JAG CAPITAL MANAGEMENT LLC

Quarterly Comments

Closing the Gap

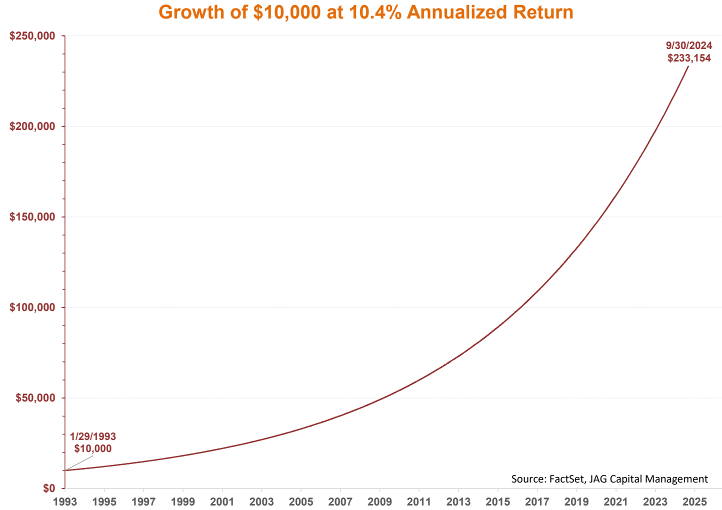
Market Overview

Stocks continued to advance in the third quarter, albeit with more volatility than experienced during the first half of 2024. Some of the market's zigs and zags were driven by economic data, which appeared to be signaling a slowdown in the US economy. These concerns came to a head in early August, resulting in equities experiencing their biggest volatility spike since 2022 (as measured by the VIX Index of S&P 500 volatility), amidst a short-but-sharp 8.5% pullback for the S&P 500. Within a few weeks, markets had calmed down, and the Federal Reserve's September 18 announcement of a relatively aggressive .5% interest-rate cut made investors more optimistic that the economy would be able to sidestep a recession.

The S&P 500 returned 5.9% for the quarter, taking its year-to-date gain to 22.1%. Additionally, in what comes as welcome news to many diversified investors, the market's gains broadened out last quarter. Technology and adjacent stocks – which had led the major indices during the first half of 2024 – took a relative breather, along with the so-called "Magnificent Seven" mega-cap stocks that we described in our **Concentration Conundrum** piece last quarter. In fact, the S&P 500 Equal Weight Index - which holds all 500 stocks in the index at equal weights - materially outperformed the traditional capitalization-weighted S&P 500 Index last quarter. We think of the Equal Weight Index as a reasonably good representation of the overall US stock market. As such, when it outperforms the relatively top-heavy S&P 500, it implies that a more diverse group of stocks are sharing in the gains. All else being equal, we view this broader participation as healthier and potentially more durable for the investment markets.

With 20/20 hindsight, it is now apparent that stocks are in a bull market that began in October 2022. While bull markets are much more enjoyable than bear markets, it is important to remember that the stock market will always have a pesky habit of periodically forcing investors to suffer through painful corrections and drawdowns. Successfully benefiting from the long-term power of compound interest requires us to greet these bear market swings with magnanimity, rather than fear or loathing. This is easier said than done, and it is also one of the key reasons that investing is simple, but far from easy.

The ubiquitous SPDR S&P 500 ETF Trust (SPY) is an exchange-traded fund that tracks the performance of the S&P 500 Index. SPY began trading on January 29, 1993, making it available for investment to anyone in the US with a brokerage account. Between its inception and 9/30/24, SPY produced an annualized total return of 10.4%. Here is what investing $10,000 at 10.4% per year looks like on a compound interest calculator:



