ASHTON THOMAS
PRIVATE WEALTH

ASSET ALLOCATION PLAYBOOK

Annual Outlook 2024

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Macro Comments

Recently one of our senior professionals reminded us of a famous quote by the brilliant Danish Physicist Niels Bohr: "Prediction is very difficult, especially about the future."[1] History has confirmed that predicting (guessing) returns of assets is very inaccurate and is considered a loser's game.

Still, with the recent run-up in stock prices, bond yields falling, and risk assets performing better in general than most thought, we want to look ahead to what we can reasonably expect in the foreseeable future. In the wealth management business, whether we like it or not, our job depends at least somewhat on having a clear crystal ball.

Realistically, most of our time in managing wealth consists of following markets, coaching clients on the actions we are (or are not) taking, and generally staying invested through good and difficult markets, while adding value on the margin. Unfortunately, the financial media lives and dies on guests who make our jobs more difficult by professing to know market outcomes, both short-term and long. In November, an economist who is known and respected gave a shockingly honest answer when asked for his end-of-year market predictions on a financial news program: "I have no idea, and neither does anyone else who sits in this chair."

We tirelessly try to understand what is predictable and what is not. What model has shown accuracy, and to what extent? Predicting the future is probabilistic, meaning a "method or model…based on the theory of probability or the fact that randomness plays a role in predicting future events."[2] The fact that there is always randomness in predictions, in and of itself, makes them inaccurate. A "fault" of investors is that sometimes they do not see the randomness or inaccuracy of models or opinions in predicting markets.

1 https://www.goodreads.com/author/quotes/821936.Niels_Bohr
2 https://www.statisticshowto.com/probabilistic/

Macro Comments

We do know, however, that certain relationships generally hold true. When interest rates go up, stocks tend to go down, and vice versa. As interest rates rise, bonds become more attractive and compete for capital with stocks. Stocks can also become less attractive due to diminished future cash flows. As debt service increases, corporate cash flow decreases to cover the higher cost of debt service, and thus, negatively impacting stock prices over a long enough time horizon.

However, looking at history, we can learn several things. From approximately 1945 to 1981, the United States encountered a rising interest rate environment as measured by the 10-year Treasury Bond. Within that timeframe, we witnessed two wars, government overspending, and some serious inflation. As rates went from approximately 2% to 16% over that time, the cumulative average growth rate (CAGR) of stocks was 5.7% a year. Once the Federal Reserve got inflation (and thus rising rates) under control, the CAGR from 1981 to approximately 2021 was a much more attractive 11.8% a year. So, one thing we can interpret is that rates rising at that magnitude generally serve as a headwind for equity returns, while falling rates act as a tailwind.

Ashton Thomas is not predicting returns coming back to 5.7% CAGR a year, given that some great companies with bright prospects are included in the index. But we do agree that 11.8% CAGR in a higher—or at least relatively high—rate environment could dampen returns going forward. To predict the exact number is, again, a loser's game subject to inherent inaccuracy.

Source: Strategas

Macro Comments

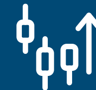
"Caution. The following contains observations which might prove inaccurate." – An Economist

While the quote is certainly intended to be read tongue-in-cheek, we are presently observing several things which can be construed as going in a positive direction. The rate of inflation is declining to the point where the Federal Reserve (the Fed) will probably go ahead and lower rates in 2024. It appears that economic policy has slowed inflation to where it will probably not have an impact on employment. *Probably* is the key word here.

In the last couple months, we have been in a risk-on environment where "animal spirits" have taken over. Given where valuations are today, the probability of markets matching 2023 returns appears low. We hope the Fed does not expand its balance sheet materially and the government gets hold of its spending. With deficits approaching more than 6% of Gross Domestic Product (GDP), and total-debt-to-GDP of roughly 100% despite being in an era of relative peace and full employment, economic gravity stands a chance of taking over, meaning inflation and higher rates stand a chance of a second wave.[3]

The optimist in us looks at artificial intelligence (AI) or some form of government austerity helping to keep both inflation and interest rates at acceptable levels.

