



Quarterly Investment Newsletter

2023 Q4 Economic and Market Overview



**SOCIUM
ADVISORS**



Economic and Market Outlook

Performance and Market Outlook

Performance

Markets surged in Q4 as the Fed pivoted interest rate policy by indicating the end of the rate hike campaign. This sparked a sharp rally in both stocks and bonds. Notably, small caps, as measured by the Russell 2000 Index, led the charge increasing by 140% in Q4. The S&P 500 added 11.7%. Bonds, as measured by the Barclays Aggregate Index, rose 6.8%.

Market Outlook

- We see the risk to reward in equity markets as skewing positive in the near-term - but the range of outcomes remains wide. Given attractive starting yields and the end of rate hikes, we believe the outlook for fixed income is also attractive.
- With the Fed pivot the odds of a soft landing have increased - although still not our base case given the historical pattern of recession following tight monetary policy regimes. The lagged effect of monetary policy on the economy is still very much in question.
- We see value in the market outside of the magnificent 7 stocks. Specifically, traditional defensive sectors tend to perform well at this stage of the cycle. Small and mid-caps appear to be attractively priced for meaningful outperformance vs large caps on a multi-year timeframe.
- We see a potential recession and rising geopolitical tensions as the most significant near-term risks. We are prudently positioning portfolios that incorporate hedges to these risks.

In client portfolios, as always, we remain diversified to whether any market environment while also positioning to take advantage of valuation and fundamental distortions we see in the market.

The Hiking Cycle is Over = Better Backdrop for Fixed Income

To get inflation under control, the Fed hiked interest rates at the most aggressive pace in over four decades. The speed at which the Fed hiked and the uncertainty of where the terminal Fed funds (peak rate) rate would land, created a difficult environment for risk-based assets over the past 2 years as evidenced by the S&P 500 being roughly flat since the end of 2021.

Fortunately, in December, the Fed telegraphed that the rate hike cycle is over as significant progress has been made in bringing down inflation. The Fed is keenly aware of the lagged impacts of monetary policy, and they view rates as sufficiently restrictive to bring core inflation back to their 2% target over time. The Fed is anticipating 3, 25bps cuts in 2024 while the market is pricing in 6-7, 25bps cut by the end of the year. As we discussed in our Q3 newsletter, a peak in Fed funds results in lower long-term interest rates. This, in addition to, relatively attractive starting yields is supportive of reasonably attractive returns in fixed income from here. This also has important cross sectoral implications in the equity market, which we will discuss shortly.



Rates Set to Move Lower - Relationship between Fed Fund and 10 Year Treasury Yields



Source: Bloomberg; Socium Advisors

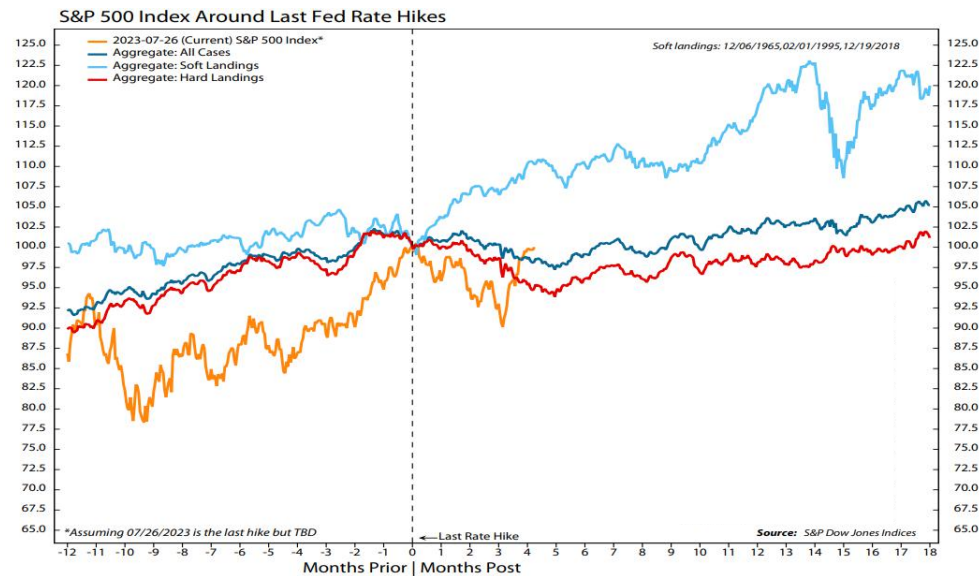
USGG10YR Index (US Generic Govt 10 Yr) rates and fed Daily 23OCT1985-24JAN2024 Copyright© 2024 Bloomberg Finance L.P. 24-Jan-2024 13:11:53

