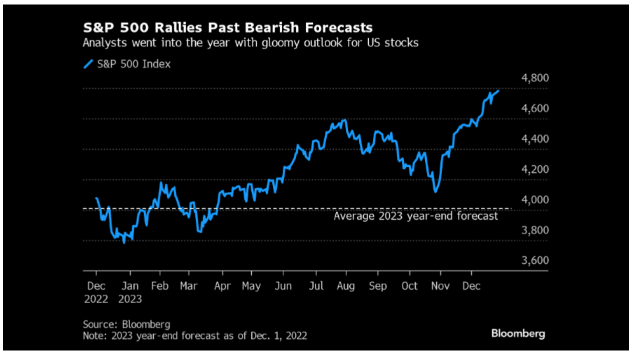
thenavigator

Winter 2024

Clueless

This was the name of the of the 1995 teenage cult movie starring Alicia Silverstone, loosely based upon Jane Austen's 1815 novel Emma. We could, perhaps, also use this word to describe the accuracy of Wall Street forecasters, especially for 2023.



Source: "S&P 500 Rallies Past Bearish Forecasts" Chart, by Bloomberg

After the consensus got the drawdown in 2022 wrong, it turned negative for 2023, forecasting that the widely anticipated US recession would happen then. It didn't and some have now pushed that forecast into 2024.

While we ourselves were not surprised by the positive outcome in markets last year, the sectors which drove it (helped by the AI craze) couldn't have caught us more unawares. January 2024 so far has also proved highly perplexing to investors, with the first week of January posting negative returns for stock investors and USD 123bn flowing into money market funds after a record USD 1.2 trillion of inflows last year.

Those investors no doubt missed out on last year's equity rally, and while there is the novelty of receiving a relatively high rate of return on cash compared to recent history, when we dig deeper and take out inflation of 3.5% and then taxes, the returns look rather less appealing.

Source: "Money Market Funds Assets at Record" Chart, by Bloomberg

Of course, just to confound investors even further the S&P 500 index, having spent 512 days without hitting a new record, reached intraday and closing record highs on Friday 19 January 2024, officially putting it into a new bull market and joining European indices, which had achieved their bull market last year. The familiar seven names which drove the US markets' gains last year were the driving forces once again.

Historically, further gains have resulted after such a long period without new highs BUT the gains have been much more moderate if the preceding bear market was shallow in nature and did not entail a recession (which we are not holding our breath for).

Major S&P 500 Advances*
(1957 To Date)

Date of Low	Date of High	Chg. In Price (%)	Duration (Mos.)	Followed Recession?
October 22, 1957	December 12, 1961	86.4	50.0	Yes
June 26, 1962	February 9, 1966	79.8	42.5	No
October 7, 1966	November 29, 1968	48.0	25.5	No
May 26, 1970	January 11, 1973	73.5	29.5	Yes
October 3, 1974	September 21, 1976	73.1	23.5	Yes
March 6, 1978	November 28, 1980	61.7	32.5	No
August 12, 1982	August 25, 1987	228.8	60.5	Yes
December 4, 1987	July 16, 1990	64.8	31.5	No
October 11, 1990	July 17, 1998	301.7	93.0	Yes
August 31, 1998	March 24, 2000	59.5	17.0	No
October 9, 2002	October 9, 2007	101.5	60.0	Yes
March 9, 2009	April 29, 2011	101.6	25.5	Yes
October 3, 2011	September 20, 2018	166.6	83.5	No
December 24, 2018	February 19, 2020	44.0	14.0	No
March 23, 2020	January 3, 2022	114.4	21.0	Yes
October 12, 2022	*December 28, 2023*	*33.7*	*14.5*	*No*
Average (ex. latest)		**107.0**	**40.6**	**8 of 15 advances preceded by recession**
Median (ex. latest)		**79.8**	**31.5**	
Average (ex. latest) if:				
Advance preceded by recession		**135.1**	**45.4**	
Advance not preceded by recession		**74.9**	**35.2**	

*A Major Advance is defined as an upswing in the S&P 500 not interrupted by a 19% drop (i.e., by a Major Decline)

Source: "Major S&P 500 Advances" Table, by The Leuthold Group

Our Beliefs

We are in a significantly different environment from what has been witnessed for decades. Looking back to the 1980s there was a general downtrend in both interest rates and bond yields (except for a blip in the mid-1990s).

Cash rates on the face of it look attractive to many investors (not us) and these, along with higher bond yields, are a hurdle that risk assets – equities in particular – will have to surmount.

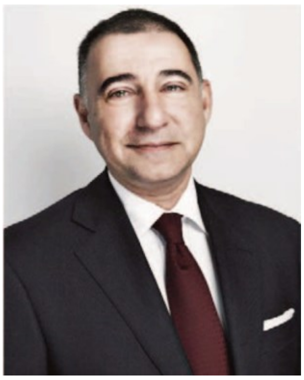
We believe that over the last 13 years or so investors have become addicted to the drugs of low rates and free money and their withdrawal symptoms are effectively what is causing huge volatility in bond markets especially and, to a lesser extent, in equity markets. Our base case is for the global economy to achieve a soft landing, but we don't think that this requires aggressive rate cuts by central banks.

The last bit of inflation may prove much stickier than most expect and therefore central banks are likely to move cautiously (we only see a maximum of three rate cuts each for both the US and the eurozone, though these expectations are subject to change based on evolving economic conditions).

Unemployment rates in developed economies are at low levels and with decent wage gains for middle and lower earners along with moderating inflation, consumers have more purchasing power despite having drawn down on pandemic savings. These very consumer segments are more likely to consume rather than save, upping their lifestyles to meet their new incomes. This is something that hasn't happened for decades. We expect the equity market rally to broaden out from just the seven stocks which have dominated the S&P 500 index as investors finally figure out that stocks can do just fine in an era of higher economic growth, higher inflation and higher rates.

If the same narrow band of stocks keeps going up then the payback on the other side will be truly awful. In over 30 years of investing, we have yet to find the magic stocks that perform in all environments. The biggest opportunity is perhaps in those areas which at the moment are out of fashion and which have lagged markets, such as economically sensitive companies.

Investors should perhaps dampen their expectations of gains at the index levels similar to those achieved over the last decade or so, but better performance could very well be achieved through individual stock selection. Despite the strategist consensus being bullish for 2024, individual investors have been more negative and are sitting on large cash piles. With indices hitting new all-time highs, pressure on these cash-rich investors is likely to increase significantly as they become increasingly concerned about missing out on another year of gains.



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