Q3 Asset Management

4th Quarter 2024 Market Commentary ***January 8, 2025***

"Life is either a daring adventure or nothing at all."

~ Helen Keller

Nothing Ventured, Nothing Gained (By Bruce Greig)

Having recently watched the rock-climbing documentary Free Solo, I was struck by the sheer astonishment of how anyone could possibly do what Alex Honnold did. Naturally, I began to think of the similarities between the risks that a "free solo" climber might take, and how that relates to investing.

Free solo climbing is an endeavor that exists at the very edge of human capability and reason, an exhilarating mix of athleticism and mental discipline that seems almost impossible to comprehend from the outside. To watch a climber scale a sheer rock face without ropes, harnesses, or any safety equipment is to witness a person defy the natural laws that govern us. The drama of the sport is in its simplicity—one wrong move and the consequences are permanent. For those who take it on, it is the ultimate expression of personal mastery and freedom, yet it's also a precarious balancing act between courage and recklessness.

Consider Alex Honnold, the climber featured in Free Solo. Alex is a world-renowned free soloist who became famous for his 2017 climb of El Capitan, one of the most intimidating rock faces in the world. What was once thought of as an impossible feat became a reality because of his obsessive preparation, extraordinary focus, and an almost unnatural calm under pressure. It's a breathtaking achievement—he scaled 3,000 feet of vertical granite with only his hands and feet for protection, without the usual safety precautions that climbers rely on.

Honnold, renowned for his minimalist approach to climbing, had meticulously prepared for this feat. He spent years practicing on the route, carefully analyzing every move, every handhold, every foothold. He focused on identifying and mitigating any potential points of failure, such as altering his route to avoid particularly dangerous sections of the rock face.

The route Alex chose presented a variety of technical challenges. Smooth, featureless rock demanded precise footwork and delicate balance on the slab sections. Climbing through wide cracks, often using unconventional techniques and contorting his body, tested his strength and flexibility. Overhanging sections required significant upper body strength and endurance. The key, though, was in the planning and being able to adapt as needed.

The weather on that day played a crucial role. Calm winds and stable temperatures provided ideal conditions for the climb. Had the weather been inclement, with high winds or rain, the climb would have been significantly more dangerous and potentially impossible. Again, it's all about the preparation and being able to control what is controllable.

Free soloing, at its core, is about pushing the boundaries of human endurance and willpower. It's about feeling the weight of every decision and every movement, where a simple slip or misjudgment could result in death. The climber is forced to reckon with the risks in real-time, understanding that each step carries the potential for disaster. In that way, free solo climbing mirrors many aspects of life—whether in the pursuit of greatness, personal goals, or even in how we engage with the world around us. There is a constant balancing act between pushing limits and respecting the forces that may work against us.

This relationship between risk and reward is one of the most compelling aspects of free solo climbing. The reward—the accomplishment of doing something most people would consider unthinkable—makes the climb worthwhile. It's not about the physical exertion alone, but the satisfaction that comes from knowing that the climber has conquered not just the rock, but their own fear, doubt, and limits. However, the price of failure in free soloing can be catastrophic. A fall, a slip, or even an unexpected gust of wind can be fatal, making it one of the most extreme and dangerous sports in the world.

In both free soloing and investing, it's not just about the preparation, it's about managing the unknown. Despite the years of practice and study, there are always factors outside of one's control. For climbers, it's the weather, the condition of the rock, or the inability to control emotion. For investors, it's the unpredictability of market fluctuations or the emergence of unforeseen global events. In both scenarios, it's not enough to rely solely on preparation; success often hinges on the ability to manage the unknown.

Climbing and investing are ultimately defined by risk tolerance. Free solo climbers like Alex Honnold don't operate in a world where safety nets are available. They take on the challenge with full awareness of the potential for disaster. Similarly, in the investment world, high-stakes moves are often driven by an individual's risk tolerance. Those who invest in speculative ventures, like tech startups or cryptocurrency, are often willing to put their resources on the line for the chance at a large return. But just like a solo climber's every movement carries the risk of failure, every dollar invested carries the risk of loss. There are no guarantees, only calculated risks, and the rewards can be substantial or nonexistent, depending on how well the individual understands the landscape.

When thinking about free solo climbing through the lens of investing, it's hard to ignore the similarities between the two. Investing, much like free solo climbing, is about balancing risk with potential reward. Whether you're taking the plunge into the stock market or into the unknowns of cryptocurrencies, the thrill of high-risk investing is not far removed from the exhilaration a climber feels when taking on a seemingly impossible route. Both pursuits require a deep understanding of risk, preparation, and the ability to act decisively without subjectiveness, or human emotion – something we understand very well here at Q3, even if we do spend most of our time behind computers and not on the face of a rock.

