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Market Commentary

Weekly perspective on current market sentiment **December 20, 2023**

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Last week's S&P 500 Index: +2.5%

What to do now

Key takeaways

- Market participants appear to be hanging their hats on aggressive Federal Reserve rate cuts in 2024.
- We believe there are actions investors can take to help portfolios benefit from the environment that lies ahead.

The S&P 500 (the Index) has surged slightly more than 15% since the late-October lows. Over the same time frame, bond prices have also staged a robust rally, pushing the yield on the 10-year Treasury note from an intraday high of just over 5% to the current 3.92% at the time of this writing. These significant price moves have occurred as market participants appear to be hanging their hats on strong earnings growth, lower inflation, and aggressive Federal Reserve (Fed) rate cuts in 2024. We continue to be skeptical that earnings for the Index will increase as significantly and we expect only half the number of Fed rate cuts the federal funds futures are suggesting. The Index and long-term Treasuries look priced for perfection at current levels in our opinion.

So, for many investors, the question becomes: What to do now? Equity valuations are high, and the Index is trading above the midpoint of our year-end 2024 target range (4,700). In addition, our target midpoint for the yield on the 10-year Treasury note at the end of next year is 5%. We do not favor chasing the Index or the price of the 10-year Treasury note higher. But given these rallies, we do believe there are actions investors can take that have the potential to add value in the 6 – 18-month time frame.

With the Index trading at an optimistic 21.5x our $220 earnings number for next year, we believe investors should consider taking action in select sectors. The Information Technology, Consumer Discretionary, and Communication Services sectors are the only sectors (out of 11 total) that have outperformed the Index on a year-to-date basis, and their magnitude of outperformance has been dramatic. It is likely that many investors are now overweight these sectors relative to their representation in the index. Our rating is neutral on Information Technology and Communication Services, and we are unfavorable on the Consumer Discretionary sector. We prefer to trim positions on all three sectors to bring them back in line with our ratings.

With the proceeds from taking the above actions, we favor investing in our favorable-rated Health Care, Industrials, and Materials sectors. These high-quality sectors have not kept pace with the Index in this narrow equity rally but in our view offer attractive relative performance potential between now and the end of next year.

Should excess funds be left over after taking the favored equity sector actions, we continue to favor short-term fixed income as a good place to "park" funds with the intention of putting that money back to work in stocks as anticipated opportunities arise as the economy and earnings slow. We still favor long-term fixed income but, as we foresee yields moving higher later in 2024, we prefer to be patient. Despite high equity valuations and lower interest rates, we believe there are actions investors can take to help portfolios benefit from the environment that lies ahead.

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