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HORAN Capital Advisors

Quarterly Investor Letter

Summer 2024

"Change. But start slowly, because direction is more important than speed."
- Paulo Coelho

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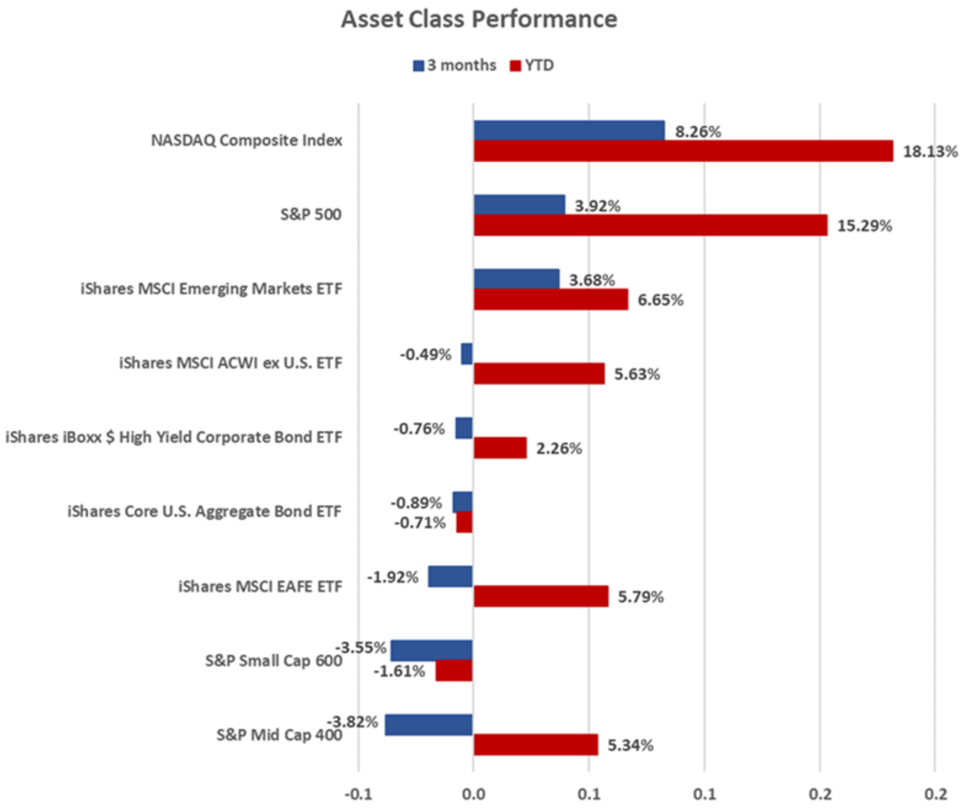
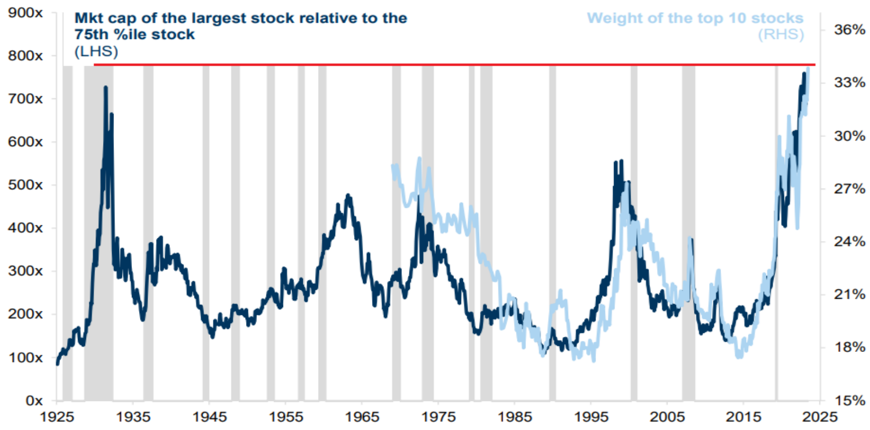
More of the Same

With the first half of the year in the books, the 6-month index returns achieved so far this year would satisfy most investors if they were 12-month results. The S&P 500 Index is up 15.29%, yet the S&P 500 Equal Weight Index is up just 5.08% and the Dow Jones Industrial Average is up only 3.79%. These performance results are indicative of a market where the returns are generated from just a handful of stocks. Earlier this year these stocks were known as the Magnificent 7 and now they are referred to as just the Fab 4, i.e., four stocks driving market returns. On a year-to-date basis, 50% of the S&P 500 Index's return has been generated by four stocks – NVIDIA, Microsoft, Amazon and Meta Platforms.

