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INVESTMENT VIEWS

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MARKET UPDATE - COMING ELECTION YEAR TENSIONS

With 2023 nearing the finish line, we recap the dynamics that went into a volatile but good year for the market and preview what might be in store for 2024.

The Unimpressive 493

Investment returns for the broad market were dominated by the so called "Magnificent 7," which includes Microsoft, Apple, Amazon, Alphabet, Nvidia, Meta and Tesla. These seven stocks started the year comprising 20% of the S&P 500 market capitalization weighting and they are ending the year over 26%, For such a small list of companies to comprise such a large percentage is quite rare and hasn't been seen since the mid 1960s.

As stated, the Mag 7 stocks have also been essentially the sole contributor to the year-to-date returns for the market. In fact the other 493 stocks, as an average, were actually down for the year at the end of October. While they have recovered in November, their returns are still lagging behind cash as an investment this year.

A heavy concentration of a few stocks does not mean the market needs to fall necessarily, but if everyone has poured into the Mag 7, then where do future buyers come from? This is generally where you enter a topping phase as there are not enough buyers to push stocks higher. However, if this money finds its way into the other 493 stocks, that is the broadening out we would like to see and have alluded to in past newsletters Since mid-November the Mag 7 have started to fall while the S&P has been fairly steady - this could be the first sign of money rotating to the rest of the index.

Tight Policy

The Federal Reserve steadfastly held to a tight monetary policy as it was determined to get inflation under control. For the moment, recent CPI numbers support the idea that it has succeeded. Indeed, as we enter December, the market is pricing in an end to the tightening dynamic and the possibility of a "soft landing." Fears of a recession have subsided for the time being and more prognosticators are predicting rate cuts by June 2024. If the economy is strong and inflation continues its cooling phase, we see no reason why the Fed will begin to cut rates. Some Fed presidents have hinted at their belief the economy would cool, which is why economists are starting to believe in future rate cuts. A rate cut in June, however, would be atypical as the Fed tends to avoid such actions immediately prior to national elections.

2024 Elections

With the election in mind, it is likely that pressure will be very high for monetary and fiscal authorities to avoid causing a recession or other economic problems. While it is true that policymakers cannot control everything that occurs, and they do make mistakes, our view is that they remain activists in the economy and financial markets. We believe that this activism will be supportive for the markets going into the November 2024 election.

January Profit Taking

Investors should keep in mind that January could start with some profit taking (selling) after a good 2023. For taxable accounts, selling at the beginning of the year creates taxable gains that do not have to be paid until April 2025. This gives those investors 15 months to reinvest their gains to compound their return. We have witnessed this behavior in other years, most recently in January 2022, after a very good 2021.

ALL THAT GLITTERS

Gold is set to close at an all-time monthly high this November. Last month we were anticipating strength in precious metals and it has born out so far. Currently, gold is firmly above $2000 an ounce and silver is above $25. We admit that gold and silver miners have severely underperformed up to this point. However, with continued strength in the underlying metals, precious metals miners will be in an excellent position to catch up.

The reason for this optimism and the prior underperformance is about margins. Costs have been rising faster than the prices of the metals, crushing mine profitability. Once prices are on the move again it will lead to profit margin expansion.

Lastly, we observe that gold miners, as represented by GDX above, seem to be in a bullish falling expanding wedge pattern that often signals much higher prices ahead. We will continue our updates as the story unfolds.

WHEN GAMBLING MEETS THE MARKET

One of the better performers of the year has been Draftkings, a pioneer in mobile betting platforms. The stock IPO'd in the early innings of sports betting legalization in the U.S. It has had its ups and downs early on as heavy advertising expenses and very few states allowing sports betting created a ton of uncertainty about the viability of the industry. A good amount of the stress has subsided as more and more states approved betting on recent ballots. The company is not taking its foot off the gas either as they see their addressable market growing to $30 billion in 2028, from $20B this year. Even more important to investors is the bottom line and DKNG is guiding to be breakeven on earnings sooner than most predicted. New states coming on board are also generating positive profit much faster than early adopters. While there is more competition coming (notably a partnership between ESPN and Penn Entertainment), but this should actually just broaden the addressable market.

URANIUM GLOWING

The bull market in uranium is off and running hard. Uranium prices have soared recently to over $80 per pound as western buyers seek out the radioactive metal from non-Russian sources. As a reminder, Russia is a major source of uranium and due to its war against Ukraine, western nations are seeking alternative sources. This only adds to the nuclear renaissance dynamic already underway as nuclear power is increasingly seen as a clean, stable and reliable source of energy.

US DOLLAR REJECTION

The US Dollar is unquestionably the world's reserve currency and it is likely to be so for many more decades to come. No other currency comes close to its nearly universal acceptance for trade and as a store of sovereign currency reserves. That said, we might be witnessing its apex, or peak as a reserve currency.

Over the past several years there has been a growing rejection by certain nations regarding the use of the dollar for trade. Many nations, most notably Japan, China, and Russia have also reduced their US dollar reserve holdings for various reasons. Most recently, the UAE announced that it will no longer accept US Dollars for oil export transactions. Add to this the so called "BRICS" movement which is a confederation of nations that is working to create an alternative to the US dollar-based trading system.

The world is clearly unhappy with the US dollar and is eager for an alternative reserve currency. While it may take some time, at some point in the future a clear alternative will emerge to take its place. In the meantime, we expect this dynamic to drive demand for precious metals higher over time.

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