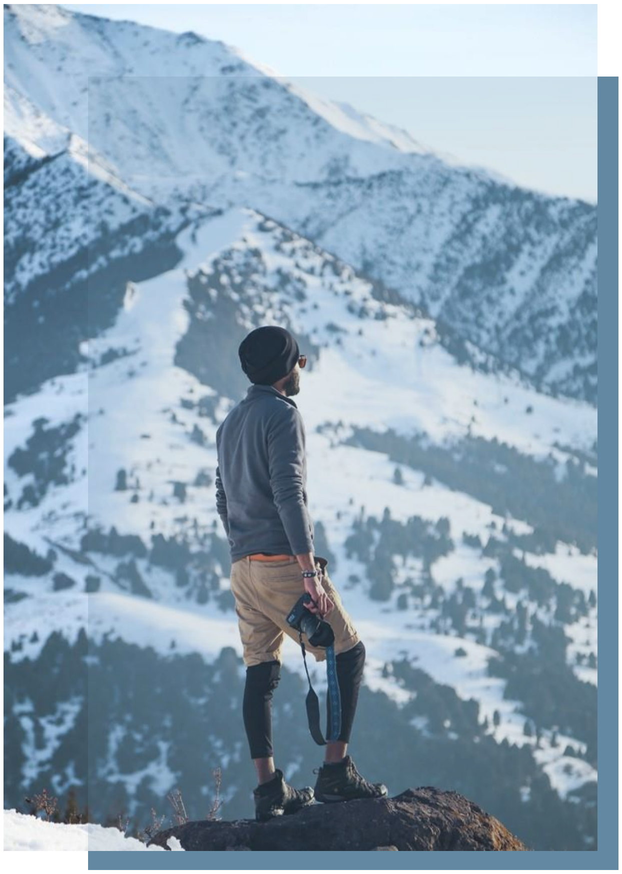
PERSPECTIVES

Benefit Financial Services Group Newsletter

Quarter Ending March 31, 2024



What's New

Market Recap

BFSG is proud to welcome Brent Miller to the team. Brent works out of our Phoenix, Arizona office. As a Senior Portfolio Manager, Brent is responsible for managing and monitoring client portfolios, reviewing portfolios with clients, and providing analysis and recommendations on stocks, portfolio strategy, and the economy to help drive future investment decisions. We are lucky to have his 20 years of investment experience to help us achieve our clients financial goals.

Brent Miller, CFA® (Senior Portfolio Manager)

The U.S. stock market surged in the first quarter of 2024 (Q1), once again led by the S&P 500 Index.[1] The index notched 22 new highs in the quarter, increasing by 10.2%. Mega cap technology stocks led the charge with NVIDIA (NVDA), Meta Platforms Inc. (META), Amazon.com Inc. (AMZN), and Microsoft Corporation (MSFT) appreciating by 82.5%, 37.2%, 18.7%, and 11.9%, respectively.[2] However, a deeper analysis reveals that the Q1 2024 large cap rally was broader than it appeared at first blush. For example, the S&P 500 Equal Weight Index was up 7.4% in the quarter, trailing the performance of the market cap weighted index by just 277 basis points.[3]

International stocks lagged their U.S. counterparts with the MSCI World ex USA Index yielding a return of 4.6%.[4] In advanced economies, Japan's export-oriented stock market and European equities hit unprecedented levels, buoyed by the Japanese Yen's prolonged weakness and optimism surrounding advancements in healthcare. Emerging market returns trailed those of developed international markets, with the strengthening dollar dampening the substantial gains witnessed in Taiwan, Korea, and India. Meanwhile, China's ongoing economic difficulties translated into underwhelming market results.

