2023 Wrap-up & 2024 Investment Strategy

- INVESTMENT CLUB MEN'S CLUB – January 23, 2024

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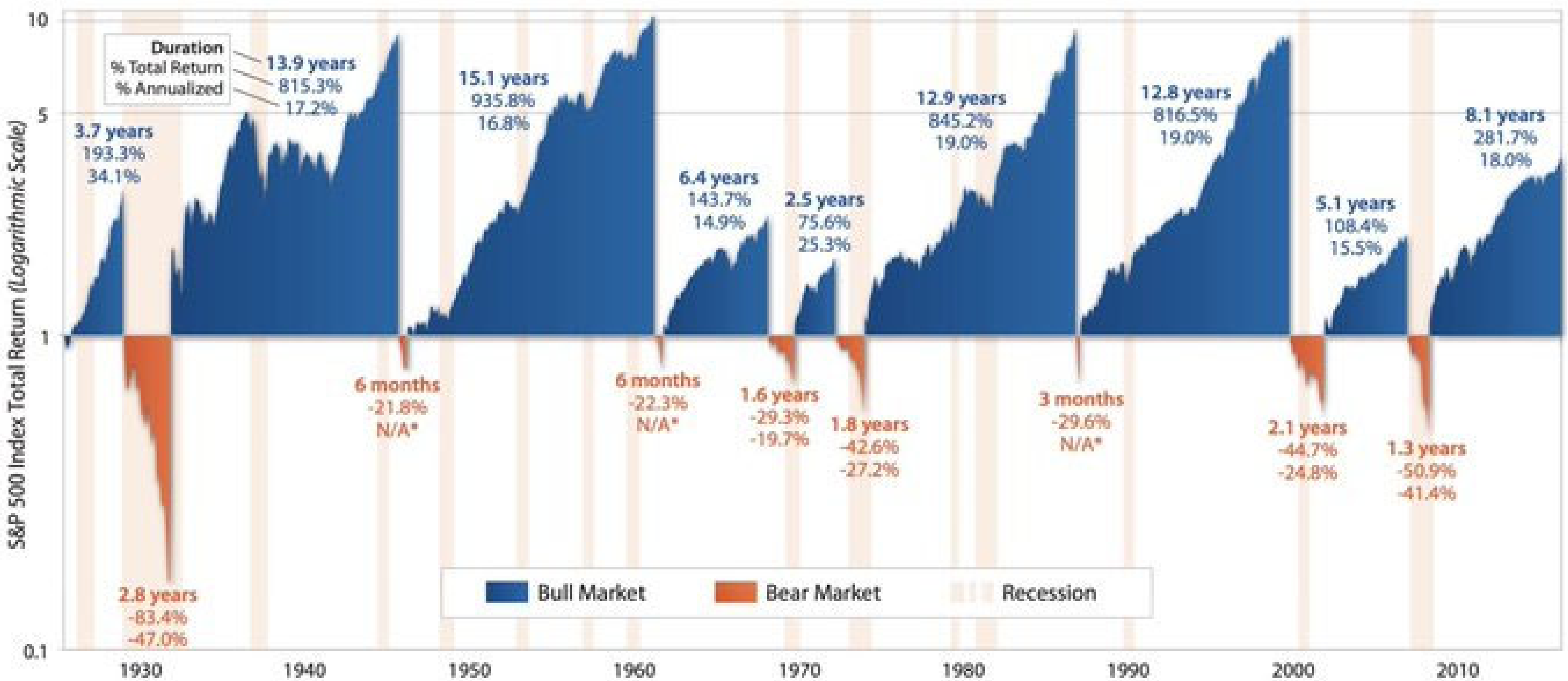
- "When all the experts and forecasters agree – something else is going to happen." - Bob Farrell

Winter landscape with ice skaters – Hendrik Avercamp

In the long run, the market will make you wealthy.



The S&P 500 has returned 9.8% annualized since 1928 with an average intra-year drawdown of -16.4%. There's no upside without downside, no reward without risk.

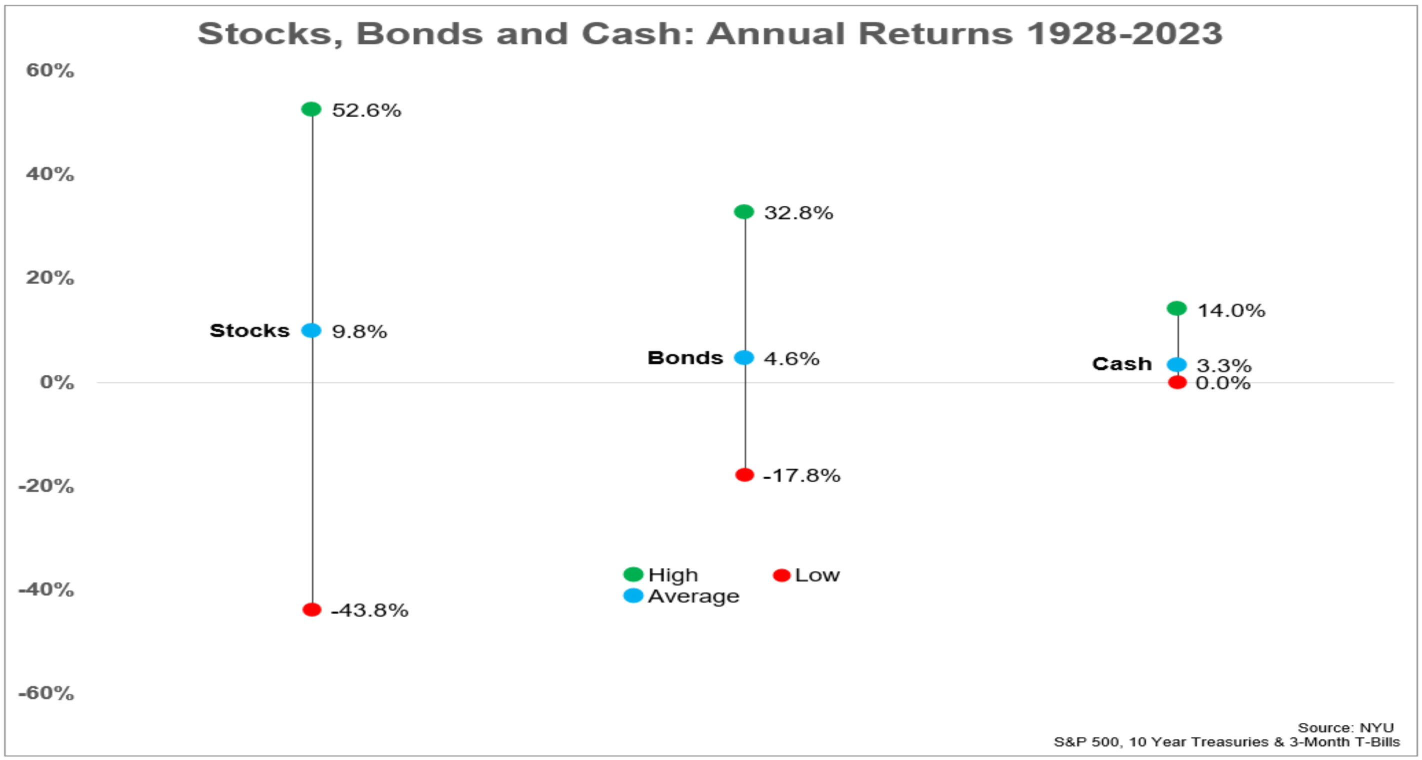
S&P 500 Annual Total Returns (1928 - 2023)

@CharlieBilello

CREATIVE PLANNING

<-40%	1931
-30% to -40%	2008, 1937
-20% to -30%	2002, 1974, 1930
-10% to -20%	2022, 2001, 1973, 1957, 1941, 1940
-10% to 0%	2018, 2000, 1990, 1981, 1977, 1969, 1966, 1962, 1953, 1946, 1939, 1934, 1932, 1929
0% to 10%	2015, 2011, 2007, 2005, 1994, 1992, 1987, 1984, 1978, 1970, 1960, 1956, 1948, 1947
10% to 20%	2020, 2016, 2014, 2012, 2010, 2006, 2004, 1993, 1988, 1986, 1979, 1972, 1971, 1968, 1965, 1964, 1959, 1952, 1949, 1944, 1942
20% to 30%	2023, 2021, 2017, 2009, 2003, 1999, 1998, 1996, 1983, 1982, 1976, 1967, 1963, 1961, 1951, 1943, 1938
30% to 40%	2019, 2013, 1997, 1995, 1991, 1989, 1985, 1980, 1975, 1955, 1950, 1945, 1936
40% to 50%	1958, 1935, 1933, 1928
>50%	1954

Annual returns in the US 1928-2023: Stocks +9.8% Bonds +4.6% Cash +3.3%
Real returns: Stocks +6.8% Bonds +1.6% Cash +0.3%



A Century of Investing

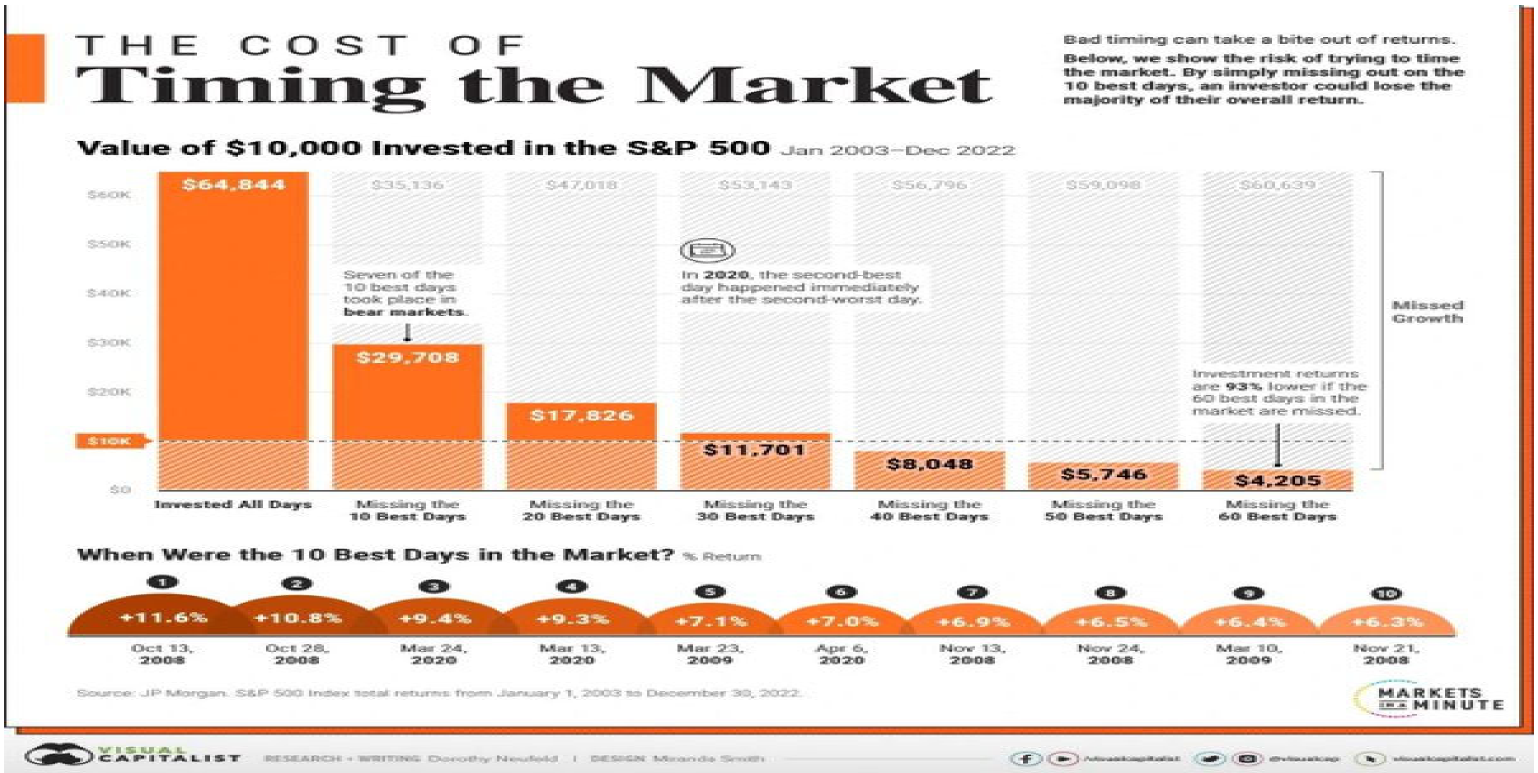
A Century of Investing

Compound Annual Rates of Return

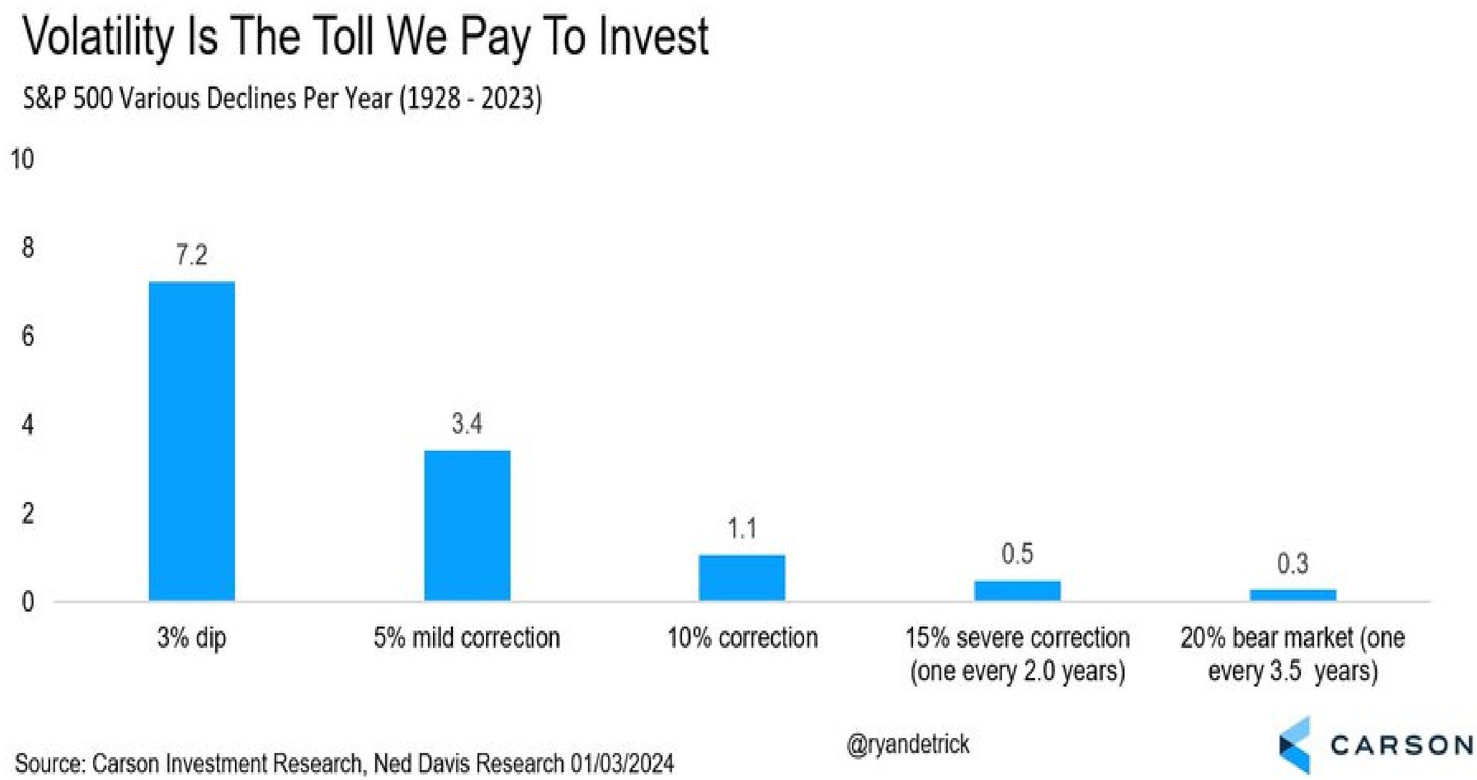
	Stocks	Bonds	Bills	Inflation
20s	12.0	-4.7	1.8	4.6
10s	13.6	6.9	0.6	1.8
00s	-0.9	7.7	2.8	2.5
90s	18.2	8.8	4.9	2.9
80s	17.5	12.6	8.9	5.1
70s	5.9	5.5	6.3	7.4
60s	7.8	1.4	3.9	2.5
50s	19.4	-0.1	1.9	2.2
40s	9.2	3.2	0.4	5.4
30s	-0.1	4.9	0.6	-2.0
1926 - 2023	10.3%	5.1%	3.3%	2.9%

Source: Ibbotson Associates BAML Estimates as of December 31, 2023

Staying invested is better than timing the market.This chart considers the GFC and the pandemic crash - two significant drawdowns. It also considers the low-rate environment that's dominated most of that period.



