Kim Brown:

Hi, I'm Kim Brown, president of JNBA Financial Advisors in Minneapolis, Minnesota. Thank you for joining us today as we build a discussion around current market activity. Always an interesting one. Clearly the rally that started in the fourth quarter of 2023 has continued into the first half of 2024. Major market indices are strong, so it seems the question that is on everyone's mind is what's in store for us for the second half of the year? Today, joining me for this discussion is John Foster and Mark Rosenkranz, both Investment Strategists here at JNBA. Thank you for joining me. Mark and John, I was thinking to start, we should take a step back and actually talk a little bit about what we experienced in the markets in the first half of the year.

Mark Rosenkranz:

Yeah, yeah, I can kind of give it a start. I think it's been a very unique time in that regard where you look at the surface of the markets and you kind of look at where things are at as we get through the half point of the year and S&P 500's up around 15%, and I think the common person on the street would say, "All is pretty well, I'd take a 16% return over six months almost any day of the week." I think what's kind of unique is that under the surface there's been a little bit more going on and in our investment communities, we've been using the analogy, the duck on the pond so to speak, where on the surface things are kind of gliding along normally, but underneath is where you're getting a lot of choppiness and where some of that kind of volatility and noise that we're starting to see is really manifesting in a lot of the same areas that we saw throughout the start of 2023 and into 24.

We've seen a lot of narrow market leadership where only a handful of companies within the S&P 500 are driving a majority of the returns and really leaving out a majority of the market kind of on the sideline or flat to even negative performance so far. The other thing that I'd note is not only has the kind of unique narrow leadership benefactor, it's also been the path we've taken to get to that really strong 15% number. We were having a similar conversations at the end of Q1 and market's around 10%, come April down 4%, come May up 4%, June up 4%. This type of month-to-month volatility is even beyond normal market cycles, normal market movement. So, you're looking at that nice 15% number on paper, but there's really been a lot more going on under the surface. And that's been the similar case on the fixed income side as well.

Same story where a quarter ago the 10-year yield was hitting right around 4.2. You look at the end of Q2, we're sitting right around 4.2, but during the quarter we saw it reach up to 4.5, 4.6, come back down. There's been a lot of noise on the equity side and the fixed side that kind of really gets glossed over when you just take a look at that one snapshot period on June 30th and zooming out to the kind of broader equity markets, you see another similar trend that we saw in 23 where mid cap, small cap, international, that emerging markets all are lagging the S&P 500 by anywhere from eight to 16%. So, you have a very small subset that's doing well, and within that small subset you have an even smaller group of companies that are really driving a large majority of their terms.

I kind of liken it to if we were on a farm and we planted a hundred acres, we got about three acres that are doing pretty well right now and about 97 that are growing nothing. Now that three acres is growing plenty for a pretty good harvest for the year, but that puts a lot of pressure and that puts a lot of focus on that three acres.

Kim Brown:

It does.

Mark Rosenkranz:

In a kind of normal healthy environment, you'd like to see a little bit more of the rest of the farm. And I think that's the big question going forward is when do we start to see the full participation?

Kim Brown:

Right.

John Foster:

Yeah. And I think getting into a little bit the details there, Mark, what a lot of investors don't realize is the 10 largest components of the Dow make up 56% of the index. The four largest components of the S&P 500 are over a quarter of the index. And then you look at the NASDAQ and the top 10 companies are over 50% and almost all these companies are technology companies. And so, you have a market that has very narrow leadership, very tech oriented, and the last time this really happened was the late 90s and the early 2000s where the market got very narrow, very tech heavy. Tech is almost, if you add things that they don't count as tech but are like Facebook or Meta back into tech and Amazon, which counts as a retail company, but add that back into tech and tech is almost half of the market right now.

The next largest sector would be healthcare at just 12%. And so it's very reliant on a few companies and very reliant right now in terms of the day-to-day on one sector. And then this kind of large versus small dichotomy that you brought up. Right now, large cap stocks the first half of this year outperformed small caps by the most since data goes back to 1979, it might've been longer than that, but that's all the farther back the Russell indices go.

And so, you just have narrow leadership and I think this gets into the importance of staying diversified and having other things in the portfolio beyond just kind of some of these headline indices that you see. For example, the small cap 600 index, the top 10 companies make up only 6%. And so, getting beyond some of those headline indices and staying diversified is going to be really important for consistency of return moving forward because it's very easy to fall into that trap of getting involved in just a narrow subset of the market. But when the indices themselves are very concentrated, you really want to focus on making sure you do have some international or small cap or some of these areas that are a lot cheaper than large cap stocks to provide that consistency over time for when momentum wanes and leadership broadens back out.

