The Howard Group
Market Commentary

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5 Reasons I'm Still Bullish

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-Gray Howard, Senior Portfolio Manager

Ocean tides are a great reminder that every ebb is followed by a flow and while we can attempt to change its natural pattern, it is far better to respect and get in sync with its very powerful force.

Financial markets are no different. Throughout my career I've seen many very intelligent people try and convince the market of their opinion, or claim the market is irrational. Sadly, this thinking always offers an uncomfortable reminder that we are all subordinate to nature's path.[1]

Don't get me wrong, I'm not suggesting that investors blindly throw money into the market and hope for the best, although, in my view, that strategy might work better than some of the more complexed products pushed today. I'm suggesting the market is a forward predictor and gives us clues as to the environment we will likely see in the future. [2]

For example, one of the key reasons we were bullish in late 2022 and all of 2023 were the homebuilding stocks. They made a low in June of 2022 but didn't make a new low later in October when the overall market did. At the time, that was a pretty good clue that the economy wasn't heading into a recession as the economically sensitive stocks, like homebuilders, are stocks you want to own coming out of a recession, not going into one.[3] Keep in mind that we did have two negative GDP prints in Q2 and Q3 of 2022 which likely would have been considered a recession in less political times.[4]

As we entered 2023, many were calling the rally off the October low a bear market rally and telling investors to remain defensive as the worst is yet to come.1 But the economically sensitive stocks continue to lead the rally, only confirming a recession was just not in the cards.3 In fact, we pinned in our 2023 outlook titled, "Animal Spirits": 'there is always a disconnect between the financial markets and the real economy and it's human nature to distrust the cycle, especially coming out a bear market.'

It wasn't until the fourth quarter of 2023 that the consensus finally started to believe that maybe the stock market is not irrational and has been correct all along.[5] Again, just like the ocean tides, markets are a very powerful force.

After a 25% rally from October through the end of March, the stock market has basically been in a trading range. We saw a healthy 5% pull back in April, followed by a 5% recovery in May and now we're hovering around all-time highs for the S&P 500.[3] I continue to believe the market will remain a bit choppy as we enter the summer months but as I mentioned in our May note, my thesis has not changed, and I feel stocks will be higher later in the year for five key reasons:

1. **Market Strength**- Strength begets strength and after a 25% straight up rally from October, all we got was a little 5% pull back in April. That tells me this is a pretty strong market, and investors are still trying to get in, not out. [6]

2. **Corporate Earnings** – Everyone wants to talk about how expensive the market is, considering the S&P 500 is trading around 21 times 2024 earnings (Price to Earnings Ratio). But these are "estimated" earnings and analysts have been forced to raise their estimates as most thought we would be a in a recession by now. I suspect they will continue to play catch up well into 2025. Again, the stock market is a forward predictor. The price is the price and estimates are just estimates.[7]

3. **Corporate Buybacks-** Buybacks or repurchase plans are when a company purchases its own shares to increase the value of the remaining shares by reducing the supply. In Q1 earnings reports, the amount of repurchase plans announced were quite staggering, especially from the top technology companies, otherwise known as the Magnificent 7. Anyone comparing the fundamentals of these companies to that of the tech companies in the late 1990s needs to have their head examined, in my opinion.[8]

4. **Liquidity**- Liquidity is what drives markets. It's the expansion and contraction of money or credit in the financial system via the Federal Reserve, bank lending or fiscal spending. In the old days, it was mainly the first two but now government spending has been the main driver of liquidity. Even with interest rates at these levels and the Fed doing quantitative tightening, liquidity in the system is more ample than before the Fed started raising rates. This is what the consensus missed last year as you have to go back to the 1940s to find a parallel with this much fiscal dominance in the financial system.[9]

5. **Investor Sentiment**- Sadly, if investors had been following the consensus narrative on Wall Street, they were likely too aggressive in 2022 and too conservative in 2023. Heading into 2024, the average year-end price target for the S&P 500 by Wall Street strategists was 5,117 which is about 4% lower than where it's trading today. After the rally in May, strategists have now revised their estimates for an average, year-end price target of 5,289, still below the current level. The point is, Wall Street is still trying to play catch up to the overall market and that is a good place to be as an investor. [5]

There are certainly risks out there - most importantly, the political and geopolitical environment, inflation, and interest rates. Of course, this all stems from the massive amount of government debt and deficits, in my judgement. But as we've been discussing since the summer of 2020, this type of environment does not create a deflationary credit bust like in 2008. When government debt passes the point of not being able to be paid back in traditional terms, they either default or inflate their way out of it.[10]

Considering the US can print its own currency, they have chosen the later and that has its own set of consequences such as inflation, higher interest rates, increased wealth inequality and social unrest. Unfortunately, this is part of the long-term cycle and has been since the creation of money and credit. Given that the US dollar is the world reserve currency and artificial intelligence is likely deflationary, we can probably kick the can a bit longer before austerity measures are taken. [11]

The good news is that the younger generation is getting a firsthand lesson in how government is not always the answer. In fact, it is often the problem, as the larger governments get, the more it crowds out competition in the free enterprise system. Of course many will say, *but what about the big greedy corporations*? As Milton Friedman so eloquently stated, “We must contrast the difference between big business and a free enterprise system.” 12

The government’s role in a free enterprise system is to promote competition, not hinder it. And if you look at the concentration of industry in the US, there is a direct correlation with their market share and the amount they spend to lobby Washington. 13 While the free enterprise system is not perfect, nothing is! But just like nature or the tides, the more we intervene, the more untended consequences tend to occur. Humans have yet to discover a utopia. But a system that encourages competition, volunteer corporation, and individual freedom has long proven to be the best path for creating greater equality and upward mobility.12

But don’t take my word for it, just look at history and the societies that have chosen the opposite.

All the best,
Gray

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