Frequency of S&P 500 declines (1928-2023) **3%** decline - **7 times a year 5%** decline - **3 times a year 10%** decline - **1 time a year 15%** decline - **Once every 2 years 20%** decline - **Once every 3-4 years**

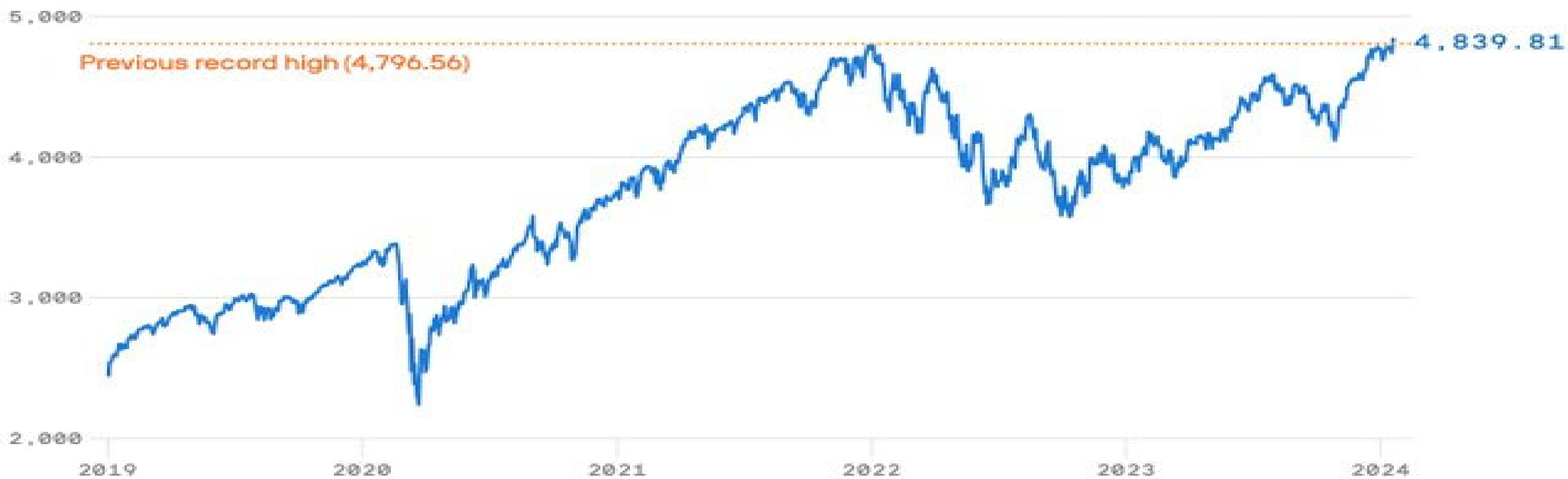


2 hours ago - Economy

The S&P 500 just closed at a new all-time high

S&P 500

Daily; Jan. 3, 2019, to Jan. 19, 2024



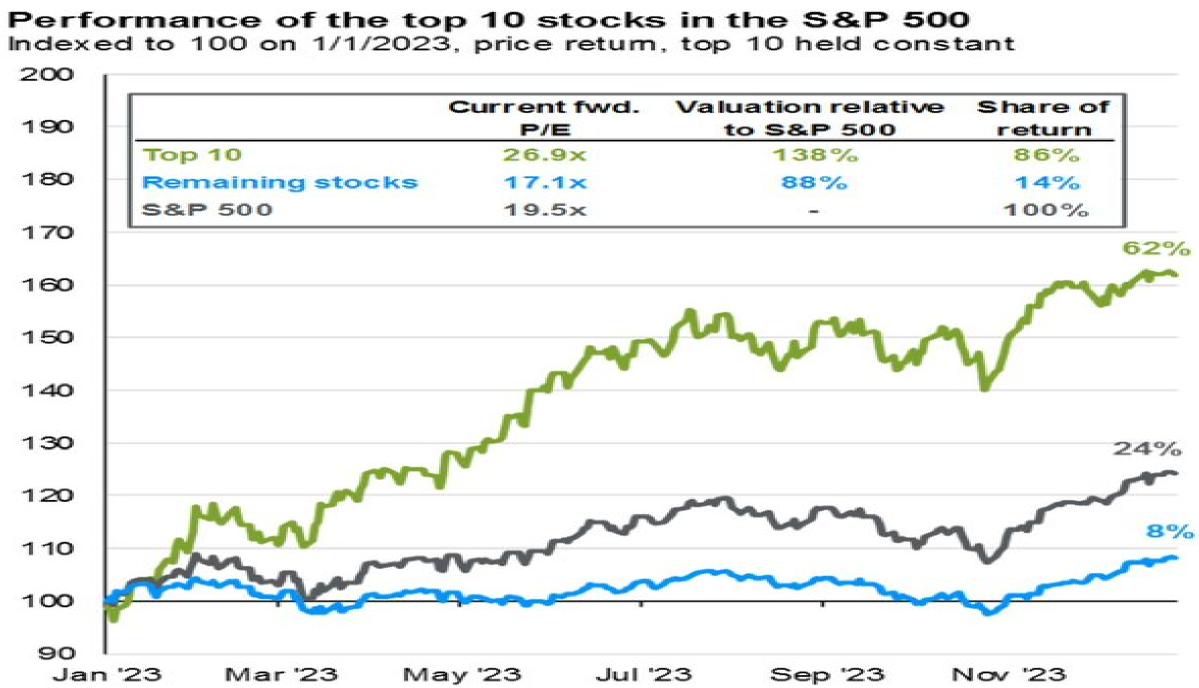
Data: FactSet; Graphic: Rahul Mukherjee/Axios

Last 10 Years... Semiconductors $SOXX: +825% Nasdaq 100 $QQQ: +420% S&P 500 $SPY: +215% Gold $GLD: +56% Energy Sector $XLE: +37%

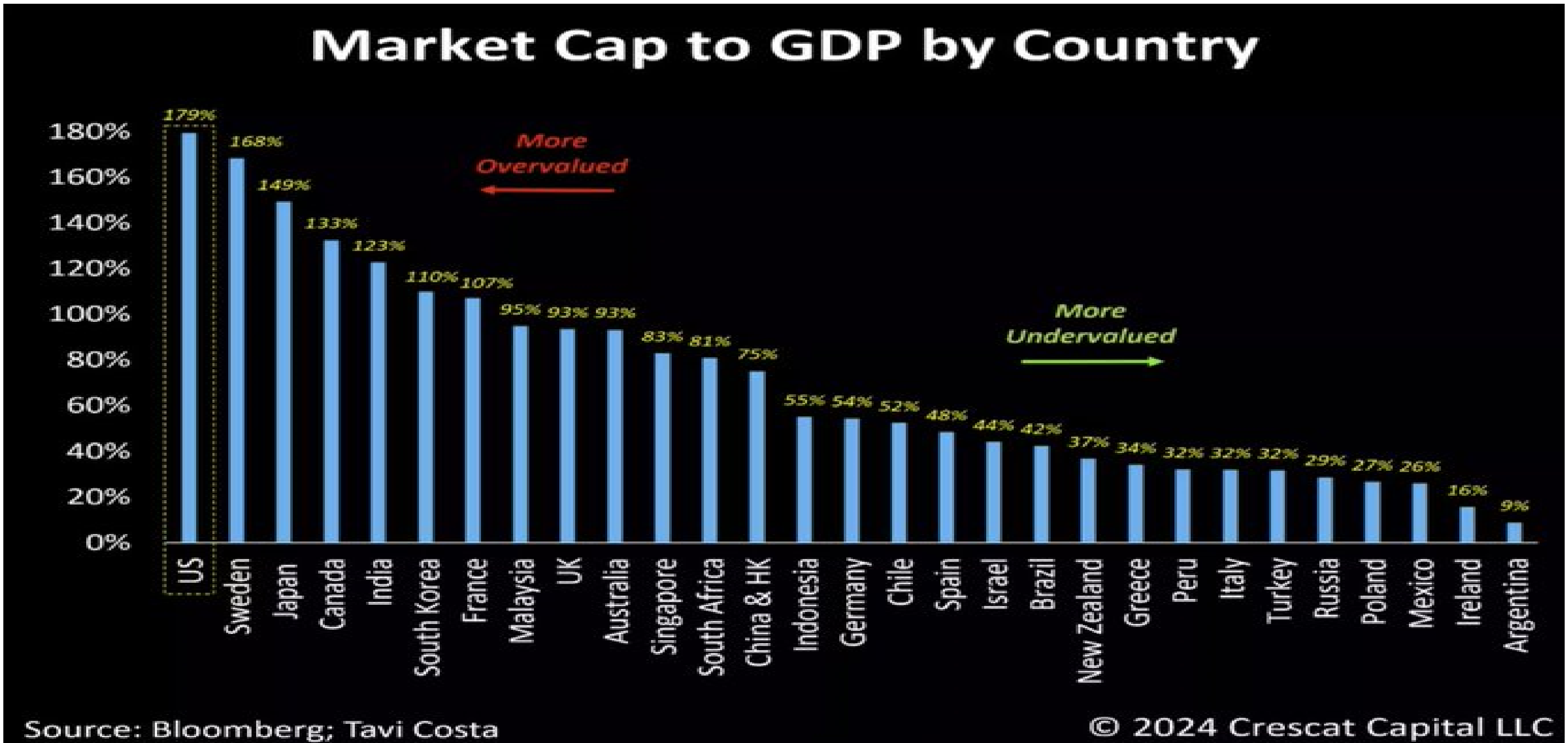
Bob Farrell rule #7:

7. [Bull] ... markets are strongest when they are broad and weakest when they narrow to a handful of blue chip names.

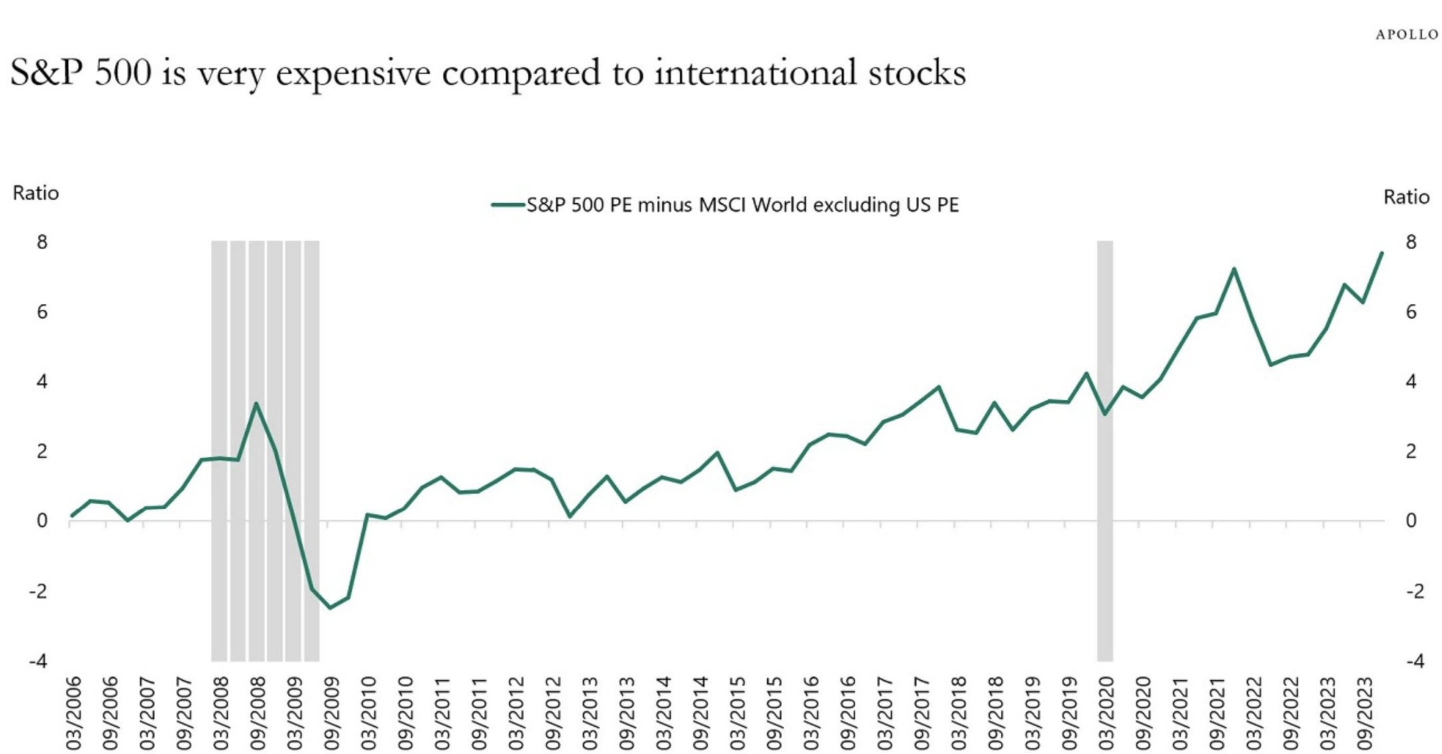
86% of the SPY's returns in 2023 came from the top 10 stocks. Only 14% came from the remaining 490. That is crazy.



The current macro environment across global equity markets presents a sharply divided investment setup for 2024 and the remainder of the decade. It's time to buy low & sell high.



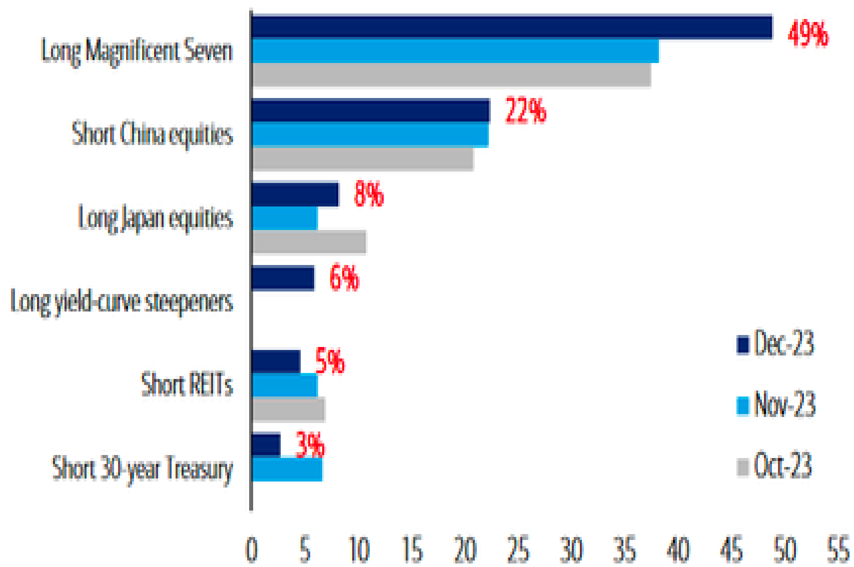
The S&P 500 valuation relative to international stocks is very expensive.



The current price / free cash flow ratio of the S&P 500 sits at 25.4x Up from 17.8x in October 2022.

Long "Magnificent 7" and short Chinese shares are the two most overcrowded trades in the market right now.

Chart 19: "Long Magnificent Seven" seen as the most crowded trade
What do you think is currently the most crowded trade?



