

About Kensington

Kensington Asset Management specializes in data-driven, quantitative investment solutions spanning across the global investment landscape. Our focus is to help provide investors with confidence through quantitative analytics, by attempting to participate in rising markets, while taking steps to help avoid exposure during times of market decline or volatility. Kensington Asset Management was founded by Bruce P. DeLaurentis, a quantitative pioneer with over 40 years of trading experience through numerous market cycles.

Investment Philosophy

Kensington believes that the best way to generate steady, above average positive returns is to employ an investment methodology that has the potential to recognize and measure consistent and repeating behavioral patterns in the financial markets. With that goal in mind, Kensington has developed clearly defined quantitative decision models that strive to minimize subjectivity in this decision-making process. The overarching goal is to capture sufficient returns in positive market conditions, while protecting capital, with rigorous mitigation during down markets.

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Geopolitics: Investors over the past few weeks have gotten a glimpse of how fragile the global financial system can be when its levered underpinnings are tested by higher borrowing costs. While the disturbance's epicenter may have been situated in Japan amid the country's unfolding monetary policy regime change (the central bank raised the policy rate for the first time in 17 years), the trepidations quickly spread worldwide, exposing how much leverage has now been built into the system.

When Investors Have Been Selling Yen, They Have Been Inflating The Valuations Of AI Stocks



This shouldn't come as a surprise to seasoned market observers, as borrowing in weak currencies with low borrowing costs and lending/investing in ever appreciating risk assets has been a popular pathway to positive returns for some time. As more and more market participants began to employ the same technique to finance their trades, system leverage increased, with those participants either unaware or willfully ignorant of the precarious instability of the underlying structure of the trade was turning increasingly unstable. And since no one actor can know how much capital is being put to work in this carry trade, each believes their own positions are safe from the upset of other sellers.

But as with any heavily margined position, when markets turn against an investor, the sell decision may not entirely be theirs to make. As more and more hit the sell button, the pressure on others to do the same intensifies, as positions fall below required maintenance levels of equity. Margin clerks soon take over and the "forced" selling ensues, leading to rapid price declines. Further, price depreciation in one asset class can soon gravitate to others as investors look to de-leverage their books to reduce risk (most often measured in volatility terms).

This is effectively what has transpired in global markets over recent weeks. Eventually, the deleveraging firestorm burns itself out and the market recovers, but ascertaining when the selling is exhausted is more problematic. In this most recent episode, fear was heightened as several economic releases indicated the slowdown in economic growth was set to accelerate. Such a combination would be problematic for investors, and it's only been when such slowdown fears were calmed that markets regained their footing, at least for the time being.

A final comment on volatility: from a seasonality view, we are entering what has historically been the most volatile time of the year as measured by the CBOE Volatility Index (VIX):



Source: Topdown Charts, LSEG

Stock Market: The month of July marked at least a short-term top for larger-cap stock indices with the S&P 500 Index peaking at 5,670 on July 17th before ending the month at 5,522, a gain of 1.13%. In similar fashion, the Nasdaq 100 saw its high for the year of 20,691 before correcting significantly, ending the month at 19,362, down -1.63%. The sell off in year-to-date leaders (principally artificial intelligence beneficiaries) didn't negatively impact all indices, as investors chose to shift allocations into the lagging small-cap sector with the Russell 2000 being a primary beneficiary, up a strong 10.1% in the month.

The rotation out of AI names was a function of perceived full, if not over-valuations, budding concern the fruits of artificial intelligence would take longer than expected to be realized, leading to a reduction in growth of CapEx on AI chips and software, and general unease about an overall slowdown in economic growth.

As we commented in last month's commentary, there have been increasing signs of a slowing economy, with the services sector contracting for the first time since 2020 and several measures of labor demand seeing significant weakness. Combined with a manufacturing sector that has been in a months-long slowdown and a relatively declining housing market, the odds of recession have moved higher and, with it, concerns corporate earnings would fail to meet expectations.

Those concerns have been put to rest for the most part, at least for now. As we went to press, 91% of S&P 500 companies had reported, with 78% reporting earnings above the mean estimate. That said, in aggregate, earnings have exceeded estimates by only 3.5%, substantially below the 5-year average of 8.6% and below the 10-year average of 6.8%. How have analysts reacted in terms of their Q3 earnings estimates? To date, those EPS estimates, while being reduced - typically in the first month of a new quarter - are falling equal in degree to the past five or 10-year average. Looking farther out, analyst estimates for 2025 have barely changed, showing little overall concern, for now, about the economic backdrop.

