BIRLING CAPITAL ADVISORS, LLC **Think Strategically**

Navigating Market Storms: Five Essential Insights on Pullbacks and Investor Behavior

August 12, 2024

Francisco Rodríguez-Castro, President & CEO

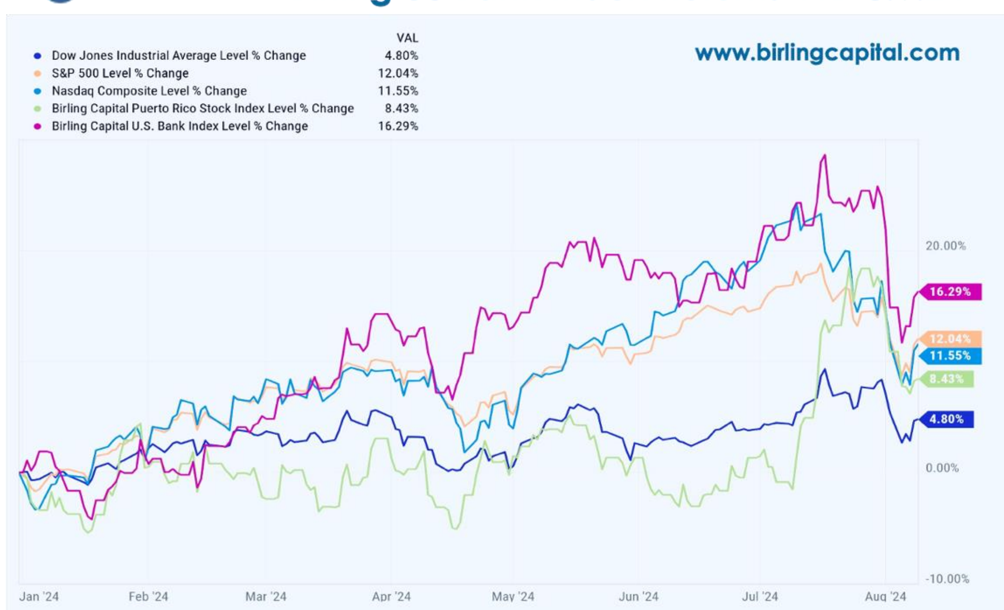
U.S. Markets Ride a Volatile Week: S&P 500's Steepest Drop Since 2022 Followed by Strongest Rebound

The U.S. markets ended the week mostly positively despite a rollercoaster of volatility. The S&P 500 faced its steepest drop since September 2022, only to bounce back with its strongest session since November 2022 as fears of a recession subsided. Although the markets recovered some of their earlier losses, investor sentiment remains cautious. All eyes are on next week's data, providing crucial insights into growth and consumer trends. The 10-year Treasury yield settled at 3.94%, indicating market expectations for a more aggressive easing cycle from the Federal Reserve. When comparing how the week ended, we note that none of the indices we follow recovered all of their losses

- **Dow Jones Industrial Average** is still down -239.72 points or -0.60% and has a **YTD return of 4.80%.**
- **S&P 500** is down -2.4 points or 0.04% and has a **YTD return of 12.06%.**
- **Nasdaq Composite** is down -30.86 points or 0.18% and has a **YTD return of 11.55%.**
- **Birling Capital Puerto Rico Stock Index** is down -88.14 points or -2.20% and has a **YTD return of 8.43%.**
- **Birling Capital U.S. Bank Stock Index** is down -262.37 points or -1.25% and has a **YTD return of 16.29%.**

While there is still ground to recuperate, the broader issue is that the YTD returns are still positive, and in the S&P 500, Nasdaq Composite, and Birling U.S. Bank Index, the returns are in the double digits.

Dow Jones, S&P 500, Nasdaq Composite, Birling PR Stock Index, Birling US Bank Index Returns YTD 8.9.24



For investors who expected 2024 to be a year of calm weather and smooth sailing, last week, the markets delivered a sharp reminder that market downturns can arise from anywhere and produce significant ups and downs. The Dow plummeted by over a thousand points on Monday, sparking dramatic headlines and causing concern among many. However, despite these fluctuations, the market ended the week with only a modest overall loss, much less severe than the headlines suggest.

