The Anatomy of a Bull Market

Q2 2024 Market Update

"Damn the torpedoes – full speed ahead!'" - David Glasgow Farragut

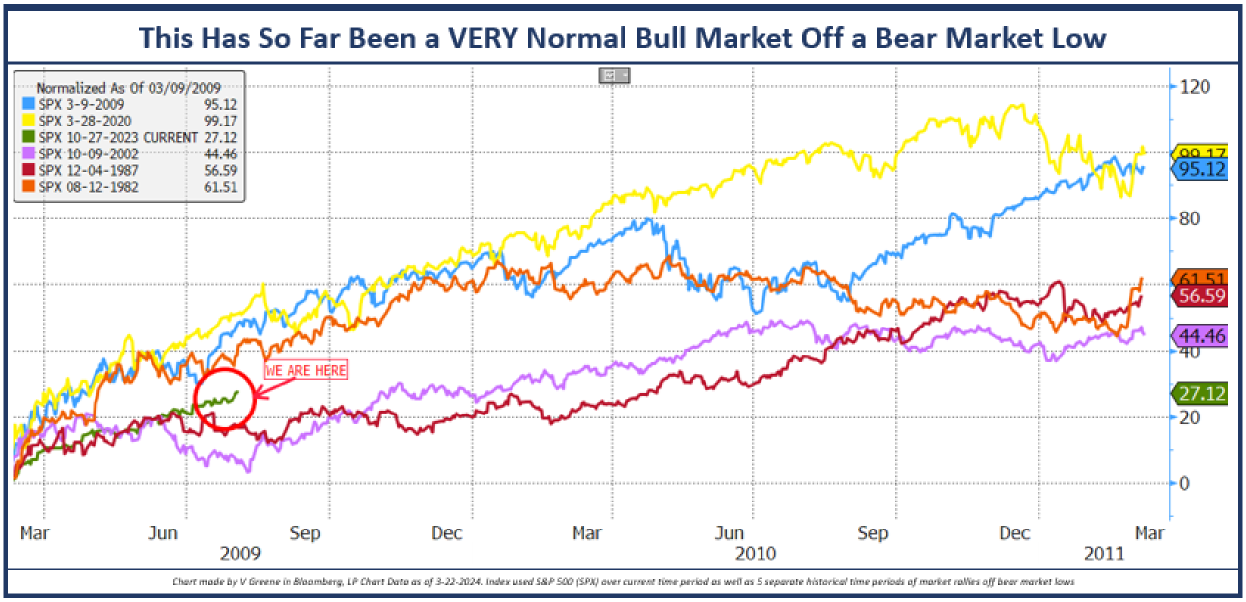
Spring brings change to the air with occasionally violent and volatile shifts in weather as winter fades and summer waits around the corner. *March comes in like a lion and leaves like a lamb* the folklore intones, and markets often take heed. A more accurate rule of thumb for this market would be 2023 came in like a bear and left like a bull.

Q1 has been a strong continuation of the year-end rally of 2023, and the Bulls are firmly in control. Yet much of the world seems like it's waiting for another shoe to drop and for what feels like an inevitable car crash. We would argue all this worrying may be for naught as history is strongly on the side of the Bull market continuing. We believe that this almost vertical ascension from the October 27th, 2023 low is not as abnormal as investors fear, although we do anticipate a bit more volatility in Q2 and the rest of the year.

There is plenty of historical precedence of this type of market run. Market bottoms are often not believed, not trusted, and constantly seconded-guessed. We too were skeptical in October and November last year, but rather grudgingly (at first) had to acknowledge the turn and reposition. Since the October lows, we have seen:

- 100 total trading days. Almost 2:1 up to down day ratio with:
    - 36 down days since 10/27/23 though 3/22/24
    - 64 up days since 10/27/23 through 3/22/24
- 0nly 4 down days > -1%, NONE with a daily drawdown >-2%
- Longest streak (273 days through 3/22) without a -2%+ drawdown, longest since 1918

To date, this has been a very normal Bull market. Below is a graph of the last 5 major Bear market bottoms (1982, 1987, 2002, 2009, 2020) compared with the recent Oct. 2023 lows and bull market rally vs. historical averages. As you can see by the green line, we are in line with (if not lagging) some of the other recent Bull markets. Yes, we may be off and running, but we are in line with a normal Bull market recovery. While it feels fast and furious, it is on par with historical Bull market turns.



