The Howard Group
Market Commentary

The views expressed herein are those of Gray Howard and do not necessarily reflect the view of UBS Financial Services Inc. or its affiliates.
Printed 1/23/2024

The Sunlit Uplands
2024 Outlook

-Gray Howard, Senior Portfolio Manager

The new year is often a time for reflection of the past while also gaining prospective for the future. The last several years have certainly been interesting times to say the least. However, if we zoom out and look at the big picture, it becomes clear that what we are experiencing today has happened many times throughout history.1

The consensus on Wall Street was overwhelmingly negative coming into 2023, thinking a recession was just around the corner. In fact, the median forecast for the S&P 500 for 2023-year-end was 4075- 17% below where it actually closed. This is somewhat understandable given the Fed was aggressively raising interest rates. In a normal environment this would have caused a recession, and their forecast would have come to fruition.2

However, as we've been stressing since the spring of 2020, this is NOT a normal environment and the only applicable parallel is the 1940s. That was the only other time the US national debt reached over 100% of GDP, meaning the national debt is growing faster than the overall economy. It was also the only other time the US ran large structure deficits with full employment. Economists refer to this as fiscal dominance because when a nation's debt and deficits become this large, monetary policy often takes a backseat to fiscal policy as government spending is the main tool for stimulating or restricting economic growth.3

For example, even with the Fed raising the funds rate by 5.25% and reducing their balance sheet by 2 trillion, financial conditions are actually looser today than before the Fed started raising rates. Why? Because fiscal spending has not only offset the liquidity the Fed has drained out of the system, but it has surpassed it. And whether we like it or not, it's liquidity that drives the economy and financial markets. 4

Many continue to draw parallels from 2008 or other periods in recent history but I think that is mistake. Just as it was a mistake for investors in the 1940s to believe another 1929 style crash or great depression was on the horizon. Leading up to 2008 it was the private sector that was massively over-leveraged and most of that debt was restructured or transferred over to government balance sheets. Today is just the opposite, as it's the government balance sheets that are over-leveraged and this debt is being transferred back to the private sector in the form of inflation and currency devaluation. This of course can drive up asset prices like stocks, real estate, and commodities but also makes it very difficult on the younger generation and middle to low-income individuals. Hence the rising populism and political tension.5

Given the amount of fiscal spending, we were never in the recession camp last year and continued to stress that the market bottomed in June of 2022, had a classic retest later that October, and we've been in a bull market ever since.

So where do we go in 2024?

While 2023 was a great year, I remain optimistic for five key reasons:

1. **Fiscal Dominance-** Since 2020 there has been a coordinated effort from the Federal Reserve and fiscal authorities to inflate our way out of this debt crisis and I don't see that changing soon.6 Given the share of federal spending and tax revenue compared to the size of the economy, it would be difficult to raise taxes or cut spending enough without slowing the economy and widening the deficit even more.6 So, in my view the only way out of this conundrum is through inflation and economic growth. This is good for asset classes that can adjust upward like stocks, real estate, and commodities, and bad for cash and fixed rate instruments. 7

2. **The Fed**- Even if the Fed doesn't cut rates this year, they are unlikely to be the headwind they've been over the past two years. However, if they do cuts rates and fiscal spending continues as expected, the market will be getting hit with two sources of liquidity which could drive risk assets higher.8 Furthermore, interest expense now makes up around 11% of the annual budget so there is motivation on the fiscal side for lower interest rates.9

3. **Artificial Intelligence -** Labor productivity has been below average since 2005 and certainly a headwind for the economy. A large component has been unskilled workers due to the advancements in technology and the time and money it takes to train the workforce. While many believe AI will replace jobs, if used correctly, it will completely transform the work environment and increase performance and productivity. Inexpensive, on-the-job training is the piece that has been missing and the advancements in machine learning should fill this void. Greater labor productivity increases economic growth while reduces price inflation; exactly what is needed to get out of this debt crisis.10

4. **Mutual Fund and ETF Flows –** Seasoned portfolio manager, Andrew Slimmon, taught me to always look at mutual fund and ETF flows to gauge investor sentiment. Sadly, retail investors typically do the wrong thing at the wrong time- they buy at the top and sell at the low. Even with the market going up last year, retail investors continued to pull money out of the equity markets as there is often about a one-year lag off the market low before they start buying stocks again. So, we've got a ways to go before retail investors fully embrace this bull market which means there's more gas in the tank.12

