

## Q3 2024 — STRATEGY & MARKET UPDATE

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### EXECUTIVE SUMMARY

- In Q3, while the market's 'melody'—its sequential progress—was buoyant across virtually all major indices, Factors, and Sectors, its 'harmony'—internal dynamic—revealed intriguing shifts that warrant attention.
- Previously lagging interest-rate-sensitive sectors such as Utilities<sup>[1]</sup> (+19.4%), Real Estate (+17.2%), and Small Caps (+10.13%) outperformed, surpassing the S&P 500's +5.9%. Utilities ended Q3 with a YTD gain of +30.4%, even outperforming Information Technology (+30.3%), largely due to AI's increasing energy demands.
- The surge in lagging sectors has raised questions about a possible shift in market leadership. However, our strategies suggest this could be temporary, similar to past patterns seen in 2022 and 2023. Utilities' performance, driven by tech-related energy demand in data centers, doesn't signal a clear leadership change.
- There are two critical propellants of potential market advance in Q4 2024 and 2025:
  - Federal Reserve Policy: Recent rate cuts can propel the market, but we argue the Fed may be late in its approach, and market pressure could be needed to drive timely progress.
  - Election Cycle: Historically, the period around US elections boosts markets due to surging in budgeting and spending. We will monitor this pattern for opportunities.
- Despite geopolitical risks and political uncertainties, our analysis assesses that the market remains in a bullish regime, though we continue to highlight the risk of market overconcentration.



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### Q3 2024 REVIEW: Counterpoints Bach himself would admire!

Despite the overall upward trend in investor portfolios during Q3, the market's advance had a complex and turbulent undercurrent. To illustrate this intriguing dynamic, we can borrow a musical analogy to help us flesh out the forces shaping the year-end finale.

In music, melody and harmony work together to create powerful compositions. Melody unfolds sequentially and horizontally, while harmony layers elements simultaneously and vertically. While melody captures our attention and lingers in our memories, harmony's depth and complexity often underpin future developments.

So, regarding the market's 'melody'—its sequential progress—Q3's story is straightforward and nearly universally positive, reverberating across all market facets, including broad indices like the Dow Jones, the S&P 500 (US Large Cap), S&P 400 (midcap), and S&P 600 (small cap), major Factors (Size, Value, Momentum, Quality, Volatility...) and Sectors (with the sole exception of Energy), most countries (with only a few exceptions), and even all corners of the beleaguered bond arena.

But what about the market's 'harmony'?

Here, the narrative becomes far more complex and intriguing, warranting investors' closer attention as we move into Q4.

For years, the market's main thrust has concentrated on Tech, Innovation, and Growth, dominated by megacaps. While this dynamic was challenged during the 2022 market downturn, it was quickly reaffirmed by the strong rebound in 2023.

Tech, Innovation, and Growth continued to dominate in Q1 and Q2 of 2024. However, in Q3, a striking counterpoint emerged, one that even Bach, the legendary late-Baroque composer and master of counterpoint harmony, would admire! Here are the fascinating specifics:

In Q3, the market advance was led by some unlikely former laggards: Utilities (+19.4%), Real Estate (+17.2%), Low Volatility + High Dividend (+14.9%), and even the much-maligned Small Caps (+10.13) all of which bested the S&P 500's +5.9% advance. In contrast, information Technology, the perennial heavyweight champion, lagged with only a +1.6% increase.

By the end of September, Utilities had achieved a YTD gain of +30.4%, edging out the +30.3% gain of Information Technology. Remarkably, nearly two-thirds of Utilities' YTD total return was generated in Q3 alone!

This vigorous catch-up extended to several other areas, including Real Estate, Consumer Discretionary, Industrials, Materials, Dividends, and Low Volatility—in short, most of the former laggards.

In contrast, by the end of September, Information Technology and Communication Services saw only modest gains in Q3, contributing a meager 5% and 7% to their yearly advances, respectively.

Worse still, in Q3, Semiconductors—the spearhead of InfoTech—experienced an unusual 4% shrinkage of its otherwise hefty YTD gains. This backward move was mirrored in a few other areas, including Software, Retail, and Energy.

So, does the market's harmony show us there is a shift in its leadership? Should investors (including our strategies) who have benefited from the Tech/Innovation/Growth/Large-Cap surge reposition their portfolios?

Our strategies aim to market-adapt, risk-control, and tax-rationalize their exposure regardless of where the market's main thrust moves.

That said, the Q3 catch-up of previously lagging areas bears similarities to moves we saw in 2022 and parts of 2023, which we assessed at the time as transient and were subsequently proven correct. So, regarding the question of a market leadership change, our strategies' reply is, 'Not so fast!'

However, our analysis extends beyond such general observations.

Traditional financial analysis compartmentalizes the market into sectors to which it ascribes distinct investment identities. Utilities have long been viewed within this framework as conservative/defensive investments, valued primarily for stability and income, much like Staples and unlike Growth/Innovation. Seen through this lens, their strong performance in Q3 and YTD leadership would traditionally be interpreted as a shift in market leadership.

