Gallagher

Financial Market ViewPoints

October 2024

The Pivotal Part of the Pivotal Year

It is hard to believe we are already three quarters of the way through 2024. At the start of the year, everyone was made fully aware by media outlets that this year, for a multitude of reasons, would be a pivotal year. While events thus far have driven financial markets to new highs, there are a couple pivotal events taking place through the rest of the year that pundits have been discussing for quite some time. Those two events being interest rate cuts from the Federal Reserve or “Fed” and yet another undeniably polarizing presidential election. So far, the year has been filled with a plethora of data and news that has helped to frame where the U.S. economy is in its economic cycle. Now, as we enter the final quarter of the year, we look to an extremely busy period ahead that has the potential to throw at least a few surprises at investors. Nevertheless, we are here to unpack it all and do our best to allay any concerns.

Selected Market Returns: September 2024

Asset Class	Index	End of 2023 Value	Ending Value (Yield for Bonds)	1Q	2Q	July	Aug	Sep	3Q	YTD
				Total Returns						
Stock Markets										
U.S. Large Cap Stocks	S&P 500	4,769.83	5,762.48	10.6%	4.3%	1.2%	2.4%	2.1%	5.9%	**22.1%**
U.S. Large Cap Stocks	Dow Jones Industrial Average	37,689.54	42,330.15	6.1%	-1.3%	4.5%	2.0%	2.0%	8.7%	**13.9%**
U.S. Large Cap Stocks (Tech. Focused)	NASDAQ Composite	15,011.35	18,189.17	9.3%	8.5%	-0.7%	0.7%	2.8%	2.8%	**21.8%**
U.S. Small Cap Stocks	Russell 2000	2,027.07	2,229.97	5.2%	-3.3%	10.2%	-1.5%	0.7%	9.3%	**11.2%**
Int'l. Developed Markets Stocks	MSCI EAFE	2,236.16	2,468.66	5.7%	-0.3%	2.9%	3.3%	0.9%	7.3%	**13.0%**
European Stocks	MSCI Europe	160.64	175.15	5.2%	0.5%	2.1%	3.9%	0.4%	6.6%	**12.8%**
Japanese Stocks	MSCI Japan	1,448.28	1,622.43	10.5%	-3.8%	5.8%	0.5%	-0.6%	5.7%	**12.4%**
Emerging Markets Stocks	MSCI Emerging Markets	1,023.74	1,170.85	2.1%	5.3%	0.3%	1.6%	6.7%	8.7%	**16.9%**
Chinese Stocks	MSCI China	55.95	70.20	-2.3%	7.2%	-1.3%	1.0%	23.9%	23.5%	**29.3%**
Bond Markets										
Broad Bond Market	Bloomberg U.S. Aggregate Bond	4.53%	4.23%	-0.8%	0.1%	2.3%	1.4%	1.3%	5.2%	**4.4%**
Government Bonds	Bloomberg U.S. Government Bond	4.09%	3.77%	-0.9%	0.1%	2.2%	1.3%	1.2%	4.7%	**3.8%**
Municipal Bonds	Bloomberg U.S. Municipal Bond	3.22%	3.32%	-0.4%	0.0%	0.9%	0.8%	1.0%	2.7%	**2.3%**
Corporate Bonds	Bloomberg U.S. Corporate Bond	5.06%	4.72%	-0.4%	-0.1%	2.4%	1.6%	1.8%	5.8%	**5.3%**
High Yield Bonds	Bloomberg U.S. Corporate High Yield Bond	7.59%	6.99%	1.5%	1.1%	1.9%	1.6%	1.6%	5.3%	**8.0%**
Highlighted Commodities										
Oil	Crude Oil (West Texas Intermediate/WTI)	71.65	68.17	9.2%	-2.0%	-4.5%	-5.6%	-7.3%	-16.4%	**-4.9%**
Gold	Gold Spot Price ($/oz)	2,062.98	2,634.58	-0.9%	4.3%	5.2%	2.3%	5.2%	13.2%	**27.7%**

Source: Bloomberg

Since last quarter’s ViewPoints, there has been a significant amount of data released that has not only shaped, but also confirmed our outlook for the remainder of the year. The Fed has maintained their restrictive policy without an adjustment to interest rates since July of 2023. Over the course of the past 13 months, the various inflation measures (Consumer Price Index “CPI“, Producer Price Index “PPI”, and the Fed’s preferred inflation metric, Core Personal Consumption Expenditure “Core PCE”) have responded accordingly by dropping precipitously towards the Fed’s 2% goal. For these reasons, among others that we will discuss later in this piece, the Fed made their long-awaited first cut to interest rates in the middle of September, which typically indicates the beginning of a less restrictive interest rate cycle.

September Summary of Economic Projections

	Current	2024	2025	2026	Long Run
Change in Real GDP	3.0%	1.9% - 2.1%	1.8% - 2.2%	1.9% - 2.3%	1.7% - 2.0%
Unemployment Rate	4.2%	4.3% - 4.4%	4.2% - 4.5%	4.0% - 4.4%	3.9% - 4.3%
Core PCE Inflation	2.7%	2.6% - 2.7%	2.1% - 2.3%	2.0%	2.0%
Federal Funds Target Rate	4.75% - 5.00%	4.40% - 4.60%	3.10% - 3.60%	2.60% - 3.60%	2.50% - 3.50%

Source: Federal Reserve Board

The September Fed meeting also came with an update to their table of economic projections from the Federal Reserve Bank Presidents. This is always an important update that we look forward to as it helps investors set realistic expectations for both the short and long-term. Overall, this table does a great job summarizing the Fed's outlook as detailed in their Beige Book. In this publication, they outline the pathway to the often discussed "2% inflation goal", what investors can expect for economic growth as measured by change in real GDP, as well as expectations for the unemployment rate. Overall, the short-term market reactions we have recently experienced are natural bumps in the road that are generally expected as the Fed hones in on achieving their longer-term goals.