The most recent Federal Open Market Committee's (FOMC) projections for rate cuts imply three 25 basis point rate cuts by the end of 2024, down from market expectations of six 25 basis point cuts at the end of 2023. Consequently, after outperforming the S&P 500 Index in Q4 2023, the small cap Russell 2000 Index took a breather, appreciating by a comparatively lower 4.8% as expectations of a "higher for longer" interest rate environment took hold.[5]

Bond yields remained relatively range bound during the first quarter with 10 Year Treasury yields ranging from 3.86% to 4.34%. From a performance perspective, the Bloomberg Aggregate Bond Index fell by 0.77% in the quarter as changing rate cut expectations and rising yields exerted downward pressure on prices.[6] The biggest losses came from long-term bonds, which tend to be more sensitive to changes in interest rates and interest rate expectations.

On the commodity front, the price of Brent Oil increased by 18.2% during Q1 2024 due to tightening global supply and better-than-expected economic growth in the U.S. and China. Perhaps not surprisingly, energy was the second best performing sector in the S&P 500 Index during Q1 2024, increasing by 12.6% during the quarter.

We look forward to the rest of the year and are hopeful that the Federal Reserve will be able to keep rates higher for the first half of 2024 without triggering a recession, resulting in a “soft landing” scenario for the domestic economy.

Forecast

Steven Yamshon, Ph.D. (Managing Principal)

Henry Hazlitt, an American journalist, said years ago, “The art of economics consists in looking not merely at the immediate, but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.”

The U.S. government is running permanent, and very large, deficits. The National Debt has surged to over $34.5 billion (122% of GDP) in 2024 and at the current rate, we don’t believe it is sustainable.[7] At the same time, the Federal Reserve is signaling rate cuts. Lower rates mean more growth and higher price earnings ratios. We don’t blame investors for reading the tea leaves and realizing that all this stimulus is probably good for the markets in the short run.

In the long run, too much debt is certainly problematic. Just look at history to see what happened to Germany in the 1920’s, or present-day Argentina, or even our own economy from 1921-1929. But it doesn’t happen overnight. However, the impact is being felt to some degree now. In the past two decades, the U.S. government has spent 1.6% of GDP on interest payments to service our national debt. Now it is at 3.1% of GDP or $870 billion per year in interest, and almost as much as we spend on defense ($891 billion).[8]

While the U.S. defaulting on its debt is a very unlikely scenario (the Treasury would just print more money), eventually the sheer size of the government and the mishandling of monetary policy catches up. Government spending ends up “crowding out" investment because it is demanding more loanable funds and thus causing increased interest rates and therefore reducing investment spending. As a result, crowding out can reduce a country’s future potential output (i.e., less growth) and lead to more inflation.

Eventually politicians, investors, and citizens will wake up from their Rip Van Winkle sleep and remember the words of Henry Hazlitt.

Portfolio Management

Michael Allbee, CFP® (Principal/Senior Portfolio Manager)

The S&P 500 Index is much more concentrated than anything we have experienced in over half a century now. The largest stocks constitute 33.5% of the index.[9] Moreover, the S&P 500 Index now has more allocated to growth (61%) than value (39%) stocks, where typically the allocations have been the same on average over the past 30 years.[10] While large-cap U.S. stocks (both growth and value) will continue to make up the core of our clients’ portfolios, our investment committee reviews and approves investments in a variety of asset classes to facilitate the construction of diversified client portfolios.

In our opinion, the three main avenues of diversification within equities right now are value stocks, small-mid cap stocks, and international stocks. We have pounded the table in past Perspective newsletters on international stocks attractive relative valuations and they should also stand to profit from cheap currencies over the next decade.[11] Now the valuation gap between U.S. small-cap value stocks and the most popular U.S. growth stocks seems extreme to us.[12] The 20-year relative return of U.S. small-cap value stocks versus the S&P 500 Index dipped negative recently for the first time in U.S. stock market history. Swings in U.S. small-cap value stocks can be swift, and we believe staying invested is the best way to capture expected gains over time.

