ACROPOLIS® INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

April 2024: Volume 23, Issue 2 // David Ott, Editor

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Contact us:

P | (888) 882-0072 (Toll Free)
| (636) 449-4900 (St. Louis)
F | (888) 453-1266 (Toll Free)
| (636) 778-2400 (St. Louis)
E | info@acrinv.com
A | 14567 North Outer Forty, Ste. 200, St. Louis, MO 63017

Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

RIDING THE MARKET'S MOMENTUM

The S&P 500 rose 29.9 percent in the twelve months ending on March 31st. That ranks in the 83rd percentile of all the rolling one-year periods since 1926.

Indeed, there are at least three fundamental reasons for the market strength. First, the market is recovering from the 2022 bear market. Second, advances in artificial intelligence have spurred substantial growth in large technology stocks. Finally, the Federal Reserve pivoted from raising rates to likely cutting soon.

Some, however, is nothing more than the market momentum or the tendency to rise (or fall) simply because markets are rising (or falling). Academics can't fully explain why momentum exists, but the main idea is that people make up markets and aren't always entirely rational.

One compelling explanation is the 'bandwagon' effect. Short-term traders might use recent performance to buy or sell, whereas long-term investors look at recent performance to confirm their convictions. Other explanations include the fear of missing out (colloquially called FOMO for short) and the recency bias, which makes long-run future projections based on recent, short-term performance. Whatever the explanation, the effect is well documented in academia.

One of the issues with momentum is that it can drive markets to become 'too' cheap in bear markets and 'too expensive' in up markets.

One example is the Cyclically Adjusted Price Earnings ratio, or CAPE, which looks at the market price over ten years of inflation-adjusted earnings. Before the bear market, the CAPE was high at 38.9. It fell to 26.0 in September 2022 but is now back to 34.1 as of the end of last quarter.

How long momentum will last is always unclear, so we don't try to time the market. Our rebalancing strategy manages the risks related to momentum by reducing stocks when they've risen or buying them when they've fallen. It's an approach we've used throughout our history in both up-and-down markets.

> "You take on what's right in front of you. You want to do the best you can with the opportunties that you have."
>
> *- Don Shula*
> *American Football Coach*

STOCK MARKET SUMMARY

By David Ott

The chart below might make you wonder why you should invest in emerging markets stocks since they 'only' made 2.3 percent in the first quarter - especially when the S&P 500 was up more than ten percent.

Of course, this question goes beyond the last quarter. Over the ten years ending the previous month, the S&P 500 is up 13.0 percent annually, while the MSCI All World exUS index, which measures all other developed and emerging markets, was only up 4.2 percent.

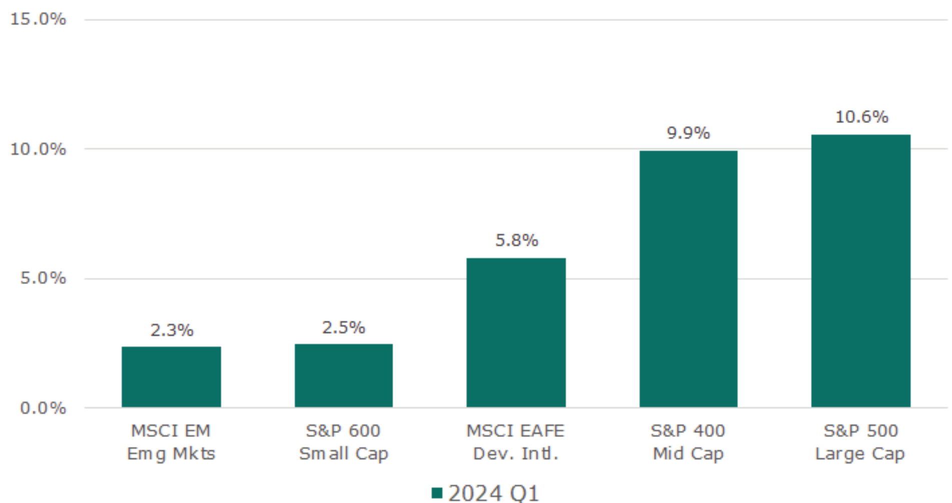
Researchers at the investment firm AQR wrote a thoughtful piece on how good the US market has been over the last ten years and decomposed the returns to establish how repeatable the returns might be going forward. The answer: It will be tough to replicate the S&P 500 returns from the last decade in the coming decade.