Source: BofA Global Fund Manager Survey

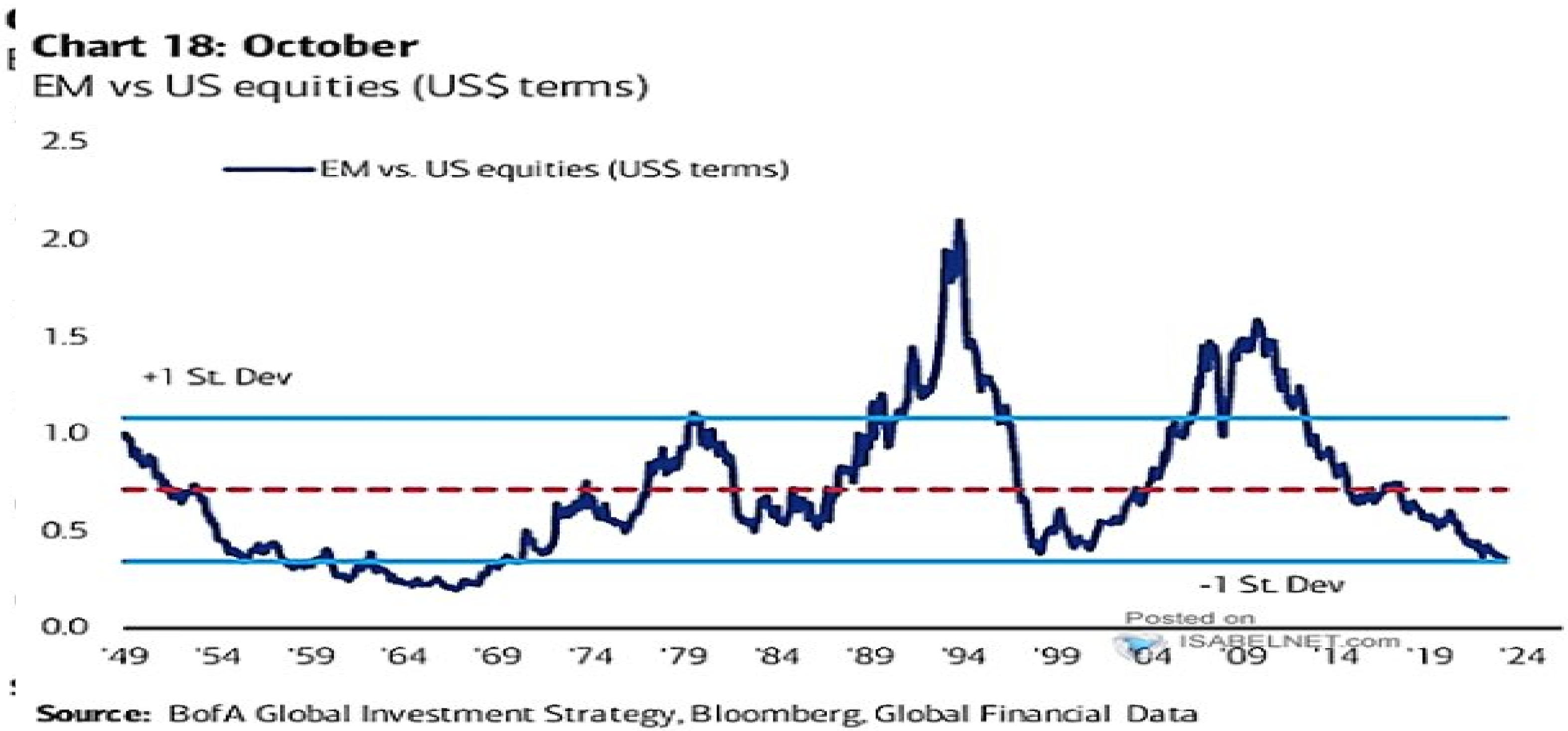
BofA GLOBAL RESEARCH

Dec'23 most crowded trade:

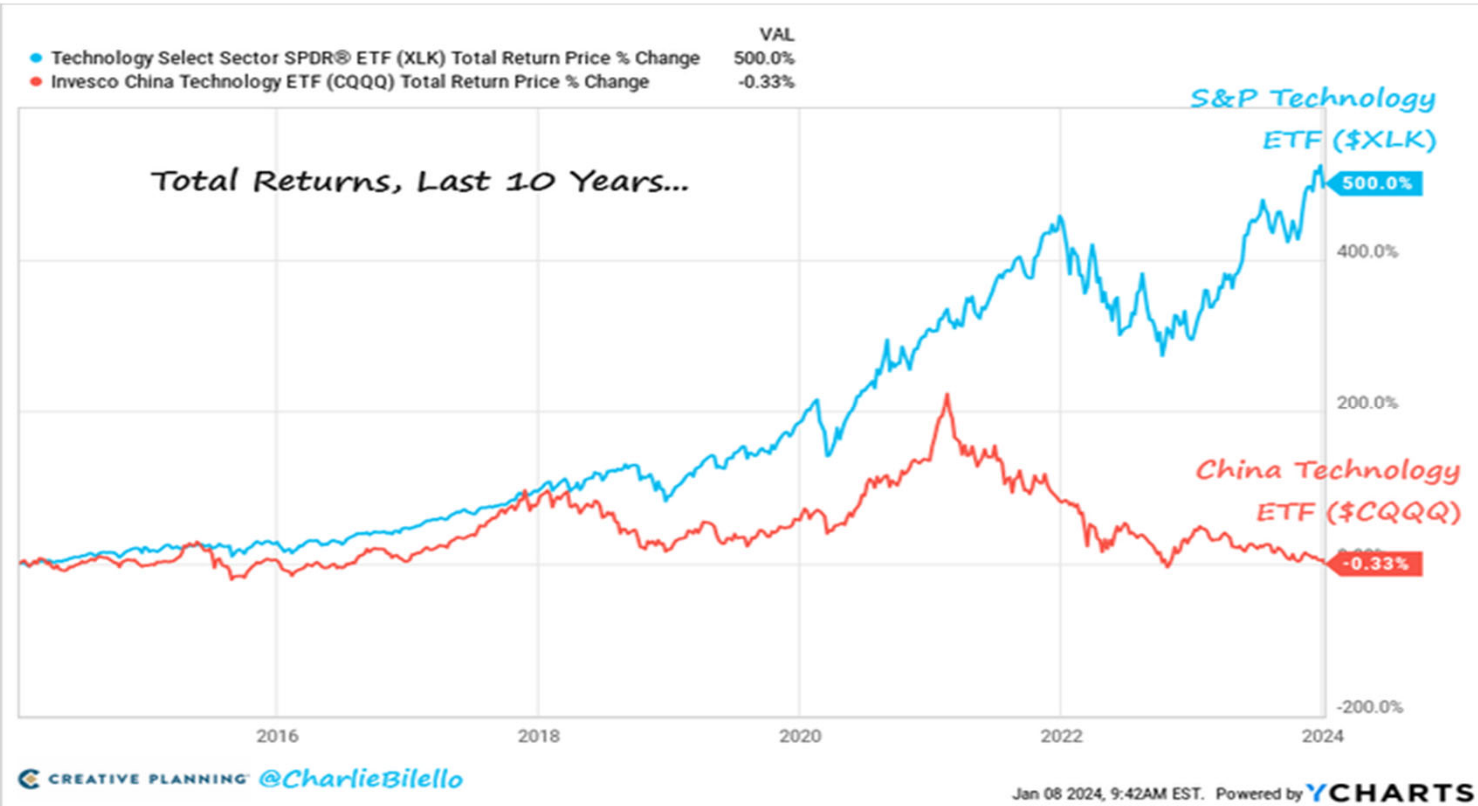
1. Long Magnificent Seven 49%
2. Short China equities 22%
3. Long Japan equities 8%
4. Long yield-curve steepeners 6%
5. Short REITs 5%
6. Short 30-year Treasury 3%

If you want to blow your mind, think about this: the $5.8 trillion combined market cap of Microsoft & Apple is $1.5 trillion more than the total value of ALL 225 members of Japan's Nikkei 225 index AND at the same time, Japan has the 2nd-largest stock market in the world.

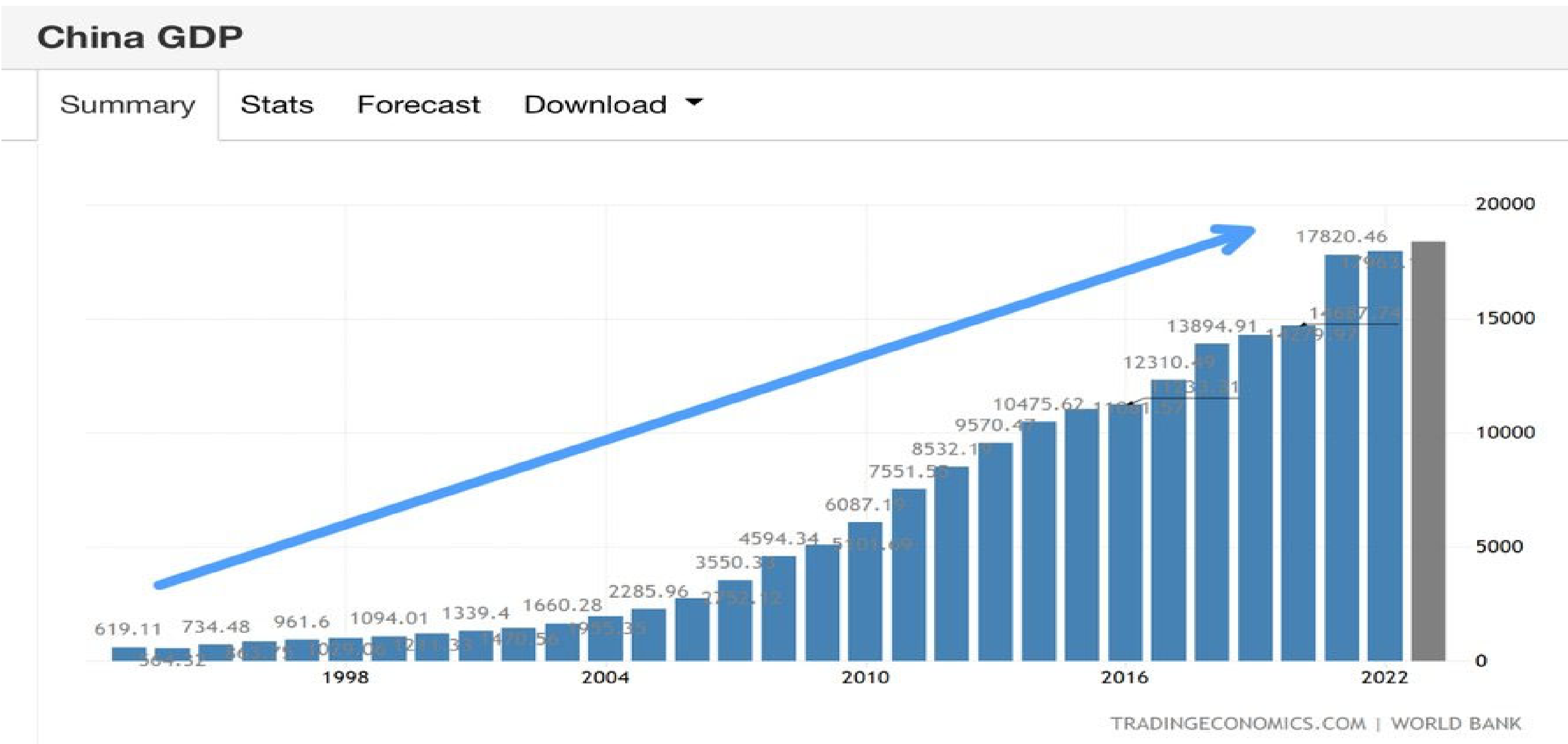
Emerging Markets are VERY cheap here.



Last 10 years: US tech stocks +500%; Chinese tech stocks flat.



China's GDP grew ~30X from 1993 to 2022



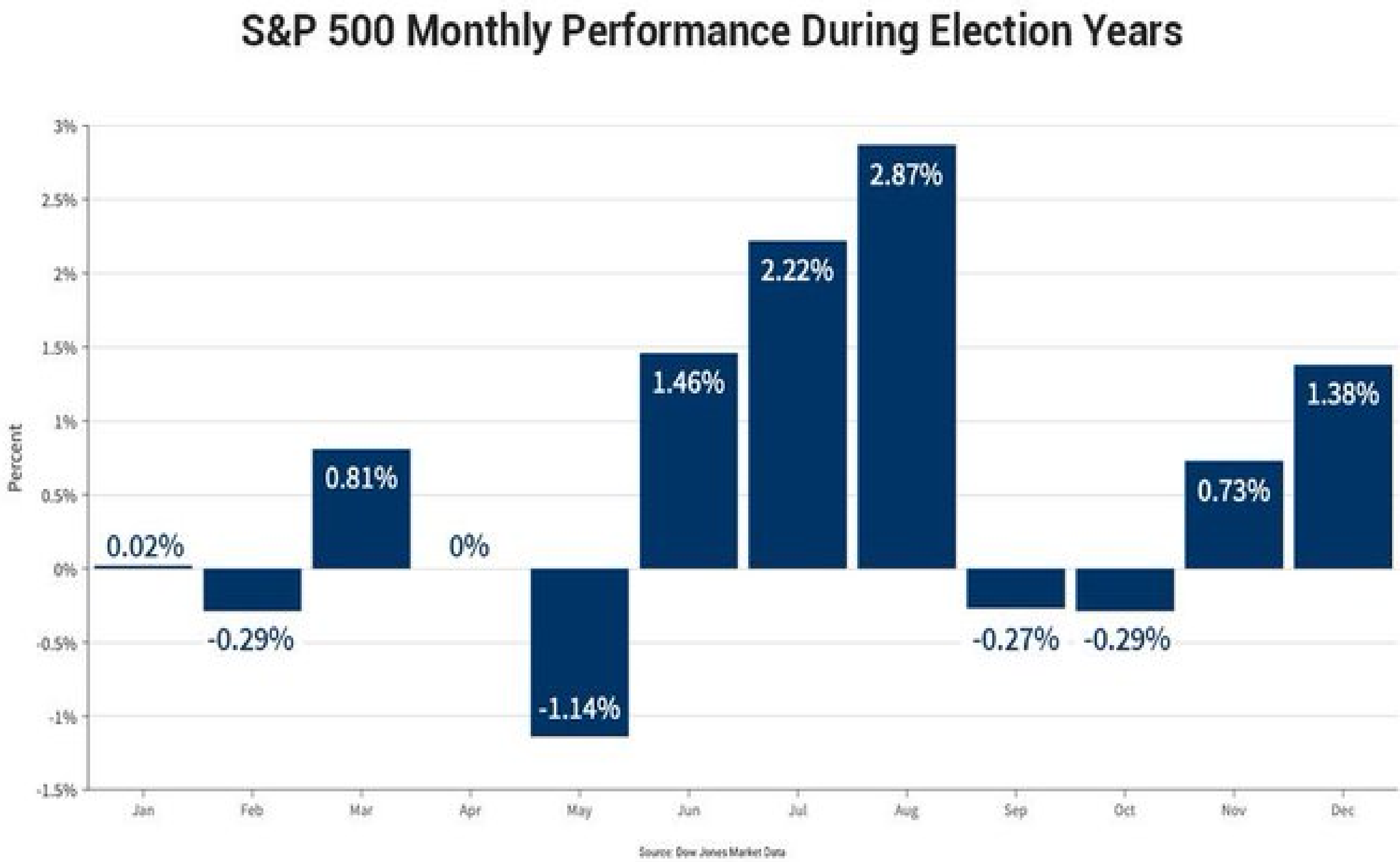
But China's stock market (proxied by MSCI China) went nowhere.

That's because MSCI China's Earnings per Share (EPS) too almost went nowhere.

No surprise MSCI China's PE multiples seem really cheap <10, and probably for good reason.

Source: LSEG Datastream and © Yardeni Research.
* Price divided by 12-month forward consensus expected operating earnings per share.

Here's how the S&P 500 performs during election years. SPY. Buy the May dip for the summer rally?



