

Q2 2024 — STRATEGY & MARKET UPDATE

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EXECUTIVE SUMMARY

- Consider reading and sharing our recent publication, '[Insights from Our Investment Process](#),' to learn more about the workings of our distinctive investment management approach. It will put our strategies' year-to-date performance in perspective and give you a sense of how they are prepared to meet future challenges.
- After an eye-brow-raising pullback in April (S&P 500 -4.08%), the market managed to resume its advance in Q2, albeit on a much narrower path (Q2: S&P 500 +4.28% vs. Russell 2000 -3.28%) than in the previous quarter. Growth, Quality, Momentum, Large Caps, and Innovation issues led the way.
- Despite the bewildering divergences registered amongst indices, our research indicates that the market regime remains bullish. The broader market is healthy and investmentworthy, but to capture its potential while controlling risk, we believe investors should abandon conventional, formulaic approaches in favor of a well-constructed market-adaptive, risk-controlled, and tax-aware portfolio.
- Q1 revealed, and Q2 confirmed, three risks that investor portfolios must counterbalance. Two of these have been features of the ongoing market dynamic: the Fed's ill-conceived rate crusade and the market's hyperconcentration. The third is the unforced error committed by portfolio managers and investors alike, who still believe that bonds are effective mitigators of portfolio risk and anchors of portfolio productivity. By midyear, bond indices had declined, with Bloomberg US Aggregate falling -0.71%.
- With election fever mounting in the US and ballot surprises emerging in Europe, investors are concerned that geo-/political singularities can jeopardize the trajectory of the market regime. Our research indicates that healthy markets have ample capacity to preserve and restore their orientation in the face of powerful exogenous shocks, including geo-/political events and pandemics (witness the CoViD episode).
- Our strategies continue to vigilantly monitor the health of the market regime, ready to adapt to, risk-control, and tax-rationalize any actionable signals of market-regime shifts.



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Q2 2024 REVIEW: Up, Flat, or... Down?!

What happened in Q2, and where do the markets stand mid-year?

Given the contrasts we saw, deciphering what transpired requires some sleuthwork:

The flagship S&P 500 added another +4.28% with its Q2 price advance and is up +15.29% for the year. This was mirrored by the tech-heavy Nasdaq 100 (NDX), which moved higher by +8.05% for the quarter and has risen +17.47% for the year.

In contrast, other marquee indices lost ground in Q2 and are only marginally up YTD, including the venerable Dow (-1.73% / +4.79%), the US Mid Cap/S&P 400 (-3.45% / +6.17%), and the US Small Caps/S&P 600 (-3.11% / -0.72%).

While impressed by the shiny S&P 500's progress this year, investors need to be reminded of the index's dark side, about which we have written [extensively](#).

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Despite all the cheerleading of index aficionados, the S&P 500 is just a market gauge and not a sustainable portfolio that can reliably serve the needs of individual investors. In case you forgot, here is a recap:

Investors cannot overlook that the S&P 500 has been at the helm of every US equity bear market, earning a reputation as a 'widow-maker.' It consistently completes the arc of every market cycle by adding a severe bear to every bull.

Throughout decades, the S&P 500 has endured prolonged stretches of sustained losses. This includes the grim years of the Great Depression (1929-1942, -86%), the era of Great Stagflation (1966-1982, -64% inflation-adjusted), and the early 2000s, marked by negative 10-yr. returns amidst two major bear markets. These extended downturns encompass nearly half the tenure of the last generations of individual investors, each time posing a threat to their financial trajectory. This contrasts sharply with the transient impact such periods may have on institutional portfolios with extra-long horizons, a crucial distinction often overlooked by indexing proponents.

Fleshing this risk out, our studies reveal that the S&P 500 has fallen short of meeting a standard 5% disbursement schedule in 13% of all sliding 30-year periods since 1900, significantly above the ideal 5% threshold (known as the 'margin of safety').

Recognizing these challenges, Standard and Poor's offers four blended benchmark portfolios in addition to its well-known pure gauges. These portfolios are calibrated using downstream risk measures such as volatility and standard deviation, aiming to enhance sustainability across market cycles: S&P Target Risk [Conservative](#), [Moderate](#), [Growth](#), and [Aggressive](#). We list their Q2 and YTD performance below:

S&P Target Risk Conservative: Q2 +0.04%, YTD +1.86%

S&P Target Risk Moderate: Q2 +0.29%, YTD +2.98%

S&P Target Risk Growth: Q2 +0.81%, YTD +5.23%

S&P Target Risk Aggressive: Q2 +1.33%, YTD +7.47%.

Classical finance theory typically celebrates hierarchical performance stratification (more risk, higher return). However, investors have valid concerns—can Conservative or Moderate portfolios still pay investors’ bills and meet their funding goals? We believe this is a legitimate concern and have addressed it in two recent publications—'[The Risk of Bond-Heavy Portfolios](#)' and '[Ask Not What Your Horizon Is.](#)'

JUDGING THE MARKET’S HEALTH & INVESTMENTWORTHINESS

Amidst these diverging gauges, what should investors currently conclude? Is this market healthy, and can it be trusted to support investors’ pursuit of growth and sustainability?

