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The Howard Group
Market Commentary

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Heck of a Run

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-Gray Howard, Senior Portfolio Manager

Since the end of October, the S&P 500 has climbed a remarkable 24% with very few pullbacks along the way.[1] Not surprising given the consensus on Wall Street was way too pessimistic in 2023 but finally flipped in the fourth quarter and forced investors to rush into stocks for fear of missing out.[2] This is the classic markup phase of the cycle as savvy institutional investors had already soaked up most of the supply at lower prices and newfound demand from retail investors sent stocks for a parabolic move. Financial markets are no different than any other business strategy- buy inventory at a discount, create demand for the product, mark up the price, and sell it retail. [3]

Unfortunately, so many fail to contrast the difference between the consensus narrative on Wall Street and "the market." The narrative is just the collection of opinions from market strategist without any large sums of money behind their calls. Conversely, "the market" is the collection of institutional investors running billions of dollars, acting in their own interest, yet creating the price moves that we all see. These investors rarely share their views publicly until they've completed their operations, however, every trade they place is captured in the price and leaves a wake as to the direction of the overall trend.[3] Hence the words from investor, Jessie Livermore - "Markets are never wrong, opinions often are."[4]

Where do we go from here?

With the S&P 500 hitting new highs every few days, it's natural to wonder if we're close to putting in a major market top. While the market is certainly extended and it'd be healthy to see a pullback or some sideways consolidation, the S&P 500 is only about 6% higher from where it traded in January of 2022.[1] Two years of going nowhere and then a breakout to new highs is hardly how major tops are formed. On the contrary in fact, as it shows the bulls have finally won the two-year tug-of-war and many of the bears have either joined the bull side or packed up and gone home.[5]

But aren't stocks expensive? The forward price to earnings ratio for the S&P 500 is around 20 times, which makes stocks historically expensive.[1] But that is assuming the future earnings projections are accurate, which is rarely the case as Wall Street is constantly playing catch up by either raising or lowering their estimates. For example, some of the biggest moves happen when a stock appears to be expensive and some of the biggest losses occur when a stock appears to be cheap.[6]

Nvidia has been the perfect illustration of this, as the PE ratio is now lower, meaning cheaper, than a year ago but the stock price is up 285%.1 How is that possible? Wall Street got the earnings estimates wrong but "the market" was once again spot on. While valuations are an important component, they are highly subjective and only part of the equation.

The US economy and consumer spending remain strong but how could it not when we are running a 1.6 trillion-dollar budget deficit with full employment.[7] Inflation has moderated for now, and we have a presidential election in November in which policymakers will do everything they can not to upset the apple cart.1 Hence the recent student loan forgiveness.8

While the focus has certainly been on large cap tech stocks, the equal-weighted S&P 500 index, which unlike the cap-weighted index does not give a higher weighting to the mega-cap stocks, just hit a new high after two years as well. 1 According to a study from sentimentrader, after a prolonged period of consolidation followed by a new high, the market continued to show signs of strength. In fact, a year later it was higher 100% of the time.[9]

While I think growth stocks will continue to do well, the growth versus value trade likely won't be as pronounced as the two years. 2022 was clearly a year for value stocks and 2023 was clearly a year for growth stocks, but 2024 likely be a year for owning stocks on both sides of the ledger and why it is important to have a portfolio manager that isn't boxed into one particular style. [1]

After such a strong run, it would be nice to see the market take a breather over the next several weeks. Therefore, if you have cash on the sidelines, it's probably best to be a little patient and dollar cost average into the market. The time to plow in has passed, in my view. Longer term though, the bullish case is still very much intact, in my judgement, and pullbacks should be considered buying opportunities.

Lastly, it's important to remain disciplined and have an overall plan. Markets are rarely intuitive and designed to fool even the brightest. But understanding the real rules of the game, as the institutions play it, is the key to successful investing. And remember the advice of Richard Wyckoff, "listen to what the market is saying about others, not what others are saying about the market."

All the best,
Gray

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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.

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