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By the Way

Monthly commentary from Jack Way

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"When you feel like bragging, it's probably time to sell"

The seemingly unstoppable rise in the S&P 500 since the low made in late October generated a rally of 28% in that Index. The first quarter of 2024, itself, rose 10% making it the 11th best start to a year since 1950. There are many good reasons for the market to be up (but maybe not that much): U.S. economic growth has been above trend; fixed income rates fell during the period; regulated rates from the FED are expected to decline; and the artificial intelligence (AI) industry is anticipated to provide a major boost to productivity and profits. On the other hand there were several factors that one might have thought would derail, or at least moderate the bullishness: wars; surprisingly 3 of the so-called "magnificent 7" stocks that have been the major factor in higher markets actually declined in the first quarter; at the start of the quarter the futures markets were predicting the FED would cut rates six times in 2024 but that number has now come down to only three times; and reports of inflation have been just okay. As ever, in the midst of a bull market when the trend is solidly higher the old saying is "the market will climb a wall of worry". The most serious concern in my mind is the lack of anxiety amongst investors about potential negatives. Any disappointment could reverse that psychology and lead to lower prices, but with a growing economy and the likelihood of increased government spending during an election year the wise course would seem to be remaining positive into the election. Personally, while I didn't put on my bear suit, I regret having spent too much time worrying about those negatives.

The U.S. economy remains resilient mostly on the strength of the jobs market and consumer spending. Now we may be able to add the manufacturing sector as an area of growth. The most recent Purchasing Managers Manufacturing Index was a surprise at 50.3 which indicates expansion, after 16 months of numbers below 50 (contraction). That's a long time; only twice before has the series been below 50 for over 12 months without a recession. There is no guarantee that the index won't flip back but given the outlook for large infrastructure spending in the AI space, it actually makes sense for manufacturing to benefit. It is also a positive to note that similar surveys around the globe are showing signs of a turn for the better.

Artificial intelligence has certainly taken over as the topic du jour and NVIDIA (NVDA) as the stock du jour (up 80% in Q1 2024). AI has been around for years, but for whatever reason has propelled corporations to now commit real and substantial investment into the sector. Exactly when and how the buildout will take place is still very much in question, but there is no doubt a scramble is on to make sure one doesn't get left behind. Nonetheless some big companies such as Microsoft and Google are attempting to counsel investors to not get carried away in the near term. One of the major drawbacks is the huge amount of electric capacity required to power AI, and that's on top of the increased demand from cryptocurrency mining. This Wall Street Journal recently wrote that "The insatiable appetite for electricity is creating risks to the grid and the transition to cleaner energy sources." While utility companies have a chance to become growth vehicles, there is no way wind and solar will be sufficient to service the expected demand (the 5-year projection has doubled in the past year). The likely fallback position according to experts is natural gas which won't sit well with the anti fossil fuel movement. An Amazon executive said a new data center gets built every three days; the problem is not going away. Speaking of Amazon, its not just letting us shop from our couch, but is the largest company in the cloud computing services space by a factor of two over second place Microsoft. It will play a major role in this story going forward.

As the U.S. Presidential election approaches, I feel like I'm watching one of those viral videos of cars on an icy road slowly sliding along before crashing into something. There seems to be no avoiding an inevitable bad result. The closer to the election and the more we see them on tv, the more I see small frightening instants of ineptitude from both of the combatants. I'm unable to see the future and in no position to evaluate the mental faculties of the two men, but it is tough to choose between one candidate who appears in his dotage and another who seems to experience psychotic episodes. It feels like there is no good answer but given the diverse possible outcomes for the country, who becomes the leader makes the choice extremely important.

And the usual other thoughts:

1. The former President is counting on money from the IPO of Trump Media to cover his court ruled settlements. We shall see.

2. Sectors like big tech and health care are facing increased regulation from governments.

3. The U.S. Treasury really helped the financial markets last fall by borrowing in the short-term markets instead of longer-term bond markets. It can't do it forever.

4. Consensus says a yield of over 4.35% on the 10-year Treasury Bond is cause for concern for stocks.

5. John Neff, one of the original celebrity mutual fund managers, once said "When you feel like bragging, it's probably time to sell."

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