Kim Brown:

Right. Okay. So, with all these things going on underneath the surface, don't both come at me at one time, what are we looking for in the last half of the year and into early 2025? What can people be looking for? What can we expect?

John Foster:

Yeah, maybe I'll start off a little bit just talking about the Fed because they always have the old analogy, "Don't fight the Fed." And it's interesting, interest... Mark talked about all the rate volatility that we've seen where interest rates have been bouncing all over the place. The last time the Fed made a move was June of last year. So, we've been in a stable Fed funds environment for 13 months, yet we've seen a lot of posturing, a lot of concern, hand wringing so to speak, over what the Fed's next move is. It really does look like they're committed. And even today Powell was out saying, "Hey, monetary policy is restrictive."

Kim Brown:

Yeah, it seems.

John Foster:

And so, the next move is still likely to be a cut, and so that should support bond prices where we really feel that yields have peaked or have been peaking over the last several quarters. And so I think the bond market should be supported, but also the rate cuts have been put on hold. Coming into the year people thought, "Hey, we'd get six rate cuts," well now we're down to maybe, "Hey, we'll get one to two rate cuts maybe." And so they've taken some of that off the table, but monetary policy has gone from supportive to restrictive and it's likely to kind of tilt back to supportive and maybe that could lead to some type of leadership change when we get a change in Fed policy because we've been in kind of this stable Fed policy environment now for over 12 months, about 12 and a half months. And so, I think that's one thing to be on the lookout for.

Kim Brown:

Yeah, interesting. Yeah.

Mark Rosenkranz:

Yeah, I'd agree. And I think the other thing to note and kind of sticking the theme of similars last year right around this time is when we were talking about seasonal volatility and just the natural ebb and flow of markets and on average on any given year, markets have an intra-year decline of around 14%, and those tend to be a little higher, lower depending the year. But when you have such a strong start to the year, you kind of have some pockets where you could see any type of negative headlines, any type of negative progression in the economy kind of get a little bit overreactive. Now, I'm not saying overreactive in terms of a bear market or that, but certainly five 10% corrections, those are very much on the table. Factor in an election year, which I know we'll get into a little bit, there's a lot of headlines, there's a lot of volatility that could really drive a lot of continued choppy experience that has so far been the norm for this year.

Kim Brown:

Right. So, question and key points that we've talked about, how are we applying those and other considerations to our portfolios?

Mark Rosenkranz:

Yeah. So, I think we talk a lot about the day-to-day action of the Fed or of market leadership or that sort of thing. And for about 18 months now, we've kind of focused on three main categories, and that's unemployment, inflation, and corporate earnings. And corporate earnings is a nice bellwether where you get at least updates every quarter. And so far, those have been largely stable. Inflation has been kind of the sticking point this year where we saw several months of negative surprise headlines where we went from six rate cuts to potentially one or two out of fear that inflation was a little stickier than normal, and unemployment in the last couple of months has been starting to maybe show some signs of weakness.

Kim Brown:

It has. Yeah.

Mark Rosenkranz:

And the key of those aspects is in those three categories is they're a little more longer term focused. They're a little more impactful going forward, but the challenge is balancing out where that data's going and where we're at position right now.

So, within our portfolios, we've been overweight stocks versus bonds since about the start of the year, just late December. And so far, that's been a benefit. Now all the reasons we discussed have been how narrow that leadership has been and why that might not be as sustainable as maybe a normal market rally. The challenge is kind of positioning for when that may occur, and we're almost to the point of two years of this kind of really narrow leadership kind of tech driven rally and just going to the sidelines, they're saying now's the time when things are going to change. That's been a very challenging argument to make for the last two years. So, I think where we're at right now is assessing how the data's progressing, maintaining our kind of overweight posture from all our internal discussions. All our external models are still pointing to a favorable environment, but recognizing the environment of how things can change rapidly and knowing what areas should benefit in those types of more challenged environments as we go through the year.

Kim Brown:

Mm-hmm. Mm-hmm. Mm-hmm. John, anything to add?

John Foster:

No, I think the overweight to equities has been something we've been focused on and continuing to ride with, but we are kind of entering that time of the year where you see that seasonal volatility. The two worst months traditionally are August and September for the stock market and sitting here in July, we know that's right around the corner.

Kim Brown:

We do.

