Accredited Wealth Management

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Investment Commentary

August 2024

U.S. and foreign stocks rallied in July and added to year-to-date gains. Bonds also rallied as interest rates came down in anticipation of the Federal Reserve cutting interest rates.

- Despite heightened volatility, the S&P 500 Index finished the month up 1.2%. The top-performing sectors were financials and industrials, while technology and communication stocks were down slightly.
- Higher-than-expected economic growth led to a sharp rally in small-cap stocks, up over 10% in July. Value stocks outperformed growth across the board.
- Foreign stocks outperformed, with the MSCI EAFE Index up 2.95%. Real estate stocks benefitted from lower interest rates and finished up 7.8%.
- The Federal Reserve left interest rates unchanged, while some of the foreign central banks began cutting interest rates.
- With Treasury yields down for the month, U.S. core bonds rallied more than 2%.
- In early August, volatility spiked and stocks sold off as concerns about a recession increased and some of the trades that had worked for an extended period have started to unwind.

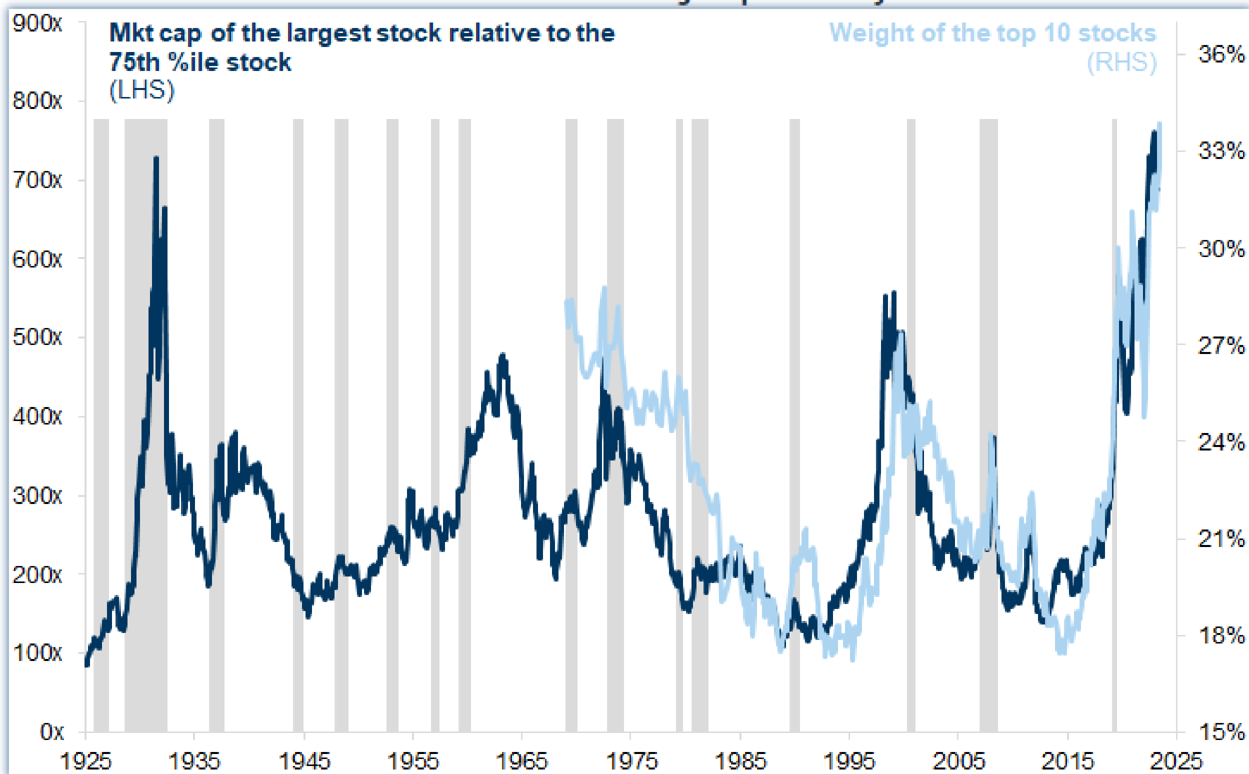
Below we share some thoughts on the recent sell-off in the stock market and the spike higher in volatility.

