Retirement Income Solutions

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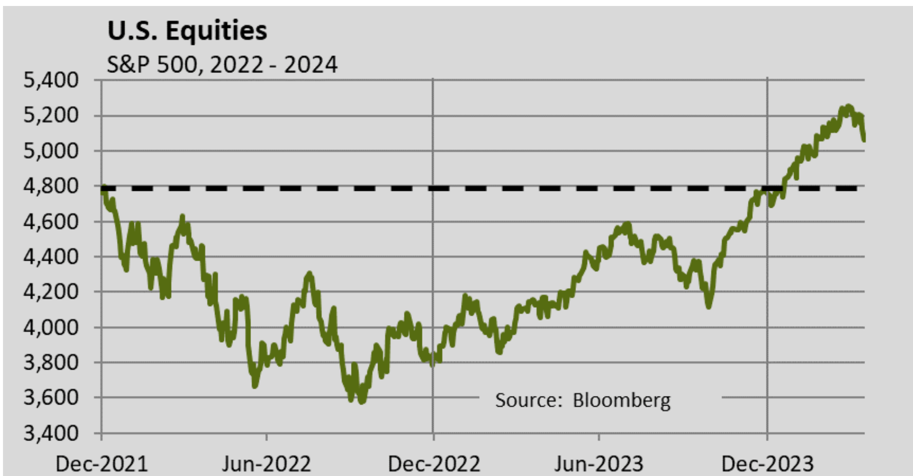
Following the Strong Winter Rally

April 2024

Summary

It took two full years for the stock market to finally reach new highs. After the recession worries of 2022 and a steady recovery in 2023, the S&P 500 finally hit new highs this January. The market strength continued through the winter, surging 28% between October and March. Consumer sentiment is back in healthy territory again as investors finally feel comfortable that the economy is steady, and inflation is under control.



*** If you have not accessed the new online portal, please see page 6 for more information. ***

A few indicators help explain the current dynamics of financial markets:

- **The U.S. stock market surged by 25% over five months,** only the seventh time such strength has occurred since WWII.
- **Plans for international travel are a notable sign of consumer confidence.** While many households state they have concerns over inflation and the economy, they have not cut back spending and, in fact, are seeking out more expensive experiences.
- **While low unemployment is excellent for the economy, it is not correlated with strong stock market returns**. The best stock market returns come when there is significant room for things to improve (i.e. when unemployment is high).
- **The four-year presidential election cycle** demonstrates a tendency for markets to pause mid-way through an election year.

The U.S. economy has been quite resilient in the face of inflationary pressures and significantly higher interest rates. Stock market returns have been strong since late 2022, and client portfolios have benefited from an overweight to stocks for the past 15 months. After periods of strength and increases in consumer sentiment, it is common for the stock market to pull back or consolidate for a period. The tendency for market weakness in the summer and in the middle of an election year is consistent with reducing risk in portfolios. Accordingly, client portfolios have been moved to their Neutral equity position.

Strong Winter Rally

Since last fall, it has been a good time to be overweight U.S. equities. Over the last five months, the U.S. stock market rose by 25%, only the seventh time such sizeable gains have occurred over a short period since WWII. The prior six cases illustrate the potential for a continued rise in stocks; however, context is important when evaluating the prior rallies.

Five Month Strong Rallies
S&P 500
1948-2024

	5-month change	Previous year drawdown	3 months later	6 months later	12 months later
February 1975	28%	-38%	11.7%	6.5%	22.2%
November 1982	26%	-19%	6.9%	17.2%	20.1%
March 1986	26%	-8%	5.0%	-3.2%	22.1%
January 1999	34%	-19%	4.3%	3.8%	9.0%
July 2009	34%	-48%	4.9%	8.8%	11.6%
August 2020	35%	-34%	3.5%	8.9%	29.2%
March 2024	25%	-10%	?	?	?
Median	**31%**	**-27%**	**5.0%**	**7.6%**	**21.1%**
Percent positive	**100%**	**0%**	**100%**	**83%**	**100%**