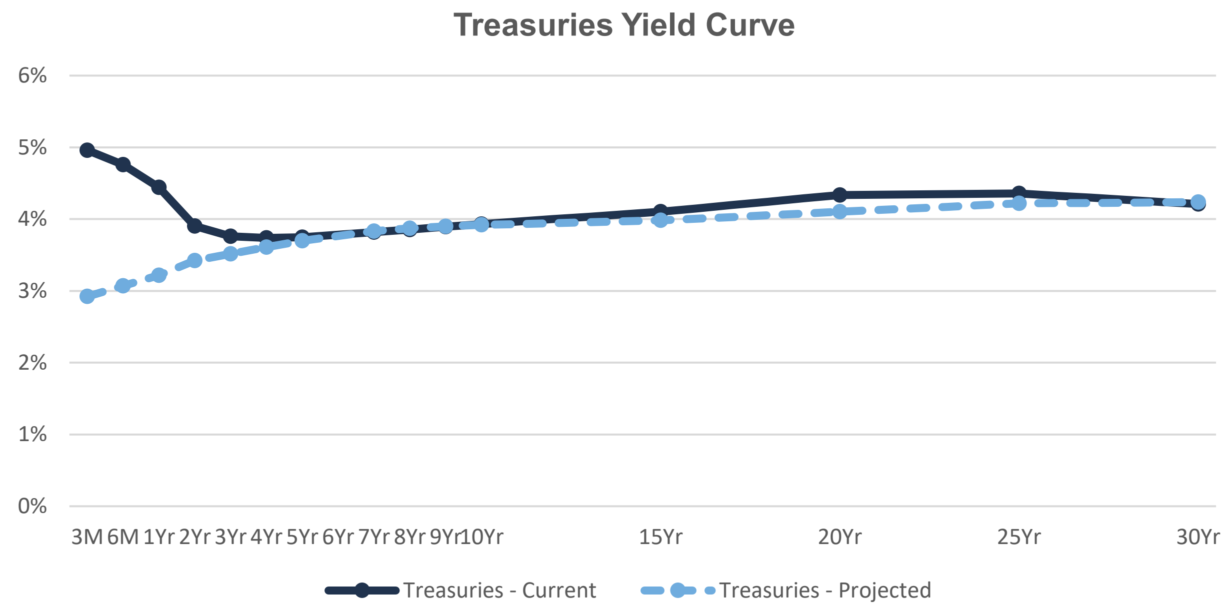
Employment

Fed Chairman Powell regularly starts the Federal Open Market Committee's (FOMC) press conference by stating their dual mandate of pursuing the economic goals of maximum employment and stable prices. Since inflation has been coming down materially, the current state of the employment market was arguably the main driver of the Fed's decision to make an adjustment to their target rate at their September 18th meeting. After a long stretch of a red-hot job market post the Pandemic, the unemployment rate has finally crossed back over the generally accepted level of full employment (4%). Now that it has hovered slightly above this threshold for a couple of months, investors have become increasingly nervous that unemployment could spike if there wasn't a reasonable adjustment made to the Fed Funds Target Rate. Conversations spiraled around themes that the Fed may be "too late" or that they are generally behind the curve, regarding supporting the labor market before a significant rise in the unemployment rate above the full employment level. Supporting this view that the Fed may have been a little late in making their first cut was that many other central banks across the globe, who also experienced high inflation following the Pandemic, began cutting interest rates months ago.

During their September meeting, Chairman Powell emphasized the committee's patient and data-dependent approach to making their first downward adjustment to their Target Rate since 2020. With employment data weakening over the past handful of months and Chairman Powell hinting at the possibility of a 0.50% rate cut at the Fed's Jackson Hole Economic Symposium, September's interest rate decision didn't come as a surprise.

Our view ultimately is that the Fed has done a good job at maintaining their dual mandate. Coming out of the Pandemic, the Fed was dealt a tough hand. By using the most powerful tool in their toolbox, the ability to adjust interest rates, they were able to engineer a decline in the inflation rate that was relatively quick considering the enormous hurdles that laid ahead of them. The cut that we saw this month was the first of what is expected to be several this cycle (as illustrated in the summary of economic projections chart) and should help to stabilize concerns that unemployment might spiral out of control as inflation continues to tick down while the Fed's policy stance is "recalibrated."

Treasury Yields



Source: Bloomberg as of August 30, 2024.
Projected Treasury Curve is based on the most recent period (December 31, 2017) in which the yield curve had a "normal" structure.

Yield curves, and more specifically the treasury yield curve when it comes to the Fed, is another important dataset we keep a close eye to. Yield curves help us to evaluate the bond market as they show the interest rate an investor is generally paid as they lend money for longer periods of time. A normal yield curve tends to see lowest interest rates for the shortest periods of time and steadily rises to the highest rate for the longest time periods. This intuitively makes sense, as money that is lent for a longer timeframe tends to require a higher payment to account for the risk that a borrower may not repay. While one's financial situation is relatively clear over a short period, it is much more challenging to estimate one's financial situation 10, 20, or even 30 years into the future.

Currently, the treasury yield curve (and for that matter the investment grade corporate bond yield curves) are not in a "normal" structure. Instead, the front end of the yield curve is actually the highest yielding segment across the curve. This "inverted yield curve" is not a sign that currently short-term investments are problematic, but rather a sign that the Fed has temporarily raised interest rates above their normal or "neutral" level. Since the current state of high interest rates is seen as temporary, the middle and long parts of the curve are anchored around long-term interest rate expectations, while the front end is heavily influenced by the Fed's temporarily high interest rate policy.

To put the Fed's 0.50% interest rate cut into context, we looked at the structure of the treasury yield curve in December of 2017, the last time in which it had a relatively normal shape. To fit the medium and long end of the current treasury yield curve (black line), the Fed would need to lower interest rates another 1.50% - 2.00% from their current range of 4.75% - 5.00%. Historically, this makes sense as it would put their target rate within less than 1% of their long-term inflation goal, which historically has been their “neutral” position. Given that the economy continues to look fairly healthy, we would not be surprised if the Fed takes their time to lower interest rates to this level, rather than risk inflation spiking again due to a rapid decline in rates.

