



Glen Eagle

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January 2024 Investment Commentary

As we enter 2024 filled with hope and expectation, we cannot help but reflect upon 2023. Despite the extreme pessimism that abounded at the start of last year, it ended up being positive from a growth perspective with the S&P 500 increasing 24%. No one was more surprised by this result than Wall Street analysts, and who could blame them? Last year inflation was still persistently high, interest rates had just been raised at their fastest pace in history, Silicon Valley Bank was just months away from bankruptcy, and the stock market had just lost a fifth of its value in 2022.

In retrospect, 2023 was an example of when the irrational confidence of some experts blinds them to the potential of facing something other than what they predict. The stock market, in particular, has a way of keeping us humble. For example, in March 2020 when the world was faced with the largest pandemic in our lifetime, the stock market proceeded to rise an astounding 65% over the next two years. Conversely, in January 2018, with unemployment at a historic low of 4.0% and corporate tax cuts on the horizon, the stock market counteractively dropped -6% over the following 12 months. As Peter Drucker, founder of modern management theory, once joked, "Trying to predict the future is like trying to drive down a country road at night with no lights while looking out the back window...The only thing we know about the future is that it will be different."⁽¹⁾

With this poignant lesson in our mind, we believe that we can use the start of this year, as we optimistically begin our New Year's resolutions, to take the opportunity to question some of the potential "certainties" that market pundits and media outlets are once again publishing with certainty. Our Investment Committee has identified four narratives we often hear:

1) Narrative #1: Technology companies are as overvalued as in the dot-com bubble.

Alternative Perspective: While the S&P 500 rose by 24% in 2023, the majority (over 70%) of the companies in the S&P 500 actually underperformed the overall index.⁽²⁾ This is because almost all the positive performance was concentrated in the top 10 largest companies in the stock market (Microsoft, Apple, Amazon, Nvidia, Alphabet, Meta, Berkshire Hathaway, Tesla, UnitedHealth, and Eli Lilly). As excitement over both artificial intelligence and obesity drugs grew over the past year, so too did the stock price of these companies. The magnitude of this overconcentration of performance in so few companies is unprecedented and has led these top ten companies to now be worth more than the combined value of the bottom 415 companies in the S&P 500.⁽³⁾ Put a different way, these ten companies have a larger economic value than the entire stock markets of the UK, China, France, and Japan put together.⁽⁴⁾ Yet that does not mean the largest technology firms on this list are as overvalued as the dot-com era. Many of today's tech firms run hugely profitable businesses, with some (Apple, Alphabet, and Microsoft) sitting on more than \$1 trillion of cash.⁽⁵⁾

2) Narrative #2: Inflation will continue to fall quickly in 2024.

Alternative Perspective: Inflation has now fallen to around 3% from a recent record of 9.1% a year ago. This decline was nothing less than extraordinary in such a short period of time, and many expect inflation to hit 2% in 2024. There are currently three risks to the lower-inflation outlook: 1) wages 2) housing and 3) energy prices. With unemployment below 4%, and close to one-third of small businesses reporting that employee wages will continue to increase, it may be harder for the Federal Reserve to bring inflation down further.⁽⁶⁾ To make matters worse, the housing market is starting to recover as would-be buyers are responding to the slight decrease in mortgage rates from their recent highs. A resurgence in home prices would be problematic since housing represents 40% of the inflation computation. Finally, geopolitics is threatening to reverse the drop in energy prices that we have all benefited from over the last year.

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3) Narrative #3: Interest rates have peaked and will drop to pre-pandemic levels over the next few years.

Alternative Perspective: During the pandemic, our nation's debt ballooned as the federal government went on a near-continuous spending spree. To put this in perspective, the US government went from paying \$1 billion a day in interest payments, to around \$2 billion a day in less than five years.⁽⁷⁾ Unfortunately, we also have fewer young workers who will be able to service this growing debt burden over the coming decades. According to the government census, three-quarters of all counties in the United States have more deaths than births in their populations.⁽⁸⁾ While interest rates are likely to drop over the next year or two from current elevated levels, we do not see them returning to pre-pandemic levels.

4) Narrative #4: The presidential election will lead to a drop in the market.

Alternative Perspective: Despite the fact that 32% of Americans believe the U.S. economy could enter a recession within a year if their preferred political party does not win, history tells a different story.⁽⁹⁾ Volatility increases during election years, but investment returns have remained generally positive. In fact, since 1936, the 10-year annualized return of the S&P 500 has been positive and only negligibly different for the two political parties (11.2% when a Democrat won vs. 10.5% when a Republican won).⁽¹⁰⁾

The point of the above commentary is not meant to imply that all the above alternative narratives will necessarily take place but rather to remind us to question our own self-assurance in what the future will bring. The stock market often rallies or falls when least expected. It is our job to ensure that our risk tolerance and timeline align with our financial plan rather than try to predict the future. Following Peter Drucker's above quote, we would argue that a smart investor should never have been trying to drive down the country road, at night, with no lights, looking backward in the first place. For 2024, we can just set our GPS, look forward, and enjoy the ride...despite the inevitable bumps in the road.

Wishing you a wonderful start to the new year!

The Michel Team

Susan, Rob & Carol Ann

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1. Goodreads "Peter F. Drucker: Quotes" 2. Apollo Chief Economist "Extreme Concentration in S&P500 Returns" 3. Wall Street Journal- "It's the Magnificent Seven's Market. The Other Stocks Are Just Living in It." 4. Advisor Hub - "Forget the top 5, These stocks were the biggest movers in the S&P 500 in 2023" 5. Investors Business Daily "13 Firms Hoard \$1 Trillion In Cash (We're Looking At You Big Tech)" 6. Apollo Chief Economist "Outlook for wage growth" 7. Apollo Chief Economist "Rising US Government Debt: What to watch?: December 2023" 8. Census.gov "Deaths Outnumbered Births in Half of States between 2020 and 2021 Figure" 9. Capital Group Outlook 2024 Edition 10. MFS "Beyond the News"

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