



Capital Markets Review

Q1 2024

Maintaining Discipline in Unprecedented Times

The first quarter of 2024 delivered surprisingly strong returns for almost all global equity indices. Asset classes and sectors that feature prominently amongst Hamilton Capital portfolios, including Quality and Energy showed particularly strong performance. Energy was the leading sector in the S&P 500 with total returns of 13.69% and industry fundamentals continue to be strong.

Double digit returns to start the year were largely unexpected by many market forecasters due to muted economic expectations and beyond expensive valuations. While the economy has shown continued resilience thus far, broad market indexes are at historically dangerous levels, suggesting subsequent future returns may be minimal at best.

Protecting capital and managing risk become far more critical at these price levels. Maintaining a disciplined process that follows this core belief has always been of paramount importance at Hamilton Capital. We believe it is foundational to compounding both in the current environment and future market cycles.

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The stock market is a device for transferring money from the impatient to the patient.

Warren Buffett

The Importance of Sticking to the Game Plan

The recent strength in the S&P 500 dating back to October has been marked by performance that has been concentrated amongst a few select equities. This market behavior has supported the strongest momentum-based rally the S&P 500 has experienced since the tech bubble as shown in Chart 1. It is quite clear from the exhibit that momentum moves of this nature often end with sharp declines that betray investors who chase this performance. Our portfolio construction process seeks to avoid this kind of volatility. As a result, we would not expect to fully participate in market environments like today.

Developing a foundational understanding of the psychology of markets can help clarify the benefits of consistency and a long-term perspective. The following quote from John Templeton captures the essence quite well: "Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell."

Identifying where the market is along the spectrum from maximum pessimism to

Chart 1

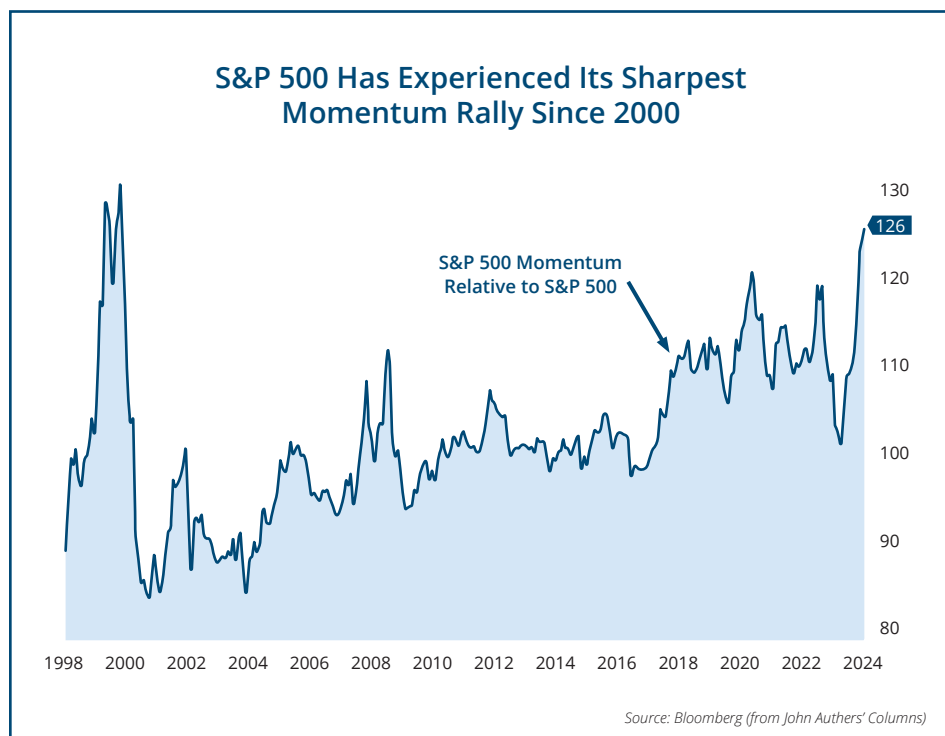
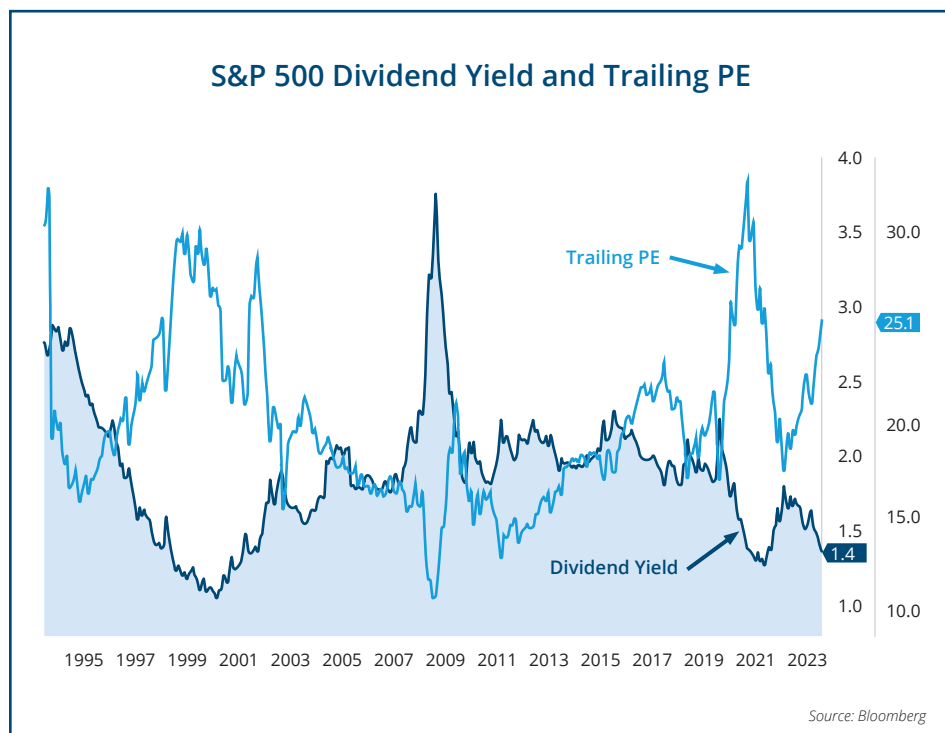