Looking Ahead

Overall, we expect the final quarter of 2024 to be a very busy and “pivotal” period. Because of this, we believe these events will create plenty of opportunity for both stocks and bonds. Ultimately, the base case is that as yield curves for bonds continue to heal, the concentrated stock market rally we have seen throughout the first half of the year should continue to broaden out to the rest of the market. As a result, we continue to position portfolios to capture these trends and have increasingly relied on actively managed strategies to capitalize on unique investment opportunities within the markets. With this stance, we feel portfolios are well-positioned as we enter the final quarter of the year, but plan to review our asset allocation strategies in November after the election to make any necessary changes at that time. In the meantime, please enjoy the rest of our quarterly ViewPoints publication. Your comments and questions are always welcomed.

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Stock Market Performance Throughout the Election Cycle

By Ryan Gallagher

It's about that time again as the presidential election on November 5th comes into view. This will be the 60th presidential election in the United States which marks yet another milestone for our country. The two candidates are former President Donald Trump, representing the Republican party and current Vice President Kamala Harris, representing the Democratic party. This is set to be one of the most polarizing elections in modern history as the divide between the two major political parties feels much wider than normal. However, regardless of which party you support, most people are wondering, "How will the presidential election affect my investment portfolio?"

Historical Performance Leading Up to the Election

Uncertainty is one of the largest factors that affects returns prior to the election

Leading up to this election, there is a lot of uncertainty over which candidate will ultimately be elected due to what appears to be a very close race at this time. There is the potential for large swings in support over the coming weeks as key events have shown their potential to sway voters to a particular side. Due to these swings, only in rare cases is it possible to determine which candidate will be elected at the start of an election year. For this reason, stock market performance tends to be lackluster in the first 10 months of the election year, in large part due to this unknown.

When there is uncertainty in the marketplace, investors typically default to a more cautious approach. It tends to result in investors keeping more cash on hand or opting for more conservative investment vehicles like CDs and bonds. This has an adverse effect on the stock market because the continuous buying of stocks by individuals and institutions is one of the main drivers that push stock prices higher. Through this lens, it's not terribly surprising that returns during a presidential election year tend to be muted until the election is in its final stage.

Stock market performance leading up to the election has historically trailed the average return in the first 10 months of the year since 1950

In our historical analysis of presidential elections, we reviewed the performance of the S&P 500 since 1950 to gauge how the U.S. stock market has responded to this major event for the government. We found that the average total return in the first 10 months leading up to the presidential election was 6.2%. Though the growth is positive, it does lag the average performance of the S&P 500 over the first 10 months of the year since 1950 of 8.2%.

S&P 500 Total Returns Since 1950

Year	First 10 Months	Last 2 Months	Full Year
First Year In Office	7.6%	3.1%	11.2%
Midterm Election Year	3.5%	4.4%	8.4%
Third Year In Office	15.5%	4.6%	20.9%
Presidential Election Year	6.2%	4.0%	10.7%
All Years	**8.2%**	**4.0%**	**12.6%**

Source: Bloomberg.

Volatility in the market tends to decline significantly following the presidential election

On average, during a presidential election year roughly 40% of the year's returns have occurred after the election

Excluding years of financial crises, the average return in the last two months of the election year is 5.4%

Historical Performance After the Election

While performance prior to the election tends to be underwhelming, stock market performance picks up significantly after the election as the incoming president is declared and investors get a better idea of what to expect for the next four years. As a result, the final two months of the year following the election have historically realized an average total return of 4.0%. This equates to nearly 40% of the average returns during presidential election years materializing in the last two months of the year. To further emphasize this point, we found that in 13 of the 18 presidential election cycles since 1950, the monthly performance post-election has been greater than the monthly performance leading up to the election.

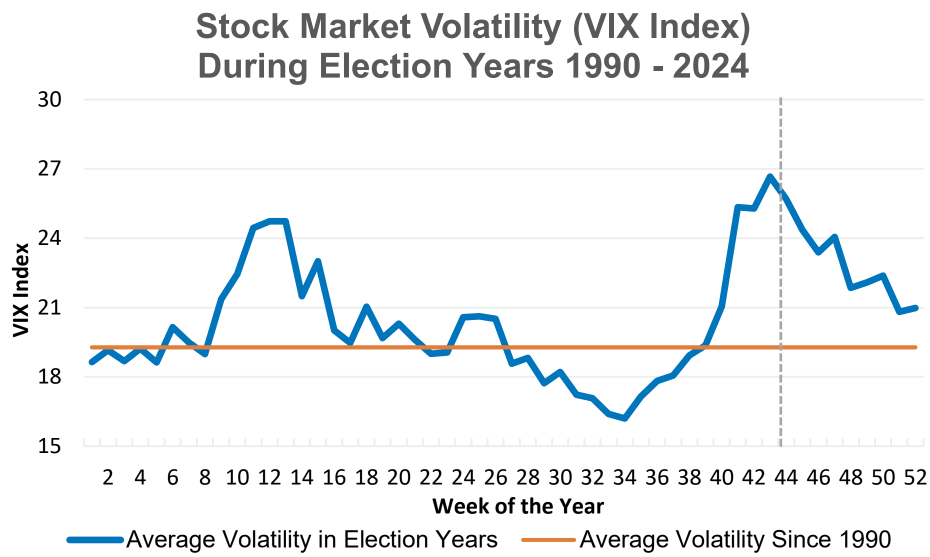
S&P 500 Total Returns
Last 2 Months & Full Election Year

Election Year	Last 2 Months	Full Year
1952	10.1%	18.2%
1956	3.4%	6.5%
1960	9.8%	0.5%
1964	0.8%	16.4%
1968	1.2%	11.0%
1972	6.3%	19.0%
1976	5.2%	23.9%
1980	7.3%	32.5%
1984	1.5%	6.3%
1988	0.3%	16.6%
1992	4.7%	7.6%
1996	5.4%	22.9%
2000	-7.4%*	-9.1%*
2004	7.6%	10.9%
2008	-6.2%*	-37.0%*
2012	1.5%	16.0%
2016	5.7%	11.9%
2020	15.2%	18.4%
Average	4.0%	10.7%
Average Without Crisis	5.4%	14.9%

*Dot-Com Crash (2000) and Financial Crisis (2008)
Source: Bloomberg

Digging a little deeper into election year returns provides additional insight into how the market performs. When looking at every presidential election year since 1950, there have only been two years where the final two months post declines for the S&P 500. Interestingly, both of those years, the Dot-Com Crash in 2000 and the Financial Crisis in 2008, had a major economic and market disaster take place during an election year. With those two extreme data points removed, the average return for the final two months of a presidential election year rises to 5.4% and all observations are positive. While certainly each presidential election cycle is unique, there is some comfort that since 1950 presidential elections have generally been a positive catalyst for the S&P 500, as long as there has not been a major economic crisis earlier in the year.

