**Investment Update**



# **2024: Don’t bet against anything…**

Any genuine recap of 2023 must involve several exclamation points. What a unique year! Who among us would have expected a stock market surge of over 25% given the headwinds we encountered (and still face)?

Likewise, any 2024 outlook should involve as many question marks as periods. On a recent call with JP Morgan, one of the speakers remarked that the strongest conviction was the lack of conviction in the marketplace. It isn’t for a lack of trying to project and anticipate…it’s simply been near impossible to script the market’s moves post-Covid.

Below is a sampling of what some of Wall Street’s brightest and most accomplished managers and economists see ahead in 2024:

* JP Morgan: S&P year-end 2024 4200 and 10-year Treasury yield of 3.65%
* Morgan Stanley: year-end ’24 of 4500 for the S&P 500; focus on quality and free-cash-flow yield
* Tom Lee at Fundstrat: 5200 for the S&P 500 by YE ‘24
* Deutsche Bank: 5100 target on S&P and 4.1% 10-year yield
* Amundi (Europe’s largest asset manager): first half ’24 recession
* NY Life: 60% likelihood of a US Recession
* Goldman Sachs: YE ‘ 24 S&P 500 at 4700 with 4.6% 10-year Treasury yield
* First Trust economist Brian Wesbury’s 2024 outlook are “2024 will be a tough year.”

So, to summarize…there are many accomplished investment professionals whose outlooks vary widely. Ultimately what the stock market represents is an aggregate of the viewpoints of all its participants.

**So, what’s our take? What does HIP suggest doing with this information? What are our “best bets” headed into 2024?**

For those who read this newsletter regularly, much of this may sound familiar (but worth a repeat, nonetheless). Our positioning bias for 2024 breaks down into 4 main themes:

* Quality
* Cash flow
* Patience
* Balance

**QUALITY:** While few can describe an environment where quality is out-of-favor, there are economic periods when low-quality, heavily levered companies outpace more established peers (i.e. 1995-99). To us, quality isn’t a discussion about large cap vs. small cap or value vs. growth, but rather one about balance sheet, business stability and growth, and economic moat vs. competitors.

There are dominant large cap value names worth owning (JNJ, PG, HD, etc.) just as there are growth names (MSFT, NVDA, AMZN, etc.). We don’t believe it to be an either-or decision when speaking of growth and value. The same holds true for small and mid-cap companies. We prefer companies in these areas with low debt and positive earnings. As we enter 2024, we believe there are few reasons to venture far beyond the best of the best brands and leadership teams.

**CASH FLOW:** Cash flow refers to both the equity and fixed income allocations of one’s portfolio. In bonds, allocating beyond short-duration and money market will help diminish the reinvestment risk in 2024. Furthermore, absent a surprise mass credit event, the spread picked up versus treasuries can also be quite meaningful. There are currently investment grade bond portfolios paying 2-3% more than comparable treasuries. That figures likely goes a long way toward total return in 2024.

In equities, dividend-paying equities figure to fare better versus growthier peers. Additionally, non-US dividend payers are particularly appealing, given higher starting yields and lower starting P/E ratios. Several of our equity strategies boast incomes over 5%. This cash flow, coupled with reasonable starting valuations and the potential of appreciation make these strategies poise to fare well if ’24 results in more muted results for the broad markets.

**PATIENCE:** Entering 2023, most “experts” agreed on a ’23 recession…the debate was on its timing. Our approach was to be defensively postured, but fully allocated. As another 12 months have passed, the recession is still not upon us, and the pundits are saying a lot of the same things as 12 months prior. And we recommend patience with those portions of the allocation that have lagged in ’23. Dividends, value, and bonds (until the last 8 weeks) all fared relatively poorly in 2023 versus the Magnificent 7.

As we recently suffered the passing of Charlie Munger, we are reminded of his greatest contribution to Warren Buffett’s investment approach. Rather than the dirt-cheap “cigar butt” companies that Benjamin Graham advocated owning, Munger recommended paying a fair price for better businesses. The rest is history.

To us, being early to own high-quality, dividend-growing stocks doesn’t make us wrong. Allocating to great non-US brands still makes sense. Owning a blend of credit-sensitive and duration-sensitive bonds is justified and prudent. Patience isn’t sitting idly, but rather intently watching to see what (if anything) warrants a change. For both a professional and retail investor, doing less is often the hardest task! Given how we are positioned entering 2024, we will not be surprised to be a bit less “active” in 2024.

**BALANCE**: Rarely has the S&P 500 so dramatically outpaced more diversified portfolios. Entering the year’s final 2 months, nearly all of the index’s returns were attributable to 10 stocks, while small-cap, mid-cap, and bonds hovered around even for the year. The Q4 surge resolved a bit of the gap, but it nonetheless remains. Furthermore (FactSet, as of 9/30), valuations of large-cap US Equities traded ~30% above their 20-year average while small-cap value traded at 84% of its 20-year average.

We aren’t selling out of mega-cap growth, but rather scaling it less aggressively than returns would tempt one to do. We believe the diversified and risk-managed portfolio we oversee have a chance to meaningfully outperform in 2024.

