ADVISORS ASSET MANAGEMENT

2024 Investment Outlook

EXECUTIVE RECAP

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2023 witnessed several dramatic shifts from 2022.

From a capital markets perspective, US equities shifted direction as the S&P 500 Index gained over 26% in 2023 versus a decline of -18.1% in 2022. Several of the most negatively impacted stocks from 2022 became market darlings again in 2023 as investor enthusiasm for artificial intelligence, coupled with a shift in interest rate expectations, drove returns substantially higher. These mega-cap technology, communication services and consumer discretionary stocks have been dubbed the "Magnificent 7" and have been the drivers behind the index's performance.

There was a clear dichotomy of returns in 2023 however as the tech-heavy NASDAQ 100 gained 55% versus a less noteworthy 16% gain for the blue-chip Dow Jones Industrial Average. International stocks, as measured by the MSCI ACWI ex-US Index, gained over 16% and US small cap stocks gained almost 17%. On the fixed income side, the Bloomberg US Aggregate Bond Index — a measure of the broad fixed income market — gained over 5% this year versus a decline of -13% in 2022.

Economically, the shift from 2022 to 2023 has been equally dramatic. The rate of inflation — just 3.1% on a year-over-year basis in November 2023 — has declined from its high of 9.1% in mid-2022. The Federal Reserve (Fed) paused after its 11th interest rate increase, signaling that it is likely done with its tightening campaign. Economic growth has remained surprisingly strong, supported by still high levels of employment and consumer spending. While the US was able to avoid the widely expected recession in 2023, the question remains whether it can achieve a soft landing in 2024.

Geopolitical pressures grew in 2023. Tensions between the United States and China continued, war in Ukraine hit its second anniversary, and the longer-term implications of the Israel / Hamas war remain unknown. In the US, Kevin McCarthy was voted out as Speaker of the House (the first time in history); confidence in the US Supreme Court waned; and 2024 is a presidential election year, which has already begun to insert additional vitriol into the news cycle.

For investors, we believe 2024 could be the year where market participants finally begin to realize that the "New Regime" is really the "Old Regime" and that the past twenty years — filled with consistent hopes of ever-low interest rates, endless Fed and fiscal "puts" bailing out the capital markets and the economy, along with low volatility — were the abnormal. We expect the next twenty years will not look like the past twenty. This shift could have significant implications for the economy, interest rates and capital markets in 2024 and beyond.

Bottom Line: We firmly believe investors should be fully invested at all times and should remain patient during periods of volatility. We favor a diversified portfolio of high-quality companies that tend to be resilient in turbulent markets.

2024 Investment Outlook

2023 was a year in which narratives shifted on a dime. While it clearly was defined by an increased apathy in the form of cash and safe higher returns, it also displayed strong equity performances that were extremely specific to the movements of the overall market. Nearly 70% of the equities in the S&P 500 underperformed the overall index due to the concentrated returns in the Magnificent 7. While certain companies began to perform late in the year, such narrow and concentrated returns only increased the anxiety of a different narrative potentially occurring in 2024.

So many historical economic and market patterns were delayed in either resolution or justification of their historical prognostications that investors only became more entrenched in their original narratives. We have often found that when we get married to narratives, it's easier to be divorced from reality. Whenever we hear, "It's different this time," past events remind us that it's often not; in reality, it is often very much the same.

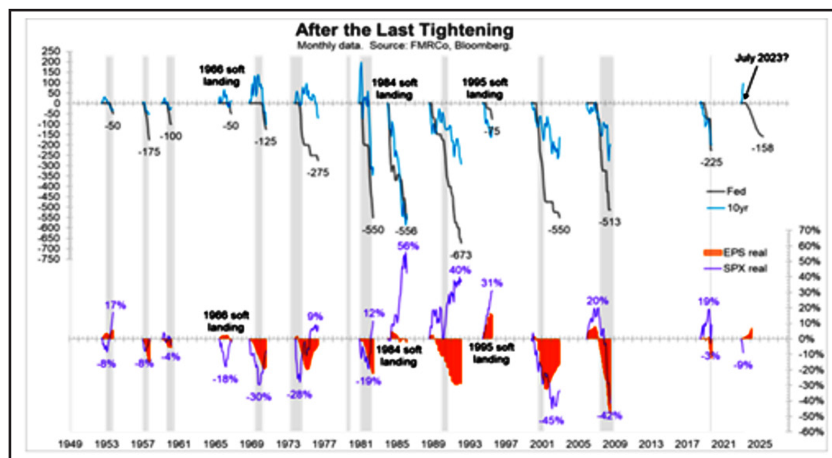
As we embark on 2024, we are reminded of Shakespeare's quote from The Tempest: "What's past is prologue." While 2023 influences the current trajectory, there is an opportunity to experience a broader number of outcomes that need to have investments made for various contingencies. We filter down the broad economic landscape as the "Harry Potter economy," in that the ultimate conflict between the protagonist (solid economic growth) and the antagonist (anemic to negative economic growth) was painfully obvious from the first book. However, the ultimate resolution took seven books and as such the time between the many contradictory economic measures will look to ultimately be resolved this year.

The three probabilities of a soft landing, hard landing, or no landing appear more clearly as we continue through 2024. As of now, we see little probability of a soft landing as history has told us that this has been almost as rare as a unicorn spotting in that we only saw it in the 1996 timeframe. Recall this period also saw a micromanaging of the Fed Funds Rate as the rate rose from 3.00% to 6.00%, but as 1996 began it had already been reduced 75 bps (basis points). That 300 bps rate hike cycle was a fraction of the average cycle seen over the last 60 years when the average cycle of interest rate hikes is right at 500 bps, or 5%.

For the markets, it feels like a "Confirmation Bias market" in that regardless of investors' opinions and investment biases, they can find metrics to corroborate it. Whether based off historical context or immediate results, there is not only data that can affirm it but also data that can prove to be troubling. Cognitive dissonance is a psychological trait by which, in most simplistic terms, is our search to minimize inconsistencies in our lives and causes a binary choice when reality doesn't match up with our belief system. Logically, one would think that when reality doesn't match up with our belief system, we adjust our belief system; however, the exact opposite tends to happen, and we adjust our reality to match our belief system. This is perhaps the biggest reason for unexplainable market moves we have witnessed throughout history — from 1600s tulip mania to current increased holdings and out-of-this-world performance of such a narrow number of companies.

We enter the year with the dilemma of whether a true soft landing is possible and look to history for clues. From there we need to take the preponderance of current economic and market metrics to discern if this time is different…. **Hint: it almost never is.**

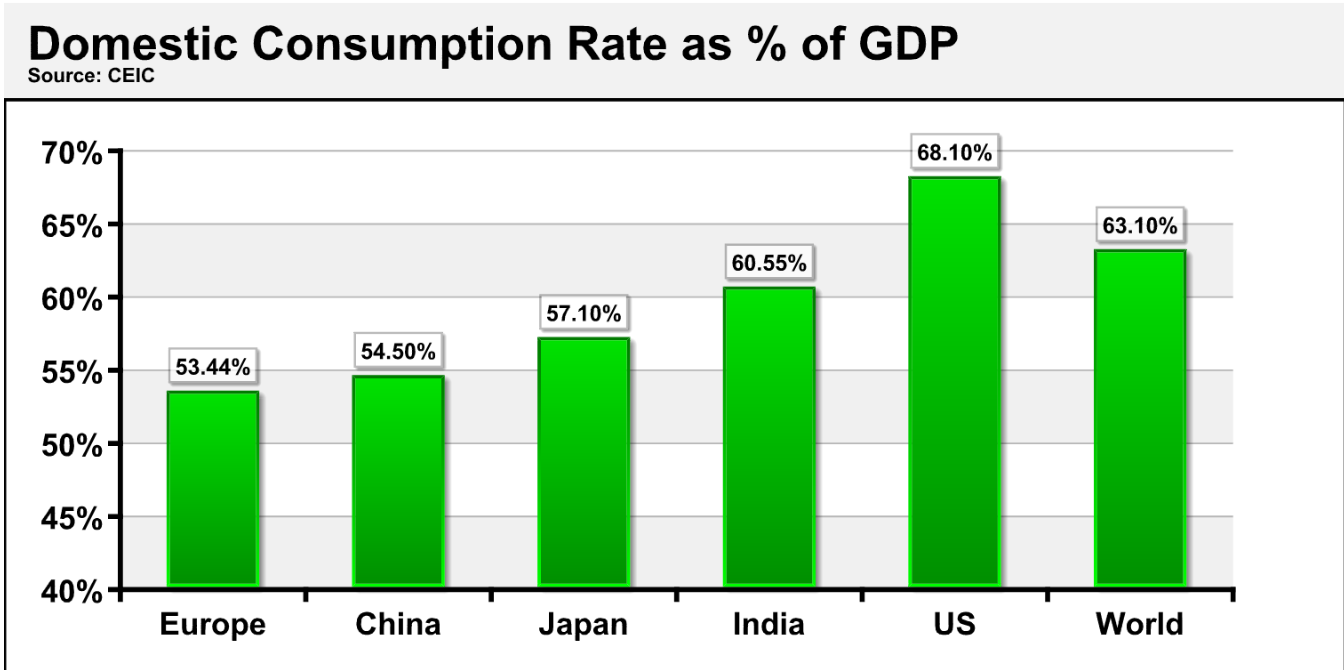
Jurrien Timmer, the head of Global Macro at Fidelity, offers a visual guidance of soft landing and what has happened in 14 previous scenarios.



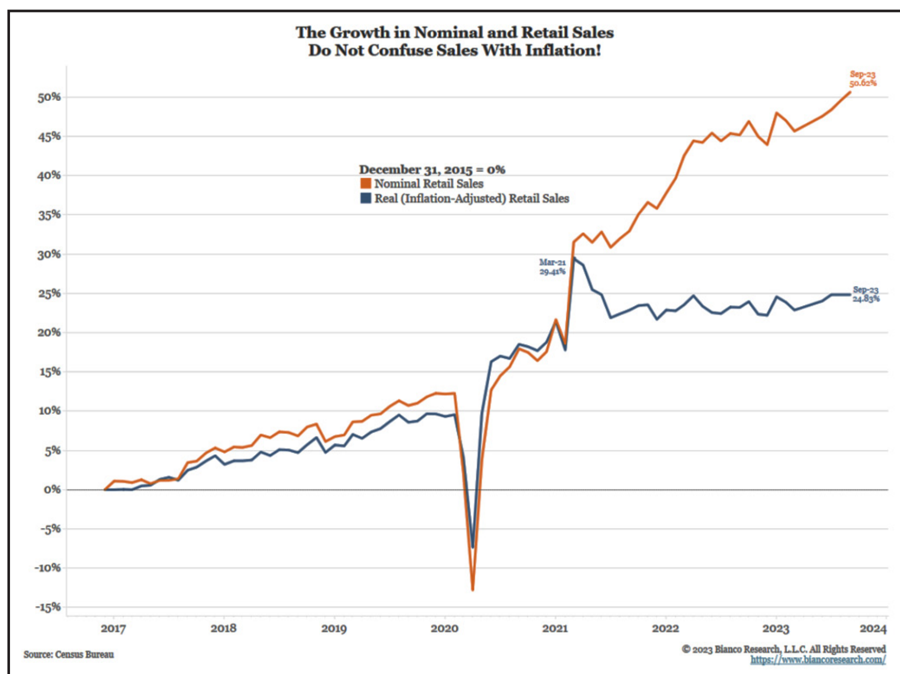
Source: Fidelity | Data as of 11/26/2023 | Past performance is not indicative of future results.

While he points out that three of the last 14 cycles were technically considered a soft landing, the question arises as to how to define what is soft. The real EPS (earnings per share) growth rate mirrors a bit of the 1996 soft landing, however, the projections embedded in risk assets may be a bit optimistic. Traditionally, we see real negative growth and truly need to see other metrics corroborate this in the form of consumer optimism to not only consume but have an increased level of disposable income to offset the cumulative impact of inflation. Notice the scenarios when a soft landing occurred and, disregarding equity real returns, we see it occurred during longer-than-average expansions.