Broadening out to the full year, there appears to be a relationship between stock market performance pre- and post-election. One reason for this is the reduced uncertainty. Another is that the current administration uses the remaining two more months to wrap things up. At this point, investors can assume that little to no policy changes will be made as the transition to the next president is in process. This instills a sense of security for investors that tends to reduce volatility[1] and often leads to investment inflows. As seen in the chart below, volatility steadily declines after the election, which typically takes place around the 44th week of the year.



Source: Bloomberg.

Historical Performance in the Year Following the Election

The first year, more specifically the first 100 days following the inauguration of the president, is one of the most important periods of a president's candidacy as they look to set the tone for their administration for the next four years. During this time, the previous administration has been fully phased out and the new president starts to make their own respective policy moves. When the newly elected president is of a different political party than the previous administration, these changes may occur more slowly. However, the changes that are passed often represent major differences between the two administrations.

Regardless of how the president approaches their first 100 days in office, the trend since 1950 supports positive stock market performance. The year following the election generally, on average, has realized the second-highest return of the four-year presidential cycle at 11.2%. This consists of an average 7.4% in the first 10 months and 3.1% in the final two months of the year. However, these figures still slightly lag the average stock market return since 1950 as the third-year's performance has historically tended to be the highest with an annualized average return of 20.9%.

Stock market performance in the first year following the election tends to be the second best out of a presidential election cycle

The Impact of Having Two Seasoned Candidates

While we have established that there is a inverse relationship between uncertainty and stock market performance, an interesting element of this election is that both candidates have already been in office. Donald Trump was the president from 2016-2020 and Kamala Harris is the current vice

[1] Volatility (as commonly measured by the CBOE Market Volatility Index or VIX) is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500 Index's call and put options.

A unique aspect of the 2024 Presidential Election is that both candidates have already sat in office

president for the Biden administration. Therefore, investors already have an idea of how the economy and markets might perform under each candidate as they have in essence "seen both candidates in action". Despite temporary drawdowns from events such as Covid-19 and generationally high inflation, the stock market managed to hit all-time highs multiple times throughout each candidate's time in office. Additionally, the U.S. economy also grew during each candidate's term. For this reason, investors could feel a sense of security as each candidate has ushered in growth in the past.

Performance of the S&P 500 Index
During the First Year for Incumbent Vs. New Presidents

	First 10 Months	Last 2 Months	Full Year
Reelected President	12.0%	5.3%	18.3%
New President	5.9%	2.3%	8.5%

Source: Bloomberg.

The stock market has historically had a positive reaction when incumbents have been reelected

In addition to the performance of the stock market during a presidential election year, analyzing the historical performance for the following year also has had an interesting pattern. There have been five instances since 1950 where the incumbent was reelected, which includes Dwight D. Eisenhower in 1956, Ronald Reagan in 1984, Bill Clinton in 1996, George W. Bush in 2004, and Barack Obama in 2012. In the first year following an incumbents' reelection, the stock market generated an average return of 18.3%. This is not only well above the historical average annual returns for the market, but also well above the 8.5% average for a new person elected to the presidency. Although there is no guarantee that the market will have the same reaction in 2025, there is historical support for the claim that the stock market performs better when an incumbent is reelected.

All in all, investors should remain optimistic as we enter the new year, as history supports strong stock market performance in the first year following a presidential election. This is especially true in years where the newly elected candidate was previously in office. While there may be volatility as we approach the election this November, it is important to remain focused on the long term as historically the conclusion of a presidential election tends to be a positive catalyst.

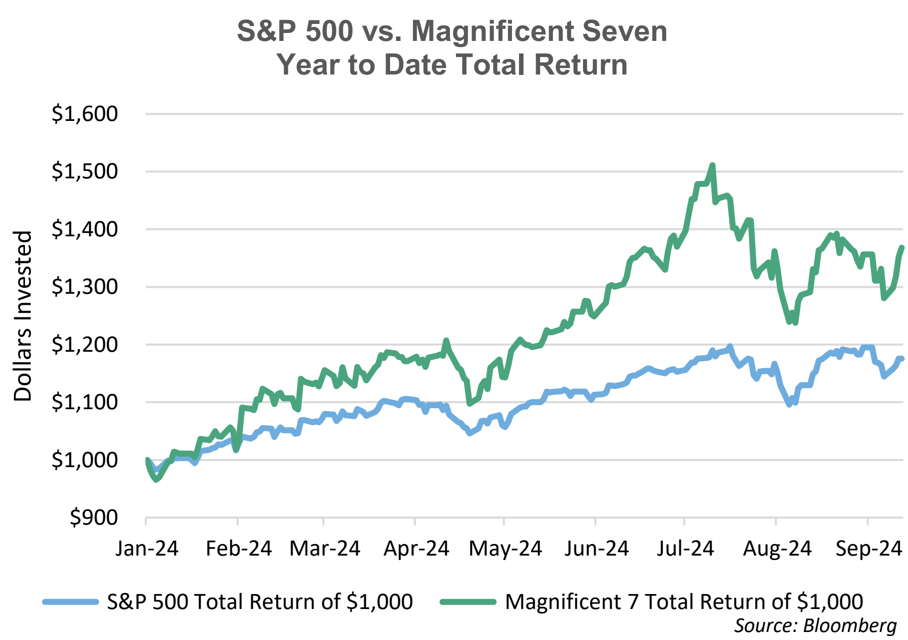
A Rotation is Brewing

By Jim McCarriston

In 2023, the now common nickname "The Magnificent Seven" started as a name that primarily financial analysts used to describe some of the largest tech companies in the market. Today, this industry moniker has migrated from financial news desks to dinner table conversations. This nickname is an evolution of the older and arguably more descriptive nickname of "FAANG" stocks (Facebook, Amazon.com, Apple, Netflix, and Google [Alphabet]). After significant evolution in the marketplace since "FAANG" was initially coined, new players have been added, now including Meta Platforms (Facebook's parent company), Apple, Alphabet (Class A and B shares), Amazon.com, Microsoft, Nvidia, and Tesla.

