

THE QUARTERLY ADVISOR

CONTENTS

PAGE 2

HOW WILL POLITICAL INSTABILITY AFFECT THE MARKETS?

By Robert Stoll, CFP® CFA

With about 100 days to go before the 2024 election, it's anyone's guess what other surprising events will happen between now and then. We will not try forecasting what will happen next, but want to help clients understand how political instability affects markets.

PAGE 7

MEET THE CHIEF INVESTMENT OFFICER

By Financial Design Studio, Inc.

Robert Stoll is our Chief Investment Officer, and in this video he shares a little of his story. In his own words, hear how sitcoms and meteorology led him to investment management and why he loves working with clients.



QUARTERLY PERSPECTIVE

Coming back from a recent weekend with my family, I noticed how many people are trying to fit in their last minute fun trips or adventures before school starts again (our family included). While people are setting aside time to enjoy another summer adventure or their final summer adventure we're also aware there are many different things happening around the world.

The Olympics have kept us hoping for our team to earn the gold! The school shopping lists have us getting ready for school. The vacation adventures have kept us thinking how to savor and make all the moments together memorable. In the midst of these positive, memorable moments we know we could all check the news or our social media accounts and see less than desirable things happening.

I've really just been reminded to enjoy the positive and meaningful things in life rather than let the negative things weigh me down. Another way to say this is... you can choose to let yourself get caught up in negative distractions or you can let yourself get carried away by the positive.

- Michelle Smalenberger, CFP®, CEO

LISTEN TO OUR PODCAST!



HOW WILL POLITICAL INSTABILITY AFFECT THE MARKETS?

BY: ROBERT STOLL, CFP® CFA

This article is being penned on July 23. In the last 10 days, we've seen an attempted assassination of a former president and the sudden and still unexplained departure of President Biden from his re-election campaign. With 100 days to go before the 2024 election, it's anyone's guess what other surprising events will happen between now and then. Let's be honest: we're not used to this kind of political instability in the United States. But such instability isn't necessarily "new;" it's simply been on hiatus the last 50 years. We will not try forecasting what will happen next, but want to help clients understand how political instability affects markets.

STOCK MARKET RETURNS DURING ALL PRESIDENTIAL ELECTION CYCLES

In recent election cycles, we've been told that it is "the most important election of our lifetime." The media and mainstream political parties do a "great" job (note: sarcasm) whipping the public into believing that the victory of XYZ candidate will either save the country or ruin it. For investors, it's not uncommon for political views to inform their views about the economy and stock market.

According to work by the Swiss banking group, UBS, the average annual return of the U.S. stock market is +9.5% since 1900. Of course, any year can be significantly better or worse than that average.

Looking at stock market returns of all presidential election cycles since the end of WWII, we find that the median annual return in those years is – you guessed it – +9.5%. **No matter who was running, or who won the election, the returns were exactly the same as the average.**

S&P 500 Returns in Presidential Election Years

<u>Election Year</u>	<u>Sitting/Retiring President</u>	<u>S&P 500 Return</u>
1948	Truman	-0.7%
1952	Truman	11.8%
1956	Eisenhower	2.6%
1960	Eisenhower	-3.0%
1964	Johnson (Kennedy)	13.0%
1968	Johnson	7.7%
1972	Nixon	15.8%
1976	Ford	19.1%
1980	Carter	25.8%
1984	Reagan	1.4%
1988	Reagan	12.4%
1992	Bush Sr.	4.5%
1996	Clinton	20.3%
2000	Clinton	-10.1%
2004	Bush	9.0%
2008	Bush	-38.5%
2012	Obama	13.4%
2016	Obama	9.5%
2020	Trump	18.4%

Median Return: All Election Cycles	9.5%
Median Return: Open Field Cycles	7.7%
Median Return: Re-election Cycles (bold)	13.2%

Source: Standard & Poor's

STOCK RETURNS IN RE-ELECTION AND OPEN FIELD ELECTION CYCLES

The main differentiator in election year market returns is whether there's an incumbent running for re-election or if it's an open-field election. Presidents running for re-election have enjoyed stronger stock market years, whether or not they've won. Returns were worse when it was an open field.

That's not a surprising outcome. Markets don't like uncertainty. Re-election bids have more certainty to them, whether it means the sitting president is clearly going to win again or clearly NOT going to win again. Open field elections are more uncertain, hence the below-average returns by stocks in those years.

