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Quarterly Review and Outlook

The setup going into 2024 is almost the direct opposite to that of 2023. Last year fears of rising inflation and a hard landing for the economy led to broad expectations of recession, spiking interest rates, and falling corporate profits and stock prices. After nearly two years of monetary policy tightening, Fed Chairman Jerome Powell announced at their meeting on December 13th that the Federal Reserve was prepared to begin to pivot away from monetary tightening to prospective easing. As a result, investors are now looking at the prospects of a soft landing, reasonable growth, moderating inflation and falling interest rates.

The Federal Reserve guided that 2024 could see up to three interest rate cuts of 25bps each as inflation continues to moderate and conditions in the labor market move to a more balanced state. This pivot in Fed policy has caused interest rates to move lower and created a catalyst for stock prices to advance. The yield on 10-year U.S. Treasuries declined by 110bps from 5% in October to a current level of 3.9%. The stock market, having corrected about 10% from its July high into October, rallied strongly in November through year-end. The S&P 500 finished the fourth quarter up 11.2% and for the year gained 24.2%. Leading the advance has been a group of large capitalization stocks referred to as the “Magnificent Seven”, consisting of Alphabet (Google), Apple, Amazon, Meta (Facebook), Microsoft, Nvidia, and Tesla. Together these stocks account for about a 28% weight in the S&P 500 and, on average, more than doubled in 2023. Having fortress-like balance sheets and being totally self-financing, these companies were seen by investors as defensive in an environment of rising interest rates. With rates falling and economic growth expectations improving, we would expect to see the market broaden out beyond these seven stocks and investor interest to begin to rotate toward companies that are more economically sensitive.

Despite most economists’ and analysts’ dire forecasts, the U.S. economy has remained resilient and avoided a recession because of a strong job market and continued strong consumer spending. While exhibiting some signs of slowing, the labor market still shows more job openings than the number of those unemployed. The unemployment rate remains below 4%, which is historically low, and full-time employment is at a record high. Consumers have purchasing power and are continuing to spend. Helped by government payouts during the Covid pandemic, consumers built up excess savings. Some consumers may have begun to deplete these savings, but most are likely to continue to consume, as long as their job security remains high, which it will as long as there are plenty of job openings. Retail numbers in November were better than expected and the sales number of the all-important December Christmas season are expected to be strong too, evidencing continued consumer resilience. Another supportive factor for the economy has been the slowdown in the rate of inflation.

The latest economic data releases have been encouraging. Both the Consumer Price Index, (CPI) and Producer Price Index, (PPI) have signaled that inflation on a six-month annualized basis is nearing the Federal Reserve's 2% inflation target.

The fact that the Federal Reserve has indicated a pivot to an easier monetary stance in the foreseeable future bodes well for the outlook for equities and bonds. However, the Fed is still in a data dependent mode, so if inflation were to turn higher or conditions in the job market were to tighten, investors would face a less hospitable investment climate. For now, with the Fed seemingly having reached the end of its rate hiking cycle, the investment climate has brightened.

In the current environment we remain constructive on both the stock and fixed income markets. As previously mentioned, we expect to see the stock market broaden out beyond the Magnificent Seven. Improving growth and the lower cost of capital should allow more economically sensitive companies to catch up to the stocks that led the market in 2023. Additionally, falling yields might be a catalyst for the large money flows which have gone into short-term Treasury Bills and safe interest rate assets, such as money market funds and CDs, to flow back into equities. Lower interest rates will help new and existing home sales, which in turn will increase housing related retail sales. Supply chain disruptions during the pandemic and geopolitical tensions between the U.S. and China have stimulated an onshoring boom which is boosting capital spending and increased construction spending on manufacturing facilities. The federal government's increased spending on public infrastructure should boost new orders for construction, machinery, and materials.

Our investment criteria have remained consistent. We continue to look for companies with competitive advantages and secular growth underpinnings that can drive long-term capital appreciation. Our focus remains in the technology, industrial, healthcare, specialty finance, and consumer sectors.

With the prospect of interest rates moving lower and the yield curve flattening, fixed income markets should also do well. In a falling rate environment, we prefer a barbell approach to take advantage of higher short-term rates, while also locking in cash flows with longer dated securities. Our bias continues to be towards quality as credit spreads do not offer an attractive premium to warrant investing in lower quality securities.

As always, we are grateful for your support and encourage you to reach out to us with any questions or concerns you may have regarding your portfolio investments.

Wishing everyone a very safe, happy, and healthy 2024.