VAN LIEW TRUST COMPANY

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THOUGHTS FROM OUR CHAIRMAN

In this Winter issue of As We See It, Wade Walbrun reviews the predictions and "play it safe" strategies of many investors in 2023, and some unexpectedly different outcomes - elements of which look to follow through in 2024.

Alfred B. Van Liew

Born on Pessimism

Wade M. Walbrun

As I sit here and think about what 2024 may bring I harken back to the days in late 2022. At that time, the consensus view of nearly all economists and market strategists was for a US recession sometime in 2023. Many expected corporate earnings estimates to fall, the unemployment rate to rise, higher interest rates, and consumer spending to be "tapped out". GDP expectations for 2023 were flat, at best. There was little confidence in the US economy and even less so in stock markets deemed to have only a slim chance of positive returns late in 2023, "after" the recession. Fearing the worst was just around the corner many investors sold stocks and bought short-term bonds and money market instruments that seemingly offered competitive rates of return (around 5%) relative to stock returns. As stock markets pushed higher throughout 2023 many investment professionals remained unconvinced and steadfast in their assertions of weakness in the near future. Despite such a gloomy, bearish forecast, the S&P 500 racked +23% gains by year-end. Such significant market moves seem antithetical to the broad-based lack of conviction by many investors. Or are they? Stock market sage, the late Sir John Templeton once said, "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria". To us, last year certainly seemed to have all the earmarks of the so-called "pessimism" stage. Yet, there are a number of reasons to be optimistic about the US economy and stock markets. Here are just a few.

The Fed seems done raising rates. Unlike during 2022 and 2023, when the Federal Reserve raised the Fed Funds Rate from 0% up to 5.25%, the Fed has not raised interest rates since August 2023. Yet, in the face of the string of strong economic reports that roll in, many investment professionals call for more than the consensus of three rate cuts by the Fed in 2023. Those who call for more cuts seem to suggest the Fed will be compelled to make additional cuts to stimulate a US economy experiencing significant economic weakness. We think this reflects an underlying pessimism. Either way, the old adage "don't fight the Fed" continues to be a simple yet effective way to gauge the investment

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climate. An accommodative Fed, at this time, signals to us the clouds are clearing in the US economy and for stocks, too.

Inflation has backed off significantly. Since the highs of 7% in the Personal Consumption Expenditures Price Index (PCE) back in 2022, the PCE (the Fed's favorite measure of inflation) has fallen down to 2.6%. Views that levels of inflation will remain persistently high have not played out. Inflation, surprisingly, has made steady progress downward in the face of stronger than expected GDP growth, higher interest rates and a steady jobs market. Lower levels of inflation should ease year-over-year costs for all businesses, will help maintain profit margins and support bottom line earnings. As long as inflation continues to move in the right way directionally, stock markets should benefit.

Interest rates look to have peaked. While the 10-year bond yield rose throughout most of 2023 to a high of 5.00% in November, it has since fallen to around 4% after the Fed signaled a pause in further rate increases. Lower interest rates should broadly stimulate the economy, affecting the housing market through lower mortgage rates, banks and lending institution activities and consumer discretionary spending. We think lower interest rates will also encourage increased corporate capital expenditures, as businesses make up for any spending held off in response to the last year's dramatic rise in interest rates and forecasts of recession. This resurgence of cap-ex spending could put a much-needed floor under the beleaguered manufacturing industry.

Unemployment is low. As the Fed raised interest rates in 2023 in efforts to slow down the economy (and thus control inflation), the typical consequences of such actions often show up as weakness in the jobs market. Higher unemployment affects consumer sentiment, consumers desire to spend, and their financial ability to do so. Not so last year. The economy has not slowed significantly and the unemployment rate is still hovering under 4%. With a robust jobs market, continued demand for workers has led to average yearly wage increases of 4%+, a number that finally outpaces the overall rate of inflation. This helps put consumer's finances on a good path. We believe strength in retail sales (up 5.6% year-over-year in Dec.), higher consumer sentiment (the best level since 2021) and robust GDP reports (up 3.3% in 4Q23) are resultant of a healthy consumer. With consumer spending comprising around 70% of the total US economy, a happy consumer should mean a happy stock market, too.

Additional nuggets. We like the investment opportunity in the Artificial Intelligence (AI) push underway, as it seems to have the promise to drive future technology spending and improve productivity. We see such a trend spread out over years and benefiting all sectors. We also believe a portion of the $2 trillion recently put into short-term bonds and money markets to move back into stocks to support further stock market increases as investors get more confident in the economic soft/no-landing scenario underway.

In general, we remain constructive on the latest economic and stock market movements, and optimistic about their future prospects. The time for pessimism appears to be past. We encourage investors to, at the very least, move to the "grow on skepticism" stage. Sir John Templeton would approve.

We would be delighted to meet with you to share comments about this article, or to review your portfolio in detail.

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