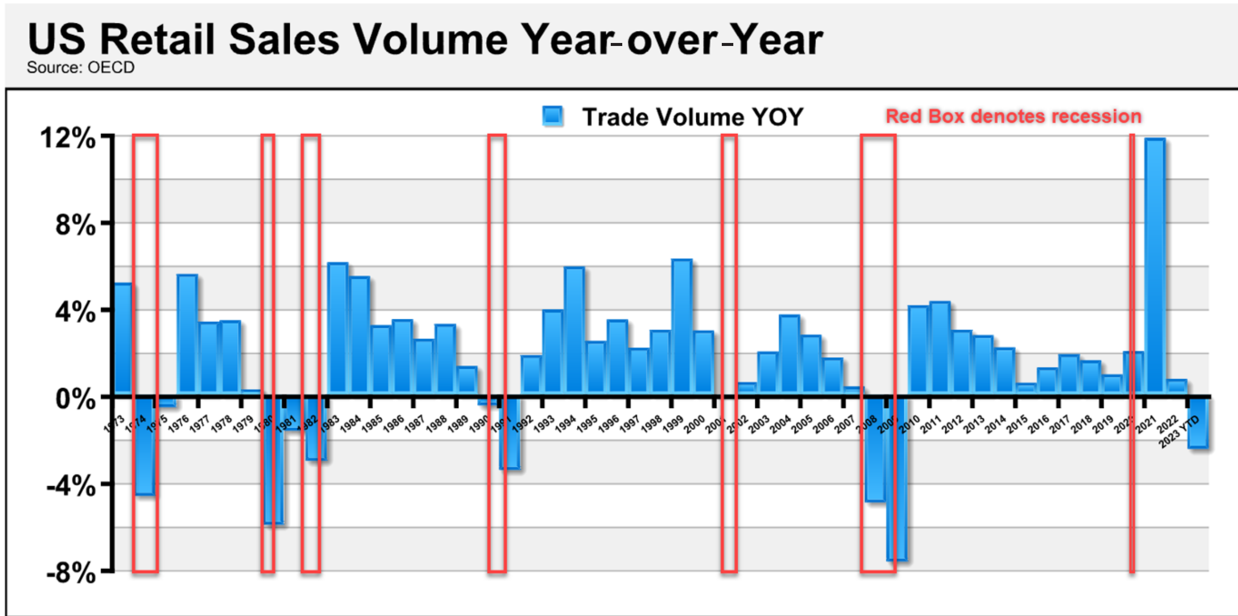
The various domestic consumption rates below show the importance of U.S. consumption to the domestic market; however, it also accounts for over 17% of global GDP and makes countries that rely on manufacturing vulnerable to U.S. consumer sentiment.



Many point to growth in retail sales as a bullish point — a key determinant in many GDP models; however, it presents a different picture when we account for real (inflation adjusted) retail sales and sales volume. Bianco Research gives this view in an amazingly simple graph since 2015.

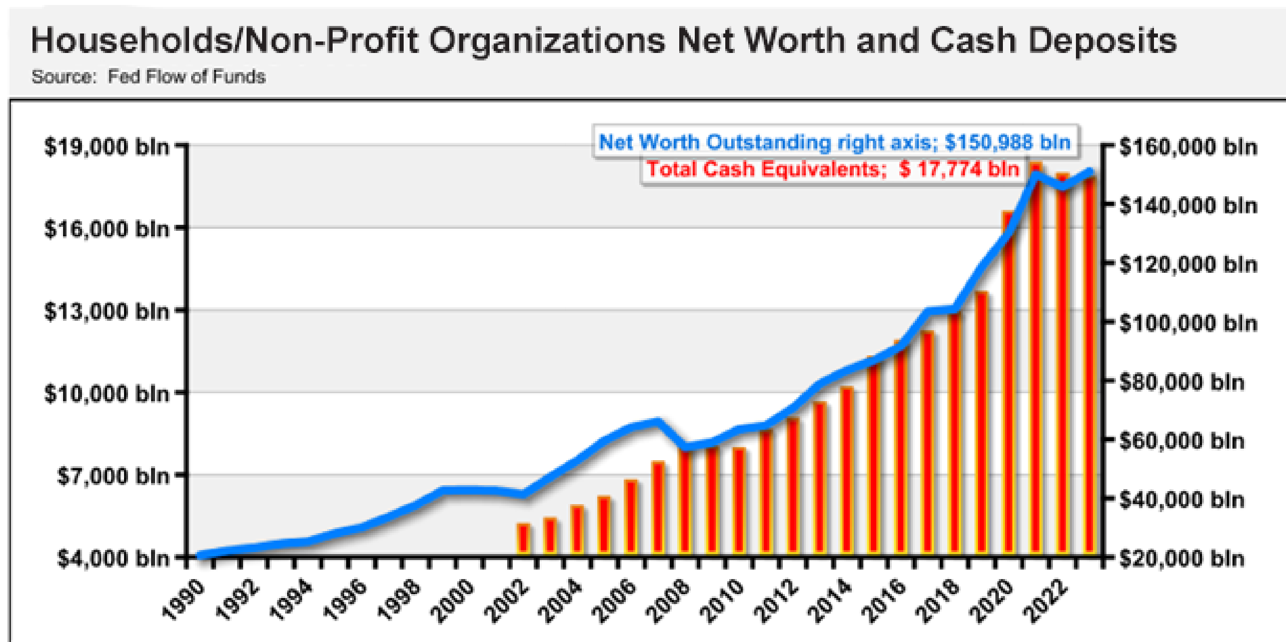


Below denotes the sales volume year over year from the OECD (Organization for Economic Co-operation and Development) that, in a way, reveals one of the murkier, but very impactful, measures of inflated prices: “shrink-flation.” “Shrink-flation” is the action of reducing the size of a good while keeping the same price — getting less for the same or more.



Taking a more in-depth view of the consumer and the dichotomy that has everyone perceiving it through the lens of their particular bias, one can certainly understand why there is both optimism and concern.

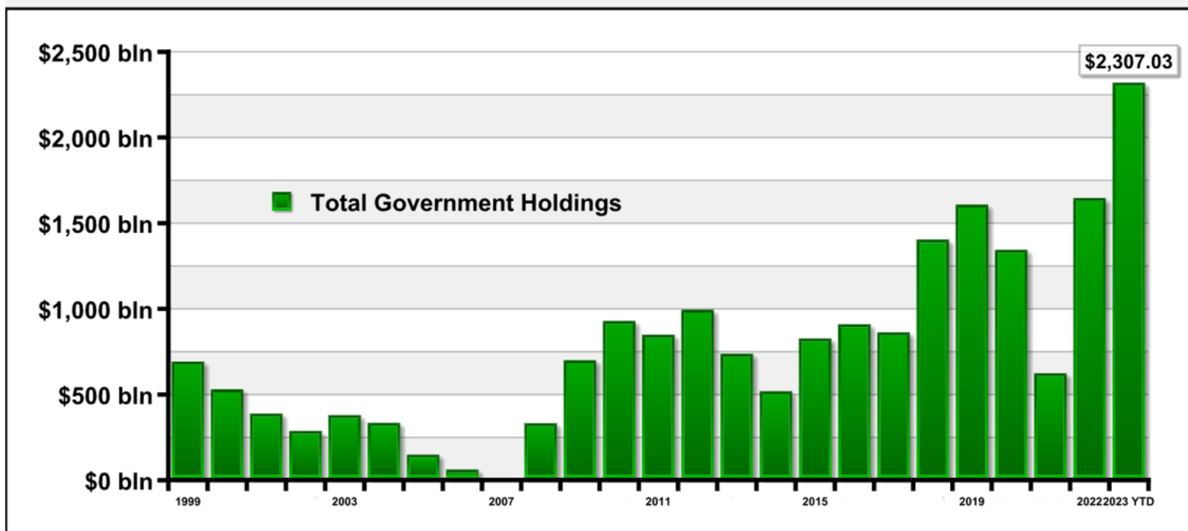
We have been using the chart below for the better part of a decade to show just how profound the balance sheet improvement after the Great Financial Crisis/Great Recession in 2007-2009 was on the predisposition of consumers to increase cash equivalents.



While total cash equivalents have fallen by nearly $1 trillion, they are still very robust when compared to the past. Current total debt stands at just under $20 trillion, so we still stand around 90% cash to total debt…well above long-term levels. One takeaway is that during historical contractions the DNA of the consumer can shift radically.

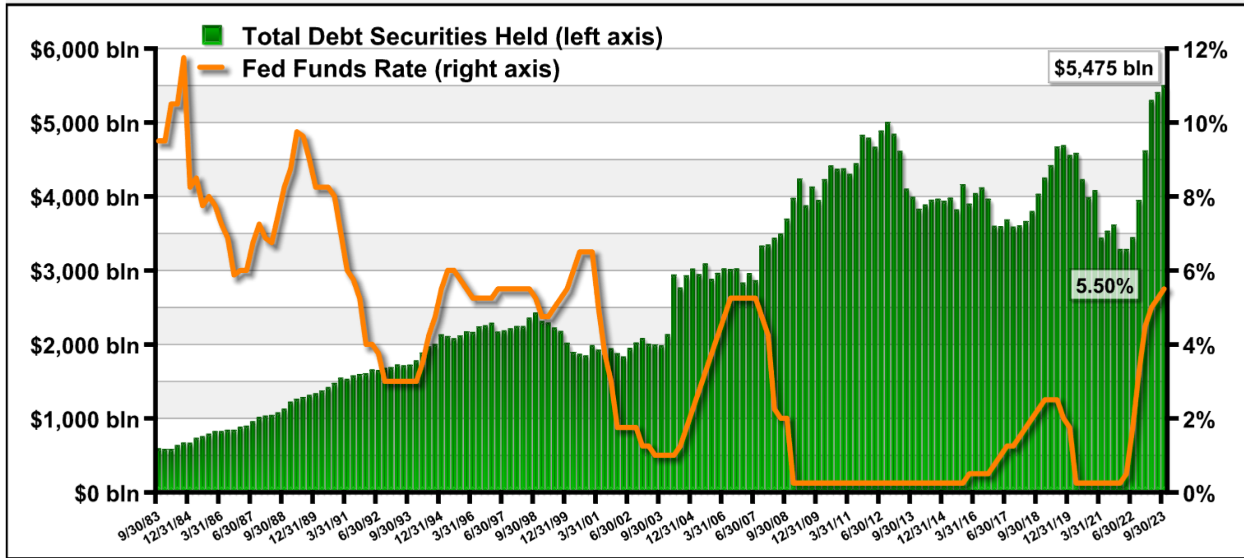
However, the savings rate has plummeted after being artificially high from pandemic stimulus that inflated households' liquidity conditions. Higher rates on outstanding debt, and the cumulative impact of inflation on everyday goods and services, accounts for the drop.

The byproduct of increased levels of cash and 5+% short-term Treasury rates is that prompted households to lock-in higher returns in a "risk-free rate" of return in Treasuries. Households and nonprofits are buying the highest level of government securities in history now totaling $2.3 trillion.