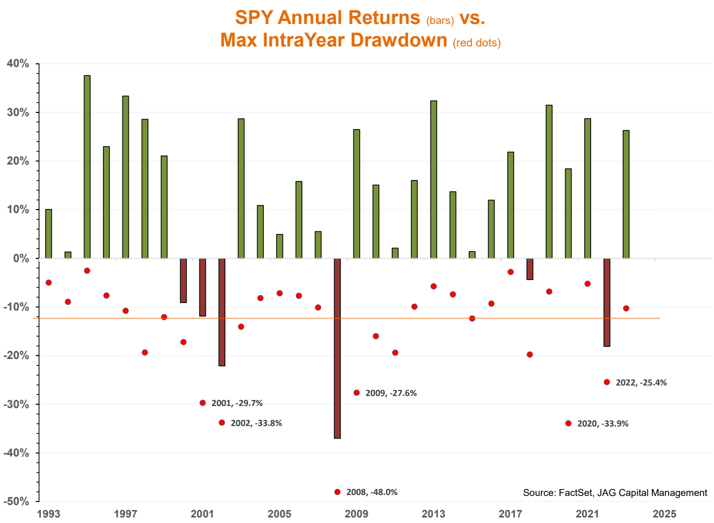
As we can see, the magic of compound interest turned the $10,000 initial investment to more than $233,000, which is a simple and amazing example of the power of long-term investing. However, realizing that wonderful return was anything but easy on the nerves.

Firm Highlights

As a reminder, JAG is moving! Effective Monday 10/21/24, our address will be **1610 Des Peres Road (Suite 120)**, St. Louis, MO 63131. Located in the Corporate Hill complex near the northwest corner of I-270 and Manchester Road, our new space will provide our clients and team members with a convenient location, modernized work environment, and room for future growth.

Moving our corporate home has been a complex, months-long project for JAG. Thankfully, **Kelly Yovandich** has helped us smoothly navigate this transition. A valued JAG teammate since 2013, Kelly is a consummate organizer. She has been instrumental in keeping us on-schedule, focused, and prepared for our big move. Congratulations to Kelly for embodying our **Adaptive** Core Value!

Here is what that earning, the same 10.4% annualized return, looked like on a year-by-year basis for our long-term SPY investor:



The red dots mark maximum annual drawdowns in the value of SPY. Red is an appropriate color for these notations, because in real time, declines in market value cause psychological pain. We have provided percentage declines for the six pullbacks for the SPY that exceeded -20%. This means that a long-term investor in SPY would have experienced a significant decline in the market value of their investment roughly every 5.8 years on average. And in an ironically cruel fact of investing, the corrections tend to feel worse as time goes on and the value of the original investment grows.

In our example, the original $10,000 invested in SPY in January 1993 would have grown to over $40,000 by March 2000, only to decline to less than $21,000 in October 2002 in the aftermath of the bursting of the dot-com bubble and the post-9/11 recession. The investment's value would have recovered to an all-time high of almost $46,000 by October 2007, before the Great Financial Crisis knocked it all the way down to $20,600 in March 2009. For investors who maintained their resolve and held SPY, they were rewarded with a smoother ride higher the next 11 years. Their SPY holding was worth just shy of $128,000 by February 2020 – just in time for the COVID crisis to knock it down to less than $85,000. Our most recent bear market occurred just a couple of years ago, in 2022. The "fun" that year was shared by both stocks and bonds due to the Fed sharply raising interest rates, and it caused the value of the investment in SPY to cascade from over $186,000 in January down to $141,000 in October 2022.

In investing, the more success one achieves over a long period of time, the more capital one has accumulated, which tends to create more anxiety during the inevitable periods of falling stock markets. Many investors react to unpleasant market movements by selling or reducing their exposure to the asset class that is causing them the most anxiety at any given point of time. In practice, this means that people tend to sell stocks at (in hindsight) inopportune times – especially during those unpleasant bear markets. After "the coast is clear" and stocks have recovered over a period of weeks, months, or years, these same investors are tempted to buy back into the market – but only after having missed much of the post-correction recovery. This behavior is normal, and no one is completely immune from the emotional freight that comes with the process of investing. But it is also a reliable way to penalize long-term results.

Investment research firm Morningstar produces an annual report on investor returns called Mind the Gap. They study dollar-weighted returns that investors earned over rolling 10-year periods, compared to the returns delivered by their actual mutual funds and ETFs. In their "Mind the Gap 2023" report, they found that "… Investors earned… about 1.7 percentage points less than the total returns their fund investments generated over the same period. This "gap" stems from poorly timed purchases and sales of fund shares, which cost investors roughly one-fifth the return they would have earned if they had simply bought and held."

Circling back to our SPY investment, assuming the 1.7% "gap" Morningstar identifies was held constant, the average investor in SPY would have earned roughly 8.7% annual returns between 1993 and 2024. Although that rate of return may not sound so bad on the surface, a $10,000 investment that earned compound annualized return of 8.7% would have grown to less than $141,000 by 9/30/2024 – roughly 39% less than the $233,000 that would have been earned by simply buying and holding the investment.