I will simplify the paper for brevity, but they show the significant returns for the S&P 500 above cash. First, there is the dividend yield, which was 3.4 percent. Then, there was real earnings growth at 2.6 percent, and, finally, multiple expansion came to 1.8 percent. Those three elements add up to 7.8 percent, and the rest of the return, which totals 11.4 percent, is related to cash and inflation.

The excess return in the last ten years is 11.9 percent, 2.4 percent more than the long-run averages. We know that dividends are smaller now at 2.1 percent, which means that the remainder had to come from real earnings growth and multiple expansions.

Indeed, real earnings growth was 4.5 percent, about 75 percent better than the long run, and multiple expansion was 3.6 percent, twice as much as the long run.

They conclude that while repeating the real earnings growth and multiple expansion is possible, it's improbable. AQR isn't arguing for a crash or anything like that, but their piece makes me think international diversification makes sense, given their valuations and the unlikely repeat of the last decade for the S&P 500.



Data Source: Bloomberg

BOND MARKET REVIEW

By Ryan Craft, CFA

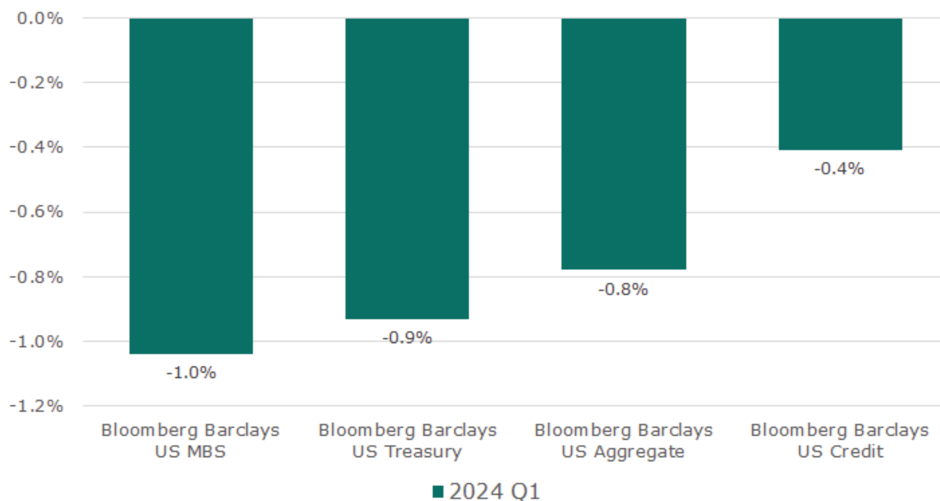
After a torrid decline in rates at the end of 2023, interest rates reversed course and have been in an upward trend thus far in 2024. Short-term rates remained relatively constant, but longer-term yields rose, with the 10-year Treasury bond yield rising 32 basis points as inflation data was less friendly to start the year. This resulted in the broad Aggregate index posting a loss of -0.8 percent for the first quarter.

Last year, declining inflation and a pivot in the outlook for Fed policy sparked a significant drop in interest rates. So far this year, some of that move looks overdone and has reversed. While significantly lower than a year ago, inflation has shown signs of leveling off and becoming more sticky at around three percent. Even more concerning, measures of core inflation (excluding food and energy prices) remain very elevated. To get inflation down the rest of the way may take tighter policy, more time, or both.

The Fed remains committed to its goal of two percent long-term inflation yet still forecasts several rate cuts in 2024. In December, the market optimistically priced in six rate cuts in 2024. This sparked a massive rally in stocks and bonds as markets expected easier policy. This year, the Fed has tried to temper those expectations and continues to state that it needs more data to be comfortable cutting rates. The market has adjusted and expects three rate cuts, consistent with the Fed's forecast.

The result of this volatility is a steeper yield curve. Short-term rates have been steady, but yields longer than two years have risen 30-40 bps. Looking at the market for Treasury Inflation-Protected Securities, this increase results from the market demanding higher compensation for inflation and an increase in real yields.