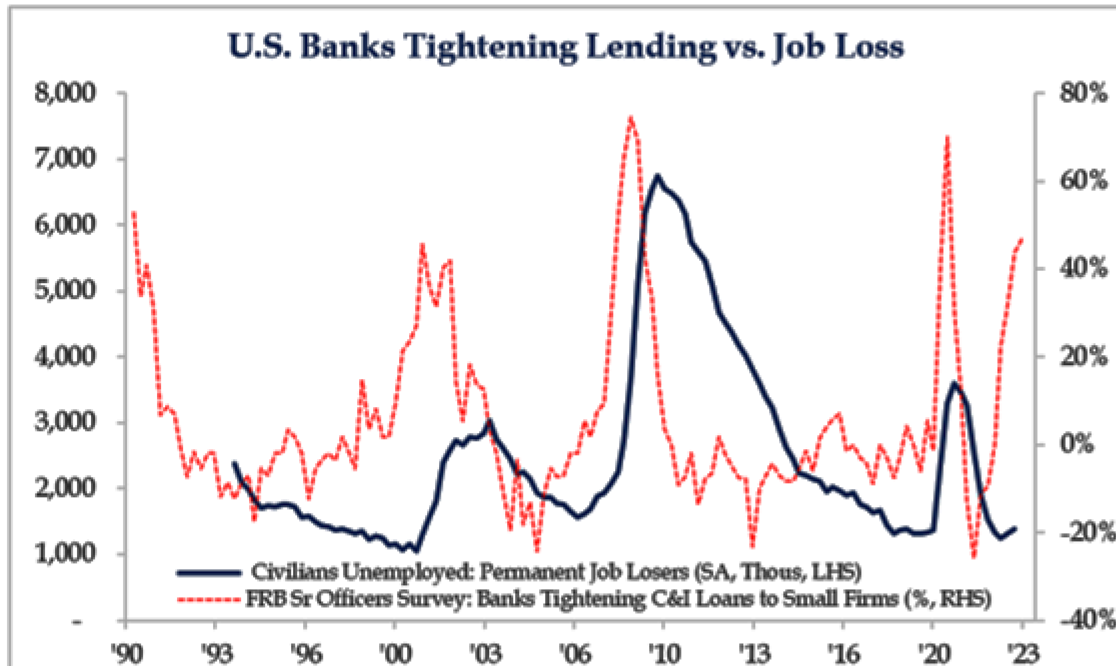
One area to glean more from this is the history of the Fed Funds rate and total debt investments on the household balance sheet shows some predictable patterns that we have not had to think about in a secular bull market in rates. This has set the stage for a "vuja de" (the experience of feeling unfamiliar with something that is very familiar) — as I like to call it — management of fixed income vehicles and allocations moving forward.

Fed Flow of Funds Household and Non-Profit Total Debt Securities Holdings
Source: Federal Reserve



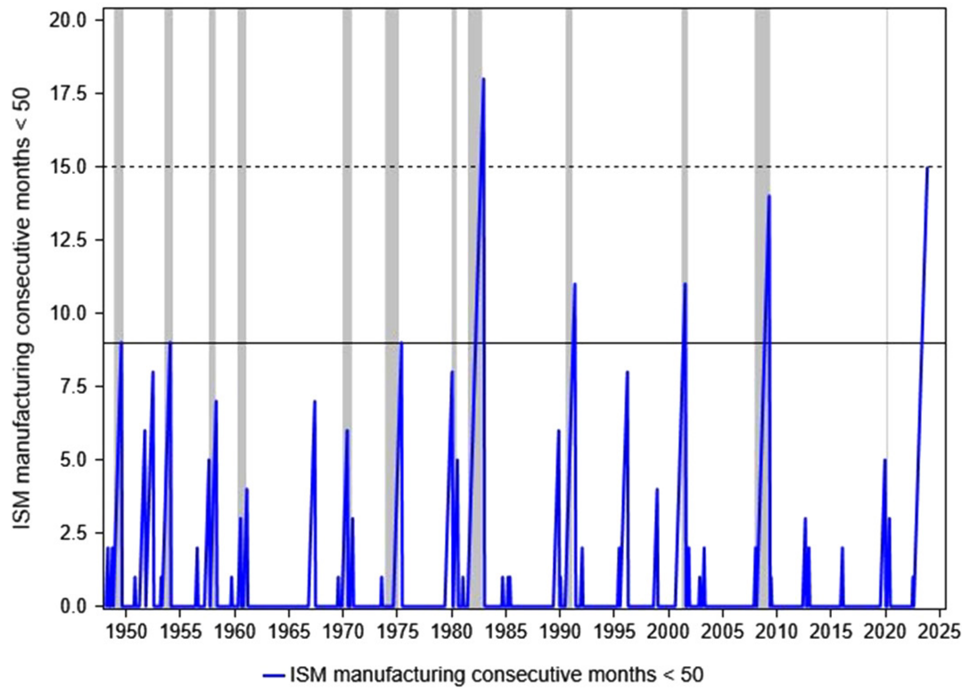
To justify a longer-term expansion, we need to see increased income to justify the expansion from an earnings standpoint. The labor market continues to be strong but is starting to show cracks. Remember that employment, from an economic standpoint, is a lagging indicator. Consider that when lending standards rise, as has been the case for some time, employment often sees a tougher environment in the next 12 months.

TIGHTER LENDING STANDARDS HAVE HISTORICALLY PRECEDED JOB LOSSES

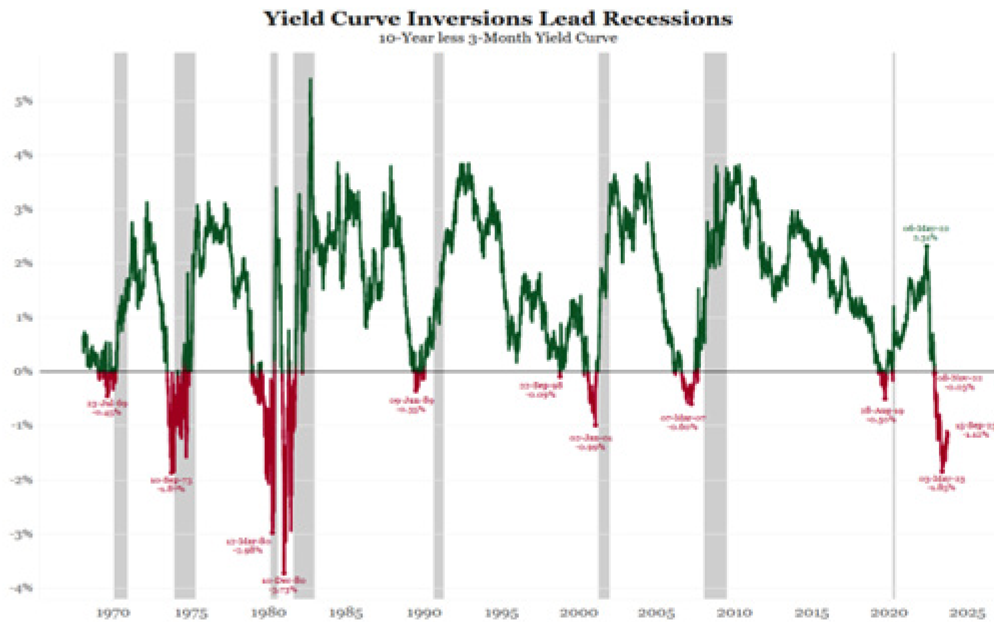


Source: Strategas

We also need to see more growth in the balance of manufacturing and services, which has not been the case. The contraction in the manufacturing sector is now at its second longest consecutive months at 15, which is only superseded by the nearly 18 months during the 1980 timeframe.

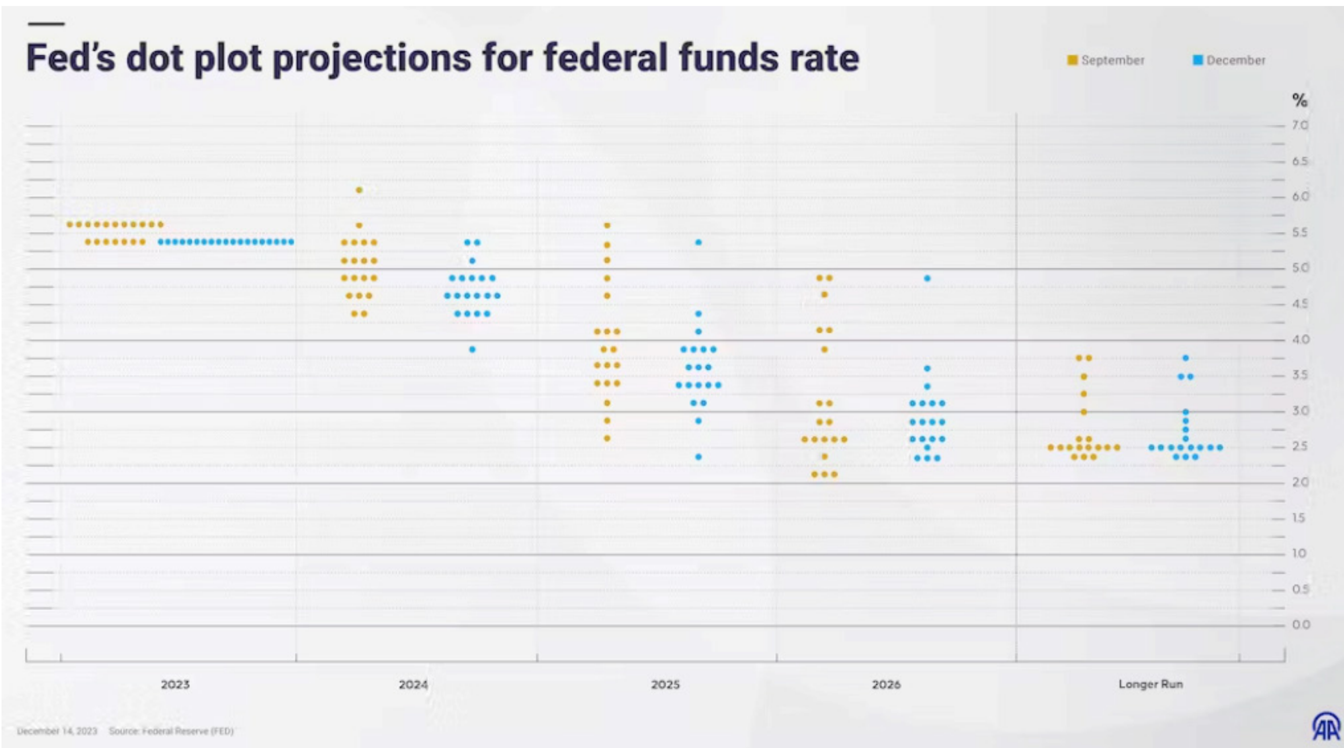


Looking at historically reliable indicators, the yield curve inversion has proven to be more correct than many attribute to it. One vital point to remember is that the curve will steepen well before the recession is officially called. As such, many who only use the yield curve to promote a bullish scenario often get caught in a trap assuming all is clear for investing in the risk on pool of assets.