A few thoughts on the recent market sell-off and higher volatility

To a large extent, the recent market sell-off and higher volatility were a result of several long-running trends reaching extreme levels that started to unwind. As often happens when investment trades become too popular (extreme), they tend to reach a tipping point and correct sharply. Here's a couple of examples from the early August sell-off.

The first is the so-called "Yen Carry Trade." Rather than get into the weeds of this investment strategy, I'll try to sum it up as follows. With interest in Japan at zero for a very long time, investors were simply borrowing Japanese Yen at zero rates and reinvesting those funds in other markets around the world in search of better returns. This trade worked for a long time, however, when the Japanese Central Bank raised interest rates and the Yen started to appreciate it stopped working and investors ran for the exits. As often happens when too many investors rush to get out of a trade, accidents, and market selloffs happen! The ongoing risk is whether the end of this trade could spread to other markets. It's too early to tell but in the near term, the markets seem to have absorbed it fairly quickly.

Another area is the concentrated performance in the U.S. stock market. The chart below shows that the top ten stocks in the market reached a level of concentration that has only been seen a handful of times in the past 100 years. A lot of the recent sell-off was focused on these stocks (Nvidia, Amazon, etc.). Again, this is a good example of how markets will often correct when a trade becomes too popular (extreme).



Universe consists of US stocks with price, shares, and revenue data listed on the NYSE, AMEX, or NASDAQ exchanges. Series prior to 1985 estimated based on data from the Kenneth French data library, sourced from CRSP, reflecting the market cap distribution of NYSE stocks

Source: Compustat, CRSP, Kenneth R. French, Bloomberg, Goldman Sachs Global Investment Research

In many ways, the current market resembles the market of early 2000, a market that experienced a recession and a sharp sell-off of over 40%. The good news is the largest companies today are higher quality and trade at more reasonable prices than the largest companies back in 2000. Below is a chart that compares the top 10 global stocks during both periods and it's clear that valuations are not nearly as stretched as they were back then. There is still room for current valuations to come down further, however, we do not expect a replay of the 2000-2002 debacle in the stock market.

EXHIBIT 2: LARGEST COMPANIES GLOBALLY – NOW AND THEN

Now (6/30/2024)

COMPANY	MARKET CAP ($B)	P/E
Microsoft	3,321	34
Apple	3,252	30
Nvidia	3,089	41
Alphabet	2,273	23
Amazon	2,010	39
Saudi Arabian Oil	1,800	15
Meta	1,279	24
Berkshire Hathaway	878	21
Eli Lilly	861	58
Taiwan Semi	772	22

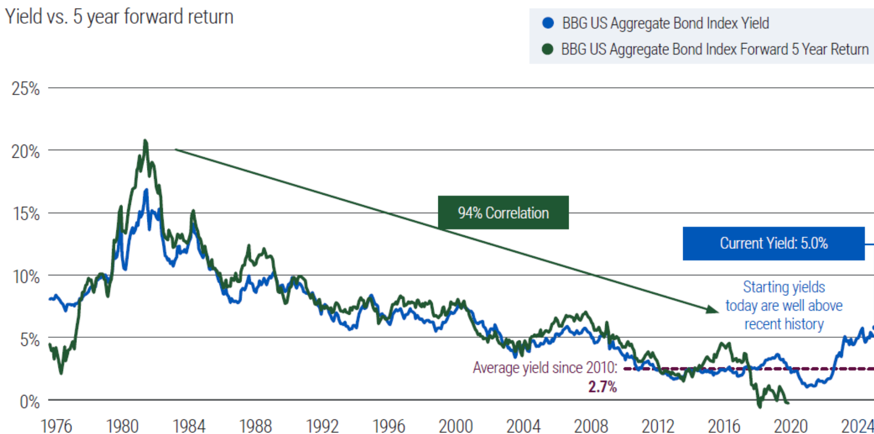
Then (2/28/2000)

COMPANY	MARKET CAP ($B)	P/E
Microsoft	469	53
Cisco	455	109
GE	435	37
Ntt Docomo	386	136
Intel	378	36
Vodafone	337	49
Exxon Mobil	261	24
Deutsche Telekom	253	102
Nokia	242	66
NTT	220	2,922

Source: GMO

It is important to note that

Higher returns have historically followed higher yields



Past performance is not a guarantee nor a reliable indicator of future performance. Chart is provided for illustrative purposes and is not indicative of the past or future performance of any PIMCO product. As of 30 June 2024. SOURCE: Bloomberg, PIMCO. Yield and return are for the Bloomberg U.S. Aggregate Bond Index. It is not possible to invest directly in an unmanaged index. Refer to Appendix for additional correlation, index, investment strategy, outlook and risk information.