John Foster:

After what's been a pretty calm start for headline indices to the year, would not be surprising. In fact, we haven't even seen a 2% correction so far in 2024. Okay, that's not a lot of volatility. We'd expect volatility here to likely pick up the second half of the year.

Kim Brown:

Mm-hmm. So, summer will come to an end, school will start and November come, and with that comes the election 45 years, JNBA has been taking care of clients and doing our thing. And so, election cycles are not new to us, but what are we thinking? I mean, what are people looking towards? What's the road going to take us down this election? Where are we going, do you think in terms of the markets?

Mark Rosenkranz:

Yeah, I can't wait to talk about this.

Kim Brown:

Get your crystal balls out.

Mark Rosenkranz:

We've talked about this before and I think trying to project who's going to win a presidency or who's going to win a House or a Senate type of race and how that means for markets going forward has been a very challenging exercise.

Kim Brown:

Yes.

Mark Rosenkranz:

There's a lot of data of when X party is in this House, the market does this and really the problem with a lot of that data is there's a lot of unique things going on, and it's a pretty small sample size. We've only had 20 presidential elections since World War II. We've had about six since the internet was really adopted and invented and throughout those cycles, there's a lot of other things going on under the surface. The 2020 election, yes, it was a lot of policy and change of who takes leadership, but there's also a global pandemic that probably had a lot more impact on the economy, on corporate trade, on everything that was not really easily defined by this president is in power or this party is in office, and that's why things will go well.

And so, the only thing I'd kind of focus on when it comes to an election year is this story on both sides has said that you can usually anticipate some volatility even more so than a non-election year. And that's leading right up to the election, you generally see not necessarily weakness or strength, but just a lot more. As headlines become more digestive, you start to project how things could change, that becomes a little more volatile. The good news is generally you do see improved performance regardless of party affiliation or who wins or loses. You do start to see some improvements right after the election. That's really just driven by more certainty. Markets like certainty. Whenever you know who won or lost an election, then you can start to project on the more long-term focus on what really drives companies and economies.

Kim Brown:

Mm-hmm. Mm-hmm.

John Foster:

Yeah. And I think that's probably my biggest word of caution as you have the old elephants make money, donkeys make money, it's gone up under both parties, but the old pigs get slaughtered. And so, I think what you want to be careful about is extrapolating political views into market views because most of the time it's about 90% of the time actually between election day and inauguration, the market will work its way higher.

The one exception that we have seen over the last number of years was the Bush-Gore election where things where you were hoping for uncertain to be relieved, and then we got into chads and hanging chads and this long-drawn-out process. But really, it's important to recognize that, hey, the market's done well with both parties in office. There's all sorts of different combinations of Congress and how much gridlock or not gridlock you have or other things, but over time,

companies make more money, profits go up, markets go up. And so don't let your political views kind of short circuit your portfolio, which is really designed with the long-term in mind because all too often people want to sell shortly after election day only to find themselves buying high or after inauguration when they realize, "Okay, that wasn't a well-planned long-term investment strategy."

Kim Brown:
Yeah, I think that's for me what I appreciate the most is that we do take a disciplined approach. Slow and steady wins the race, keep your focus, don't get distracted right? So, thank you John and Mark for joining me for today's discussion. I do think it's going to be an interesting end to the year and beginning to a new year. And thank you to our listeners. We appreciate you joining us today. We appreciate the trust that all of you continue to place in JNBA, not just as your financial advisor, but as your advocate. If you would like to learn more or listen to previous podcasts, please visit jnba.com.

DISCLAIMER:
The previous presentation by JNBA Financial Advisors, LLC ("JNBA") was intended for general information purposes only. No portion of the presentation serves as the receipt of, or as a substitute for, personalized investment advice from JNBA or any other investment professional of your choosing. Different types of investments involve varying degrees of risk, and it should not be assumed that future performance of any specific investment or investment strategy, or any non-investment related or planning services, discussion or content, will be profitable, be suitable for your portfolio or individual situation, or prove successful. Neither JNBA's investment adviser registration status, nor any amount of prior experience or success, should be construed that a certain level of results or satisfaction will be achieved if JNBA is engaged, or continues to be engaged, to provide investment advisory services. JNBA is neither a law firm nor accounting firm, and no portion of its services should be construed as legal or accounting advice. No portion of the video content should be construed by a client or prospective client as a guarantee that he/she will experience a certain level of results if JNBA is engaged, or continues to be engaged, to provide investment advisory services. A copy of JNBA's current written disclosure Brochure discussing our advisory services and fees is available upon request or at jnba.com.