



CAPITAL INVESTMENT COUNSEL

The Columns

July 2024

Observing the Russell 2000 Small Cap Index over the past two years reminds me of the advice Kurt Vonnegut, the celebrated author of "Slaughterhouse-Five," gave to aspiring writers. Vonnegut believed that awful things must happen to the main characters, regardless of how likable they are, because readers want to see what they're made of.

Readers crave a protagonist they can root for, and adversity reveals how a character reacts when faced with hardships. Everyone loves redemption stories. While a happy beginning, middle, and end might be ideal for life, it makes for a dull story. Given everything that's transpired since 2022, the Russell 2000 Small Cap Index could make a fascinating fictional character.

The market value of the median stock in the Russell 2k is around \$1 billion. Let's contrast that with Apple's market cap of \$3.4 trillion or Exxon at \$520 billion. Because of their capital structure, the Russell index stocks tend to be aligned closely with interest rate moves, and it feels like that's more pronounced over the last two years as inflation raged. Fed Chair Jerome Powell's higher for longer stance on interest rates took a heavy toll on the Russell. Powell's infamous August 2022 speech in Jackson Hole helped Russell 2K plunge 9% in the two weeks following the speech. It felt like every time the Russell made progress, an inflation spike would send it back to the bottom of the hill again. Google Sisyphus from Greek mythology and you'll get an idea of Russell's journey.

The good news is the Russell has a happy ending – one for the record books actually. A series of solid inflation reports in July set the Russell on its way higher. For the four trading days ending July 16th, the Russell was up four days in a row for a total gain of 10.5%. The absolute gain was impressive, but it also outperformed the big cap S&P 500 by 9.8 percentage points over that same time frame – the largest gap on record. Thanks to Charlie Biello for the stat.

Even more impressive is the contrast with the big tech NASDAQ 100. Since July 10th, the Russell is up 9% while the NASDAQ 100 dropped 8%. I'll admit I love Russell's July move but I love its potential for 2025 even more. Ryan Detrick at Carson notes we've seen this type of outperformance 13 times, and the Russell was higher a year later 11 out of 13 for an average gain of 25%.

This rotation from big into small is a natural one and probably should have happened months ago. I love and own big cap tech for me, personally, but the current valuations seem stretched to me. Apple has had a great run lately, but its current PE is 32 versus a ten-year average of 20. Microsoft is currently trading at a 35 PE versus an average of 26. Google on the other hand is, at present, right in line with its ten-year PE at roughly 23 times.

I don't advocate getting completely out of tech, but there may be better potential performers out there, like small caps or some of the financials that have roared to life lately. On top of that, Lance Roberts at RIA Advisors notes that the Global Equity Risk-Love indicator trades at the 96th percentile, indicating a high level of love and potential complacency for stocks. Again, not a death knell, but maybe tech stocks need to catch their breath before potentially moving higher again in 2024.

You know I can't close on a somber note so let's look at the bright side of this selloff. As of June 30th, eight sectors were massively underperforming tech. It often felt like tech

was doing well but not much else. The combo of the drop-in rates and high valuations may have pushed tech lower, but it's also pulled a Dr. Frankenstein and brought many sectors back to life. Since June 30th, financials are up 4.5%, pharma is up 3% and utilities are up 4.4%. Meanwhile, big tech, as represented by the XLC and XLK, ETF's are down 2.5% and 4%, respectively. It's short-term pain for tech, but it's a massive positive to see the market broaden its leaders. The markets like life are better when more participants are doing well. If you have any comments, feel free to contact me at heddins@capital-invest.com or call at 919-656-0836.

Disclosures:

***Past performance is not indicative of future results. This material is not financial advice or an offer to sell any product. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account, if any; and (iii) market exigencies at the time of investment. Capital Investment Counsel reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed may not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.**

Capital Investment Counsel is a registered investment advisor. More information about the advisor including its investment strategies and objectives can be obtained by visiting www.capital-invest.com. A copy of Capital Investment Counsel's disclosure statement (Part 2 of Form ADV) is available, without charge, upon request. Our Form ADV contains information regarding our Firm's business practices and the backgrounds of our key personnel. Please contact us at (919) 831-2370 if you would like to receive this information.

CIC-20240701

Capital Investment Counsel, Inc. 100 E. Six Forks Road, Ste. 200; Raleigh, North Carolina 27609

***Securities offered through Capital Investment Group, Inc. & Capital Investment Brokerage, Inc.
100 East Six Forks Road; Raleigh, North Carolina 27609
Members FINRA and SIPC***