

Market Outlook:

The “Jack La Lanne” effect

At the beginning of every new year there always seems to be a heightened volume of emotion regarding investments...renewed hope, dreams, and expectations. On January 1st all things seem possible for the year ahead. Any persistent pessimism or sadness regarding unfulfilled goals are now in the rearview mirror. And yet, this amplified optimism is anathema to those of us in the quantitative sciences because we don't necessarily live in a world defined by the calendar...more specifically, a twelve month delineation comprised of 52 weeks. Rather, trends are defined by us as measurable cycles indifferent to labels like “January” or “May”. The denominator in our equations does not mathematically correlate with the change of seasons, specific holidays, or the turn of a page.

That is why it is particularly vexing this time of year to hear moderators and talking heads in the media pontificate about whether or not the markets are already “*on track*” or “*off on the wrong foot*”. To be clear, we hold no animus towards optimists, nor are we anti-renaissance. But when deciding between science and misplaced euphoria, particularly in the area of portfolio decision-making, we are decidedly pro-science.

Let's just agree that markets are inexorably linked to myriad global phenomena and that we all wish for sufficient (investment) outcomes.

The economic data is incontrovertible: the steepest rate hike cycle in decades is near completion; consumer spending and inflation are discreetly receding; the post-Covid spending binge has increased household and corporate debt; unemployment has declined from a high two years ago of over 6% to nearly 3.7% today; a “soft landing” is more likely than a full-blown recession; and the rally in stocks accelerated because traders and speculators fueled a buying spree, worried that they might miss out on gains if they weren't “in it”.

We know that monetary campaigns have insufficiently captured the imagination of the marketplace. Issues like mortgage affordability have dampened enthusiasm in the real estate market. *Policy and people* are at odds over whether these monetary strategies are getting the job done in a way that serves the need of the consumers. We have a *moral dilemma* in the midst of a *practical problem* about how money is appropriated for kitchen table economics. The wealth gap favors those who already have the money. When policy is seen as the impediment to a solution, market trends quickly devolve and the public loses its altruistic enthusiasm.

Because investors become infatuated about believing that January 1st represents some kind of spiritual annual rebirth of opportunity and optimism, many are losing focus from the underlying secular trendlines. It's kind of like signing up for a gym membership every January, ever optimistic and hopeful that this is the year of our ultimate success.....until our attention and commitment is diverted elsewhere!

Cycles....not hyperbole

As part of this secular macro “bigger picture” it is more important to recognize that at any date (or data) is a *snapshot*, a part of a longer continuum in an adventure to get from here to there. The terms *magnitude* and *duration* represent a quantifiable plethora of possible outcomes. While sentiment is valuable, statistics and stochastic integers are more conclusive in the exercise to determine efficient portfolio allocations.

Our models are showing a distinct shift in sector weightings this year. Consumer discretionary equities are particularly vulnerable to pricing pressure and diminishing demand. Higher core costs (commodities) are affecting earnings and supply chains (inventories). Filling the gas tank is an onerous proposition for many families. The recent modest decline in inflation takes a long time to unwind completely, measured in years not days or weeks. We still see emerging opportunity in sustainable socially responsible themes (agriculture, energy, infrastructure).

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The bottom line this week, and going forward, is to find and invest in earnings and accelerating trends. The economy is healthy enough (in spite of shortcomings and inefficiencies) to sustain innovation, morality, and profits at the same time. We anticipate breakouts, not breakdowns, from our portfolios in the coming weeks.

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