Source: Bloomberg, Ned Davis Research

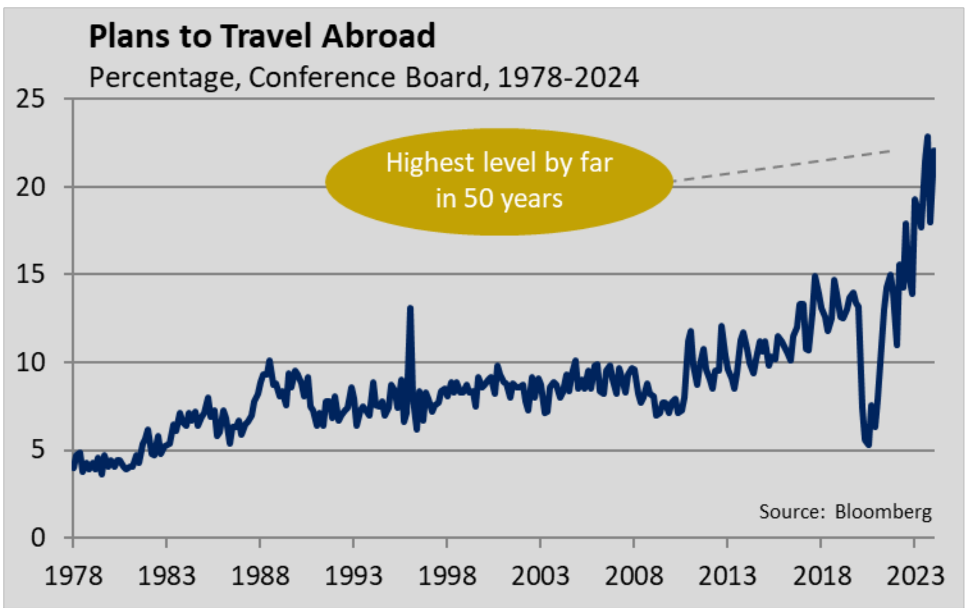
It is common for markets to realize bursts of strength, and most of such periods occur after large drawdowns. In five of the six prior cases, markets fell significantly in the year prior to the rally. For example, the last two bursts occurred in 2020 (after the pandemic stock market bottom) and 2009 (after the financial crisis stock market bottom). Only the 1986 case saw a 26% rally with a minor pullback in the prior year. The 1986 case is most similar to the current period, and notably incurred the most volatility in the subsequent periods (advance, then drawdown, then advance).

After periods of strength, it is also common for markets to at least pause or pullback for a period.

Why Have Markets Been So Strong?

In the January Outlook commentary, "Vibecession," it was noted that many consumers are pessimistic, despite strong economic and financial market trends. Consumer confidence was lower in 2022 than it was during the Great Financial Crisis in 2008, despite unemployment remaining steady below 4%.

When trying to assess the investment environment, it can be helpful to follow what consumers are doing instead of what they are saying. An example of this is the Conference Board survey on plans to travel abroad in the next six months. International travel is clearly a discretionary item for families; Macro strategist Jim Bianco summarized this succinctly, "A foreign vacation is the ultimate 'thing' that no one needs but everyone wants."

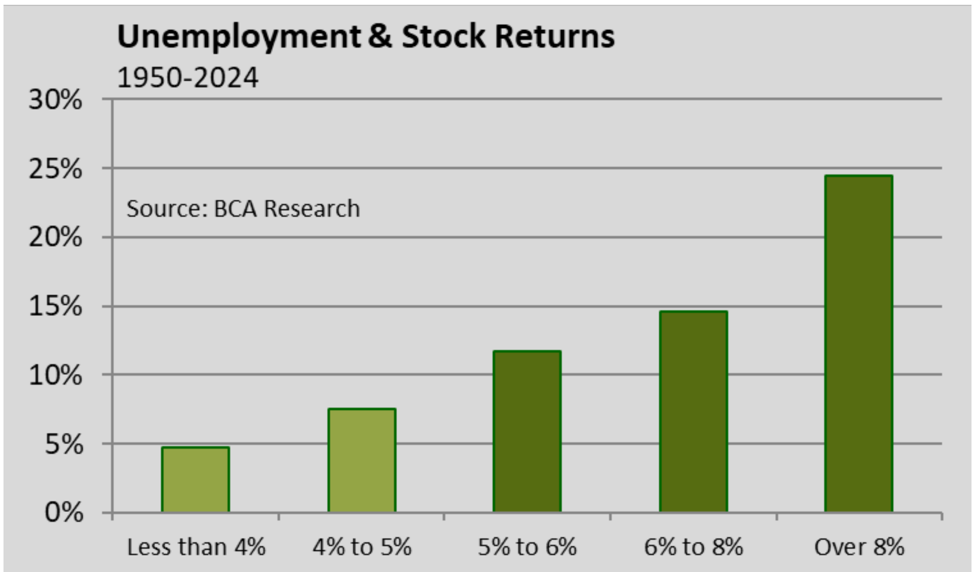


A position taken by some strategists over the past few years is that consumers have a higher propensity to spend in the post-COVID era. The YOLO (you only live once) mindset means that people are seeking out and spending on experiences – vacations, concerts, sporting events, international travel, etc. Some analysts theorize the pandemic could generate an extended period of economic strength, like the Roaring 20's which occurred after the Spanish Flu of 1918.

