

SC Capital Advisors Investor Insights



41-750 Rancho Las Palmas Dr, Ste N-3, Rancho Mirage, CA 92270

Phone: 760-776-1488

Email: info@scadvisors.net

4th Quarter 2024

2024 4th Quarter in Review & Outlook

“There are four factors that create irrational market behavior: overconfidence, biased judgments, herd mentality, and loss aversion.” — Burton G. Malkiel

Cheap stocks get cheaper

While the 3rd quarter of 2024 saw the broadening of returns into value, size, and international asset classes, the fourth quarter witnessed a reverse of this trend as investors returned their focus on the relatively small concentration of the largest growth stocks related to the Artificial Intelligence (AI) theme. Per the quotes above, this herd mentality is creating some unique valuation issues that we think could become problematic for market capitalization-weighted indexes in 2025.

Asset Class Returns 2024 (12-31-2024)								
	US Large	US Mid	US Small	REITs	Intl Large	Intl Small	Em Mkts	Bonds
Q1	10.3%	10.0%	5.2%	-1.2%	5.8%	2.4%	2.4%	-0.8%
Q2	3.6%	-3.5%	-3.3%	-1.7%	-0.4%	-1.8%	5.0%	0.1%
Q3	6.1%	6.9%	9.3%	17.1%	7.3%	10.5%	8.7%	5.2%
Q4	2.8%	0.3%	0.3%	-7.8%	-8.1%	-8.4%	-8.0%	-3.1%
2024	24.5%	13.9%	11.5%	4.9%	3.8%	1.8%	7.5%	1.3%

Indexes: US Large, Russell 1000; US Mid, S&P MidCap 400; US Small, Russell 2000; REITs, DJ US Real Estate; Intl Large, MSCI EAFE; US Small, MSCI EAFE SSmall Cap; EM, MSCI Emerging Markets; S&P GSCI TR; Bonds, Bloomberg US Agg Bond. Source: Morningstar.

Although the Federal Reserve Board cut short term interest rates in December 2024, long term interest rates rose with the perception of stronger economic growth under the incoming Trump administration. This caused bond prices to fall resulting in a -3.1 percent total return for the broader U.S. bond market in the 4th quarter, above. Broader international classes posted near correction-like total returns, all down in excess of 8 percent for the quarter with REITs also posting a 7.8 percent loss. U.S. asset classes eked out positive total returns led by U.S. Large Cap stocks at 2.8 percent in Q4. Speculative and highly volatile digital assets like Bitcoin and Ethereum are trading once again near all-time highs as the Trump administration has pledged support for cryptocurrencies.

The cap-weighted S&P 500 is up more than 25 percent for the second straight year, thanks to a select few of these mega-cap companies. This has only occurred three times since 1930, according to VanEck. Many index-based alternatives to the “beta” offered by S&P 500 Index investments have also thrived this year from exposure to the same leading companies. These alternatives range from factor investments to dividend strategies to the tech-heavy Nasdaq 100.

The performance leadership of these large cap stocks has increased concentration across the market, driving their portfolio exposure higher and stretching valuations. The S&P 500’s torrid pace in 2024 did not reach all-time high

calendar year levels, but on a historical basis, its return has been among its best in nearly 100 years, according to VanEck. Many of the S&P 500's strongest years have occurred in the last five years. Since 1930, the S&P 500 has posted a calendar year return of greater than 25 percent twenty-five times, three of those occurring in 2019, 2021 and 2023. The list also includes 1995, 1997 and 1998, preceding the dot-com bubble.

Market concentrations at decades high

The drivers of impressive 2024 index returns have been concentrated in a select few companies and have made some of the world's largest companies even larger. Most investors may not appreciate that these companies have grown to account for an increasing portion of headline market indexes. For example, the largest U.S. companies haven't represented this much of the MSCI All Country World Index since the 1970s, according to VanEck.

Weight of Largest US Companies in MSCI ACWI (1973 – 2024)



Source: Datastream, Goldman Sachs Global Investment Research. Past performance is not a guarantee of future results. Index performance is not illustrative of fund performance. It is not possible to invest in an index.

As these mega-cap companies grow bigger, their corresponding exposure increases in S&P 500 Index funds, as well as many other U.S. equity funds that provide similar exposures. This means that these companies will also naturally represent a more significant portion of investor portfolios.

Valuations become problematic

Based on a composite of intrinsic valuations of the more than 700 stocks that trade on US exchanges covered by Morningstar, as of Jan. 6, 2025, the US equity market was trading at a price/fair value estimate of 1.04. This represents a 4 percent premium to Morningstar's fair value estimates. This might not sound like much, but, since the end of 2010, the market has traded at this much of a premium or more less than 10 percent of the time, according to Morningstar.