I think one of our primary goals at JAG is to assist our clients in minimizing or eliminating the "gap" between investment returns and our clients' actual investment outcomes. After more than three decades as a professional investor, I believe that expecting investments to grow continuously – without setbacks or volatility along the way – is a great way to achieve investment misery. Bull markets provide us with a great opportunity to remind ourselves that volatility is a feature of investing – not a bug!

Market Outlook

At the time of this writing, the upcoming Presidential election is less than 30 days away. We will leave predicting the winner to the pollsters and pundits, but we feel confident in our expectation that roughly 50% of Americans will be deeply disappointed by the results of this election – and almost 100% of us will be glad the election cycle is finally over (at least until the 2028 cycle starts spinning up in approximately two years). As we saw in 2016 and 2020, election-related positioning could drive some near-term turbulence in the markets, as investors across the political spectrum attempt to calibrate their portfolios to align with the policies of the victorious candidate. Longer-term, however, we believe markets will continue to be driven by corporate revenue, earnings, and profit margins. History shows that investors who allow politics to unduly infect their portfolio decisions are more likely to find disappointment rather than excess returns.

There remains a plethora of known and unknown risks to the economy and investment markets. The global geopolitical situation is generally awful, with tragic and destructive hot wars raging in Ukraine and the Middle East. We have no special insight into how these conflicts will end, and both could escalate into wider conflagrations. The upcoming transition in the Oval Office and a potential shift in power within Congress could result in meaningful changes in economic policy. Markets tend to be repelled by policy uncertainty, no matter which political party is blamed for creating it.

Notwithstanding the above, we continue to have a cautiously optimistic outlook into 2025. The current bull market began in mid-October 2022, roughly 720 days ago. The S&P 500 has gained more than 60% since then, but - as noted recently by Bespoke Research in their "Equity Market Pros and Cons" piece dated 10/4/24 – the average bull market gain since 1926 has produced gains of more than 100%. Similarly, bull markets tend to last longer than their ursine cousins. The average bear market lasts 286 days (2022's bear market clocked in at 282 days), while bull markets average over 1,000 days in duration. Therefore, from a historical perspective, the markets have room to run higher.

After its extremely aggressive rate hikes in 2022, the Federal Reserve has now begun to ease rates. If inflation remains subdued, it is reasonable to expect the Fed to further lower rates by 150-200 basis points over the next 12 months. Lower interest rates could help the housing market recover and support continued resilience in consumer spending, which should be supportive to corporate earnings.

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Finally, as we have noted repeatedly over the past 18 months, we are witnessing two simultaneous waves of disruption in society and the economy. The **Artificial Intelligence** boom is driving massive investment by corporations in a race to dominate the next era of computing. While it is possible that the benefits of AI could take longer to materialize than some investors anticipate, we are highly confident that it will result in significant innovations and investment opportunities in the coming years. The advent of **GLP-1 treatments** for diabesity could improve the health outcomes of tens of millions of Americans and reduce the load on our strained healthcare system. Longer, healthier, more productive lives would provide a truly welcome benefit to our economy, albeit to the probable detriment of manufacturers of sweets and ultra-processed foods.

Best wishes to you and yours as we finish out 2024!

Norm

Norm Conley
CEO, Chief Investment Officer & Portfolio Manager

Disclosures

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A Veteran Owned Business (VOB) is a business owned, (51% ownership or greater) by a Veteran who has met the definition of a veteran. The following represents the criteria that the National Veteran Business Development Council (NVBDC) uses in determining ownership:

Ownership: Fifty-one percent ownership by a Veteran or Veterans. The applicant must share in all risk and profits commensurate with their ownership interest.

Control and Management: Proof of active management of the business. Veteran must possess the power to direct or cause to direct the management and policies of the business.

Contribution of Expertise and Capital: Contribution of capital and/or expertise by Veteran owner(s) to acquire their ownership interest shall be real and substantial and be in proportion of the interest acquired.

Independence: The Veteran owner(s) shall have the ability to perform in their area of specialty/expertise without substantial reliance on non-Veteran-owned businesses.

About JAG

JAG Capital Management (JAG) actively invests for institutions and individuals in highly selective, customizable, and nimble equity and fixed income strategies. JAG is a boutique, independent, employee-owned investment management firm in St. Louis.

Learn More About JAG

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