



Party Like Its 1999

Q1 2024 Market Update



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“To those waiting with bated breath for that favorite media catchphrase, the U-turn, I have only this to say, ‘You turn if you want, the lady’s not for turning.’”- Margaret Thatcher

It’s very en vogue to quote Taylor Swift in your 2024 outlook. Frankly, 2023 could be dubbed the year of Taylor Swift with her record-breaking concert tour, rerecording albums for her control, and the hard to miss the frenzy over Taylor and Travis at NFL games. Markets followed Taylor’s lead, shaking off the bear market of 2022 and performing better than most investor’s wildest dreams. Karma became the Fed pivot igniting an equity and fixed income rally in November that made any investor sitting on the sidelines jealous. This year has been fraught with danger (Regional banks and 2 Wars), but the markets have successfully climbed the wall of worry to flirt with all-time highs.

Last year, in our 2023 outlook we called for it to be a year of transition out of the bear market. While that was the right call, we certainly underestimated the strength of the Q4 rally. If the year had ended 10/31/23 we would have been spot on, but November’s torrid rally followed by a strong December saw us undershoot the strength of the bull market. Stepping back and considering the big picture, over 2 calendar years, markets have moved a total of less than 2%. Markets closed 2021 at 4,766.18 and currently, as of close 12/21/2023, the S&P 500 sits at 4,746.75. Sound and fury signifying nothing indeed. 2022 was the year of Value’s comeback over Growth, with the Dow Jones outperforming its Growth counterparts the S&P 500 and NASDAQ handily. For 2022, the Dow was down -9.39% vs. S&P -19.95% and NASDAQ -33.89%. But the tables have turned this year as the markets bottomed in Oct. 2022 and Growth and Tech have far outperformed their peers. YTD for 2023 (though 12/20/23) the S&P 500 is up 22.86%, NASDAQ up 42.27% and The Dow Jones up 11.91%. With the Dow hitting new highs in December of this year, and the S&P flirting with the record high of 4,796.56 set Jan 3, 2022, markets seem poised to continue their breakout.

2024 Outlook

We anticipate market strength to continue in 2024, albeit at a much slower and more volatile pace than in 2023. There have been recent confirmations of breadth strengthening and a much broader market rally to support the ability of most indices to break out to new highs in 2024. There will be 4 keys to '24 to keep an eye on: The Fed, The Labor Market, Corporate Profits, and Valuations. We caution that as the Fed pivots from pause to cut, there has inevitably been a sell-off after the Fed starts cutting rates. While we are moderately bullish, we are wary of the economic wheels falling off causing slowing profits ergo slowing the market. While the stock market is not the economy, companies are not immune to if and when their consumers start to suffer and slow.

2024 Outlook:

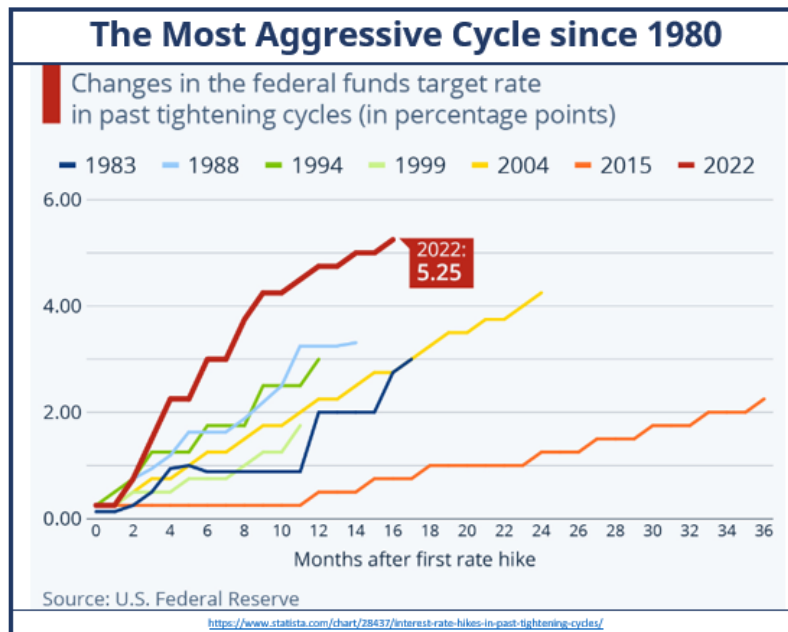
- S&P 500: 5,000
- Earnings: \$240
- 10-Year Treasury: 3.50%
- Year End Fed Funds rate: 4.25-4.50% (100bps of cuts)

Our outlook cause for moderately positive markets, led more by small caps and international than by growth, as well as multiple expansion and earnings growth. We feel the Fed will start cutting rates bringing the 10-year yield down as well as Fed funds. Initially, rate cuts help companies, but at some point, the reason WHY the Fed is cutting rates will outweigh the benefits of lower interest costs and a loser monetary policy. Our outlook puts us in the upper end of forecasts as far as other analysts and projections go. Currently, Fundstrat and Oppenheimer have the highest outlook at 5,200 and JP Morgan comes in lowest at 4,200 with the average target at 4,801.47 across 17 strategists.