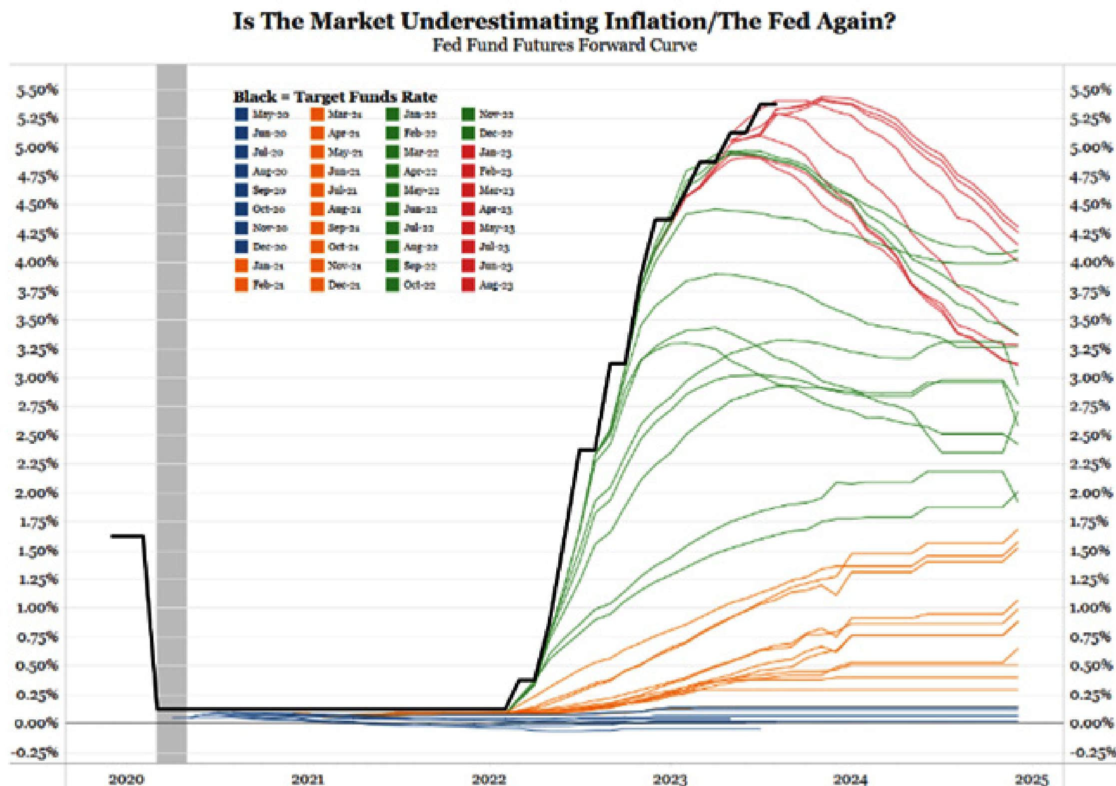


Source: Bianco Research LLC

Perhaps the most narrative-driven and bias-exhibiting graphic is what the Federal Reserve has done with their forward-looking dot plots. During the entire rate hike period since December 2021, long-term expectations of the Fed Funds rate has been in the 2.50% range. The most recent release continues to push out long-term expectations of the rate no matter what short-term inflation and interest rate environment look like.

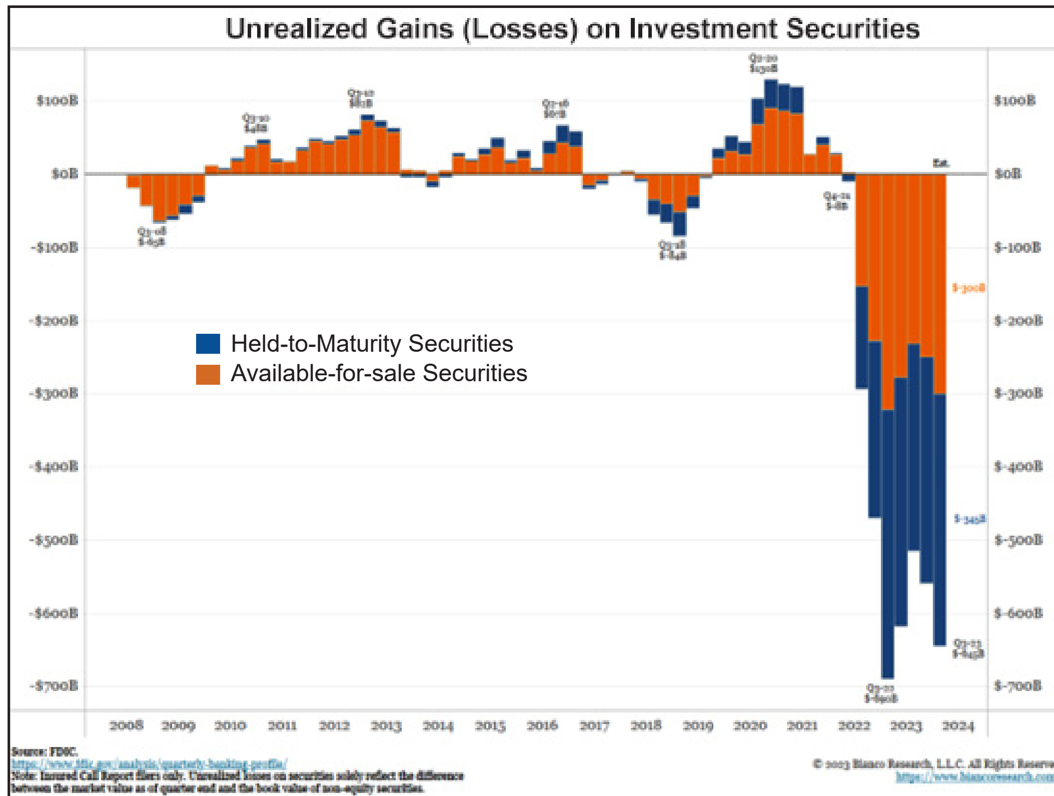


One of our favorite graphics from Jim Bianco Research and Data Arbor Research is the consistent lower expectations for inflation that correlate well with interest rates from the futures market. The market continually underestimated the inflationary picture and is really "patient zero" in the future market moves across the globe. Constantly underestimating inflation leaves assumptions for a soft landing and receding inflation as one that may surprise the market more than perhaps any other event in 2024. Be aware of assumptions being priced in, and remember, perfect execution of forward assumptions only affirms current price levels.

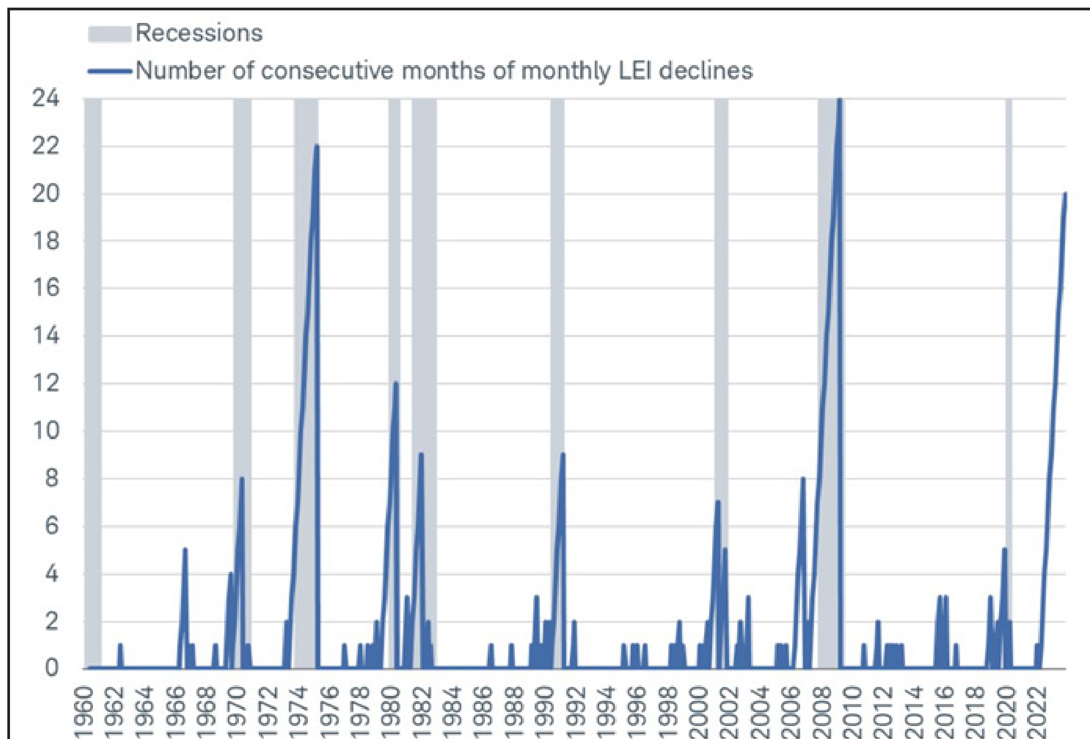


Source: Biano Research, LLC

As we approach the rate hike cycle finish line, the ramifications of what rate hikes did to portfolios is substantial. Below is the measure of banks' holdings and "paper" losses on the balance sheet due to the Fed Funds rate increasing by 525 bps.



One area that has historically been a great predictor of economic growth or retracement is the Leading Economic Index which measures multiple indicators. It has been in retracement for 20 consecutive months, which is the third longest in history. It has occurred during a time when we saw negative growth and impressive GDP growth; which begs the question, is this a reliable indicator?



Source: Charles Schwab, as of 11/30/2023

We see this as evidence that the underlying components are still teetering on a cliff's edge when we combine it with the multiple data points.

2024 Equity Market Outlook

The equity markets begin this new year with three key themes:

1. Substantial momentum
2. Increased competition
3. Great expectations

Substantial momentum

The S&P 500 finished 2023 with a bang, approaching the all-time high set over two years ago in January 2022. Concentrated returns that defined most of the year have begun to broaden out with a high percentage of stocks rallying together. The percentage of stocks above their 200-day moving averages was as high as 75% in December, signaling that the vast majority of stocks' primary trend was up to end 2023.

Increased competition

Over $1 trillion flowed into money market funds in 2023, pushing money market assets to a record $5.9 trillion. This outpaced flows into the equity funds by a factor of 4 to 1, and outpaced flows into the bond funds by a factor of 5 to 1.

Money market funds with 5% yields clearly supply a reasonable alternative to equities, in our view. This can be measured by the Equity Risk Premium that compares the earnings yield of the stock market to the yield on the 10-year U.S. Treasury. It suggests an excess return that investing in the stock market provides over a risk-free rate. Our work suggests the Equity Risk Premium is still slightly positive, however, it is at the lowest level since 2004.

We expect the record levels of cash equivalents to begin to move off the sidelines and back into a variety of risk assets including stocks, bonds, and alternatives as higher interest rates have caused asset allocations to evolve.

Great Expectations

We believe equity markets are a function of two things: the direction of earnings and interest rates. Bottom-up EPS estimates for S&P 500 constituents in 2024 is $244, an 11.4% increase from 2023.

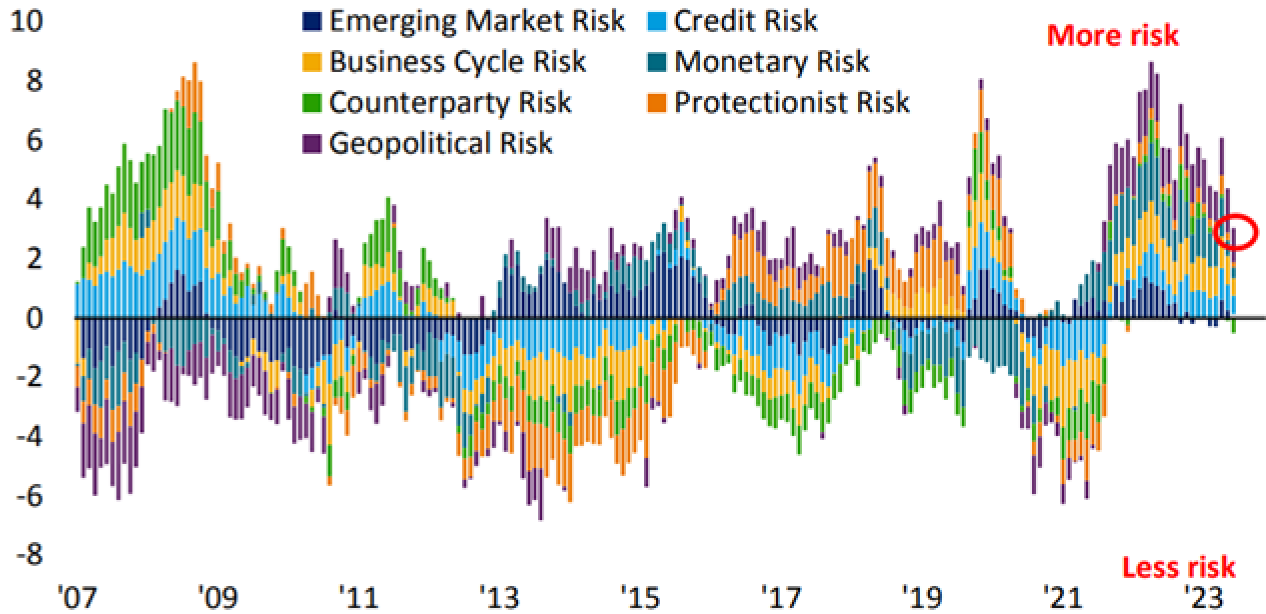
The Federal Open Market Committee (FOMC) voted unanimously in December to keep the benchmark rate unchanged for the third straight time. This could end the hiking cycle and set the table for rate cuts in the year ahead. The committee's dot plot indicates at least three rate cuts 2024, while the market has been pricing in double that.