This brings us to the 2024 election cycle, which just offered a major twist. It has flipped from a re-election cycle to an open field cycle. Through July 16 – the Friday before President Biden announced he was abandoning his re-election bid – the S&P 500 index was +16.3%.

As we'll see in a moment, this isn't the first time such a shift in the election has occurred.

But it raises the question whether stocks can continue making upward progress through Election Day.

1968: A YEAR OF POLITICAL INSTABILITY & CHANGE

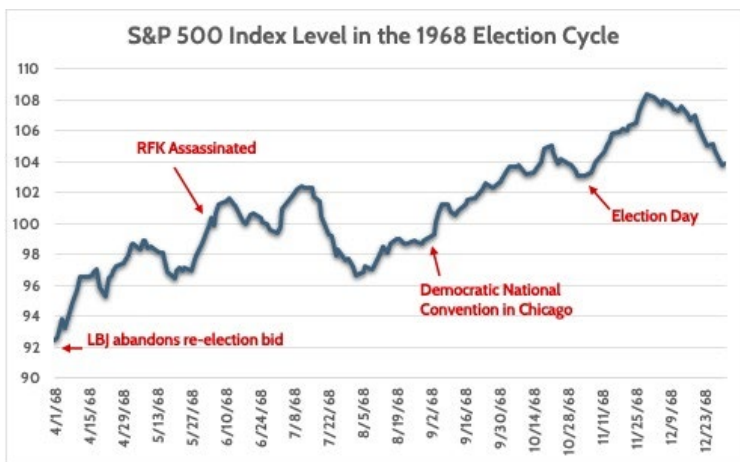
The year 1968 was one of the most challenging in American history. It was also the year that President Lyndon B. Johnson would have run for re-election. He himself had assumed the presidency after John F. Kennedy was assassinated in 1963. During his term in office, LBJ successfully pushed through several important pieces of legislation, namely the Civil Right Act, Medicare, Food Stamps, and the Clean Air Act.

Despite these accomplishments, the extended “quagmire” of the Vietnam War dogged LBJ's re-election prospects. So much so that on March 31, 1968, he made the shocking announcement that he would not seek re-election in November 1968. Suddenly, what seemed like a predictable re-election bid against Richard Nixon turned into an open field election.

The Democratic field after LBJ's announcement turned into a two-man race between LBJ's Vice President, Hubert Humphrey, and Robert F. Kennedy. On June 4, RFK won the California Primary election, which catapulted him into the lead for the Democratic nomination. Tragically, he was shot the next day and died on June

6. This event was followed by the (in) famously violent Democratic National Convention held in Chicago that August.

If this sounds eerily familiar to what we're experiencing in 2024, it is! At the risk of coming up with a conclusion from a single election's example, we can look at how the S&P 500 did during that tumultuous year.



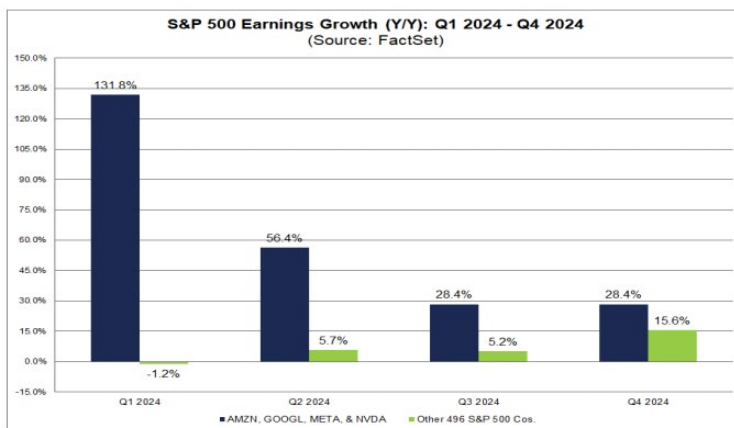
Shockingly, the stock market took all the political and societal turmoil of 1968 in stride. That's not to say markets will ignore what's going on in 2024. But it's a reminder that as much as we may think stock markets depend on who wins elections, investors historically look right through them.

