An Investment Publication for Clients and Friends

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## A Leadership Rotation in the Markets

David Sowerby, CFA
Managing Director, Portfolio Manager

The stock market has recently experienced a significant rotation among leadership, which has naturally received extensive coverage in the financial media. The rotation has primarily been a shift from large tech stocks to value-oriented stocks, most notably into U.S. small-cap. The magnitude of this rotation draws parallels with what we witnessed when the Pfizer vaccine was announced in November of 2020 and, perhaps even more tellingly, the rotation out of dot-com tech stocks in 2000.

The question now is how sustainable this recent rotation will be. Similar rotations in the last five years have proved transitory, but there are some notable metrics that would suggest the recent rotation has a higher probability of being sustained. These include:

- The magnitude of the price swing of this rotation is significant enough to represent a shift in market leadership.
- The valuation difference between large-cap tech stocks and the rest of the market, measured by price-to-earnings and price-to-cash flow ratios, is historically wide, favoring a reversion to the mean.
- The prior earnings superiority of large-cap tech stocks, notably the "Magnificent 7", compared to the rest of the stock market has been narrowing this quarter. Importantly, by early 2025 earnings growth rates for the Magnificent 7 and the other 493 stocks in the S&P 500 Index would be nearly equal, based on current projections.
- While I embrace the productivity potential from artificial intelligence, there is a growing mismatch between mentions of AI and actual spending on AI. This potentially creates unusually high expectations that AI-related stocks will keep raising forward earnings and revenue guidance needed to keep up their outsized stock price gains.

In a short period of time, we have witnessed a significant rotation in stock market leadership, as shown in the following table.

This rotation may have meaningful implications for portfolio construction.

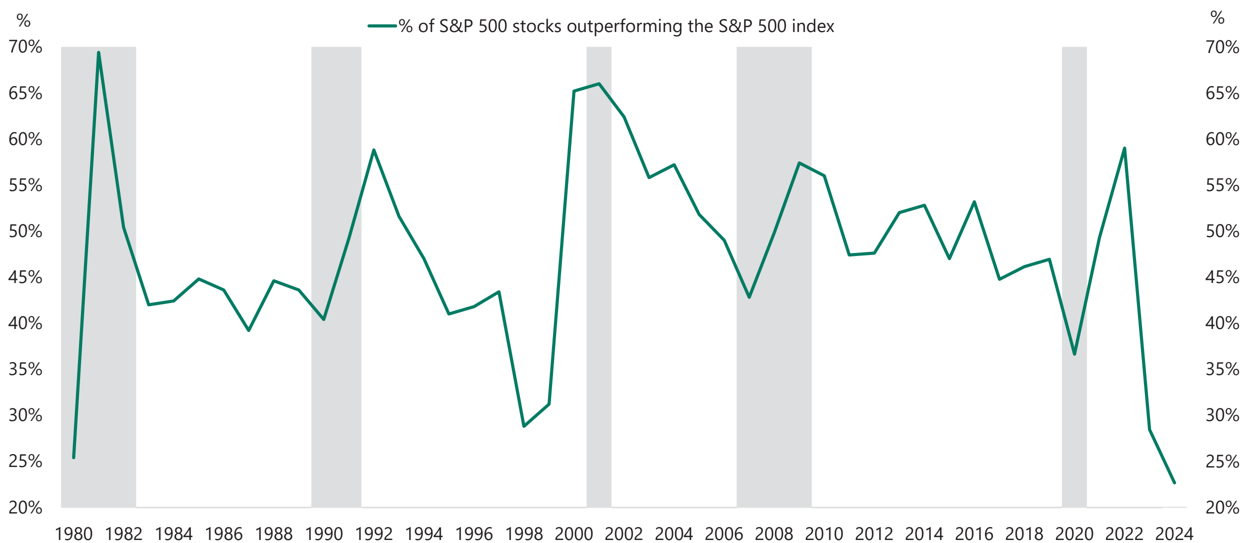
**Index Total Returns from 7/10/2024 - 8/16/2024**

| Index | Return |
|---|---|
| S&P 500 Index | -1.3% |
| S&P 500 Equal Weighted Index | +3.4% |
| Bloomberg Magnificent 7 Price Return Index | -9.6% |
| Russell 2000 Index | +4.5% |

Source: Bloomberg

1. Greater stock market participation among a larger number of stocks bodes well for balanced and actively managed portfolios. This contrasts with the highly-concentrated stock market returns in the first six months of this year where less than a quarter of the S&P 500 constituents outperformed the actual index. This is one of the lowest measures of stocks exceeding the index in the last 40 years, as shown in the following chart.