In theory, double-digit earnings growth, coupled with Fed easing, is a constructive setup for equity returns. This, of course, assumes both things come true and with a current multiple of 18 times 2024 earnings, high valuations leave little room for error. The question becomes: what is already priced in, and can the equity market deliver on great expectations?

Strong momentum and increasing market breadth are supportive into 2024, however, a macro economic slowdown — including downward pressure on real GDP, an active Fed, and stretched valuations — leaves markets vulnerable to repricing and volatility.

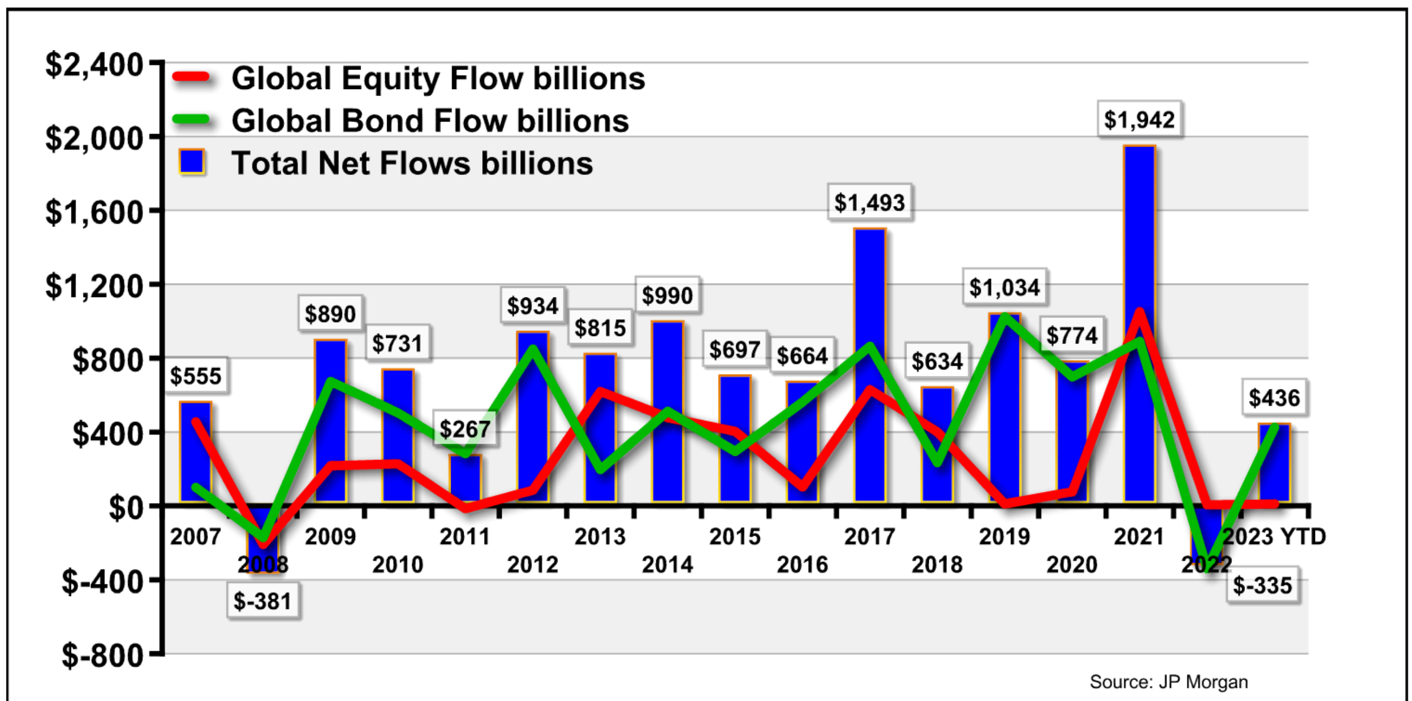
In November 2023, we got our first look at strategists' consensus estimates for year-end 2024 including an S&P 500 Index closing price of 4,546 on $233 EPS, on average.

What we know is that the proliferation of cash and the recession fears that amplified also coincides with a large amount of fear from money managers as evidenced by the unprecedented level of anxiety about the multiple risks seen in the market.

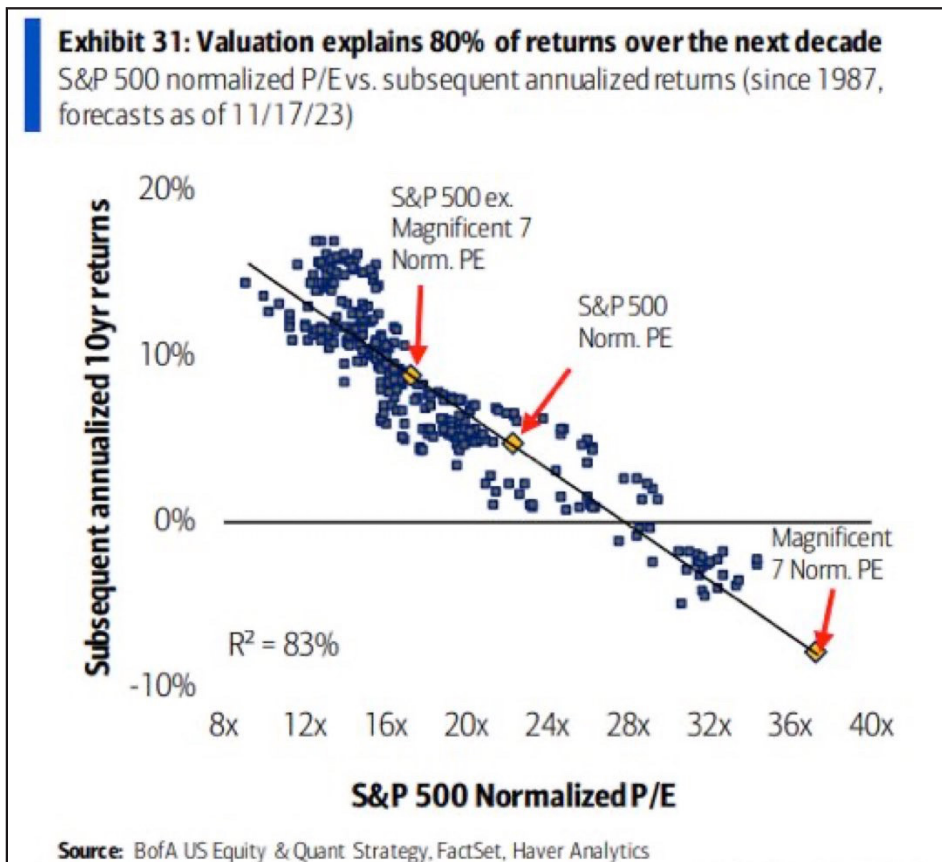


Source: BofA Global Fund Manager Survey

Further proof of the apathy in risk assets from a global perspective is the benign allocation in global equity flows, and bond flows for that matter. This is an anemic net $101 billion in total net flows for global equity and bond flows for the last two years. We know that during elevated inflationary periods that long-term flows to equities are somewhat anemic in household balance sheets and increased bond and cash holdings.

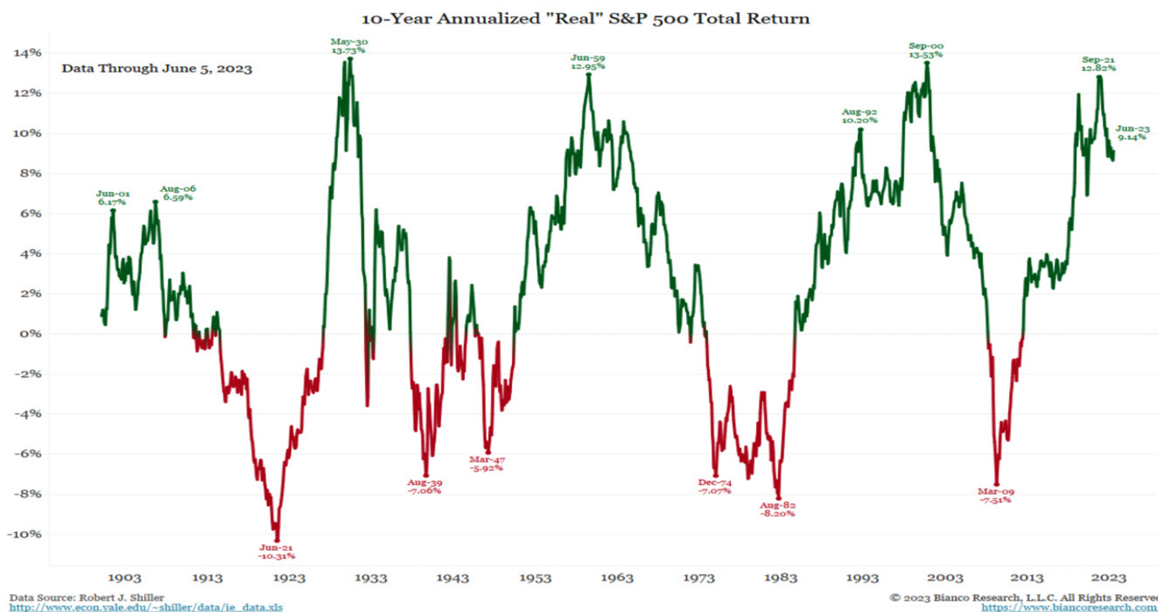


When we zoom out and look at short-term vs longer-term expectations, we begin to more clearly see what Shakespeare meant when he said, “What’s past is prologue.”



Past performance is not indicative of future results.

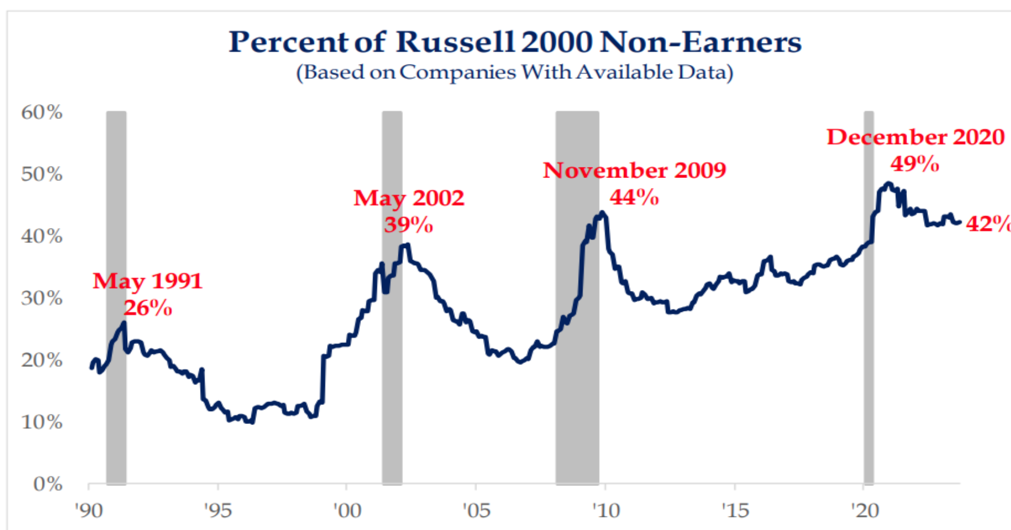
A more historical perspective is the rolling total real returns (nominal total returns minus inflation) in the S&P 500 that gives us caution, but also reminds us to always be invested in the marketplace with such a longer-term timeline. Since early in the 1900s, there have been extended periods of outperformance and underperformance, the key term being “long term.”



