Marketline February 2024

Stocks:

One of the rules of investing is "don't fight the Fed". This catchphrase means that if monetary conditions are tightening and stocks are heading down, one should err on the side of selling. But when the tightening stops and switches course, stocks will rise and investors should remain invested. We don't time markets, but this short phrase is unusually useful. At any particular time, we probably own five to ten companies that are technically overvalued – and we like to sell those names. But in the current economic environment, the Fed has clearly stated that it's done hiking interest rates – so the next move in rates, someday, will likely be down. That means we'll stick with our overvalued positions for the most part, unless we can immediately reinvest any sale proceeds. So for us, February meant mostly sitting still while scanning for opportunities.

The month bucked the usual behavior of "normal" Februrary's by delivering rising stock prices. The S&P increased more than 5%, the Dow managed 2.2% and the NASDAQ was quite strong at 6.1%. We can rationalize the good returns all we want – well, it was because of Nvidia, or well, it was because of tech stocks generally, or well, it's AI – but the fact is, the backdrop for stocks is decent, no matter what their ilk. It's not just the Fed: we are running trillion-dollar budget deficits, and all that money is flowing into infrastructure.

Overseas, though, returns were paltry. The FT-SE was flat, Canada's TSE was up just 1%, and Mexico declined. We've had several conversations recently about international investing, and while we keep roughly 5% to 10% of assets invested in foreign stocks, it's not because we believe we have to own foreign stocks to chase some holy grail of diversification. We own those stocks because they passed our valuation criteria and due diligence process like any stock must. In fact, in some cases, the companies were headquartered in the US to start with and moved overseas during our ownership. The fact is, foreign stock returns, except for a few moments in the last ten years, have not come anywhere close to matching US returns. That's a long time to experience relative underperformance. This is just one way we buck convention in our industry, where nearly everyone advocates international investing.

Bonds:

So good, we'll repeat it again: in December, we wrote, in reaction to rapidly falling interest rates: "…On the other hand, that move was so fast that we think 2024 will bring at least a small yield rebound." So far, rates have risen during both months of 2024. We closed 2023 at about 4% on the long bond, but today we sit at 4.4%. While the short end of the market was quiet last month, it joined the party in February. Yields on the one-year rose from 4.7% to 5.0%. The all-important ten-year – which dictates mortgage rates – increased from 3.9% to 4.3%. So the yield curve remains inverted, with rates in the shortest maturities still higher than longer maturities. All but once in US economic history, this situation has forecasted a recession. If there is a recession in the offing, it's taking a long time to arrive.

The thesis of imminent rate cuts has been tested, but we still stand on the precipice of an easier rate environment, despite last month's action. Meanwhile in terms of sectors, for the first time in some months, municipal bonds saw good relative performance, and corporates held their own. We're fans of corporate issues, where yields on good quality bonds are still hanging around 5% and sometimes more. Our typical searches revolve around sifting through the industrial segment of the market – bonds issued by companies such as Timken, the bearing maker, or Cummins, the engine maker. But lately, we've also given a glance at bank bonds. Overall, we're gradually running down our holdings of Treasury bills to invest more permanently, either in stocks or longer-term bonds.

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