

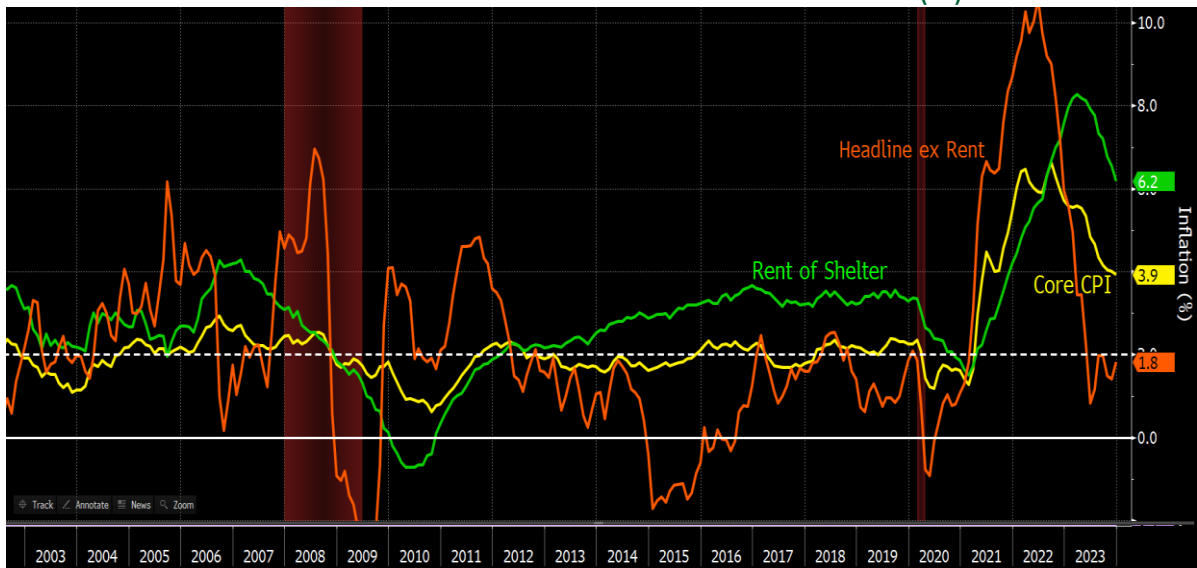
*"Acknowledging what you don't know is the dawning of wisdom."*

*Charlie Munger*

## 1. NEW BEGINNING

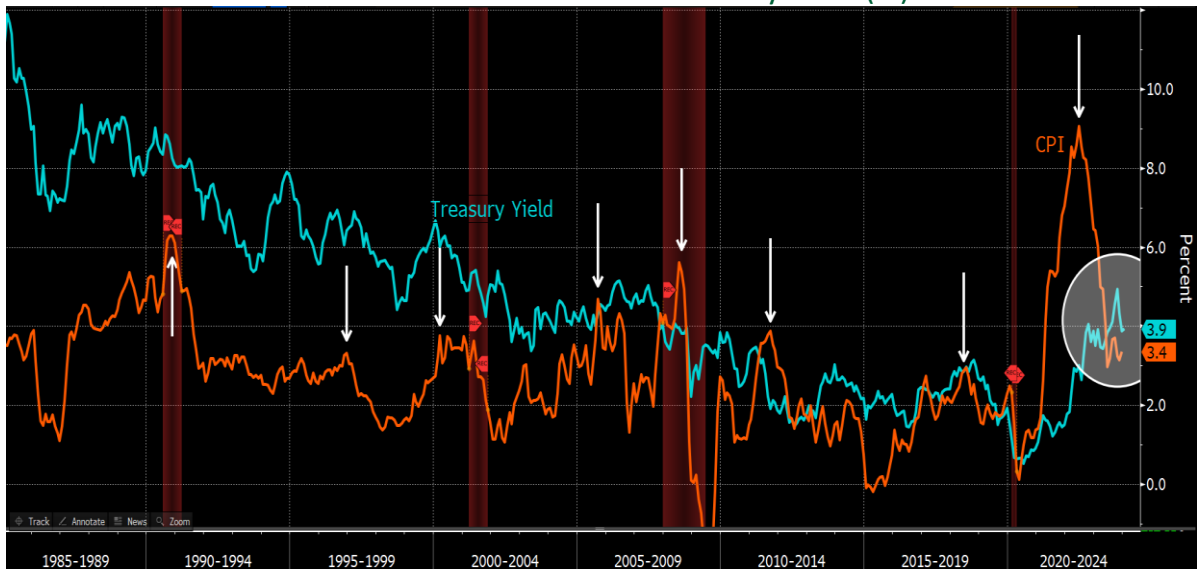
The economic backdrop going into 2024 is markedly different than the one at the beginning of 2023. Back then, the main issues were headline inflation at an uncomfortable 6.8%, the Federal Reserve aggressive tightening pathway and fears of uncomfortably high rates still to come.

