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Aptus 3-Pointers: August 2024 Highlights

Market Overview

August began with significant volatility, notably marked by the unwinding of the "Japanese Carry Trade." Despite the turbulence from the August 5th event, the market showed resilience, with the VIX peaking at 65 before stabilizing back to 15 by month's end. This volatility was short-lived, and the month overall delivered strong performance across various asset classes. Market breadth improved notably, with U.S. small caps and international equities, which had been relatively undervalued, seeing robust gains. This strength was largely driven by better-than-expected earnings growth and inflation data, fueling optimism around the possibility of a "soft landing." The market's ability to navigate these disruptions underscores its underlying strength.

Equities vs. Fixed Income: A Case for Duration

August reinforced our strategic emphasis on equities over fixed income. The Bloomberg US Aggregate Bond Index posted a 1.5% return, yet this still lagged the more substantial gains in equities. In the current environment, where equities offer a more favorable duration play—essentially a higher likelihood of outperforming over the long term relative to bonds and inflation—it remains prudent to decrease reliance on bonds for both returns and diversification. Stocks continue to present a stronger case for long-term growth and inflation protection.

Broadening Market Participation

A significant shift in August was the broadening of market participation beyond the dominant tech stocks that have led the market for much of the year. Strong returns in small caps, international equities, and the equal-weighted S&P 500 index suggest a healthier, more balanced market with multiple growth drivers. This diversification in market leadership is a positive sign for sustaining broader and potentially more durable market gains moving forward.

Policy Impacts and Liquidity

Fiscal and monetary policy continued to play a crucial role in driving market liquidity, a key focus for our investment team. The substantial liquidity being injected into the market supports the case for maintaining a stock-heavy portfolio. However, high government debt levels and potential future fiscal challenges present ongoing risks, particularly for fixed-income assets. The environment remains favorable for equities, which are better positioned to navigate the potential devaluation of fixed nominal payouts that could result from fiscal policy challenges.

Earnings Season Takeaways

The recent earnings season provided critical support for the market, with companies like Nvidia delivering standout results. However, there has been a noticeable shift in market sentiment, with investors increasingly favoring value stocks and sectors with more reasonable valuations after the strong run-up in mega-cap technology stocks. As we move into the final quarter of the year, margins and profitability are becoming increasingly important metrics for investors, indicating a more discerning market environment where fundamentals are once again taking center stage.

Looking Ahead: Fed Decisions and Market Outlook

As August drew to a close, the focus shifted to upcoming Fed decisions and their implications for monetary policy. The market is watching closely as the Fed seeks to transition from a restrictive to a more neutral stance. Smaller rate cuts, aimed at stabilizing rather than stimulating the economy, might be preferable and could help avoid the need for more aggressive, recession-driven cuts. Historical parallels, such as Fed policy in 1995, suggest that even small adjustments can have a significant impact. With several central banks already easing, the global demand picture is improving, adding to the cautious optimism. Our focus remains on positioning portfolios for growth while being mindful of the potential risks associated with both fiscal and monetary policy shifts.

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