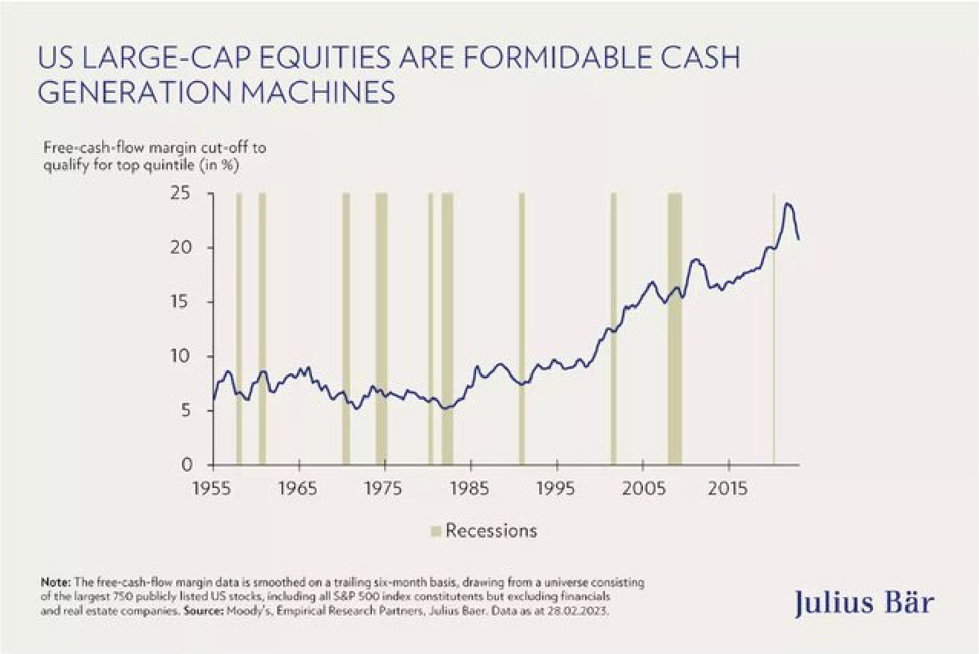
Corporate Insiders are very nervous

Insider Transactions Ratio - Readings under 12:1 are bullish Readings over 20:1 are bearish Current ratio of insider sales/insider buys is **145:1**

Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish. The total top 20 sales and buys are 405,919,502 and 2,793,570 respectively; Source: Thomson Reuters

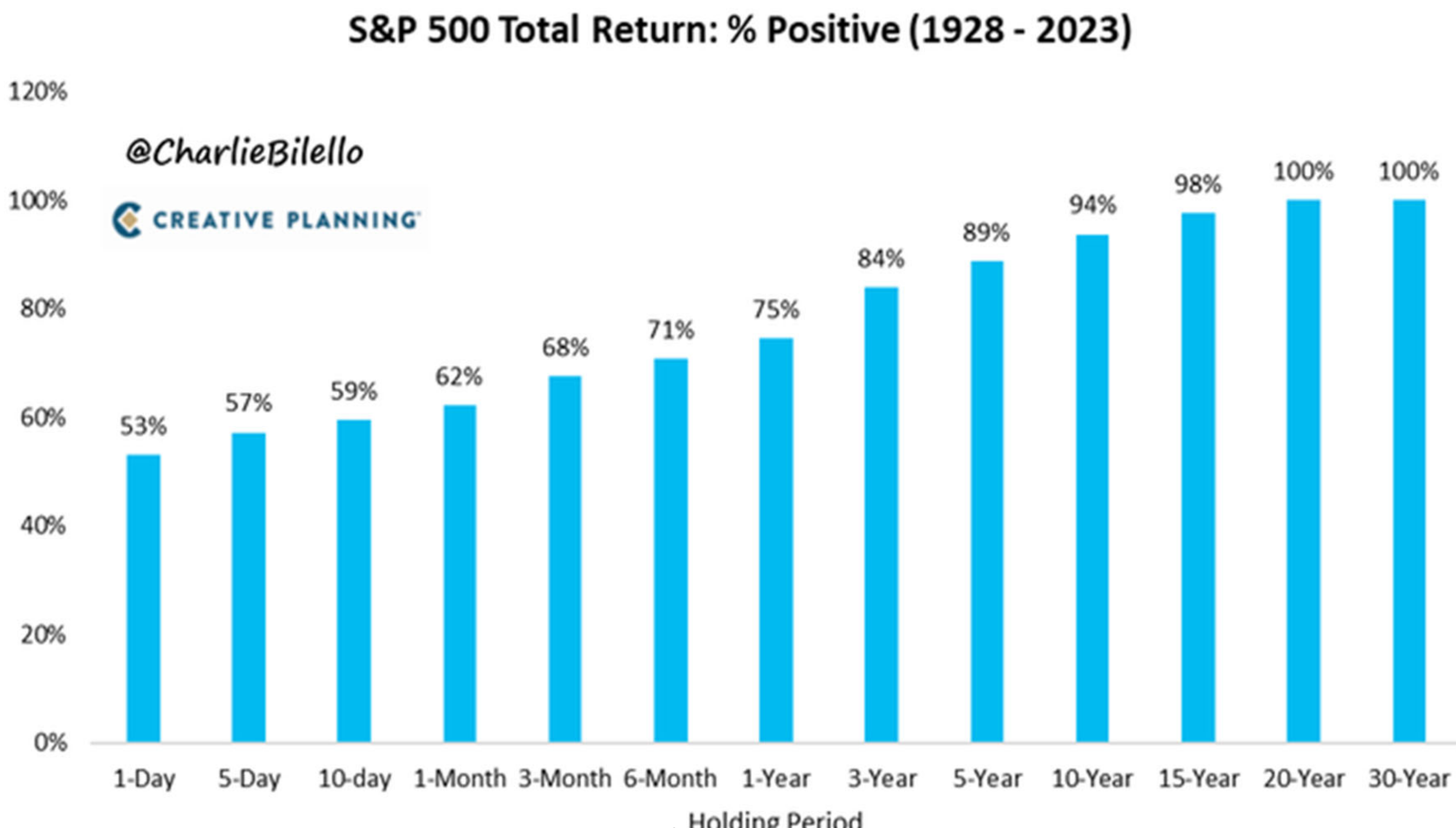
Holding periods have been shrinking

A lot of valuation signals are flashing caution, but one thing bears can't deny is that relative to the past, US companies are cash machines, which may explain the resilience in the face of higher than historical average valuations

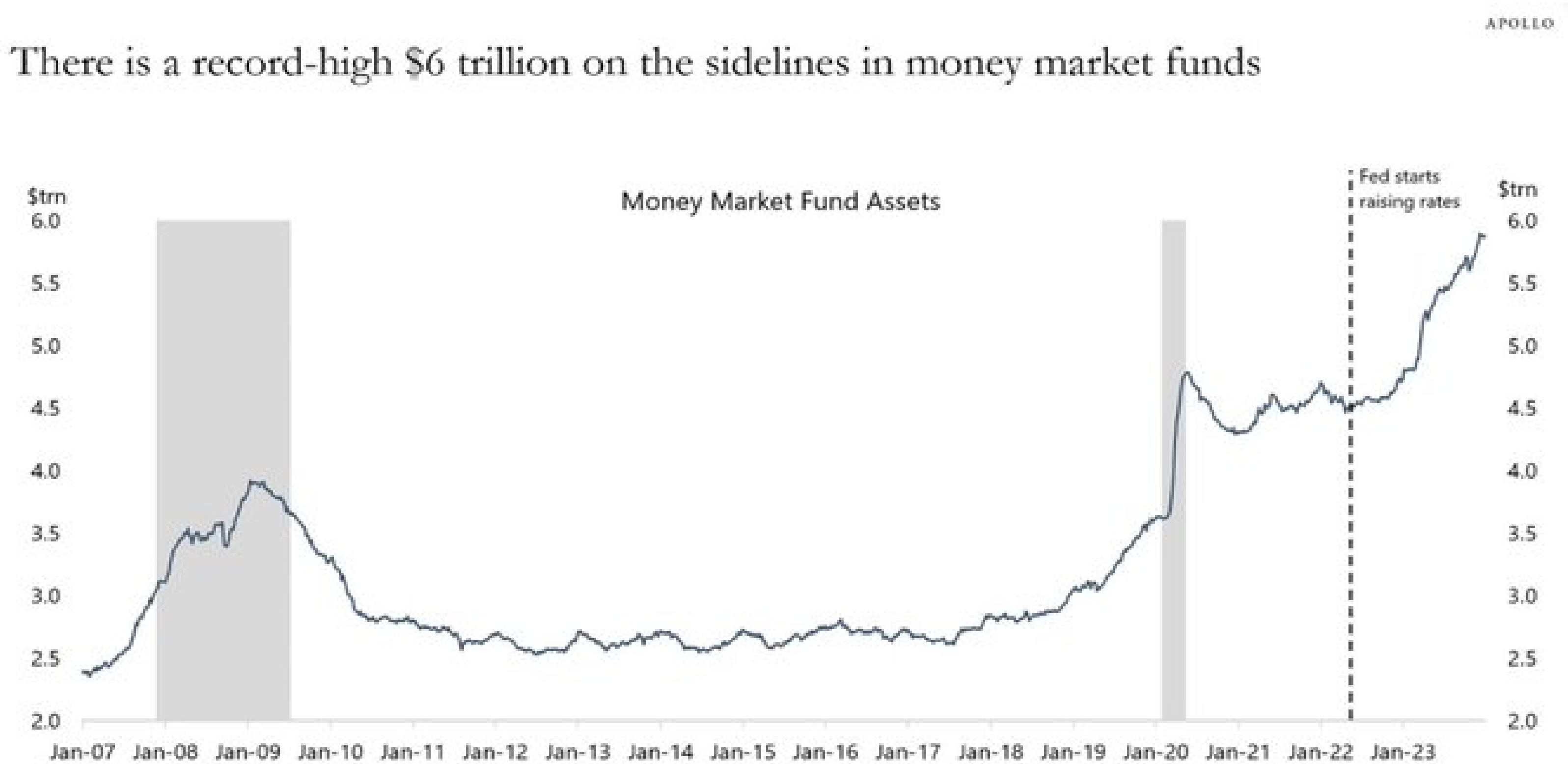


S&P 500 index companies have massively increased their ability to generate free cash flow in recent decades.

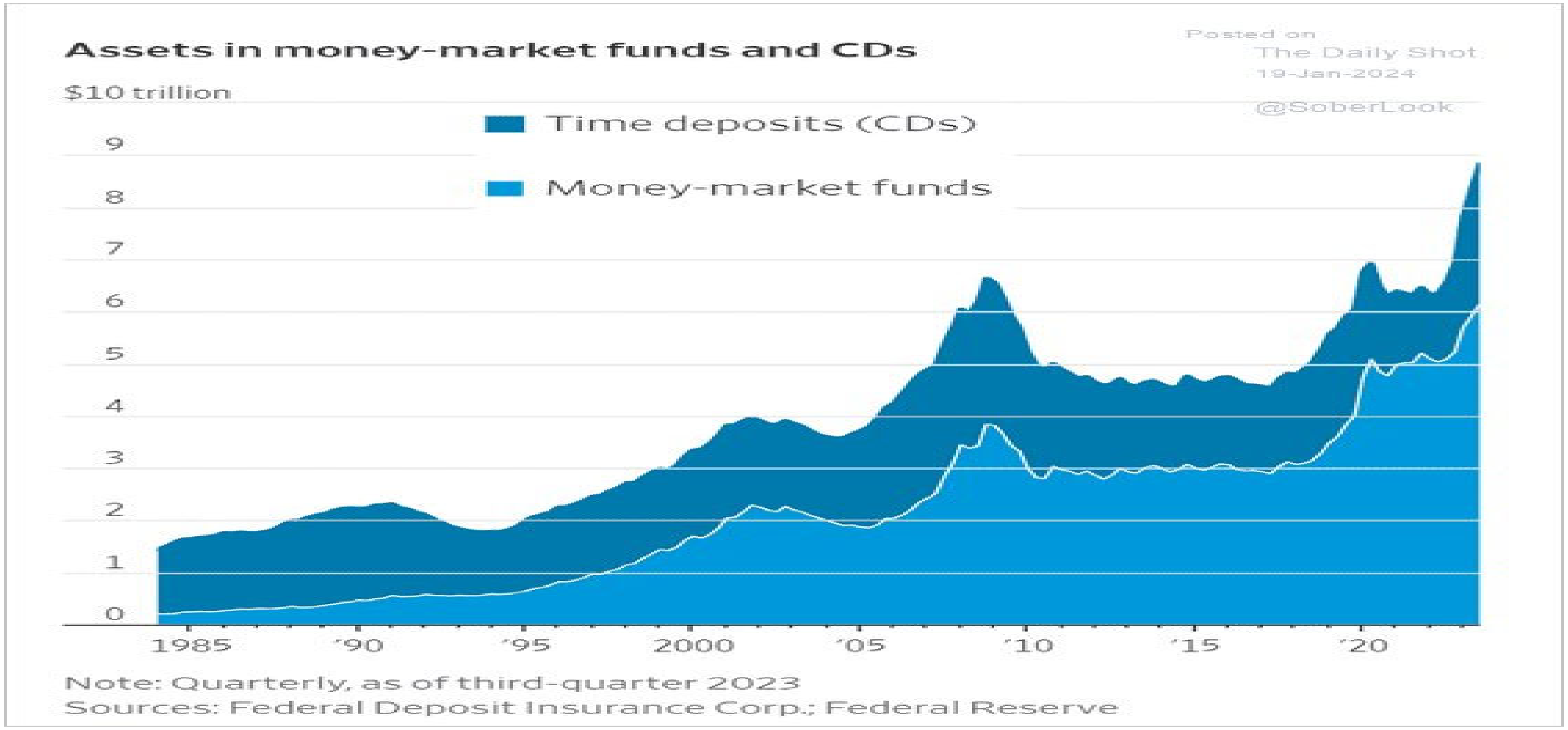
"The stock market is the opposite of a casino. The longer you play, the higher the odds you win."



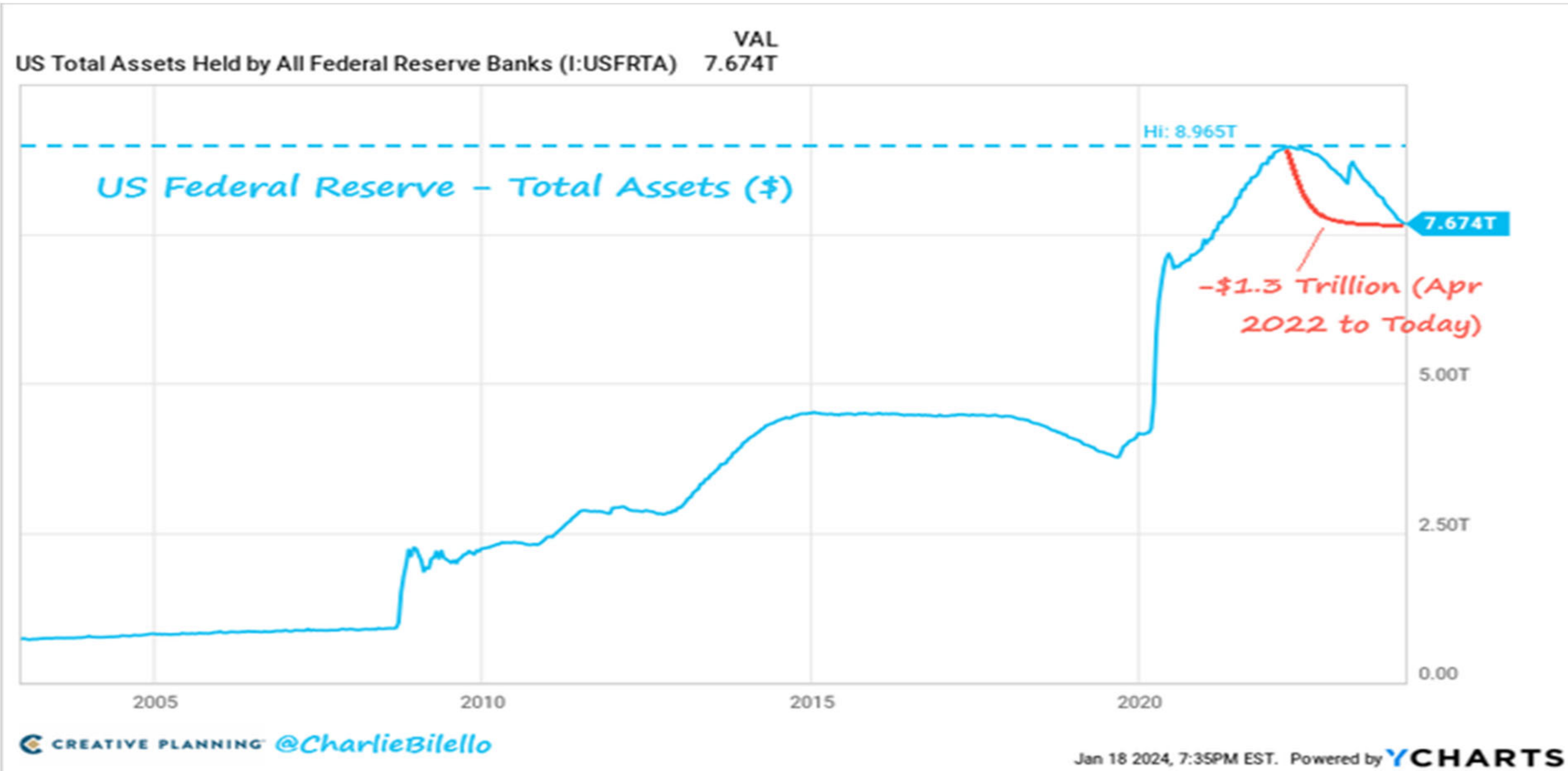
Since the Fed started raising interest rates in March 2022, money market funds have seen massive inflows. If this capital goes back into the equity market, the recent run is far from over.



