

**Q2 2024**

**QUARTERLY COMMENTARY**

The U.S. stock market is off to its best start in five years and 14th best since 1926. Most ICC clients have benefited meaningfully by remaining overweight relative to their investment policy statement’s target equity exposure as the Standard & Poor’s 500 climbed to record highs. Unlike the beginning of the rally late last year, when the largest gains were concentrated among the Magnificent Seven (Google’s parent company, “Alphabet,” Apple, Microsoft, Amazon, Meta, Nvidia, and Tesla). This rally is now broad-based. U.S. mid, small, and foreign companies are participating, too, carrying stocks in most industries along. Even old economy companies in the energy, industrial, and financial sectors are contributing to market gains. As a result, household wealth has hit a record high, rebounding from the 2020 Covid-19 pandemic lows. Most astounding is stock ownership by wealth group. According to the Federal Reserve, the top 10% of households own 87% of the stock market while the top 1% owns 49%. Undeniably, stocks are the best wealth building financial asset available.

As we repeatedly noted in our quarterly letters, many investors, including Wall Street experts, are overconfident in their pessimistic or optimistic outlook and therefore often get the short-term market direction wrong, sitting with too much money in the wrong asset class (stocks, bonds, real estate, cash, etc.). That is why our clients have a written investment policy statement outlining the parameters for each asset class that we monitor continuously. A recent CNBC interview with Tony Pasquariello, Goldman Sachs Global Head of Hedge Fund Client Coverage, revealed the trap of *accurately* attempting to decipher economic and financial data, “*If you were told in early January that three of the Magnificent Seven stocks would trade lower during the next three months, that sellers of stocks would rise to the highest level since late 2021, core inflation would rise instead of fall for two consecutive months, and the number of anticipated Federal Reserve interest rate cuts for 2024 would decline from seven to three or less, who would have guessed that U.S. equities would do nothing and instead move higher*”? Mr. Pasquariello incorrectly surmised that this confluence of facts could not result in the continuation of the bull market. The lesson: if highly educated economists often fail to predict accurately the direction of the economy and consequently the direction of the financial markets, perhaps others less trained should avoid this trap, too, and evade costly errors in judgment. There are too many known factors and factors that can’t be known influencing financial market short-term outcomes.

Then what can investors do to gain some degree of insight regarding the future direction of financial markets? Looking to history and drawing from similar events can reveal a limited number of past outcomes, and therefore, offer probabilities of repeating events. But this process does not identify all future possibilities. Nevertheless, what does history tell us about what may be ahead after such a strong quarter? When the S&P 500 has climbed at least 10% in the first quarter of the year, investors often have continued to prosper. According to NDR Research, in 13 of 15 occasions (except for 1930 and 1987) the market has risen a median 7.6% over the final nine months of the year. Another institutional research firm, Strategas Research, reports that among 130 past observations when the market was up 27% after five months (as is the case this time), in the next 12 months only 1 time has the market experienced negative returns (the average return was +15% during the next 12 months). These results are not to be confused with forecasts, just probabilities of expected future outcomes. Anything is possible, just not probable. From a historical point of view, the rest of the year looks promising.

Since the rally started late last year, the U.S. stock market has risen steadily with minimal down days along the way. Many investors would prefer the market pause now and allow corporate profits to catch up with today’s higher stock prices. Thankfully, valuations are nowhere near 1999 extreme levels, but are well above the historical median. Experienced investors have learned to avoid becoming overly concerned regarding stock market valuation levels, except for extreme lows and highs, because companies can trade at higher or lower valuations for extended periods before changing directions. Many remember former Federal Reserve Chairman Alan Greenspan sending out the alarm in late 1996, almost four years before the market peaked, referring to investor enthusiasm for U.S. stocks as “*irrational exuberance*.” Greenspan wrote in his 2008 book that the phrase occurred to him in the bathtub while he was writing a speech. Perhaps the Federal Reserve Chairman should have taken the advice of Wall Street’s most stalwart investor, Warren Buffett, “*Occasional outbreaks of those two super-contagious diseases, fear and greed, will forever occur in the investment community. The timing of these epidemics will be unpredictable. And the market aberrations produced by them will be equally unpredictable, both as to duration and degree. Therefore, we never try to anticipate the arrival or departure of either disease. Our goal is more modest: we simply attempt to be fearful when others are greedy and to be greedy only when others are fearful*.” *Berkshire Hathaway Inc.’s 1986 Chairman’s Letter.*

Investors are correct to ask about bonds. Unlike late 2023 when both stocks and bonds appreciated handsomely, this year bonds have remained dormant waiting for the Fed to lower interest rates. The Fed has already earmarked three rate cuts later this year. Many get disillusioned with any asset class that has not met their expectations in recent times. Bonds are no exception. Fortunately, the only free lunch investors can receive according to Nobel Prize laureate Harry Markowitz is increasing performance consistency through efficient diversification. This means that some asset classes will underperform in the short-run, while in the long-run asset classes overall deliver acceptable results. The unwelcomed alternative is all asset classes deliver positive and negative returns simultaneously with more extreme price volatility. There are two lessons here: 1) diversification works over time, but not necessarily all the time, and 2) high-quality bonds are the absolute best defense against a recession and the only asset class likely to appreciate during such environments.

Today, investors remain consumed with the Federal Reserve’s next decision and the direction of short-term interest rates. The Fed expects to cut rates sometime this year but needs further conviction before a decision is made. Per the current Fed Chairman, Jerome Powell, “*It is not appropriate to lower the policy rate without more confidence inflation is coming down. The economy has made considerable progress toward our dual mandate (achieve maximum employment and keep prices stable). We are strongly committed to returning inflation to our 2% objective*.” Sometimes investors get confused about which economic news, good or bad, is positive for financial markets. The answer is, as you might expect, it all depends. That is one reason you see daily volatility in the market as investors react to daily news.

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Sincerely,

Randy Garcia

Chief Executive Officer

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