What is next? That will depend on the upcoming inflation data. If the past few months have just been an aberration, the Fed will cut rates later this year as inflation moves closer to target. This would be good for bond market performance as yields across the curve would likely fall. However, if the past quarter is a new trend for inflation, long-term yields will increase further. All eyes will be on inflation indicators.



Data Source: Bloomberg

"Procrastination makes easy things hard, hard things harder."

- Mason Cooley, American Academic

> **"A problem is a chance to do your best."**
>
> *- Duke Ellington, American Jazz Pianist*

UNDERSTANDING THE NEW 529 RULES

By David Ott

College planning is complicated. I discovered this the hard way, through my own situation. My daughters are in college now, and I started 529 accounts for each of them the year they were born.

When my older daughter was a freshman in high school, I realized the problem: Even though she was starting college in three years, I had no idea whether she would go to Mizzou or Harvard. I'd be proud either way, but there's a $50k per year cost difference.

At that point, I was way overfunded for Mizzou and deeply underfunded for Harvard. I knew I could solve the underfunding problem by using some of my salary and borrowing money if needed.

The overfunding was trickier. Yes, I could transfer any unused balance from one daughter to the other, but I had the same over/under funding problem with her and even less insight into where she might be headed.

I didn't want to end up with unused 529 balances because I would have to pay tax on the withdrawal and a 10 percent penalty for not spending the money on education. So, I stopped funding the accounts.

The Secure Act 2.0 solves this problem by allowing unused balances to be deposited into Roth IRAs for the kids. As soon as I heard that, I regretted ending contributions, but after looking at the rules, I think it's okay that I stopped.

There are a lot of rules to convert, and I won't cover them all, but here are the biggies:

1. The 529 account has to be opened for at least 15 years.

2. The dollar amount you want to convert must have been in the plan for five years.

3. The beneficiary of the 529 has to be the Roth owner.

4. At the time of the conversion, the beneficiary has to have earned income, just like they would with a Roth IRA.

5. Roth conversions can't exceed the annual deposit limit of $7k, meaning converting $35k will take five years.

There are several open questions that the government has yet to answer. For example, if I transfer $5k from my older to my younger daughter, does the five-year (or 15-year) clock start with the initial deposit or with the transfer?

I've kicked around the idea of starting 529 contributions again with the idea of intentionally overfunding for a Roth conversion, but concluded that it probably isn't worth overfunding. If I'm giving the kids extra money beyond tuition, I could make a regular annual gift and have them contribute it to a Roth.

The only hiccup is if my kids earn so much money immediately after graduating that they aren't eligible for Roth IRAs. That's a high-class problem that I'm not worried about.

The purpose of the law was to get parents to contribute. Surveys showed that one of the primary reasons parents didn't start 529 plan accounts was the fear of overfunding them, which resolves that issue.

My conclusion is that a conversion is a good backup plan for excess savings but not a secret saving strategy that gets you something special.

TRADING TO WIN FOR CLIENTS

By David Ott

Ten years ago, Michael Lewis, one of my favorite authors, went on 60 Minutes and claimed that the market was rigged to promote his new book, Flash Boys.

I knew that he was making outrageous claims to sell his book, but people were scared by his comments. Underneath the hyperbole, he said that market makers take much money away from investors.

Even though I knew the market wasn't rigged, I decided to hire an outside firm to measure the market impact of our trades. I wanted to know just how much market makers earned on our trades—the answer: something, but not much.

The chart below tells the story. A basis point is one-hundredths of one percent, and it says that market makers make a little bit of money on our trades, about 1.5 one-hundredths of a percent (or 1.5 basis points).

