MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

DECEMBER 31, 2023

MARKET EXUBERANCE

As we close 2023, the markets are finishing on a very strong note, up at least 18% or more with some indices nearing all-time highs. Investors are clearly exuberant as several catalysts appeared to shock the markets to the upside. We also note that the majority of gains were centered around the so called Magnificent 7 (mostly tech stocks).

For now, the markets are celebrating the US economy avoiding a recession (so far), the Federal Reserve pausing interest rate hikes, and possibly cutting rates next year. Inflation pressures have been easing as oil has been weaker, leading to hopes that pressure on profit margins will recede. Certainly, with the labor market holding up and inflation relatively tame, consumer confidence is rebounding. If consumer confidence continues to rebound, the US economy will likely continue on its growth pace.

As for the Fed, it is likely that the aggressive rate rise policy is finished for now. While no rate cuts have happened, the markets do anticipate actions and currently they appear to be pricing in as many as six interest rate cuts. This seems aggressive, but there are many other factors that can continue to lift equity prices. On the flip side, if the US economy avoids a recession, there may be little economic impetus for rate cuts by the Fed aide from relieving pressure in the housing market.

After crashing stock prices in 2022, 2023 turned out to be a banner year for the US stock markets. For perspective though, the two year return for the S&P is slightly negative. While we are positive in our outlook for 2024, the source of anticipated returns is different than that of 2023, which was much more focused in the tech area and seven stocks in particular.

MANY EXPECTING FIREWORKS TO START THE YEAR

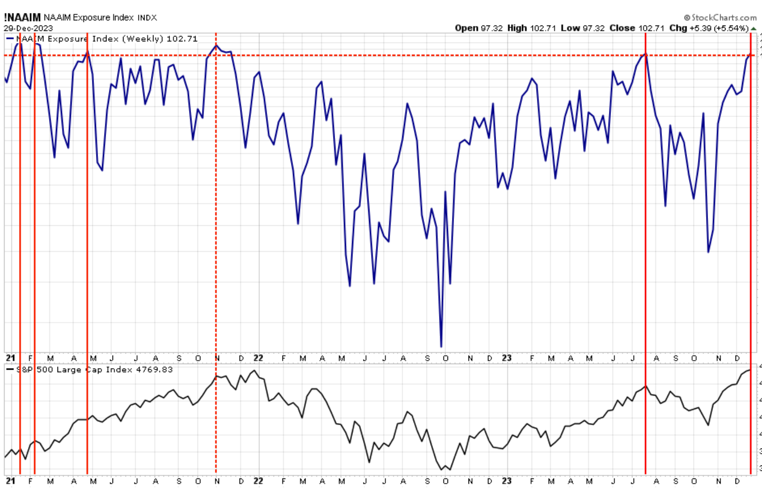
Many analysts are expecting a volatile start to 2024. There is some historical precedence for this as the first week of the year is the most volatile week for the S&P 500 index with a median change for the week averaging over 0.62% going back to 1927. By comparison, most other weeks of the year have average moves under 0.5%.

The same tends to apply to bonds as well, with the opening week being the third most volatile. This was definitely the case the last few years, with yields rising over 30 basis points into the end of 2022 before having a huge reversal at the start of 2023. In 2020 and 2021 it was the opposite, with bond prices getting crushed to start the year.

January activity does have a decent (but far from perfect) record of predicting what the market will bring for the balance of the year. We are fairly bullish on the market at the moment, but believe we could see some selling to start the year as investors have been hesitant to create taxable events before year end. They would rather create these gains at the start of the year, thus giving them 15 months before having to pay taxes on them. If this were to happen we would view this as a buying opportunity to initiate positions in stocks that have made very good moves in the past couple of months.

LEANING BULLISH, BUT NEAR TERM CAUTIOUS

Our overall view of the market is that we may be at the beginning of a new bull market, but that does not mean the markets will go straight up. We are definitely not alone in our positive outlook if you look at the NAAIM Exposure Index which shows the average exposure to US Equity markets by active investment managers. As of the end of December the exposure index climbed above 100%, meaning that active managers are now leveraged long equities. As the chart below indicates, the times when this index climbs above 100, you should probably be expecting a near term top in equity prices. The duration of a correction definitely can vary, like high readings in early 2021 fronted quick sell offs, but can lead to longer drawdowns like the extreme readings in late 2021 and mid 2023. While our longer term view leans bullish on the equity markets, a cooling off is likely in order. With the S&P nearing the all time high set at the end of 2021, an initial failed test of this resistance would not only be expected, but could in fact fuel a future move forward. Indicators underneath the market are confirming the advance the market has seen since October and breadth is finally improving.



ELECTION ANTICIPATION

We previously wrote about the position that the Federal Reserve would be in in 2024 due to the November election. It was noted that in order to avoid any appearance of political favoritism, the Fed would likely be limited to the first few months of the year to take any significant policy action.

However, recent comments from the Fed indicated that no such policy action is likely to occur during that time. This effectively shuts the door to major policy action in 2024. Only the most dire or urgent circumstance would likely prompt the Fed to make significant changes to interest rate policy in the coming year. It appears that markets have priced this in the strong finish to the year.

CURVE INVERSION

The yield curve represents interest rates at different points in time. Usually interest rates are lowest in the near term and higher as you go farther out in time.

The reason for the yield curve being closely watched has to do with a so called inversion, when longer term interest rates go lower than short term ones. This has a good track record of warning about a oncoming recession. The yield curve inverted in mid 2022, which is why economists have been predicting a recession.

Will this time-tested signal hold true for 2024? Investors need to pay attention to this as the year unfolds.

WATCH THE MOON

Back in 1908, W.D. Gann, a prominent investor of the day, produced a financial time table that attempted to predict macro market events based on the cycle of the north node of the moon. The cycle completes itself every 18.6 years and according his table, the markets should experience a major crash in 2024. Before you run for the hills, understand that the table has very mixed results in terms of predictive power, but did "predict" high stock prices for 2019 and also the crashes of 2001, 2008 and 2020. So take this for what it's worth and it seems, based on an incorrect rising stock prices prediction for 2022, it might have a shifted a year or two forward (i.e. a macro event in 2025 or 2026). While interesting, these kind of predictions do not factor into our decision making.

Recommendation List: A list of all previous specific investment discussions made over the past 12 months will be provided upon request. Please email or call our office for this list.

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