The Fed Put

As we shift into 2024, we can reflect on the new Era that dawned in 2023: the Fed Pause and acknowledgement of likely cuts in 2024. 2023 might even be called the year of The Fed Put, as almost every time the Fed talked in the second half of the year, the market rallied around Dovish Sentiment. The Fed started hiking rates in March 2022 with ten consecutive meetings resulting in a hike, followed by the final singular 25bps hike in July 2023 taking the target rate from 0.00-0.25% at the start of 2022 to 5.25-5.50% in the Fall of 2023. The speed of the hikes has been seen only a few other times in the recent history of the markets, with the Fed moving faster than any other period than the crazy late 1970's and early 1980's. During that era, we saw hikes at individual meetings of 5.00% in the Feb 1980 meeting as well as 1.50% and 2.50% hikes back-to-back both in October of 1979. It is worth noting that there was an immediate -8.50% cut in April 1980 due to the aggressive tightening slowing the economy too much. A -17% decline in the S&P 500 between Feb and the end of March mayhaps played into that decision as well. The Fed isn't supposed to care about markets, but they also don't live in a bubble.

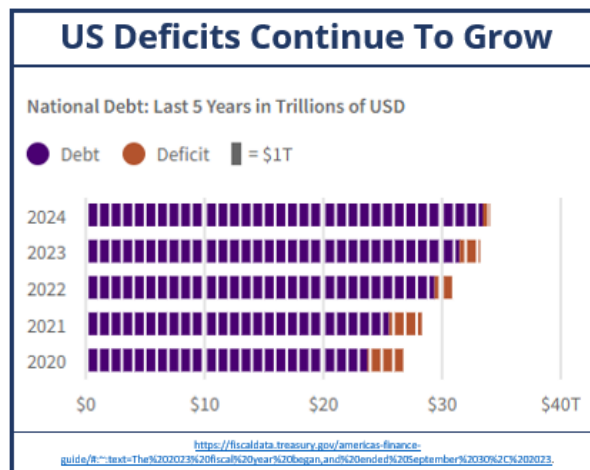


2022-2023 hiking cycle looks to have peaked at 5.25-5.50%, and the average pause is about 12 months which would put the first cut over the summer. However, Fed Fund Futures as well as OIS (Overnight Index Swaps) are both pricing in cuts beginning in March which would be very early for a cut short of an economic meltdown. It is worth remembering that the Fed does not (or rather should not) care about the market. Per their Website www.federalreserve.gov "The Federal Reserve Act mandates that the Federal Reserve conduct monetary policy so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Employment, inflation, and interest rates are their mandate. Stock market prices, home values, and GDP growth are not. However, the Fed is a politically appointed board, and it can be difficult to avoid political pressure- especially in a very contested election year. They may frame any early cuts as needed for market stability, as we saw in March 2023 when they paused tightening due to the Regional Banking Crisis. They also intervened in the middle of the 2020 meltdown during COVID to provide liquidity and stability. Historically, it would take a big event and a significant enough turmoil to give the Fed leeway to intervene in the name of stability.

Labor Woe or Grow

A major key to Fed trajectory in 2024 is how the Labor and Inflation data evolves. Labor has remained stronger than even the staunchest believer could imagine during this hiking cycle, with unemployment staying below 4% for twenty-two straight months. During 2023 (since Feb 2022 actually), the unemployment rate has barely budged, fluctuating from 3.4% to 3.9% all year. In general, an aggressive hiking cycle during high inflation sees the labor market tighten and the unemployment rate rise as firms cut back on workers to save profits. We also saw numerous large tech companies announce layoffs this year with Google announcing a 6% staff reduction or almost 12,000 job cuts, Microsoft announced a 5% cut or about 10,000 employees being laid off; Meta also announced a 10,000-workforce reduction which was its second wave of layoffs, and Salesforce announced it would cut about 10% of its staff. There was a heightened focus on increasing profits, streamlining and, as META CEO Mark Zuckerberg put it, “the year of efficiency.” Corporate efficiency means higher profits and markets rewarded those companies.