Exhibit 6: ...And Rate of Change of Earnings Revisions Breadth Points to Softness in Forward EPS Growth



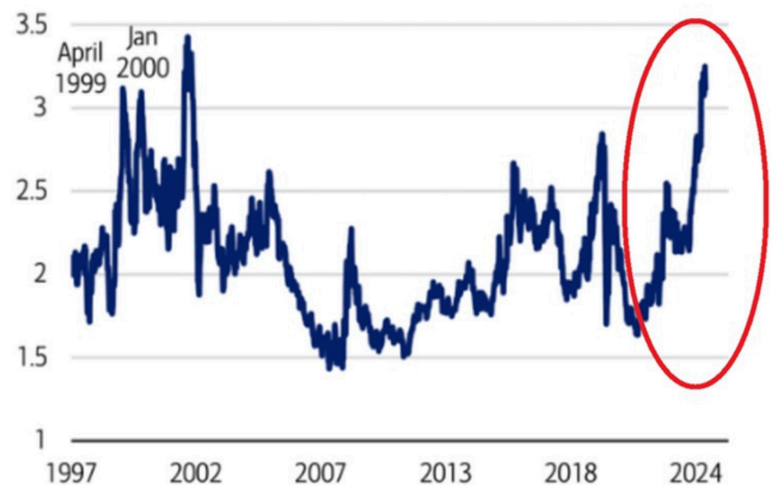
Source: Factset, Morgan Stanley Research

Turning to revenue expectations, analysts are expecting 5-6% revenue growth over the next four quarters, translating into low double-digit growth in earnings over the same time frame. With the Index's overall valuation extended by historical measures, meeting sales growth and margin expectations will be especially important in the quarters ahead.

Fixed Income: Fixed income markets continued to advance in July on the back of weakening economic data, led by government bonds with the 30-Year Treasury bond up 3.65% and the 10-Year 2.88%. Bloomberg Mortgage-Backed Securities Index performed almost as well, up 2.64%, while Bloomberg US Aggregate Investment Grade Corporate Bond Index gained 2.38%. Bloomberg US Corporate High Yield Index trailed but still turned in a solid month, returning 1.94% in the month.

Sector returns have been driven almost entirely by the decline in interest rates as credit spreads have actually widened noticeably over the first two weeks of the new month. This divergence bears watching as spread expansion – which is normally seen in the lowest quality credits and gravitates up from there - has historically signaled increasing odds of a meaningful slowdown in the economy, with an attendant negative impact on corporate earnings.

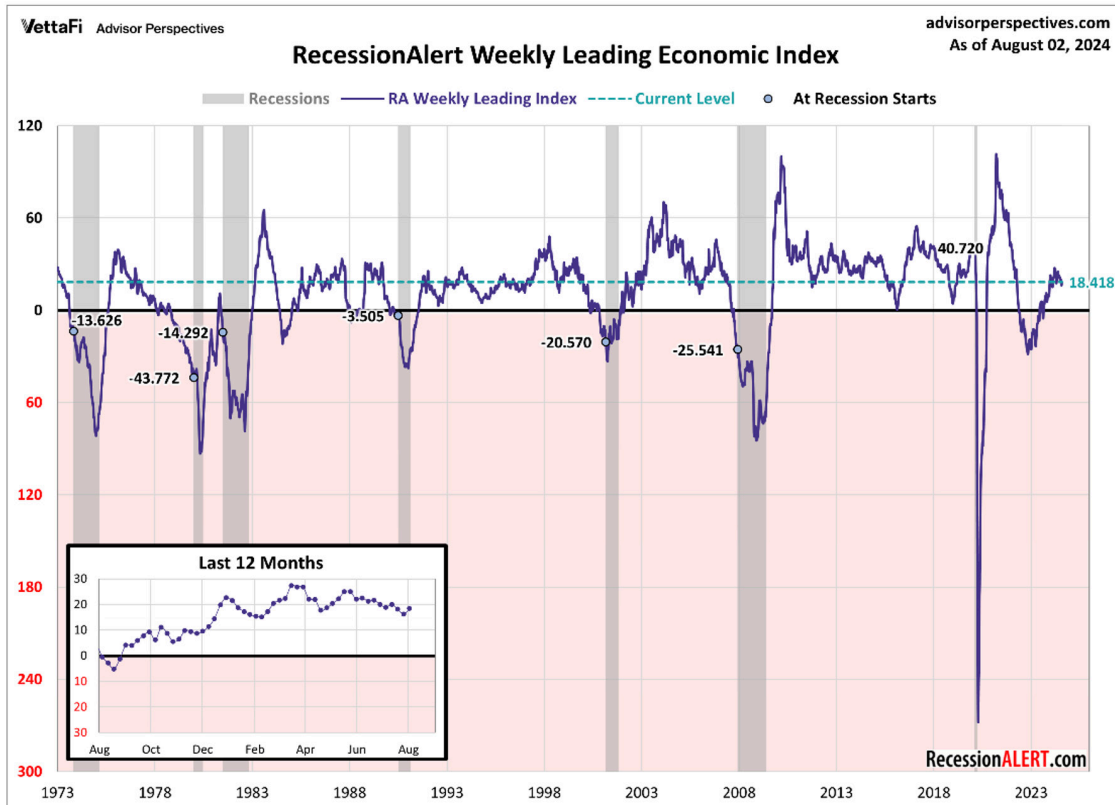
Exhibit 4: Low quality credit dispersion is the widest since 1999-2022
Ratio of CCC spread to single-B spread