WHAT IT MEANS FOR INVESTORS

With starting yields nearly two times higher than the average yield since 2010, investors could stand to benefit from attractive return potential in fixed income investments going forward.

S&P 500 Beige Book

Each quarter the research team at Goldman Sach's puts together a research report, the S&P 500 Beige Book, summarizing the key themes being discussed on S&P 500 companies conference call. We always find the report informative and helpful to understand the key issues that corporate management teams are focused on. Below is a summary and highlights of the three key themes discussed in this quarter's report.

- The state of the labor market and hiring needs
- The condition of the U.S. consumer
- The impact of Artificial Intelligence (AI) on their businesses and plans for AI investment

Labor Market: this quarter's commentary regarding hiring plans and the labor market suggests a relatively healthy labor market. Although there were discussions of reducing headcount or slowing the pace of hiring, the general commentary reflected an improved balance between companies' hiring needs and the available pool of talent. Overall, the number of companies discussing layoffs on earnings calls remained quite low. This should be seen as a positive for the economy, and in contrast, to the recent uptick we have seen in the national unemployment statistics. Note that unemployment statistics can change quickly as the economy shifts so we will be watching these numbers closely.

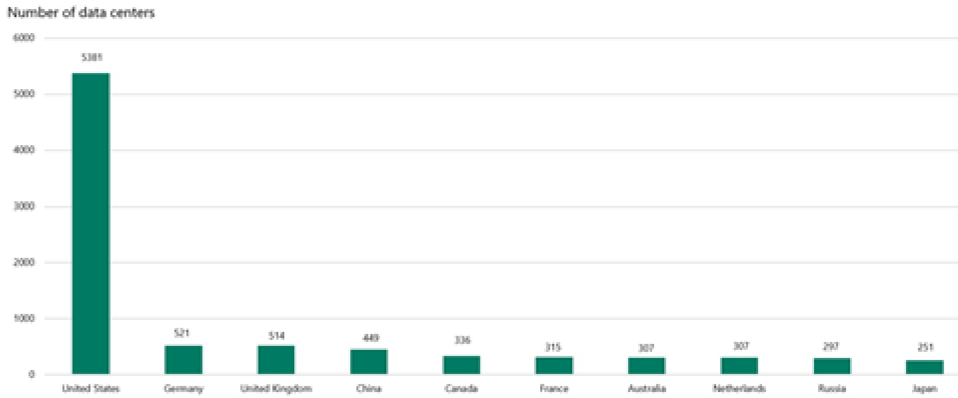
The Consumer: the overall commentary reflected a mixed picture for the U.S. consumer. Several companies highlighted that the consumers of their products remained under pressure from current economic conditions, and it was leading to lower sales. In contrast, other companies reported that they continue to see resilient consumer spending. The common denominators are that companies selling affordable or perceived value experienced steady sales compared to others. While companies selling to the higher-end consumer fared better than companies focused on the low-endconsumer. This is consistent with the belief that consumers at the lower end have spent down their accumulated savings from the COVID years and the higher-end consumer is still in relatively good shape.

The Impact and Plans for AI: There is still a lot of enthusiasm for AI, however, more attention is being focused on how much investment is required to build out the technology and what the eventual return on that investment will be. Significant capital investments continue to be made by the largest technology companies, with the general consensus being that it is better to 'overspend' than 'underspend' in the transition towards artificial intelligence. In other words, the fear of underspending and falling behind the industry leaders is greater than the fear of overspending. This should continue to bode well for AI infrastructure in the near term, however, longer-term the market will expect these huge investments to start paying off.

