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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **March 13, 2024**

Scott Wren
Senior Global Market Strategist

Last week's S&P 500 Index: -0.3%

Keep the right longer-term thoughts in mind

Key takeaways

- We view equity valuations as stretched, especially for sectors such as Information Technology, Communication Services, and Consumer Discretionary.
- Building wealth over time means taking advantage of pullbacks and buying equities when investors are nervous.

The investing world is always paying attention to the latest "hot" idea and the stocks that are posting very large gains over short periods of time. Currently, artificial intelligence (AI) is clearly all the rage. While AI isn't a new technology, the way it will be used in the future compared to how it has been used over the last 25 – 30 years (massive number-crunching exercises) is a book that is still to be written beyond the initial chapter. The technologies that have taken the world by storm such as the personal computer and the internet have all come about over the last 45 years, a virtual blink of an eye in human history. It is hard for most to imagine, much less guess, at where AI technology will take us over the next 45 years.

Investors tend to overestimate innovation in the short run but underestimate it in the long run. So, in the short run, we view equity valuations as stretched, especially for sectors such as Information Technology, Communication Services, and Consumer Discretionary. But valuations alone are typically not a good timing mechanism. Fairly recent history (1999 – 2000) shows that the market can push valuations to even greater extremes before a meaningful pullback occurs.

What about the long run? We believe AI will be a positive disruptor, and we expect net gains — despite periodic pullbacks — in S&P 500 Index (SPX or the Index) performance. A chart of the Index's past performance will show that over the last nearly 100 years its long-term trend has been up as the global population has risen and global gross domestic product (GDP) has grown over time, allowing companies to increase earnings. While there have been many stalls, stumbles, and tumbles along the way, some lasting for extended periods of time, the stock market has benefitted from the growth of the global economy and, in our view, should continue to do so in the decades to come. We firmly believe that one of the best ways to benefit from this long-term global growth trend is through the ownership of equities.

Investors are often sensitive to equity-market pullbacks. That makes sense. Nobody wants to see the value of their portfolio go down. But it is important to grasp the concept that pullbacks in stocks happen frequently. Looking at Bloomberg data over the last 60 years, the SPX has experienced a 10% pullback every 10½ – 11 months on average.

Part of this concept also revolves around an investor's time horizon. We believe in the investment goal of building wealth over time. That means investing in stocks on a regular basis, often referred to as "dollar cost averaging." It also means taking advantage of pullbacks and stepping in to buy equities when many investors might be nervous. Once again, time horizon is important. If there is a meaningful cash need over the next three or six months, then perhaps it is best to hold on to those liquid funds. But we believe if your time horizon is three, five, or more years, then buying stocks when the market pulls back is likely to be a good decision in the long run.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. A periodic investment plan such as **dollar cost averaging** does not assure a profit or protect against a loss in declining markets. Since such a strategy involves continuous investment, the investor should consider his or her ability to continue purchases through periods of low price levels.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes; pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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