US – Core Inflation vs Headline Inflation ex Rent (%)



Headline Inflation has halved to 3.4% over the year and Core Inflation has dropped to below 4%. The cost of rent, the main remaining culprit contributing to inflation, has turned the corner and, importantly, the ex-rent component of headline inflation (the orange line) has already spent some time below the Federal Reserve (Fed)'s overall target of 2%. The view has firmly formed that US inflation is under control and no longer a threat to capital markets.

US – Headline Inflation vs Treasury Yield (%)

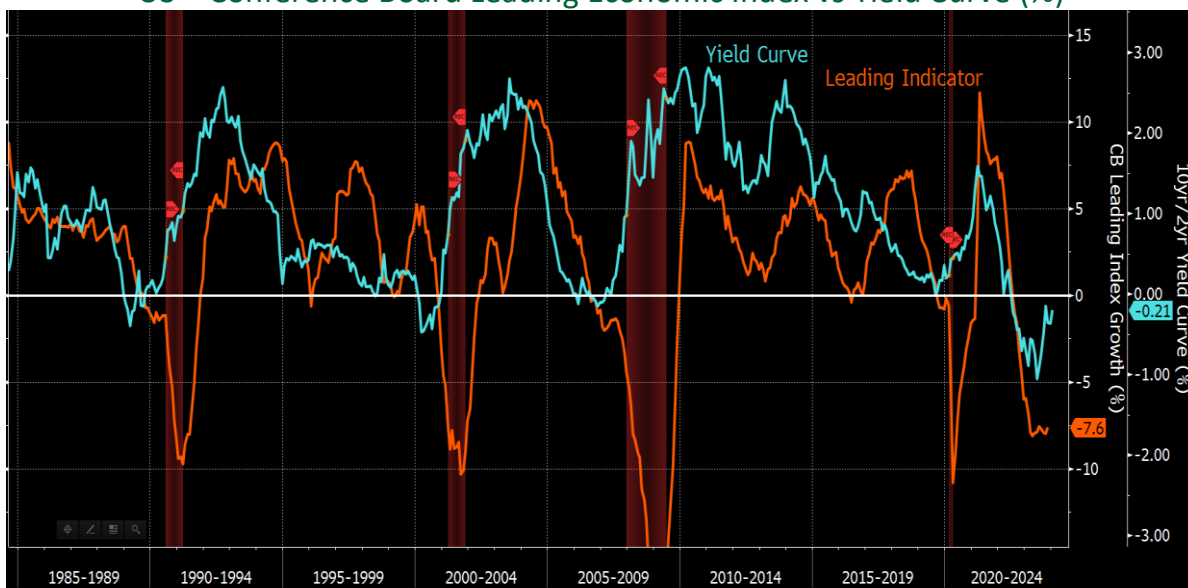


Historically peak inflation has usually soon been followed by peak interest rates. This time interest rates drifted lower for a while following inflation peaking (the chart preceding this) on the expectation of a weakening US economy (which did not materialize). It now seems that ten-year treasuries have peaked at 5.0% in October and that 2024 will be a year of lower rates.