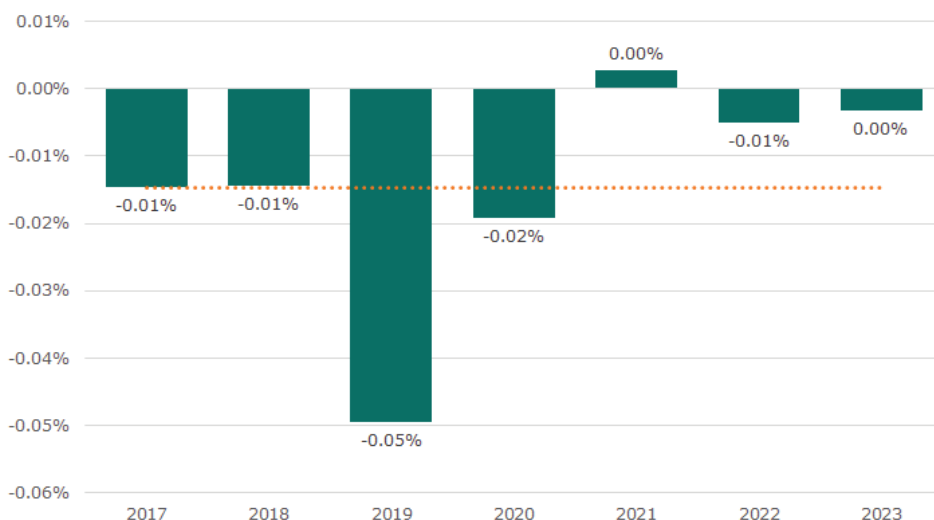
According to the newest report, we traded slightly more than $1 billion in stocks and exchange-traded funds last year. That's an astonishingly large amount, in my opinion, and the report suggests that the market impact, or trading cost, was about $35,000.

Of course, there are some caveats. The firm we hired takes all of our trading data for the year and uses its model to estimate the market impact. We know the report isn't exactly right, but we believe it gives us a reasonable estimate. I doubt, for example, that we made money trading in 2021.

I expect market makers to profit – why would they be market makers if they didn't? We just don't want them to make too much because their profit comes out of the client's pockets.

We use the report with regulars to show that we get what is called 'best execution,' along with reports from Schwab, where we do most of the trades.

A lot goes into our traders' work, and I am deeply grateful for the effectiveness, efficiency, and speed at which they work, especially when market conditions are choppy. Thank you, traders!



"Perhaps too much of everything is as bad as too little."

- Edna Ferber
American Writer & Playwright

INSIDE THE ECONOMY: EMPLOYMENT

By: David Ott

Perhaps one of the reasons that the US has avoided recession despite all the talk of one coming is that Americans are still gainfully employed. While the labor market appears to be cooling off some, it still seems hot by several measures.

The most basic measure of the labor market is the unemployment rate, which was 3.9 percent at the last reading in February. As measured by Bloomberg, the consensus forecasts for the unemployment rate suggest it will remain relatively low, around four percent, in the foreseeable future.

Another measure of the labor market that caught my eye during the pandemic is the number of job openings compared to the number of unemployed people looking for work.

Over the history of this indicator, the average number of people looking for jobs compared to the number of job openings is 2.1. You can see, though, that there is a very wide range, especially around recessions highlighted in gray.

Between the 2002 and 2008 recessions, the average ratio matched the long-run average of 2.1, but the Great Recession was a not-so-great reset because there were seven job seekers for every job opening.

In the recovery and expansion that followed, that ratio fell fairly continuously until there was less than one job seeker for every job opening, translating into a pretty hot labor market. The pandemic upended the imbalance by letting go of people, increasing the unemployment rate to 10 percent. It didn't take long to find ourselves in the same situation before the pandemic: more job openings than seekers.

While the ratio is normalizing and getting close to 1.0, it's still a hot labor market since I've read that economists think that the 'natural' ratio of seekers/openings is somewhere around 1.1. The tight labor market is part of the argument that could allow the Federal Reserve to keep rates higher for longer.

"There are always flowers for those who want to see them."

- Henri Matisse, French Artist

Data Source: St. Louis Federal Reserve Database

PROTECT YOURSELF AGAINST FRAUD

By: Marie Tustin, CFP®

Editor's Note: This is the second of a two-part article by Marie about protecting yourself from fraud.

As I noted in my last article, it is more important than ever to stay abreast of the current risks, be ultra-vigilant in our communications, and be highly skeptical of anything we receive.

It's also time to start making reporting scams a common practice to help law enforcement crack down on criminals and provide accurate data for meaningful regulation.

Below are some recommendations from the FTC on how to avoid imposter scammers.

Don't wire money or use gift cards, cryptocurrency, or a payment app to pay someone who says they're with the government. Scammers insist you can only pay these ways because it's hard to track that money and just as hard to get it back. They'll take your money and disappear.