WHAT REALLY MATTERS TO STOCKS: PROFITS

If political turmoil doesn't move stocks, what does? The answer is simple: individual company earnings, economic expectations, and the Federal Reserve. Company earnings are driven by

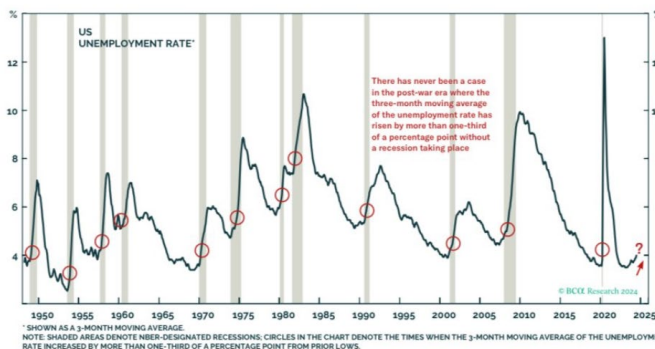
economic conditions, while interest rate policy by the Federal Reserve influences the value investors place on individual stock profits.

Regarding company earnings, headline earnings for the S&P 500 have been strong. But under the hood, this growth has largely been driven by four key stocks: Amazon, NVIDIA, Meta, and Google. The "Other 496" stocks in the S&P 500 index have seen stagnant profit growth. This, however, is expected to change in coming quarters as profit growth for the "Other 496" picks up (below chart, in green).



A lot will depend on the economy. And while the economy has remained strong, the employment situation continues to flash warning signals. Job openings are falling and layoffs are increasing.

The Unemployment Rate Is A Highly Mean-Reverting Series

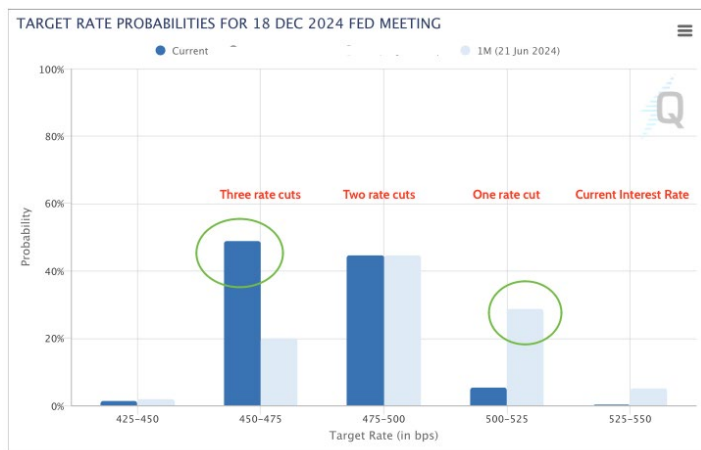


The employment situation is the indicator we are watching most closely. As noted in the chart above, once unemployment picks up, it moves up quickly.

WHAT MATTERS TO STOCKS: FEDERAL RESERVE

The other key factor for stocks is the future path of Federal Reserve interest rates. As we all know, we've endured high inflation in recent years, and the Fed responded by hiking rates to over 5%. But since December 2023, the market has been eagerly expecting the Fed to cut rates, only to be disappointed by high and sticky inflation and a more resilient economy.

This, however, is changing. The June Consumer Price Index ("CPI") reported in early July came in better than expected, suggesting that the Fed may finally get the upper hand on inflation. This report reignited hopes that the Fed can start cutting interest rates this year. Just a month ago (light blue in below chart,) markets were pricing in 1 or 2 rate cuts by December. After the CPI report, the chances of 3 rate cuts increased significantly (dark blue.)



Regardless of who wins the 2024 election, we think the Fed will start cutting interest rates in September and into 2025. The pace of these cuts will depend heavily on the strength or weakness of the jobs market.