The market's reaction to recession fears was the utterly exaggerated market reaction. The best evidence is the GDPNow for the Third Quarter of 2024, which shows the GDP increasing to 2.90%, above the Second Quarter's 2.80% GDP. The macroeconomic and fundamental baQuarter'smains optimistic despite concerns over future U.S. economic growth, the weak PMI manufacturing and jobs reports, and the Bank of Japan's contrarian action or increasing interest rates, while other Central Banks are lowering rates or at a pause, proved to be one too many issues to change the market sentiment.

In my view, the trigger was Japan's Nikkei, which fell 12% on Monday, August 5, 2024, at 31,458.42, and by Friday, August 9, 2024, it had rebounded, closing at 35,025.00, rising 3,566.58 points or 13.05%.

The Five Essential things to understand about market pullbacks:

While this bout of volatility is worth noting, it's important not to overreact. Often, doing nothing will save you losses and heartache. Market pullbacks are never pleasant, especially after a period like 2024, where stocks have been consistently hitting new highs with little drama. Maintaining perspective is crucial, and here are five essential things to understand about market pullbacks:

1. Perception vs. Reality: The Hidden Truth Behind the Hype

A 1,000-point drop in the Dow is hard to ignore, and Monday's 1,034-point decline was the 12th-largest in history; while the size is alarming, context is critical. This 2.6% drop pales compared to a similar drop in 2018, a 4.2% move. Such declines, though notable, are not unprecedented.

Market downturns, especially when they follow record highs, can feel more severe than they are. For example, last week's lows left the S&P 500 just 8% below its all-time highs despite the alarming headlines. The market is still up nearly 20% from last year and 50% since this bull market began in October 2022. When looking at the bigger picture, the recent pullback, while abrupt, is part of a broader upward trend.

2. Market Dips: The Calm Before the Surge

During a pullback, something extraordinary might be happening. However, history shows that such declines are far from unusual. Over the past 25 years, the market has experienced an average 5%-plus drop about

thrice a year. These dips are a normal part of market cycles and should not come as a surprise.

Market corrections, defined as 10%-plus declines, are less frequent but still familiar. They occur about once a year on average and understand that regular pullbacks can help investors make more level-headed decisions during these periods.

3. Riding the Storm: Why Market Patience is Your Best Ally along with Emotional intelligence

The emotional impact of a market decline can make it feel like a marathon, but these downturns don't usually drag on for long. For instance, since 2010, market corrections have lasted an average of 63 days, with smaller 5%-10% pullbacks having even shorter durations. While the market doesn't rebound instantly, it returns to new highs within months. Investors can often benefit from these temporary dips by staying the course.

Emotional intelligence (EI) can be crucial for investors and business leaders during economic uncertainty. By understanding and managing their emotions and empathizing, they can make more informed and balanced decisions. EI helps them navigate market volatility calmly and strategically, fostering resilience and maintaining a long-term perspective.

4. Economic Growth, Labor Markets, and Wall Street

The GDPNow estimate for the third quarter of 2024, last updated on August 8, remains steady at 2.90%. The coming week will be critical as investors focus on key indicators such as retail sales and July's inflation data. A recent rise in jobless claims initiated recession fears, redirecting attention toward consumer behavior. Following June's surprisingly strong performance, analysts predict June's increase in headline retail sales and a 0.1% rise in control-group sales. Earnings reports from major retailers like Walmart, due on Thursday, will provide further insights into the health of consumer spending.

BIRLING CAPITAL ADVISORS, LLC

GDPNow for the third Quarter 2024

Date	GDPNow 3Q24	Change
7/25/24	2.80%	Initial Forecast
8/1/24	2.50%	-10.71%
8/6/24	2.90%	16.00%
8/8/24	2.90%	0.00%

On the inflation front, the Producer Price Index (PPI) is set for release on Tuesday, followed by the Consumer Price Index (CPI) on Wednesday. According to Inflation Nowcasting, the headline CPI is expected to come in at 3.01%, with the Core CPI projected at 3.33%, both higher than last month. If these forecasts hold true, it could heighten Federal Reserve officials' concerns about labor market pressures and lead to enacting multiple interest rate cuts this year beyond the single cut anticipated in June.

