

Straus Group 2024 Economic Outlook and Market Commentary

The highlight of last year was the U.S. economy. Its performance exceeded most investor expectations and, in some instances, by a wide margin. Looking back, in January 2023, there were doom-and-gloom forecasts all around. The debate centered around in which calendar quarter would the expected recession begin. Throughout it all, economic fears were avoided, and the stock market moved steadily higher. The \$2.5 trillion of stimulus following three regional bank failures helped the economy but pushed the federal deficit higher than what was expected. Long-term oriented investors, like ourselves, with a focus on fundamentals maintained our discipline and grew client capital last year, as a result.

Now, as we enter 2024, the consensus outlook is more challenging for a contrarian. Today, there are generally more optimistic forecasters than negative ones. Fortunately, many of the core factors required to have a continued strong economy seem to remain in place:

- Unemployment at year-end 2023, is at a very healthy level of only 3.7%. The number of unemployed in the U.S. is approximately six million versus some 160 million who are gainfully employed...while there are roughly nine million job openings. Stated differently, the number of those currently looking for jobs exceeds the unemployed totals by some 50%.
- In addition, the back of inflation has clearly been broken and the June 2022 peak CPI inflation level of 9.1% has proven to be the top of this cycle. We are currently enjoying a much-reduced inflation level of around 3.0%. That is not a bad position for the U.S. economy to find itself in.

Interest rates are perhaps the most interesting and complex observation of all. The 10-year Treasury Yield, which made an all-time low of 0.45% in July of 2020, rose to a peak of approximately 5.4% earlier in 2023 and has now receded to 4.1%. Meanwhile, the Fed Funds Rate remains at its recent peak of between 5.25% - 5.50%. The importance of having the Fed Funds Rate held at this high current level is that it gives the Federal Reserve (the "Fed") the equivalent of a new and powerful tool in its arsenal to cushion any economic weakness that might develop over the next 12-18 months. Rising interest rates increase the cost of capital restricting economic growth, whereas falling interest rates often accelerate economic growth. One of the principal reasons for the strong 4Q23 stock market is the realization that the Fed now has a "Put Option" with which to fight economic weakness. This has brought about a much-improved change in the tone and actions of investors toward the equity markets.

Goldman Sachs analysts recently came out with a forecast that the Fed is likely to announce three rate cuts of 0.25% (25 bps) each during the months of March, May and June of 2024. Goldman further believes that this will be followed by further rate reductions of 0.25% each calendar quarter through the third quarter of 2025, at which point the Fed Funds Rate will have declined to between 3.25% - 3.50%. This forecast assumes that there is no interim upward boost in the expected rate of inflation. This also highlights why we believe that 2024 will likely become a carefully watched and monitored year in the stock market.

There is currently a record high level of some \$5.5 trillion invested in money market funds. As of this writing, the 6-month and 12-month US Treasury yields are 5.0% & 4.8%, respectively... while the 5- and 10-year Treasury yields are 4.1% & 4.2%, respectively. The 10-year Treasury Yield peaked out at 5.4% in early 2023 and we believe that it is probably on its way to a more normalized range of between 3.8% - 4.2%. Assuming that shorter-term money market and Treasury yields decline by perhaps 0.75% - 1.0% from their current levels, funds could be freed up for investment in equities and other alternatives.

Another major strength of the U.S. economy relates to how solidly the American consumer has been spending on goods and services. Part of this consumer-related financial strength has been due to the last portion of buildup in cash reserves that was brought about during the March 2020 – December 2021 period, related to COVID-19. As the vestiges of COVID-19 wore off, the \$2.5 trillion in estimated built-up consumer "excess" savings began to get spent; consumers began traveling again... and retail sales grew very strongly. Concurrently, consumer savings (which historically has ranged between 6% to 7% of personal disposable income (PDI)) were reduced to an almost record low of some 3% of PDI. More recently, the savings rate has risen back toward 5%. Also, the single largest investment held by the American consumer...their home, still held firm at approximate record level prices despite the 2 ½-year upsurge in the 30-year mortgage

rate from 3% to 8%. The fact that few borrowed at this elevated rate meant that home prices experienced little impact from the change in affordability.

There is an economic belief which we subscribe to stating that the American consumer spends at a rate commensurate with how wealthy they feel. Unemployment is still within a few tenths of a percent above of an all-time low...essentially everyone that wants a job has a job. And most consumers feel secure in their jobs. While there are roughly six million unemployed in the United States, there are approximately nine million widely publicized job openings. In addition, while above average levels of wage increases have been experienced in this country, the lower quartile of compensated workers have experienced a much greater percentage increase in wage income.

A number of negative forecasters have been projecting the eminent onset of a recession and significant future economic weakness in the U.S. Thus far, these forecasters have been proven wrong. Such weakness has not occurred, and the U.S. stock market has remained strong. Also, many American consumers have Social Security, 401(k) plans, pension plans, profit sharing plans, and other sources of longer-term allocations to equities or recurring income. And when 401(k) plans and pension plans rise in value, this contributes to an improved "wealth effect" and this encourages consumer spending.

There is no doubt that we are confronted with many serious challenges. The answers to how some of these major problems get resolved are not clearly known. Geopolitically, there is an abundance of well-publicized concerns...beginning with the Ukraine-Russia conflict, the devastating Israeli-Gaza conflict, the Houthi-Red Sea struggle, very serious climate control issues, and the always present concern over how are we going to feed, provide jobs, and provide education for the ballooning growth in population in some of the poorest and most destitute countries in the world...as well as in the United States. Also, there are many important elections going on in the U.S. and other countries in the world which could have regulatory, policy and trade implications.

With our continued focus on these aforementioned positives, despite relatively high valuations in the stock market, we remain cautiously optimistic about the future. No one quite knows how the Ukraine-Russian war will end, but all wars do end... and they often end in a stalemate compromise that no one is happy with. The heavy fighting in the Middle East will hopefully end sometime. And the deteriorating financial situation of the Federal Government, characterized by rapidly escalating federal debt and inexorably rising Federal, State and Municipal Expenditures, must somehow be addressed...although it is unclear as to how or when this major issue will be ultimately resolved.

While we recognize the importance of the major issues weighing on the market, we believe that U.S. equities remain attractive. As our many decades of investment experience has taught us, in order to compound wealth, one must take a long-term view and maintain a disciplined approach to evaluating and monitoring individual portfolio holdings for longer term investment. Furthermore, it is important to construct portfolios that can prosper in a variety of economic outcomes since our ability to correctly predict the zigs and zags in the macro environment is limited. We remain steadfast in the tenets of our investment philosophy of focusing on owning high-quality businesses with strong cash-flows, paired with low (if any) financial leverage. Our principal portfolio goals will continue to be to compound capital, minimize risk and protect principal, all while remaining tax efficient and encouraging our portfolio holdings to invest throughout the cycle.

We wanted to remind you that our Firm has a full suite of Wealth Management capabilities. We have mentioned in the past that our Straus Group has a dedicated Wealth Planner, Courtney Perez. In addition, Neuberger Berman's Trust Company offers comprehensive fiduciary and investment services for individuals and institutions. The Trust Company can assist with gift and estate tax planning, trustee and executor services. The Trust Company can also provide access to the favorable trust laws of Delaware through two national trust companies, headquartered in New York and Delaware. We would be happy to introduce these services to you at any time.

We sincerely appreciate your continued trust and confidence in us and look forward to speaking with and, hopefully, meeting you at our offices in the not-too-distant future.

Sincerely,

The Straus Group

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