The Conference Board survey illustrates the YOLO concept well. The percentage of consumers that plan to travel to a foreign country within six months hit 22% in recent months – more than double the rate in the 2000s and 50% more than just a few years before the pandemic. This is even more impactful considering the pressures brought by the highest inflation, home prices and mortgage rates in 20-30 years. While this data series is only one aspect of consumer spending, it illustrates the resilience of consumers in today's environment.

Low Unemployment & Stocks – Not Intuitive

It is normal to feel good when markets are strong, and the economy seems resilient. However, it is important to remember that feeling good about the environment is likely not an indication that stocks will continue to do well. There are numerous indicators that help warn of overconfidence in financial markets, and one very basic indicator is the unemployment rate.

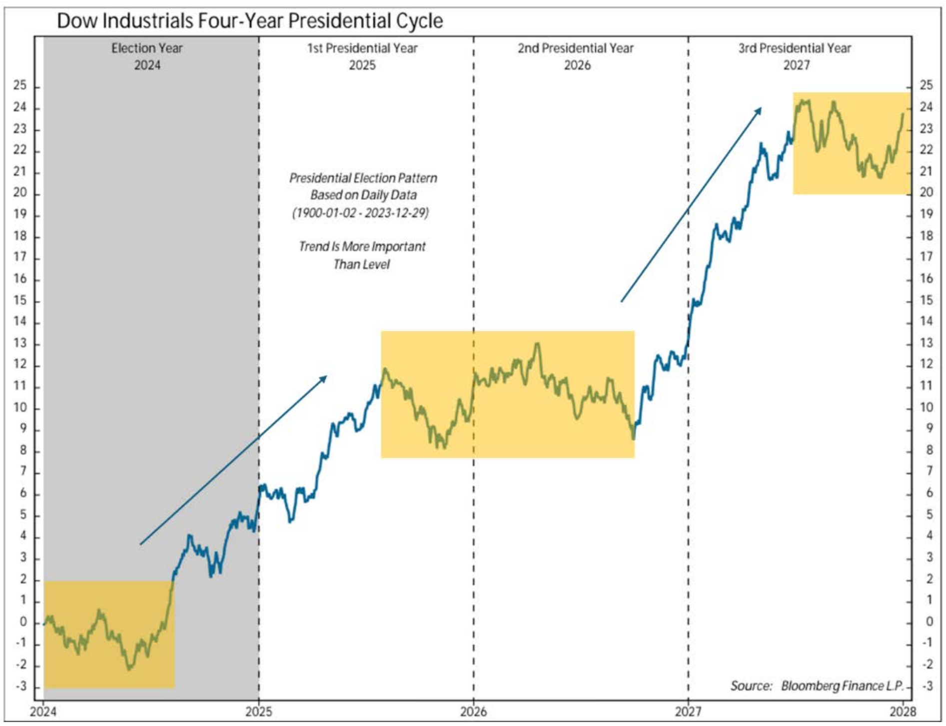


It may be counterintuitive, but low unemployment is not correlated with strong stock market returns. In fact, it is the opposite. In periods where unemployment is low, the stock market tends to see low returns, and in periods when unemployment is high, the stock market tends to see higher returns. For example, when the unemployment rate is below 4%, real (inflation-adjusted) stock returns are relatively low at 4.7%. When the unemployment rate is over 8%, real stock returns are significantly higher at 24.5%. See chart above.

Most of the explanation for such correlations is expectations. When things are going well (i.e. unemployment is low), expectations are high for economic growth, corporate profits, etc., and there is a lot more room for disappointment. When unemployment is at 3.7%, how much better can it get? Not much! When the environment is concerning (i.e. when unemployment is high), expectations are low and there is plenty of room for small pieces of good news to provide a boost to the stock market.