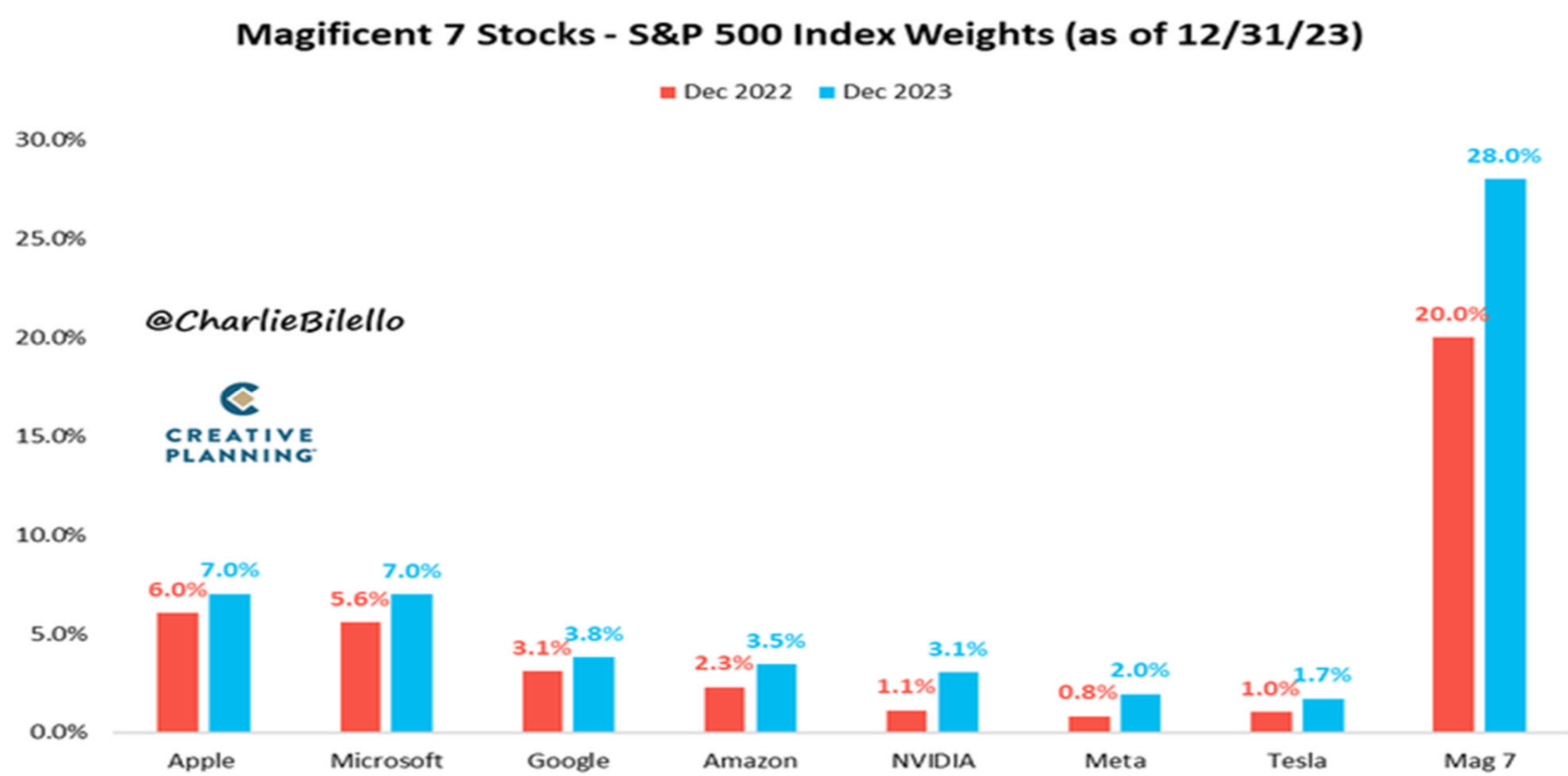
An additional $2.8 trillion in deposits



The Fed's balance sheet is now at its lowest level since March 2021, down $1.3 trillion from its peak in April 2022. How much more QT is needed to unwind the massive QE from March 2020- April 2022? $3.5 trillion.



The Magnificent Seven's weighting in the S&P 500 grew from 20% to 28% over the course of 2023, the largest share for any 7 companies in the index on record.



The Magnificent Seven stocks — Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla — now sport a market cap of around $12 trillion. Looking further into the market, the sales and profitability of the next $12 trillion in market cap are represented by 42 companies from a broad set of industries ranging from tech and health care to financials and consumer companies.

Can the Magnificent Seven maintain their dominance?

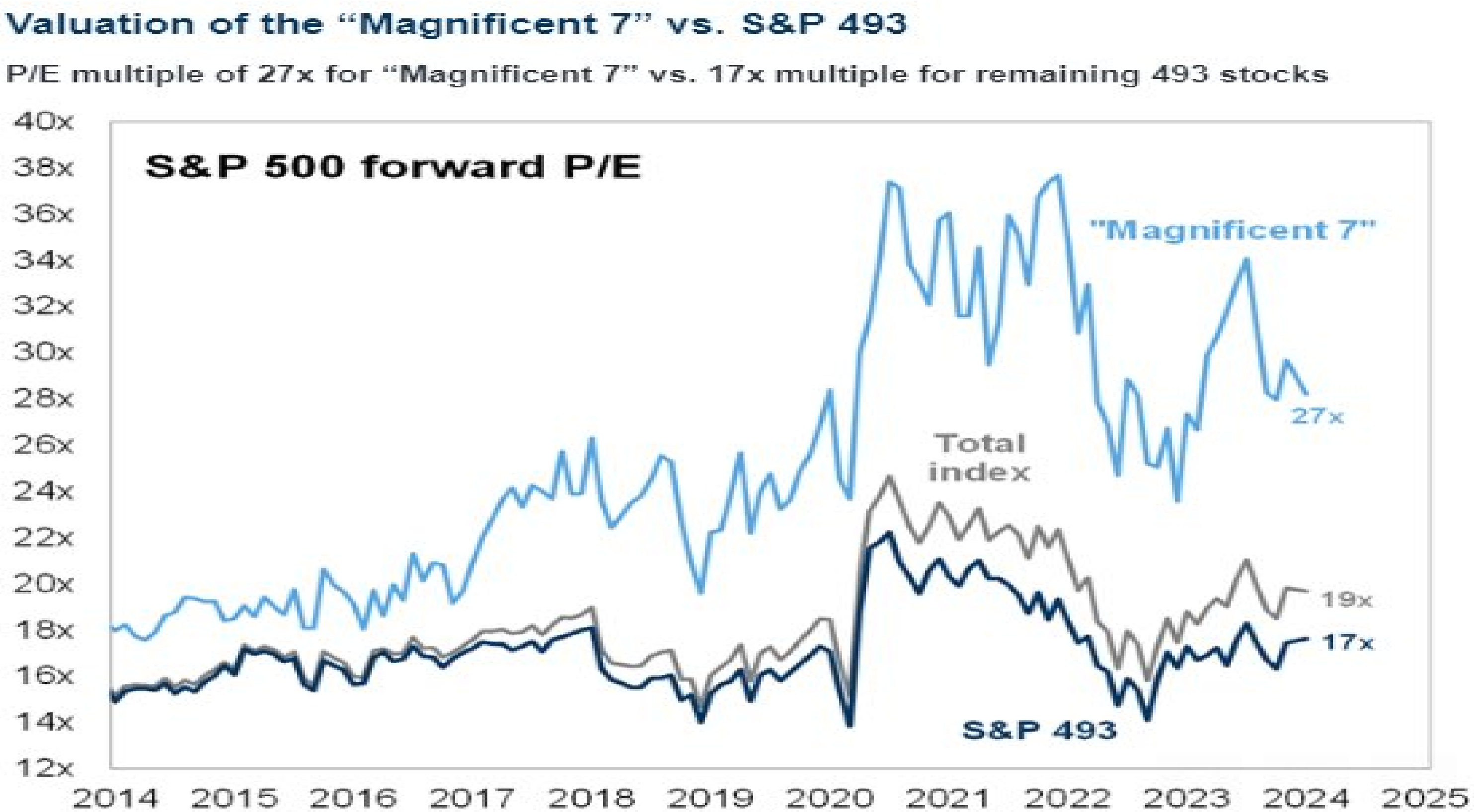
Stocks of the S&P 500 (USD billions)

Sources: Capital Group, LSEG. Next 42 companies represent stocks following the Magnificent Seven, ranked by market capitalization, with the above stocks topping the list. Sales are the net sales (or revenues) of the relevant item reported in the last 12 months. Profit is represented by the trailing 12-month operating profit. As of December 31, 2023.

Both the 12-month forward sales and earnings for this next set of companies making up a $12 trillion market cap are higher than for the Magnificent Seven, according to London Stock Exchange Group (LSEG) data as of December 31, 2023 — yet another data point indicating U.S. stock market performance could broaden in the coming years, pending earnings outlooks.

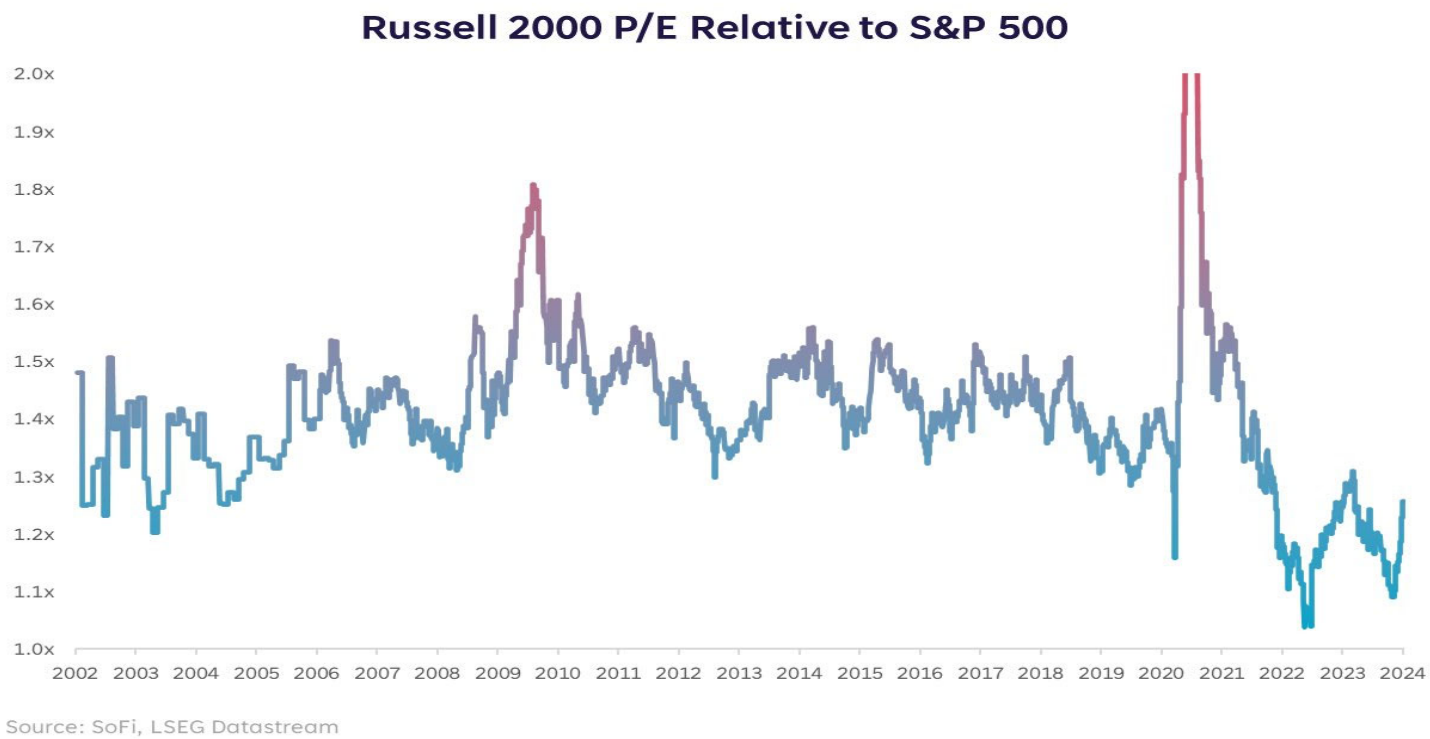
Our focus remains on valuations given the rise in share prices for the Magnificent Seven. The S&P 500 Index has a forward price-to-earnings (P/E) ratio of about 15.5x excluding the Magnificent Seven, while the Magnificent Seven has a P/E of about 35x, according to data compiled by FactSet as of January 2, 2024. Earnings growth estimates in 2024 bring the division into high relief — the Magnificent Seven boasts 20.8%, with the S&P 500 at 11.5%, and S&P 500 sans-Magnificent Seven at 6.7%, respectively. For 2025, earnings growth estimates for those three groups are projected at about 17%, 12% and 6.7%, respectively. Longer term earnings estimates for the M7 remain higher, but the uncertainty band around them would also be higher. Hence, the need to diversify.

Forward P/E of 17 for S&P 493 doesn't appear to be outrageously high. 27 for some of the Magnificent 7 is also justified by their growth, but not for all seven of them given sluggish growth or even recent revenue declines.