## 2. ECONOMIC LANDING

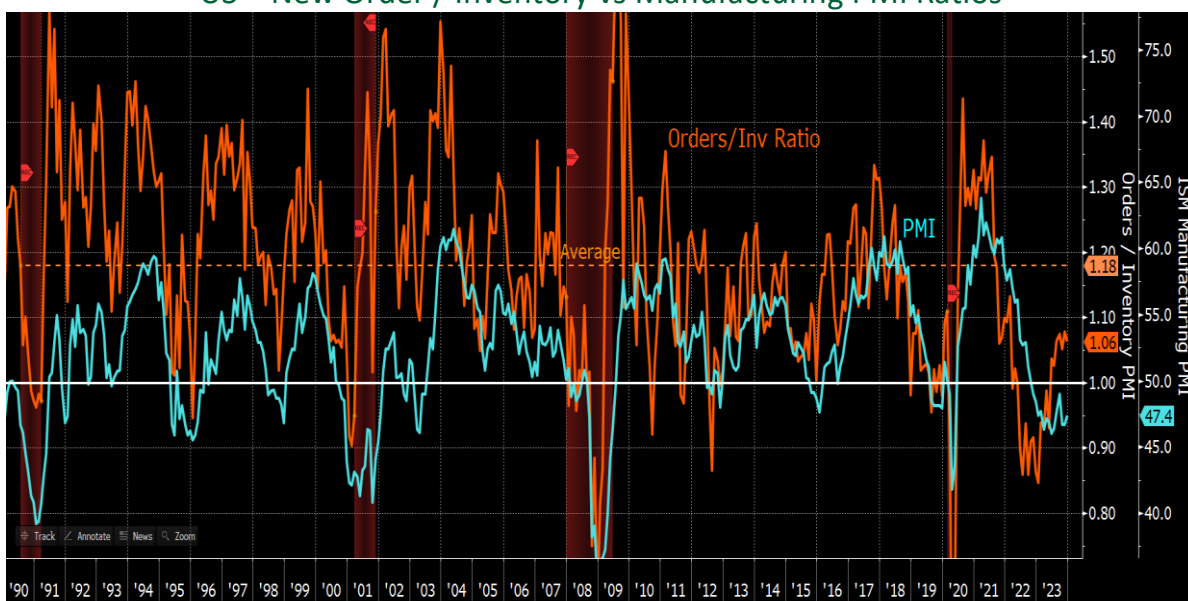
The main capital market issue currently is gauging how severe the most expected US recession might be – should it arrive this year.

US – Conference Board Leading Economic Index vs Yield Curve (%)



The Leading Economic Index in the above chart has been in a seemingly bottoming out process for long. It is currently at the low levels generally associated with the end of previous recessions. Along with that, the yield curve is currently in a steepening process. This combination seems to indicate a soft rather than a hard economic landing.

US – New Order / Inventory vs Manufacturing PMI Ratios



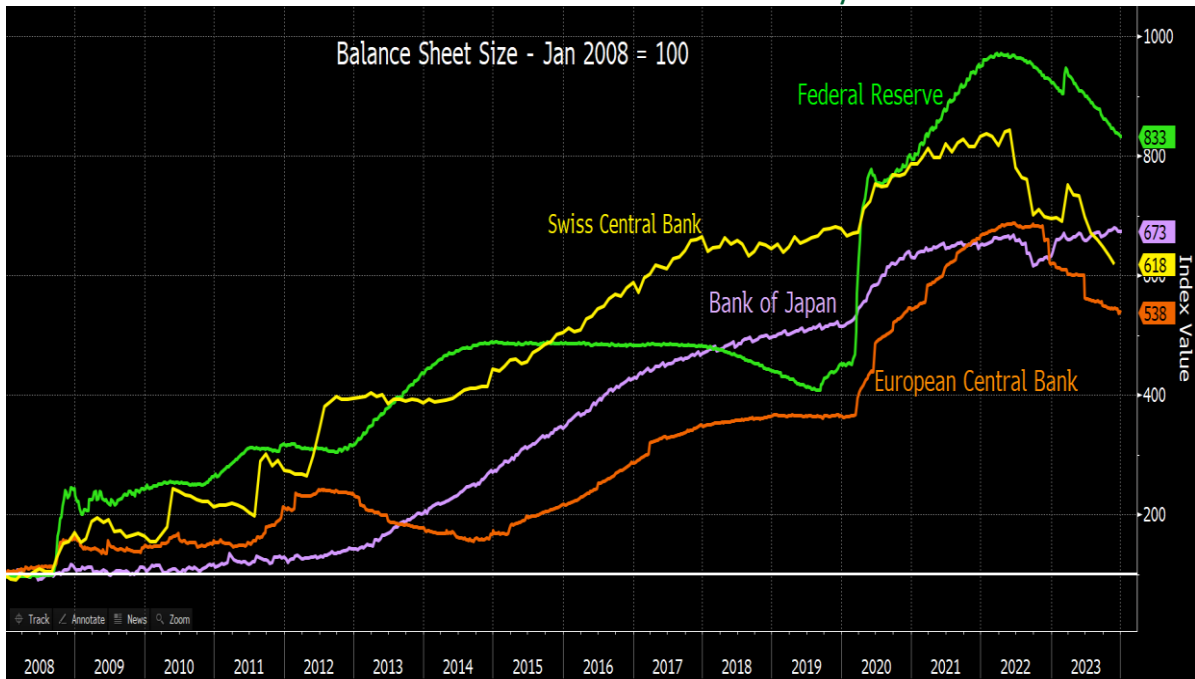
The US Services PMI ratio is marginally in constructive territory. On the manufacturing side, New Orders currently exceed Inventory levels (the orange line), with the Manufacturing Index (blue line) seemingly bottoming out. Whilst Services are critical, it appears that Manufacturing also rather argues in favour of a soft potential economic landing.