Presidential Cycle Mid-Year Weakness

Many investors assume that Republicans generate a stronger stock market environment than Democrats because they are more "pro-business" or endorse "free markets." Intuitively, such an assumption seems to make sense – policies that seem friendly to business should lead to better business outcomes and stock market returns. Analysis of historical stock market returns reaches a different conclusion. Ned Davis Research analyzed data since 1901, "Looking at just presidents, on a nominal basis, the Dow Jones Industrial Average (DJIA) has risen 7.8% per year under Democrats versus 3.5% under Republicans. The gap closes after inflation. The real (inflation adjusted) return for the DJIA under Democrats is 3.7% versus 1.4% under Republicans."



For financial markets, the four-year presidential election cycle is more important than the candidates themselves. Repeated behaviors have been observed around spending, regulation, monetary policy, etc. The stock market's four-year presidential cycle has followed the pattern of government stimulus, with weakness in mid-term years and strength in pre-election years.

Despite anxiety caused by the pending decision, the election year is relatively stable. Monetary policy is typically limited since the Federal Reserve seeks to avoid impacting the economy during the election. Legislative and fiscal policy changes are typically small since many politicians wait for a more optimal mix of legislators to arrive after the upcoming election.

Each cycle is different, but financial markets tend to pause midway through the election year. Sometimes there is momentum that carries through from the pre-presidential election year (the strongest period in the four-year cycle). A rally has tended to occur in the second half of the year, but the timing of the rally varies greatly depending on when the winner of the election is widely accepted. For many companies, knowing how to plan for future legislative and regulatory changes is important. In many cycles, the winner is "known" well ahead of the November election date. Since neither candidate has strong approval ratings, it may make longer this year for the "widely accepted" rally to begin.

NEW Portal Release!

Retirement Income Solutions (RIS) is proud to announce the launch of a new client portal experience powered by Orion. The portal will replace ShareFile as our quarterly report delivery mechanism and will allow you to see a consolidated overview of your investments with values and performance updated daily.

Information you will have access to through the new RIS client portal includes:

- Daily consolidated account and position values
- Data from multiple custodians (Pershing, TIAA, Fidelity, etc.)
- Current portfolio asset category allocation
- On demand, daily portfolio performance for multiple time periods
- A document vault that acts as a secure delivery and storage location for your regular RIS-generated performance reports and other illustrations
- The ability to link personal bank, investment, loan, credit card, and other financial accounts not managed by RIS

A few important notes:

- If you have an account in your portfolio custodied by an institution other than Pershing, TIAA, or Fidelity, you may experience a lag in updated transaction and pricing data.
- You can control whether your RIS advisor sees data on other accounts not managed by RIS.

Invitations to the client portal were sent earlier this month from "noreply@orion.com" with the subject line of "Retirement Income Solutions Client Portal Invitation". The invitation email will include your user ID (email address) and a link to establish your client portal password and two factor authentication method.

For security reasons, the link has a short life of 24 hours. For those that have not yet logged into the portal, another invitation will be sent shortly. Please let us know if you need the introductory 24-hour access period restarted. If you don't see the client portal invitation message in your email inbox, please check your spam or junk folders.

Even if you prefer to receive paper reports, the portal is a great resource. Please give it a shot!

The new client portal experience will be accessible via the following:

Portal direct website:
https://risadvisory.com/client-portal/

RIS website:
https://risadvisory.com/client-access/

iOS App:
https://apps.apple.com/us/app/retirement-income-solutions/id6459479740

Google/Android App:
https://play.google.com/store/apps/details?id=com.advisorlynx.mobileadvisor.retirement

Summary of Current Positioning

While it is certainly possible that recent market strength will continue for the rest of the year, markets do not typically go straight up. On average, 10% pullbacks occur every nine months, and the last occurrence ended roughly five months ago. Monetary policy is still restrictive, and the Fed is unlikely to change course until inflation is more clearly on track to its target. Late last year, market expectations were for seven interest rate cuts in 2024; current expectations are for two cuts later in the year with increasing probability of no interest rate cuts this year. Increased volatility is a risk after a period of extreme stability. As a result, a reduction in equity allocations to Neutral is appropriate.

If you have questions on the investment environment or your portfolio, please call us at 734-769-7727. To find an electronic copy of this document and other recent commentaries, please visit our website at www.risadvisory.com.

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