Bull markets typically never announce themselves and feel awkward and wrong when they get started. Sometimes investors have been burned by a perceived rally, only for it to peter out and markets push to even lower lows. There is also this initial feeling of doom that comes in the early innings of a Bull market as we look backward at recent causes of the Bear market and are reminded of all the potential problems that derailed the market. In the most recent 2022 Bear market, rising interest rates, high inflation, regional banking crisis and 2 failed banks, an inverted yield curve, as well as concerns on labor market health all dragged down stocks.

This is not to say this Bull market does not come with its own set of unique challenges. First and foremost is the premise the Fed will engineer a soft landing (no recession), successfully bringing down inflation while keeping employment steady. This assumption is baked into the market at this point, and it has been done before (1990s), however it is a rarer occurrence. The yield curve has now been inverted for a record number of trading days, as well as concerns about Government spending, government's ability to legislate effectively, and rising debt levels are all areas that concern investors. However, we feel comfortable that the macroeconomic environment will hold up enough to support the Bull market rally. Remember, your portfolio cares a lot less about politics than you do personally. Election years are often strong years in the market, especially with an incumbent running.

Outside of the Fed, we see 4 main potential threats to the Bull market that still have investors spooked and many refusing to believe this market has staying power. This includes high equity multiples, market concentration, narrow breadth, and macroeconomics concerns. However, when we dig into each of these hurdles, we find that more than likely the Bull rally can clear them.

1.) Market multiples are neither too high nor expensive

Yes, the market is expensive and outside of a small handful of sectors, P/E ratios are above average and trending higher. If you remove the 10 largest stocks and review the 490 remaining S&P 500 members, markets are trading at a 19x multiple, which is high but more in line with the average. Even the 10 largest stocks are still well below the multiples we saw in prior bubbles like 2000. If you look at SPW (S&P 500 equal weight), its P/E is 16x, which is more in line with average and shows that markets as a whole are not at stretched valuations – just the 10 largest weighted stocks are expensive vs. historical average of 16xP/E. The current top-10 holdings in the S&P 500 by % of market cap are (according to Goldman Sachs): MSFT 7%, AAPL 6%, NVDA 5%, AMZN 4%, GOOGL 3%, META 3%, BRK/B 2%, LLY 1%, AVGO 1%, & JPM 1%.

Multiples can also be mitigated by rising profits and earnings to offset the growth of stock prices. Corporate profit growth is key to the market continuing to rally, as growing profits support rising stock prices and keep multiples from getting to the extreme 40x area we saw back in 2000. As AI (Artificial Intelligence) and technology drive more innovation and efficiency, we may see profit multiples keep up with the rally more than initially thought. Multiple investment companies have already raised their 2024 S&P 500 targets and, more importantly, their 2024 EPS targets.

2.) The market rally is concentrated, but the bubble isn't close to popping yet

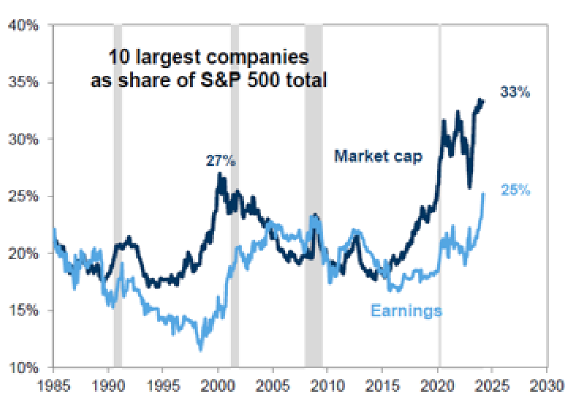
Concentration in the S&P 500 is high compared to historical averages. Currently, the 10 largest US stocks account for 33% of the S&P 500's market cap and 25% of its earnings. We acknowledge this concentration typically occurs around bubbles. However, we believe that we're a ways off before the bubble pops and that market concentration isn't necessarily a death knell to this Bull market right now. Market concentration in stocks that are growing profits faster than the average S&P 500 member could actually propel indexes higher.

Per research by Goldman Sachs, if you review the two most important historical eras of market concentration – the Nifty-50 bubble in 1973 and the Internet/Tech bubble of 2000 – you see that, while we are expensive, we are not at bubble poppling levels. Yet, during 2000, markets started trading at a 53x trailing P/E and 43x next 12-month PE. Whereas currently we are at 31x and 26x respectively. Profits are also growing much more rapidly for the top 10 companies now than in the prior 2 bubbles. Currently the top 10 median stock has an ROE of 29% and Net Margin of 28%. This compares very favorably to the tech bubble (ROE of 25% and Net margin of 11%) and Nifty-50 (ROE of 18% and Net margin of 10%).