And yet, those job losses were successfully absorbed by the market with JOLTs (Job openings) falling and the unemployment rate steady. Service and hospitality industries initially supplied the job growth earlier in the year, but in November gains were led by health care, government, and manufacturing. It is worth noting that the US and State and Local Governments combined are the USA’s largest employer and as we see the debt burden grow and US deficits become more of a concern, we could see a reduction. The US government has been the model of dysfunction the last decade or so, the recent Moody’s outlook downgrade to “negative” from “stable” could be a catalyst towards action. Currently, the CBO projects that US debt will rise to 119% of GDP by 2033, and there is the potential due to higher borrowing rates and higher debt levels that by around 2026 interest costs could consume a larger portion of the budget than Defense or Medicare. For the Fiscal Year 2023 that ended in September, we ran a 2-Trillion deficit, 2x the size of the 2022 deficit. It is extremely rare to run deficits this high outside war or pandemic crises.



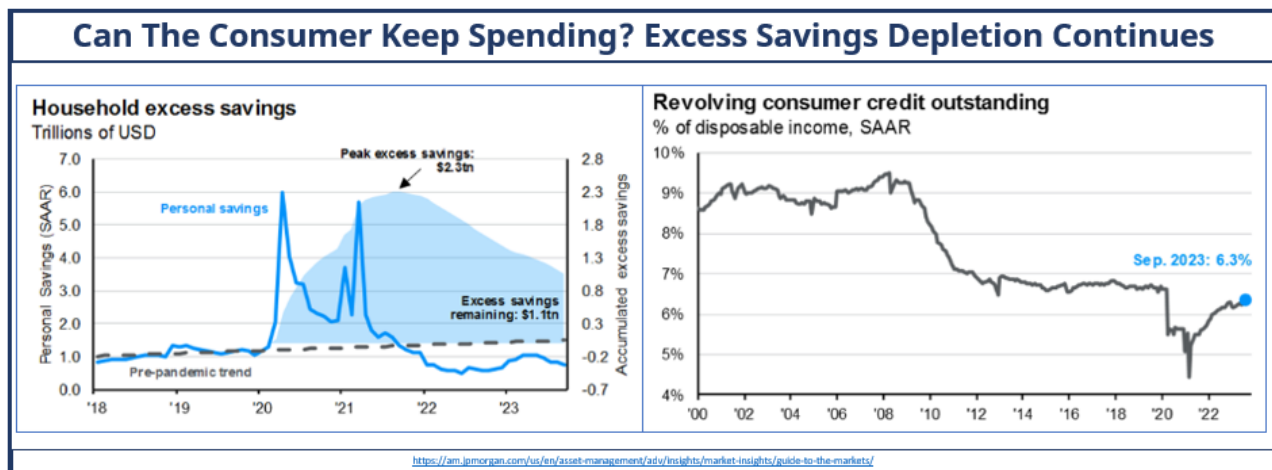
Per Bloomberg, as of 12/20/23 their model sees it more likely than not that there will be a gradual increase in unemployment to 4.5% by the end of 2024. However, there is a wide range of credible intervals (68% chance interval ranging from 3.2-5.5%.) Forecasting labor markets has been difficult in this post COVID world and will likely be even more hit or miss as AI (Artificial Intelligence) gets adopted by more and more firms. The AI effect could amplify any labor stress by reducing the needed corporate workforce via automation, algorithms and Chatbots. AI adopting has been hard to forecast as its alien territory, though will likely move more rapidly than internet adoption in the 2000’s.

Corporate Profits

2023 profits look to have grown about 8.8% on the year, which is slightly in front of the 20-year average growth rate for the S&P 500. Currently, it's estimated that corporate profits will continue to grow in 2024, though we have seen some earnings revisions start to wobble and contract. Currently, FactSet sees 2024 earnings growing 11.8%, above the 10-year average of 8.4%. Profitability will depend on the economy's ability to stick the soft landing and avoid a recession. During recessions, profit margins historically contract and earnings slow. Profit margins have fallen from their highs of 13% in Q1, 2022 to 11.2% as of end of Q3. Profit margins matter as they represent the amount of sales that the company actually profits from. Lower margins mean you must sell more products to generate a stable level of earnings. Operating margin and earnings expansion are projected to help drive higher earnings in 2024, thus propel the markets to new highs. Currently the Real Estate Sector, Financial Sector, and Energy Sector look to have the best potential to expand their profit margins when looking at current margins vs. historical ranges.

