BLAIR
CAPITAL MANAGEMENT

January 2024

First Quarter 2024 Analysis

Financial markets ended 2023 with very strong momentum, sparked most recently by a meaningful dovish pivot by the Federal Reserve in December. For the third straight meeting the Fed held interest rates at current levels and even projected three rate cuts in 2024. Anticipated rate cuts in 2024 and 2025 result from projected growth in GDP of less than 2% in each of the next two years, according to the Fed, which is below trend. Bad news for the economy is still good news for financial markets, at least for now.

Credit markets experienced dramatic shifts in investor sentiment during the year, from bank failures in the spring, a second year of interest rate increases, to a Fed pivot in December. The Federal Reserve raised their preferred benchmark rate at the fastest rate since the 1980s, from essentially zero in January 2022 to over 5% in July of 2023. This created enormous losses for bond holders. Indeed, Blackrock says the three-year negative returns in 10-year Treasuries are the worst they have been in 150 years while holders of 20-year plus Treasuries suffered losses for the third consecutive year, inclusive of interest earned.

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Mega cap tech companies now comprise almost 30% of the S&P 500 Index. The so called Magnificent 7, Apple, Amazon, Alphabet (Google), Meta (Facebook), Microsoft, Nvidia, and Tesla, gained around 75% last year, after falling around (40%) in 2022. The weighting of these seven stocks in the Morgan Stanley All Country World Index is greater than all the stocks from Japan, France, China and the U.K. Amazon, Alphabet, Meta and Tesla are still trading below where they ended in 2021. This is a historic concentration in the index by a very small number of names and exceeds the concentration we witnessed at the top of the tech bubble in 2000. The performance gap between the market cap weighted S&P 500 Index and the Equal Weight S&P 500 Index is the largest in 25 years. Broader equity averages saw gains around half of the market cap weighted S&P 500, and that is only because of the sharp rally in November and December.

There is much deserved attention regarding artificial intelligence. I have taken a two-track approach. First, by investing in large technology companies that are investing in and developing AI products while also augmenting their current, large technology platforms and second, by investing in individual companies in different industries that I believe are utilizing AI technology to leverage existing world class businesses. Some of the widely followed AI companies have had spectacular gains but they are very crowded holdings, trade at extremely high valuations, and will face increasing competition.

I remain very positive on the future of nuclear energy, as it is secure, sustainable, affordable and carbon free. The likelihood of getting to net zero emissions in the near term through wind and solar remain dismal. The technology is simply not available, and the costs are proving difficult. EV sales are falling, despite unprecedented government support, and offshore wind projects are being cancelled. The S&P Global Clean Energy Index fell sharply last year. At the recent United Nations Climate conference in Dubai, amazingly, 22 countries, including the United States, committed to triple nuclear energy capacity by 2050. I see continued and increasing bi-partisan support for nuclear energy and little if any opposition. Nuclear energy comprises about 20% of our nation's energy presently, and uranium prices have reached 16-year highs, according to the U.S. Energy Information Administration.

I continue to maintain we are in the very early stages of the obesity drug revolution. Several studies offer very promising data suggesting even wider applications for the underlying compounds in addition to treating diabetes and obesity. Such infirmities as cardiovascular disease, liver disease, sleep apnea, fertility and alcohol abuse are being widely studied today. Any additional applications would strengthen their blockbuster status.

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Investors shunned diversification in 2023, and instead, followed the outsized performance of the Magnificent 7 stocks and balanced funds had mediocre performance, but in 2024 investors are likely to seek diversification and we started to see that in recent weeks.

While we must remain vigilant of the unexpected, the coming year begins with a resilient consumer, a resilient economy, a strong labor market, the Fed no longer raising interest rates and inflation no longer accelerating. I believe the biggest surprise in 2024 could be a year of increased productivity gains galvanized by artificial intelligence which produces GDP growth exceeding estimates. We are seeing the convergence of many innovative technologies which are being enhanced by AI and this will bring improved productivity, resulting in increased wealth generation. According to the Investment Company Institute, cash levels in money market funds are approximately $5.7 trillion. I believe much of that money remains there out of fear of the economic and political environment as well as being attracted to the highest short-term rates for many years. However, if investors gain confidence that the economy is not falling into a recession and if the stock market continues to rally, this level of cash could provide an enormous tail wind for further gains in equity markets. I believe investors proved to be too pessimistic in 2023 and risk being too pessimistic for 2024.

I remain resolved to safeguard client capital and minimize losses. There is no substitute for discipline, and I am reminded that in writing about behavioral finance, Daniel Kahneman and Richard Thaler concluded that the "Pain of losing money is twice that of the joy of making money."

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