THE LONG & WINDING ROAD

As we reflect on the ebbs and flows investors have experienced throughout the past few years, it remains clear that staying invested is the best way for long-term investors to capture overall gains. As a discounting mechanism, the stock market often presents the best forward-looking investment opportunities when investor sentiment is at its lowest. For instance, consider the investor experience since market lows in October 2022. At that time, investors had been beaten up by the market free-fall since the beginning of the year. Stocks were relatively cheap, but investors were not eager to buy them.

Since that time, the market has advanced 36% (through February 29, 2024). Now that the market has recovered and is currently hovering around all-time highs, it feels expensive. As such, investors who may have missed out on the recent rebound may be inclined to wait for a market pull-back before re-entering. While it is certainly possible (or even plausible) that there will be a pull-back, we believe investors with a long-term time horizon are better off staying invested than they would be waiting on the sidelines.

The chart, on page 2, from Charlie Billelo illustrates how an investor would fare if they only bought the stock market at all-time highs. Over each time period, investors earned a positive return despite investing at each respective market high (when the market felt "expensive"). Perhaps more importantly, investing at market highs did not lead to a materially different outcome until the 10-year average returns were reviewed.

While we are not advocating for waiting for market highs to consider investing, this data points to the fact that consistent contributions – whether through cash contributions or dividend reinvestments – have historically led to a positive investor experience, even if those contributions are made on the most expensive days – when the market experiences an all-time high.

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ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor.

As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results. FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

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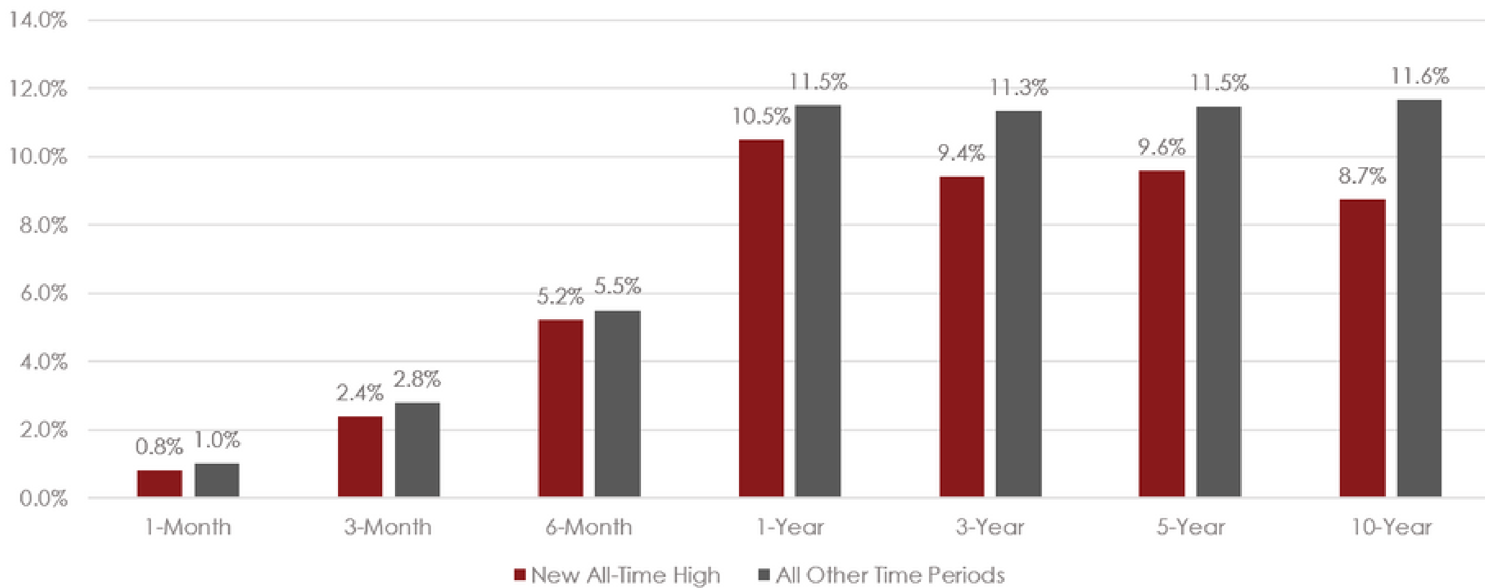

Source: Charlie Billelo, S&P 500, FSA Investment Group; Past performance is not indicative of future results. 1-year and above data is annualized

As we survey the landscape for 2024, we see a balanced range of scenarios including potential upside surprises and negative catalysts. On the positive side, while earnings remain robust for the Magnificent 7 stocks, the rest of the S&P 500 seems to be at an inflection point. The 'bullwhip' indicator, defined as ISM new orders minus inventories, is trending upwards after bottoming out in 2023, signaling potential future earnings growth.