The Magnificent Seven currently make up approximately 30% of the S&P 500 Index

Today, this grouping isn't just a club of the largest tech companies in the world. Over recent years, these companies have seen their stock prices rise dramatically leading to outsized growth of their market cap, or company value. As a result, these seven stocks currently account for approximately 30% of the S&P 500 Index by market cap. This, in turn, leaves the other 493 stocks to make up the remaining 70% of the index. Due to this outsized weighting, much of the outperformance that indices like the S&P 500 have seen in recent years can be attributed to the Magnificent Seven as illustrated in the chart below.



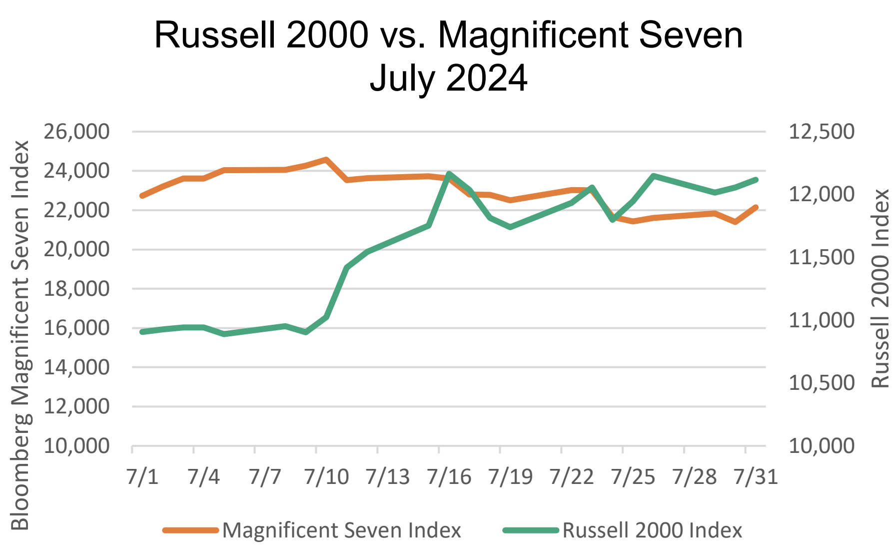
Earnings for the Magnificent Seven have helped justify their record stock prices, however concerns still exist

There, of course, are many reasons for these *magnificent* runs. The main driver being the continued development, and for lack of a better term, explosion of sales for both artificial intelligence software and hardware. Year to date, the Bloomberg Magnificent Seven Total Return Index is up approximately 38% compared to the S&P 500 Total Return Index which is up approximately 22%. Although 22% is still quite impressive considering the S&P 500 has annualized just over 11% historically, it is important to understand that the outperformance for 2024 is well above the historical average and can largely be attributed to the Magnificent Seven.

Emerging Trends

Many Magnificent Seven companies, like Nvidia, continue to have elevated earnings expectations. If these expectations are not met, the stock price bears the brunt

Valuations for these companies, like industry bellwethers Nvidia, Apple, and Alphabet, have edged closer to the high end of their range, and for some have been setting new highs. This has led to views that a number of these companies have become "overbought" a handful of times over the course of the year due to their lofty valuations. Despite robust sales and earnings growth, valuations for these companies have remained elevated. With this, some investors have become increasingly nervous ahead of each quarterly earnings announcement. Some investors, therefore, have decided to lock in gains and move capital to "cheaper" areas of the market over concerns that these lofty expectations may not be met. We saw this trend emerge a couple times this year, most notably in July's market selloff.



Source: Bloomberg

Small cap stocks exhibited stellar performance in July, but only time will tell if this is the start of a lasting trend

July was a great example of this as the Russell 2000 Index, which measures the performance of the top 2000 small cap companies in the U.S. stock market, had a stellar month. Although this rally quickly lost some of its steam, the outperformance gave investors a taste of what could develop into a lasting trend down the road. Current low valuations for small cap companies combined with improving fundamentals could help propel this sub-asset class back to relevancy, especially if more interest rate cuts take place during the rest of 2024 and into 2025.

For years now, higher rates have disproportionally affected small cap companies as it became increasingly more difficult to finance projects, bolster their workforce, and deal with higher operating costs in general. All while having weaker competitive advantages relative to their larger cap competitors. All in all, as inflation continues to tick down, and the Federal Reserve or "Fed" builds off their first cut to the Fed Funds Target Rate,

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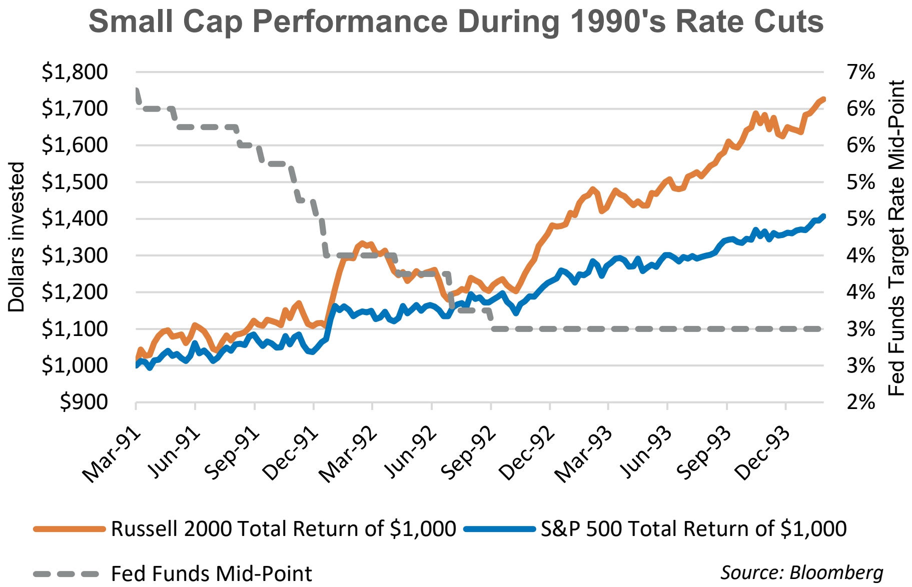
small caps are expected to make it back to the forefront of investor portfolios. An example of a time this took place was in the early 1990s. As illustrated in the chart below, when the Fed gradually made changes to their Target Rate, the Russell 2000 experienced significant outperformance relative to large cap stocks.

