Quarterly Newsletter

Roth FINANCIAL PARTNERS

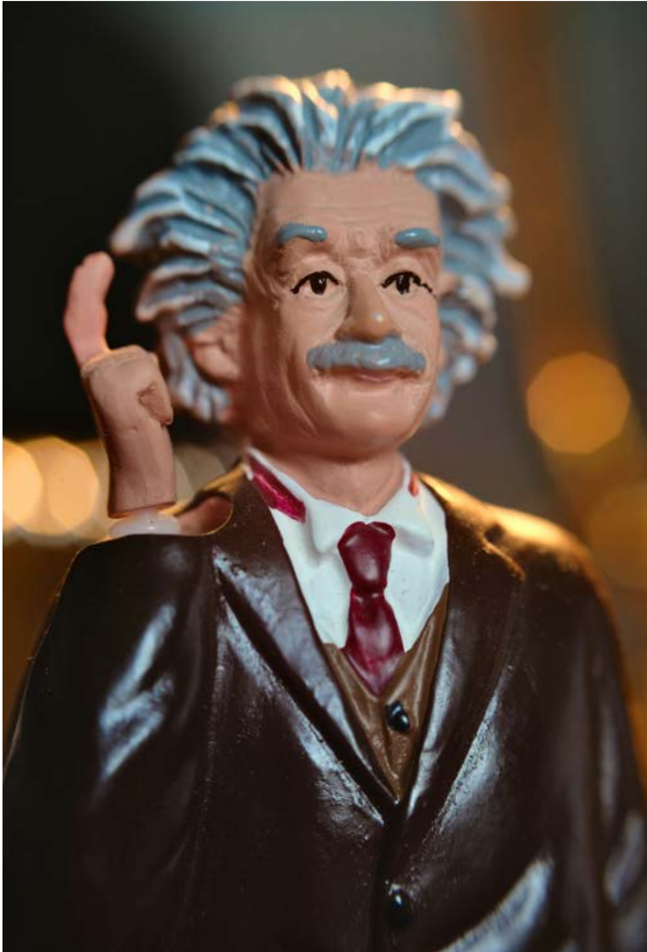
Q1 2024

WHAT GOES UP, MUST COME DOWN?

By: Eric Johnson

Before diving into the bulk of the quarterly newsletter, I want to selfishly raise my hand and politely ask you (if you have not already) to upload to the Vault in Raymond James Client Access your recently filed income tax return(s) or ask your CPA to email copies to us. Also, for next year, please let us know if you would like us to send your tax forms to your CPA, if we do not already. We use your tax returns to fine-tune our financial planning estimates for the coming year and confirm assumptions/look for additional tax efficiencies.

Thank you for taking the time and making the effort! Now back to regular programming.



Physics!

Science was never my favorite core school subject growing up (which was surely a disappointment to my engineer-by-education father!), but when I had a choice between the scientific disciplines to fulfill extra science requirements, I always picked physics over biology and chemistry. Physics had a more mathematical bent to it that made it slightly more appealing, though I would have preferred to instead take a straight math class and stick to the algebra and calculus. Do I remember much from the three years I took a physics course? Not really. The best I can do today is figure out which end of the Allen wrench to use to get the most torque (a term I like to use in front of my engineer buddies.)

One basic application of physics is the concept/formulation of the law of gravity and the famous phrase “what comes up, must come down.” This phrase also seems to work itself into investors' minds, especially after strong recent stock market performance. After stocks go up for a while, it is common to hear commentators state that “we are due for a correction” – and they are not necessarily wrong! From a compliance perspective, financial advisors are recommended not to use declarative statements, but I feel very comfortable declaring that there will be periods in the future in which stocks, after going up for a period of time, will (to use the common definition of “correction”) go down at least 10% from their all-time high point. It occurred historically and will occur again, but there is no telling when it will occur.