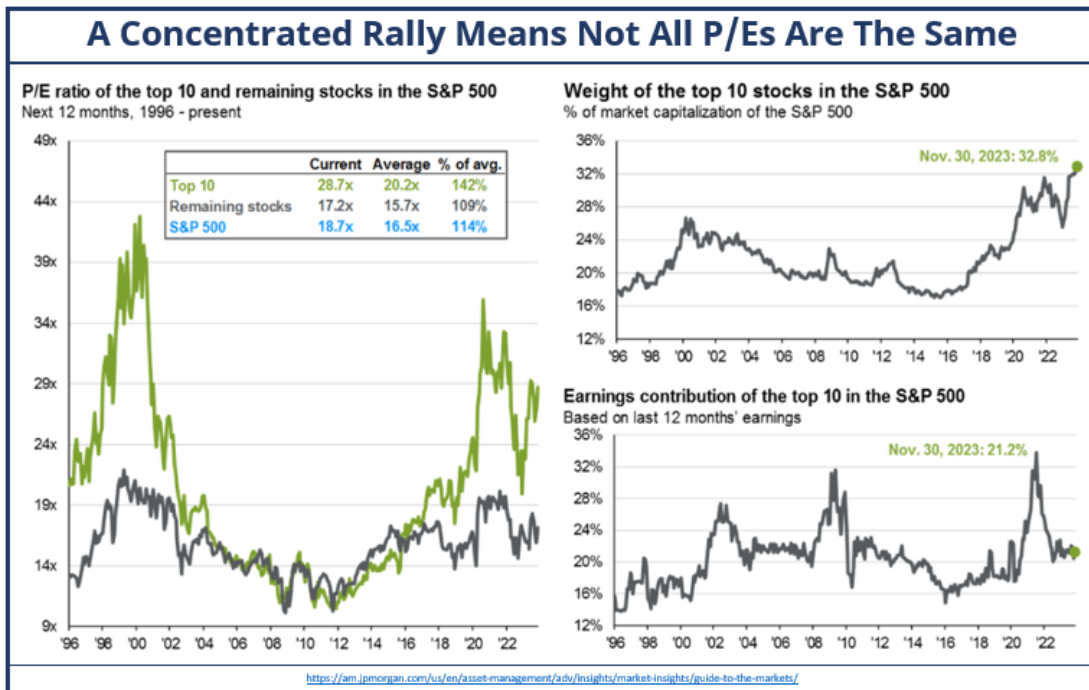
Earnings expansion depends also on whether you believe the soft-landing narrative or if you feel a contraction is coming. JP Morgan, who has the lowest current 2024 S&P 500 target at 4,200, forecasts earnings growth of only 2-3% next year to \$225 citing the highly concentrated nature of the index as well as an erosion of pricing power by corporations that will be a big headwind to margins. They also feel excess liquidity will finally be exhausted by the second quarter of 2024 and cause a drag on earnings. Oppenheimer, which has one of the most bullish 2024 outlooks with a 5,200-price target, expects the transition by the Fed to easing to be a major catalyst for earnings growth. They recommend more cyclical sectors (including the 3 that performed the best this year) with Technology, Communications and Consumer Discretionary their favored sectors. Basically, same song different year with 2024 acting similar to 2023. Overall, they see a 9% earnings growth to \$240 with a P/E expansion to 21.7x.

As we have pointed out, the trajectory of profits and earnings will depend heavily on the Fed, the economy, and the consumers ability to spend. How tapped out the US consumer is, and how much excess liquidity is still in the system are major challenges for 2024. Consumers have continued to spend, even as credit card balances rise and savings dwindle, but for how long can they support this pace? NKE, HD, WMT and multiple other consumer sensitive companies have flagged concerns on the direction of consumer spending, yet we also saw record amounts spent over the Black Friday weekend. If the consumer does not break in 2024, it is likely it supports the viewpoint of soft landing and expansion.



Do Valuations Matter?

Irrationality, high valuations, and bubbles can persist far beyond what market strategists like. While the markets are expensive vs. historical standards (using S&P 500 to represent the market) we are still well below the 25x or 30x multiples we saw during the tech bubble era. Often during a bull run, it becomes much less about the fundamental valuation and more about the growth potential. We have seen this with the AI driven tech sector as well as the concentrated S&P 500 returns in the megacaps this year (AMZN, AAPL, GOOGL, MSFT, META, NVDA, TSLA). If you look at the P/E of the top-10 stocks they are trading at 28.7x vs. the 18.7x average for the S&P 500 and the 17.2x average for the remaining 490 stocks in the index outside the top-10 holdings.