BIRLING CAPITAL ADVISORS, LLC

Inflation Nowcasting CPI, Core CPI, PCE & Core PCE

Inflation Nowcast	CPI Forecast	Core CPI	PCE	Core PCE	Updated
July	3.01%	3.33%	2.59%	2.73%	8/9/2024

It's important to remember that Wall Street operates with a forward-looking perspective, constantly pricing in future expectations of economic growth, inflation, and labor market trends. As such, sticking to your financial goals and maintaining a diversified portfolio will serve you well, helping you navigate through the market's inevitable ups and downs while keeping your long-term objectives on track.

5. There's a Silver Lining

The critical question last week was whether this pullback signaled something more severe. While volatility may continue, this is not the start of a significant downturn. The rebound late last week suggests that the market's fundamentals are stronger than the initial sell-off indicated.

While ongoing concerns exist, such as the possibility of a recession or geopolitical tensions, the current economic environment remains relatively favorable. Corporate profits continue to rise, and the Fed will likely ease monetary policy soon. Historically, market pullbacks not accompanied by a recession have been temporary and followed by substantial gains.

The bottom line? Market pullbacks offer opportunities for investors. A recovery has followed every pullback in history. While uncertainty remains, we don't expect this time to be different. Staying calm and invested through these periods can lead to substantial gains.

The Final Word: The Investor Emotional Cycle

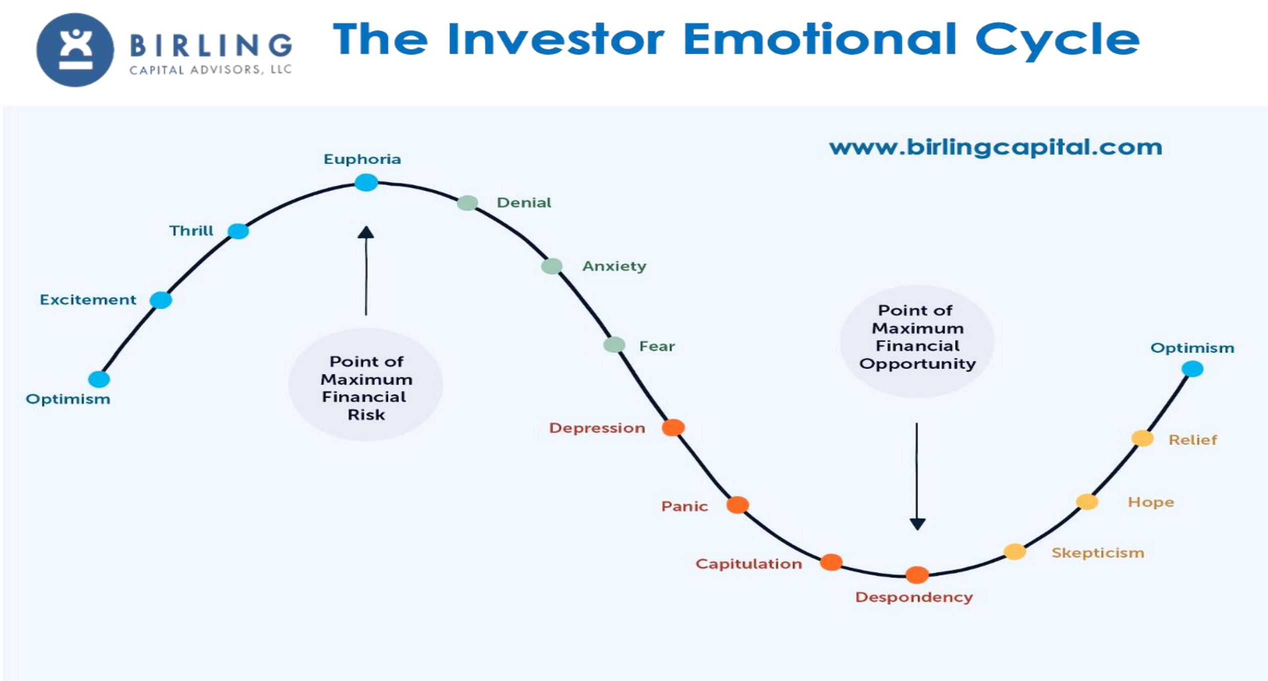
During periods of significant market volatility, it's essential to understand the Investor Emotional Cycle. This concept illustrates the psychological journey that investors typically experience as markets fluctuate. Emotions often dictate decisions more than logic, leading to a predictable sequence of feelings that can profoundly impact investment outcomes. By familiarizing yourself with this cycle, you can better manage your emotions, avoid common pitfalls like buying at market peaks during euphoria and selling in panic during downturns, and make more informed decisions.