However, as our investors and followers [know](#), we hold a different view as proponents of 4th-generation Factor investing and pioneers of Market-Region navigation. We believe that "there is very little economic reality in traditional categories of holdings—like sectors [...], and, because of that, we do not find them to be reliable portfolio building blocks." Utilities serve as a prime example of this perspective.

Within the Wall Street orthodoxy, Utilities are classified as conservative/defensive investments because they power a relatively static industrial and consumer base that grows at the modest rate of GDP. Yet, this reality has shifted drastically in recent months with the rise of AI, which has significantly increased energy consumption in data centers—the backbone of proliferating cloud services. Data center energy consumption is projected by the International Energy Agency/IEA to rise 50% from 4% to 6% of total US demand by 2026. Utilities are increasingly driven by Tech's insatiable demand for energy, making them a crucial part of the broader Tech infrastructure—hardly consistent with their traditional conservative/defensive profile.

For this reason, we do not interpret Utilities' YTD leadership alongside InfoTech as a clear sign of shifting market leadership.

Still, the broader question of the locus of market leadership—its current lineup and potential shift—is of paramount importance. So, how do our strategies track market leadership?

In Q2, we completed a two-year project aimed at integrating our key proprietary indicators, analytical workflow, and portfolio-engineering tools into a single console with an intuitive user interface.

The project outcome has exceeded our expectations, and we're excited to invite our clients and followers to schedule a visit or a Zoom call for an interactive tour. Please reach out with a bit of advance notice to arrange this.

#### **Q4 2024 – PROPELLANTS: FED(-up)**

There is yet another factor with the power to propel the entire market higher—one that also significantly impacts debt-laden sectors like Utilities and Real Estate: the Federal Reserve and, by extension, the world's central banks.

Recently, major central banks around the globe, except for Japan, have begun cutting interest rates. On September 18, the US Fed joined this chorus with an outsized 0.50% rate cut and an outline of a commitment to an accommodative path forward.

In our piece, [“The Most Powerful Equation in Investing,”](#) we explain why rate cuts are inherently a powerful catalyst for higher stock valuations. We encourage our investors and followers to revisit that piece.

Yet, the Fed may be acting too late. In this series (e.g., [here](#)) and elsewhere (see [“Unintended Consequences of the Fed’s Policy”](#)), we have long argued that the Fed’s strategy has been misguided.

“(…) by keeping the Target Fed Funds Rate +2% above the inflation rate [for over a year], 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.”

Despite the lavish praise from Wall Street pundits, we believe the market is ‘Fed up’ with the central bank’s policy. After orchestrating a controlled decline in 2022 to counter the Fed’s aggressive rate hikes, which ultimately led to the conclusion of the central bank’s rate crusade in July 2023, the market is now rallying from behind—catching up with a long-overdue advance in a normalizing environment. While this is not the only factor shaping Q4 and 2025, its importance cannot be overstated.

#### **Q4 2024 + Q1 2025 – PROPELLANTS: THE FOUR-YEAR CYCLE**

It may sound abstract, but the calendar does not lie. While our strategies view politics—and even geopolitics—as distant secondary factors in shaping market direction, US elections are recurring critical junctures for budgeting and spending, and these money flows influence the market. Historically, the stretch straddling the US presidential election has been fertile ground for market gains. Our strategies specialize in pattern recognition and will closely track this favorable alignment.

#### **Q4 2024 – THE BOTTOM LINE**

As mentioned before, and as the S&P Dow Jones organization’s indices for typical portfolios listed below demonstrate, investor portfolios that followed<sup>[1]</sup> the market advanced broadly in Q3:

S&P Target Risk Conservative: Q3 +5.54, YTD +8.83%

S&P Target Risk Moderate: Q3 +5.70%, YTD +10.16%

S&P Target Risk Growth: Q3 +6.02%, YTD +12.81%

S&P Target Risk Aggressive: Q3 +6.33, YTD +15.46%.

But has the market surged too far, too fast? Could the domestic political calendar and the recently heightened geopolitical tensions (as of this writing, the Middle East conflict has escalated) undermine further advance—or even lead to a sustained market decline?

We have long advised investors to move away from forecasting, which has a poor record, and instead focus on in-depth assessment and vigilant monitoring of the dynamic of the market regime as it unfolds. We practice this within our discretionary PIM® portfolios, which at the end of Q3, using our console of proprietary indicators and innovative analytics, assess that the market remains in a bullish regime and is still investment-worthy. However, we continue to highlight a critical risk we have repeatedly addressed in recent Updates—lingering market overconcentration.

## LAST WORD

We invite you to spread the word about your GNH Capital Group experience within your circles of influence. The last five 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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[1] Market Data throughout this Update: S&P Dow Jones Indices.

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