### 3. CENTRAL BANKS

The ballooning of central bank balance sheets since the Financial Crisis and then the Pandemic has been a threat to the capital markets.

Central Bank Balance Sheets – Index to January 2008 = 100



The Fed's balance sheet has increased more than eightfold since 2008, and more than doubled since immediately before the Pandemic, even after the disciplined buying back of treasuries over the past two years. The Swiss Central Bank has been most successful, with their balance sheet currently back to 2017 levels.

Federal Reserve Balance Sheet as Ratio of US GDP (%)



As a ratio of US GDP, the Fed's balance sheet has already shrunk by a fifth and has another 15% to get to its 2014 peak level, or another quarter to its average since before the Financial Crisis. It is somewhat comforting that half of its work on this basis seems to have been done.

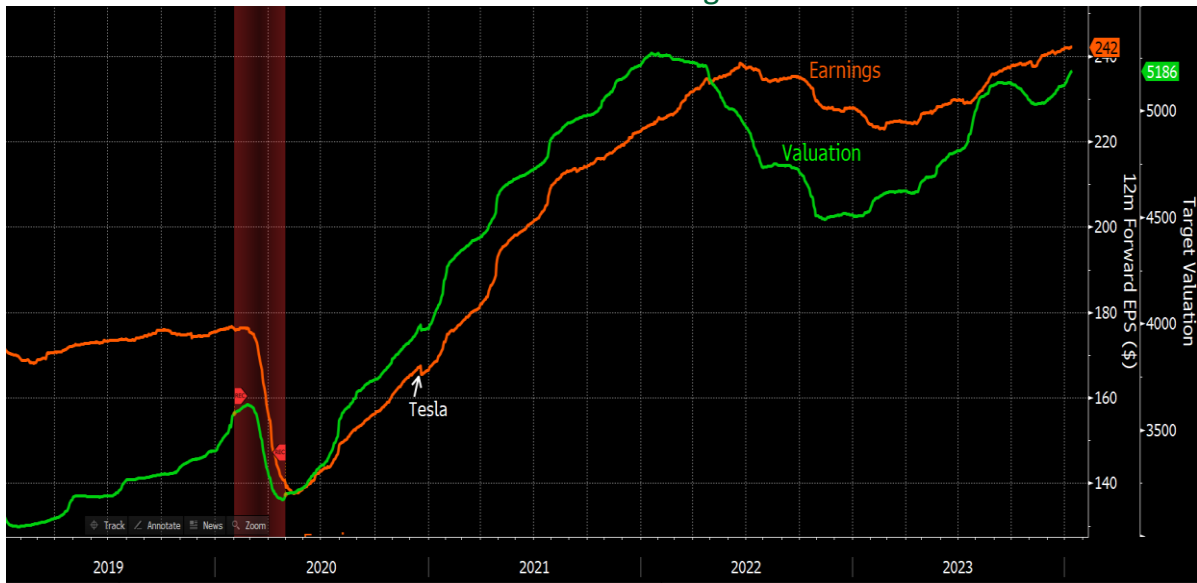
The current FedFund futures market indicates an expected drop of 1% in their target rate by year end (we expect less of a drop). Pressure on the pace of further shrinking their balance sheet may subside. All of this indicates that we can expect equities to enjoy further support from the bond market.



## 4. EARNINGS

Logically share prices follow earnings over time.

