INVESTOR'S EDGE

August is historically a down month

Here are answers to reader questions about the markets.

"The market is often stupid, but you can't focus on that. Focus on the underlying value of dividends and earnings." — John C. Bogle

Jim Burns CFA
Guest columnist

August was among the worst summer weather months I've seen in years. Cool, rainy, and cloudy.

August's lousy weather also corresponded with a lousy stock market, with the S&P 500 Index down around 4.5% for the month at the time of this writing.

I've been getting a number of questions from clients and readers so I thought I would try our time-tested question and answer format for this month's column.

Do you think August's stock market weakness will continue?

It certainly may, but there are some important statistics to keep in mind for context. In my January Investors' Edge column titled: "Markets historically offer best returns when the outlook is poor," I encouraged readers to stay the course with stocks because, among other things, the third year of the presidential election cycle is overwhelmingly positive. In fact, 92% of the time stocks end the year positively.

Now, historically, much of those gains do come in the first half of the year. And that will most likely hold true this year, as the S&P 500 Index was up a powerful 20% through the end of July. However, the second half of the year is also up 82% of the time, with a more muted — but still solid — 7% average rate of return.

Furthermore, looking out into 2024, presidential election years are also traditionally strong for stocks, with most of the gains coming immediately following the election.

The Stock Trader's Almanac points out that the worst two months for stock market performance are in August and September. So, I think it certainly is possible that we could see a continuation of August's weakness this month. However, remember that close to 70% of the stock market's return in any given year takes place in the fourth quarter. So as for me and my house, I'm sticking with equities.

I hear many bearish stock market pundits on CNBC claim that stocks are overvalued. Do you agree?

Yes and no.

Currently, the S&P 500 index is selling at 20.4x forward earnings, indeed above historical levels. However, that price-to-earnings multiple can be misleading, as the "magnificent seven" mega-cap technology stocks, which include the likes of Amazon, Alphabet, Microsoft, Nvidia, etc., are selling at elevated P/Es, arguably for good reason.

In fact, if you take out just those seven stocks, the broad-market indices sell at around 14x forward earnings. Considering the 10-year average price to earnings ratio for the S&P 500 is 15 to 16x earnings, I don't believe you can say the overall market is overvalued.

Finally, keep in mind, through Aug. 31, the Nasdaq remains 15.4% off its previous peak on Nov. 19, 2021, and small

cap stocks overall are still in a bear market, down around 24% from their last peak on Nov. 8, 2021.

Where can I get solid portfolio income?

As a money manager, I believe that simplicity equals profitability.

For short-term liquidity needs, you can currently get high-yield money market mutual funds paying more than 5% vs. 0.5% or less in a regular sweep account at your brokerage firm. Custodians such as Schwab, Vanguard, and Fidelity all offer these kinds of funds you can purchase with your idle cash. Keep in mind that these money market funds are not insured by the FDIC and are traded like a mutual fund.

CDs from a large, brand name bank are also a fine option right now. CD's went from yielding almost nothing back in 2021 to well over 5% at the time of this writing!

On the equity side, the Vanguard International High Dividend Yield ETF (ticker symbol: VYMI) focuses on international companies in both developed and emerging markets with above-average dividend yields. You will find many foreign and recognizable companies in this fund such as Toyota, Novartis, Shell, and HSBC to name a few. VYMI also pays a very attractive dividend yield of 4.3% that will grow over time.

Finally, for the more aggressive income investor, the J.P. Morgan Equity Premium ETF (ticker symbol: JEPI) is a high-quality fund that pays a monthly distribution from stock dividends and option premiums. Its current yield is almost 10% and has 36% less volatility than the S&P 500 Index.

JEPI has returned around 6% in 2023 and was down "only" 4.1% in 2022 when the S&P 500 was down 18%, making it a wise choice during market downturns. This fund launched in 2020 and has grown to $28 billion in assets, making it the largest actively traded ETF.

In summary, for the first eight months of this year, stocks have surprised just about everyone — pleasantly I may add. The stock market weakness in August should almost be welcomed and is overdue.

Overall, however, the economic resilience and high levels of investor liquidity should provide a ballast for stock gains for the remainder of the year.

As an old Wall Street saying goes: "Bears may sound smarter, but the bulls make more money."

I remain bullish.

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Contact him at jburns@jwburns.com

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