Market outlook as of January 2024

"The problem is not that people are taxed too little, the problem is that government spends too much."

Ronald Reagan (February 1911 – June 2004), - Politician and actor who served as the 40th president of the United States from 1981 to 1989.

Almost everyone was cautious at the beginning of 2023 with strong consensus that the US would go into a recession. Predicting markets are always very challenging and should be carefully calibrated into one's own investment risk tolerance and asset allocation, which we think should always remain paramount. One factor that helped propel markets was the focus on AI (artificial intelligence) technology and the potential economic benefits the US economy will reap. Now, most economists are almost unanimously bullish and think 2024 will be a good year.

We are not convinced that the US economy is out of the woods yet. There is still lots of economic uncertainty in the form of monetary headwinds from a restrictive policy, higher interest rates, quantitative tightening, a weakening economy, and more permutations for geopolitical risk than we have seen in the past. There is also the potential for increased market volatility in a contentious US presidential election year. The strong year end performance of the S&P 500 index has more than likely also pulled some returns from 2024 into 2023 but basically recouped the losses for 2022.

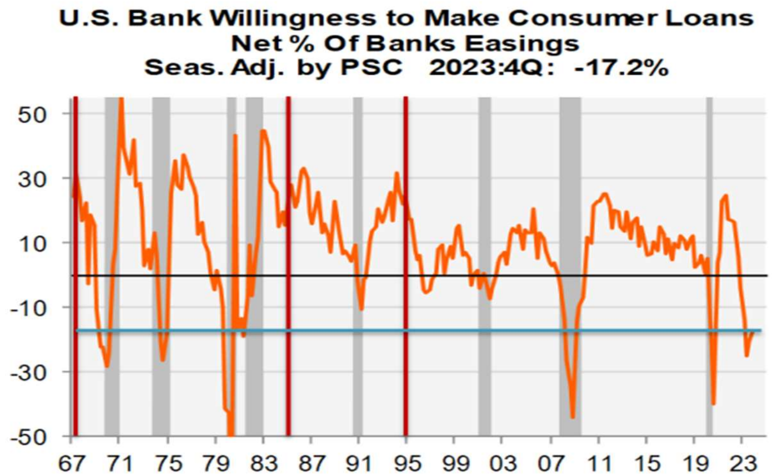
Federal Reserve

Currently an overwhelmingly optimistic **"soft landing"** narrative is built into this year's returns. Markets expect the Fed to deliver at least three rate cuts in 2024. We see the Fed at a fragile point, that needs a very fine balancing act to make sure inflation is not reignited and ensuring that they stick a soft landing. The fact that a recession has not occurred yet does not mean that it's off the table.

The path of what the Fed does and/or signals will continue to dominate the stock market direction. There is even an outside risk of inflation re accelerating, igniting a second wave which the Fed would have to raise rates, undoing all the progress that they have made over the past two years.

Soft landings are uncommon especially after such aggressive rate hikes. Markets nearly always rally when the Fed signals that they are done tightening ("Pivots") and investors anticipate a soft landing. However, since 1979 we have had 6 recessions, and 3 soft landings from Fed rate hikes. Recession risks still remain elevated (but lower than last year) for most of the developed world in the current year ahead. The U.S economy is expected to grow by 2.1% better than the rest of the developed world.

In the past a combination of Fed tightening, and tougher lending standards has always led to a recession (hard landing) (see charts below, Piper Sandler) – time will tell!



Fed tightening cycles AND banks tightening lending standards lead to recessions (gray bars). Soft landings occur after a Fed tightening cycle, with banks NOT tightening lending standards.

We are concerned that the consumer (representing 70% of the US economy), especially in the middle to lower economic echelons could be at the core of an economic slowdown as their excess savings have now run dry as “real” high interest rates take their toll on economic activity. Bankruptcies are increasing too.