Past performance is not indicative of future results.

What we believe this tells us is that at times we should emphasize quality and predicable earnings and cashflows and others where more growth with unpredictable levels of these metrics are worthwhile. The chart below shows a potential inflection point, or further erosion, based on the economic and interest rate environment when it comes to unprofitable companies. The higher hurdle of interest rates makes these investments a bit more problematic when combined with the level of desire for long-term investors to speculate in this area.

UNPROFITABLE COMPANIES LIKELY TO BE LESS SUSTAINABLE IN A PERIOD OF HIGHER INTEREST RATES

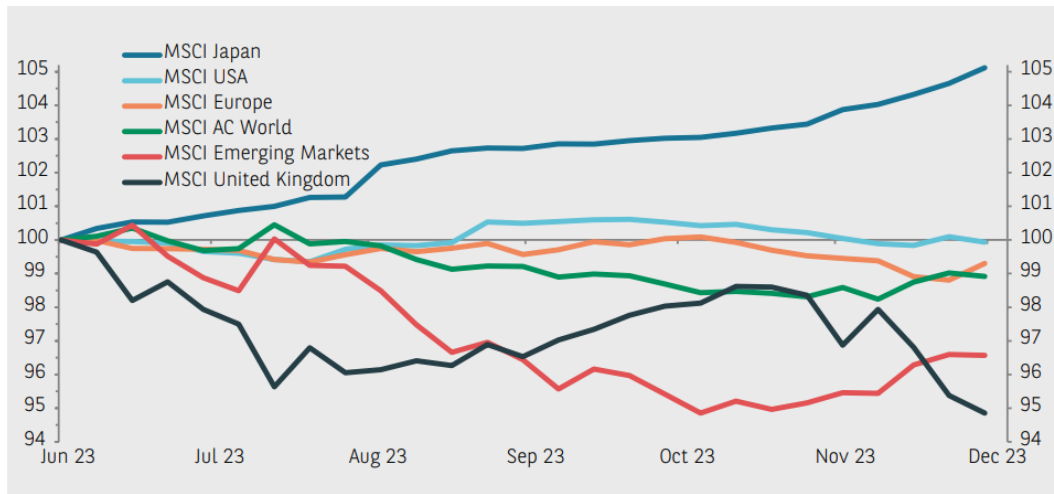


Source: Strategas | Past performance is not indicative of future results.

As we continue to build upon Shakespeare's quote about the past, monitoring the global earnings environment over the last year gives a sense of how reasonable or unrealistic certain growth conditions are. One thing we know, the closer we get to a concluding event, the more likely certain scenarios are, and others are not feasible.

In the last six months the country/region earning expectations have been subdued outside of Japan.

Earnings per share estimates, 2024
Local currency terms except ACWI and Emerging Markets in USD



Data as at 1 December 2023. Sources: FactSet, BNP Paribas Asset Management.

Past performance is not indicative of future results.

This level of cash build-up, and the most prolific interest rate hikes from such an anemic level, has led to the drawdowns in bonds being the most negative in quite some time…1840s for those keeping track at home, according to Bianco Research and Data Arbor.

Rolling Three-Year US Long-Term Nominal (Before Inflation) Bond Total Returns

1842 -28.24%
1932 -12.75%
1969 -9.37%
2022 -26.46%
2023 -17.92%

Source: Edward F. McQuarrie
http://www.edwardfmcquarrie.com/wp-content/uploads/2021/07/Real-returns-on-stocks-and-bonds-1793-to-2019-version-2-0.xlsx

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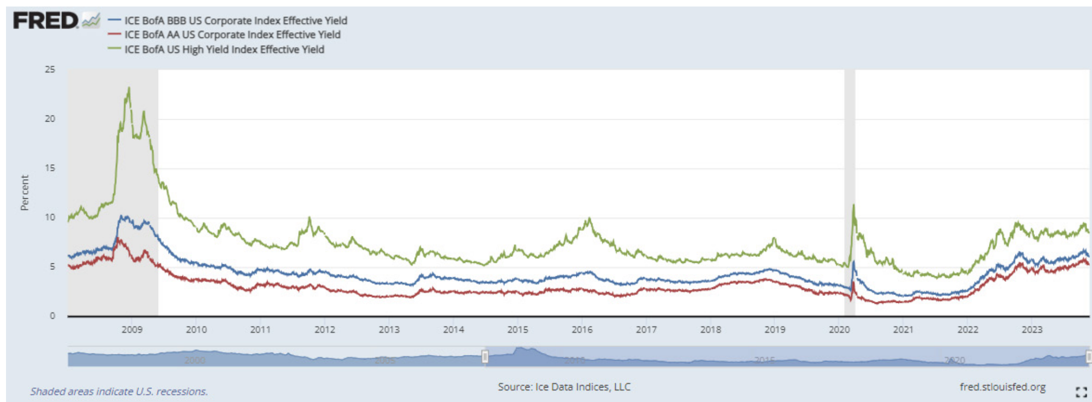
Past performance is not indicative of future results.

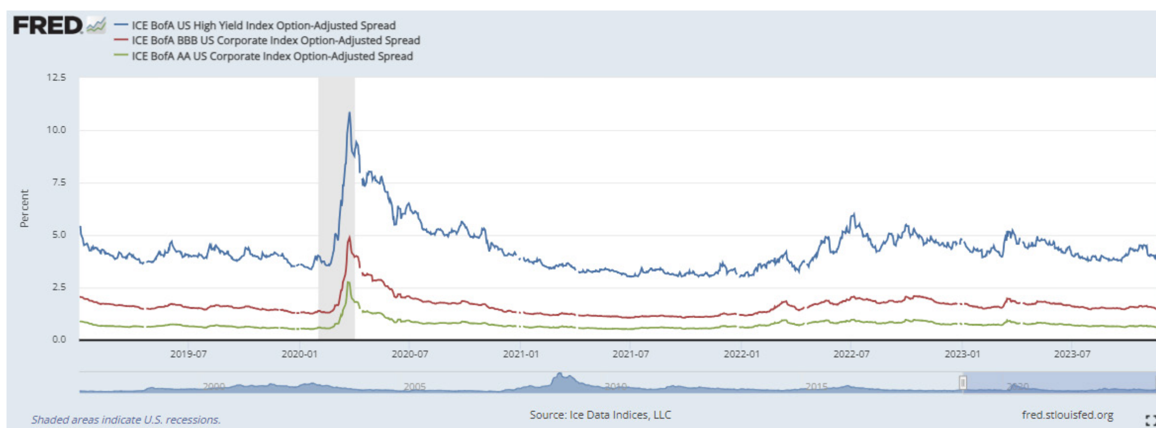
Taxable Fixed Income Outlook

Market valuations and our economic outlook suggest maintaining an allocation to taxable fixed income in 2024 and our theme is: “Get Off Your Cash.” The past two years of rising rates and fixed income volatility may have created a more attractive entry point for investors looking for income as yields are near 14-year highs. The ICE BofA ML U.S. Corporate IG index yield-to-worst has reached levels seldom seen since 2009 and the chart below reflects that yields across ratings remain elevated when compared to a 3.44% average yield-to-worst over the past 10 years.



We remain optimistic on corporate credit in 2024 and continue to stress the importance of diversification across sectors to help mitigate risks. We believe this probably isn't the time to reach for risk so balance sector exposure with a focus on higher-rated debt and shorter duration in portfolios. Although there may be opportunities to selectively add duration in portfolios, the time to extend duration will eventually come.

Investment grade (IG) credit spreads are the narrowest they've been since February 2022. The average spread in IG over the past 30 months is 124 bps. Estimates for IG spreads in 2024 range from 100 bps to 200bps depending on base case scenarios vs a hard landing scenario. If we enter a recession, we expect spreads to widen and will be prepared to deploy cash when the curve steepens.



Although the existing macro backdrop reflects the possibility of a recession in 2024, the ability to diversify a portfolio across asset classes is appealing when looking to improve overall credit quality for fixed income investors. Treasuries were volatile in 2023, as evidenced by the ICE BofA ML MOVE Index which measures the implied volatility in the Treasury market reached 198 in March of this year; this is a level last seen at the end of the Great Financial Crisis.

The ICE BofA ML U.S. Treasury Index has been under pressure in 2023 as yields reached 16-year highs. After losing 1.75% in the first nine months of the year, it rallied over 3% from its October 19 low and finished November up 44 bps year to date. Although we remain underweighted in this asset class, it can provide a ballast when facing a potential economic slowdown when you position portfolios appropriately across the yield curve.

Projections for Treasury yields in 2024 vary, with the possibility of an increase in yields with CreditSights forecasting a base case 3.8% 10-year U.S. Treasury and Blue-Chip forecasting 4.0% in a steadily declining year. A rally in Treasuries is possible over the coming year, but the possibility of an economic slowdown will play a significant role in any move.

While no fixed income portfolio is immune to higher rates or higher inflation, it's important to position assets where we feel we are going, not where we are now. The last few years have been challenging in bonds, but opportunities exist as yields are sitting near 15-year highs. We are constructive on valuations and see compelling total returns for investors this year even with the current backdrop of an economic slowdown. Bonds have a maturity date and a defined stream of cashflows that can be advantageous during short-term price fluctuations. It is also important to remember the importance of income in the total return calculation. We also understand the risk of a recession is inflated and that scenario could lead to spread widening in IG and high yield (HY). In 2024 we believe that staying invested during volatile periods is the best approach.

Tax-Exempt Fixed Income Outlook

"It was the best of times, it was the worst of times." The famous opening line from the Tale of Two Cities by Charles Dickens describes an age of extremes and is an apt description for municipal markets in the 4th quarter of 2023. Municipal markets posted their third monthly loss in a row to end October, in one of the roughest patches for municipals in recent memory, ending the 90-day period down 4.42%, only to be followed up in November with one of the best months in the history of municipal markets. While the recent volatility seems abnormal, the end of the Quantitative Easing/zero interest rate era likely means this is a return to normalcy, not the other way around. It is understandable that many municipal investors are anxious after the latest round of rate volatility, especially in the normally stuffy, slow moving world of municipal bonds. That said, volatility breeds opportunity and the 2023 reset in municipal markets paves the way for long-term

gain, in our view. Municipals stand uniquely positioned in 2024 to offer elevated levels of income alongside safety, at a time when economic uncertainty reigns supreme.

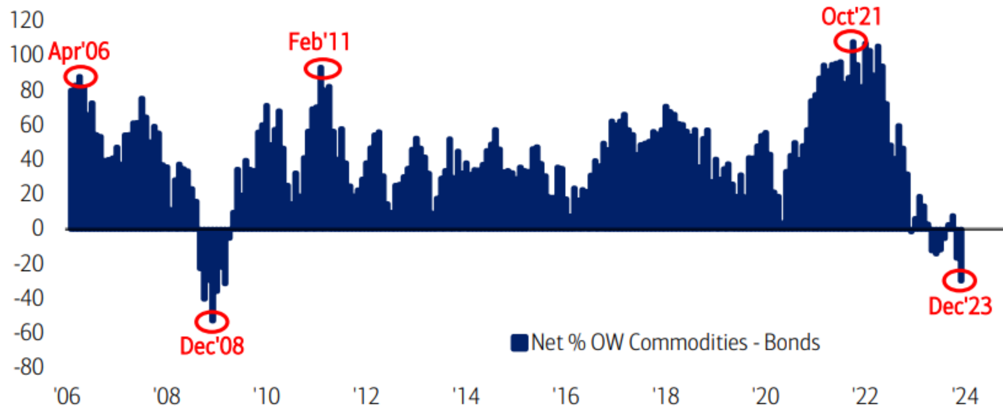
The argument for municipals starts with yield. After spending much of the last five years under a 2.25% yield-to-worst, the broad municipal market is now through a 3.25% yield-to-worst, which rivals some of the highest levels in the last decade. Outside of a brief timeframe during the Covid crisis, one would need to go all the way back to 2011 to obtain yield levels over 3% for any consistent period. In 2024 municipals have the potential to offer investors a yield opportunity seen only a few times since the Great Financial Crisis. While cash has been king for the last two years, cash returns lag traditional fixed income returns by a significant margin over longer-dated periods. The additional yield now available in municipals could make it tough for cash to keep pace, even if interest rates remain elevated. It also seems reasonable to assume price volatility could mitigate moving forward as yield provides more cushion. It is important to note that the lack of "carry," or coupon income, made the ride up from 0% interest rates especially painful. With little to no income to offset price losses when yields are under 1%, large moves in interest rates from an effective floor of 0% become acute. Current municipal yields offer attractive levels of income, but the additional cash flows also offer a much larger cushion against future rate volatility.