Chart 2



maximum optimism is the first step in using this wisdom to your advantage. The second step is to apply patience and discipline to the decision-making process. These are the key attributes that underpin our long-term strategy.

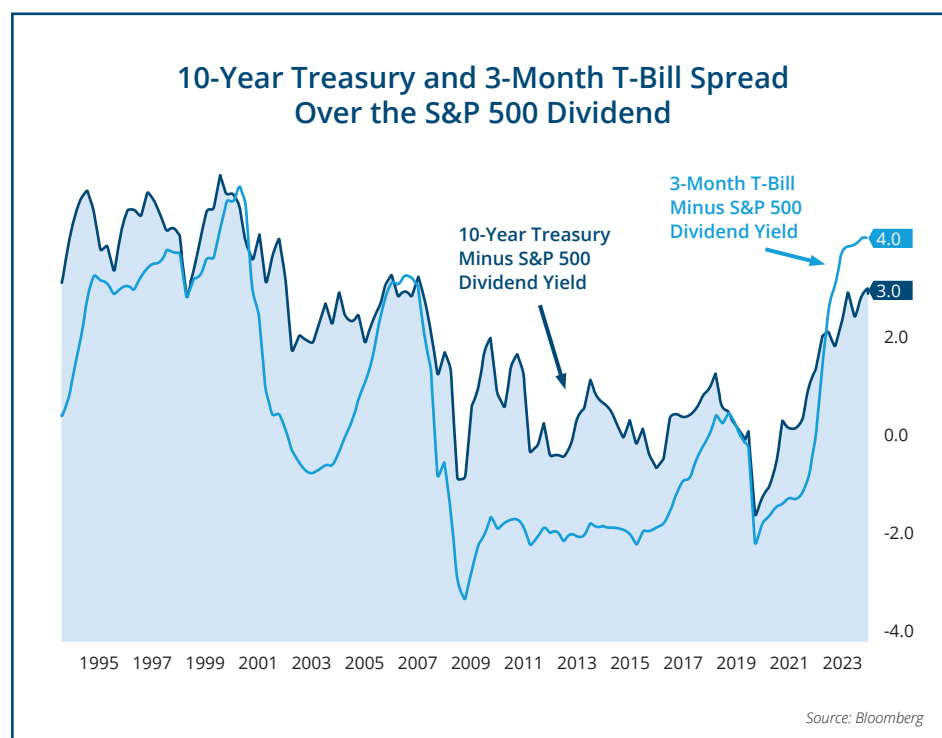
Heightened Risk of Overpaying Can Create Vulnerability to Large Losses

