Time Is A Flat Circle: Part Deux

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- YTD, the S&P 500 has provided investors with a 16% total return, roughly 5% greater than our original year-end 2023 expectation published in our 2023 Outlook. However, the year is not over.
- We remain puzzled about the resilience of the capital markets, given current valuations combined with the deluge of negative headlines and potential for geopolitical and economic disruption, which we highlighted in our recent note entitled "The Dog Days Are Here."
- The S&P 500 is currently trading at a forward price-to-earnings (P/E) multiple of 18.4x, compared to its long-term average of 17.0x. Further, stocks are not cheap compared to bonds. As we highlighted in our 2023 Outlook, the long-term average for the S&P earnings yield (a comparison of yield prospects of the S&P 500 to the 10-year U.S. Treasury Note) is 285bps, compared to only 95bps currently.
- The Federal Reserve remains concerned that inflation poses an economic threat while attempting to orchestrate a soft landing for the economy. However, our confidence in achieving a soft landing is less than 50%. In fact, a soft landing was achieved only 33% of the time over the last 11 economic contractions, according to research conducted by Alger. To this end, we continue to reiterate our expectation for a shallow and short recession by mid-year 2024. The caveat herein is that the NBER typically conflates signal from noise and will again be late to declare the recession has started officially.
- Add to all this is the self-inflicted bout of amnesia suffered by many capital market pundits who may have little to no appreciation for history or aren't old enough to remember the lead-up to the last several recessions. As per Walt Whitman, "...history never repeats itself, but it often rhymes." Less sanguine adaptations of a similar paradigm can be attributable to Winston Churchill, who said, "Those that fail to learn from history are doomed to repeat it," or even a more esoteric version by Nietzsche, suggesting that "...time is a flat circle." The common theme is that human beings are bound to repeat the same mistakes.
- So, we continue to caution investors and clients. In the aggregate, we may be early in our prognostication for the equity market and economy, as in Part I of "Time Is A Flat Circle." However, history is on our side, and it has only been four months since we began to dial back risk. We are finally noticing Consumer Discretionary names (think homebuilders, leisure/hospitality, and retailers) roll over in favor of Healthcare and Utilities. And let us not forget that almost 75% of the YTD return for the S&P 500 has been driven by the Magnificent Seven (AAPL, AMZN, GOOGL, MSFT, NVDA, META, and TSLA), an equal-weight S&P 500 Index is higher YTD by only 5%. So, in our opinion, markets – much like the economy – may meet notable resistance in the near term. Apart from continued labor market resilience, unprecedented capital market liquidity borne from the COVID pandemic is finally dissipating, and the "new normal" is really the "old standard" relating to yields, equity market returns, and economic growth – for those of us who can remember!

We'd love to hear your thoughts!

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