Don't give your financial or personal information to someone who calls, texts, emails, or messages you on social media and says they're with the government.

If you think a call or message could be genuine, stop. Hang up the phone and call the government agency directly at a number you know is correct. If the call is a robocall, don't press any numbers. Pressing numbers could lead to more calls.

Don't trust your caller ID. Your caller ID might show the government agency's phone number or name — like "Social Security Administration." But caller ID can be fake. It could be anyone calling from anywhere in the world.

Don't click on links in unexpected emails, texts, or social media messages. Scammers send emails and messages that look like they're from a government agency but are designed to steal your money and personal information.

Don't click on any link, and don't pass it on to others. Just delete the message.

These are essential practices, but it's also important to remember that scammers are always working on new ways to take advantage of you.

Recently, OpenAI announced that they have a new artificial intelligence model that can take a single 15-second audio clip and generate natural-sounding speech that closely resembles the speaker from the original audio.

Although they clearly understand the risks of the model (which hasn't been released yet), it's also clear that fraudsters will use a tool like this to take an audio clip of you and use it to communicate with others, including us.

Right now, we rely on phone calls to authenticate requests to move money outside of the norm, but we will have to adapt along with technology.

As a bit of a Silver Lining to an unregulated AI world, face-to-face interactions and deep intrapersonal relationships have never been so important from a security perspective.

As a company built on a foundation of trust and developing deep intrapersonal relationships, this partnership with our clients has created a strong foundation to insulate us and work together to protect your interests.

"Commitment is the nucleus of all success."

- Diana Nyad
American Swimmer
& Journalist

Major Indexes	2024 YTD
Dow Jones	6.1%
S&P 500	10.6%
S&P 400 Mid-Cap	9.9%
S&P 600 Small-Cap	2.5%
MSCI EAFE (Intl)	6.0%
MSCI Emerging Mkt	2.3%

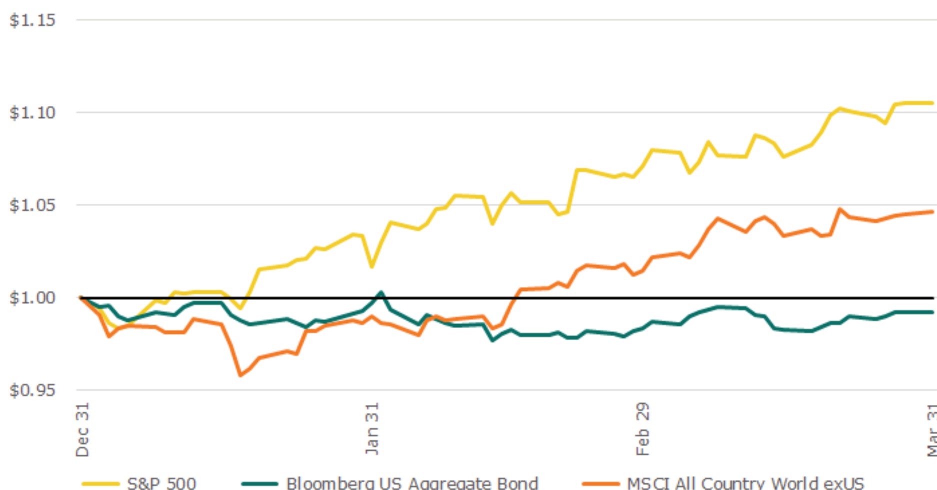
Equity Styles	2024 YTD
S&P 500 Growth	12.8%
S&P 500 Value	8.0%
S&P 500 Quality	12.2%
S&P 500 Momentum	22.6%

S&P Sectors	2024 YTD
Basic Materials	9.0%
Communications	10.1%
Consumer Discretion.	5.0%
Consumer Staples	7.5%
Energy	13.7%
Financials	12.5%
Healthcare	8.9%
Industrials	11.0%
REITs	-0.6%
Technology	12.7%
Utilities	9.0%

Interest Rates	2024 Q1
Fed Funds	5.3%
Prime Rate	8.5%
3-mo. Treasuries	5.4%
2-yr. Treasuries	4.6%
5-yr. Treasuries	4.2%
10-yr. Treasuries	4.2%

All Data as of 03/31/24

THE BIG PICTURE



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Thank You

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