Quarterly Market Recap

Over the past three months, major US stock market indexes were positive, but that does not tell the whole story. The S&P 500 and the NASDAQ 100 Indexes were indeed both to the upside, but those are both large-cap growth indexes. The rest of the market—small and mid caps, value stocks—did not fair nearly as well.

Small cap stocks (Russell 2000), for example, fell 2.5% and value stocks (MSCI Value) lost 4.1%. This wide dispersion seemingly undercuts the value of diversification since most of the gains were concentrated into one part of the market. Savvy investors, however, know that being diversified will usually lead to better results—especially when the markets turn in the other direction.

Domestic stocks –again primarily large caps—were bolstered by prospects for deregulation and hopes for continued interest rate cuts in the new year. Such an environment should continue to lead to strong earnings and increased consumer demand. Sectors such as Technology and Financials may reap the most benefits as the new presential administration gets underway.

Corporate earnings and consumer sentiment were the primary drivers of market performance for the last three months, and resulted in equites posting new all-time highs. Also, the 4th quarter saw all-time highs in Bitcoin and Gold. Some investors sought out these alternatives as an inflation hedge, others for speculation purposes. The inherent volatility in these assets, though, should give investors pause as Bitcoin has lost over 60% on average during it's losing years.

- After consecutive quarters of broad equity sector gains, just 4 of the 11 major sectors were in the black this time around. Leaders were Communication Services (XLC) and Consumer Discretionary (XLY) gaining 7.3% and 12.6%. The "Magnificent 7" stocks (all mega-cap, tech-based) helped buoy those sectors, though they fell off in December. Laggards were Materials (XLB) and Health Care (XLV) falling 12.0% and 9.8%.

- After two quarters of outperformance, international equities significantly lagged their domestic counterparts over the last three and twelve months. Nearly every major country and region experienced losses, with Latin America (ILF) dropping the most shedding 16.0% largely on Brazil's runaway inflation fears. China (MCHI) and Europe (IEV) did not fare much better dropping 9.9% and 9.0%. Looming threats of tariffs, and slowdowns in economic recoveries have hindered much of the world's equity markets.

- Alternative asset classes often zig when equities zag due to their lack of correlation with stocks. This aspect can make them a great addition to a portfolio—especially in down markets. Over the last quarter, though, alternatives were mixed. Bitcoin (GBTC) surged 50.7% hitting a new all-time high. Gold (IAU) and Commodities (DBC), however, were to the downside losing 1.4% and 0.6%. The energy markets, such as Oil (USO) bucked the commodity trend adding 4.8% on renewed demand from much of the world.

- Fixed income markets continue to be volatile as they look for direction. Nearly every bond sector was down for the quarter as interest rate uncertainty, and inflation fears continued to linger. High Yields (HYG) were relatively strong losing just 0.1% as they piggybacked off strength in the equity markets. Long-term Treasuries (TLT) took a huge hit losing 10.4% ending the year down over 8%. The Aggregate bond market (AGG) dropped 3.4% while Municipals slipped 1.2%.

7 Things to Watch for in the New Year

2024 will go down as a good year for the stock market. While we consider December 31st the end of one year and January 1st as the start of another, the markets view it as a continuous flow. So, should you expect more of the same in the new year? Here are some things to watch for:

1) Stock Market Takes Down Crypto or Vice Versa

If the stock market faces significant volatility due to economic uncertainties, it might drive investors toward digital assets as a hedge, increasing crypto’s value. Conversely, if cryptocurrencies face tighter regulations or a market crash, stocks could see a ripple effect, with investors shifting away from riskier assets. A significant downturn in either market could affect the other as both are closely tied to investor confidence and overall economic conditions.

2) Buy the Rumor, Sell the News

The adage "buy the rumor, sell the news" could be highly relevant following the 2024 U.S. presidential election. Markets rallied leading into the election, and soon thereafter, as experts believed Trump could be good news for the stock market. How long this glow lasts, however, remains to be seen as any new administration often comes with a certain amount of disruption and uncertainty.

3) Lingering Inflation

Inflation remains a concern for the US economy. Although inflation rates may slow, they could still be above pre-pandemic levels, leading to higher costs for everyday goods. Persistent inflation challenges consumers and businesses, as wages may not keep up with rising prices. Cost of living increases could impact consumer behavior and spending patterns, leading to slower economic growth.

