Lynx Capital Group Ltd

Disciplined Strategic Investment Management

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Market outlook as of April 2024

"Thirty years ago, many economists argued that inflation was a kind of minor inconvenience and that the cost of reducing inflation was too high a price to pay. No one would make those arguments today."
Martin Feldstein (November 1939 – June 2019) an American economist and Professor of Economics at Harvard. Feldstein served as chairman of the Council of Economic Advisers and advisor to President Ronald Reagan (his deficit hawk views clashed with the Reagan administration's expenditure policies).

The year got off to a good start with the first quarter being the best for the market since 2019. The market demonstrated good breadth, with a wide range of sectors either outperforming or following the overall market, with no sector posting a loss for the quarter. The Morningstar US Value Index gained 8.4%, ahead of the Morningstar US Growth Index's 8.3% return. This indicates that the markets have started to broaden out beyond the Magnificent 7 stocks. That advance was mostly driven by value equities in energy, healthcare as well as financial sectors. So far, the second quarter has had a rough start due to higher inflation numbers with the Consumer Price Index being up over 3.5% in March (year over year) and Middle East tensions.

The U.S. economy has remained comparatively stable despite a lot going on behind the scenes and it has been driven by well-established factors such as a strong labor market and well-off consumers who are willing to spend freely due to high property values and adequate household wealth. In 2024, economic growth is anticipated to pick up steam globally, and corporate profits are expected to rise sequentially.

Prior to reducing interest rates, the Federal Reserve is waiting for inflation to abate. The timing of rate cuts has now been called into question by persistent inflation pressures. Stubborn core inflation has driven up interest rates, causing economists to revise their outlook for rate cuts. At the end of last year markets were pricing seven quarter point reductions, it is now 2 or less. A global industrial/manufacturing recovery is also taking place. The unemployment rate continues to remain robust, which has been below 4% for over two years and at record lows since the 70's, a testament to how resilient the overall economy is. (see below)

The Feds challenge is that it's still dealing with the aftermath of unprecedented government stimulus during Covid (roughly $5 trillion) and further packages passed by the Biden administration in the form of the Creative Helpful Incentives to Produce Semiconductors (CHIPS) Act, as well as the Inflation Reduction Act (IRA) and, to a lesser extent, the Infrastructure Investment and Jobs Act (IIJA) and Student debt forgiveness which have severely reduced the impact of much higher interest rates and have all served as further stimulus to keep the US economy strong. To slow down and stop a fresh monetary cycle from sparking the inflation fire, the Fed has raised interest rates. However, it is now delaying taking additional action until all these excesses are eliminated from the system**. *Our personal view is that rates will stay higher for longer assuming unemployment remains low and the market stays strong there is no reason to cut, which could cause inflation to reignite.***

Portfolio Positioning. No one can argue that The Magnificent 7 Companies are all spectacular, however high valuations and their concentration cannot last forever. While one is tempted to concentrate portfolios even further into these stocks, lessons in history say otherwise.

The "Magnificent Seven" still contributed over 60% of the S&P 500's returns this last quarter, following their over 60% contribution in 2023. But as they say, anything that goes up, must come down, and these big businesses have the potential to seriously hinder index or portfolio performance just as they did for the rise. These stocks currently account for roughly 30% of an index of S&P 500 stocks!

The worst-performing company (in the S&P 500) in the first quarter was Tesla (TSLA - down 29.4%). Tesla's EV sales are being forced down by increasing competition in China, and a general slowdown in the EV market. The company's automotive revenue in the fourth quarter fell to just 3% year over year. Apple was also down 10.8% for the quarter due to lack of revenue growth and valuation.

Despite their seeming invincibility, these behemoths can lose their momentum and be surpassed in the market leadership. History bears this out. The graphic below shows how shifts in industry and economic pressures have rearranged the ranks of the largest companies in the globe throughout time. For instance, of the current top ten corporations in there, only 6 companies that were top of the list in 2020 are currently there today, going back further to 2010 there are only 2.

1980	1990	2000	2010	2020	2023
IBM Corporation	IBM Corporation	Microsoft Corporation	Exxon Mobil Corporation	Apple Inc.	Apple Inc.
Exxon Corporation	Exxon Corporation	Cisco Systems Inc.	PetroChina Company Ltd.	Microsoft Corporation	Microsoft Corporation
AT&T Company	Industrial Bank of Japan Ltd.	GE Company	Apple Inc.	Amazon.com Inc.	Alphabet
Amoco Corporation	Fuji Bank Ltd.	Intel Corporation	BHP Group Ltd.	Alphabet	Amazon.com Inc.
First Quantum Minerals Ltd.	GE Company	Vodafone Group Plc	Microsoft Corporation	Tencent Holdings Ltd.	NVIDIA Corporation
Chevron Corporation	Philip Morris Companies Inc.	Exxon Mobil Corporation	Industrial and Commercial Bank of China Ltd.	Tesla Inc.	Tesla Inc.
BP Amoco Plc	Sakura Bank Ltd.	Deutsche Telekom AG	Petroleo Brasileiro SA Pfd	Facebook	Meta
Atlantic Richfield Company	Sumitomo Mitsui Banking Corporation	Nokia Oyj	China Construction Bank Corporation	Alibaba Group Holdings Ltd.	Eli Lilly and Company
GE Company	Dai-Ichi Kangyo Bank Ltd.	Nippon Telegraph and Telephone	Shell Plc	Samsung Electronics Company Ltd.	Broadcom Inc.
General Motors Company	Toyota Corporation	Wal-Mart Stores Inc.	Nestle S.A.	TSMC Ltd.	Visa

