WEEKLY CLIENT COMMENTARY | JANUARY 12, 2024

Mitch on the Markets

Portfolio Manager Investing Insights

Will We Get a "Goldilocks Economy" in 2024?

The past few years have been anything but normal for the economy and capital markets. The U.S. experienced a pandemic-induced recession, trillions of dollars of fiscal stimulus, and near-zero interest rates…followed by soaring inflation, a greatly imbalanced labor market, and rapidly rising interest rates. The market response was also quite wild, with a sharp bear market in 2020, an equity market boom in 2021, a 10-month-long bear market in 2022, followed by yet another strong recovery for stocks in 2023.[1]

After this dizzying stretch, investors are hoping for a return to normalcy in 2024.

Investors' wish list is pretty long. We'd like to see inflation numbers continue on a downtrend and settle below 3% levels. We're hoping for an interest rate policy that pulls the benchmark Fed funds rate back in the direction of its neutral rate (2.5% or so), not away from it. And we'd certainly like to see modestly positive quarterly GDP growth accompanied by an earnings rebound in the realm of 10+% year-over-year.[2]

ABOUT MITCH ZACKS

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Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

Ticking all of these boxes would be the equivalent of the U.S. economy settling into a 'goldilocks' state, with modest inflation, modest growth, and 'normalizing' interest rates – conditions we haven't experienced in years. This goldilocks outcome would also bode very well for stocks, in my view, and deliver a nicely positive second year of the bull market.

The upshot is that given what we see today, there are early signs investors could get everything they want. The Fed's preferred measure of inflation, the personal consumption expenditures (PCE) price index, is already hovering just above 2% when viewed on a six-month annualized basis. The Federal Reserve, while generally striking a cautious tone, has signaled 75 basis points of rate cuts on the table for this year. On the earnings front, Zacks Investment Research is forecasting earnings growth of 11.6% for the year. And finally, trends in the labor market suggest the economy is holding up just fine, with employers anticipating 4% wage growth in the new year – enough to keep consumers spending.

In short, the U.S. economy is fundamentally strong. But I also think that's the precise reason investors should be extra vigilant in 2024.

To understand my thinking, consider the example of 2023. At the outset of the year, nearly every economist and pundit on TV was calling for an economic recession sometime during the year, and for good reason. All of the traditional recession indicators, like the inverted yield curve and declining leading economic indicators, were screaming recession. But it never happened. Any investor clinging to that recession narrative, who then also allocated away from stocks as a result, felt some pain last year.

In 2024, many of those same experts are more sanguine about the economy, and the expectation for a 'soft economic landing' with single-digit stock market returns has become a crowded trade. A December survey conducted by Bank of America Securities found that fund managers were more optimistic than in any month since January 2022, which, ironically, coincided with the beginning of that year's bear market. The latest addition came this week, with the World Bank calling an economic soft landing "increasingly possible."

This growing consensus by itself makes me think we should expect a different outcome. And in my view, that means 2024 will either be a big up year or a slightly down year.

Bottom Line for Investors

As I've written many times before, it all comes down to reality versus expectations. Inflation could come in hotter or cooler; interest rates could fall more or less than expected, or even go up; earnings growth could disappoint to the downside or surprise to the upside; the U.S. economy and labor market could perform better or worse than many expect; and/or, geopolitical issues globally could make the world more or less investor friendly. Not to mention the swirling uncertainty surrounding the U.S. presidential election.

I continue to be in the camp of seeing the U.S. economy as under-appreciated, which makes me inclined to believe the year will turn out better than most expect. But I also plan to be hyper-sensitive to risk in the new year, precisely because most are expecting a soft landing. Consensus was wrong in 2023, and I wouldn't be surprised if most get it wrong in 2024 too.