Elections

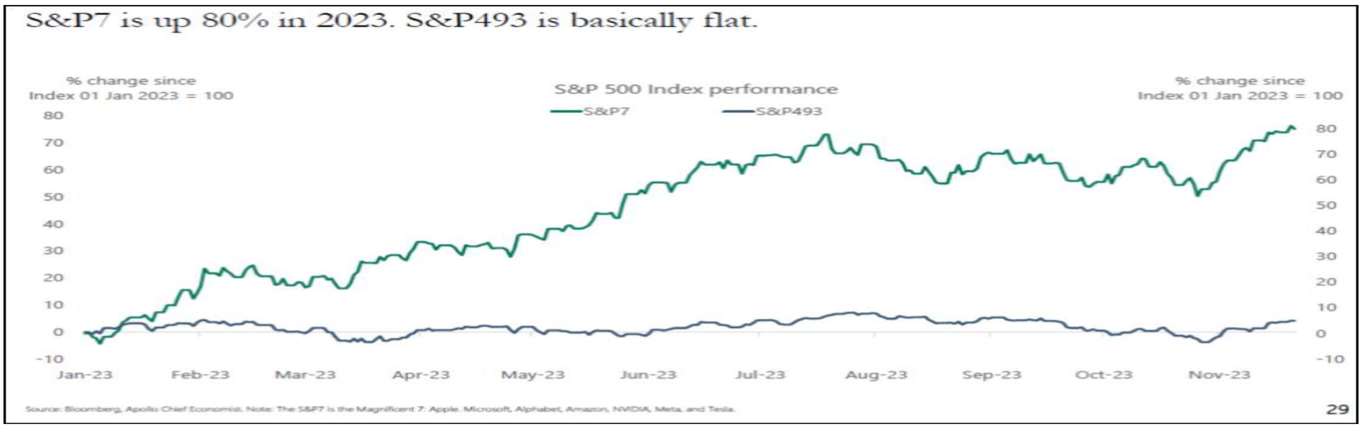
This year’s election will also play an outsized role, as the current administration wants to ensure that the economy remains robust to get re-elected and will stimulate the economy as much as possible through spending. We think that 2024 could be the year of a third-party candidate tipping the elections one way or even possibly preventing an outright win of the majority of the Electoral College, throwing the outcome to the House of Representatives.

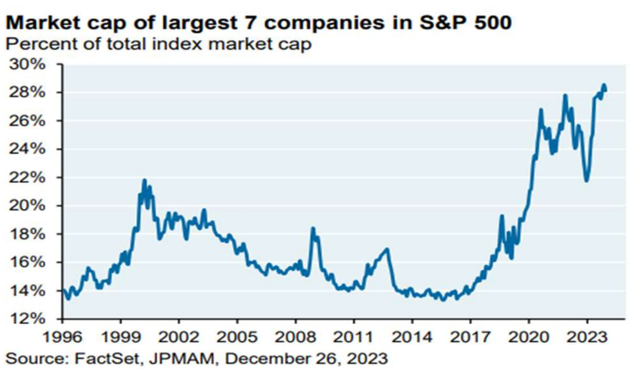
In **2024, Elections** around 2 billion voters will be going to the polls worldwide with the US being the most consequential, but also include India, Russia, Taiwan, South Korea and South Africa – politics will surely contribute to some market volatility. However, historically US elections are mostly positive for markets. (Chart Below – Raymond James)

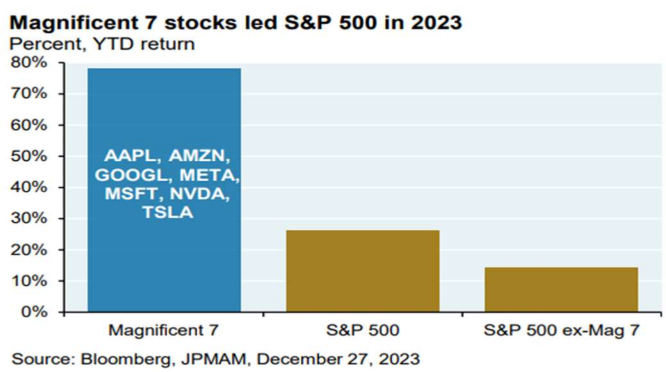
The **US government's insatiable need for borrowing will crowd out** corporate investment activity and economic activity in the form of permanently higher interest rates. The current path of **US deficits is unsustainable** and will matter at some point in time with potential serious consequences. Annual US deficits are running around 6% of GDP, about double the historical norm. This is one area to watch and could keep interest rates higher than most are anticipating.