Sacrificing commitment to a sound long-term perspective at the wrong time often proves to be detrimental to a well-defined investment strategy for multiple reasons. The primary point of concern is overpaying for risk assets as this sets up investors to potentially experience large losses that wipe out years of hard-earned gains.

In addition to the heightened momentum of the market, the valuation measures displayed in Chart 2 (dividend yield and trailing price-to-earnings ratio for the S&P 500) indicate that the market has only exhibited the current risk of overpayment on two other occasions during the last 30 years. Both ended very poorly for investors.

High PE ratios and low dividend yields go hand in hand. They both signify a drastically reduced return environment in coming years. The wise investor maintains discipline and patiently waits for higher dividend yields and lower PE's which will inevitably come.

Chart 3



Continuous Compounding Without Interruption Is Always Preferable

Essential to building and maintaining wealth is the principle of consistently building returns on returns. This requires conscientious portfolio construction that takes advantage of today's compelling opportunities, avoids debilitating risks and has ample resources to take advantage of better prices that eventually emerge.

The tendency of so many others to abandon strategy at the wrong time creates long-term opportunity for our investment approach. The quote from Warren Buffett on the front of this version

of the Capital Markets Review underscores this idea: "The stock market is a device for transferring money from the impatient to the patient." Like us, Warren Buffett is allowing resources to pile up on Berkshire Hathaway's balance sheet as his company waits for more attractive prices to make additional investments.

Taking Advantage of Today's Opportunities

Consistent with our view that expected returns for equities are likely to be very low, we continue to have notably reduced equity exposure throughout most of our investment strategies.

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Continued from page three.

Pockets of opportunity are still present as energy shows a shareholder yield (dividends plus share buybacks) in line with long-term portfolio objectives and quality offers lower volatility and sustainable profits.

Moreover, the potential to compound portfolios positively outside of equities has improved markedly over the last 18 months. Chart 3 depicts the current yield premiums for the 10-Year Treasury and 3-month T-Bill above the S&P 500 yield. Short-term treasuries provide the highest yield premium over equity dividends that we have witnessed in over 20 years creating opportunities that have not been present since the financial crisis.

Additionally, we have increased our exposure to structured credit (e.g., residential mortgage loans) to take advantage of favorable risk-adjusted returns. Since short-term treasuries yield over 5% and structured credit offers yields with equity-like return potential, we believe our portfolios can demonstrate effective compounding of returns in the face of a precarious environment for equities.

Summary and Outlook

We continue to believe that our dynamic approach to asset allocation will preserve capital and generate attractive compounded risk-adjusted returns. More appealing entry points should emerge as the long and variable lags of tightening policy flow through the economy. Until then, we are taking advantage of the most compelling opportunities in the current environment.

As always, we are grateful for the privilege of allowing us to guide your assets forward. Should you have any questions or observations, please don't hesitate to contact us.

Learn More

The content in Capital Markets Review is authored exclusively for Hamilton Capital clients and friends by the professionals on our Investment Team. If it raises any questions or you'd like to learn more about our proprietary research and top-down, forward-looking investment process, please feel free to contact us any time.

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