The fact the S&P 500 Equal Weighted Index return is a low single digit percentage confirms that smaller stocks in the S&P 500 Index have not kept pace with the return for larger cap stocks. With performance concentrated in a handful of mega cap stocks, the weight of the top 10 stocks by market capitalization stands at 34%, the highest on record.



Periods of extreme market concentration during the past century



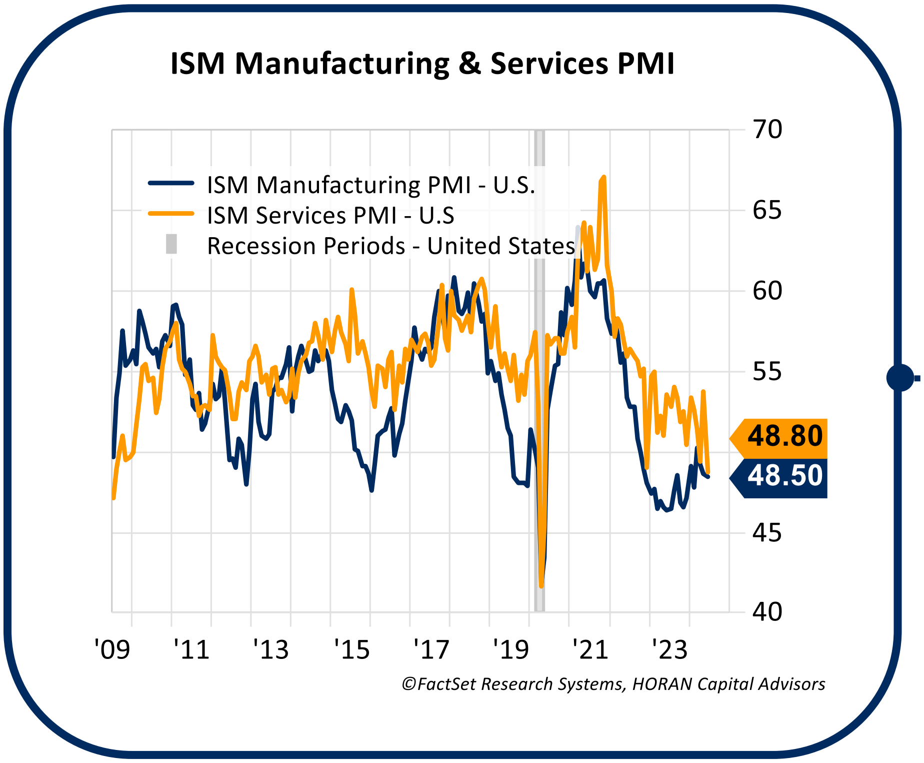
Universe consists of US stocks with price, shares, and revenue data listed on the NYSE, AMEX, or NASDAQ exchanges. Series prior to 1985 estimated based on data from the Kenneth French data library, sourced from CRSP, reflecting the market cap distribution of NYSE stocks

Source: Compustat, CRSP, Kenneth R. French, Bloomberg, Goldman Sachs Global Investment Research

One aspect of the strong market since October of 2023 is the lack of any material volatility and its narrowness. The S&P 500 Index is up over 30% since the October 2023 low maybe suggesting a pullback is in order, yet timing the market is a difficult strategy. In a recent article by Jim Paulsen, a former Wall Street Economist and Chief Investment Strategist for more than 40-years, he noted, “when the S&P 500 is extended and overbought, most stocks within the index have enjoyed significant participation in the Bull and the S&P shows widespread vulnerability to a Bear. In the contemporary Bull market, however, concentration has been so intense, most stocks have not participated excessively making the Bear’s job much more difficult. Without broad economic or stock market vulnerabilities, an ‘imminent’ Recession or Bear market may remain elusive.” Certainly, the market and the economy are not the same, but with strong economic skepticism and the narrow market breadth, any downside volatility may be limited and/or short in duration. This narrow return concentration or lack of market breadth is generally not the sign of a healthy market.

A Broadening Market?

As we have noted in our recent Investor Letters, many of the economic variables continue to be mixed making it difficult to ascertain whether the economy is close to tipping into a recession or not. More recent economic data is indicating a slower pace of economic growth though. For example, the recent report for the ISM Services Purchasing Manager’s Index fell into contraction territory in June with a reading of 48.8. This coincides with a manufacturing PMI reading below 50 as well at 48.5. Some areas in the Services report experiencing contraction are the Business Activity Index, the New Orders Index and the Employment Index.