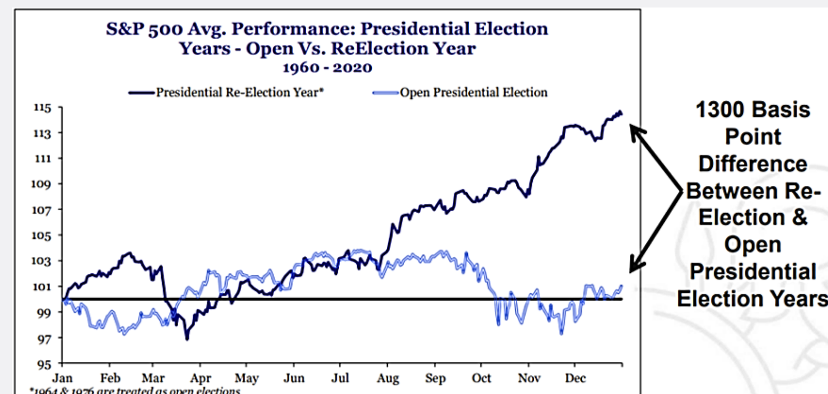
3 https://www.cbo.gov/publication/59331#:~:text=forecast%20underlying%20them.-,Deficits%20and%20Debt,percent%20of%20GDP%20in%202053



As with any prognostication, a good economist will always say, "Well, on the other hand…" The positives and negatives of the current environment are as follows.

Various Positives

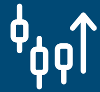
- Approximately 40% of the world's market capitalization is undergoing national elections.[1] To the extent governments can help boost economies, they will. Elections in which the incumbent is running generally do well as equity markets have increased in every presidential re-election year since 1944—16 out of 16 years. This is usually attributed to both monetary and fiscal policy being much looser than in other years.
- The drop in yields since late October has provided a tailwind to all risk assets. Rates stand a good chance of dropping further as "sticky" inflation subsides.
- The flood of liquidity released by the Treasury is still filtering through the markets. Additionally, markets are assuming the Fed will be exceptionally accommodating over calendar year 2024 and lower rates 4 to 5 times.[2] We at Ashton Thomas are somewhat skeptical about seeing so many rate cuts in a short amount of time. If the Fed does lower rates to that magnitude, it will imply a weak economy, potentially triggering a second wave of inflation.
- As with any year, the risk of recession stands. The silver lining is if we do experience negative economic growth, employment should hold up, and the Fed still has ammunition to lower rates to kickstart the economy.
- A decrease in wage inflation could directly lead to expanding profit margins.
- Should rates take longer to fall, the dollar could weaken, and exports strengthen.



