

## Rotating from Excitement to Concern

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During the first half of 2024 stocks moved steadily higher. The cadence was slow and steady with little worry amongst investors. In fact, volatility readings fell to low levels and up until this last week the market had not experienced a daily decline of 2% or greater all year. Those market dynamics shifted in a swift and meaningful way during July. The catalyst began as some investors started to become concerned that the market rally was getting to be long in the tooth and further spread as data began to suggest that broader economic growth may, at the margin, be slowing.

This resulted in a notable reversal (shift) during the month of July as the market quickly repositioned to favoring what had been the laggards year-to-date. For example, while large company stocks were up a modest +1.2% in July, small cap stocks were up +10.2%. Stocks of high growth companies, which had driven year-to-date gains in the first half of the year, sold off by -1.7%. Alternatively, more attractively priced value stocks added +5.1%. In aggregate the so called Magnificent 7 (Apple, Microsoft, Amazon, Alphabet, Meta, Tesla, and NVIDIA) had an uneventful month losing -0.6% and were no longer the force driving the market.

Throughout the year sentiment among equity investors continued to trend higher culminating in an overly bullish positioning by the end of June. Moreover, investors had tended to congregate in similar trades such as owning Magnificent 7 stocks, under owning small cap stocks, and among hedge funds favoring the U.S. dollar over the Japanese Yen. This was indicative of a crowded market where a large swath of investors seemed to be doing the same thing. The reversals out of crowded exposures can be painful when the tide inevitably shifts and investors elect to rotate out of their positioning all at once. This is exactly what happened during July and why we saw such a large divergence in returns in what at the aggregate level would indicate a mundane month where stock prices were +1.2% higher (based on the S&P 500).

By the end of July, the reasons for the rotation in the market extended to include growing concerns around the economy. The recent drop in yields offered on U.S. Treasuries reflected the bond market pricing in a softer economic climate ahead. Given their proclivity toward being concerned with downside risk, bond investors are

often ahead of equity investors in recognizing potential risk factors. Economic data released during the first two days of August points to weaker manufacturing activity and a notably softer employment picture.

We have been anticipating an eventual downshift in economic data. Much of the unexpected growth that occurred during 2023 was fueled by monetary and fiscal stimulus. As the lag from these impacts has started to burn off, we'd expect consumer spending to moderate, unemployment to rise and the pace of economic growth to moderate. Though slower, current economic trends appear to us to be reasonable. Employment data for July showed the unemployment rate at 4.3%, up from 4.1% at the end of June and 3.7% at the start of 2024. While the trend may catch the attention of some, we must recognize we are coming off the lowest unemployment rate since the 1960's and the current level is still well below a typical 5-6% range.

Adding to the picture are corporate financial results, which aren't pointing to any notable trouble ahead. Public companies are in the midst of reporting their financial results for the second quarter of 2024. While there is always a mix of good and bad results, the general trend we are seeing is that business conditions, on a broad basis, are solid. In fact, per Factset, the companies within the S&P 500 that had released their Q2 2024 financial results through July 26th had grown their revenues a full percentage point greater than expected.

If anything, the market gyrations experienced thus far in the third quarter reinforce the importance of focusing on the long-term. The first six months were predicated on a narrow trade that emphasized large, growing technology companies that were experiencing accelerations with their business. That has quickly reversed during the third quarter as market and economic sentiment have begun to adjust to a normalization in conditions. Famed value investor Benjamin Graham once stated "In the short-term, the market is a voting machine, but in the long run, it is a weighing machine." This statement alludes to the fact that in the short-term, investor emotions can drive prices (both higher and lower). In the long-term the broader economic and corporate fundamentals drive the true weight (value). We are electing to focus on the broader weight and not place too much emphasis on the short-term voting of the market whether that be on the excitement of trends such as artificial intelligence or the worry of a short-term adjustment in the economic trend.