**Record Low Percentage of Stocks Outperforming the S&P 500 Index**




Source: Apollo; Bloomberg, Apollo Chief Economist. Note: Annual data is from January 1 to December 31 for each year. The 2024 data is as of July 2, 2024 (year-to-date).

2. Small and mid-cap stocks may well be in the early innings of a multi-year rally.

3. Portfolios which pay greater heed to valuation have better potential in a return-seeking and risk-mitigating market environment.

4. While maintaining a decided bias to U.S. stocks in an overall asset allocation continues to be a strong strategy, monitoring the possible valuation opportunities in non-U.S. stocks also deserves attention.

5. The first half of 2024 witnessed generally flat returns in the bond market, but as interest rates have modestly declined, bond returns have been positive in July and yield opportunities, net of inflation, are modestly positive.

As I look ahead to the coming months, the upcoming election will garner considerable focus on its potential impact on the markets. Fortunately, in my investment career, I have experienced eight presidential elections and about six bear markets. Throughout those years, the primary emphasis has been on highlighting micro factors, notably the ability of resilient companies to create shareholder value through sound capital allocation. Having a perspective of macro factors, including elections, assists in understanding where the risks are. Combining the micro with the macro enhances overall portfolio decision-making. ◊

## Inflation Making Waves

Kevin Gale
Managing Director, Head of Fixed Income

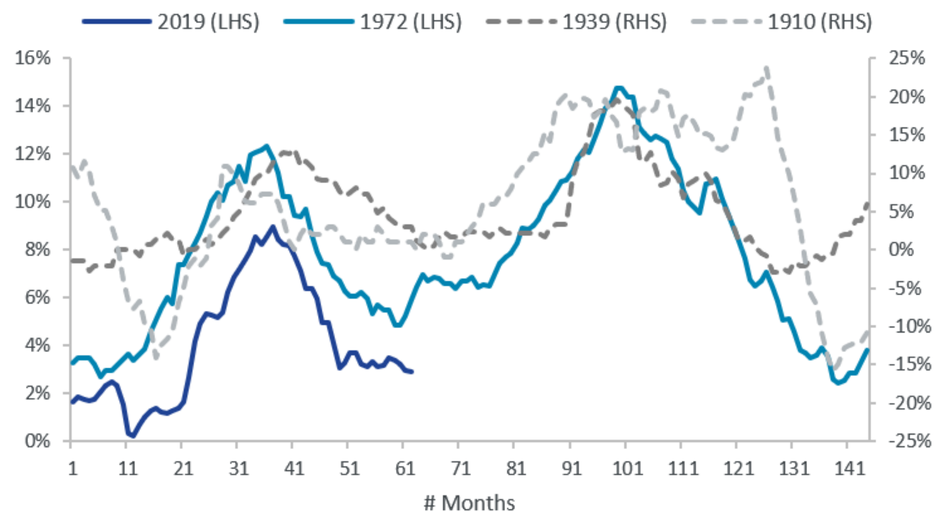
The Federal Reserve is largely expected to begin cutting interest rates at its September meeting. Many economists believe that the Fed has finally tamed inflation and the all-clear signal is there to start the interest rate 'normalization' process. However, history tells us that the Fed needs to be cautious.

Inflation is the Federal Reserve's worst enemy. Post-pandemic, trillions of dollars of fiscal and monetary stimulus combined with supply chain constraints pushed inflation, as measured by year-over-year CPI, to as high as 9.1% in June 2022. Since then, CPI has moderated significantly to its most recent reading of 2.9% in July 2024. While this is certainly significant progress, for the Fed to achieve its long-term target inflation rate of ~2%, we expect the last mile to be the most difficult and dangerous.