The percentage of stocks that outperformed the S&P 500 in 2023 (through 12/14/23) stood at around 29% per RBA advisors, well below the median 49% of index members outperforming the broad index. Many stocks that have lagged this year include dividend payers, high quality, and value. In fact, through 12/22/23, only 3 sectors outperformed the broad index: Technology, Consumer Discretionary, and Communications. All three are heavily weighted to the Magnificent 7. The other 7 sectors lagged, led by Utilities down -11.51%. Valuations for the broad market are average at best, and if we achieve the anticipated earnings growth, you may see further upside in the markets as there is room to run supported by higher earnings and potentially margin expansion as well. If you look at the median S&P 500 valuation (not the cap weighted) it is sitting at 17.1x and well within +/- one standard deviation of normal. Expensive, but not alarmingly so. There are certainly areas of the market that look expensive vs. historical comparisons, however areas like technology, discretionary and communications tend to trade expensive vs. more defensive sectors such as utilities or health. Growth looks expensive vs. Value, and some of the indices with the highest operating leverage and potential growth are value sectors such as Energy and Financials. What you own will matter in 2024, and while we believe AI is a strong theme, it might be prudent to consider rotation.

The Road Goes On Forever, But This Party Will Sometime End

For those of you unfamiliar with the song, this heading is a play on a famous Texas Country song by Robert Earl Keen called "The Road Goes on Forever and the Party Never Ends." Highly recommend a listen!

We believe the inevitable conclusion of pivoting to cuts will be a slowing economy and a falling stock market. It does take time from when the Fed pauses and begins to cut to when the stock market begins to sell-off. And no economic cycle or market cycle is the same- every cycle has unique attributes and risks that other cycles may not bear. Reviewing the last 5 hiking cycles going back to 1986, outside of the 1994-1995 cycle all saw a market top within 325 trading days of the pause beginning. We reviewed the data and charts on when the hiking cycle began, when the pause began and then compared that to the S&P 500 and if/when there was a market top around the pause as well as where the market bottom appeared in the cycle. On average, it was 208 trading days from the start of the pause to the market top.

Rate Hikes Start	Hikes End/ Pause Begins	Pause Ends/ Cuts Begin	Rate Cuts End	Date of Market Top	Date of Market Bottom	Peak-Trough Market Change	# of Trading Days From The Pause Start To Market Top
12/16/1986	2/24/1989	6/5/1989	9/4/1992	7/16/1990	10/11/1990	-19.02%	282 Days
2/4/1994	2/1/1995	7/6/1995	1/31/1996	Markets Rallied 1995-1998. Early 1990's was unique			NA-
6/30/1999	5/16/2000	1/3/2001	11/6/2002	3/23/2000	10/7/2002	-49.14%	-37 Days
6/30/2004	6/29/2006	9/18/2007	12/16/2008	10/9/2007	3/9/2009	-56.78%	322 Days
3/19/2014	1/30/2019	7/31/2019	3/15/2020	2/19/2020	3/23/2020	-33.92%	265 Days
3/16/2022	7/26/2023	??	??	??	??	??	??
AVERAGE							208
<small>Data from Bloomberg LP as of 12/22/2023. Table made By G Squared Private Wealth</small>							

This does not mean an immediate crash or meltdown is coming. We are merely pointing out, short of a very anomalous or unique situation, the rate hiking cycle ends with rates coming down and markets falling. In the tech bubble crisis, which we have many parallels to with the AI driven rally this year, the market top came before the pause in the hiking cycle began. The 2008 market crash took longer to develop but followed the same formula with markets peaking right before rate cuts began and bottoming out around 3 months after the cuts were finished at 0.00%. While I believe we are on the clock, it may be a long time before we see the full effects and slowdown.

Historical data does not mean the EXACT same pattern will occur. We must consider whether the outside effects on the market and the extent of liquidity pumped into the system may mean this market rally lasts longer than average. Markets are also in a very strong technical charting pattern as well as entering the 4th year of the Presidential cycle which historically bodes well. Per LPL Financial, during a re-election cycle with an incumbent running, markets average 12.2% returns. It is also worth noting that stock markets perform best in times of a divided government where one party controls the presidency and the other the House and/or Senate.

2024 has the potential to be positive and bullish but likely noisy and chaotic at times. Remember the markets care much less about politics than you do. Geopolitical risks remain high with conflicts in the Middle East and Ukraine continuing and there is always the risk of disrupted trade and volatile commodity markets. Intra-year drawdowns are common, so while we are wary of a lurking bear, staying the course has often proven the most successful strategy. As Shakespeare opines, "Ambition should be made of sterner stuff." Bull markets favor the bold.