As of Jan. 6, growth stocks were trading at a 24 percent premium to a composite of Morningstar’s stock coverage. Since 2010, growth stocks have only traded at this much of a premium or more less than 10 percent of the time, according to Morningstar. The most recent example occurred in early 2021—right before the disruptive technology bubble popped.

Core stocks are trading at only a 3 percent premium, whereas value stocks remain attractively priced at an 8 percent discount to Morningstar valuations. While we think it is important to maintain some exposure to growth stocks in portfolios, we have been trimming higher portfolio concentrations to what we believe are expensive stocks and reallocating our Core Equity to companies with better valuations and, thus, higher margins of safety. We have also been increasing our mid- and small-cap exposure via factor-based ETFs.

Core Equity valuations versus the market

Our Core & Factor approach to equity investing is one that considers and prioritizes risk over return. We do this by thoroughly evaluating the potential downsides of an investment with Core Equity before considering potential gains, focusing on companies with sustainable competitive advantages, broad diversification, prioritizing reasonable valuations, and strong financial positions. We think a risk first approach is particularly important for clients in the distribution phase of their lives and have portfolio spending liabilities during retirement. Our approach is evident when comparing our Core Equity to a broad capitalization weighted index like the S&P 500.



... the index has become markedly less diversified as the largest holdings have grown to dominate. . .

diversified as the largest holdings have grown to dominate the portfolio over time. We calculate the average price/fair value of these top 50 holdings to be 1.14 or collectively 14 percent overvalued. The current dividend yield of the S&P 500 is 1.21 percent, half of our Core Equity. We think this bodes well for downside protection in a market downturn.

US Stock Market Trading Above Fair Value Estimate
Valuations of Morningstar’s equity research coverage by equity style box.



Looking at our largest Core U.S. individual and ADR holdings collectively, we calculate the current average price/fair value of 0.83, meaning our core holdings are nearly 20 percent undervalued. While we do not prioritize dividend yield, the average dividend yield of our top core holdings is 2.44 percent.

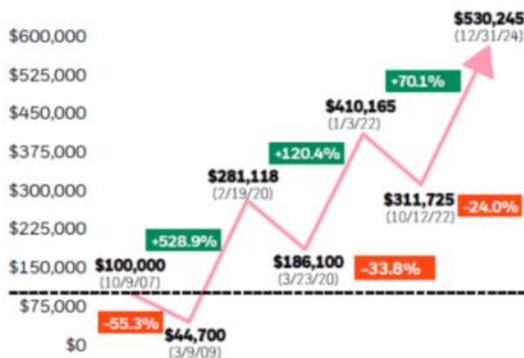
When we analyze the top 50 holdings of the S&P 500 index, we find the top 50 represent about 60 percent of the holdings of the entire index. Thus, the index has become markedly less

Win more by losing less

Roughly 83% of the up and 83% of the down got you all the up with only 83% of the risk.

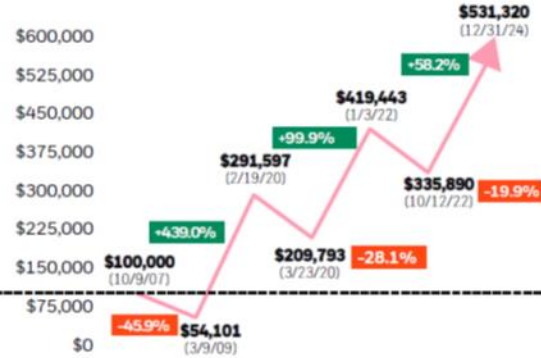
All the up & all the down

S&P 500 Index, 10/9/2007 – 12/31/2024



83% of the bear and 83% of the bull markets*

Hypothetical portfolio capturing 83% of S&P 500 bull market returns and 83% of S&P 500 bear market returns, 10/9/2007 – 12/31/2024



Source: Morningstar as of 12/31/24. *Hypothetical investment or portfolio that captured 83% of each bull and bear market return of the S&P 500 when benchmarked to that index. Returns shown are based on the S&P 500 index only. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

The above hypothetical by Blackrock is a great example of the idea behind risk first investing. Portfolio management is all about the compounding experience. Would you rather have a portfolio experience over time with an average return of 8 percent and a standard deviation of 10 percent or a portfolio return of 10 percent with a standard deviation of 20 percent? Many might pick the higher return without consideration of the variability component.