If the Federal Reserve begins cutting interest rates too soon, it risks inflation spiking back higher. If that should happen, it could force the Fed to reverse course and begin raising rates again. This happened in the 1980s when Paul Volcker was forced to raise rates to a peak of 20% in June 1981. On the other hand, if the Federal Reserve waits too long to cut interest rates, it risks pushing the economy into a recession.

As history shows us, inflation tends to come in waves. Looking back at various inflationary environments, we have seen similar patterns where inflation starts declining, then rises, falls and rises even higher. The current inflationary and now dis-inflationary (when the rate of inflation slows but remains positive), environment we are experiencing appears no different than historical patterns. We have now entered the dis-inflationary phase where the Federal Reserve needs to be cautious about cutting rates too soon and risk pushing inflation back higher. History shows that this phase lasts around 10-20 months before inflation spikes back higher due to rate cuts.

**U.S. CPI Year-over-Year**




Source: Strategas; Bureau of Labor Statistics through May 2024

While many want the Federal Reserve to cut rates significantly (some have called for multiple 50 or even 75 basis point rate cuts,) they must be careful about cutting too much too soon. The Fed must have patience to ensure that inflation is in fact under control. ◊

## A Look under the Hood at the Economy

Michael Santelli, CFA
Managing Director, Portfolio Manager

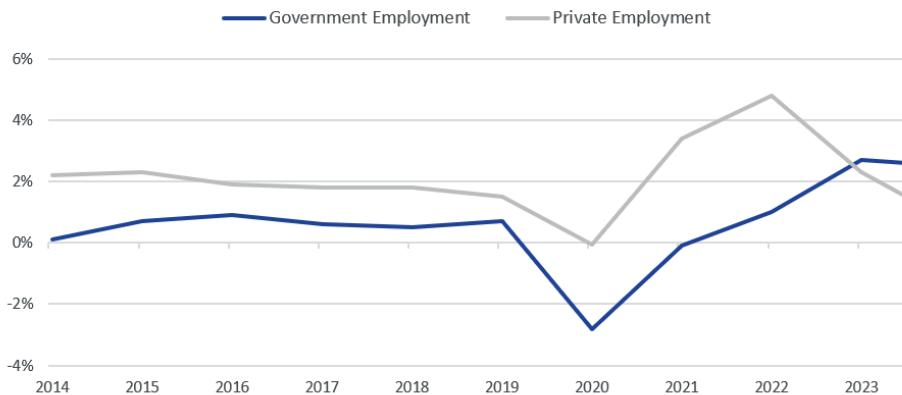
Depending on who you ask, you may get a very different answer when you ask how the economy is doing. "Official" stats show a fairly robust economy that is still expanding. Real GDP growth has been in the 2.5% range, which is pretty much in line with the 10-year average. Unemployment is at 4.3%, which is fairly low in comparison to historical levels. Inflation has been coming down after

a big spike in 2022. So why do polls suggest that the average American is not feeling as good about the economy? Let's take a closer look at GDP, unemployment and inflation.

Thinking back to Econ 101, GDP is computed as Consumption + Investment + Government Spending + Net Exports (typically a negative number since the U.S. exports less than it  imports). When looking at changes to GDP, the composition of these underlying figures is important. Arguably the least valuable of these components is government spending, yet with the deficit running at ~7% of GDP in a full employment economy, it is currently driving GDP growth. On the flip side, investment is the engine of future growth, but it seems to be stalling, increasing by just 2.7% cumulatively over the past two years.

Next, we'll turn to unemployment. Though relatively low, a closer look suggests that government hiring is primarily behind the fairly strong employment numbers. Over the last two years, government employment has grown at a ~3% rate while private employment has grown at a lower rate, which is in contrast to most of the past decade. Government employment does not add to the productive capacity of the U.S. economy and, in fact, some would argue it slows things down.