ISM Manufacturing & Services PMI

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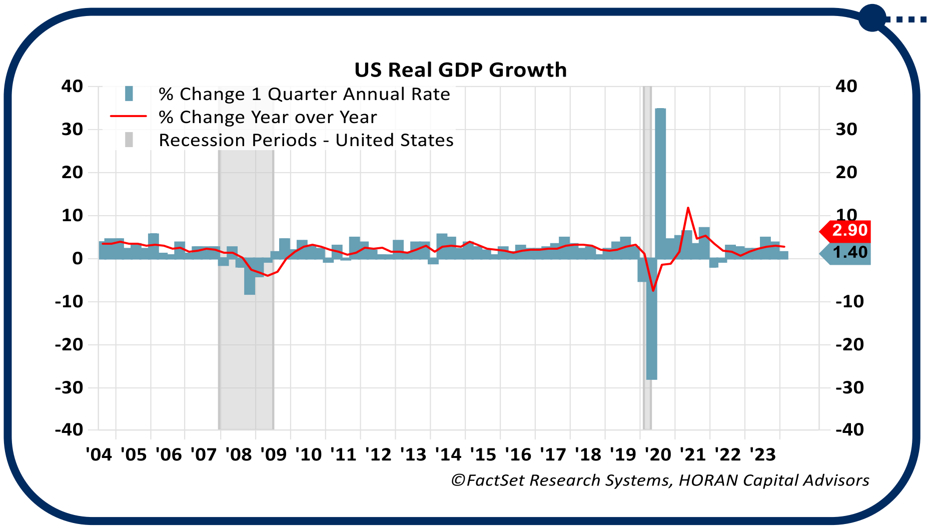
The final reading on first quarter GDP was reported at the end of June and real GDP growth continues to slow. The final reading shows the one quarter annualized growth rate of real GDP at 1.40%. This is down from the third quarter 2023 GDP growth rate of 4.90%. With economic activity slowing the unemployment rate continues to trend higher too. The most recent unemployment rate came in at 4.1% and is above the low of 3.4% reached in April this year. Additionally, nonfarm payroll growth is occurring at a quicker pace in the government sector versus the private sector over the course of the last three months.


US Real GDP Growth

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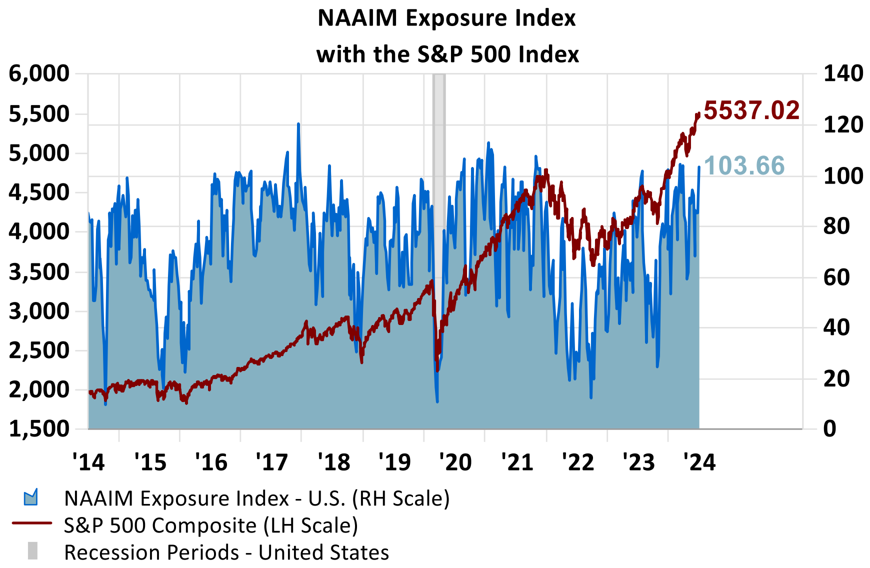
With more variables indicating the economy is slowing, the Federal Reserve may feel the need to begin lowering the Fed Funds Target Rate from its current 5.5%. The Federal Reserve last raised rates in July of last year. The weakening job market is a factor that weighs in their decision, along with inflation which continues to run above the Fed's 2% target.