5. **Free Markets -** During the great depression, many viewed the crash of 1929 as a failure of the free market. Many countries, including the US, moved away from a free market system to a more collectivist or socialist style economy. Obviously, some countries went farther than others, but central planning was the popular theme. Essentially, economic decisions were made by a central authority rather than volunteer cooperation among market participants.13 Similarly, many viewed the banking crisis of 2008 as a failure of the free market.14 But Milton Friedman taught us that we must contrast the difference between big business and the free market. Any good CEO will say they are for free markets, but spend millions of dollars lobbying Washington for their own company's special interest, only stifling competition and the basic tenants of a free market system. 1 While this time may be different, history is very clear- societies that have had a free enterprise system, while not perfect, have experienced a far greater standard of living and upward mobility than those without. Of course, many will blame the wealth inequality on big corporations while others will blame it on big government, but throughout history, it's the collusion of the two that do the most harm to the average individual.16 And if we look around the world today, from Europe, to Taiwan, to South American, and to the US, people are overwhelmingly rejecting the central planning approach for a system based on individual choice, individual rights, and volunteer cooperation.17

Conclusion

I believe 2024 will be another good year for stocks, but not without volatility. It's going to be important to remain focused and remember that markets like to climb a wall of worry and there will be plenty of things to worry about, especially on the geopolitical front. But it's always important to look for extra context, have an open mind, and try to see things through the lens of history. I mentioned in my 2023 outlook that we are in what Neil Howe and William Strauss coined a Fourth Turning- a crisis period that comes around every 80 to 100 years that breaks the existing worn-out system and gives birth to a new. The last fourth turning was the Great Depression and WWII, before that the Civil War, the American Revolution, the Glorious Revolution, Armada Crisis, and the War of the Roses.19 And just as with these periods, I suspect people will be studying the 2020s long after we're gone. While the conclusion has yet to be written and the next renaissance may take some time, if we look out over the horizon, we might just see the sunlit uplands and realize the universe has an overall plan beyond our control.

All the best,
Gray

Please note: *If you do not have assets under management with our group and would like more information on our process and performance, please let us know.*

Also, If you've been forwarded this email and would like to be included on future commentary, please feel free to reach out to hilary.miller@ubs.com.

Diversification does not assure a profit or guarantee against loss in declining markets. Asset Allocation does not guarantee a profit or protect a gainst loss in a declining financial market. Past performance does not guarantee
future results and current performance may be lower or higher than past.

This article has not been prepared with regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments or to participate in any particular financial, trading or investment strategy. Readers should not construe the contents of this article as legal, tax, accounting, regulatory, or other specialist or technical advice or services or investment advice or a personal recommendation.
As a firm providing wealth management services to clients, UBS Financial Services Inc. offers investment advisory services in its capacity as an SEC-registered investment adviser and brokerage services in its capacity as an SEC-registered broker-dealer. Investment advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate arrangements. It is important that clients understand the ways in which we conduct business, that they carefully read the agreements and disclosures that we provide to them about the products or services we offer. For more information, please review the PDF document at ubs.com /relationship summary.
UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.
Neither UBS Financial Services Inc. nor Its employees(including its Financial Advisors)provide tax or legal advice. You should consult with your legal counsel and/or you accountant or tax professional regarding the legal or tax implications of a particular suggestion, strategy or investment, including estate planning

© UBS 2024. All rights reserved. The key symbol and UBS are among the registered and unregistered trademarks of UBS. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.

Sources;

1. https://www.federalreservehistory.org/essays/feds-role-during-wwii
2. https://www.bloomberg.com/news/features/2023-12-29/wall-street-s-worst-investing-mistakes-of-2023
3. https://www.clevelandfed.org/publications/working-paper/2016/wp-1632-fiscal-dominance
4. https://www.chicagofed.org/research/data/nfci/current-data
5. Dalio, Ray, 11/30/2021, Changing of the World Order,
6. https://www.businessinsider.com/david-rubenstein-us-debt-solution-taxes-spending-inflation-income-inequality
7. Refinitiv
8. https://fortune.com/recommends/banking/fed-rate-change-history-forecast/
9. https://www.crfb.org/blogs/2023-interest-costs-reach-659-billion
10. https://www.mckinsey.com/mgi/our-research/rekindling-us-productivity-for-a-new-era
11. Sentimenttrader

12. LSEG Lipper, https://www.ici.org/research/stats/flows
13. Hayek, Friedrich, 03/1944, The Road to Serfdom
14. https://time.com/5956255/free-market-is-dead/
15. https://www.econlib.org/archives/2007/02/milton_friedman_8.html
16. https://politicalresearch.org/2005/01/12/mussolini-corporate-state
17. https://www.reuters.com/world/americas/argentina-readies-vote-likely-presidential-election-thriller-2023-11-19/
18. https://www.cnbc.com/2023/11/15/goldman-sachs-is-out-with-its-official-2024-outlook-heres-where-it-sees-stocks-going.html
19. Howe, Niel, Strauss, William, 12/1/1996, The Fourth Turning.