Sources: Capital Group, FactSet investable universe. 2020 and 2023's lists excludes Aramco and Berkshire Hathaway. Indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index. Past results are not predictive of results in future periods. Data is as of December 31 for each year, except 2000, which is as of February 28, 2000.

For this reason, our main focus towards the end of the quarter was to rebalance portfolios, by reducing the biggest gainers back to market weight and adding to underweight positions. Studies show that this enhances portfolio returns over time.

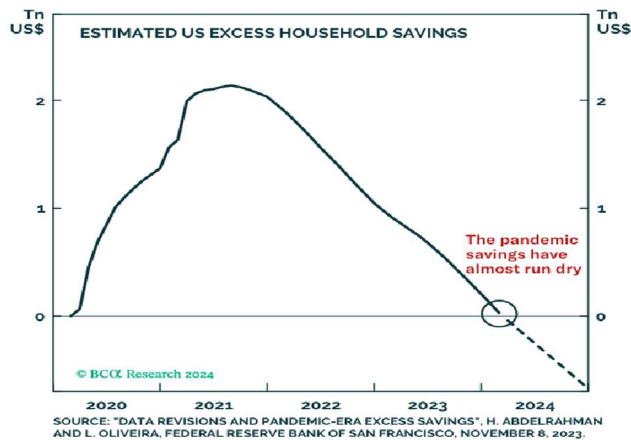
Areas of Concern:-

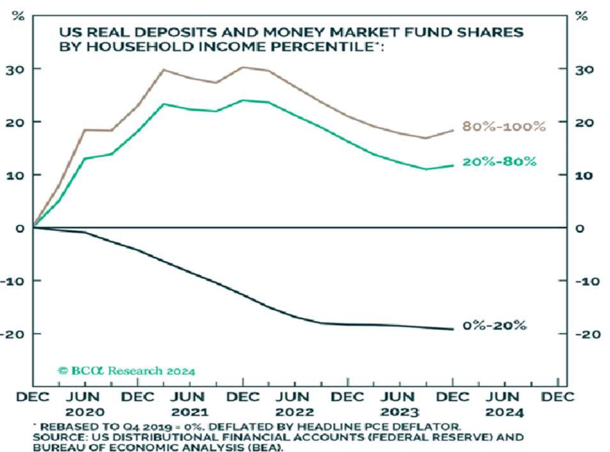
1.) Even while inflation has decreased, it is still higher than the Fed wants. A sharp increase could force the Fed to hike rates once more or, more likely, postpone the rate reduction that the market is expecting, which it is already doing.

2.) Valuations are not at extreme but are NOT cheap either as shown in the chart below. Many new and younger investors are complacent and are chasing the market leaders without fear. The speculative mania is back with bitcoin and other ***"meme"*** (Shares that are going up due to viral popularity, and not due to fundamentals) stocks.

3.) A recession, while becoming less likely in 2024, still cannot be ruled out. There are many areas that are already signaling weakness. Banks have curtailed lending and small corporations' defaults are rising. Credit card delinquencies and debt are back to 2012 levels. Even a mild recession could cause a 20% drop in the market, and even more in speculative areas.

Excess Pandemic Savings Have Been Depleted, Especially At The Bottom Of The Income Distribution





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Conclusion

There are still a lot of reasons to be optimistic moving forward, particularly if the much-desired rate cuts happen. Based on history, when the S&P 500 has started with a very strong first quarter, it has averaged a 6.5% gain over the final nine months of the year. However, several obstacles, such as a stock market that is still heavily top weighted, a heated Presidential race, and growing worries about budget deficits, Middle East, and Ukraine/Russian war, could work together to increase volatility to high levels.

We continue to be overweight healthcare for its defensive characteristics. Healthcare has historically been the best performer after the Federal reserve starts cutting interest rates which should start sometime this year. We anticipate a strong profits recovery in this severely oversold industry, fueled by ongoing investments in cutting-edge medications, medical technologies, and treatments. The indication is that the demand for these now reasonably valued stocks has increased and that a catch-up phase is likely due soon.

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 us if you feel that you want to take less risk going forward or discuss your current asset allocation.

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 we always encourage you to contact us should you want to make any changes to your portfolio allocation.

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

Brian Chait

President, April 15th, 2024

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