Marketline January 2024

Stocks:

January brought modest stock gains – except for Europe, where the FTSE 100 sank about 1.3%. Germany is flirting with recession and the remainder of the Eurozone is hit-and-miss economically. Still, the long-term operative impacts overseas overwhelm today's concerns; these include regulation, demographics, and high energy costs. Even in steady seas, European stocks have produced underwhelming returns. The compound annual growth of the FTSE 100 for the twenty-five years from 1998-2023 has been just 1%.

Canada and Mexico produced fractional returns this month, though these were at least positive.

Back at home, despite a rocky start to January, the Dow racked up 1.3%; the S&P rose 1.5%, and the NASDAQ increased 0.9%. We are in the midst of earnings season and with a few exceptions over at mega-cap technology companies, we've seen several shortfalls. Volatility has increased, and breadth – which is the number of stocks rising – has been poor. Valuations are high in aggregate with the S&P 500 PE ratio sitting around 23, but if we dissect the market in a more representative way – viewing the S&P 600 for instance – that PE ratio is only about 14, much lower than the recent historical average. Through this lens, it is difficult to argue that stocks are expensive, but it's easy to argue that *some* stocks are expensive.

Among sectors, health care is notably cheap, and dividends are healthy. We've recently sifted through names here and instituted a few "starter" positions. Too, earnings season usually offers the opportunity to add to positions: companies experiencing temporary setbacks can see steep sell-offs by traders concerned with short-term gains, rather than long-term returns.

Bonds:

Last month, in reaction to rapidly falling interest rates, we wrote: "…On the other hand, that move was so fast that we think 2024 will bring at least a small yield rebound." That turned out to be the case, as bond yields rose from last year's late-December low-water mark. We closed 2023 at about 4% on the long bond, but today we sit at 4.3%. (For those not familiar with bond math, that's a significant correction.) Why did this happen? Investors – as they are wont to do – became too frisky about the notion of cuts to interest rates coming from the Fed. When Chairman Powell reminded participants that while there was no hike in December, the Committee ***did not*** set a date for reductions, the news sank in, and both stocks and bonds struggled.

Meanwhile, in the short end of the market, action was more subdued. Yields on the one-year declined from 4.8% to 4.7%. The all-important ten-year – which dictates mortgage rates – hovered around 3.9%, not much change from December. Lower rates have given the housing market a small boost though it takes more than one month's worth of data to see a real effect.

The current debate in fixed income centers around when the Fed will cut rates; that time frame, as evidenced by the correction in long maturities this month, has shifted from "soon" to "maybe later". Complicating the scenario is the ever-worsening federal deficit, which requires that the US Treasury come to market with copious quantities of bonds no matter where rates sit. This behavior is the opposite of municipalities and corporations, which can plan a bond issue but delay or pull it if interest rates are not favorable. The flood of Treasuries will continue to test our market for the foreseeable future; fortunately, with yields higher than in previous years, investors have a modicum of protection from poor outcomes.

As far as sectors, we favor corporate bonds of almost any flavor at this point, above municipals and Treasuries. Good quality corporate issues still pay in the 4.5% to 5.5% range at reasonable maturities.