Winter 2024 Quarterly Commentary

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Does the bull market have legs?

Economic Perspective: The economy seems to be on firm, but not quite solid, footing. While 2023 saw an acceleration of economic growth spurred by inflation (and price increases), it looks as though 2024 will experience moderating economic growth. Hence, our forecast for a 'soft-ish' economic landing is still on the table. As usual, there are numerous data points that have us cautious. Specifically, on the jobs front. December job openings (JOLTS report) came in weaker-than-expected at 8.79 million jobs – its lowest reading since March 2021. The hiring component within the report was the weakest since March 2020. The manufacturing sector remains cool as well. The ISM Manufacturing Index December report came in sub-50 (economic contraction) once again at 47.4. It was the fourteenth consecutive month that the manufacturing sector declined – its longest stretch since 2002! However, not all is gloom-and-doom with our domestic economy. Consumer spending, while slowing, is still relatively solid. According to Mastercard, retail sales advanced 3.1% during the holiday season – led by online sales up 6.3% while in store sales gained 2.2%. This is certainly much slower than the 2021 (+8.5%) and 2022 (+7.6%) gains but we are reminded that both years were boosted by inflation and stimulus dollars while this year we have experienced disinflation. We are also encouraged by the recent decline in mortgage rates from previous highs just under 8% to 6.6% today. While existing home sales have dropped near August 2010 lows, there are some signs of stabilization. An improving housing market could help lift construction employment and provide a tailwind for the economy.

Market Perspective: The stock market's rally in 2023 was driven by an improving economic climate as well as corporate profits. Last year, the market's valuation multiple (price-to-earnings ratio) expanded by 14.4% as profits grew 8.6%. Therefore, the strong returns of 2023 were driven more by improving investor sentiment and to a lesser extent company fundamentals. As a result, the S&P 500 Index's P/E ratio ended the year at 22.3 times trailing 12-month earnings (above the 25-year average of 19.3 times). Will we see a reversal of the market drivers in 2024? Will company fundamentals need to catch up to investor sentiment? We think so. Wall Street currently predicts 12% profit growth for this year. This may be a bit of a stretch in a slowing economy unless a few things happen. First, we believe the economy needs to avoid a recession at all costs! Second, interest rates need to stay range bound around 4% (+/- 50 basis points). The positive benefits from the recent interest rate relief we have experienced could provide an economic tailwind in the coming quarters. Third, we would like to see a continuation of disinflationary trends. With that said, it will be important for current disinflationary trends not to be replaced by deflationary fears. That kind of a change in the economic narrative would be very difficult for the market to digest. We believe, if disinflation continues, we could see an improvement in corporate profit margins. While a slowdown in the economy will naturally slow the rate of corporate revenue growth, it is likely that input and labor costs will decline at a greater rate. Companies are notoriously slow to lower their prices unless the economy forces them to do so. This gives us increased confidence that margins could expand towards Wall Street's 12% earnings growth forecast.

Looking Ahead:

As we all know by now, 2024 is a big election year – not just in the U.S., but globally as well. According to Strategas Research, "2024 will be a year in which national elections will take place in countries that represent more than 40% of the world's population and 80 % of its stock market capitalization…we believe it is important to remember that incumbents will be even more incentivized to keep their economies out of a recession at all costs." Our investment committee believes that, with so much at stake, it is important for global investors to not get overly pessimistic. A much more-than-anticipated economic slowdown would awaken monetary policy makers – likely responding by aggressively cutting interest rates going into national elections. At year-end, Wall Street strategists had forecasted a handful of interest rate cuts. Yes, interest rate cuts! While it is certainly possible, our base case is for fewer rate cuts than that unless deflation becomes problematic.

Historical data suggest that the stock market could do well this year. In fact, the S&P 500 has finished green in 13 of the last 15 U.S. Presidential Election years with an average gain of 10%. The only two times the market finished in the red were 2008 (the Global Financial Crisis) and 2000 (the Dot Com Bubble). After a strong 2023, a correction is certainly possible. However, with current cash at $5.9 trillion (sitting in money markets) on the sidelines, we believe that a market correction is likely to be met with an investor 'buy the dip' mentality. We are likely to see much more broad-based returns in 2024 as last year's market leadership came from less than ten names. If our economic forecast is accurate, there is a chance this could be another strong year for the market. We could see investor sentiment shift from cautious optimism to FOMO (fear of missing out) – giving this bull room to run. Hang tight for the upcoming ride. It is likely to be an interesting year.

"These voices in your head…do they ever tell you the Fed's next move?"