4) Fed Stops Cutting Rates

In 2025 the Fed may stop its rate-cutting cycle, indicating that inflation is under control or that the economy is stabilizing. While halting cuts could boost confidence in the economy, it may also slow down borrowing and investments. Even with two cuts in 2025, interest rates would still be higher than the previous 10+ years. This would significantly affect house payments, student loans and credit card debt.

5) Falling Corporate Profits

A decline in corporate profits could reflect an economic slowdown or increased competition. With inflation and rising labor costs, businesses might find it harder to maintain profit margins. Plus, if consumer demand weakens, companies could face difficulties in passing higher costs onto customers. A reduction in corporate profits may lead to layoffs as companies attempt to cut costs.

6) Artificial Intelligence (AI) and the Job Market

The rise of AI could have negative effects on the job market, especially for low- and mid-skill jobs. Automation could replace roles in manufacturing, retail, and professional services, leading to potential job losses. Workers without specialized skills might struggle to find new opportunities. As AI continues to improve, reskilling programs will be essential for workers to adapt to new technologies.

7) Reduction in Consumers Spending

Consumers may cut back on spending due to inflationary pressures and economic uncertainty. Higher prices for goods like food, gas, and housing could eat into income, leading people to prioritize necessities. This cautious spending could slow down sales and dampen economic growth. Consumers may seek budget-friendly alternatives, impacting sectors like luxury goods, travel, and entertainment.

While these challenges may present hurdles, they also offer opportunities for innovation and adaptation. The rise of AI, for example, while potentially disruptive, also presents a chance to create new, higher-skilled jobs and improve productivity. Similarly, inflation could incentivize businesses to streamline operations, increase efficiency, and develop more cost-effective products. The key lies in embracing these challenges as opportunities for growth and preparing for the future. A great place to start is with a solid investment plan, as the foundation to build upon, regardless of what the new year brings.

The Road Ahead

Alex Honnold's free solo climb of El Capitan serves as a powerful metaphor for navigating the unpredictable landscape of economic and investment challenges. Just as Alex meticulously prepared and analyzed every move, we are here to do the same for your investments.

The beginning of a new year often comes with both anticipation and a tinge of regret. Anticipation of all the lofty goals we make for the year, and regret from those plans from last year that did not pan out for one reason or another. It is important to maintain a healthy balance, though, between one’s goals and one’s limitations – be it money, time or effort. Even with the best planning, there are forces beyond our control that may waylay our intentions. For climbers, this could have extremely serious consequences and for investors – maybe not as dire - but still very important.

As we, and others, have often pointed out: investing is not a sprint, but rather a marathon. Success should not be measured in days, weeks, or even a year. Success is achieving your ultimate goal knowing there will likely be obstacles along the way. And while we cannot control the market, we can control our emotions and our decisions. As investors ourselves, we know all too well how challenging this can be, which is precisely why we use investment models which are entirely rules-based and devoid of human emotion. When it comes to maximizing the chances for success – be it for climbing, investing, or just about anything else, one can only control what can be controlled.

We appreciate your continued trust in Q3. If you have not yet received your account statement, it should be arriving shortly. As always, if you have any questions or concerns please do not hesitate to contact either your Representative or Q3 Asset Management directly.

Have a safe & prosperous 2025!

All the best,

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IMPORTANT NOTICE: Our Form ADV Part 2A Brochure was last updated on October 22, 2024. Material changes include: (1) Updated assets under management as of 12/31/2023; (2) The conversion of the Q3 All-Season Sector Rotation Fund into the Q3 All-Season Systematic Opportunities Fund; (3) The availability of new strategies including BRI - Active Stock, BRI - Active Equity, BRI - Active Bond, and Active Income & Growth; and (4) Additional language summarizing potential conflicts of interest in relation to (a) strategies that utilize a signal provider, and (b) conflicts related to Q3’s new Active Income & Growth strategy, (5) The launch of the Q3 Collective Investment Trusts (“CITs”). More details are available by request and can be found in the Brochure. If you would like a copy of the Brochure, our Form CRS, or our Privacy Policy, please contact our office at: info@q3tactical.com or 248-566-1122 x 102. Additionally, a copy can be downloaded at the following URL: https://www.q3tactical.com/Forms/Q3_Form_ADV_CRS.pdf. As a reminder to clients, we ask that you contact either Q3 or your Representative if your investment objectives, suitability considerations or investment time frame has changed. If you would like to update your suitability questionnaire, a copy can be obtained by going to www.q3tactical.com/Forms/questionnaire.pdf. Once complete, it can be faxed to us at 888-439-2572. If you would like to impose reasonable restrictions on the management of your account, or modify existing restrictions, you may do so by providing such restrictions to Q3 in writing, via fax (888-439-2572) or mail (2175 Cole Street Birmingham, MI 48009).