During the early 1990s, as the Fed reduced interest rates, small cap stocks outperformed large caps



We will continue to watch closely to see if this rotation out of big tech names and into a broader subset of companies is a trend that is here to stay, or just a blip in the current rally for the Magnificent Seven. The sustainability of this trend relies, of course, on a few catalysts discussed previously; earnings results, interest rate cuts, and lower yields just to name a few. Referencing the 0.50% interest rate cut that the Fed announced on September 18th, it was impressive to watch small cap indices such as the Russell 2000 react to the news. Although much of the news of an interest rate cut was already priced in the market, the 0.50% point cut, as opposed to 0.25% that was speculated, gave small cap stocks the green light to rally. After the announcement, the Russell 2000 spiked over 2% and continued to rally the following day.

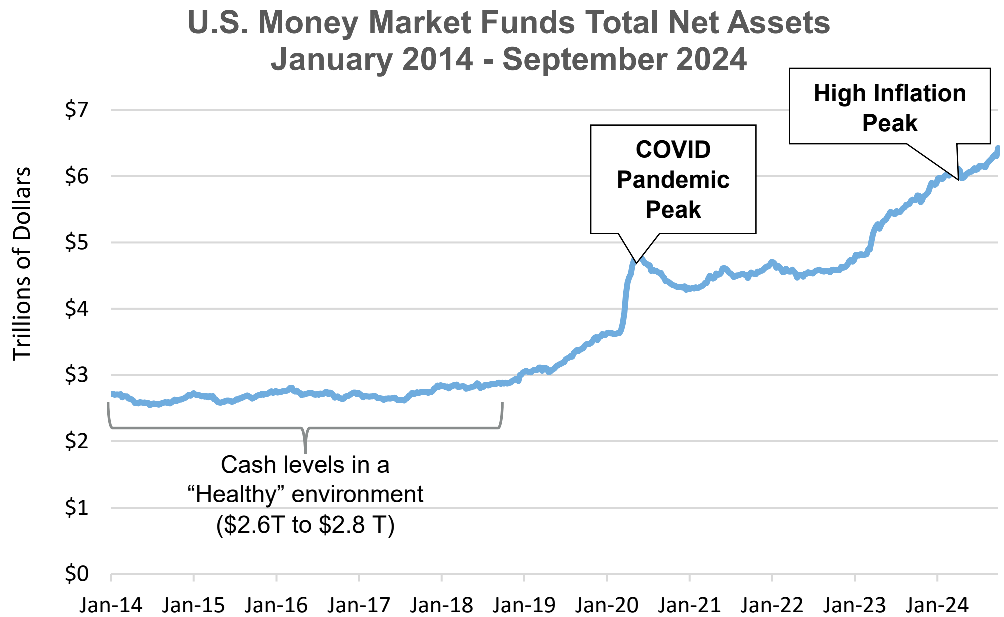
What This May Look Like Moving Forward

Investors have begun moving portfolio assets to other, relatively "cheaper" areas of the market in recent months

As we move into the final quarter of the year, investors are anticipating increased volatility. This is due to the combination of what appears to be a closely contested presidential election, the final earnings season for the year, as well as other major factors. It has become evident that investors have started looking toward areas of the market that theoretically have "less room to fall" regarding their current valuations in the marketplace. With valuations for many large growth stocks elevated, investors may look to lock in more of their gains. Potentially, investors might use the proceeds from these sales to buy in other areas that are not only relatively cheap, *As of the end of September, the total amount in U.S. money market funds were at an all-time high*

but also may have potentially lower drawdowns if there is a downturn or mild correction that takes place within the current bull market.

One final catalyst that we are watching closely as investors rotate capital around the marketplace is the record levels of cash currently sitting in money market investments. As of the end of September, the total amount in U.S. money market funds were at an all-time high of $6.4 trillion. Comparatively, leading up to the Pandemic, this value ranged from $2.6 to $2.8 trillion.



Source: Bloomberg. U.S. Money Market Funds are the ICI All Money Market Fund Total Net Assets.

As a result of the Fed rolling back their restrictive stance on interest rates, it is expected that money market yields will, in turn, also decline. As money markets become less and less attractive from a yield standpoint, investors will likely pull their capital out in an effort to find a more attractive return. Ultimately, this has the potential to be another catalyst to not only drive the markets higher, but to also see the market rally broaden out to other corners of the stock market beyond the Magnificent Seven.

Understanding Pullbacks and Corrections

By Ryan Gallagher

The stock market has experienced many fluctuations this year as inflation and unemployment data, in addition to news related to the Federal Reserve or "Fed" cutting rates, has weighed heavily on investor's minds. These, among other news and data, have caused three separate drawdowns over the course of the year. Unfortunately for long-term investors, these events can create anxiety for investors and may lead to irrational, emotion-based selling. An example being those that sold portfolio holdings this summer due to the fear that the Fed was behind on cutting interest rates. Less than two months later, those panicked investors have been left behind as the Fed's 0.50% interest rate cut in September propelled the S&P 500 Index to a new all-time high.

Since 1950, the stock market has made all time-highs roughly once every two weeks when in a bull market

The pitfalls of deviating from a long-term plan and making the decision to sell based on emotions are evident when "looking in the rearview mirror", but in the moment of a selloff, it is rarely so clear. This year's stock market has seen plenty of investors opt to keep higher levels of cash, whether it be due to the relative newness of the current bull market[2] or the compelling yield being earned on money markets and CDs. Unfortunately for these investors, the S&P 500 has set numerous records throughout the year and finished the third quarter at yet another all-time high. Ultimately, this isn't terribly surprising as the market has historically set a new high roughly once every two weeks during a bull market cycle. While this statistic supports further upside for the market, some investors continue to worry about the next drawdown as flashbacks of 2022-2023's bear market come back to mind. For this reason, we thought it would be prudent to dig a little deeper into stock market dynamics and analyze the frequency of pullbacks and corrections during bull markets.

