May 2024

Mid-Quarter Update

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The purpose of our mid-quarter update is to provide our investors with some relevant insight or perspective on what is happening in the capital markets. Shorter than our quarterly letters, the intent is to be brief but also keep our clients informed of near-term economic and financial developments that may be impacting their investment portfolios. Because it is easy to get lost in the details and weekly machinations of both the stock and bond markets, at this time we want to frame the current economic and market progress in relation to the past couple of years. The punchline is that a lot has happened, but when examined more carefully, one will find that many of the developments have essentially canceled each other out. Let us explain.

Despite all of the promotion and hullabaloo exuded by the financial press, the fact is that over the past 28 months, stocks around the world are really not up by that much at all. Yes, we can find specific periods in the past few years where the stock market experienced big gains, and certainly, there are individual stocks that have provided impressive returns. But, overall returns over the past few years are pedestrian, at best. The weak periods have offset the advances to a large degree, and the strongest-performing indices have only compounded at mid-single-digit levels. The worst are actually negative. It has been a "sawtooth market," meaning there have been ups and downs but not a lot of overall progress. A table accompanying this reality helps make our point.

	Annualized Returns 1/2022 – 4/2024
S&P 500 Index	4.03%
Value Stocks	3.16%
Growth Stocks	3.30%
Small Cap Stocks	-3.98%
Dividend Stocks	1.63%
International Stocks	2.36%
Bonds	-4.97%
60/40 Blend	0.56%
Diversified Blend	0.58%

Source: Evestment
Please see the footnote at the end of the piece.

So what has caused such mediocre results? It is fairly simple and is distinguished by two factors: interest rates and high valuations on stocks.

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Interest rates are certainly elevated relative to the period immediately following the financial crisis in 2008, but their level is not nearly as extreme when compared to longer-term historical data. It is hard to believe that just a little over two years ago the fed funds rate stood at 0% and the Federal Reserve (Fed) was soon to be embarking on one of its most aggressive tightening campaigns ever. This led to a bear market in bonds, higher borrowing costs for corporations, and issues in the banking sector. All of this conspired to create headwinds for stocks.

High valuations on stocks were created by the previous zero interest rate policy and excess liquidity. Stocks had awesome returns in 2019, 2020, and 2021, but this created a situation where most of the good news was incorporated into security prices, and stocks became expensive. It is no wonder that the stock market took a break because the increase in prices was unsustainable, particularly against the aforementioned backdrop of higher interest rates.

To summarize, the bond market endured one of the worst bear markets in history in 2021 and 2022. This took stocks down initially, causing a bear market in stocks as well. But, the equity market has reversed its decline, mostly on the prospect of higher earnings, lower inflation, and continued economic expansion. This all means that over the past few years, stocks are up modestly, bonds are down, and balanced portfolios are somewhere in between. Psychology plays a critical role in both consumer and investor sentiment, and the everyday noise of financial news and pundits can be deceiving. As a result, today, many investors may feel they have “missed out” on the market’s returns over the past few years. In reality, there has been not much at all to miss out on because of the neutrality of the return picture.

Over our history as a firm, we have experienced several periods such as this. The reality is that returns are never earned in a straight line or on schedule. The important thing is to be sure the right companies are owned so that when the return picture brightens, the portfolio will participate. We believe we are invested for long-term success, and we look forward to a more return-rich period where both stocks and bonds provide meaningfully positive returns.

Value Stocks are measured by the Russell 1000 Value Index, Growth Stocks are the Russell 1000 Growth Index, Small Cap Stocks are the Russell 2000 Index, Dividend Stocks are the S&P 500 Dividend Aristocrats Index, International Stocks are the MSCI EAFE Index, Bonds are the Bloomberg U.S. Aggregate Index, *60/40 Blend is 60% S&P 500, 40% Bloomberg U.S. Aggregate, Diversified Blend is 30% S&P 500, 25% HFRX Global Hedge Fund, 20% Bloomberg U.S. Aggregate, 15% MSCI ACWI ex-US, 5% Russell 2000, 5% 3-Month T-Bill.

The S&P 500 Index is the Standard & Poor’s Composite Index and is widely regarded as a single gauge of large-cap U.S. equities. It is market-cap weighted and includes 500 leading companies, capturing approximately 80% coverage of available market capitalization. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. The Russell 1000® Growth Index measures the performance of the largecap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2 year) growth and higher sales per share historical growth (5 years). The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. S&P 500® Dividend Aristocrats® measure the performance of S&P 500 companies that have increased dividends every year for the last 25 consecutive years. The Index treats each constituent as a distinct investment opportunity without regard to its size by equally weighting each company. The MSCI EAFE Index consists of the following 21 developed market countries: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. The Bloomberg U.S. Aggregate Bond Index is an unmanaged index of domestic investment grade bonds, including corporate, government and mortgage-backed securities.

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