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The Market Continues to Hustle

Source: HBO, Photo Snagged on 10/1/2024

Nicknamed *Charlie Hustle*, Pete Rose is one of the most polarizing athletes in sports. His go-for-broke head-first slides and habit of sprinting to first base on a walk marked him as among the game's most irrepressible showmen and iconoclasts. Also known as the *Hit King*, he holds the MLB record for most career hits at 4,256, yet he's likely remembered for being one of only 24 baseball players currently banned from the game – earned by gambling on the game itself.

In Q3 2024, the market took on the life of Pete Rose, as it hustled to end the quarter at a new all-time high ("ATH") – with the S&P 500 catapulting 5.89% higher. Year-to-date, the market has witnessed 43 new ATHs, increasing by 22.1%, marking the 9th best start ever for the S&P 500.

The market hit new ATHs from a number of different "whys". While the character of the market changed over the past three months, the direction remained the same with strong breadth. The broadening rally is an encouraging sign for stocks, following previous concerns that the market could be vulnerable to a reversal, particularly if the cluster of tech names propping it up fell out of favor. Even without the outperformance of the Magnificent Seven, we believe in the strength of the recent rally. This is still a bull market, and it has broadened, which should be a welcoming sign for the economy – the soft-landing narrative continues.

The market was led by the average stock, which is fitting for a ball player known for his average physical attributes and upbringing in Cincinnati's hardscrabble westside. The equal-weight S&P (+9.48%) outperformed its cap-weighted counterpart by 3.59%, while U.S. Small Caps and International also performed well, showing that the market favored relatively cheap areas of the market. Underneath the hood of the S&P 500, interest rate-sensitive areas outperformed, i.e., Utilities, Consumer Staples and Real Estate.

Though not a surprise, the biggest news of the quarter was that the FOMC started its rate-cutting cycle after leaving policy untouched for thirteen months. The caveat is that the Fed is performing more of a "recalibration" to policy, instead of cutting rates due to an economic dilemma. The leader of the brain trust, Jerome Powell, emphasized a shift towards supporting employment more than fighting inflation – indicating a more flexible approach to managing their dual mandate.

S&P 500 Returns After Fed Cuts within 2% of All-Time High

Date of Cut	1M	3M	6M	1YR
7/25/1980	3.60%	7.20%	7.50%	7.60%
1/11/1983	-0.50%	6.90%	13.50%	15.20%
2/28/1983	2.40%	11.10%	9.50%	7.60%
1/15/1985	7.30%	6.10%	14.00%	21.90%
5/20/1985	-1.60%	-1.80%	4.70%	24.50%
3/7/1986	3.50%	8.90%	11.00%	28.90%
4/21/1986	-3.50%	-3.50%	-2.40%	16.90%
8/26/1986	-8.30%	-2.10%	12.30%	33.20%
7/31/1989	1.10%	-3.20%	-6.00%	2.60%
7/13/1990	-8.10%	-19.80%	-14.20%	3.50%
3/8/1991	-0.30%	1.30%	4.10%	8.10%
8/6/1991	-0.10%	0.20%	6.10%	8.80%
10/31/1991	-2.80%	4.30%	5.20%	7.40%
7/2/1992	3.20%	1.10%	5.80%	9.00%
9/4/1992	-2.40%	3.60%	9.00%	10.60%
7/6/1995	0.90%	5.00%	11.50%	21.40%
1/31/1996	1.30%	2.90%	0.60%	21.50%
7/31/2019	-1.90%	1.90%	10.20%	8.90%
9/18/2019	-0.30%	6.20%	-19.90%	11.60%
10/30/2019	3.10%	5.90%	-7.10%	8.60%
9/18/2024	?	?	?	?
Average	0.82%	1.45%	4.29%	9.53%
Median	0.53%	1.76%	4.89%	9.28%
% Higher	45.0%	75.0%	80.0%	100.0%

Source: Aptus, Bloomberg, Data as of 9/30/2024

Contrary to common belief, rate cuts are not always a negative for markets. The last twenty times that the FOMC cut policy rates when the S&P 500 was within 2% of an ATH, the index performed well over the following twelve months. Historically, the market has been higher after every single occurrence – a batting average any baseball player could hope for – with an average return of 9.53%. Remember, it pays to be patient, not clever.

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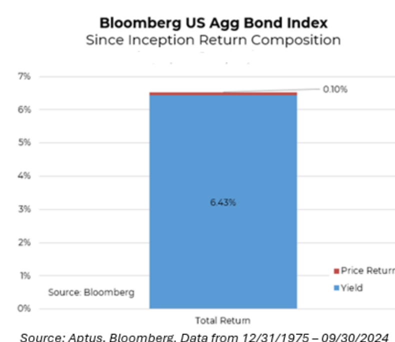
	1M	QTD	YTD	1-YR	3-YR	5-YR	10-YR
S&P 500	2.14%	5.89%	22.08%	36.33%	11.90%	15.96%	13.36%
NASDAQ	2.76%	2.76%	21.84%	38.70%	8.88%	18.86%	16.20%
Dow Jones Industrial	1.96%	8.72%	13.93%	28.85%	9.97%	11.78%	12.02%
MSCI EAFE	0.96%	7.35%	13.55%	25.45%	6.11%	8.82%	6.32%
MSCI EM	6.68%	8.82%	17.13%	26.41%	0.75%	6.09%	4.40%
Bloomberg US Agg Index	1.34%	5.20%	4.45%	11.57%	-1.39%	0.33%	1.84%
U.S. Small Caps	0.71%	9.25%	11.02%	26.55%	1.71%	9.27%	8.73%
Investment Grade Bonds	2.07%	6.62%	5.35%	15.82%	-1.72%	1.01%	3.09%
High Yield Bonds	1.64%	5.38%	7.78%	15.55%	3.04%	4.07%	4.52%

Source: Bloomberg. Data as of 09/30/2024. Returns include Dividends. Returns over 1YR are Annualized.