However, the above example depicts a portfolio that under performs in up market and out performs on the downside by capturing only 83 percent of the upside return but also just 83 percent of the downside. The end result is the same or even slightly better, but with much less risk or variability.

Going forward

We think we are well positioned as we move into to 2025. According to Blackrock, the current economic expansion is about 57 months old. Going back to 1927, the average economic expansion is about 61 months, but, since the early 1980s, the average economic expansion has lasted closer to 100 months, according to Blackrock. So, there are reasons to be optimistic that economic growth will continue. Also, the current bull market is about 26 months old with the median bull market lasting about 55 months, according to Blackrock. This outlook suggests optimism for equities. However, we think the stock market will have to broaden out significantly in 2025 and are positioned accordingly.

Please let us know if you have any questions. We look forward to talking with you soon.

—Dana L. Crosby, CFA, CFP®

ETF Returns

For the period ending 12-31-2024

Name	Ticker	YTD	1 Month	3 Months	12 Months	3 Year	5 Year	10 Year
U.S. Large Cap								
iShares Russell 1000	IWB	24.32	-2.82	2.79	24.32	8.29	14.14	12.73
iShares Edge MSCI USA Momentum Factor	MTUM	32.89	-4.10	2.41	32.89	5.84	11.79	13.14
iShares Edge MSCI USA Quality Factor	QUAL	22.28	-3.60	-0.38	4.92	22.28	13.58	12.89
PowerShares S&P 500 Low Volatility ETF	SPLV	13.92	-6.34	-2.00	13.92	2.89	5.93	8.62
Vanguard High Dividend Yield ETF	VYM	17.59	-4.59	0.28	17.59	7.65	9.75	9.77
VanEck Vectors Morningstar Wide Moat ETF	MOAT	10.73	-4.53	-3.07	10.73	8.04	12.45	13.07
U.S. Mid Cap								
SPDR® S&P MidCap 400 ETF	MDY	13.63	-7.18	0.35	13.63	4.59	10.10	9.41
PowerShares S&P MidCap Low Volatil ETF	XMLV	17.07	-6.44	0.30	17.07	3.67	4.66	8.5
PowerShares DWA Momentum ETF	PDP	26.06	-7.71	4.34	26.06	4.79	11.10	10.46
PowerShares High Yld Eq Div Achiev™ ETF	PEY	5.24	-7.16	-1.94	5.24	4.97	7.02	9.02
U.S. Small Cap								
iShares Russell 2000	IWM	11.39	-8.37	0.33	11.39	1.15	7.31	7.76
PowerShares S&P SmallCap Low Volatil ETF	XSLV	9.81	-6.43	-0.71	9.81	-0.64	0.96	5.93
REITs								
iShares US Real Estate	IYR	4.42	-8.29	-7.89	4.42	-4.51	2.73	5.26
International Large Cap								
iShares MSCI EAFE	EFA	3.51	-2.95	-8.36	3.51	1.63	4.71	5.21
iShares Edge MSCI Intl Momentum Factor	IMTM	12.19	-3.25	-5.98	12.19	2.07	6.73	-
PowerShares DWA Developed Mkts Mom ETF	PIZ	16.29	-3.29	-3.40	16.29	-1.57	6.28	5.72
iShares Edge MSCI Intl Quality Factor	IQLT	1.55	-3.59	-9.51	1.55	0.76	5.38	-
PowerShares S&P Intl Dev Quality ETF	IDHQ	1.31	-4.12	-10.36	1.31	-1.35	4.42	6.48
iShares Edge MSCI Min Vol EAFE	EFAV	5.32	-3.14	-6.70	5.32	0.21	1.52	4.35
iShares International Select Dividend	IDV	4.08	-3.36	-8.18	4.08	2.48	2.52	3.78
International Small Cap								
iShares MSCI EAFE Small-Cap	SCZ	1.54	-3.16	-8.48	1.54	-3.32	2.14	5.43
WisdomTree International SmallCap Div ETF	DLS	3.07	-2.07	-7.70	3.07	-0.59	1.60	5.21
Emerging Markets								
iShares MSCI Emerging Markets	EEM	6.50	-1.69	-7.27	6.50	-2.67	0.79	2.88
PowerShares S&P Em Mkts Low Volatil ETF	EELV	1.89	-2.81	-8.88	1.89	2.12	3.53	2.74
PowerShares DWA Emerging Markets Mom	PIE	-0.27	-2.15	-6.61	-0.27	-6.86	2.29	2.93

Data source: Morningstar

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