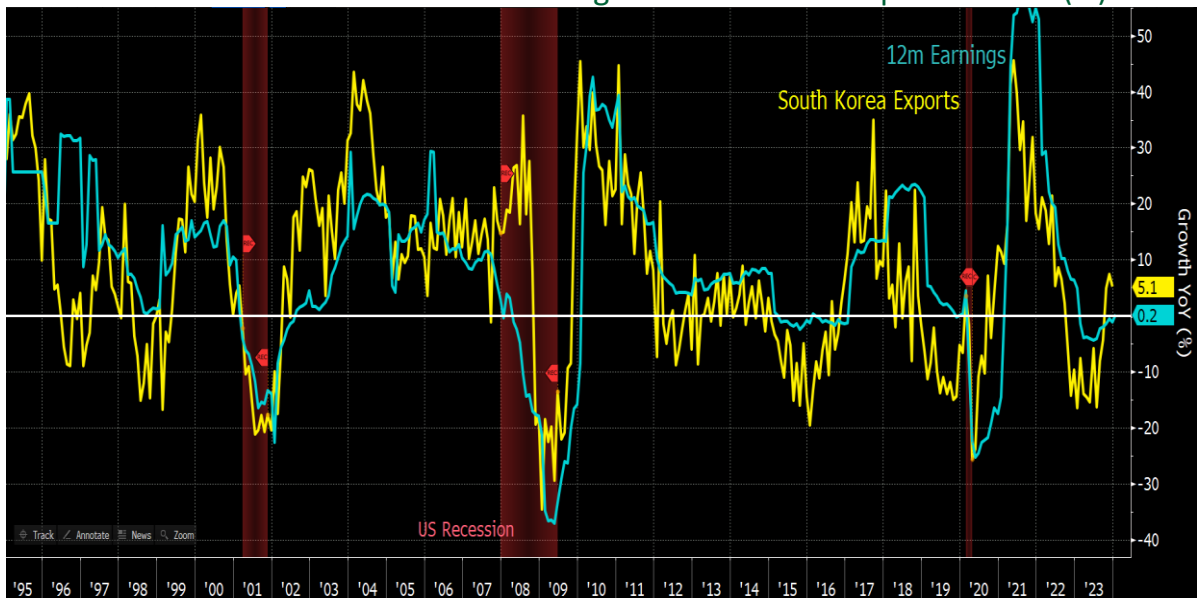
### S&P 500 – Consensus Forward Earnings and Index Valuation



Forward consensus S&P 500 expected earnings are currently in an upwards trajectory (orange line), and are currently at a record level. Likewise, the bottom-up Index valuation is currently also picking up well. While the US economic outlook is not materially supportive, the weaker Dollar contributes towards positive earnings revisions.

The S&P 500 Valuation Index is currently 8% above the Price Index. Whilst this is a reasonable upside, it is lower than the historical 13% average upside. Whilst this may not sound overly encouraging, the more important issue at this juncture is for the earnings revisions to stay positive.