Investment Wisdom: *We'd Rather Be Right Until We're Wrong Than Wrong Until We're Right*

After a challenging few years, many market participants have become enamored with bonds, as nominal rates are at levels not seen since before the financial crisis. While this has attracted flows into fixed income, we believe it exposes portfolios to a silent killer: longevity risk. To directly attack this issue, the Aptus investment philosophy is to maximize our ownership of equities, reducing dependence on fixed income, while keeping risk neutral. Our underweight bond conviction lies in the belief in the following two things:



Source: Aptus, Bloomberg. Data from 12/31/1975 – 09/30/2024

1. Bonds have a higher correlation to equities in the future, and may not protect capital during drawdowns, and
2. Equities are a more efficient way of owning duration and compounding capital over longer timeframes.

During the quarter, the Bloomberg Aggregate Bond Index rose 5.20% - its 6th best quarter over the last 40 years (Q4 2023 witnessed the best quarter during this period). In Q3, rates dropped sharply, as the market began to anticipate the start of the rate-cutting cycle. The 10-year Treasury declined 0.65% (to 3.74%) and the 2-year Treasury fell 1.14% (to 3.62%). The duration play, the thesis for many bond bulls, did work well in the quarter – from an absolute standpoint.

However, from an opportunity perspective, stocks continued to outperform bonds across the board. Continuing to move with fixed income, stocks of all market-caps outperformed bonds during the quarter. The S&P 500 had a return of 5.89% in Q3, besting the US Bloomberg Agg by 0.69% even with one of the best quarters ever for bonds. This demonstrates that the same factors driving bond performance also fueled equity gains, suggesting that bonds may not offer protection in future downturns—just as they didn't in 2022.

Those playing devil's advocate with our ideology – more stocks, less bonds, while remaining risk neutral, would point to our overweight of stocks as a risk and our under allocation to the "safe" asset class of bonds as a risk. We disagree. We'd rather be right until we're wrong than wrong until we're right. And if we are wrong, and risk assets fall, we are prepared. Our allocations are designed to protect against equity drawdowns. In an environment where we believe fixed income can no longer be trusted to provide downside protection due to potential positive correlations with stocks, we've built in hedges to provide insulation during bouts of volatility.

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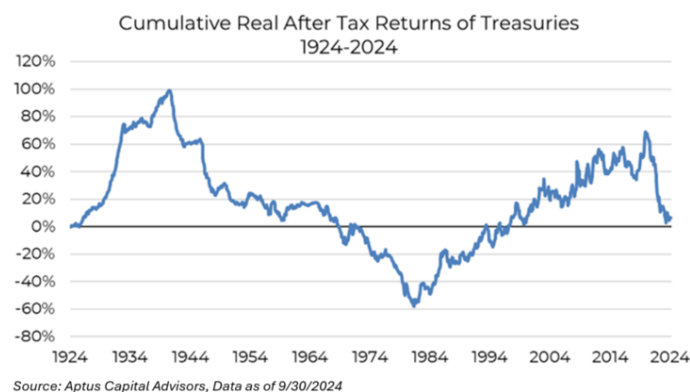
At the end of the day, the biggest risk that we see for advisors is an overreliance on fixed income. At Aptus, we've freed ourselves from the need to hope and pray that bonds will offer support during drawdowns and generate real returns. If bonds don't protect on the downside, it's difficult to justify their ownership, as they have provided virtually no real return after accounting for taxes and inflation. For those needing a store of value, bond yield might be sufficient. However, for those aiming to grow their capital for retirement or other long-term financial goals, this return is likely to prove insufficient.



Source: Aptus Capital Advisors, Data as of 9/30/2024

Conclusion: *Investors Need to Be Like Pete Rose*

Singles are the most unglamorous of hits—no one gets awarded the singles crown at the end of the baseball season. Younger kids try to mimic the likes of Barry Bonds or Aaron Judge, as hitting "bombs" provides the fame. Or for the younger investment kin, the likes of Michael Burry, who hit a homerun by successfully calling the housing crisis in 2007. That individual investment bet forever solidified Burry in the financial *Hall of Fame*. Yet, we disagree with this philosophy. We think investors are better served heeding to the *Hit King's* mentality.

The fundamental basis of our asset allocation is to increase the number of plate appearances, so an investor can maximize the number of times they can get a hit. We believe this methodology can increase one's batting average and slugging percentage. Investors need to maximize their opportunities for hits.
It's not glitzy. It may not be fun. But that is the structure of our asset allocation. By efficiently and cost-effectively utilizing hedging at the allocation level, we have the conviction that our defense can protect capital on the downside, so we can own more stocks, allowing us to maximize our opportunity at the plate to get on base.

The *Hit King* is not in the Hall of Fame, but that's not due to his style of play on the baseball diamond. But we firmly believe that hitting singles is an investment philosophy that he'd bet on.

Be an investment hit king.

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