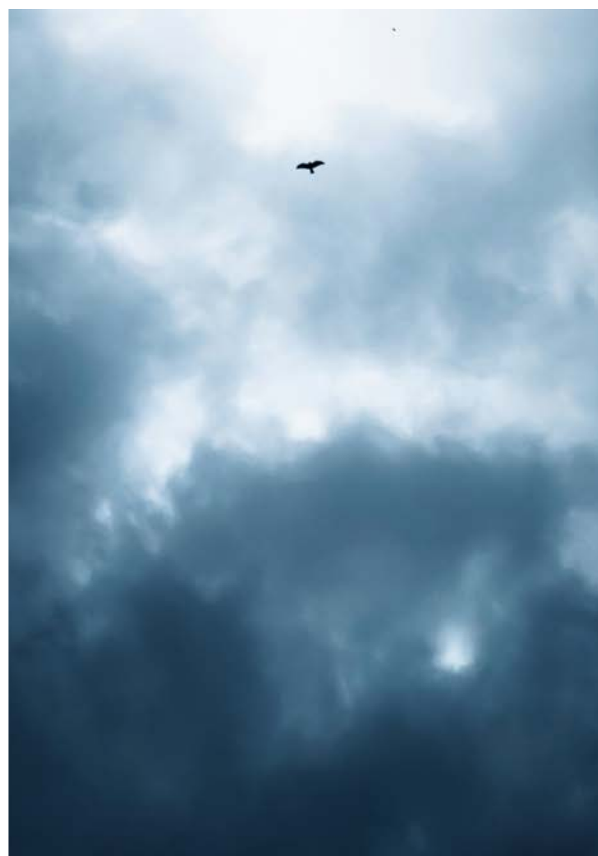
Through the end of the first quarter of 2024, the S&P 500 index (the index we mostly refer to when thinking of the largest U.S.-domiciled public companies) has made 22 all-time highs, meaning at the end of 22 trading days, the price of the index was higher than it has ever been (not considering dividends.) Looking back at all trading days since the beginning of 2020, the S&P 500 has been at an all-time high a little less than 12% of trading days. Flipping that on its head, therefore it has been flat or in a downdraft the other 88% of the time! To add even more detail to this example, the index has been in a ”correction” in over 35% of days this century (thanks to the COVID pandemic in 2020 and the brisk raising of interest rates in 2022.) If both (i) being up too much because we are at an all-time high and (ii) being down at all makes you uncomfortable, then stocks may not be for you.

But what about in the near term? If the stock market has performed above average in the past quarter or two, does that say anything concrete about the next quarter’s performance, positive or negative? What about the next year or three?

To see if there was any broad trend, I looked at the MSCI World Index (an index consisting of large and mid-sized companies from developed economies throughout the world, which is more appropriate for the globally diversified equity exposure that we espouse) since the beginning of 1970. On an annualized basis, the MSCI World Index (which has no fees embedded and is not technically investible, though you can get close,) has returned 9% a year, or 2.2% a quarter (taking compounding into consideration.)

I first looked at three-month rolling periods (instead of calendar quarters) that were above the 2.2% average quarterly return. I wanted to answer the following question: Were you more likely, based on history, to have better or worse forward-looking returns over the next one- and three-year periods when the stock market has recently done well? Looking at a high level, forward-looking one-year returns have historically been better when you have recently had an above-average three-month return (11.2% over the next year) compared to a below-average period (9.7%). For forward-looking three-year periods, the difference is minimal. Either way, there is nothing about the past three months of performance when looking at the broad stock market that should spook you from staying invested in equities. Stocks should be treated as long-term holdings and the recent past seems to say little about the long-term future.

What if you have had two very strong quarters? Based again on the MSCI World Index (large and mid-cap global developed markets), we are just finishing two straight quarters of above-average returns (11.4% for Q4 2023 and 8.9% for Q1 2024.) Now we must be feeling like the Greek myth of Icarus with the stock market flying too high/close to the sun, right? According to the data, our assumptions are wrong. Using calendar quarters this time, forward-looking one-year returns have been better again in periods where there has been two better-than-average quarters in a row (12.1%) compared to when the two quarters were either both below-average or only having one better-than-average quarter (10%). The forward-looking three-year return averages are pretty much equal as well.



All of this is to say that the law of gravity does not necessarily apply to equity markets. We are not more likely to have poor performance in the next quarter just because we had two above-average quarters. It is important to remember though that poor quarters (or years or even decades) do happen! One of the unexpected benefits of sending our newsletter a little late this quarter is to include the fact that just after Q1 2024 ended, the S&P 500 dipped a bit over 5% on (presumably) an increase in interest rate projections and concerns regarding war in the Middle East. This should not surprise us. There will always be geopolitical risks, worries about the economy, political uncertainty, and overvaluation concerns that cause near-term market consternation.

Our goal as your advisors is to educate and walk with you through those storms (while also occasionally pouring a small cup of cold water when returns have been strong, like over the past few months.) Fear and greed continue to be drivers of equity returns in the short term, but we are firm believers that over the long term (which can feel longer than is comfortable), equity returns tend to outperform cash and fixed income (bonds).

Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Roth Financial account holdings correspond directly to any comparative indices or categories. Please Also Note: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Roth Financial accounts; and, (3) a description of each comparative benchmark/index is available upon request.

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Around The Office Updates

As of today, we are about one month away from summer break! It's hard to believe, but school is nearly out and all three of the Roth kids are charged up and ready to play. Kaylee (6) plans on spending 90% of her days dancing and the other 6% coloring. (We are praying she'll consider sleeping during the remaining 4%). Maggie (4) will be very busy playing with her barbies in the barbie dream house, while Casey (1) plans on destroying the barbie dream house with his toy trucks. It should be a peaceful summer!

It's April and that means baseball season is in full swing. It has also been an odd start for our Houston Astros, who find themselves lagging behind most of the other teams in the league. But despite the slow start and the incoming summer heat, Eric and his family aren't sweating it! In fact, he and Ellie are excited to take Abe (4) and Jonah (2) to an Astros game later this summer - Jonah's first. These boys might just be the good luck charm our 'Stros need!