One interesting note is MSFT was the top member in the S&P 500 in 2000 (4% weight $557B market cap was the largest stock by cap weight and % of S&P 500) as well as they are a CURRENT member of the top stocks in the S&P 500 (7% weight, $2.988B market cap currently the largest market cap and S&P 500 weight). From the 1973-2000 era, we also had 3 stocks that remained top S&P 500 holdings: IBM, GE, and XOM all remained core top-10 S&P 500 stocks over 25+ years. Just because a stock is heavily weighted, that does not necessarily mean it's marked for a downfall. We do have to be aware that eventually this concentration may bring issues, and often it is related to a bubble. We argue that yes, we are bubbling, but we have a way to go before it pops.

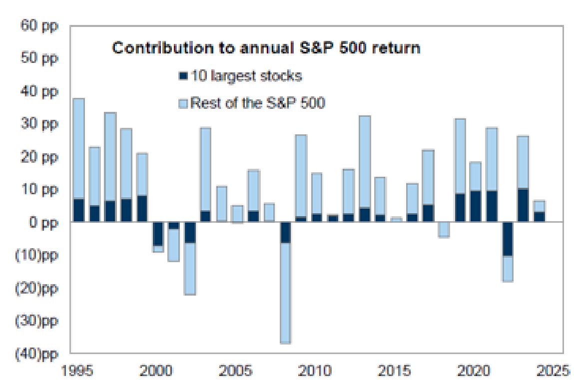
Concentration in Large Stocks Driving Gains

Exhibit 1: Concentration within the S&P 500 has surged to the highest level in decades
earnings are consensus forward 12-month estimates



Source: Compustat, FactSet, IBES, Goldman Sachs Global Investment Research

Exhibit 2: The largest stocks have been major drivers of the aggregate S&P 500 return in recent years



Source: Goldman Sachs Global Investment Research

Goldman Sachs, US Equity Views, Pg. 2, published 7March 2024. Written by Ben Snider and team.

3.) Market breadth is widening

More stocks are trading above their 200-day moving averages and market performance is widening beyond just discretionary, technology and communications. More sectors are positive and trending up. Earnings growth is expected to be stronger across the board and not just limited to the Magnificent 7. Recently, small caps have started to rally after lagging the S&P 500 for all of 2023. Per Ned Davis Research's strategist Ed Clissold, almost 70% of stocks in their multi-cap universe are trading above their 200-day moving average. Historically, when greater than 60% of stocks are trading above their 200-day moving average, that leads to a gain of around 11.41%. Mr. Clissold stated, the "focus on mega-cap tech's attribution to returns misses that most stocks are in uptrends." He also remarked, "It is okay for mega-caps to lead if they are taking other stocks with them." CFRA also notes that breadth is wider, and the markets have been lifting most stocks by noting that more stocks than average in S&P 1500 (a wider index) are trading above their 10-week and 40-week Indicators.

Breadth Widens Out

% of S&P 1500 Sub-Industries Above Moving Averages

% Above	S&P 1500 Sub-Industry Participation Rate			
Indicator	Now	Average	Overbought	Oversold
10-Week	76%	59%	85%	5%
40-Week	78%	63%	80%	10%
Both	72%	48%	70%	5%

Source: CFRA, S&P Global. Overbought/Oversold: Approximately one standard deviation above / below the mean. Data as of 3/8/24.

Data from CFRA Sector Watch, US Equity Research Pg. 1 Published 3/11/24. Written by Sam Stovall

4.) The macroeconomic environment remains resilient

Markets and many investors have been waiting for the economic shoe to finally drop. They have been waiting for 12+ months now for data to get worse and see the expected unemployment to spike and spending to slow. The consumer has been the resilient backbone this rally has been built on, and the consumer has the strength to propel the rally further. Personal Income, as measured by the US Personal Income monthly release by the Bureau of Economic Analysis, has been steadily growing since COVID. Even as Government payments have slowed, wages have been rising steadily and more recently have been outpacing CPI. The January 2024 reading came in up 4.8% Year-over-year, moderating slightly from the 5.7-5.8% readings in early 2023 but still well outpacing CPI. Personal Spending has been boosted as well by the higher incomes and lower CPI. Though housing affordability has continued to be a challenge for many low to moderate income earners, it has not prevented continued spending on services such as travel and eating out. The consumer spent record amounts of monies over the 2023 holiday season, and we are seeing surprising strength in travel from hotels to cruise lines. 2024 is apparently the year of the cruise with bookings continually surprising to the upside. So, until we see a sustained uptick in unemployment, or a drop in real spending, the consumer not only has more income to spend, but a large savings cushion as well.