Valuations

Valuations, especially in high growth assets, are priced very close to perfection, while the rest of the market looks inexpensive. Market returns for 2023 were highly concentrated in the "magnificent 7" stocks. (See Charts below)



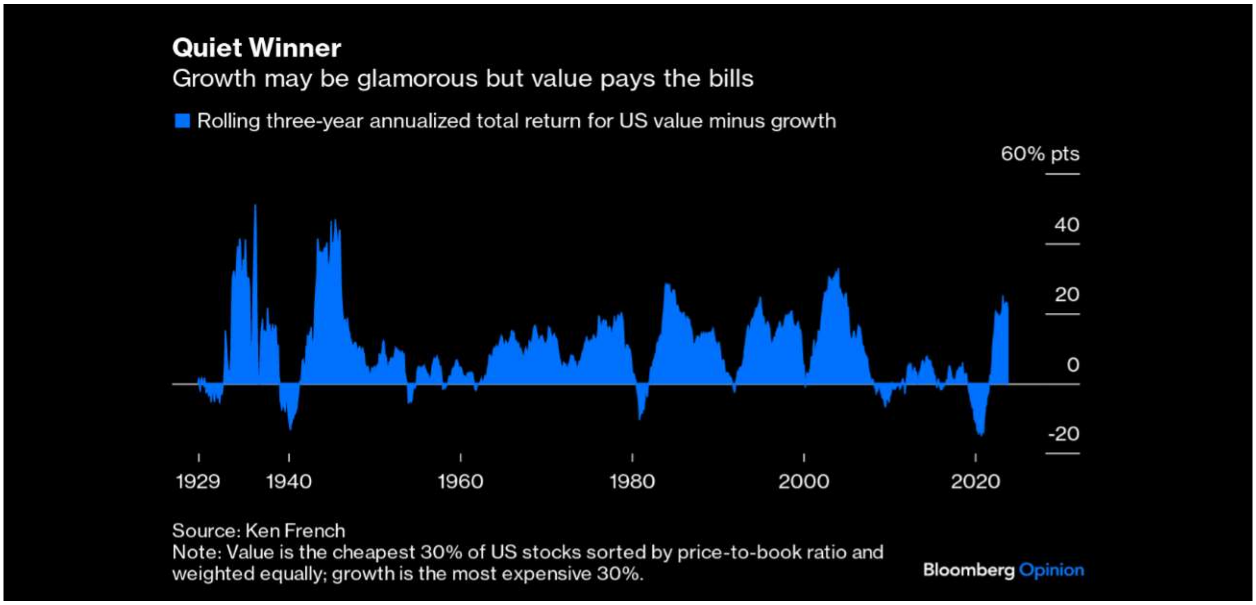




In the past such concentration has proved to be unsustainable. Cisco Systems (CSCO) for example went from $80 to under $10 after the dot.com era ended.

Valuations for dividend paying stocks have also drifted lower over the past few years making them more appealing for their lower volatility and income characteristics in the form of dividends adding to total returns for investors.

As we often emphasize, we are value biased and for good reason. Value investing shows that stocks are less volatile and more boring than growth. Most investors prefer owning Tesla and Nvidia, rather than JP Morgan and Abbott Labs. For stocks like Microsoft and Alphabet (which we own) there are a similar number that flame outs such as Chewy (CHWY currently around $20.00 from a high of $120)) and Lucid Motors which now trades at $3.50 but was as high over $50.00 at one point.



While 2023 was dominated by a small number of high performing companies, we strongly believe in diversification for long term investors in a wider range of sectors that are attractively valued, with strong secular growth. The market should broaden out from here. We favor quality companies with robust balance sheets, proven management, strong cash flow, ability to defend profit margins and are best positioned to grow long term earnings in a slowing global economic environment; especially suited for investors that seek lower volatility and risk. Diversification remains key especially given the potential for heightened volatility.

Healthcare, which particularly underperformed in 2023, should do well in 2024, and has very good defensive qualities should we sustain a recession.

For more risk averse investors, due to higher interest rates "**T**here **A**re **R**easonable **A**lternatives" (TARA) including high quality government and corporate bonds. – Please call to discuss if you feel that you want to take less risk going forward.

It is always advisable to review one's individual circumstances and tolerance for risk. If any of your financial circumstances have changed, or you want to adjust your portfolios risk profile <u>we always encourage you to contact us should you want to make any changes to your portfolio allocation.</u>

As always, please feel free to contact us with any questions or concerns.

Brian

Brian Chait

President, January 11th, 2024

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