Different Types of Drawdowns in the Stock Market

Panic selling is the result of fear in the marketplace and can be a detriment to your investment portfolio

The most common drawdown experienced by investors is commonly referred to as a pullback. This occurs when the market declines by five percent or more from its highs. Pullbacks are a regular occurrence in all markets; and despite the market going down, they are a healthy part of a bull market. This is because it often provides investors and strategists an opportunity to test the strength of their investments and can create a convenient time to reposition portfolios.

While generally brief, these market moves can cause investors to feel anxious due to fears that the decline will continue. While not as common in a pullback, this anxiety has the potential to result in "panic selling". The effect of this action can easily compound, as instead of adjusting one's portfolio and adding potentially discounted investments, panic sellers tend to lock in their profits. Meanwhile, investors who stick to their long-term investment plan and take advantage of the pullback's opportunity by adding to their portfolio, position themselves well for when the stock market

[2] The current bull market started on December 13, 2023.

recovers. This action of putting extra cash into the market or "dry powder" as many strategists tend to say, is one of the reasons why pullbacks tend to be mild and short lived.

Moving up the drawdown spectrum is the less common stock market correction. A correction occurs when the market declines 10% or more from a recent high. Thus far for the current bull market, there has only been one correction, which took place in August of this year[3]. During a correction, investors may hesitate to add to their portfolio due to a sense of doubt or uncertainty regarding the market's path in the short-term. This is understandable, as the correction threshold also denotes that the market is more than halfway towards ending a bull market. At these points, it is important to review the current dynamics in the marketplace and economy to see if something larger is brewing for investors. Ultimately, by sticking with one's long-term plan, and removing the potential for making emotion based selling decisions, investors can also benefit by capitalizing on discounted investments as the market recovers.

Bear markets represent an opportunity for investors to add stocks to their portfolio at significant discounts

The final type of drawdown is the well known bear market. This occurs when the stock market declines 20% or more from its recent highs. A bear market also signifies the end of the current bull market. Thankfully bear markets are much less common than a market pullback or correction but do tend to emerge after a few years of a bull market[4]. Such a drawdown typically requires a significant event or a development in either the economy or financial markets to trigger a bear market. During these periods, investor emotions spike, generally due to the rapid declines that usually take place at the start of a bear market. Compounding this is the often-long road to recovery that ultimately brings an end to the bear market. In the depths of a bear market, some investors start to enter a state of disbelief whether the market will recover, and struggle to add to their portfolio. However, bear markets have historically been one of the best times to add to one's portfolio and is one of the main reasons for the colloquial phrase "buy low and sell high".

Understanding Momentum in the Stock Market

RSI can help investors gauge if a stock or index is over bought or oversold

Regardless of which type of a drawdown the stock market is in, investor anxiety almost always rises. Outside of economic and company data that can potentially shed some light on recent weakness in the stock market, a third tool is often used by strategists: momentum. Although there are many ways to measure momentum and other technical aspects of the stock market, one of our preferred methods is to measure investor sentiment through the Relative Strength Indicator or RSI. This tool was developed as a shortcut to understanding stock charts as without formal training and

[3] Starting in the middle of July the S&P 500 Index began to decline over fears of rising unemployment, the Fed being too late on lowering interest rates, and concerns in overseas markets. This culminated in the index being down more than 10% from its peak in the pre-market session on August 5th.
[4] Since 1950, the average bull market for the S&P 500 has lasted approximately four years and is followed by a bear market that lasts a little less than two years.

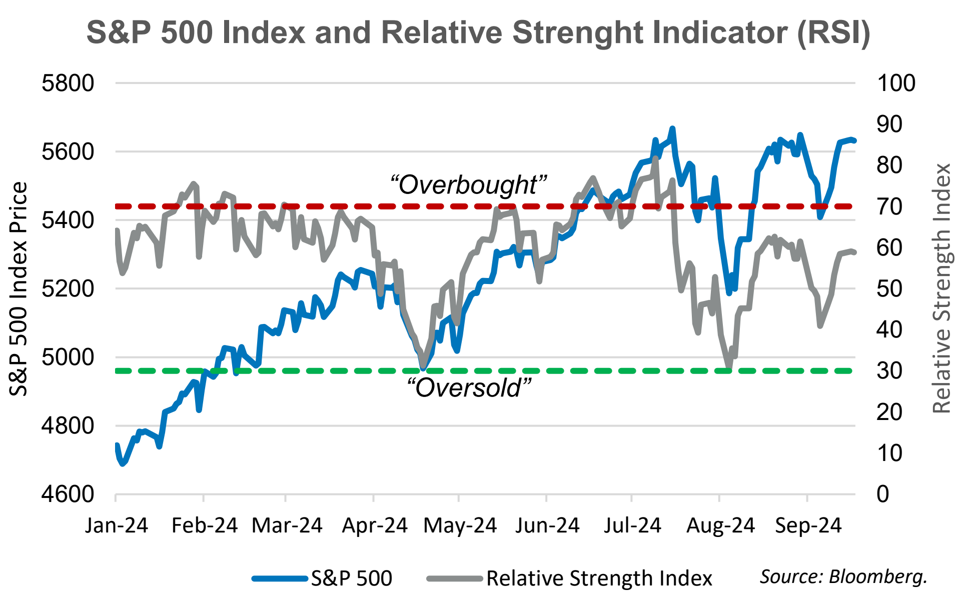
years of experience, looking at a stock chart can be confusing. Since they often consist of several different colored bars, lines, and indicators such as moving averages, the overload of information can make it difficult to comprehend.

The RSI was developed to simplify the process of reading stock charts for momentum and sentiment. At its core, this indicator oscillates between zero and one hundred based on a stock's or index's momentum. Generally, this is measured on a 14-day basis. Next, the RSI's value is broken into three categories:

- Normal market RSI: 30 – 70
- Overbought market RSI: 70 – 100, often indicated with a red line
- Oversold market RSI: 0 – 30, often indicated with a green line

An RSI level of 70 and above is considered overbought and a level of 30 and below is considered oversold

For the most part, a stock or index tends to spend the majority of its time with a normal market score (30-70). When the stock price rises rapidly and continues to go up, the RSI also rises and has the potential to reach the "overbought" level. This is an indicator to market technicians that a stock or index may have gone up much faster than normal and is now in a position for a potential drawdown in order to return to a normal level. Conversely, if there is a steep selloff, the stock or index can reach the "oversold" levels in which the RSI indicates that there is potential for some level of a recovery to bring the position back to normal levels. It is important to note that just because a stock or index reaches the oversold or overbought category, there is not necessarily an immediate reaction in the markets. Historically, there have been plenty of times in which an oversold or overbought condition persists for a lengthy period of time before the market corrects.