At any given time, portfolios must align with the prevailing market regime, track its shifts, and leverage this understanding to calibrate their adaptation, risk posture, and tax stance.

Our concise, six-part series , '[Insights from Our Investment Process](#),' offers a brisk walkthrough of our proprietary investment process aimed at addressing these questions.

We emphasize that portfolios designed for robust and sustainable long-term wealth cultivation must first and foremost be *market-regime navigators*.

In our view, formulaic investing based solely on personal risk appetite (conservative, moderate, aggressive), objectives (income, growth, both), and horizon does not offer adequate guidance for constructing and managing portfolios with a low shortfall probability—capable of paying bills or meeting funding goals in changing market environments. We highlighted this limitation in our article titled '[Ask Not What Your Horizon Is.](#)'

What sets our perspective apart?

Our research has shown that market activity is structured within regimes—large-scope waves characterized by a dominant directional orientation, either bullish or bearish. At any given time, portfolios must align with the prevailing market regime, track its shifts, and leverage this understanding to calibrate their adaptation, risk posture, and tax stance.

In our practice, every portfolio decision stems from a meticulous analysis of the current market regime—assessing the market’s health and investmentworthiness. Over the years, we have integrated a comprehensive lens comprising cutting-edge academic findings, industry insights, and proprietary tools, rules, and procedures. This lens enables us to evaluate the state of the market regime and track its shifts.

Midyear, our assessment indicates that despite apparent contradictions and divergences amongst its various gauges, the market is currently in the bullish regime we have been tracking for some time.

However, this overarching investment green light marks just the beginning of our portfolio work. From here, our strategies follow their individual playbooks to calibrate allocations across leading Factors, Sectors, Industries, and Geographies, balancing offensive and defensive exposures for risk-control management.

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As Q2 concluded, our strategies emphasized US over foreign stocks, Large Caps over Mid- and Small-caps, Growth/Innovation Sectors and Industries, and balanced out this offensive exposure with a carefully selected mix of preservation-oriented equities and short-term income instruments. Although our research indicates that such a lineup represents a good adaptation to the market's current trends, our strategies remain vigilant, monitoring market conditions closely and poised to pivot when actionable signals emerge from the noise of market activity.

LINGERING RISKS

Our research outlines three sources of risk, two of which we noted in our Q1 [review](#):

- The first risk relates to the Fed policy:

“(…) by keeping the Target Fed Funds Rate +2% above the inflation rate, the Fed is undermining the economy and artificially restraining the market. It’s an expensive policy mistake that can have long-lasting consequences. Thankfully, we believe that market pressure has the potential to eventually dislodge the entrenched Fed—an eventuality we are actively monitoring.”

You can read more about our objections in our recently aired LinkedIn post, [‘Unintended Consequences of the Fed’s Policy.’](#) As it currently stands, there is a chance that the Fed will deliver the first rate cut in its September meeting, or at least before year-end, allowing the market and the economy to stabilize.

- The second risk relates to the market’s lingering concentration:

“In 1999, the top-10 capitalization stocks in the S&P 500 commanded 26% of the index’s value. And we know what happened next (remember the dot.com crash and the bear of 2000?!). After years of plummeting in between, this figure recently surged to over 33%, reaching a multi-decade high. Whether it was last year’s “Stupendous (aka Magnificent) Seven,” this year’s “Fabulous Five,” or Europe’s “Elite Eleven” (aka “The Granolas”), the market is hyper-concentrated. This presents an elevated risk that our strategies have been vigilantly tracking.”

While concentration in the US broader market indices is indeed a problem, investors must know that there is no relief to be obtained by ‘international diversification,’ as is often advocated by Wall Street pundits. Please read our recent LinkedIn post, [‘From Bad to Worse—Country Index Overconcentration.’](#)

- The final risk pertains to the potential for complications in the domestic or geopolitical arena, including those related to the US or European (France, UK...) elections, to derail the market trajectory. Our research indicates that this apparent risk, which is a significant concern for some investors, is overestimated. History demonstrates that market regimes have a remarkable capacity to defend and restore their equilibrium in the face of substantial political or geopolitical disruptions.

History demonstrates that market regimes have a remarkable capacity to defend and restore their equilibrium in the face of major political or geopolitical disruptions.

Please read our notes on the topic of elections and the key drivers of market returns: [‘Who Should Win the Next Election,’](#) [‘What’s the Primary Driver of Investment Returns,’](#) and [‘The Most Powerful Equation in Investing.’](#)

LAST WORD

We invite you to spread the word about your investment experience within your circles of influence. The last six years have been challenging for most investors. They have been battered by the historic bond market fall, and whipsawed in the steep downdraft of 2018, the crash of 2020, and 2022’s rolling turmoil. And throughout the last fifteen years, they have been torn between the Scylla of speculation and greed and the Charybdis of worry and indecision. As our veteran clients have discovered, our strategies’ adaptability and risk controls have been an excellent antidote to haphazard performance and a booster of investor confidence. Please assist us in spreading the word.

We remain grateful for your trust, loyalty, support, and friendship!

On behalf of GNH Capital Group’s entire team with Henrik, Richard, Chad, and Isabel,

Kostas

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Data Source: YCharts.

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