Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – September 1, 2024

Chemistry in the Markets?

We currently have a high school daughter who is undergoing two modern rites of passage. First, filled with hope and a bit of trepidation, she will gather up her temporary driving permit this month. And before you offer prayers for her parents' well-being, know that we emerged from the novice driver period with her older brothers with little more than hoarse voices, honed reflexes, and mild dyspepsia. On second thought, pray.

Her next rite of passage is a chemistry course. We now hear talk of atomic weights, isotopes, and Avogadro's number bandied about the house. Sooner or later, we fully expect to hear the discussion fall to catalysts. While we're certain that those readers who took chemistry some five decades ago or more confidently recall the definition of a catalyst, we'll take the liberty to remind the younger set of readers whose memories might not be that long. A catalyst is a substance that hastens a reaction without itself being consumed in the process.

The concept of catalysts came to mind recently in light of stellar market returns and elevated large stock multiples (PE, PS, EV/EBITDA). In effect, we asked ourselves what catalyst might occur that would justify yet higher prices? What results, what internal or external events would have to happen at companies to propel their prices higher (or lower)?

Normally, one would expect the long-run return of the broad stock market to be in line with its earnings growth rate plus inflation. Periods of rapidly increasing stock prices usually occur when there is a rapid increase in those earnings growth rates. Other times stock prices soar when the earnings and growth rate don't change much, but investors perceive the value of those existing earnings as greater than before.

We've had a bit of both reasons propelling the market run of late. Earnings have rallied, especially in technology companies. And investors keep proving they are willing to pay more for every dollar of earnings than they did in previous years. This latter reason has boosted the trailing PE on the S&P 500 to roughly 26 (high by historical measures). But because earnings growth is expected to continue, the forward PE is estimated to only be about 22 (still high compared to history).

And so, a catalyst is truly required to forecast above average returns for the coming twelve to twenty-four months. What might those catalysts be?

Interest rate cuts – To be sure, cuts are already baked into stock prices. So much so that if the Fed fails to cut by 50 to 75 basis points before year-end, the market will consider them woefully behind and likely sell-off. Only aggressive cuts coming faster than anticipated can be considered catalytic.

Unexpected growth surge – The AI-fueled investment into chips et al for a myriad of large language models tripled or quadrupled earnings for some technology companies since early 2023. To drive prices higher than the long-run average rate would require even more astounding growth to continue in this sector or to be unleashed elsewhere.

Peace – Resolutions in the European or Middle East conflicts would remove constraints to trade and open more global markets to businesses. A small surge of perhaps one-half percent of global GDP could be expected (in addition to a vast reduction of human suffering).

Election outcome – Tax, defense, and border policies are starkly different between the two major parties. There are many other differences as well. Depending on the magnitude of the November outcome either victor may decide to focus on one or more areas. Taxing unrealized capital gains would be a negative catalyst for the market. Extending the 2017 tax cuts beyond 2025 would be a positive catalyst.

And since most of these catalysts are un-knowable in advance, we base our decisions on history. Market multiples are extended. That is a fact today. In our commentary last month, we indicated that we expect to trim toward our strategic portfolio targets for clients in these current price ranges. We are pruning along now. A nip here. A tuck there. Not eliminating risk, for that is impossible. We aim to right-size it, to survive and thrive in whatever environment comes our way.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely
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