April 2024

THE CAPSTONE QUARTERLY

The changing of the seasons reminds us of the ever-changing landscape of the financial world. The first quarter of 2024 brought dynamic shifts in the stock market with a blend of optimism and volatility. Despite some early fluctuations in the markets, they ended the quarter with some modest gains. In this newsletter, Bryce discusses our investment strategy and Casey takes a behind-the-scenes look at our recent market rally.

BRYCE'S POINT OF VIEW

Bryce Pease, CFP®

Letting the Winners Run

One thing all financial advisors can agree on is the price of a stock/fund/security at any given moment. It is also the only information we have available to us, in real time, that is 100% accurate. Any news that we see or hear, by definition, is already old, which is why our investment strategy takes a large focus on the price of an investment.

A study by Hendrik Bessembinder in 2017 found that much of the gain we've seen in the stock market since the 1920's can be attributed to about 4% of the stocks traded in the markets.[1] To add to this, a study by Geoffrey West found that half of all companies that go public on the stock market in any given year will be gone within about 10 years.[2]

If only a few stocks drive all the gains in the market and most companies disappear, we think it makes sense to have an investment strategy that cuts losers early and lets winners run. If a fund/stock lags the market long enough it will usually get cut from the portfolio, making room for the up-and-coming names. On the other end, a winning trade we will usually hold on to until something better comes along.

Now when we cut something to make room for the "up-and-coming", this doesn't necessarily mean we are buying a company that is new to the stock market. This can mean that something is coming up from the bottom and showing signs of life again, like a sector of the market (ex. technology, healthcare, etc).

Put simply, we care a little less about why the stock is going up/down (Was their earnings forecast right? Was there a big headline in the news?) and care a little more just for the fact that is it going up or down. Supply and demand are a big part of this price movement in stocks. The premise of Economics 101 tells us that if more people want the stock, the price will go up, and if less people want the stock the price will fall.

The same forces that affect prices in the supermarket (peaches can be more expensive in the winter months), also affect prices in the stock market. Stocks, sectors, countries and asset classes move in and out of favor just like produce in the stock market.

Momentum investing is based on inputs (like supply and demand) that attempt to identify leaders in the market. It is not designed to target exact tops or bottoms in a fund, but rather tries to participate in long-term strength (or trends). Of course, momentum investing doesn't work 100% of the time otherwise everyone would be using this strategy.

Markets with stable leadership (like in 2020 when technology led the pack for a long period of time), and markets with a big difference between the winners and losers will be the most favorable for this type of strategy. Markets with frequent changes in leadership, or choppy trendless markets will be unfavorable for this type of strategy.

We are certainly aware that various processes (not just ours) can yield favorable results over extended periods. The key in that sentence is "processes". There needs to be an objective and repeatable process to the strategy – any strategy – in order for it to be successful over time.

CASEY'S CORNER

Casey Morris, CFP®

The Magnificent 7

Have you heard of the Magnificent 7?

The term is not an official one, of course. An investment analyst coined it last year and it quickly caught on. I'm referring to the seven companies most responsible for the stock market's rise over the past year. In fact, they have played such an oversized role that it's time to start thinking about what might happen if they were to… stop.

The Magnificent 7 are: Amazon, Alphabet (aka Google), Apple, Meta (aka Facebook), Microsoft, NVIDIA, and Tesla. Collectively, these companies have a greater market capitalization than all the combined companies in nearly every country in the world.[3] In 2023, their market capitalization represented a staggering 29% of the entire S&P 500.[4] The stock prices of these companies rose by an average of 111% last year.[4] In January 2024 alone, just five of these seven stocks were responsible for 98% of the S&P 500's gains for the month.[5]

When we zoom out and look at the stock market, we tend to see it as a single squiggly line. Sometime the line goes up. Sometimes it goes down. Sometimes, it zig-zags. But this isn't really an accurate way to think of stocks. At any given time, some stocks will be moving up, and some will be moving down. If more stocks are moving in one direction than another – especially if they are weighted more heavily, which we'll get into in a moment – then that's what drives the overall direction of the market. It's uncommon, however, for such a small handful of stocks to affect the squiggly line so thoroughly. And that's why the Magnificent 7 matters.