BROADENING STOCK PERFORMANCE

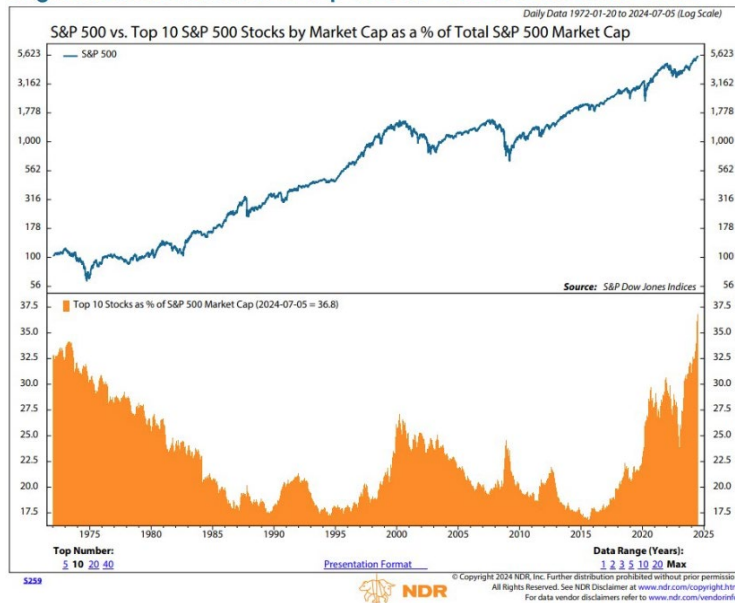
These two trends – stronger earnings for non-tech companies and increasing odds of interest rate cuts by the Fed have driven a strong performance rotation since June. Through June 30, the top 7 stocks skewed S&P 500 returns. These stocks are often called the “Magnificent 7” stocks of Apple, Microsoft, Google, Amazon, Tesla, Nvidia and Meta. The performance of these 7 stocks against the other stocks in the index was dramatic.

2023 Stock Index Performance		
	Through June 30	July 1-23
S&P 500	15.2%	1.9%
S&P 500 Equal-Weight	5.0%	3.1%
Mid-cap Stocks	6.2%	4.5%
Small-cap Stocks	4.4%	8.6%

But in the wake of softer inflation and increasing odds of an interest rate cut by the Fed, large tech stocks have sold off as investors quickly switched exposure to smaller company stocks. How long these trends last is anyone's guess. But investors should know that the S&P 500 index is more concentrated today than

any time in the last 52 years. If you buy an S&P 500 index fund, you're getting 37% exposure to just 10 stocks.

Highest concentration in top 10 S&P 500 stocks since 1972



DOES POLITICAL INSTABILITY AFFECT MARKETS?

The contentious 2024 election season is well underway and more surprises are likely in coming weeks. But we think investors overstate the impact that politics has on stock market returns. The primary influence on stock markets are good ol' fundamentals: earnings, economy, and interest rates.

That doesn't mean we can ignore what's going on politically. Whomever wins will have significant policy decisions to make. Social Security needs to get shored up, and the Trump tax cuts will expire at the end of 2025, increasing tax rates for most of the population. Ballooning budget deficits also needs attention.

Separating one's view of politics from views about the stock market isn't easy. Politics is emotional and gets the best of us from time to time. But there is a wide body of academic research that shows how behavioral mistakes – greed & fear – cost investors investment returns.

Successful investors play the “long game,” avoiding panic in uncertain times and not taking too much risk during speculative excesses. It's easier said than done, but that's why we at FDS have dedicated a lot of time and effort to building a disciplined and consistent investment process.

We believe a well-constructed, diversified portfolio with a disciplined rebalancing process is the best way to achieve long-term financial success. It's a repeatable process that has stood the test during the trying times of recent years.

The success of a client's short or long-term goals depend on having a strong investment process in place. It increases a client's confidence that if they follow the recommendations we make, their chances of success are good. And if there's one goal we have at FDS, it's that our clients feel confident about their future.

MEET THE CHIEF INVESTMENT OFFICER [VIDEO]

BY: FINANCIAL DESIGN STUDIO, INC.



SCAN TO WATCH NOW!

Robert Stoll is our Chief Investment Officer, and in this video he shares a little of his story. In his own words, hear how sitcoms and meteorology led him to investment management and why he loves working with clients.

Listen to our full conversation in episode 47, “Start with Why: Rob’s Story.” Find it by streaming the Behind the Designs podcast. Watch the video on our CEO and our COO, or learn about our whole team on our About page!

If you have more questions, then reach out! We specialize in complexities like executive compensation, tax planning, and investment management. Our team would love to see how we can help bring confidence to you and your family’s finances.

THANKS FOR WATCHING!

WANT TO SHARE THIS WITH SOMEONE?

Know someone who wants to receive this newsletter?

Send us the mailing address at team@financialdesignstudio.com If you prefer to no longer receive this newsletter please email us at team@financialdesignstudio.com



FINANCIAL DESIGN STUDIO

Q3 2024 NEWSLETTER



FINANCIALDESIGNSTUDIO.COM

21660 W. Field Parkway
Suite 144
Deer Park, IL 60010