We also must not forget that small-cap companies tend to carry higher relative levels of variable rate debt and tend to underperform large cap stocks in high interest rate environments due to their higher carrying costs of debt. With our forecast of a modest rate cutting environment and a possible “soft landing” scenario, this should provide a tailwind to companies with higher levels of debt. But our focus remains on finding higher quality small-cap companies with either little debt or strong enough cash flows to cover their borrowing costs. Academic research suggests that returns can be boosted even further by emphasizing stocks shown to have higher average returns than the market, such as those with smaller market caps, lower relative price, and higher profitability.

In summary, while the U.S. stock market, in aggregate, appears to be priced at a premium, we believe there are pockets of the global stock market that still appear attractive from a valuation perspective, and within these undervalued market segments, it is possible to find stocks that trade at a discount relative to their long-term earnings power. There are always going to be the diamonds in the rough, but it takes a lot of work to find them.

Talk With Us!

Henry VanBuskirk, CFP® (Wealth Manager)

Is investing in the stock market the same thing as gambling? The short answer is, NO! Do movies and books dramatize and romanticize our profession to make it look like it is gambling? Yes. Why? Well, if the media accurately depicted what we do daily, few people would read those books or watch those movies. Few people want to hear a tale of advisors who are hard at work researching market trends, crafting a tailor-made diversified portfolio for our individual client’s needs, and mapping out their life goals on their financial planning journey through a comprehensive financial planning process. The narrative works, but it’s not a very exciting one. People instead want to hear about that fabled advisor down the street who bought and sold GameStop stock at the right time or their cousin’s friend’s adviser who bought NVIDIA stock at an all-time low. The truth is those other advisors just got lucky. Luck is not a repeatable process. BFSG’s repeatable process of building long-term wealth for our clients in a calculated manner through meticulous financial planning and investing strategies is a work of nonfiction.

With that being said, why are stories of luck in the stock market so prevalent? Is there a link between gambling and investing? To answer these questions, let’s use the S&P 500 index as a representation of the stock market. If we analyze the performance of the S&P 500 on any given day between 1951-2023, we find that the stock market had a 53.6% chance of being positive on that day.[13] Now let’s compare that to a game of Roulette where you bet only on black. There are 38 possible numbers that the Roulette wheel could hit (1-36 alternating between red and black, 0 and 00 are uncolored). Your odds of winning any one game of Roulette where you bet only on black is 18/38 (or 47.4%). That is slightly worse than either a coin flip (50%) or earning a positive return in the stock market on any given day (53.6%). However, people rarely play one game of Roulette and people rarely invest only one day in the stock market.

What if you invested in the stock market for a year? If you invested in the stock market for one year, the odds of you having a positive return jump to 73%. There are 252 trading days in a year. Now what are the odds that you will have more money than you started in Roulette if you play the game 252 times where you only just bet on black every single time? The answer is 18.41%.[14] Quite a far cry from the 73% that the stock market can do over 252 trading days in a year. The odds of having a positive return in the stock market only increase in your favor the longer that you are invested. Investing in the stock market for three years means you have an 84% chance of having a positive return, an 88% chance of having a positive return after five years invested, and a 94% chance of having a positive return after ten years invested.[15]

This is why time spent in the market is more important than trying to time the market. The former you can control, but the latter you can’t. Over long periods, investing in the stock market looks less and less like gambling until they no longer resemble each other. If you are looking to retire soon, your retirement could last 20 years, 30 years, or longer. Not investing to help fund that long of retirement is more of a gamble than playing some games of Roulette in Las Vegas. Of course, nothing is guaranteed with investing and nothing is guaranteed when gambling, which is where the similarities between the two end. However, I’d wager that you aren’t looking to leave your financial plan and investment portfolio to a game of chance. Best of luck to you in your gambling adventures or your financial planning journey and always remember that “Past Performance is No Guarantee of Future Results.” If you’re feeling uncertain about the odds of your financial plan or your investment portfolio’s success, Talk to Us!