We found the chart below, from a separate study, very interesting and highlights the magnitude of capital spending happening in the U.S. compared to the rest of the world. Currently, the U.S. has built out more data centers (a key part of the AI build-out) than all other major countries combined, the difference is astonishing! We should get some good insights on the state of spending on AI infrastructure next week when Nvidia reports its earnings, Stay tuned!

APOLLO

More data centers in the US than in all other major countries combined



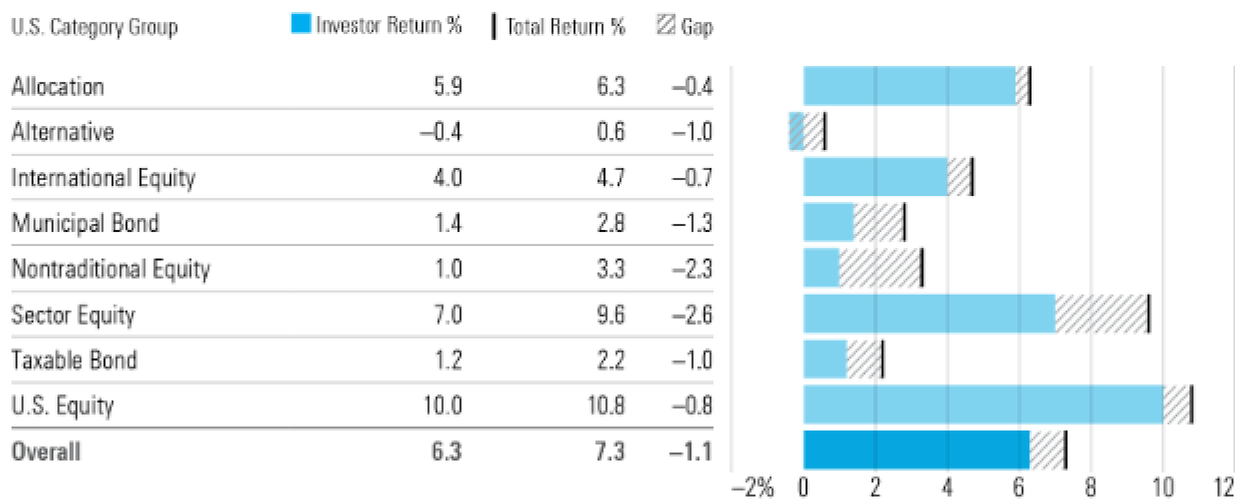
Source: Statista, Cloudscene, Apollo Chief Economist. Note: Data as of March 2024.

Mind the Gap 2024

Another report we regularly review is Morningstar’s annual Mind the Gap report. The report compares the actual returns on investment funds compared to the returns that individual investors actually earned over the same period. In other words, did the individual investor’s buy and sell decisions lead them to outperform or underperform the results of the funds they were invested in? As you have probably already guessed, the results are not great for individual investors! Their findings found that the average dollar invested in investment funds earned 6.3% per year over the 10 years ended December 31, 2023. This is roughly 1.1% less than the average fund’s total return of 7.3% per year over that time period. The 1.1% “gap” per year is explained by the timing of investors’ purchases and sales of fund shares and reflects the behavioral mistakes individuals often make when trying to time the market.

The size of the gap varied based on the type of fund investors invested in and is summarized in the table below.

Exhibit 1 Investor Return Gaps by US Category Group (10-Year Returns)



U.S. Category Group	Investor Return %	Total Return %	Gap
Allocation	5.9	6.3	–0.4
Alternative	–0.4	0.6	–1.0
International Equity	4.0	4.7	–0.7
Municipal Bond	1.4	2.8	–1.3
Nontraditional Equity	1.0	3.3	–2.3
Sector Equity	7.0	9.6	–2.6
Taxable Bond	1.2	2.2	–1.0
U.S. Equity	10.0	10.8	–0.8
Overall	6.3	7.3	–1.1

Source: Morningstar. Data as of Dec. 31, 2023. Excludes commodities category group. Gap numbers may not match differences in returns because of rounding.

The best strategy for avoiding the "gap" is to develop a detailed investment policy statement (IPS) that is based on your financial planning goals, comfort level taking risks and financial factors unique to your situation.

If you have any questions regarding your personal IPS please do not hesitate to reach out.

Best regards,

Steve Giacobbe, CFA, CFP®