In addition to higher yields, municipal markets seem well positioned to offer a defensive approach to investing in fixed income as start the new year. The increase in yields has certainly put the "income" back in fixed income, but it is not all strawberry fields. The current macroeconomic backdrop is one of the most challenging environments for fixed income investors in recent memory. The two biggest risks for fixed income investors are credit risk and interest rate risk and the outlook for both remains very murky. On the credit side of the equation, credit spreads across fixed income markets remain stubbornly tight. This calls into question whether investors are being compensated for the risk. While tighter-than-average spreads could be consistent with a "soft landing" scenario, they don't seem lockstep with a softening in recent economic data and are most certainly not consistent with any scenario where recession comes into play. After the August 1 downgrade of U.S. sovereign debt, 12 U.S. states — and a host of county and city credits — now have a credit rating higher than that of the U.S. government, having AAA ratings from at least two of the major ratings agencies. While municipals will never replicate the liquidity of the U.S. Treasury market, there are now many areas that stand on equal or better footing from a credit rating standpoint. Over 65% of the municipal market carries a rating of AA- or higher. With over 50% of the U.S. Investment Grade Corporate market rated BBB+ or lower, the unique combination of income and safety available in municipals could provide an attractive alternative to U.S. Treasuries without the credit quality sacrifice associated with corporate bonds.

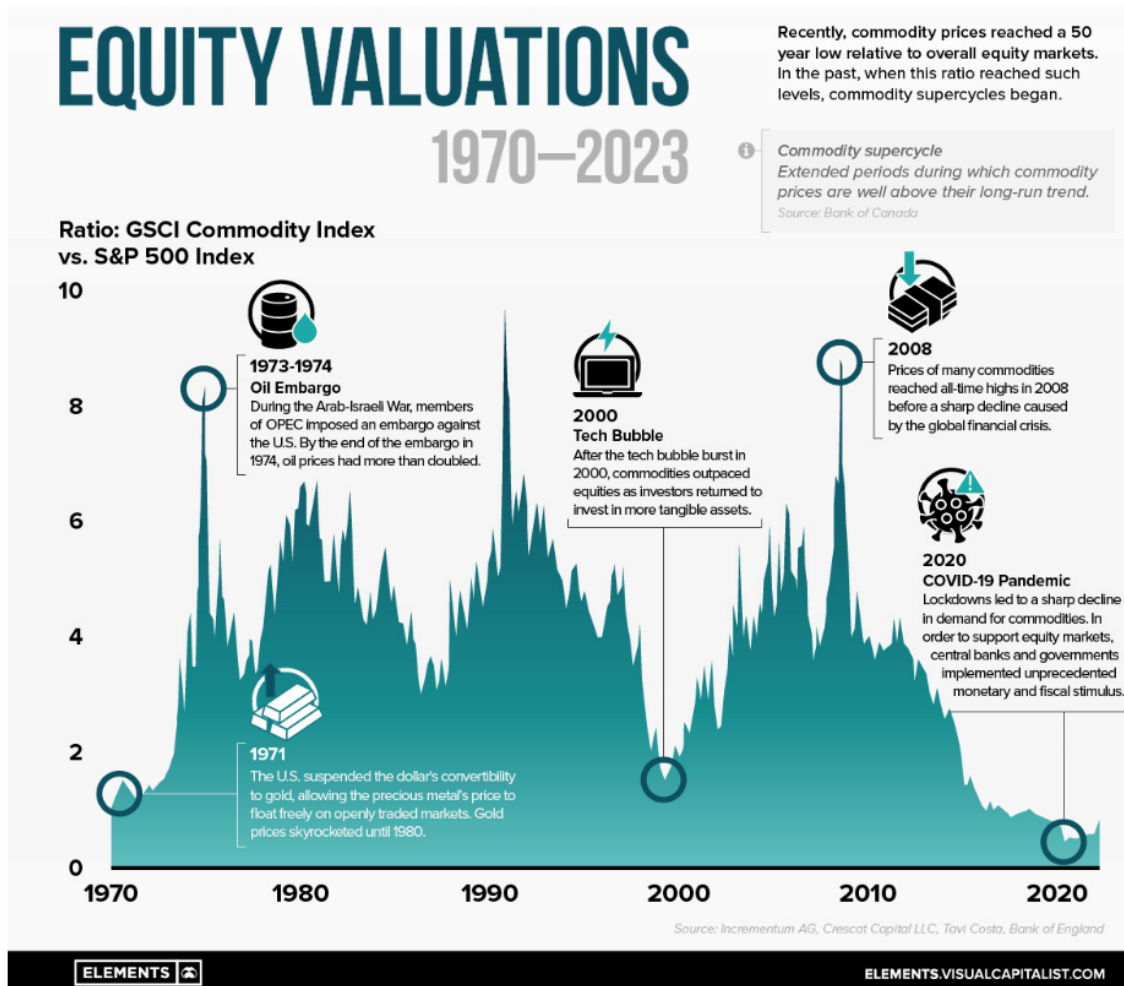
From an interest rate perspective, rate volatility could continue to mitigate with the Federal Reserve seemingly at an end-game. Unfortunately, the late summer/early fall selloff in long-term rates presents a conundrum. Unlike the 2022 increase in interest rates, predicated on concern that the Federal Reserve would keep short-term rates elevated for an extended period, the more recent rate volatility was driven by an increase in long-term interest rates controlled by the market, not the Fed. Stronger-than-expected growth could be contributing to higher long-term rates, but continued concerns over the Fed's ability to get inflation to 2%, along with concerns over the state of the U.S. balance sheet, also seem to be playing a role. The last Federal Reserve meeting of the year cleared the way for a Christmas rally in both risk assets and rate markets, but volatility is likely to remain and the interest rate backdrop for 2024 remains somewhat hazy. 2024 may well be the year the Fed ends one of the most aggressive tightening cycles in U.S. history, however, markets will still be left to contend with weakening U.S. finances, GDP-to-Debt over 120%, the continued lagged effects of a 5% cost of capital, the largest U.S. Treasury buyers stepping out of the market and inflation that is not yet at the Fed's 2% target.

The recent ride in bonds has been rough, but what seems to get lost in the mix is the fact that, alongside the volatility of the last two years, cash flows have increased fivefold with yields at levels not seen since the Great Financial Crisis. Along with many areas of the bond markets, municipals were also a victim of the zero-interest-rate era. Municipal market yield to worst bottomed at 0.86% in August 2021 and the ride back has been bumpy, but at least yields bonds are back! Coupon income tends to dominate returns in high grade fixed income, with municipals no exception, and this means in turn that time in the market is much more important than timing the market, in our opinion. It is human nature to place a greater emphasis on recent events but the recent price drawdown in municipals might not be the most reliable indicator of their path forward. The longer the investment horizon, the smaller the role played by price volatility with yield becoming the most reliable indicator of future returns. Investors are now staring down one of the best buyer's markets for municipals in recent memory. And the best of times might be ahead, in our opinion.

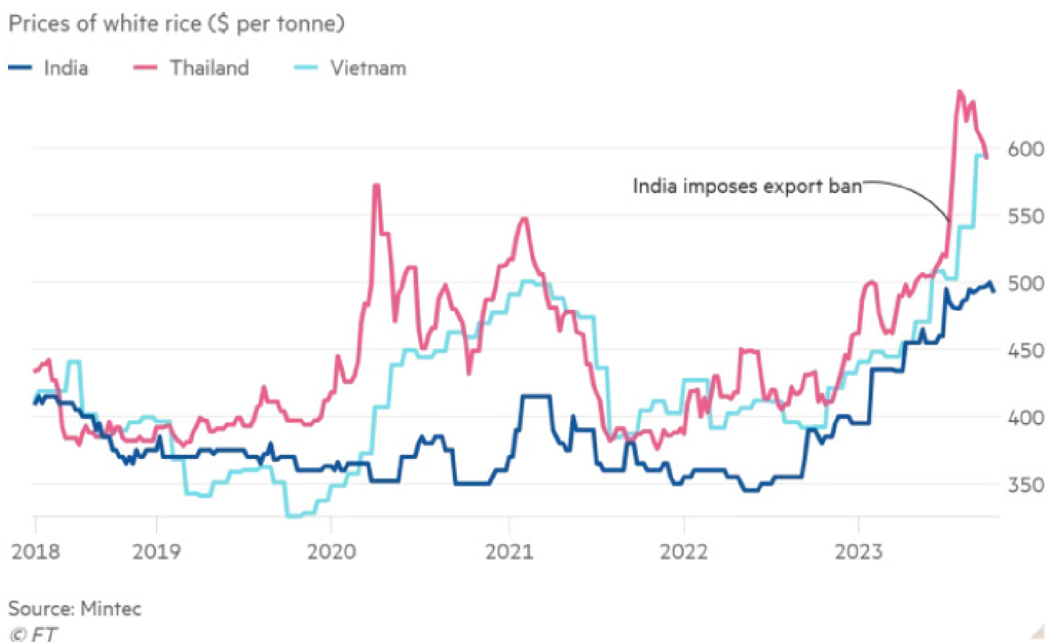
A couple of notes on commodities that may surprise many is the extremely depressed levels of commodities based on some risk-off measures for fund managers preferring bonds over the most basic of goods.



The relative value to equities has been in place at historic low levels for some time. With the diminishing value of just-in-time manufacturing, the shipping problems as we detail below, we believe one would be wise to have long-term allocations to broad-based commodities but have a longer-term outlook for them. This allocation also does well in mitigating the correlation of a portfolio that gets exacerbated during excessive liquidity conditions.



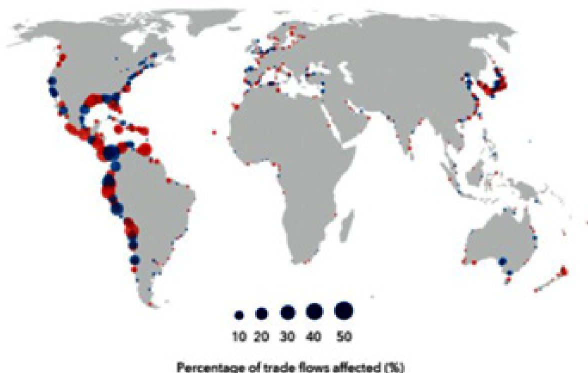
One particular concern that could accentuate the anxieties of geopolitical-focused investors is what is happening with rice. Nearly one-fifth of the world's total caloric intake is derived from rice, which has a very temperamental characteristic in regard to its growing conditions. The last time we saw spikes and hoarding like this was back in 2008, which coincided with Japan and China hoarding excess inventories. There is talk about supply disruption not only from shipping challenges, but also weather patterns that have historically strained yields. Below are a few geographical areas of concern with rice, especially after India implemented a ban on rice exports.



Past performance is not indicative of future results.

Fortunately, while we are seeing many shy away from commodities, when we look at the last time bonds were favored over commodities, we note that there was a striking rebound. In December 2008, when the previous disparity took place, the Bloomberg Commodity Index was up an average of 11% annually for the following three years.

