APTUS CAPITAL ADVISORS

Q3 2024 Market Recap and Allocations

In our latest Q3 update, the Aptus Investment Team discussed the market backdrop, including strong stock returns, the Fed's monetary policy, and the fiscal policy environment. We also emphasize our continued focus on higher compounded returns, adjusted for drawdown risk, rather than just raw returns and advocacy for more stock exposure with risk-mitigating hedges.

Key topics:

- Stocks had a strong quarter, with the market reaching new all-time highs. We expect equities to continue performing well, with the Fed and fiscal policy providing support.
- Bonds also performed well, but we are cautious about the outlook for fixed income, citing low yields and the potential for the Fed to be less aggressive with rate cuts.
- An allocation framework with more stocks / less bonds with hedges to manage downside risk.

Strong Equity Performance

The third quarter of 2024 saw strong performance in equities, with the market reaching new all-time highs. This momentum is expected to continue as both monetary and fiscal policies remain supportive. Despite some volatility, the overall outlook for stocks remains positive, driven by broadening market participation and healthy earnings growth. The performance in the quarter reflects a continuation of the favorable environment for equities, and there is confidence that this trend will persist into the near future.

Cautious Outlook on Fixed Income

In contrast, while bonds performed well during the quarter, there is a more cautious view regarding fixed income. Yields remain low, and the Federal Reserve is expected to slow the pace of rate cuts, which could impact bond returns. While bonds have historically provided a safety net in portfolios, there is growing concern that they may not offer the same level of protection in the event of future market downturns. The relationship between stocks and bonds, particularly in terms of correlation, continues to evolve, and the reliability of bonds as a hedge against equity market declines is being questioned.

Emphasis on Risk-Adjusted Returns

Rather than focusing solely on raw returns, there is a commitment to achieving higher compounded returns while mitigating the potential for significant drawdowns. This approach highlights the importance of managing risk, particularly through hedging strategies, which allow portfolios to maintain exposure to equities without taking on excessive downside risk. The focus is on balancing the pursuit of growth with the need for capital preservation during periods of volatility.

Revised Allocation Framework

Our allocation strategy continues to lean heavily toward equities, with a reduced reliance on bonds. This shift is driven by the belief that, over the long term, bonds may pose more risk than stocks, particularly in an environment where yields are low and inflationary pressures persist. As a result, the recommended portfolio structure includes a higher allocation to stocks, with risk managed through appropriate hedging mechanisms. This framework is designed to enhance risk-adjusted returns over time, aligning with long-term financial goals rather than reacting to short-term market movements.

Fed's Role and Market Impact

With further rate cuts anticipated through 2025, there is an expectation that liquidity will continue to support risk assets. However, inflation remains a concern, and the labor market is beginning to show signs of strain, which could influence the Fed's future decisions. Fiscal policy, particularly government spending, also continues to play a key role in maintaining economic stability, though the long-term outlook for bond returns is tempered by rising deficits and the increasing cost of government debt.

Long-Term Focus on Risk Assets

Looking ahead, the preference for risk assets, particularly equities, remains strong. While market pullbacks are expected and considered a natural part of the cycle, the broader perspective is that the risk of being underexposed to stocks far outweighs the potential risks associated with holding more equities. Bonds, on the other hand, are viewed as a more significant risk over the long term, particularly in the context of the current macroeconomic environment. The strategy moving forward is to maintain a higher allocation to equities while utilizing hedging strategies to manage potential volatility.

Summary

In summary, the outlook for Q4 and beyond is focused on maintaining a strong equity allocation, managing downside risk through hedges, and remaining cautious on bonds. The goal is to generate strong long-term compounded returns by prioritizing risk management and focusing on strategic allocations that align with the current market environment. The strategy reflects a commitment to growth, tempered with a disciplined approach to risk, ensuring that portfolios are well-positioned to navigate any market challenges that may arise.

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