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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **August 7, 2024**

Scott Wren
Senior Global Market Strategist

Last week's S&P 500 Index: -2.1%

Hysteria

Key takeaways

- When investors forget that equity markets ebb and flow, they can get into trouble.
- Our goal has been to be patient, wait for opportunities, and stay invested in high-quality equities that have strong balance sheets and dependable cash flows.

Human emotion frequently gets the best of investors during times of uncertainty. The result in the equity market, in its most basic form, often translates into buying high and selling low. Just the opposite of what a long-term investor ideally should be doing. Clearly, when this ill-advised "strategy" is followed time and time again over the course of multiple years and multiple economic and market cycles, one's returns can be impacted in a meaningfully negative way. When times are good and the economic sun has clearly been shining for some time, everyone wants to get on board. They don't want to miss the next leg higher. Some might even think investing is easy and potentially risk-free. You jump in and buy stocks and they keep going up, right? How hard can that be?

But the other side of the coin isn't quite as fun. Just look at the last handful of trading days. When investors forget that equity markets ebb and flow, they can get into trouble. What frequently happens is investors feel like they have missed out on the initial and intermediate stages of a stock market rally and their patience wears thin. They finally jump into stocks when valuations are elevated, frequently buying near what turns out to be an interim top in the market.

Our goal has been to be patient, wait for opportunities, and stay invested in high-quality equities that have strong balance sheets and robust, dependable cash flows. That means we prefer U.S. large-cap stocks over U.S. small caps and international equities. We have chosen not to chase the stock market higher for most of this year as we believe the underlying fundamentals do not support the recent record highs seen in the S&P 500 Index (SPX). We have favored trimming positions in the Information Technology and Communication Services sectors back to neutral in equity portfolios as we felt those two areas had become meaningfully overvalued.

It has been a quick move down, and the SPX trades 8.5% lower than the record high set just three weeks ago at the time of this writing. In our view, the economic data has been consistent with a moderating economy and a soft landing (no recession). We are not jumping on the bandwagon calling for an "emergency" Federal Reserve (Fed) rate cut but do believe our central bankers will likely feel compelled to cut rates more than we initially expected.

There is a term that describes investor emotions when they react in an extreme way because of fear. A close to 10% intraday move down from the recent record high in the SPX over a short period of time, without much change in the underlying fundamentals, qualifies. You could call it fear of the unknown. A more concise term is hysteria. Welcome to the new growth and Fed-policy-fearing U.S. stock market. We will continue to look for opportunities in markets that result from volatility. We suggest investors do the same.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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