Source: BofA Research Investment Committee, Bloomberg, ICE Data Services, LLC

Federal Reserve and Monetary Policy: The Federal Reserve has reached an inflection point in its policy making. Economic data supports – and the market fully expects – a reduction in the Fed Funds rate at the September FOMC. The question now is whether the economy will continue to weaken necessitating further cuts and, if so, to what degree.

A recession still looks to be a ways off in the future, though, as evidenced by the graph below:



The graph is based on the Economic Cycle Research Institute's (ECRI) work, an economic forecasting firm that seeks to identify key short and long-term turning points in the economy. What's particularly interesting is how the leading economic index lines up with what ECRI is seeing in its inflation data. Here is how founder Lakshman Achuthan put it in a recent interview [synopsized for our purposes]:

"There are cycles in growth and when they contract there can be business cycles, recessions and expansions. There are cycles in employment, which are related but distinct. And there's a third cycle, which are cycles in inflation. And one of the things critical to understand is that inflation is cyclical. In the US, our forward looking drivers of inflation collectively stopped falling a year ago and are now starting to edge up."

"That doesn't give me anxiety. What gives me anxiety is if we look around the world at inflation cycles in Europe, in Asia, emerging markets, major emerging markets, we see that in this century they've been largely synchronized. And lo and behold, today all the leading indicators of inflation, the future inflation gauges abroad are moving up sharply so that we have an international inflation cycle upturn taking shape. What are the odds the US is gonna set this out? I'm not so sure about that. So I'm watching the future inflation gauge very, very closely."

Managed Income Strategy – Manager Commentary

During July, bonds across all asset classes continued to advance, as market participants continued expectations the Federal Reserve could move to cut rates as soon as September. Further data from inflation and the labor markets reinforced the possibility of rate cuts. In response, the yield on the 10-Year Treasury closed below 4% for the first time since January 2024.

As was the case in June, duration-sensitive bonds, such as Long-Term Treasuries and investment-grade corporates, led the way. US High Yield also surged on improving data. The Managed Income model remains in a Risk-On state, as conditions continue to remain favorable for fixed income. As a result, Managed Income turned in its highest-performing month-to-date for 2024. During the month, all holdings in the portfolio advanced. However, we do note credit spreads expanded toward the end of the month, as poor manufacturing and jobs data triggered a selloff. While we believe this is a buying opportunity for US High Yield at this time, further deterioration could lead to a Risk-Off move for the Strategy. For now, we remain focused on maximizing current yield to the portfolio while mitigating price risk.

Dynamic Growth Strategy – Manager Commentary

Equity markets were mixed during July. After starting the first half of the month in positive territory, the S&P 500 and Nasdaq Composite indices pulled back after notching new highs on July 17 and July 10, respectively. However, small cap companies saw large gains, as market participants rotated away from large growth after favorable inflation data supported expectations of future rate cuts. The so-called “Magnificent Seven” group of tech stocks lost over \$1.52 trillion in market value during the final three weeks of the month, which was the largest drop over a three-week period on record. However, this served to reduce concentration risk within the S&P 500, as these stocks now comprise approximately 31.6% of the S&P 500 market cap, which is down from 34.4% at the peak.

In response to a rising trend, the Dynamic Growth model entered a Risk-On posture in mid-July. For this positioning, the portfolio management team allocated approximately 60% into Nasdaq-style growth, with the remaining 40% in S&P core positioning. As a result, the Dynamic Growth portfolio was allocated into the market during the drawdown to end July, without participating in the growth from the first half of the month. This led to underperformance to the S&P 500 benchmark for the month. It is not uncommon for the Dynamic Growth Strategy to experience periods of relative underperformance to the broader equity markets, as it is designed to exhibit a low correlation to a passive equity strategy. As we move into August and September, which are historically more volatile for large growth equities, we anticipate the Dynamic Growth Strategy will be active, should volatility increase.

Active Advantage Strategy – Manager Commentary

The Active Advantage model remains positioned in a fully Risk-On state, with a balanced posture across fixed income and equities. For the equity portion of the portfolio, Active Advantage held primarily S&P exposure. In mid-July, the portfolio management team added a small tilt to growth equities, but reduced this position after the Nasdaq began falling considerably from the all-time highs on July 10. For the month, the core equity positions produced a slight positive return, but the growth portion fell, resulting in a loss for the overall portfolio.

