

06.24.2024 Market Update – Two Reasons

Many moons ago, when I was in my first life, there was a phrase I used to say to my kids – “There’s two reasons for doing something. One that sounds good and the real one.” Of course, when you listen to politicians talk, this is a good thought to keep in mind. No doubt, there’s times we’ve all said something to our children or a friend where this idiom could apply. More on this thought below.

This is not a standard market update. It’s an explanation and expectation of styles of investing that I thought important and appropriate to address now because of the following:

- 1) A number of client accounts from Nationwide have transitioned to AXOS using Q3AM (Q3 Asset Management) as a sub-advisor.
- 2) Several new clients coming onboard.
- 3) The recent stock market action has been narrowly focused on tech stocks and the big 3 or 4 mega cap tech in particular

Expectations are everything when investing. If one is investing in short term bonds and expecting to make big bucks or if one is investing in growth stocks and expecting to not lose if the market goes down 20%, then one will be unhappy. Generally, there are 3 ways in which most people invest (these are broad explanations):

- A) Long only: This means buying various stocks/bonds or stock/bond mutual funds and hoping all works out. In rising stock markets, everyone’s happy. In falling markets, they aren’t. In my opinion, this method favors those who are younger, still working, and regularly contributing to one’s accounts. Buying “for the long term” is a great idea if one has a long term to go. If one’s time horizon is shorter than infinite, then it may be difficult to stay invested in periods of distress. This is especially true if one is withdrawing income during down markets due to the “sequence of returns” rule*.
- B) Trend-Following: This involves tracking the performance of 70 or more different stock and bond sectors, indexes, and “alt” markets. Every 1 or 2 weeks, performance returns for each of them for different time periods are downloaded into a spreadsheet, fed into a mathematical formula, and then each separate category of investment is sorted from best to worst. The “best” performers in each category are then selected for the account. While this may result in big changes every few weeks, often only a few substitutions are made. If there are few “positive” performers meeting certain thresholds, this system will automatically move funds to the money market until the next review. Sometimes this method will correlate with the general stock markets and other times not at all.
- C) Mean-Reversion: This is a rules-based method designed to only invest when stock markets “deviate” from the mean trend to take advantage of mean-reversion tendencies in the market. It is not correlated to long only or trend following styles of investing and, historically, sits in the money market about 40% of the time waiting for opportunities. Statistically, it has been an excellent way to invest in combination with either long only or trend following styles and may work well in both up and down markets.

Trend-following is how I’ve managed accounts at Nationwide Advisory for many years. One of the reasons I’ve moved many clients to AXOS, using Q3AM as a sub-advisor, is because they are able to use both trend-following and mean-reversion styles in a single account, which, for me, means we can eliminate the use of cash and bonds to hedge risks. For the past almost 4 years, bonds have been a losing trade (source: Yahoo Finance). The fund AGG, which is a basket of most all types of US bonds available, has a negative price return since mid 2020, meaning it has been hard to generate good returns for moderate and conservative investors who require hedges against risk. This has worked well as Q3AM’s mean-reversion strategy is about +4.5% through 05.31.2024 while AGG is about flat (including dividends) this year (source: Yahoo Finance).

As mentioned, 2nd quarter stock market gains have been caused by 4 or 5 large tech stocks driving the indexes upward,* meaning that index investing and accounts using structured contracts that link gains to the indexes have had excellent returns. On the other hand, trend following investing has had a difficult time in the 2nd quarter so far. While indexes have risen, trend followers diversified among a variety of sectors have gained little because only 1 or 2 sectors are “working” while the others are flat or losing. I just did a review across a wide range of sectors/indexes/alts and only 7 of 35 were “positive.” Ones that had been doing nicely, such as energy, precious metals, and value, have cratered, although in the past few days, it seems like things are reversing a bit. It’s important to understand, sometimes trend-following is “out of

phase” with the general indexes, which may be good or bad. In 2022, when stocks cratered, it was good. This year, so far, not so much.

Anyway, this brings me back to the opening paragraph. Yes, it’s important that you know and understand how your accounts are managed. That’s the “sounds good” reason. The “real” reason for this note is returns at AXOS this quarter have been sub-par because, after an excellent 1st quarter, their trend-following strategy has performed poorly and it’s important to recognize this will happen from time to time. Q3AM’s trend-following strategy beat the S&P 500 Index from inception 01.01.2016 – 03.31.2024 net of fees and I have confidence in the strategy, even if it is out of phase occasionally when stock market indexes go up. For what it’s worth, I recognized what was happening early on and adjusted allocations, shifting more to the mean-reversion strategy and to gold (GLD).

*<https://users.sentimentrader.com/users/sentimentedge/historic-underperformance-by-the-average-stock>

Thank you, as always, for allowing us to be of service. Please let Deena or me know if you have any questions.

Enjoy,

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