### S&P 500 Consensus Forward Earnings vs South Korea Export Growth (%)



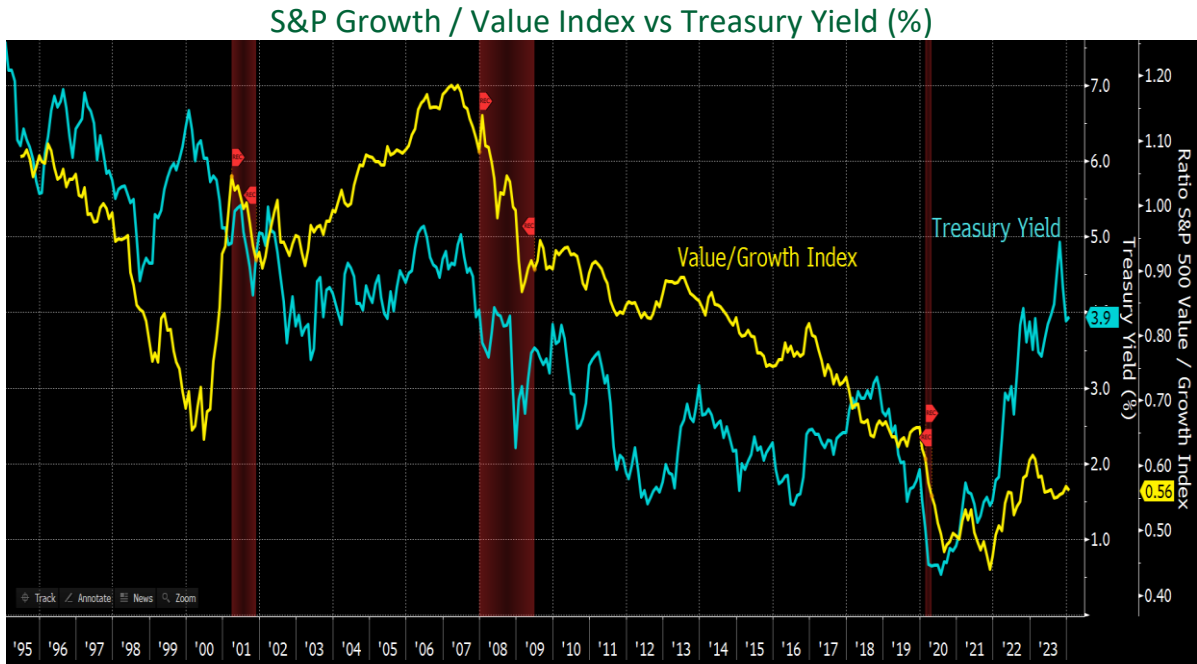
The nature of South Korea's exports (they are mainly industrial, parts, accessories, circuits, and autos related) serve as a leading US indicator. Growth in these exports (the yellow line) has recently turned positive. S&P 500 forward earnings historically, and now as well, are correlated with these exports.

Whilst these earnings indicators are constructive, investors should this year particularly stay alert for the risk of potential disappointments. We believe that, currently, a safer course is to wait for earnings announcements before buying.

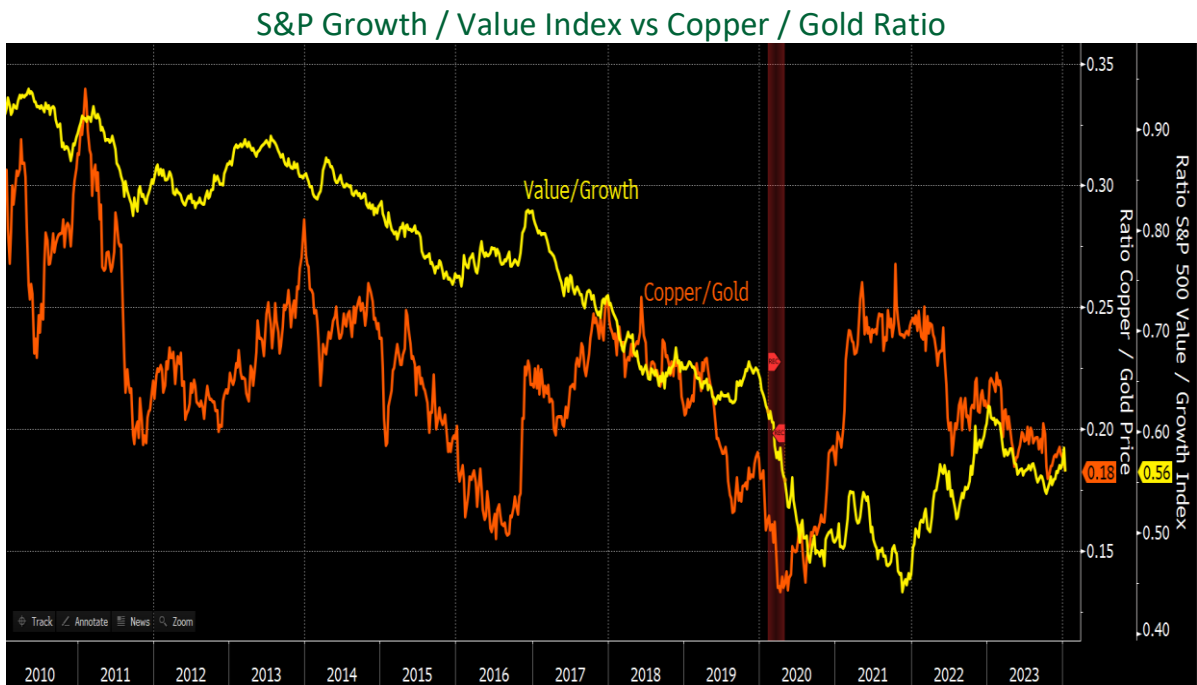


## 5. GROWTH INVESTING

The Growth style of investing outperformed the Value style in 2023. Investors might be considering those odds for this year.