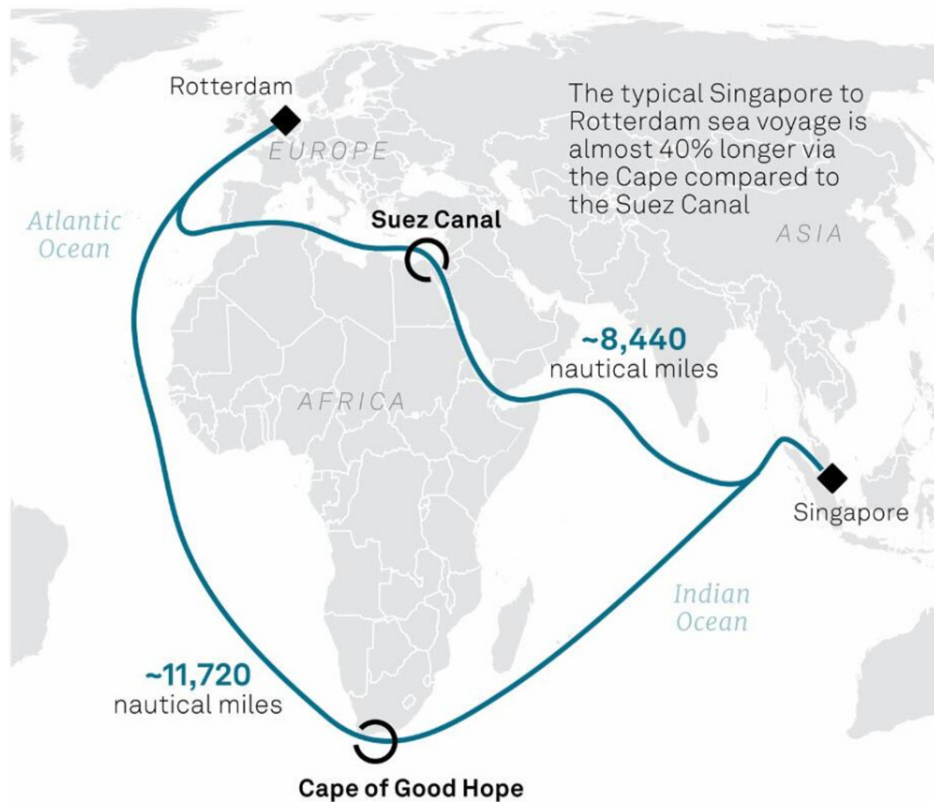
Shipping has run aground in the tail end of 2023 due to geopolitical tensions, security of shipments and abnormally low water levels in the Panama Canal.



Source: UN Global Platform; PortWatch.
Note: Chart shows share of maritime trade affected by Panama Canal drought restrictions since March 2023. Affected trade is tracked for each port visited before entering canal (outgoing trade flow) and visited after transiting (incoming trade flow). Total affected trade is the sum of outgoing and incoming trade volume, with color indicating dominant flow at port level. Share of affected trade is total affected trade divided by total trade for each port. The data are as of Oct 13, 2023.

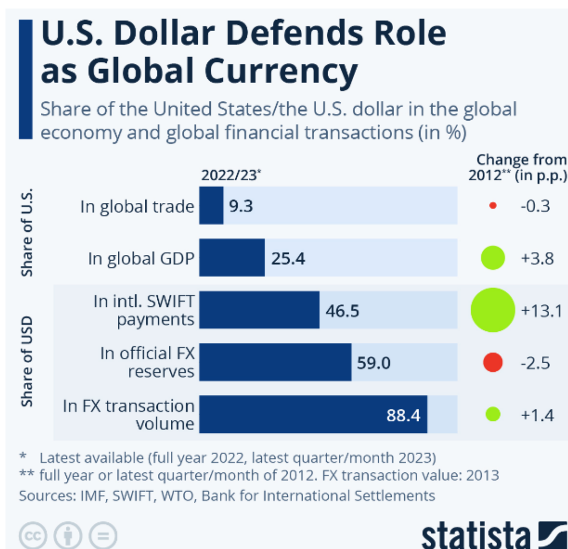
IMF

Due to the security concerns in the Suez Canal in the Red Sea, ships are being re-routed which extends trips by nearly 40%.

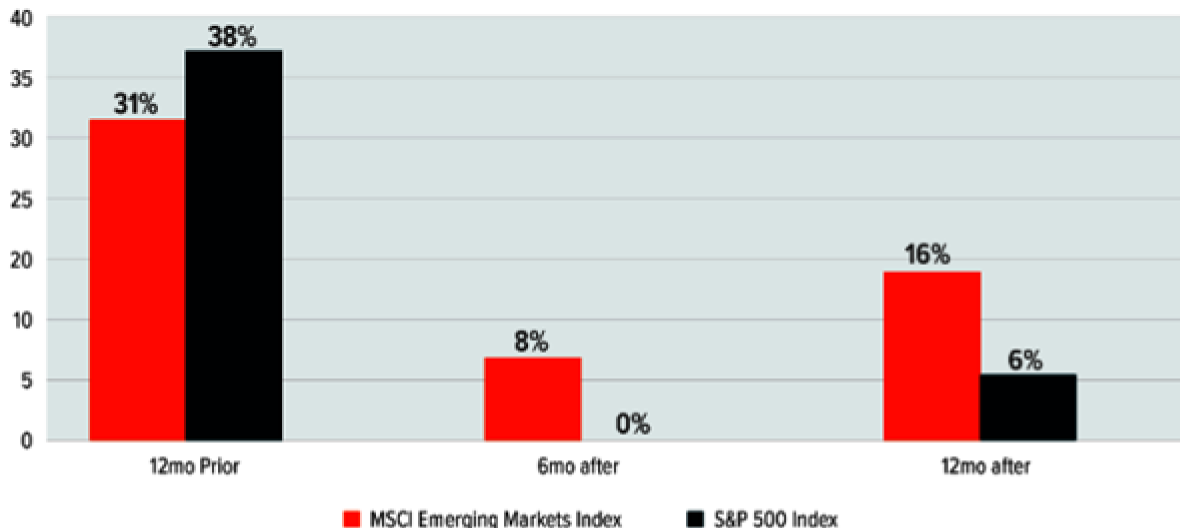


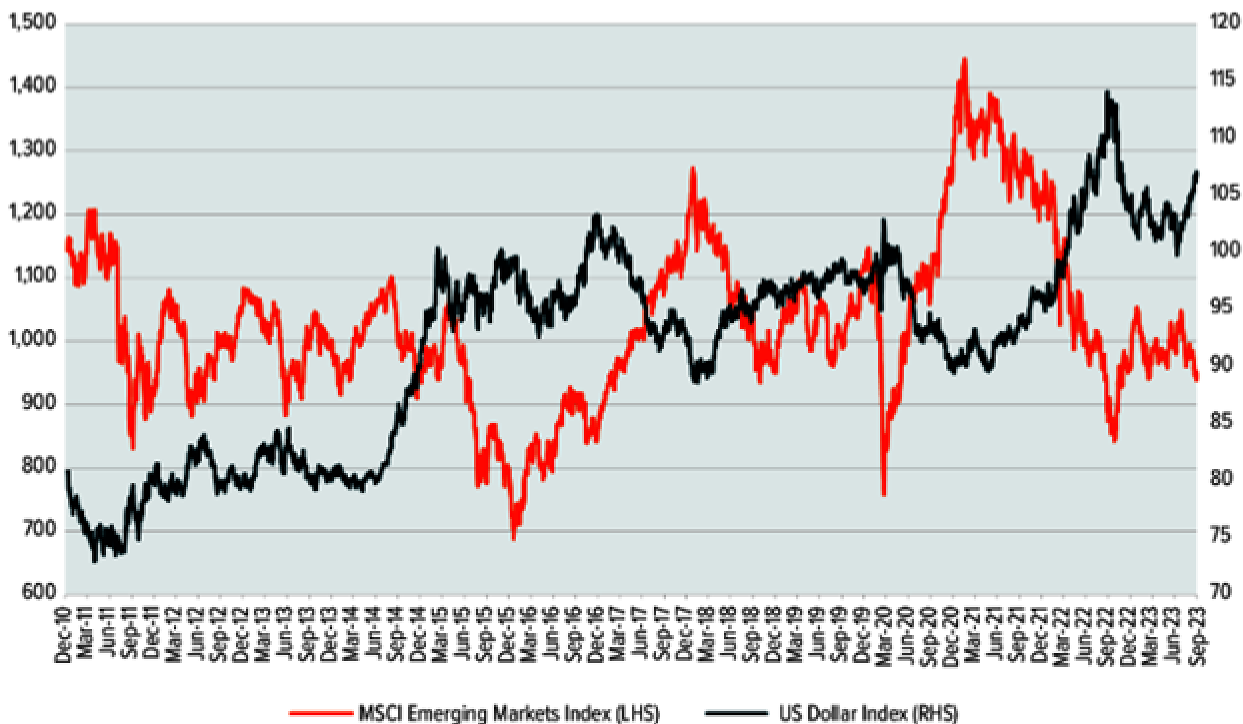
These two conditions only exacerbate the vulnerability, challenge the reliability, and decrease the affordability of shipping goods across the globe.

In currency analysis, 2023 saw a year when the trade-weighted U.S. dollar saw declines and gains many times this year, only to finish down about 2% from the start of the year. We saw significant headlines about the de-dollarization attempting to take place only to see it still dominate currency markets. In 2024 we see some more pressures on the value of the U.S. dollar from a U.S. budget deficit standpoint, Treasury issuances and simply cross-rate trades that have pushed the value down as interest rates drop.



Historically, one area that has been key to dollar declines after Federal Reserve rate cuts is emerging markets. The following data from Global X ETF displays these two scenarios. We would not expect it to be a linear move and may have many moments of building upon initial positions throughout the year.





Past performance is not indicative of future results.

In summation, we still believe the conflict between the antagonist (recession) and protagonist (soft landing) has yet to be resolved. That constitutes a vision of varying headlines proliferating each narrative along the way. This will only be condensed due to the election year and the many dynamics (read dysfunction) that this normally provides. We would be mindful of correlation among assets, be dynamically focused on allocations, have a longer-term outlook, monitor risk as much as reward when considering scenarios, utilize more active professional management than what may have been required in the past and practice a bit of “ignore-ance.” It is not ignorant of variables and peripheral data points, but rather ignoring those that are merely ancillary and focus on the fundamentals that need vigilant monitoring as we traverse the landscape that is fraught with misdirection and percolating risks.

Our summation of the macro landscape is that inflation lingers for longer and has the potential to go through many phases of accelerated inflation and declining rates of price movements. The reason for the cuts coincides with economic contraction as it has in the preponderance of economic history. This will coincide with wild movements in the Treasury market and, as a byproduct, that of the overall debt markets. We don’t foresee the quick pivots outside of a rapid decline in economic growth or problems in other areas of the capital markets. We expect continued pressure on consumer fatigue thus accentuating the pressure on revenue gains for companies.

Our ideas for 2024 are as follows:

- We anticipate **income** — whether it be dividends, share buybacks, or coupon payments — will be a key component of total return generation and a volatility suppressor. Supplemental income can potentially be gained via Master Limited Partnerships (MLPs) and select Real Estate Investment Trusts (REITs).
- We believe investors should consider adding **alternative investments**, including non-traded BDCs (Business Development Companies) and non-traded REITs, to their portfolio since these asset classes can play an impactful role in generating better outcomes for diversified portfolios.
- We favor **value-oriented stocks** over growth both domestically and internationally given current valuation levels.
- Internationally, we favor select areas of **Europe** and **emerging markets.**
- U.S. equities from a sector perspective: we like select **financials, materials, energy, commodities, health-care** and **consumer staples** with a focus on high-quality companies with durable business models.
- We expect **bonds to outperform cash** and believe now is the time to opportunistically extend duration.
- We believe **active management in your fixed income allocation** is critical, particularly regarding careful security selection and sector allocation.
- We favor **higher-rated investment grade** and **high yield securities** since a deteriorating default outlook warrants caution.
- We also like **municipal bonds** given strong credit quality and income potential.

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