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[1] Wall Street Journal. January 2, 2024. https://www.wsj.com/articles/investors-hope-for-2024-a-return-to-long-lost-normalcy-4029df63?mod=djemMoneyBeat_us

[2] Wall Street Journal. January 1, 2024. https://www.wsj.com/finance/optimism-abounds-wall-street-this-new-year-a0ec5cc0?mod=djemMoneyBeat_us

STEADY INVESTOR WEEK

- **Inflation ticks higher**
- **America's oil boom**
- **Bitcoin ETFs approved**

December Inflation Data Ticks Slightly Higher

The U.S. Labor Department reported this week that a closely watched inflation gauge, the Consumer Price Index (CPI), rose 3.4% in December from a year earlier, a slight acceleration from November's 3.1% print. On a monthly basis, prices rose 0.3% month-over-month which was also higher than November's 0.1% month-over-month gain. Digging into the data, consumers were seen paying more for rent, property and casualty insurance, and services like dentist visits. On the flip side, Americans saw lower prices for goods like furniture, toys, and sporting equipment. The divergence in prices between goods and services has been a fairly consistent theme over the past year, as supply chain pressures have fully eased and as labor shortages and high demand put pressure on services. We've written many times before in this space that rent data happens on a lag, and that its contribution to headline inflation should wane in the coming months. The Fed likely acknowledges this feature of the data, and few expect that they will change their policy stance as a result of this latest CPI data. The central bank is still projecting 75 basis points of rate cuts throughout 2024. Americans are also expecting inflation pressures to ease this year. According to a Federal Reserve Bank of New York survey, consumers are anticipating 3% inflation this year, which is the lowest level since January 2021.[1]

America's Quiet Oil Boom

The headline news on oil over the past few months has been largely centered on Saudi Arabia and OPEC+'s ongoing stance on production cuts. Many oil traders have worried that ongoing geopolitical tensions with two wars, combined with less OPEC production, would put sharply upward pressure on prices. That largely hasn't happened. One key reason that does not get much press coverage is record U.S. production. In the week ended January 5, field production of crude oil in the U.S. reached 13.2 million barrels a day, which is just a hair below the record 13.3 million barrels a day reached in December. U.S. oil production has been bolstered by productivity gains tied to technological advances, not necessarily a surge in investment and employment in the industry. Much of the U.S.'s oil is hitting global markets, with tankers carrying record amounts of crude oil to Europe and the U.K. Ship-tracking firm Kpler said that the EU and the U.K. imported some 2.3 million barrels a day in December, nearly double what they imported before Russia invaded Ukraine.[2]

Bitcoin ETFs Approved, But Investors Should Remain Cautious

In something of a landmark decision, the U.S. Securities and Exchange Commission voted 3-2 on Wednesday to approve the issuance of ETFs investing in Bitcoin. There are currently 11 applications among various brokerages to issue Bitcoin ETFs, which will give investors the ability to buy ETFs much like they would stock and bond ETFs, in a brokerage account or even in IRA and other retirement accounts. Previously, investors had to buy and sell Bitcoin on cryptocurrency exchanges with sizable transaction fees, or perhaps do so in an encrypted wallet with complex features. The SEC makes clear that the decision to allow Bitcoin ETFs is not an endorsement of Bitcoin as an asset class, and in fact, the SEC Chairman, Gary Gensler, has repeatedly emphasized the risk, uncertainty, and proliferation of fraud in the cryptocurrency space. In our view, investors should proceed with a great deal of caution. Risk assets should be valued on their ability to generate free cash flow and earnings, which Bitcoin does not do.[3]

[1] Wall Street Journal. January 11, 2024. https://www.wsj.com/economy/us-inflation-consumer-price-index-december-2023-c4ac6a19?mod=hp_lead_pos1

[2] Wall Street Journal. January 8, 2024. https://www.wsj.com/livecoverage/stock-market-today-dow-jones-01-08-2024/card/europe-is-guzzling-more-american-oil-than-ever-IhYWh7GNMIGxT32d4GWY?mod=djemRTE_h

[3] Wall Street Journal. January 10, 2024. https://www.wsj.com/finance/regulation/sec-approves-bitcoin-etfs-for-everyday-investors-dc3125ef?mod=djemRTE_h

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