In the News

- Welcome to the BFSG team – Brent Miller and Scott Sollars.
- NAPA names BFSG Institutional Services to Top Defined Contribution (DC) Advisor Teams for 2024.
- Michael Allbee, CFP® makes the Forbes/SHOOK Best-in-State Wealth Advisors list for 2024.
- BFSG is now a Better Business Bureau (BBB) Accredited Business.

The Score Board

	03/31/2024	YTD Change
Dow Jones Industrial Average	39,807.37	6.14%
S&P 500*	5,254.11	10.15%
NASDAQ Composite*	16,379.46	9.11%
MSCI EAFE (USD)*	2,346.84	4.95%
Bloomberg Commodity Index	99.49	0.85%
U.S. Aggregate Bond Index	2145.23	-0.77%
10 Yr U.S. Treasury Bond Yield	4.20%	33bps
30 Yr Fixed Mortgage Rate	7.24%	25bps
Prime Rate	8.50%	UNCH
Crude Oil ($ / Barrel)	$83.17	18.17%
Gold ($ / Oz.)	$2,229.87	8.30%
U.S. $ / Euro €	$0.93	2.36%
Core Inflation (excluding food / energy)**		3.2%
Inflation (including food / energy)**		3.8%

**Without Dividends; **Unadjusted 12-Months ended February 2024; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. These stocks, along with Alphabet Inc. (GOOG), Apple Inc. (AAPL), and Tesla, Inc. (TSLA) were formerly known as the Magnificent Seven due to their material outperformance versus the rest of the S&P 500 Index in 2023. With GOOG slightly underperforming the index in Q1 2024 and AAPL and TSLA both badly lagging quarterly index performance, the outperforming basket now consists of the four stocks noted above.
3. The S&P 500 Equal Weight Index (EWI) is the equal-weight version of the S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight of 0.2% of the index total at each quarterly rebalance.
4. The MSCI World ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets countries (excluding the U.S.) and 24 Emerging Markets countries.
5. The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell Index. The index is commonly used as proxy for U.S. small cap stock market performance.
6. The Bloomberg U.S. Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market. The index was created on July 7, 1973.
7. Source: https://www.usdebtclock.org/
8. Source: CBO, J.P. Morgan Asset Management. Estimates are from the Congressional Budget Office (CBO) February 2024 "An Update to the Budget Outlook: 2024-2034".
9. Source: Standard & Poor's, J.P. Morgan Asset Management. As of 3/31/2024, the top 10 companies in the S&P 500 Index were MSFT (7.2%), AAPL (5.6%), NVDA (5.1%), AMZN (3.7%), META (2.4%), GOOGL (2.0%), BRK-B (1.7%), GOOG (1.7%), LLY (1.4%), AVGO (1.3%) and JPM (1.3%).
10. Source: Compustat, FactSet, J.P. Morgan Asset Management. Growth stocks are those of companies that are considered to have the potential to outperform the overall market over time because of their future potential. Value stocks are classified as companies that are currently trading below what they are really worth and will thus provide a superior return. Growth stocks typically do not pay dividends, whereas value stocks often have higher than average dividend yields.
11. Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. As of 3/31/2024, the MSCI ACWI ex-U.S. Index is selling at a 34.5% price-to-earnings discount relative to the S&P 500 Index.

12. Source: FactSet. As of 3/31/24, the S&P 500 Growth Index is selling at a 52% premium (27.34x) to its 20-year average forward price-to-earnings (17.95x). Whereas the S&P Small Cap 600 Value Index is selling at a 16% discount (13x) to its 20-year average forward price-to-earnings (15.56x).
13. Source: Crestmont Research. https://www.crestmontresearch.com/docs/Stock-Yo-Yo.pdf
14. For the math nerds like Henry out there interested in how that number is calculated, you'll find his work on how he got that answer of 18.41% in the appendix of the following blog post: https://bfsg.com/is-investing-in-the-stock-market-akin-to-gambling/
15. Source: Capital Group, "Time, not timing, is what matters".

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