

Ridgetop Wealth Management Market Update - September 2023

Where We Have Been

By almost every measure the S&P 500 is in a Bull market. In fact, we are coming up on its one year anniversary. The S&P index advanced 7.0% in Q1 of 2023, jumped another 8.3% in Q2, and another 3.1% in July. This market has had its strongest start since 1997 and 10th best start since 1926.

While this is obviously fantastic on the whole, investors living the day to day have felt numerous bumps and bruises along the way. For instance, there was a 7.8% decline from February 2nd to March 13th when we had the second and third largest bank failures in U.S. history. Combine that with 11 interest rate hikes over the last 18 months, which certainly did not give the feeling of confidence and smooth sailing. However, it is exactly this “feeling” of uncertainty that has driven the Bull run. As the saying goes, Bull markets have always and always will, climb a wall of proverbial worry. Coming into Q1 investor sentiment was hitting pessimistic extremes as almost no one fathomed that a Bull market was getting started.

Where We are Today

A shaky August and September would be expected and welcome. Strong starts to the year, followed by pullbacks, are often followed by further gains through year-end. If you look back through history in all cases since 1926 when the S&P 500 rose at least 10% through July (which we did), and declined during August (which we did). From August 31st through year-end, the S&P 500 has risen 14 out of 14 times by an average of 9.9% versus an average of 1.9% for all September – December periods.

Historically, August and September are the year’s two-month stretch with the most negative seasonality, whereas the fourth quarter is the year’s strongest three month stretch. What we actually need right now is for the market to remain on the defense over the short term combined with pessimism from crowd sentiment polls. That skepticism would likely set us up nicely for a bullish year-end rally. This is all currently playing out and we are of the mindset that we will see a continuation of the cyclical Bull in Q4. This is supported by soft landing evidence that will support earnings growth that leaves the market poised to gain momentum when the seasonal influences shift from headwinds to tailwinds.

What is Concerning

Not to belabor, but expectations do matter. Unfortunately, August crowd sentiment polls showed that not only were investors getting less nervous, but they were starting to turn optimistic. As mentioned, optimism and/or extreme optimism is a bearish indicator for the stock market. Continued optimism would suggest that recession fears that dominated investors’ psyches earlier in the year, which drove the market up, have now been replaced by thinking that the market has nowhere to go but up. At that point, who would be left to propel stocks into the year-end rally?

Also concerning is the path of the small-cap Russell 2000 index. Historically, small caps surge once a new Bull market is underway, with an average 12-month gain of +74%. With only a +9.6% gain from last October’s market bottom this divergence from prior Bulls does not bode well for the health of the overall market. Another factor we are monitoring is the overall breadth of the market’s advance. This Bull has been highly concentrated in just a handful of mega cap companies. While the rally broadened

out in Q2, this concentration questions the overall market's strength. Lastly and notably the stock market is choosing to fight the Fed. Historically this level of monetary tightness has led to a recession.

In Summary

Risks remain high on multiple fronts. That said, the current overall weight of the evidence warrants giving the Bull the benefit of the doubt. What has played out year-to-date aligns with the likely continuation of the Bull gaining momentum and reaching new highs in the fourth quarter. We will be watching for increasing participation and receding concentration, then we'll have more confirmation that the Bull market is well intact and sustainable. We will keep you updated. Stay tuned and thank you.

Sincerely,

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