With a market that anticipates a Fed rate decrease, one would expect bond returns to benefit in this environment. However, bond returns have been mixed to slightly negative year to date as seen in the first chart of the Investor Letter. The Aggregate Bond Index has been negative while lower quality High Yield bonds have generated a low single digit return.

Investor Sentiment

If investor sentiment is a measure of market over or under jubilation, the institutional manager group has a strongly favorable bullish bias at the moment. The recently reported NAAIM Exposure Index came in at 103.6. Values over 100 indicated active or institutional money managers' portfolios are leveraged to the upside. Sentiment measures are contrarian ones and are most predictive at their extremes with this indicator suggesting a strong bullish bias.

Sentiment measures should not be evaluated in a vacuum and these indicators are providing mixed signals just as the economic data points. The American Association of Individual Investors' Sentiment Survey reading shows bullish sentiment declining to 41.7, down from an elevated 53 in December. The CNN Fear & Greed Index at 54 is down from an extreme greed level of 80 at the beginning of the year.


NAAIM Exposure Index
with the S&P 500 Index

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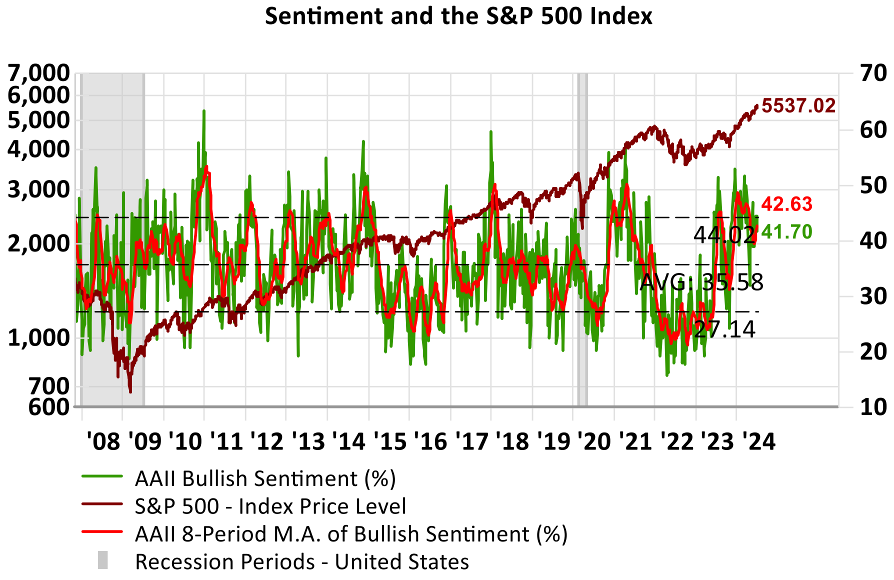
Sentiment and the S&P 500 Index

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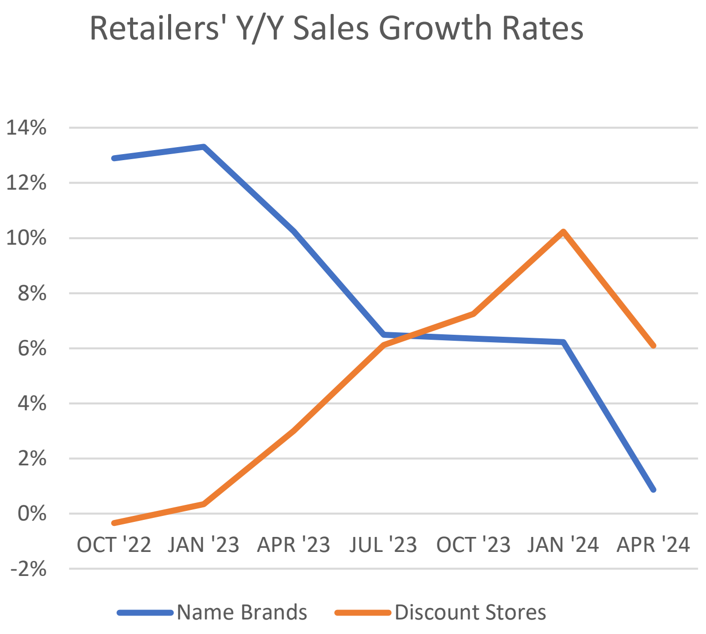
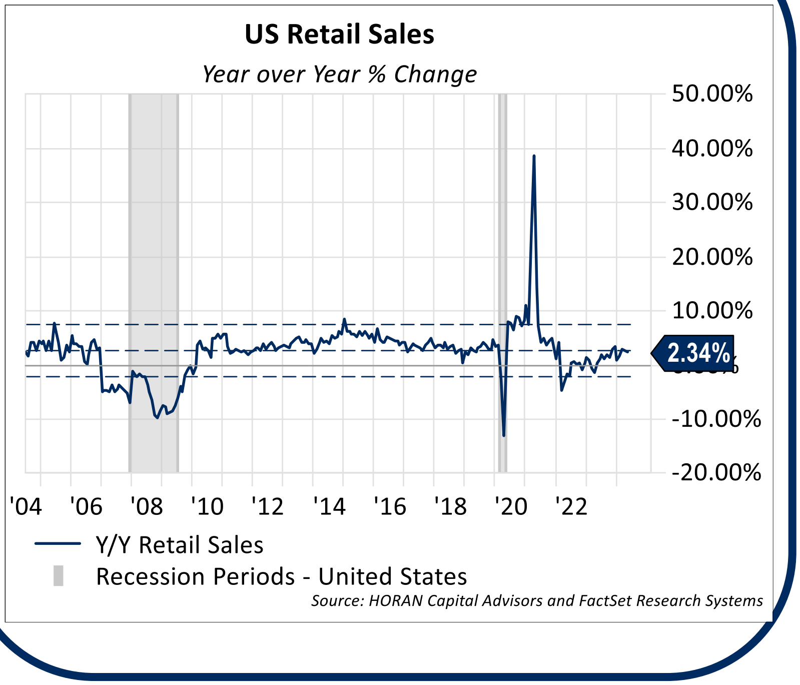
Consumers Aiming to Save