To better understand the relationship between the RSI and price movements for a stock or index, let's look at the S&P 500 Index chart for this year. In most charts, the RSI gauge is located at the bottom of a chart, but for simplicity's sake in our example we overlayed it with the S&P 500's prices data. As touched on above, there usually is a red line located at an RSI value of 70 that signifies the "overbought" territory. Conversely, there usually is a green line at an RSI value of 30 that notes the start of the "oversold" territory.

While RSI is a helpful tool, it is best used in conjunction with other indicators and analysis of news and future data releases

When looking at the relationship between the S&P 500 and its RSI, one can quickly identify areas where a peak in the RSI coincides with a top in the market, and the same goes for the lows. The market's bottom in April and top in July are both solid examples of this. In April, the RSI fell from the 70 range all the way to the 30's, which is where the market found a bottom and investors quickly bought in, leading to a healthy recovery rally. On the other hand, when RSI reached 80 in July, the market soon after found its top and proceeded to have a correction. Therefore, identifying overbought and oversold areas can be beneficial to your investing, but it is not a flawless system. For example, from January to March, the RSI was elevated between 50-75 while the market continued to rise with little to no hesitation. For this reason, RSI is generally best used in conjunction with other indicators and analysis of news and economic data releases. Simply put, it is one of many tools that we use to evaluate the current market conditions that drive changes in our portfolio models.

In conclusion, understanding the current market dynamics that are behind declines or drawdowns in the market is an important aspect for many investors. Due to the anxiety for investors around this normal part of the market cycle, it is helpful to have an understanding of how common place these have historically been. By being able to effectively categorize each market drawdown and understand when the market may be cheap or rich, investors can allay some of their concerns and make more informed decisions. Ultimately, it's the focus on one's long-term goals and objectives that can help investors remain in the markets, despite any volatility in the near term.

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Bonds: are subject to market, interest rate and credit risk; and are subject to availability and market conditions. Generally, the higher the interest rate the greater the risk. Bond values will decline as interest rates rise. Government bonds are subject to federal taxes. Municipal bond interest may be subject to the alternative minimum tax; other state and local taxes may apply. High yield bonds, also known as "junk bonds," are subject to additional risks such as the increased risk of default. Debt securities may be subject to call features or other redemption features, such as sinking funds, and may be redeemed in whole or in part before maturity. These occurrences may affect yield. Like all bonds, corporate bonds tend to rise in value when interest rates fall, and they fall in value when interest rates rise. The longer the maturity of the bond, the greater the degree of price volatility. If you hold a bond until maturity, you may be less concerned about these price fluctuations (which are known as interest rate risk or market risk), because you will receive the par or face value of your bond at maturity.

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International/Global/Emerging Markets Investments: International investing may not be suitable for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

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Index definitions

S&P 500 Index: is a capitalization weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 500 of the leading large cap U.S. companies.

Dow Jones Industrial Average Index: is a price weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 30 blue-chip stocks that are generally regarded as the leaders in their industry.

NASDAQ Composite Index: is a capitalization weighted index that is generally considered representative of the U.S. Technology market. It consists of all three tiers of the NASDAQ: Global Select, Global Market, and Capital Market.

Russell 2000 Index: is a capitalization weighted index that is generally considered representative of the U.S. Small Cap market. It consists of 2,000 of the leading small cap U.S. companies.

MSCI EAFE Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of developed international markets. The EAFE region includes developed market countries in Europe, Australasia, the Far East, and Israel.

MSCI Europe Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of European developed markets.

MSCI Japan Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Japanese market.

MSCI Emerging Markets Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

MSCI China Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Chinese market.

Bloomberg U.S. Aggregate Bond Index: is a broad-based flagship benchmark that measures the investment grade U.S. dollar denominated, fixed-rate, taxable bond market. The index includes Treasuries, government-related and corporate securities, Mortgage-Backed Securities or "MBS" (agency fixed-rate pass-throughs), Asset-Backed Securities or "ABS", and Commercial Mortgage-Backed Securities or "CMBS" (agency and non-agency).

Bloomberg U.S. Government Bond Index: consists of the U.S. Treasury and U.S. Agency Indices. This index includes U.S. dollar denominated, fixed-rate, nominal U.S. Treasuries and U.S. agency debentures (securities issued the U.S. government owned or government sponsored entities, and debt explicitly guaranteed by the U.S. government).

Bloomberg U.S. Municipal Bond Index: covers the U.S. dollar denominated long-term tax-exempt bond market. The index includes four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

Bloomberg U.S. Corporate Bond Index: measures the investment grade, fixed-rate, taxable corporate bond market. The index includes U.S. dollar denominated securities that are publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers.

Bloomberg U.S. Corporate High Yield Bond Index: measures the U.S. dollar denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating from the ratings agencies (Moody's, Fitch, and S&P) are Ba1/BB+/BB+ or below. Bonds issued from an emerging market country are excluded from the index.

Crude Oil: is represented by the generic front month futures contract for West Texas Intermediate (WTI) crude oil.

Gold Spot Price: is represented by the current spot price of one Troy Ounce of gold in U.S. dollars.

Inflation: is measured by the year-over-year change for the Consumer Price Index or "CPI". This index represents the changes in the prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer) and sales and excise taxes paid by consumers are also included.

Fed Funds Rate: is the target interest rate set by the U.S. Federal Reserve (Fed) or "Central Bank". This index reflects the Fed's efforts to influence short-term interest rates as part of its monetary policy strategy. The index value is calculated by using the midpoint of the Fed's rate policy when they target a rate range (i.e., 0.25% - 0.50%).

Indexes are shown for illustrative purposes only, may not be available for direct investment, are unmanaged, assume reinvestment of income, and have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities) that are different.