**U.S. Employment Growth**




Source: Bloomberg as of 6/30/2024

Finally, a closer look at inflation versus wages, which is likely the most important issue. The year-over-year rate of inflation peaked at 9% in June 2022. It has since fallen to about 2.9%, but while the inflation rate has fallen, prices are still rising. In fact, the consumer price index (CPI) is almost 17% higher over three years according to the St. Louis Fed. Wages have barely kept up, with real wages about flat over the past three years. Wage growth generally exceeds inflation, however, the spike in inflation that started in 2021 inverted that relationship for the next two years until wage growth caught up. Over the past three years, after inflation, many workers are barely treading water.

As financial advisors, why do we care about this? In short, it comes down to risk management. At some point, the U.S. economy will experience the downside of the economic cycle. The future is always uncertain, which is why we aim to build diversified portfolios that are expected to do well in many economic environments. As such, we like to approach the uncertain future with the equivalent of an all-terrain vehicle portfolio that will get us to our destination in all types of weather, rather than a hot sports car portfolio that may end up on the side of the road in inclement weather.

*Special thanks to Ancora intern Michael Mattimore for contributing to this article.* ◊

## Captain's Change but the Ship Sails On (Again)

Jeffrey van Fossen, CFA
Managing Director, Portfolio Manager

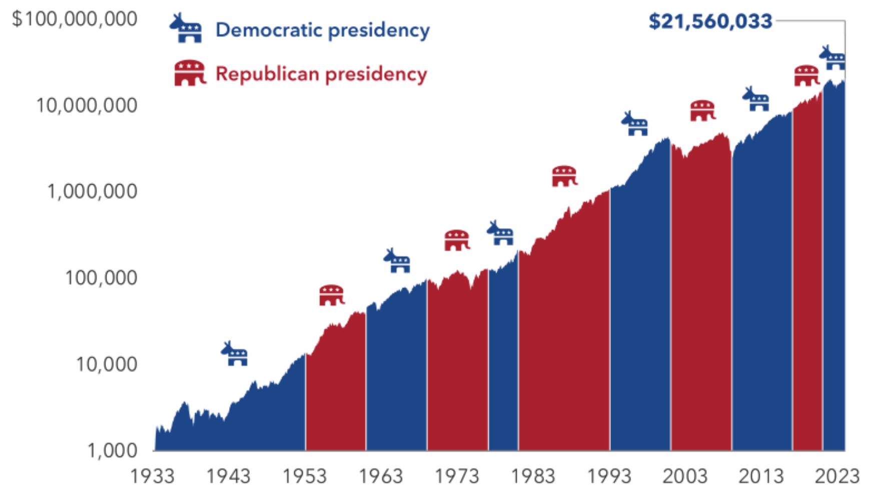
Every four years, politics and finance converge as the U.S. chooses a presidential captain, and investors try to figure out what the outcome may mean for their pocketbooks and portfolios.

As in 2020, this November's presidential contest is again steeped in extreme rhetoric, polarization and emotion. And emotion is the real threat to your portfolio, not any one candidate's platform (more on this below).

While the inhabitant of the White House can indeed alter the lives of millions of people, history shows presidential politics have a surprisingly small impact on your portfolio. There is no empirical evidence in the academic financial literature to suggest that the president, whether Republican or Democrat, should cause you to deviate from your investment strategy. The fact is that stocks generally rise over time, no matter which party is in office.

**Stocks Have Trended Higher Regardless of Which Party Has Been in Office**

**Growth of a hypothetical $1,000 investment in S&P 500 Index**




Sources: Capital Group, Morningstar, Standard & Poor's. As of December 31, 2023. Dates of party control are based on inauguration dates. Values are based on total returns in USD. Shown on a logarithmic scale. Past results are not predictive of results in future periods.

As the chart shows, long-term investors who began investing in any election year have uniformly come out ahead, regardless of the winning party. After all, an investor's time horizon is likely to be much longer than a four-year presidential term. Those who look beyond the headlines, focus on long-term goals and avoid trying to time the market have tended to reap the rewards in the long run. That's true not just during elections, but any time of the year. The bottom line is that beliefs about which political party is best for the markets may encourage you to vote, but they shouldn't discourage you from continuing to pursue your long-term investment strategy, for several key reasons.

