

Mixed Messages

According to famed economist John Kenneth Galbraith, "We have 2 classes of forecasters: Those who don't know... and those who don't know they don't know." His comments seem particularly apt after negative economic indicators caused many investment professionals to wrongly predict a recession in 2023.

During the fourth quarter, in an abrupt shift in rhetoric, Fed Chair Jerome Powell said his base case policy was 'no more rate hikes'. In fact, as a group, the Fed Governors indicated they expected to cut rates 3 times in 2024 to the delight of the stock market. This information spurred a further rally in stocks bringing the S&P 500 to a 26.3% return for the full year 2023. Bonds rallied on expected rate cuts, and the U.S. aggregate bond index turned in a 5.5% total return for the year.

Many experts anticipate an economic soft landing in 2024.

In a soft-landing scenario, inflation slows, the economy grows moderately, and unemployment remains fairly stable. The fourth quarter economic data consolidated a number of positive trends along these lines...

1. The inflation rate as measured by CPI (Consumer Price Index) fell from 9% in 2022 to 3.9% in 2023. While it hasn't yet declined to the Fed's target, we are headed in the right direction.
2. The economy grew at a moderate pace of 3.3% in the fourth quarter of 2023, a slowdown from 4.9% in the third quarter. Moderate growth around 2 or 3% is less inflationary than a faster 5% growth rate.
3. The unemployment rate remained under 4%, with a 3.7% reading in December 2023. This rate is low by historical standards.

What could derail this positive scenario?

1. While goods, food, and energy inflation has fallen, services inflation remains quite sticky. It's hard to envision inflation going substantially lower without falling wages.
2. The last mile is the hardest in bringing inflation down to the target. Geopolitical crises could cause commodity prices to go back up again. Conflict in the Red Sea has disrupted shipping, causing container prices and the cost of transport to go up.
3. If the Fed drags its feet on cutting interest rates, the economy may slow too much, causing unemployment to rise and consumer spending to fall. This is the scenario that could cause a recession.
4. If you get into a slowing economy where inflation does not subside, we would have stagflation.

The Fed's balancing act.

- If the Federal Reserve waits too long to cut rates, they can create a recession.
- If they cut rates too soon, they can cause a resurgence of inflation.
- This dichotomy combined with positive underlying economic trends explains why Powell is now showing a willingness to cut rates but hasn't committed to a timeline. He 'knows what he doesn't know' and will wait to see further economic evidence.
- Lastly, a rise in commodity prices could cause inflation – something the Fed does not control.

In the 4th quarter, the Treasury took actions affecting the U.S. bond market.

In October, Treasury Secretary Janet Yellen changed the maturity structure of U.S. debt financing. She increased short term issuance (Treasury bills) and decreased longer term issuance (2-year to 10-year notes). Removing supply pressure from longer maturity treasuries caused their rates to fall. The stock market rallied 15% between her actions and the end of the year (stock multiples generally go higher as interest rates fall).

While Yellen's actions took the pressure off 10-year rates for now, our national debt continues to grow. Ultimately, the Secretary just kicked the can down the road on Treasury financing. Larry Jeddah, a market strategist, suggests "The U.S. is shooting itself in the fiscal foot by failing to restrain fiscal spending and by managing duration on T-debt in ways emerging markets usually do - sell as much as you can on the short end of the curve."

2022	2023
Energy 64.2%	Tech 56.0%
Utilities 1.4%	Comm Services 44.8%
Cons Staples -0.8%	Cons Disc 39.6%
Health Care -2.1%	S&P 500 26.2%
Industrials -5.6%	Industrials 18.1%
Financials -10.6%	Materials 12.5%
Materials -12.3%	Financials 12.0%
S&P 500 -18.2%	Real Estate 11.9%
Real Estate -25.5%	Health Care 2.1%
Tech -27.7%	Energy -0.6%
Cons Disc -36.3%	Cons Staples -0.8%
Comm Services -38.8%	Utilities -7.2%

Our thoughts going into 2024

For the U.S. stock market, 2022 and 2023 were mirror images in terms of sector performance. Most investors are unaware that energy stocks were the winners over the entire 2-year period, which can be seen in the chart below. Energy was up 64.2% in 2022 and down only .6% in 2023. Conversely, technology was down 27.7% in 2022 and up 56% in 2023. Over the entire two year period, the S&P 500 barely budged, turning in a cumulative total return of 3%.

To explain the math of cumulative returns over a 2 year period, we provide a few examples.

If you started 2022 with \$100 invested in energy, it would be worth \$164.2 at the end of 2022 and worth \$164.10 by the end of 2023. If you took that same \$100 and invested it in technology in 2022, it would have been worth \$72.30 at the end of 2022. Even with the strong rally in technology in 2023, that \$100 would be worth only \$112.79 for the 2 years ending in 2023.

Ken Lee & Ben Lanier, Ingalls & Snyder

Given the reversal of sector trends in 2023 combined with mixed messages for the economy in 2024, we think it's prudent to take a more market-like sector approach this year. We reduced but maintained our overweight in energy and materials, increased our exposure to technology and communications which remain underweight, and took healthcare to an overweight versus the S&P 500.

Recently on 60 minutes, Fed Chair Jerome Powell said, 'Integrity is priceless. In the end, that is all you have. And we plan on keeping ours.' So do we.

Contact Us:

Lisa James

lisa@2xwealth.ingalls.net
212-269-7758

Lori Zager

lori@2xwealth.ingalls.net
212-269-7757

The material included herein is not to be reproduced or distributed to others without the Firm's express written consent. This material is being provided for informational purposes and is not intended to be a formal research report, a general guide to investing, or as a source of any specific investment recommendations and makes no implied or express recommendations concerning the manner in which any accounts should be handled. Any opinions expressed in this material are only current opinions and while the information contained is believed to be reliable there is no representation that it is accurate or complete and it should not be relied upon as such. Investing involves risk, including loss of principal, and no assurance can be given that a specific investment objective will be achieved. The Firm accepts no liability for loss arising from the use of this material. However, Federal and state securities laws impose liabilities under certain circumstances on persons who act in good faith, and nothing herein shall constitute a waiver or other limitation of any rights that an investor may have under Federal or state securities laws.

2x Wealth Group is a team at Ingalls & Snyder, LLC, 1325 Avenue of the Americas, New York, NY 10019-6066. If you would like to unsubscribe, please [click here](#).