We feel confident that our Bull market thesis is intact, even with some warts and blemishes on the drivers of this rally. That is not to say we could not see pullbacks of -5% to -15% during an uptrend and Bull market. Those are common, and typically considered healthy as the market often consolidates, takes a pause, and then continues to push higher. A Bull market typically sees at least one -5% to -10% drop within its uptrend channel.

Bull Markets Run Longer than Bears, But Pullbacks Normal

S&P 500 Post-Bear Market Recoveries Since 1946

Bull Market High		Bear Market Low		Bear Market Decline		Total Recovery		Next Rise Before 5%+ Drop			12 Month
Date	Price	Date	Price	% Chg.	# Months	Date	# Months	% Gain	# Months	>5.0%	% Change
5/29/46	19.25	5/19/47	13.77	(28.5)	12	6/9/50	37	0.7	0.1	(14.0)	11.6
6/15/48	17.06	6/13/49	13.55	(20.6)	12	NA	NA	NA	NA	NA	NA
8/2/56	49.74	10/22/57	38.98	(21.6)	15	9/24/58	11	22.0	10.3	(13.9)	14.1
12/12/61	72.64	6/26/62	52.32	(28.0)	6	9/3/63	14	2.5	1.8	(6.5)	13.3
2/9/66	94.06	10/7/66	73.20	(22.2)	8	5/4/67	7	0.3	0.1	(6.5)	4.6
11/29/68	108.37	5/26/70	69.29	(36.1)	18	3/6/72	21	3.5	5.3	(5.1)	4.9
1/11/73	120.24	10/3/74	62.28	(48.2)	21	7/17/80	69	7.4	2.2	(5.3)	7.7
11/28/80	140.52	8/12/82	102.42	(27.1)	20	11/3/82	3	0.1	0.2	(7.1)	14.4
8/25/87	336.77	12/4/87	223.92	(33.5)	3	7/26/89	20	6.4	2.5	(10.2)	5.3
7/16/90	368.95	10/11/90	295.46	(19.9)	3	2/13/91	4	5.8	2.1	(5.6)	12.1
3/24/00	1,527.46	10/9/02	776.76	(49.1)	31	5/30/07	56	1.5	1.6	(9.4)	(8.6)
10/9/07	1,565.15	3/9/09	676.53	(56.8)	17	3/28/13	49	6.4	1.8	(5.8)	18.4
2/19/20	3,386.15	3/23/20	2,237.40	(33.9)	1	8/18/20	5	5.6	0.5	(9.6)	29.8
1/3/22	4,796.56	10/12/22	3,577.03	(25.4)	9	1/19/24	15	6.6	1.6	?	?
Average	**14**			**(32.2)**	**13**		**24**	**5.3**	**2.3**	**(8.2)**	**10.6**
Average After "Garden Variety" Bears				(27.0)	10		14	5.3	2.4	(8.7)	12.2
Average After "Mega-Meltdown" Bears				(51.4)	23		58	5.1	1.9	(6.8)	5.8

Source: CFRA, S&P Global. Past performance is no guarantee of future results. Data as of 3/7/24.

Data from CFRA Sector Watch, US Equity Research Pg. 2 Published 3/11/24. Written by Sam Stovall

Beyond the aforementioned catalysts that can help the market rally continue, it's also statistically unlikely that we would have 3 Bear markets within 5 years (2020, 2022, and ?) as that pace of a Bear market every 2-3 years has not occurred in the last 100 year+ history of the US markets. While the 2000-2003 period was a painful sequence of losses due to the internet bubble popping, the downturn lasted 2.5 years approximately from peak to final trough in the Spring of 2003. I can also understand that the COVID Bear market is one that many (including myself) tend to put an asterisk next to since it was incredibly violent, brief, and driven by an almost unprecedented global pandemic and shutdown. Regardless of the qualifiers, it *was* a Bear market – falling -33.92% in 23 days. 2022 was a classic iteration of a Bear market – spanning almost 200 trading days and falling -25.18% from peak to trough.

The Bears and naysayers lurk in every Bull market. Investing, by its definition, means taking on risk. But reviewing historical Bull markets and playing into the most likely outcome, the Bull market should be able to push higher. Danger will lurk, politics will be ugly this year, and data may be messy at times, but history is on the side of a continued rally. Don't be the investor waiting forever for markets to fall again, as it may take much longer to get any meaningful pullback. Think of Spring 2009, or April-May 2020; it seemed impossible for markets to continue to rally, and many investors missed out. Gravity might be strong, but Bull markets are stronger.

6 DEGREES
WEALTH

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