Source: Strategas

1 Strategas – Policy Levers 12-23 (PDF on file)
2 https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html

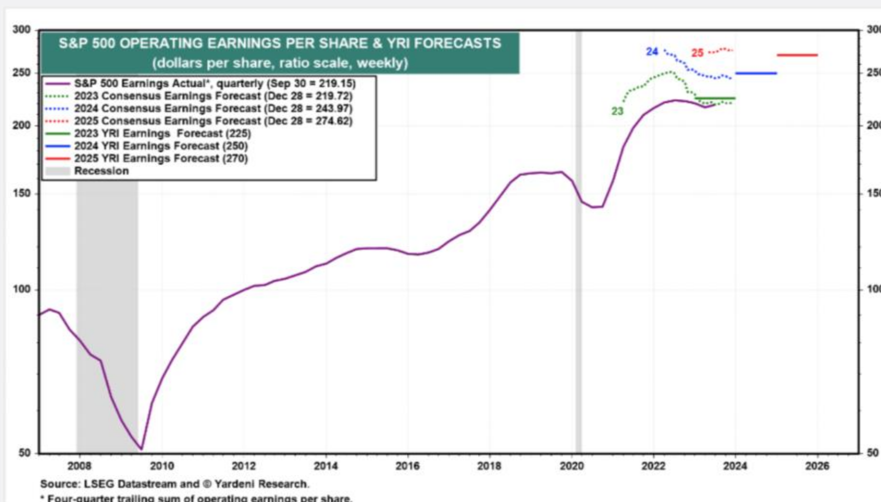
Equities



Various Negatives

- In 2023, the much publicized "Magnificent 7" led the way in performance. Where total S&P 500 earnings were flat, they were up 33% for those stocks and down 5% across the rest of the S&P. 2024 could be a year of positive, yet slowing, economic growth with potentially single-digit earnings growth and single-digit returns. A major point going forward which few investors are factoring in is potential antitrust issues. Google, Apple, Meta, and Amazon are all facing lawsuits from the FTC/DOJ. Anticompetitive activities pose a major risk to these companies, possibly triggering Glass-Steagall legislation and breaking up lines of businesses.[3]

- In general, earnings expectations for 2024 are positive, but they have come down recently (chart on *lower left*, blue line). Will the negative momentum continue?
- Equity risk premiums (the return required to move from bonds to more risky stocks) is presently at a point where bonds are more competitive against stocks than they have been in a long time. Although not a hard and fast statistic, historically bonds outperform stocks in the short run when this level is achieved. (See chart on *lower right*.)

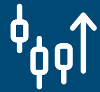


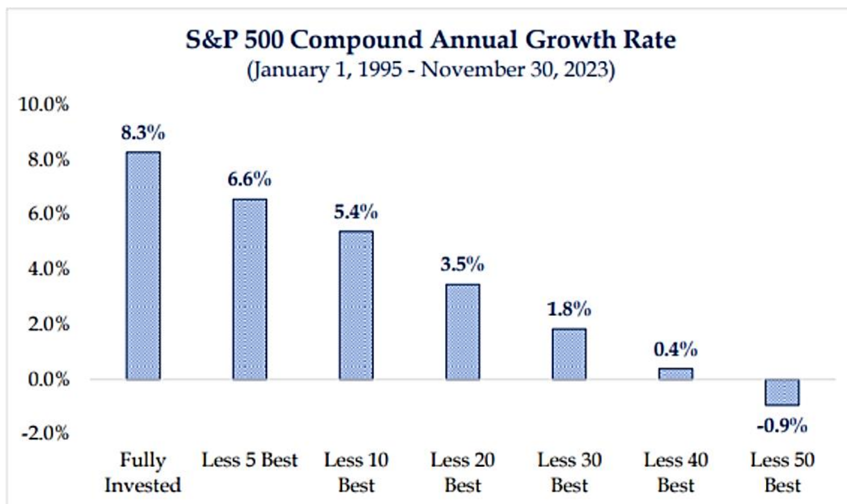
Source: https://yardeni.com/charts/yri-earnings-outlook/

Source: Strategas, Standard & Poors, Bloomberg

3 https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/eye-on-the-market/outlook-2024-amv.pdf#page=3

Equities





Source: Strategas

Finally, we want to revisit a classic chart which reminds us of some basics of investing. As mentioned in the macro notes, timing the market and guessing where it is going is nearly impossible, particularly in the short term. Market timing sounds great in theory, but it is extremely difficult (and can be expensive) in practice. The conclusion is that returns over the long term generally depend on being invested a very small percentage of time. Any portfolio which happened to miss the best five days in the market since 1995 (a very small percentage of the overall timeframe) would underperform a portfolio that stayed invested (did not time the market) by nearly 1.7% a year. As the old advisor adage goes: "Time in the market is much more important than timing the market."

Fixed Income

The second half of 2023 saw heightened volatility in the fixed income markets, which became the theme of fixed income for 2023. From July through December, we saw inflation prints and expectations start to wane, with expectations for a pause in rate hikes from the Fed. Both the Consumer Price Index (CPI) and Producer Price Index (PPI) figures began to print lower, yet still showed inflation sticky to the upside, especially in Services and Wages. The Federal Open Market Committee (FOMC) of the Federal Reserve Board chose to "pause" rate hikes for much of the second half of 2023, and their dovish commentary, especially as the year ended, pointed to potential cuts in 2024.