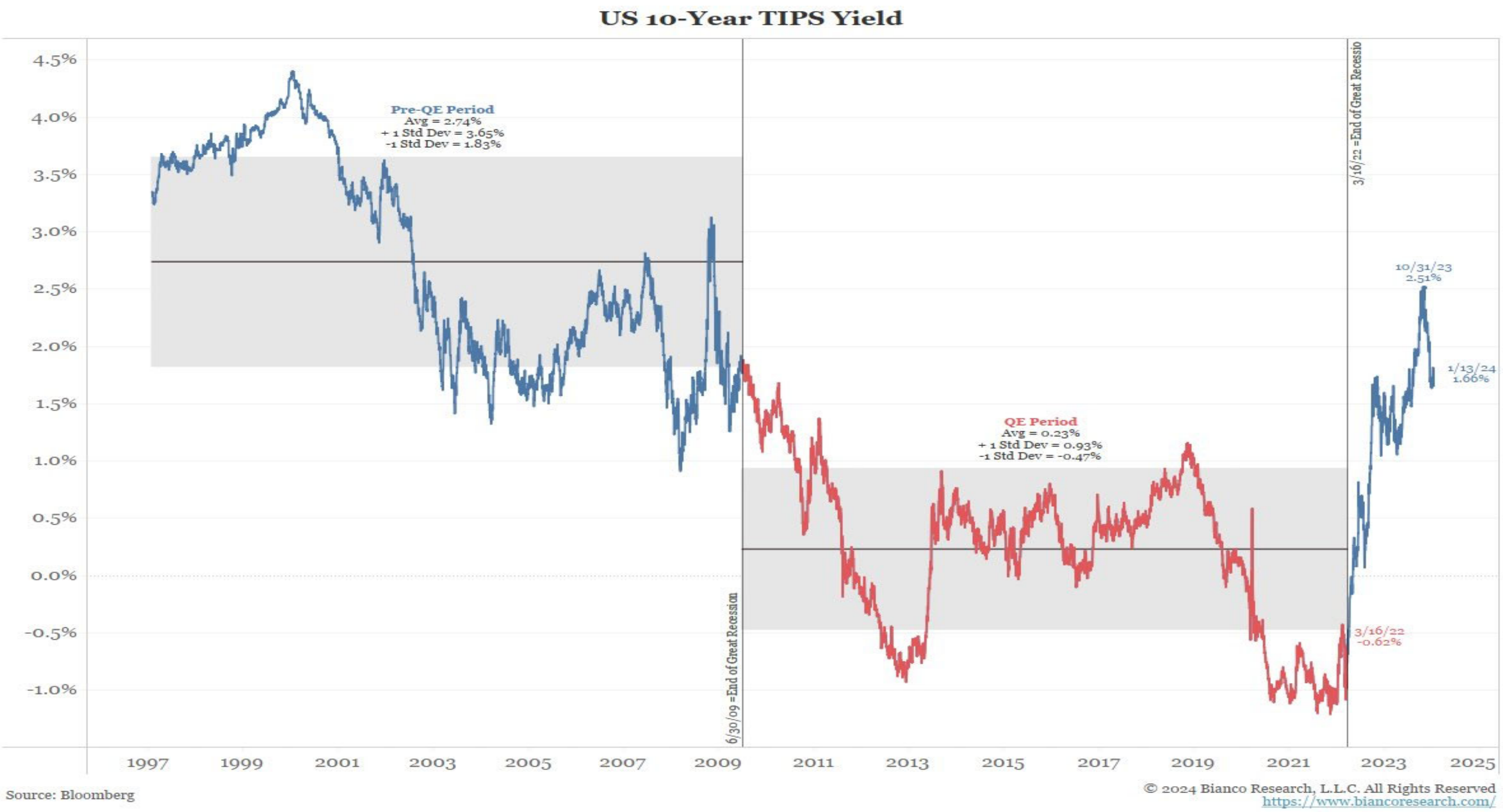


Yardeni - We see a 20% probability of a melt-up in the stock market with technology stocks leading. The forward P/E of the S&P info tech sector is currently 26. It rose near 50 in 2000, so there is room to soar in this scenario.

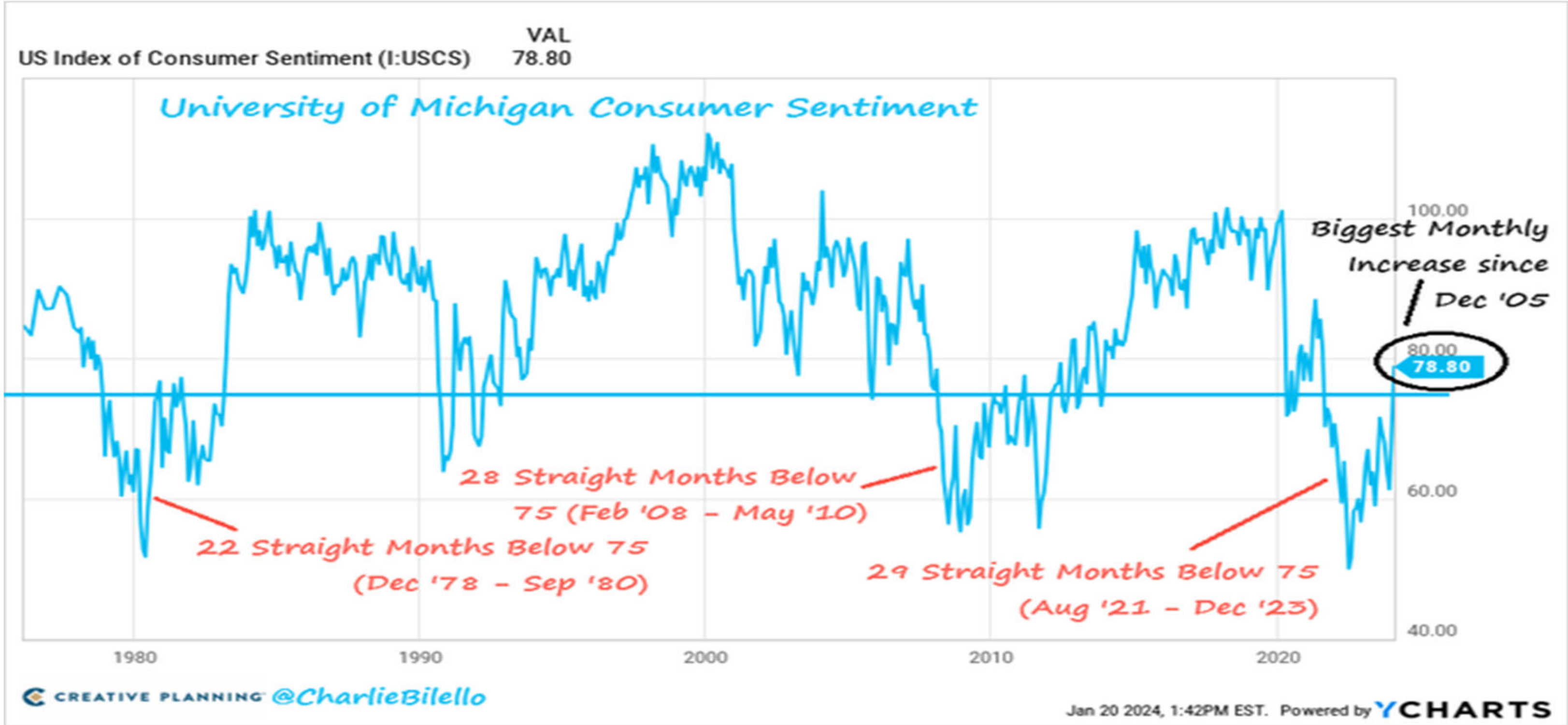
Small-caps remain cheap vs the S&P 500 even with their recent run up.



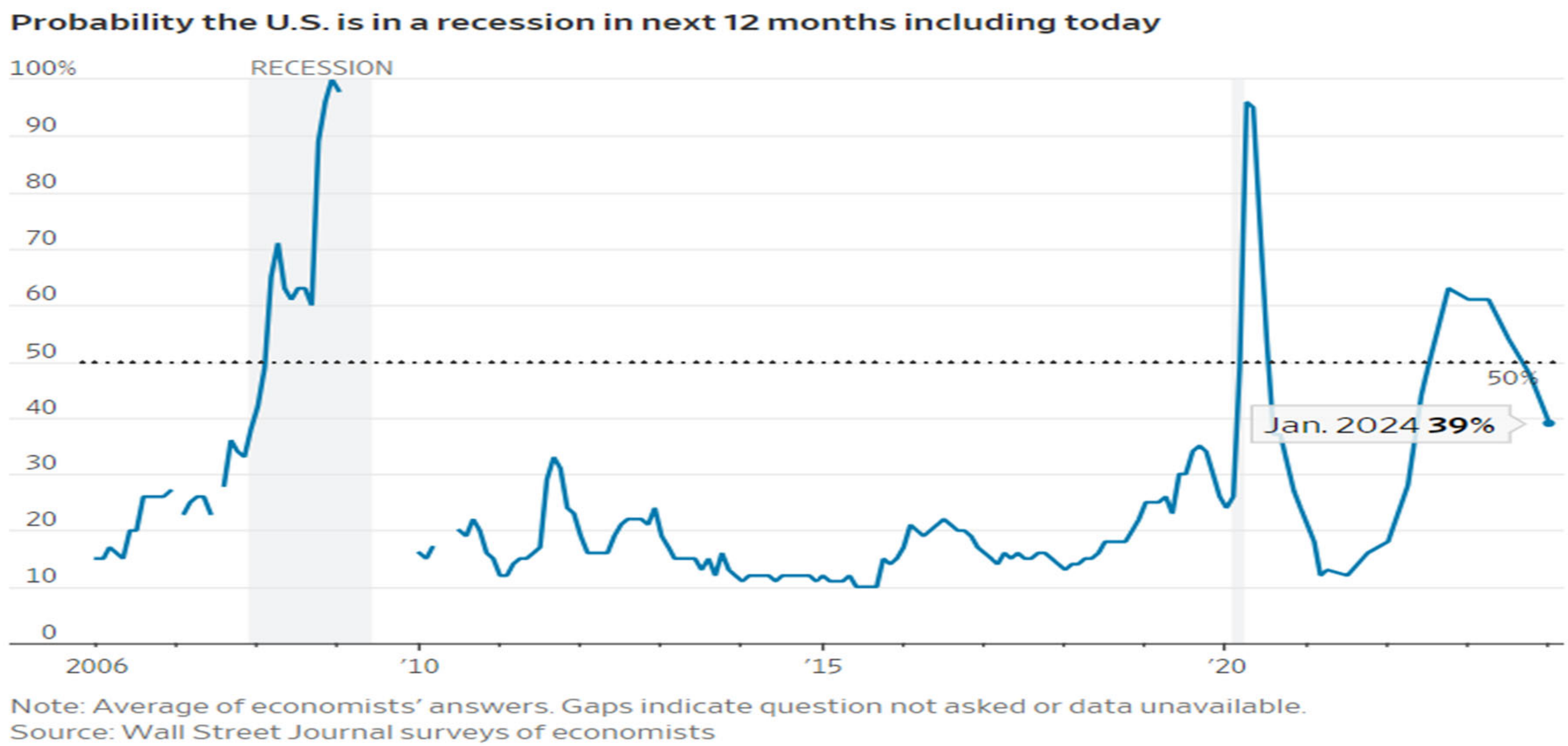
Real 10-year yields below (10-year TIPS yield).
The current level of real yields are not unusual for the pre-QE-period.



The University of Michigan Consumer Sentiment Index jumped up to 78.8 in January, ending the longest period of extreme negative sentiment on record. The 9.1 point increase in the index over the last month was the largest spike higher since December 2005.

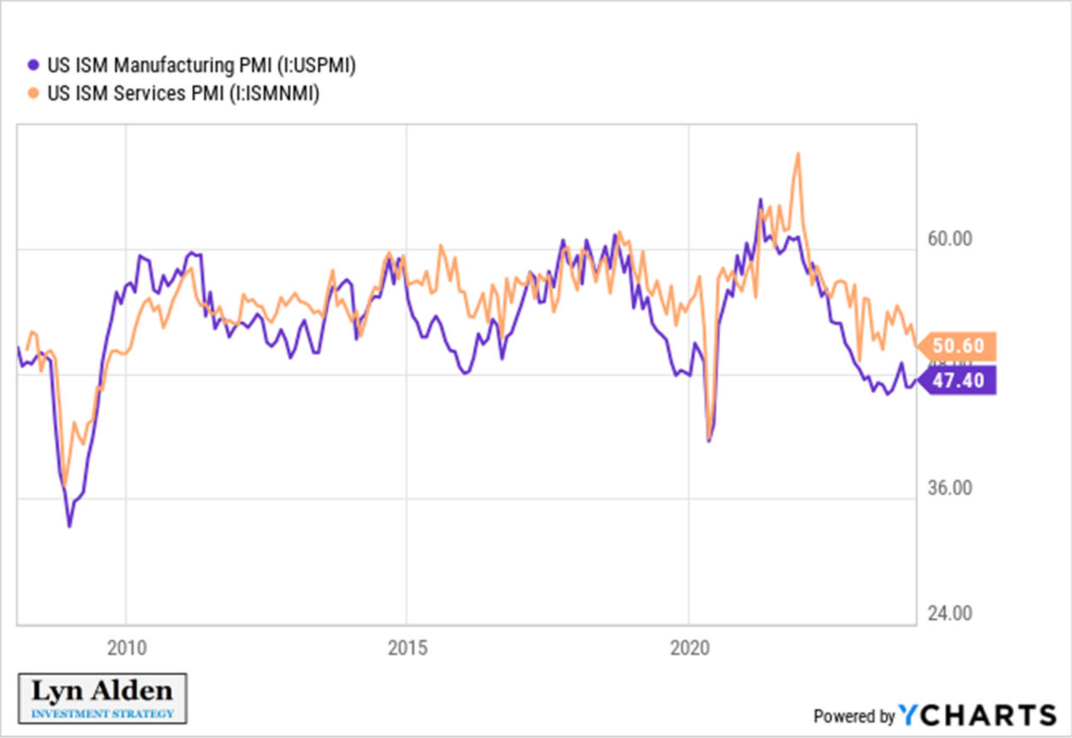


According to **economists surveyed by the Wall Street Journal**, the probability of a U.S. recession in the next 12 months has moved down to 39% from 61% a year ago.

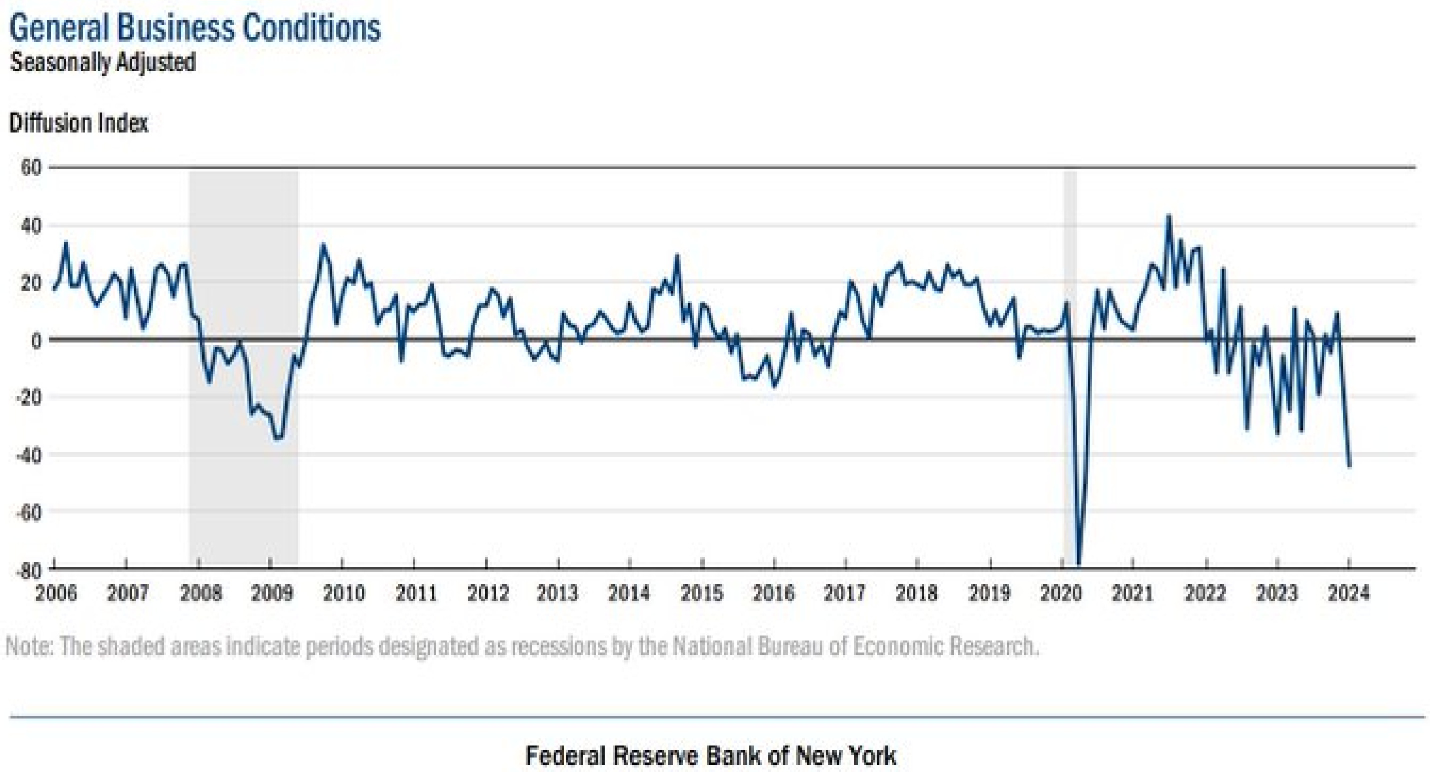


Conference Board LEI declined again in December! US LEI continues to signal recession.

