Hamilton-Bates
Market Update

January 18, 2024

2024 Starts With a Whimper (But That's OK)

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Last year ended with a bang as stocks recovered from the Fall decline with an equal if not stronger year-end rally. Given the size and duration of the end of year rally it is not a shock to see the market start the year not with a bang but with a whimper. It is atypical for stocks to struggle in January as the last week of the year into late January is usually strong. This year the Santa Claus rally didn't happen, and stocks have stumbled a bit out of the gate. In our opinion its not that Santa didn't come, he just came early. January is just a bit of a hangover. The first half of 2024 still holds plenty of bullish potential.

The Fed Pivot Remains Key

We cannot say enough how important it is that the Fed has stalled the rate hike cycle. For almost 2 years the Fed was not our friend and it led to a bear market in stocks and the worst bear market in history for bonds. For now rate hike pressure is off and that is bullish.

As for the economy, we see it as more in the 'O.K.' camp rather than 'booming'; but that is good enough to let stocks rally. The financial markets are a bit disconnected from the economy right now—and are far more tied to what the Fed is doing. The job market remains strong enough to keep plenty of Americans employed and as long as we have a job we spend. However, any cracks in the labor market will be a red flag should they appear.

In summary, in 2023 a robust U.S. economy defied recession calls. Although risks remain, we think economic resilience should help stocks this year, especially now that the Fed has stopped hiking interest rates. Solid economies coupled with slightly falling rates are a bullish combination.

The Stock Market & Investment Outlook

Rate cut expectations started to get out of hand at the end of 2023, with the market pricing in as many as 6 or 7 rate cuts this year, starting in March. That seems a bit much. We could see 3 or 4 rate cuts—largely in the second half of the year. While inflation has indeed come down, it is still stuck around 3%. So it will need to come down a bit more before the Fed can start cutting rates. Recent comments by Fed members have said as much—and this has led to some pullback in stocks and bonds this month.

While we expect that the Fed will have some trouble cutting rates as fast as the market expects, there are other levers the Fed can pull to boost liquidity. They are likely going to cut back on their bond sale program known as QT. We won't go into the wonky details of the program, other than to say that in addition to rate hikes the Fed was sucking additional liquidity out of the market via this QT program. They are likely to adjust this program so that it has much less of a negative affect. This will boost financial assets, and these changes are likely to be announced in March.

We believe a bit of January weakness is ok, and based on some historical cycles is typical. We believe the stock market could continue this pause another week or so, but we should see improvement in the markets as the quarter progresses.

Our 2024 outlook is based on a resilient U.S. economy and a consumer that, while weakening, is still spending, and still employed at near historically high levels. A resilient economy will continue to allow for modest earnings growth, and Fed Policy is no longer a headwind. It could very well become a tailwind once rate cuts arrive. We remain bullish for the first half of 2024 at least, and will look to add to both stocks and bonds on any further dips in January.

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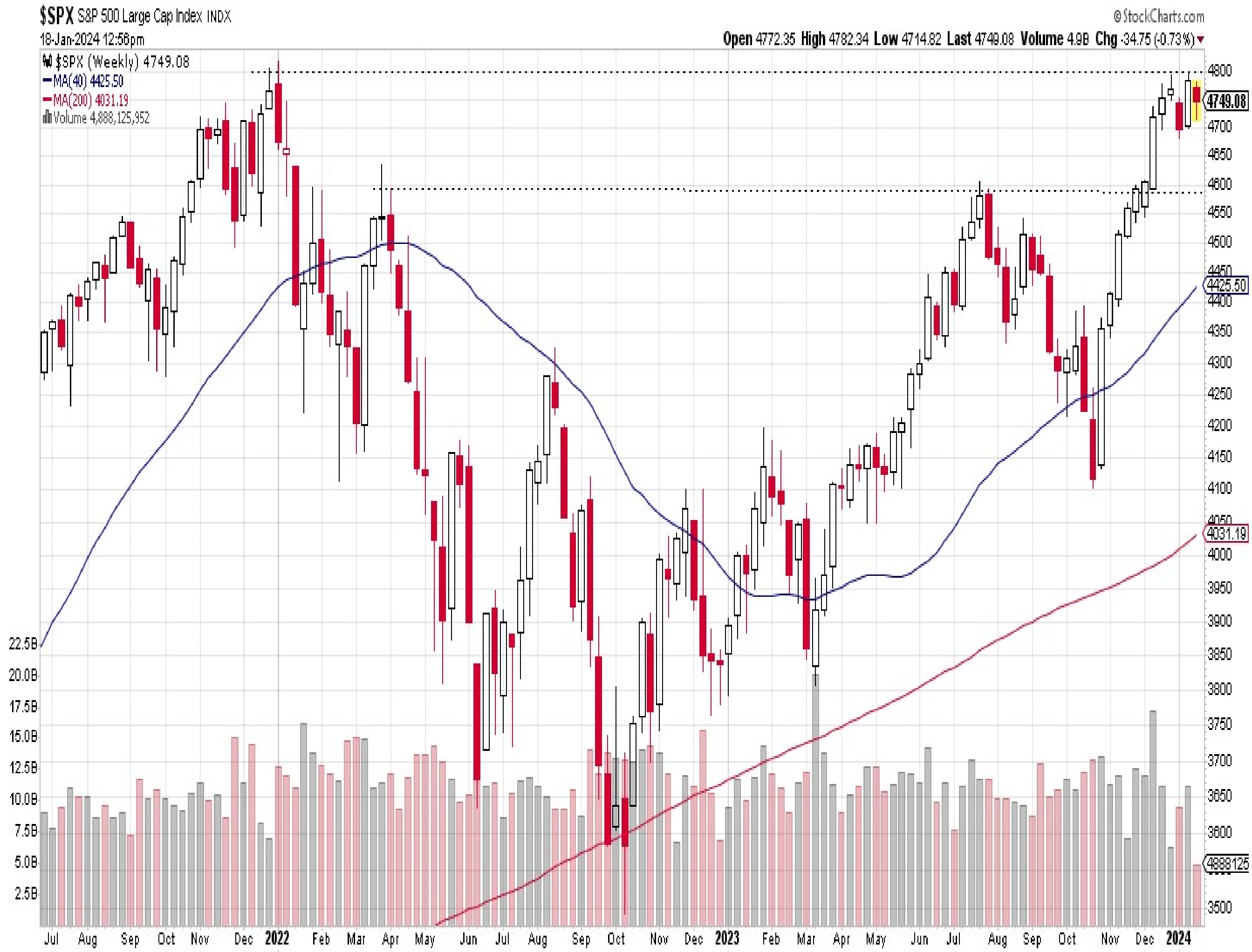
Market Charts: S&P 500—Rally Strength Implies New Bull Market



S&P 500 Chart Above

The market has struggled with a bear market in 2022 (the big decline in the left side of the chart), coupled with the halting recovering that began in 2023. The first half of 2023 was strong, but then stocks slid in the Fall as the Fed just kept on hiking beyond where they should. When they finally got the message in October, stocks vaulted the last month and half of the year and tested the 2022 highs. In our view the bit of sideways action and correction in some areas that we are seeing is very typical after such a strong two month move that we had. We believe the market will gather itself and show its resilience with further strength in the first half of 2024. Key support in the 4500-4600 area for the S&P should contain any weakness.