With a slowing economy, elevated prices due to higher inflation and a move higher in unemployment, consumers are changing their shopping habits. Retail earnings this past quarter saw several shifts in spending trends; consumers are being pressed by higher prices, looking to save on everyday items, and dialing back discretionary consumption. In fact, sales growth for some discount stores has outperformed “higher end” brand names for the past several quarters. The chart to the right compares the blended sales growth rates between name brands and discount stores. The ‘name brands’ series is comprised of Nike, Starbucks, Lululemon and Target (ex. food & beverage), whereas the ‘discount stores’ series is comprised of TJX Companies, Walmart (ex. grocery), Ross Stores and eBay. Within these companies there has been a consistent theme: consumer preference based on income cohorts are shifting down. Put more simply, simply, higher earners are now shopping at discount stores.


Retailers' Y/Y Sales Growth Rates

Walmart management guided higher sales for the upcoming year due to an increase in higher income shoppers. While not mentioned in the graph, Wendy’s has also made comments about customer financial health. In their recent first quarter report, CFO Gunther Plosch provided this insight: “We're splitting income cohorts in income households below $75,000; they are definitely under pressure. They're reducing frequency and so visitation is down. We're maintaining share with that cohort. On the other side, there's more traffic and more frequency on the higher income consumer, we are again maintaining share with that income cohort.” Additionally, these same consumers have cut back their spending on more expensive, discretionary items. For example, Starbucks highlighted in their most recent call that they have seen an increasing lack of off the street customers. Furthermore, Nike announced a decrease in sales for fiscal 2025 as they are seeing a more pronounced headwind from the consumer.


US Retail Sales

Year over Year % Change

Source: HORAN Capital Advisors and FactSet Research Systems

From a macro perspective, the year over year change in retail sales has been consistently below pre-pandemic levels. Notable detractors include furniture, shoes and sporting goods sales; whereas, there has been consistent demand for electronics and automotive parts. Additionally, the consumer appears to have shifted from goods to services as evidenced by the past several GDP readings. Personal consumption for services has increased more than personal consumption for goods since the pandemic. Now it appears another shift is underway, not necessarily between goods and services, but rather by price.

An Improving Corporate Outlook

Although there are signs of moderation in the consumer and specific areas of the economy, corporate earnings growth broadly is projected to be improving. Companies are getting costs a bit more under control and pricing has remained relatively sticky. In addition, efficiency has been leading to productivity growth, thereby helping profit margins. The current Wall Street (IBES) estimates are for earnings growth accelerating to mid-teens later this year and continuing at that rate well into 2025. That coupled with a slight reduction in interest rates would likely provide a positive backdrop for the economy and financial markets.

Thank you for your continued confidence and support in HORAN Capital Advisors and we are always available to answer your questions and discuss our outlook further. Please be sure to visit us for company news, reports, and our blog at https://horanwealth.com/insights.

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