The U.S. manufacturing sector has been decelerating since mid-2021, and since late 2022 has had 14 consecutive months of mild contraction. The services sector is less cyclical in general and has held up better, but is currently at stall speed:



Probably nothing, it will be a soft landing folks

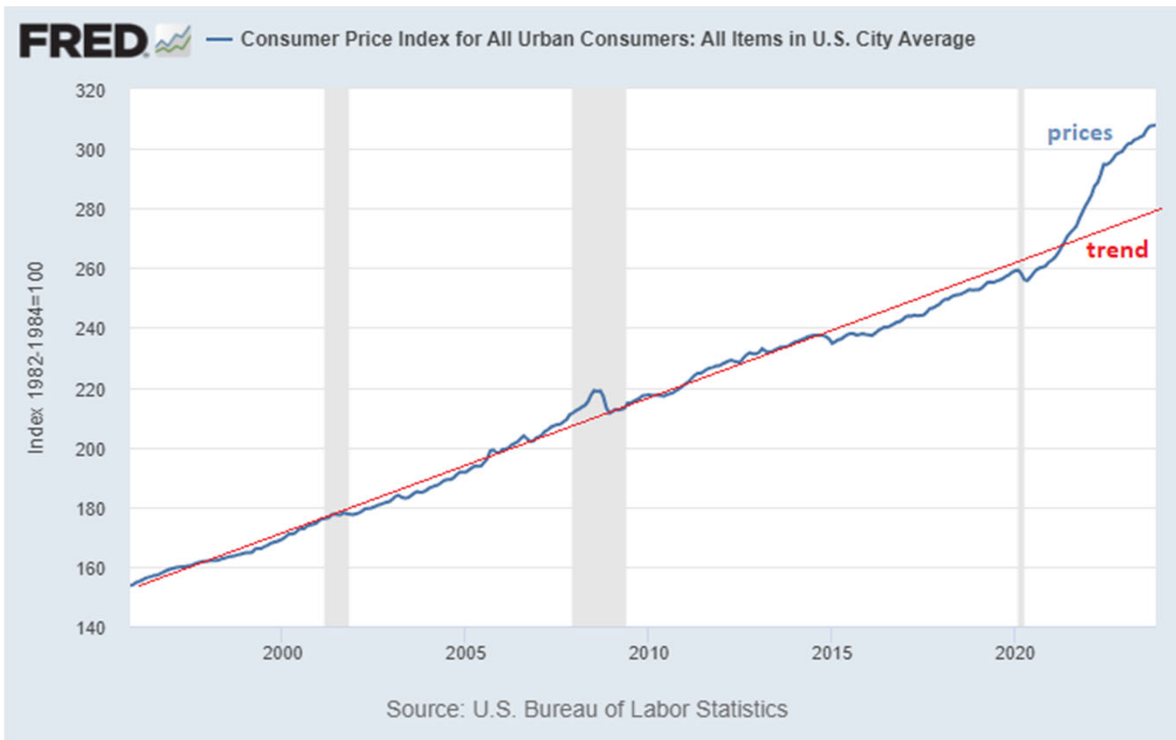


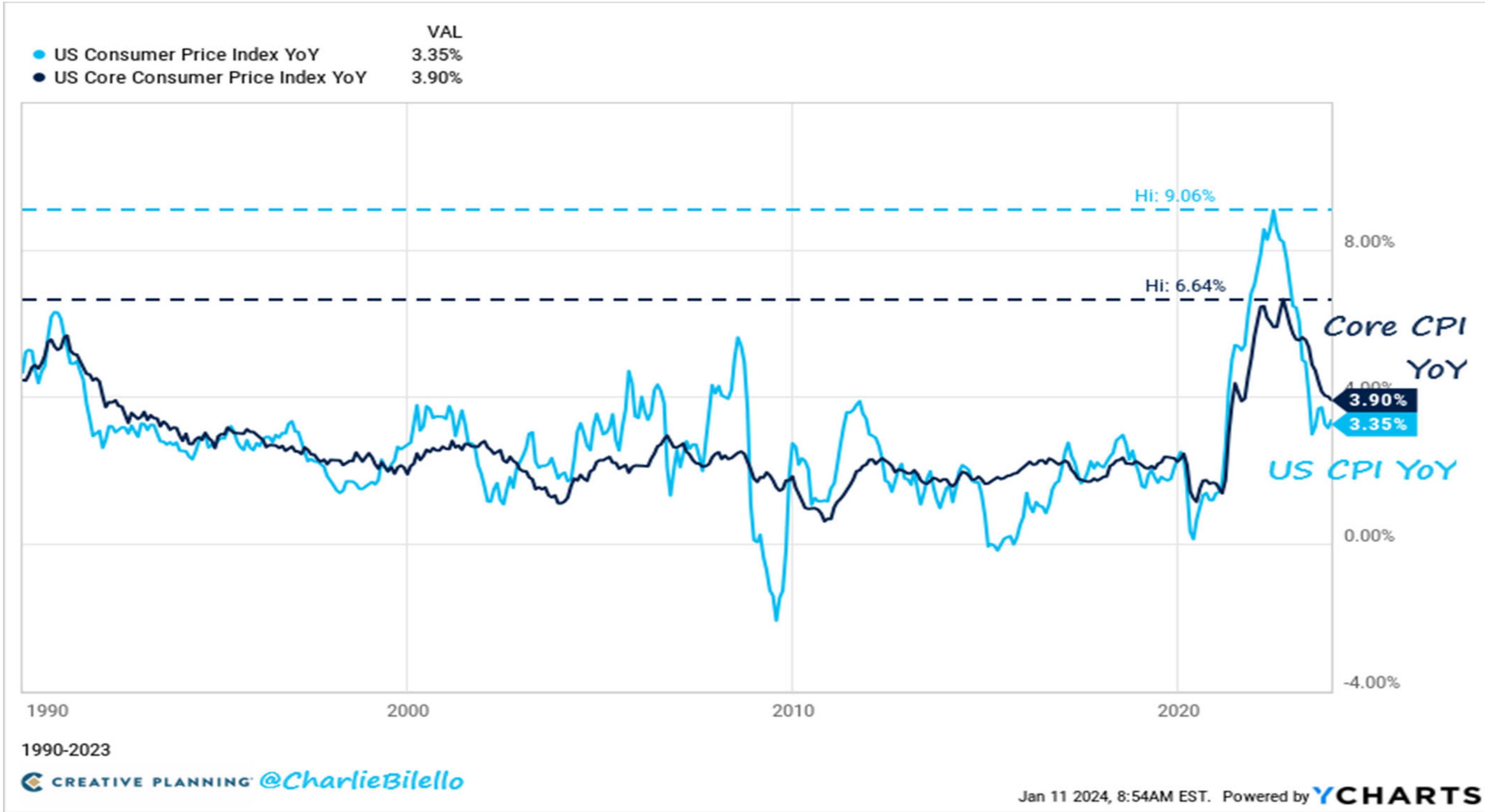
We are now 14 months into a persistent yield curve inversion, so the next few months will confirm.

Persistent Inversion	Start of Recession	Lag (months)	S&P 500 Decline
Dec 1968	Dec 1969	12	(-)36.1%
June 1973	Nov 1973	4	(-)48.2%
Nov 1978	Jan 1980	14	(-)17.1%
Sep 1980	July 1981	10	(-)27.1%
May 1989	July 1990	13	(-)19.9%
July 2000	Mar 2001	8	(-)49.1%
July 2006	Dec 2007	17	(-)56.8%
May 2019	Feb 2020	9	(-)33.9%
Nov 2022	???	14	???

Credit card delinquencies are at a record high, surpassing peaks seen during the 2001 and 2008 recessions.

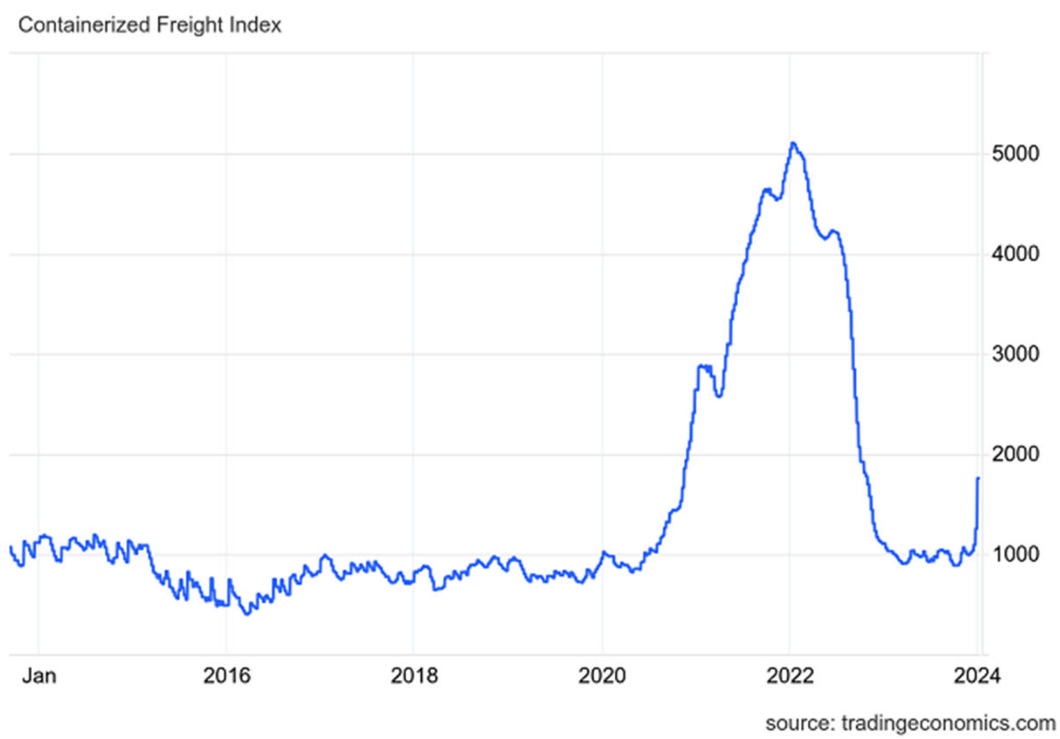
In the aftermath of the pandemic-related stimulus, most prices went permanently higher due to there being more broad money in the system:



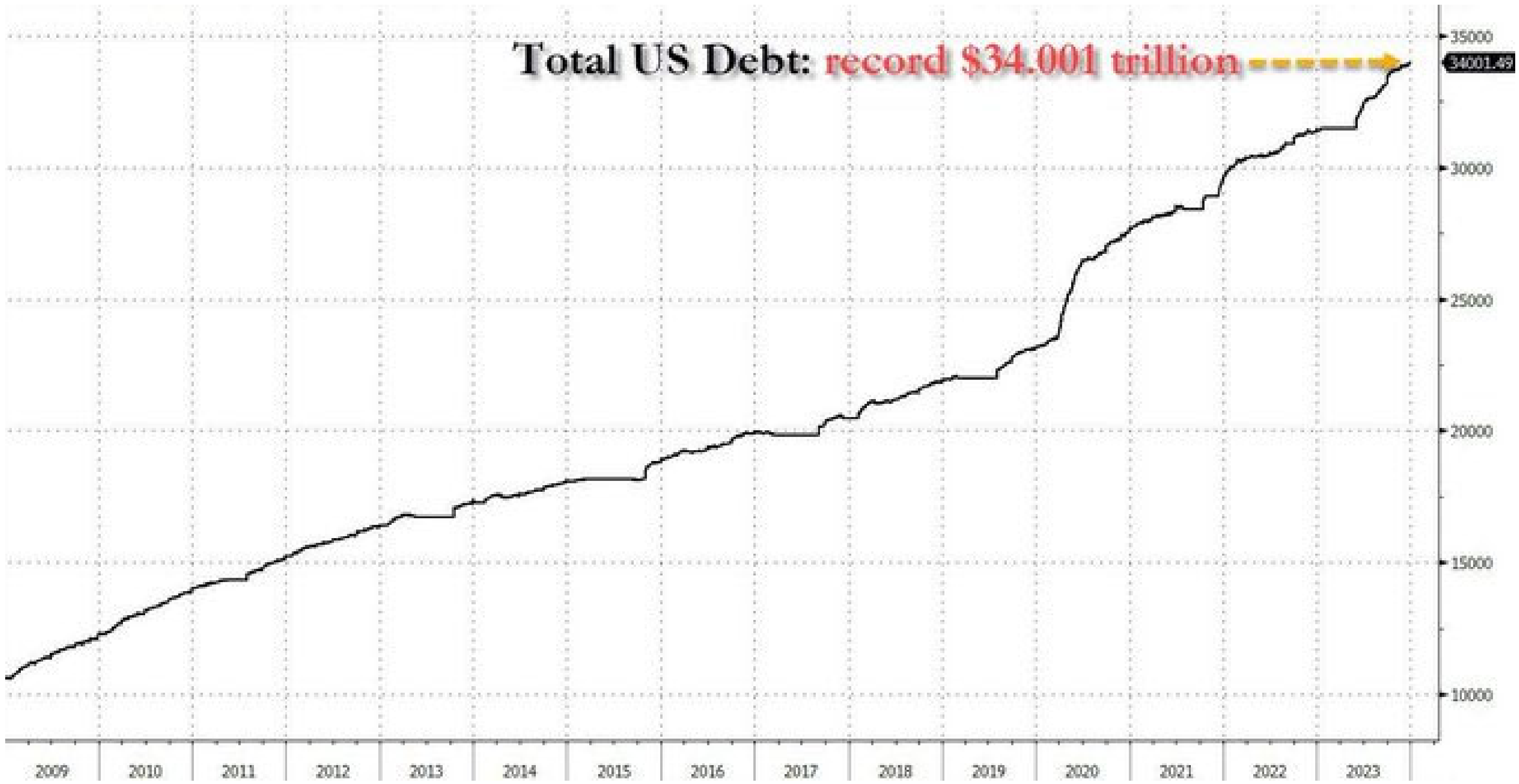

VAL
US Consumer Price Index YoY 3.35%
US Core Consumer Price Index YoY 3.90%
Hi: 9.06%
Hi: 6.64%
8.00%
4.00%
0.00%
-4.00%
Core CPI YoY
3.90%
3.35%
US CPI YoY
1990
2000
2010
2020
1990-2023
CREATIVE PLANNING @CharlieBilello
Jan 11 2024, 8:54AM EST. Powered by YCHARTS

Inflation is theft ….

