out via phone or email if you would like to speak with us.

Sincerely,

Atherean Wealth Management, LLC

[10] Source: S&P Dow Jones Indices, *What Drives S&P 500 Rebalance Turnover*, March 28, 2023

[11] For example, the turnover ratio of the S&P 500 value index was 27% (as per the SPYV exchange-traded fund) last year, the turnover ratio on the S&P 400 value index was 43% (as per the IVOV exchange-traded fund), and the turnover ratio on the S&P 600 value index (as per the IJS exchange-traded fund) was 54%.