Inflation worries eased considerably as the year drew to a close. Both the CPI and PPI continued to print lower (and below consensus expectations). November CPI, the last reading available, printed at a somewhat tame 3.1% year-over-year, down more than 50% from the reading in January 2023 of 6.4%. PPI printed at a -0.9% year-over-year, down from the 8.8% reading at the beginning of 2023. As both figures showed less inflation pressure—and perhaps a worryingly *deflationary* print for PPI—it was enough to warrant a pause from the fixed income markets for essentially the last six months of 2023. Additional data coming in showed some easing in inflationary pressures in the employment market. As the unemployment rate ended the year at 3.7%, up from 3.5% to start the year, the Fed had the justification needed to pause without surprising the markets. Wage pressures, however, continued to weigh on inflation, with Average Hourly earnings printing up 0.4% month-over-month and up 4.1% year-over-year.[1,2]

Our opinion is that, although inflation pressures are less than they were a year ago, they are still there and still sticky. If the Fed cuts too fast and too much in 2024, they run the risk of reawakening inflation and, thus, having to hike again. Couple all this with 2024 being a presidential election year, and you have a recipe for potentially dramatic swings both in equity and fixed income markets, with additional potential for short-term volatility across the board.

1 https://tradingeconomics.com/united-states/average-hourly-earnings
2 https://tradingeconomics.com/united-states/average-hourly-earnings-yoy

Fixed Income

The U.S. Gross Domestic Product (GDP) data released in September showed a robust uptick in economic growth, printing at 4.9%. Sentiment improved, especially in the second half of 2023, as measured by the University of Michigan survey, showing renewed optimism and easing inflation expectations. Consumer Sentiment, Expectations, and the Current Economic Conditions Index all rose, as respondents seemed confident the Fed has inflation at least partially under control.[3]

There is one item of note. This optimism may be somewhat short-lived, as student-debt repayments have resumed and many retailers are still predicting a cautious consumer for the next three to six months, citing consumers who have become aggressive bargain hunters. Some of this renewed positive sentiment is certainly due to less inflationary pressure, but we wonder how much of it is euphoria from an S&P 500 that finished 2023 up more than 26%, a NASDAQ 100 that finished up more than 56%, and an aggregate bond market up more than 5% (all as of the December 29, 2023, close).

As noted in previous Playbooks, to stop inflation in its tracks, it is widely believed the Fed Funds Rate needs to be about 200 basis points above CPI. We appear to be there based on the last CPI prints. In fact, Fed Funds Futures are pricing in a greater-than-70%-chance of a 25 basis point rate *cut* at the March 2024 FOMC meeting, and a *100%* chance of a rate cut by May.[4]

3 http://www.sca.isr.umich.edu/
4 https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html