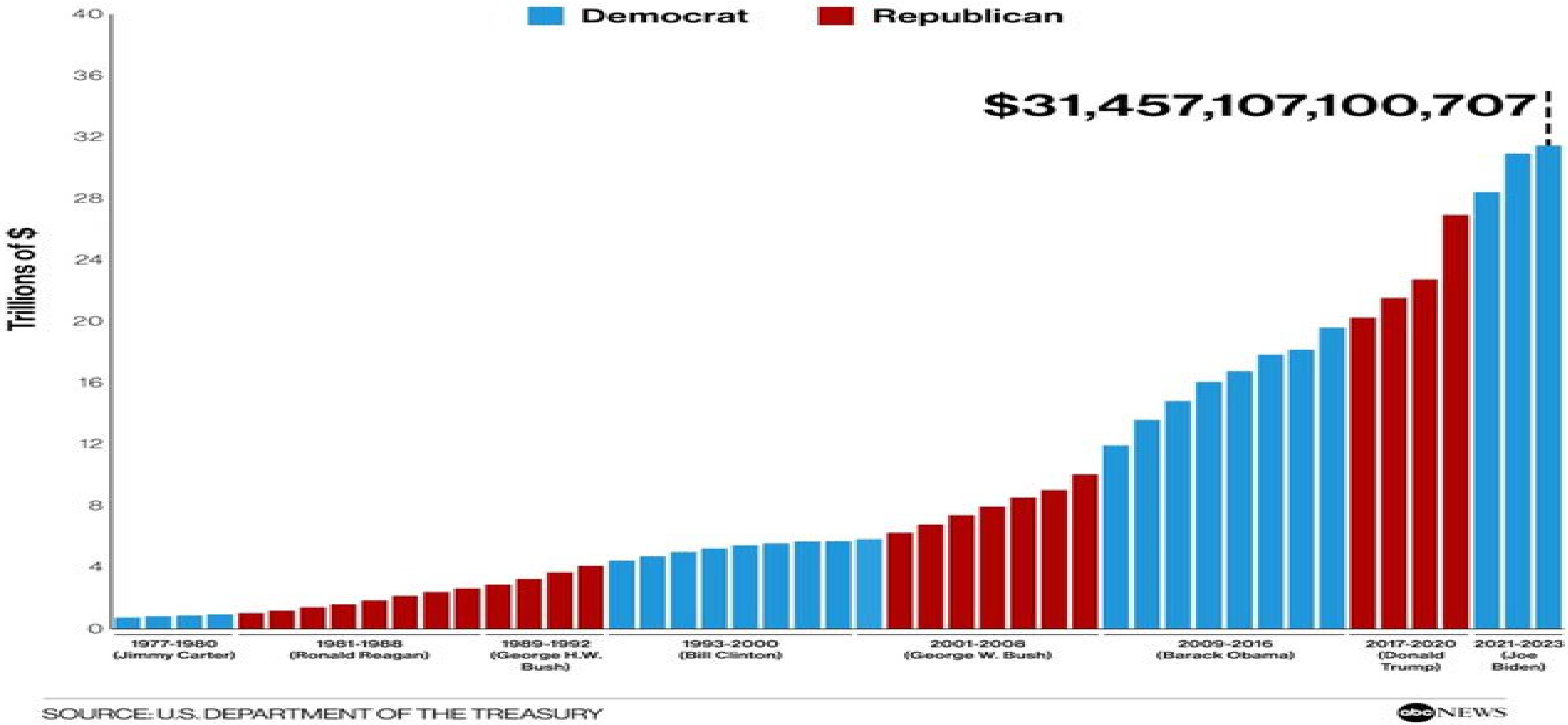
The current Red Sea situation is thus far causing a minor repeat of what happened during the pandemic, with a rapid 70% jump in containership prices:



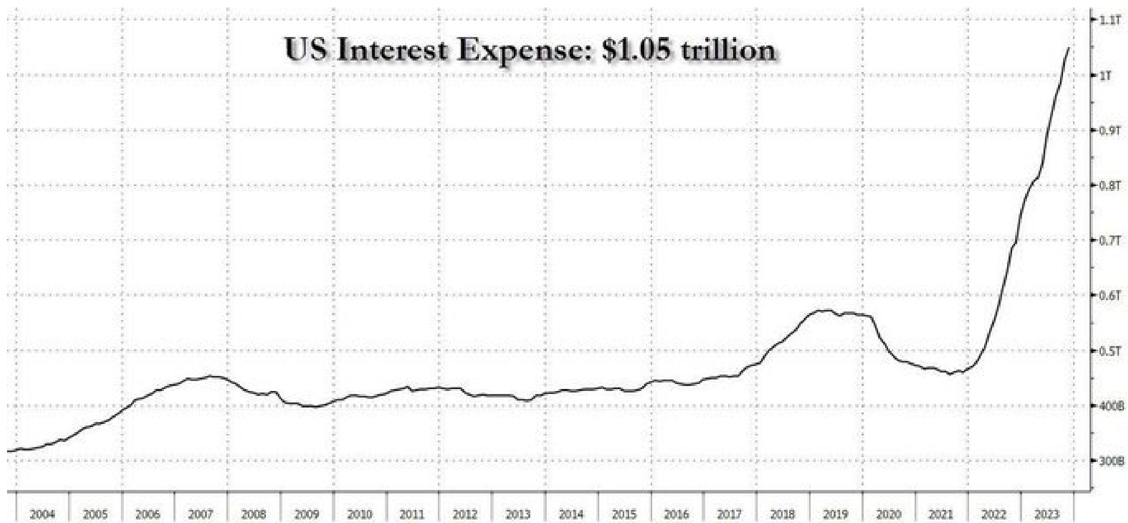
Total US debt just broke above $34 trillion which means US debt is now up: 1. $1 trillion in the past 3 months 2. $2 trillion in the past 6 months 3. $4 trillion in the past 2 years 4. $11 trillion in the past 4 years



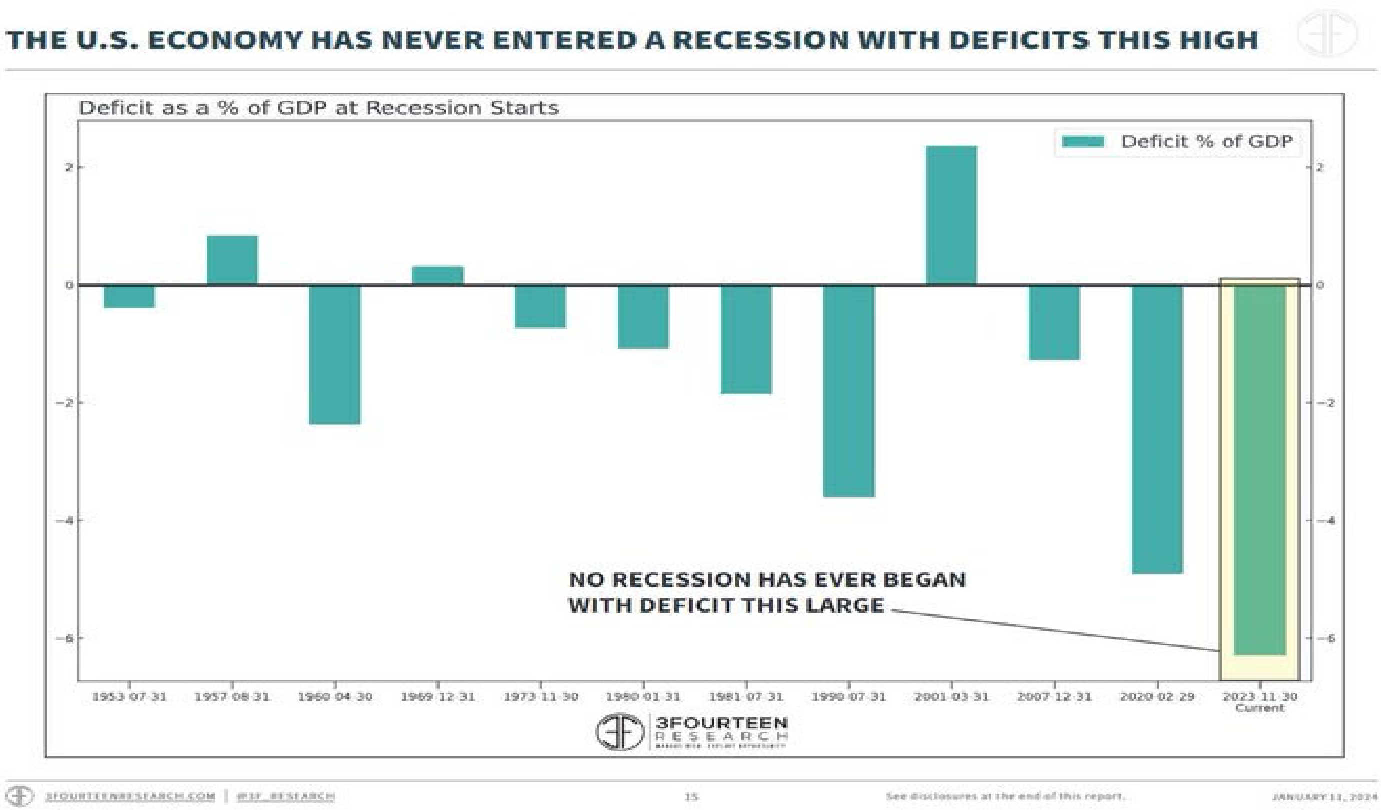
National Debt Year by Year



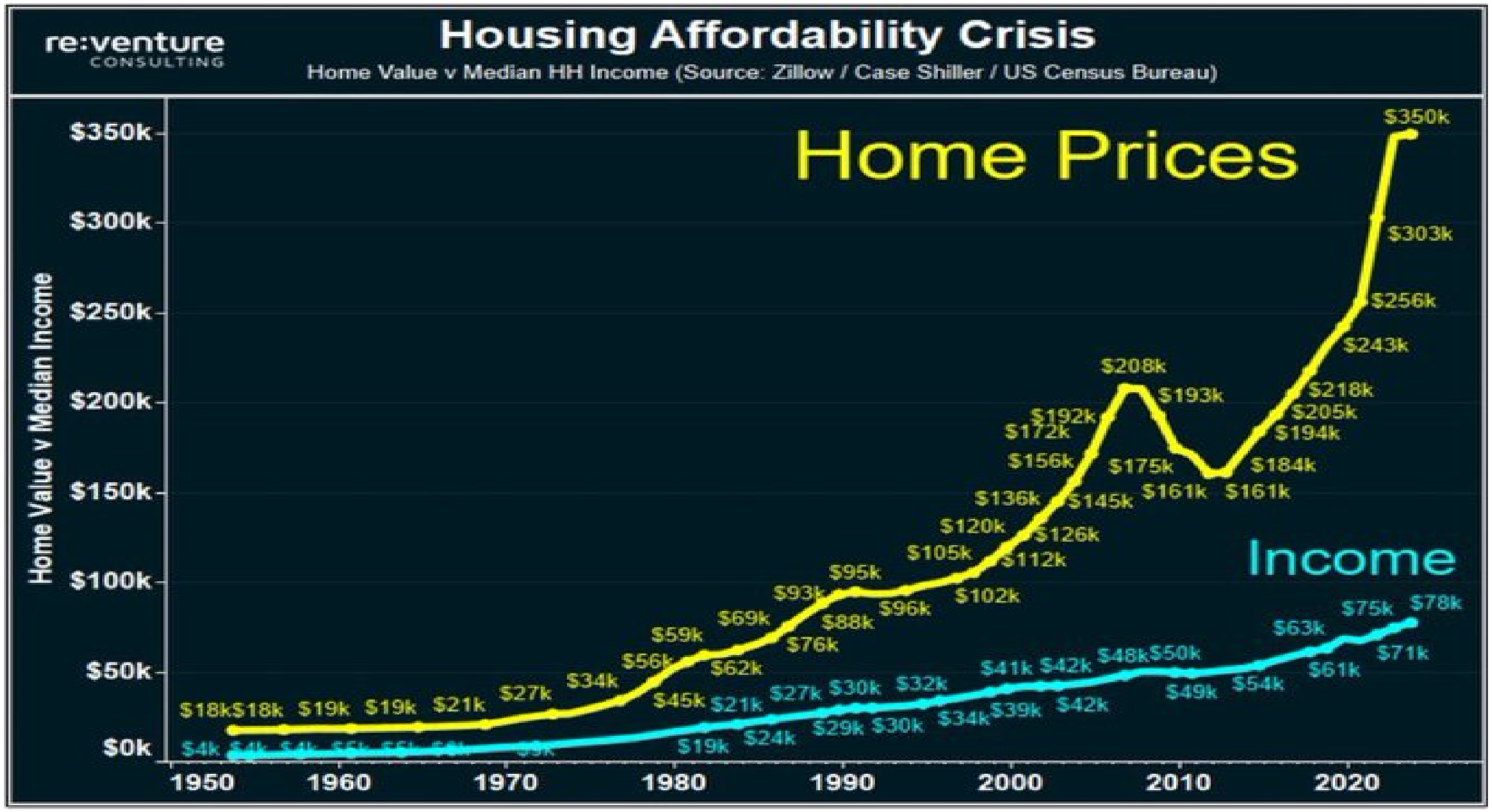
Annual interest expense was less than $500 billion just TWO YEARS ago. As interest rates rise and deficit spending soars, interest expense is becoming one of our largest costs.

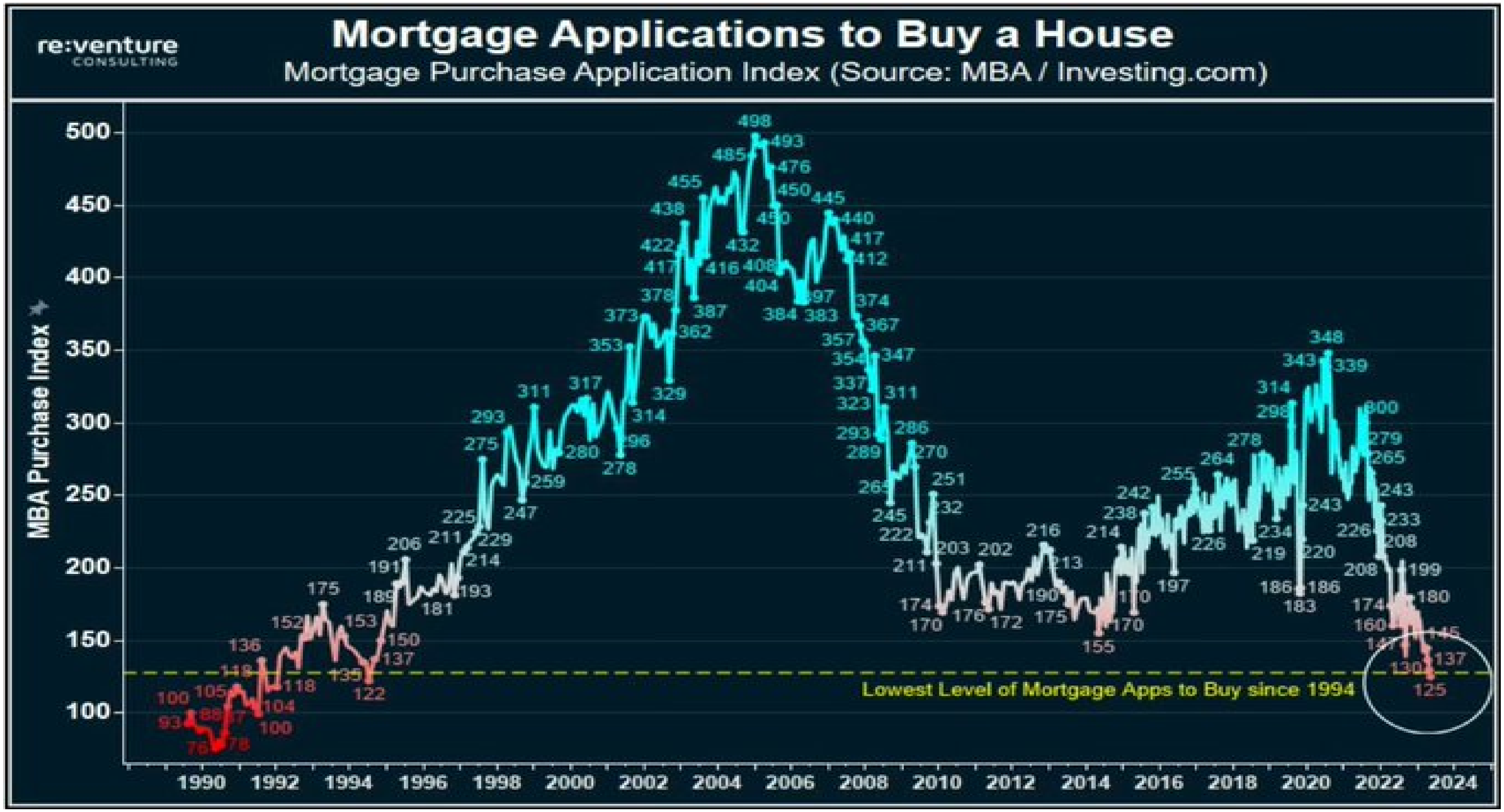


A U.S. recession has never started with the deficit this high.



Housing has gotten way out of hand.




re:venture
CONSULTING
Mortgage Applications to Buy a House
Mortgage Purchase Application Index (Source: MBA / Investing.com)
MBA Purchase Index
Lowest Level of Mortgage Apps to Buy since 1994
1990
1992
1994
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2022
2024