Logically, there is a correlation of the relative Value/Growth Index ratio with interest rates over time, as the above chart clearly depicts. With the peak in US interest rates behind us (as we believe), odds for this year seem to be on the side of Growth.



The above chart shows the relative Value/Growth Index along with the Copper/Gold ratio, also with a fair degree of correlation. The latter has been in a declining trend and the dampened economic outlook argues in favour of a continuing trend.

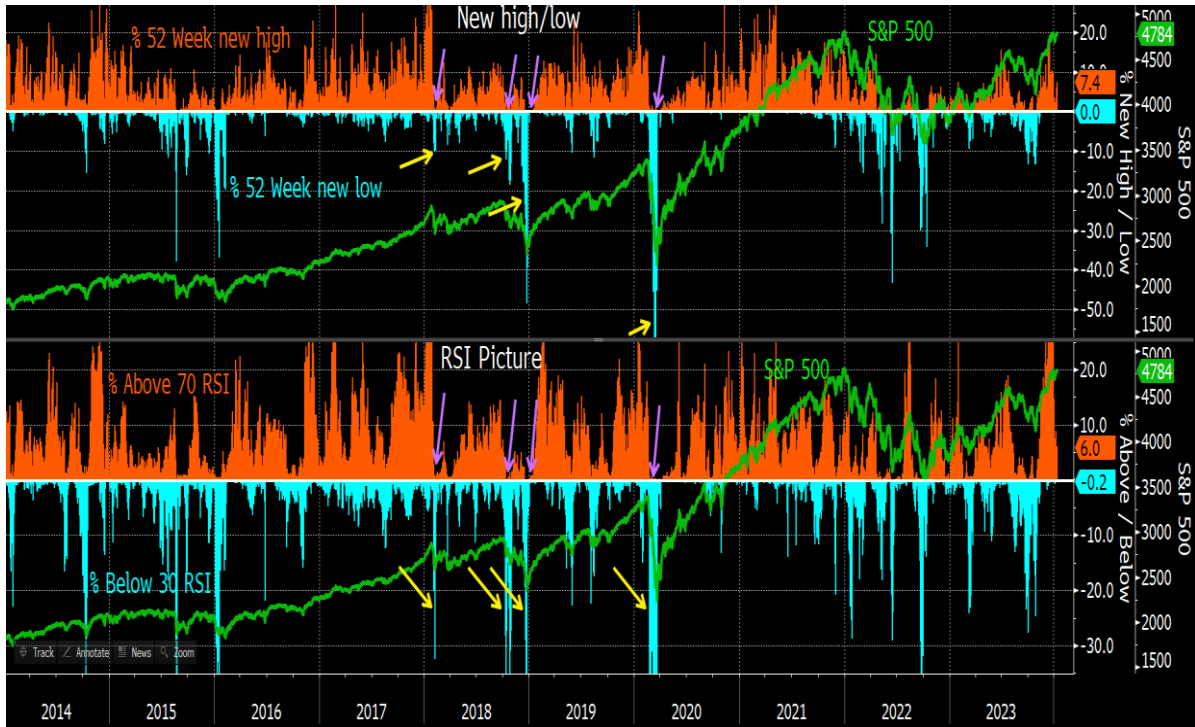
It appears that the 'yearning for growth' season is back.



## 6. TECHNICAL PICTURE

The S&P 500 technical picture is currently strong. It is trading in a rising trend, currently close to its all-time high, and both its 50- and 200-day moving averages are in a rising trend. Its RSI (Relative Strength Index) is close to the upper threshold of 70, approaching overbought territory.

### S&P 500 vs % of Stocks at New Highs/Lows and Above/Below the 70/30 RSI Thresholds



The upper half of the chart indicates that 7.4% of S&P 500 constituents are trading at new highs (the orange bars). The lower half of the chart indicates that 6.0% of the constituents are trading above their 70 RSI threshold (again the orange bars).

To us, both of these technical indicators do not yet raise alarms of an overheated market.

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