MULVIHILL

By the Way

Monthly commentary from Jack Way

"I've never seen the consensus as wrong….everyone got burned."

To quote Andrew Pease, Chief Strategist at the advisory firm Russell Investments; "I've never seen the consensus as wrong….everyone got burned." Well not everyone. If you went away for the year and did nothing, 2023 was probably a very good year for your stock portfolio. His reference was more about those investors who attempted to forecast markets and ended up on the wrong side of the trade. It wasn't hard to do. The FED, as expected, continued its tightening policies raising interest rates through to July and then preached "higher for longer". Such policies had historically led to lower stock prices, but not this time. By the summer the impact of high rates and the U.S. Treasury Department needing to finance several trillion dollars of debt to pay for government deficits was taking a toll and markets cooled off. There are several indices that attempt to measure so-called "financial conditions", including one from the FED's Chicago office. By estimating the looseness in money markets from equities to banks and even "shadow" banks they hope to develop a sense of the amount of fuel in the economy to provide for growth. Given the positions taken by the FED and Treasury mid-year there were reasons for concern. All that changed in late October when the FED announced it had finished raising rates and Janet Yellen, Secretary of the Treasury, disclosed that the Department would raise funds in the short-term market which had the effect of easing pressure on long term rates. The impact on the Financial Condition Index was sudden and of epic proportions. With sources of liquidity reopening, both the bond and stock markets went on the huge run we witnessed in November and December. While I'm not a fan of too many numbers, it is interesting to take a look at where we've been the last two years:

Markets	2023	2022
S&P 500	+24%	-19%
Nasdaq 100	+55%	-32%
Toronto Composite	+8%	-8%
US 10 yr. Bonds	+4%	-16%

That year-end rally has to have sapped some of the energy from 2024, but there is no indication we are facing any significant weakness in at least the short term. Nevertheless, I worry that valuations are high (S&P 500 is at 20x earnings), the chances of a recession have not disappeared, and the political and geopolitical risks are very real.

The U.S. economy continues to be a positive on the back of labor market strength and consumer spending. At the same time, the rate of inflation has declined significantly. Household income has been supported by wage increases rising faster than the rest of the inflation basket of goods. That is a two-edged sword though, as it also raises the cost of production and is the main source of "sticky" longer term inflation. The recently released "Quits Rate" from the Economic Policy Institute indicates workers are becoming more reluctant to leave their current employer as job openings are also declining. Again, it's a double-edged sword; it helps keep inflation down but could negatively impact spending. A sign of what might become a concern; in the third quarter U.S. credit card debt rose by 4.7%. That's not how we want to see continued spending supported.

So far, the FED's plan for a soft-landing is on track. The economy is growing, inflation is declining, and the labor market is coming into balance as job openings are declining but actual jobs are not. We still don't know if the lagged effects of earlier tightening have totally moved through the economy, but given the FED's last increase is 6 months in the rear-view mirror, we are by definition closer to the end. While I sometimes feel like some combination of the boy who cried wolf and the old man yelling at clouds, despite the many positives, I remain of the belief we will see weakness in the U.S. economy in 2024.

The American political situation would give credence to the notion that I'm wrong. (Again?) Dan Clifton, who follows Washington policy for Strategas, points out that every reelection year since 1944 has ended with a positive total return.

Then he went on to list the many tools available to politicians to boost the economy and their standing in the eyes of voters. It is hard to argue against the logic.

President Biden has the most to gain from a strong economy and the most tools at his disposal. Nevertheless, members of his party continue to fear the effects of his low approval rating, not just on his chances for reelection but also on the rest of the Democratic ticket. Barring health issues, it looks like Biden versus Trump redux. No Republican can strand up to Trump (he's taking it easy on Nikki Haley; maybe she'll be his running mate?) and Democrats are concerned that if Biden drops out the ensuing fight for the nomination would be disastrous. The huge differences between the two men and the two parties stand to make this election even more impactful than normal.

We have often spent too much time worrying about the effect of global geopolitics on financial markets, but with so much on the line this year, that could be changing. Bloomberg points out that 40% of the world's voters are going to the polls this year and much hangs in the balance, including the possible future of democracy versus populism and autocracy. The post World War II "Pax Americana" that saw the U.S. oversee global affairs appears to be waning (including in the U.S. itself), and what we Westerners refer to as "bad actors" are feeling more emboldened. (Russia, China, Iran and North Korea e.g.) Obviously nothing is certain, but the potential for negative outcomes is much closer to the surface.

As usual I have things on my mind that I either forgot to mention or didn't know where to include them.

For those who think fossil fuels are going away, Bloomberg reports 2023 saw:

1. China opened a record number of new coal-fired plants.
2. U.S. oil production hit an all-time high for any country in history.
3. Liquid natural gas shipments set a new record.

U.S. "border encounters" are close to twice the peak we saw during the Trump presidency.

Despite the volatility, the yield on the U.S. 10-year Treasury Bond at year end was 3.87%. Identical to year-end 2023.

Can Canada benefit from "onshoring" and "friendshoring" and increase trade with the U.S.?

Best quote someone sent me this month came from the late P.J. O'Rourke; "If you think healthcare is expensive now, wait until you see what it costs when it's free." As a Canadian resident, I can relate.

All the best in '24

Disclosures