We entered 2023 believing we were positioned to meaningfully outperform in fixed income…and we did. Even with the late-year surge by the AGG, our fixed income strategies outpaced by 3-5% with less volatility. While that outperformance in bonds may be difficult to duplicate in ’24, we are pleased with where we sit and believe the outperformance in ’24 could come from other parts of the portfolio, namely equities.

As we enter 2024, we do so with strategies designed to participate while also playing defense. Some will do so mechanically (i.e. Buffered ETFs and structured products) while others do so through security selection and discipline (i.e. Cash Cows and Covered call strategies). These are not new components for most clients, but essential to navigating what even the most seasoned experts call confusing and uncertain times.

***To sum it all up, don’t place big bets on predictions about 2024***. Whether it’s a grind higher or a choppy year, we believe we are positioned to hold up well.

**But if i was a betting man…**

***OK, betting is a poor choice of words. What exposures would we want (knowing the potential volatility along the way) that we believe could have huge upside potential over the next 5 years?***

Following is a list of themes we believe could provide investors with outsized gains if they fully materialize:

* India
* Japanese equities
* AI-related companies
* Cybersecurity
* GLP1 (weight-loss) drug companies

A well-diversified portfolio cannot help but have exposure to each of these opportunities. Nevertheless, we share this list because some clients want increased exposure to high-conviction ideas at times. ***If that’s you, please reach out to us to discuss it with us at greater length.***

India is now the world’s most populus nation, a young democracy with a young population. Many draw parallels to China at the turn of the last millennium. Japan, in contrast, boasts a very old population, but great businesses that are being encouraged to modernize their approach to capital allocation and growth.

AI seems destined to be a game-changer, but whether that change is akin to the 4G/5G scale change or that of the introduction of the internet remains to be seen. A lot of optimism was baked into the price of pioneers in the AI space in 2023. This one will likely take some patience in the next 2-3 years to reap the full reward.

Cybersecurity was the buzzword of the year about 5 years ago but is more critical now than ever before. The list of hacked, breached, or ransomed companies is mind-boggling. I’ve yet to hear of a CEO declaring that his company will spend less on cybersecurity any time soon. It will not be surprising to see leadership in this space continue to grow at 15-20%/year over the decade ahead. Ownership of these companies exists across traditional strategies, but specialized ETFs also exist.

Perhaps the biggest game-changer of 2024 will ultimately be the approval of the GLP1 drugs for weight-loss. Not only can the 2 companies each garner huge profits but expect further research and innovation to emerge because of these approvals. Biotech has lagged in 2023, but don’t be surprised to see some big wins ahead in the coming years…Covid sped up the approval and timeline of several technologies and AI makes processing data faster than ever. Throw in the collaborative software capabilities introduced during Covid and we will be shocked if many new therapies aren’t upon us in the next 5-7 years.

**2024’s Best Bet could again be bonds**

The final two months’ rally in bonds during 2023 pulled forward returns many anticipated from bonds in 2024. That doesn’t leave bonds unattractive, however.

The Federal Reserve’s latest statement and press conference reinforced the idea that rates have peaked and that cuts are ahead. The timing, scale, and speed are still very much TBD.

As noted in the opening section, year-end projections for the 10-year treasury still vary widely. We would not be shocked if it ends the year about where it starts…with some uncomfortable swings along the way.

As a reminder, bond strategies vary as widely as those for stocks. Across strategies, yields are meaningfully higher than at most points this century. Furthermore, the credit complex remains generally healthy. Couple high absolute yields with flat to declining yields and it’s easy to see bonds offer a healthy return in 2024.

What we are NOT recommending is a big “reach” for duration. While a longer duration would have been rewarded in November and December, it was punished the prior 2 years. We have been systematically adding duration for clients to give us less reinvestment risk and to capture higher yields for longer as we also upgrade the credit quality of portfolios.

Adding duration for our clients has meant that we have moved a portion of allocations from short and ultra-short to the 3-4 year part of the curve. Most of our diversified fixed income portfolios project an income stream of ~6% for the year ahead and a duration less than half that of the AGG(3-3.5 years).

We maintain confidence in and risk-managed allocations to equities headed into 2024. It would not shock us if our fixed income returns for clients approach or exceed that of the S&P 500 in 2024.

# **Don’t Bet Much on your Candidate…**

Each election cycle, we try to remind clients how minimally the Presidential election impacts the returns of the stock market that year and those that follow. It isn’t that the outcome doesn’t matter, but rather that the proposed/feared policies of a candidate seldom have huge nor immediate impacts.

Too often investors allow political preference and the fear/excitement of a candidate to cloud their judgment as investors. Investing based on the road ahead is far better than driving while looking only in the rear-view mirror. An investor who doesn’t like the current administration would have missed a double-digit return in 2023 by sitting on the sidelines. Investors who sold overnight after the 2016 election were punished for the negative bet on the Trump victory.

A year from now we will have plenty of content for a lengthy newsletter. There will be shocks, surprising outcomes, and “I told you so’s.” Some event or technology may come out of left field and catch most by surprise. Count on it…but don’t try to avoid everything!

Rather than an election year, perhaps think of it as a Leap year or Olympics year. A lot will happen in the next 366 days, and we will be here working hard to care for you all along the way.

 

***Stay patient and avoid big bets in 2024***

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