It helps that six of the seven are household names that just about everyone has heard of. They provide products and services that many people use every single day (cell phones, computers, the chips needed to power both, cars, delivery, etc).

But the main reason for their current rise can be summed up in two words: artificial intelligence.

The last two years have brought some stunning advances to the field of AI. There are now a multitude of AI-driven products available. Many are designed to help companies boost productivity and increase efficiency. These advances have many investors salivating at the possibility that AI will help companies produce more than ever before…and in doing so, return more value to their shareholders. Many experts believe that AI could change the world similar to how the internet did.

Each of the Magnificent 7 are either heavily leveraging AI or are actually helping to advance it. Each is an already successful company. Each has stellar brand recognition. And each is at the forefront of a potentially revolutionary new field.

Let's review some recent history. Before the Magnificent 7, the hot buzzword on Wall Street was "FAANG" stocks. (This was an acronym for Facebook, Amazon, Apple, Netflix, and Google.) In the late 2010s, these companies also represented a

Did you know?

You may have heard that the average American dollar has more germs on it than your household toilet seat, and it's not far off. Cash in the U.S. is made of 75% cotton and 25% linen making it a great transportation device for bacteria.

In a 2017 study[6], researchers swabbed dollars from a NYC bank and found hundreds of species of microorganisms. Acne causing bacteria, virus, mouth microbes… and nearly 80% of them had traces of cocaine! Luckily most of our transactions are done digitally, but if you find yourself handling cash, make sure to wash your hands after!

Check us out on social media!

Follow us on LinkedIn®: www.linkedin.com/company/capstonepacific

Facebook®: @capstonepacific or www.facebook.com/capstonepacific

Instagram®: @capstone_pacific or www.instagram.com/capstone_pacific/

huge portion of the S&P 500. But over time, things changed. Facebook became Meta. Google became Alphabet. And companies like Tesla and NVIDIA grew to have a far greater market capitalization than Netflix.

Then, too, even these tech giants haven't always been winners. Many of the same tech companies that drove the markets in '23 are what dragged the markets in '22. (This includes the Magnificent 7.) Nobody, no matter how intelligent or experienced, has a crystal ball. Nobody knows how long the Magnificent 7 will stay magnificent…or which companies will eventually, inevitably, replace them. It reminds us that the "squiggly line" we see representing the stock market doesn't always tell the full story. In this case, the line for 2023 and into 2024 looks impressive. But when you zoom in, you see the breadth of that line is remarkably skinny. While the stock market has undoubtedly done well, the majority of the market isn't quite as impressive as it seems on the surface.

It also reminds us not to get caught up in the hype…or in headlines. The Magnificent 7 represents a group of exciting companies propelling the markets. That's the story today. A story we definitely want to participate in. But what will the story be tomorrow? That is something we must never forget to consider…and always be prepared to face. In my experience, individual stocks are also like the wind. They blow over the land…and then they pass on. Our job is to be the land itself. Our job is to remain. And that is what our team will always try to strive to help you do.

FINALLY…

We recently sent out an email to our advisory clients about cybersecurity and the need to protect our digital lives. Helping clients keep their finances "cyber-secure" is an increasingly important part of our job these days. As a brief summary to our letter, a new cyber threat we have become aware of is a scam involving search engines. When a person types into a search engine looking for a financial institution (your bank or "Schwab", for example), there can be fake websites that populate under the search results. To be safe, you should try typing the exact website into the address bar (or URL bar) at the top of the webpage to navigate directly to the site. By saving your frequently visited sites in your bookmarks, it will also help make sure you get to the proper site and not land on a scam website. It is very important to protect your financial data as a way to protect your overall financial future. As always, let us know if we can provide you with any further information.

Sincerely,

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P.S. If you ever run across anyone who could use our services or is unhappy with their current adviser, we always appreciate it when you pass on our name.

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