### Policy rhetoric will inevitably fall short in practice.

The genius of our American republic is that its division into three branches of government creates checks and balances on the power to effectuate change. With few exceptions, it takes consensus to implement significant change and separation of power makes this difficult, forcing consensus and compromise. Remember, the president is not a dictator. Just because he or she runs on a platform, doesn't mean that agenda will be enacted. And even if the president gets what he or she wants, the real economy may not cooperate. It is for this reason that significant policy changes don't typically come all at once, but in increments over years, sometimes decades. Only about 3% of bills are ever enacted during a president's first year in office, and presidents typically can deliver legislatively on only about half of their campaign promises, even when their party also controls the legislature. So, take the soaring pre-election rhetoric and doomsday headlines with a healthy grain of salt.

### Consumers and businesses have a far greater impact on the economy than the government.

The overwhelming majority of what happens in the U.S. economy depends on the actions of consumers and businesses. Thus, long-term investment success has depended more on the strength of the U.S. economy than on which party occupies the White House or controls Congress during any four-year period. And the market has proven resilient to surprises and crises time and again.

The unsurprising corollary of this is that the state of the economy greatly influences who is elected president, rather than the president determining the state of the economy. Decades of history prove that a strong economy typically results in a win for the incumbent party candidate. Indeed, going back to 1964, if the misery index (comprised of the seasonally adjusted unemployment rate plus the annual inflation rate,) is down in the last year of an incumbent's term, without exception the incumbent has been reelected.

### The real threat to portfolios: Emotion.

This presidential election is again generating especially strong emotion, and this may tempt investors to try to time the market or make other reactionary short-term investment decisions that are likely to negatively impact their longer-term investment returns.

The newly elected White House occupant will affect your investments only to the degree that you fail to follow through with your established plan. Avoid letting your or others' emotions get the better of you, because when emotion takes center stage, critical thinking runs for the nearest exit. Stay disciplined and work with your Ancora team to manage your portfolio through the natural economic, market and political cycles within a framework that is customized to and consistent with your objectives, timeframe and tolerance for risk.

To conclude, captains change, but the great American ship sails on. As Warren Buffett likes to say, don't bet against the success of the United States. America makes mistakes, voters sometimes hand power to misguided politicians and the public sometimes succumbs to manias that turn into panics and crashes. But left to work, trade and invest, Americans unleash their energies in productive fashion. Stocks fluctuate, but over time they go up, often in years you least expect it.

*This article first appeared in the March 2020 issue of The Ancora Advisory and has been updated.* ◊

## Achieve More with *My Ancora*

Louis Preseren, CFP®
Assistant Vice President, Financial Planning

As part of Ancora's Estate and Wealth Planning team, we are big proponents of the My Ancora client portal because it helps alleviate financial stress for our clients and it gives our team more information so we can better serve our clients. Here are some details about My Ancora that you may not be aware of.

**First, what is My Ancora?**
My Ancora is a client portal powered by eMoney Advisor. It creates a one-stop financial hub for all of your Ancora-managed accounts, outside investment accounts, document storage and connectivity to your financial plan. Your account is protected with two-factor authentication and can be conveniently found in the upper right of every page of the Ancora website.

**Can I grant access to my account to anyone else?**
Yes, the My Ancora portal is a great central location to share access with your spouse or other trusted beneficiary, accountant, estate attorney, etc. Adding another user to your account allows them to view your financial information and access any important documents you have saved.

**Why should I use the My Ancora document vault?**
The vault is a central and accessible online location to store electronic files. Documents can be shared with your wealth advisor or saved in a private folder. Clients find the vault to be a useful place to store tax returns, estate plan documents, proof of insurance and more. It is also where Ancora's quarterly reports are posted.

**Can I view my financial plan from the portal?**
Once you have gone through the planning process with a member of our Estate and Wealth Planning team, your plan will be loaded into My Ancora for you to view at any time. Adding any outside accounts into the portal ensures that your wealth advisor and planner have real-time data to make informed decisions and recommendations about your financial situation.