Equity Market Direction in the Near-Term Dependent on Economic Outlook

Historically, after the last rate hike in a cycle, the direction of equities for the next 18 months is highly dependent upon whether the economy experiences a hard or soft economic landing- soft landings typically result in substantial upside while hard landings tend to be more challenging leading to flat to down markets for a period

For simplicity, we define a hard landing as a severe recession with the unemployment rate rising meaningfully while a soft landing would represent an economic slowdown that avoids a technical recession or even a mild, short-lived recession. We believe the odds of a soft landing have increased due to disinflationary trends, the resilience of the consumer, and the recent Fed pivot; however, when monetary policy has been this restrictive historically the economy ended up in recession with things looking good until they suddenly didn't anymore. Soft landings are exceedingly rare. As the future is inherently uncertain, we base our framework in probabilities when structuring client portfolios. It is important to have some protection if the hard landing scenario occurs while at the same time being able to participate in an upside scenario and position the portfolio for high conviction longer-term ideas and themes.

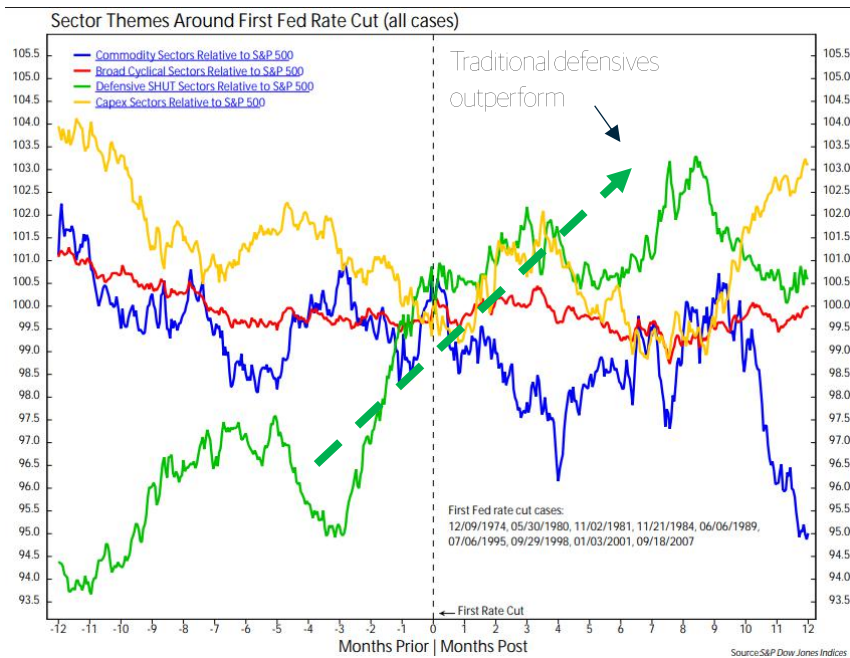




Source: Ned Davis Research You cannot invest directly in an index.

Equities Likely to be Led by Traditional Defensives Over the Next 12 Months

When looking at the end of a tightening cycle and the start of an easing cycle, there is a degree of consistency with respect to what sectors tend to perform better on a relative basis. Traditionally defensive sectors- such as Utilities, Staples, and Health Care- experience meaningful outperformance over the S&P 500 three months prior to an initial rate cut to 9 months after as the chart below displays (green line in the chart below represents defensive sectors). What is particularly unique about today's environment is that we believe purchases in these sectors can be made at significant discounts to the market while getting a relatively more predictable earnings stream than the market with reasonable growth characteristics. Quality- outside of big technology companies - is "on sale." This provides unique portfolio opportunities as quality can be purchased at a discount into what is an uncertain outlook for the economy.



Source: Ned Davis Research

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