Furthermore, while the S&P 500 has continued its advance year-to-date, valuations are not stretched for the average company in the U.S. market. In addition, the expectation for the Federal Reserve to cut interest rates while earnings are growing is very rare and may spur investors to pay higher multiples for stocks. Fiscal stimulus from the U.S. government through the Infrastructure Act, CHIPS Act, and the Inflation Reduction Act are supportive of economic growth and corporate profits. The U.S. government's deficit, currently at 7.5% of GDP, is the largest it has been during peacetime outside of a recession. While this is not sustainable over the long-term, it is beneficial to growth for the near-term.

Our outlook for 2024 is cautiously optimistic, with leading economic indicators and services activity supporting a sustained late-cycle economic expansion. The potential for additional government fiscal stimulus, particularly the R&D tax credit, could further bolster earnings growth and contribute significantly to the U.S. economy. According to Strategas, this could add $140 billion to U.S. GDP growth in 2024 alone.

The negative catalysts are related to hiccups around office commercial real estate, geopolitics and global slowdown hitting the U.S. economy. Despite assurances from banks and Federal Reserve officials that any fallout from office commercial real estate will be contained, the warning signs are hard to ignore. Offices in America are emptier than they have been at any point in the last 40 years. In the fourth quarter of 2023, 19.6% of office spaces in major US cities sat empty—the highest level since at least 1979. Furthermore, some surprise losses have been associated with CRE exposure, such as New York Community Bancorp, Japan's Aozora Bank, and the Deutsche Pfandbriefbank AG. If banks start taking losses associated with marking down these properties, then it could cause other banks to be forced to mark their own CRE holdings to market. While most believe these recent cases to be isolated to their respective organizations, the more banks that are forced to mark these loans lower, or sell them off completely, the more necessary it will be for regulators and 3rd party valuation experts to be more stringent as the distressed comparable sales will be too hard to ignore.

From a geopolitical perspective, countries making up over 40% of global GDP are voting on new leaders this year. This coincides with an increase in alliances formed along Western and China-dominated lines. As Western companies continue to de-globalize operations in the name of security and logistics, there's a heightened risk of geopolitical missteps. While energy prices have remained contained, this has been mostly predicated on the U.S. hitting all-time highs in oil production and Iran's production increasing by over 1 million barrels per day since 2021. Furthermore, Russia's output has remained elevated as it has needed to produce oil to finance its war with Ukraine. Any disruption in production could potentially drive oil prices back to $100/barrel, slowing growth and complicating the Fed's efforts to combat inflation.

While there have been some signs of slight improvement in global manufacturing, it remains an area of concern. China, the world's second-largest economy, is currently grappling with a housing crisis. The country's Purchasing Manager Index has shown its manufacturing has now contracted for 9 out of the last 10 months (note that these are the CCP's officially-reported numbers, so the reality could be even worse). In addition, while Japan's stock market is hitting all-time highs, its economy recently had negative GDP growth in the 4th quarter of 2023. Meanwhile, Europe's largest economy, Germany, is realizing the impact of elevated energy prices hurting manufacturing. Germany's IFO Business Climate Index is at the same level it was in June 2020 when the country was locked down. Lastly, investment is expected to remain weak, given high borrowing costs. All of these are known problems, but with economic growth so weak, it leaves little room for further setbacks.

What does all of this mean for the future prospects of the economy and the stock market? We begin by reviewing the FSA Market Tracker, which has shifted from being negative in September 2023 to now turning positive. The most significant changes have been slight improvements in economic indicators and a less restrictive monetary policy. Business finances overall remain solid as many corporations have locked-in low interest rates on their debt in recent years. Corporations have bolstered their cash reserves, reducing the likelihood of layoffs in the event of a short-term downturn. According to the Carfang Group, corporate cash is sitting at $4.4 Trillion. As an example, with cash yielding 5%, Berkshire Hathaway's $168 Billion in cash provides them an additional $8.4 billion in interest income each year.

Despite initial doubts about the feasibility of a soft landing, current evidence increasingly supports this scenario. Although we expect Central Banks to keep monetary policy restrictive, there is a light at the end of the tunnel, and we should see rate cuts in the next 3-5 months. While a recession remains a risk, consumers are coming from a strong financial position. We are not seeing massive layoffs, and those workers who are unemployed don't appear to have a difficult time finding jobs. All-in-all, we see a resilient U.S. economy that has already experienced higher returns versus the rest of the world which continues to struggle and thus has not seen similar gains. We believe taking a balanced, diversified approach is the best course of action for long-term investors.

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