Please reach out to a member of your Ancora team if you have any questions or would like to learn more about the My Ancora client portal. ◊

*As always, don't hesitate to contact your Ancora advisor or relationship team if you have any questions or would like to learn more about these topics. Visit our website at www.ancora.net to find other news and insights from the investment professionals at Ancora.*

## Market Data Center

As of 7/31/2024

| Stocks | 1 month | 3 months | 6 months | YTD | 1 year | 3 years |
|---|---|---|---|---|---|---|
| S&P 500 | 1.2% | 10.1% | 14.8% | 16.6% | 21.8% | 30.0% |
| Dow Jones | 4.5% | 8.5% | 8.0% | 9.4% | 16.8% | 22.5% |
| Russell 2000 | 10.3% | 14.6% | 16.6% | 12.1% | 14.0% | 4.8% |
| Russell 1000 Growth | -1.7% | 11.1% | 15.6% | 18.4% | 26.5% | 29.7% |
| Russell 1000 Value | 5.1% | 7.3% | 11.8% | 11.9% | 14.3% | 20.6% |
| MSCI EAFE | 2.6% | 5.8% | 9.0% | 8.5% | 11.0% | 9.8% |
| MSCI EM | 0.8% | 5.5% | 12.6% | 7.5% | 4.9% | -10.9% |
| NASDAQ 100 | -1.7% | 11.1% | 13.3% | 15.4% | 23.5% | 31.1% |

| Stocks | Dividend Yield | NTM P/E | P/B |
|---|---|---|---|
| S&P 500 | 1.26% | 20.8x | 4.6x |
| Dow Jones | 1.66% | 18.4x | 4.9x |
| Russell 2000 | 1.19% | 24.9x | 1.9x |
| Russell 1000 Growth | 0.52% | 27.8x | 11.7x |
| Russell 1000 Value | 1.87% | 16.2x | 2.6x |
| MSCI EAFE | 2.93% | 13.8x | 1.8x |
| MSCI EM | 2.47% | 12.0x | 1.6x |
| NASDAQ 100 | 0.59% | 25.3x | 7.3x |

| Fixed Income | Yield | 1 month | 3 months | YTD | 1 year | 3 years |
|---|---|---|---|---|---|---|
| U.S. Aggregate | 4.64% | 2.4% | 5.0% | 1.6% | 4.9% | -7.9% |
| U.S. Corporates | 5.29% | 2.6% | 5.5% | 1.2% | 5.9% | -10.8% |
| Municipal Bonds | 3.96% | 1.3% | 2.0% | 0.8% | 4.0% | -1.9% |
| High Yield Bonds | 7.79% | 2.3% | 4.5% | 4.6% | 10.1% | 3.6% |

| Key Rates | 7/31/2024 | 6/30/2024 | 4/30/2024 | 1/31/2024 | 7/31/2023 | 7/31/2021 |
|---|---|---|---|---|---|---|
| 2 yr Treasury | 4.26% | 4.72% | 5.03% | 4.22% | 4.86% | 0.18% |
| 10 yr Treasury | 4.05% | 4.37% | 4.68% | 3.95% | 3.95% | 1.23% |
| 30 yr Treasury | 4.34% | 4.54% | 4.79% | 4.19% | 4.02% | 1.89% |
| 30 yr Mortgage | 7.14% | 7.26% | 7.55% | 6.96% | 7.26% | 2.98% |
| Prime Rate | 8.50% | 8.50% | 8.50% | 8.50% | 8.50% | 3.25% |

| Commodities | Level | 1 month | YTD |
|---|---|---|---|
| Oil (WTI) | 78.53 | -3.7% | 9.6% |
| Gasoline | 2.33 | -0.6% | 13.2% |
| Natural Gas | 2.04 | -21.3% | -12.2% |
| Propane | 0.78 | -8.5% | 15.3% |
| Ethanol | 1.74 | -11.7% | 7.7% |
| Gold | 2,491 | 6.5% | 20.2% |
| Silver | 29.20 | -1.2% | 21.3% |
| Copper | 4.06 | -7.5% | 4.7% |
| Steel | 704 | 4.5% | -38.0% |
| Corn | 4.00 | -4.9% | -15.1% |
| Soybeans | 10.47 | -9.6% | -18.7% |

*Data Reflects Most Recently Available As of 7/31/2024*

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