- **Optimism:** The cycle begins with optimism as investors enter the market, confident that their investments will grow.
- **Excitement:** As the market continues its uptrend, excitement builds. Investors see their portfolios grow and begin to anticipate substantial gains.
- **Thrill:** Success leads to thrill, with investors feeling invincible. This stage often involves taking on more significant risks in pursuit of even higher returns.
- **Euphoria:** At the peak of the market, euphoria takes over. Investors are overly confident, often overlooking risks. **Biggest Risk:** The greatest risk frequently occurs at this point since overconfidence can lead to poor decisions, such as overextending investments or ignoring warning signs of a market peak.
- **Denial:** As losses deepen, denial emerges. Investors may refuse to accept the market's shift, holding onto losing positions and believing the downturn is just a blip.
- **Anxiety:** When the market begins to turn, anxiety sets in. Slight declines make investors uneasy, but many continue to hold on, hoping for a recovery.
- **Fear:** As the market continues to fall, fear dominates. Investors worry about significant losses and may begin to sell in panic.
- **Depression:** A deep sense of regret and loss can dominate, leading to withdrawal from further market participation.
- **Panic:** When fear escalates, panic sets in. Investors rush to exit the market, often selling at the worst possible time.
- **Capitulation:** This is the stage of maximum pessimism. Investors give up hope and sell their investments at significant losses, typically right before the market begins to recover.
- **Despondency:** During this stage, investors are overwhelmed with negative emotions such as hopelessness and regret. Many feel disillusioned by their severe losses, leading them to withdraw from the market entirely. This is typically when sentiment is at its worst and confidence in the market is at an all-time low.
  Ironically, despondency is also the point of maximum financial opportunity. When prices have plummeted, and pessimism prevails, the market is often undervalued. For those who can resist the emotional urge to abandon the market and instead recognize this stage as a buying opportunity, there is significant potential for future gains. As the market begins to cover, investments made during this period of despondency can yield substantial returns, positioning investors to benefit from the next cycle of growth.
- **Skepticism**: As the market begins to show signs of recovery, investors may be skeptical, unsure if the recovery is real or sustainable. This stage often involves cautious re-entry into the market.
- **Hope:** As the market stabilizes and begins to recover, hope returns. Cautious optimism leads to gradual reinvestment.
- **Relief:** Relief sets in as the market gains momentum. Investors feel more secure, believing the worst is behind them.

- **Optimism:** The cycle renews as optimism grows and the market begins another uptrend. **Biggest Reward:** Entering the market during the early stages of recovery, when hope and optimism are building, can offer the greatest potential for significant gains.

Understanding the emotional stages of the investment cycle, particularly where the biggest risks and rewards lie, can help you navigate market volatility more effectively. Sticking to your financial goals with a diversified portfolio will serve you well, ensuring that your investments continue to grow and work toward achieving your long-term objectives, regardless of where you are in the market cycle.

Staying committed to your financial goals and maintaining a well-diversified portfolio will help you confidently weather market volatility. Over time, this disciplined approach will serve you well, ensuring that your investments continue to grow and work towards achieving your long-term objectives, no matter where you are in the market cycle.



BIRLING CAPITAL ADVISORS, LLC
Francisco Rodriguez-Castro, President & CEO • frc@birlingcapital.com
PO Box 10817 San Juan, PR 00922 • 787.247.2500 • 787.645.8430