In the fixed income position of the portfolio, which represented slightly under half of Active Advantage during July, all positions experienced gains, with the high yield holdings leading the way. As we move deeper into the third quarter, we expect to remain nimble, given the typical higher volatility regime that the months of August and September bring. While recent data suggest cooling inflation continues, we remain concerned with the possibility of broader economic slowing as we go deeper into 2024.

Kensington Defender Strategy – Manager Commentary

For the month of July, the Kensington Defender Strategy delivered a resilient performance amidst a volatile market environment, demonstrating its ability to preserve capital and generate positive returns even when broader market conditions are challenging.

The Strategy's performance can be attributed to its strategic allocation to asset classes that had strong momentum going into the month, such as the Nasdaq 100, S&P 500, and Gold. These sectors showed relative strength in July, driven by investor sentiment favoring stability and consistent earnings during uncertain times. Additionally, the Strategy's exposure to the options overlay strategy positively contributed to the overall return.

However, the Strategy's disciplined approach to equal weighting exposure to the top momentum asset classes rather than overweighting to the specific sectors, such as Technology, limited the potential for even stronger gains. Nonetheless, this strategic positioning aligns with the Strategy's objective of providing downside protection and reducing overall portfolio risk.

Looking forward, the Kensington Defender Strategy remains well-positioned to navigate the evolving market landscape. The Strategy's disciplined investment approach, combined with its focus on diversifying strategies, continues to provide a reliable option for investors seeking stability and moderate growth in their portfolios.

Please see notes and disclaimers on next page.

Disclaimers:

Investing involves risk, including loss of principal. Past performance does not guarantee future results. There is no guarantee any investment strategy will generate a profit or prevent a loss.

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Certain information contained herein constitutes "forward-looking statements," which can be identified using forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events, results, or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Nothing contained herein may be relied upon as a guarantee, promise, assurance, or a representation as to the future.

Advisory services offered through Kensington Asset Management, LLC, Barton Oaks Plaza, Bldg II, 901 S Mopac Expy – Ste 225, Austin, TX 78746.

Managed Income Strategy

Risks specific to the Managed Income Strategy include Management Risk, High-Yield Risk, Fixed-Income Security Risk, Foreign Investment Risk, Loans Risk, Market Risk, Underlying Funds Risk, Non-Diversification Risk, Turnover Risk, U.S. Government Securities Risk, LIBOR Risk, Models and Data Risk.

Dynamic Growth Strategy

Risks specific to the Dynamic Growth Strategy include Management Risk, Equity Securities Risk, Market Risk, Underlying Funds Risk, Non-Diversification Risk, Small and Mid-Capitalization Companies Risk, Turnover Risk, U.S. Government Securities Risk, Models and Data Risk.

Active Advantage Strategy

Risks specific to the Active Advantage Strategy include Management Risk, Equity Securities Risk, High-Yield Risk, Fixed-Income Security Risk, Foreign Investment Risk, Loans Risk, Market Risk, Underlying Funds Risk, Limited History of Operations Risk, Non-Diversification Risk, Small and Mid-Capitalization Companies Risk, Turnover Risk, U.S. Government Securities Risk, LIBOR Risk, Models and Data Risk.

Defender Strategy

Risks specific to the Defender Strategy are detailed in the prospectus and include general market risk, credit risk, interest rate risk, management risk, equity securities risk, fixed-income securities risk, high-yield bond risk, foreign investment risk, emerging markets risk, real estate and REITs risk, commodities risk, currency risk, subsidiary risk, market risk, underlying funds risk, derivatives risk, limited history of operations risk, turnover risk, models and data risk, momentum risk or risk of the portfolio not performing as expected.

Definition:

Bloomberg US Mortgage-Backed Securities Index (MBS): An unmanaged index that tracks fixed-rate agency mortgage-backed pass-through securities guaranteed by Cinnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon, and vintage.

Bloomberg US Corporate Investment Grade Bond Index: An unmanaged index comprised of US investment grade fixed rate, taxable corporate bond market.

Bloomberg US Corporate High Yield Index: An unmanaged market value-weighted index that covers the universe of fixed-rate, non-investment grade debt in the US. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

CBOE Volatility Index (VIX): A real time market index that represents that market's expectations for volatility over the coming 30 days. Commonly used to measure risk, fear or stress in the market.

NASDAQ 100 Index: A market index that comprises of the 100 largest, most actively traded companies listed on the Nasdaq stock exchange.

S&P 500: A capitalization weighted index of 500 stocks representing all major domestic industry groups. The S&P 500 TR Index assumes the reinvestment of dividends and capital gains.

Russell 2000 Index: A market index that consists of 2,000 small-cap US companies that are part of the larger Russell 3000 Index.