Fixed Income

What to Expect

- Volatility, at least more than usual. As we know, markets hate uncertainty and love predictability. The Fed has been working hard to reduce the former and increase the latter. Bond markets try to stay about six months ahead of the Fed, so new data (especially conflicting data) will result in daily swings in yields. Additional swings in rates and rate decisions will be heavily data dependent—especially as driven by the CPI, PPI, Personal Consumption Expenditures (PCE) Price Index, and employment.
- Greater probability of a light recession and still significantly tighter lending standards. Although the Fed has certainly pumped the brakes on Quantitative Tightening, the reality is that the banking sector is "finishing the job" for them. Banks have consistently raised lending standards since the Fed began tightening—and significantly so throughout 2023. This is particularly evidenced by the rise in private equity (PE) financing and non-traditional lenders originating loans where banks have said "no." If this trend continues, and we think it will, banks will continue to reduce the velocity of money, which should naturally lead to an economic slowdown: less borrowing, less spending, less consumption, and muted expansion.
- Continued utilization of Money Market Funds and quasi-Treasury proxies. Many depositors and investors holding cash continue to shift out of "sweep" accounts paying 0.40% or 0.45% into Money Markets, Treasuries, and CDs—all paying north of 4.75% in the Taxable debt space. We expect to see further flight to high quality products and/or Treasury proxies.
- We believe fixed income investors should stay nimble and act opportunistically. We continue to lengthen duration into the 3-year to 10-year range for fixed income portfolios (where appropriate), taking advantage of rates as they rise and locking in high rates as the market starts to price in cuts into 2024.
- In the Corporate space, we continue to watch several sectors, including Banking and lower rated Consumer Discretionary names that require ongoing financing. We are still actively staying away from Commercial Real Estate exposure, as it is the most shorted segment of the market right now, and the dynamics of work seem to have permanently shifted to favor work-from-home trends. We add that, although we no longer see a run on banks, we are still witnessing assets being slowly "walked away from" regional banks into money market funds. We expect to see money market outflows if investors start to really chase the red-hot tech sector once again. When considering consumer discretionary spending, be mindful that the end of the student loan debt jubilee is here and will have a negative impact on purchasing power, along with a much more cost-conscious consumer.
- In the Muni space, we still favor quality names and extending duration into the 3-year to 10-year space. We believe attractive opportunities exist for yield pick-up, especially with continued volatility across the curve. We are actively staying away from Hospital and University paper, unless they are of superior quality and offer credit support. We continue to see very low new-issue volume, leading to slightly elevated prices from a lack of inventory.

Asset Allocation Playbook

Supporting Your Wealth Advisor

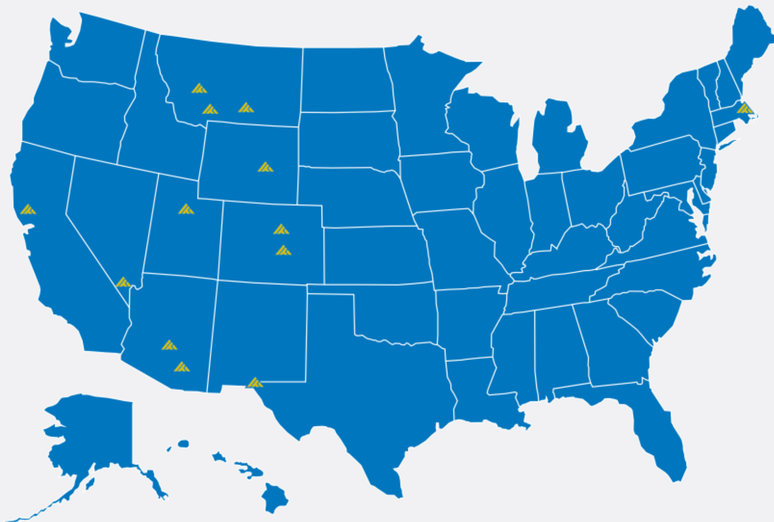
Our Commitment

For more than a decade, we have served wealth management clients and their advisors with an unwavering commitment to our CREDO. As Ashton Thomas continues to grow and innovate, these principles will remain in focus for our team members and all parties serving your wealth management needs.

COMMUNITY
RESPECT
EXCELLENCE
DISCIPLINE
OPPORTUNITY

Our Footprint

Ashton Thomas Private Wealth is headquartered in Scottsdale, Arizona. We actively serve clients throughout the country and have 13 offices in nine states:



Asset Allocation Team

Our experienced Asset Allocation Team works with your advisor to keep your financial goals in view and your investments on track for the long term.

From investment research and due diligence to portfolio construction to trade execution and support, our team is focused on providing investment solutions which are tailored to meet your ongoing needs.

Mike Serio, CFA®, CAIA®, MBA
Chief Investment Strategist

Claudiu Barbos
Director of Investments and Trading

Ron Piccinini, Ph.D.
Director, Head of Investment Research

Brandon Cromer
Portfolio Manager, Assistant Director of Investments and Trading

Kodi Thruston
Investment Analyst

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The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

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