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Hello and welcome to not only the Dividend Cafe, but to 2024. We're already Into the new year at this point, but as promised, we want to kick off the dividend cafe this year with our annual year ahead, year behind discussion where we really want to dive into what took place in 2023, evaluate even some of our own forecast from a year ago and discuss what we're envisioning for 2024.

It's one of my favorite things to do every year. It is not only. A wonderful deliverable to put in your guys hands, whether you're listening to this podcast, watching this video or reading the white paper we put together. The white paper has something in the range of 20 different charts. It's over 20 pages.

There's a lot of writing that's gone into this, and I pour myself into this project every year, but honestly the most fun part of it is not just the deliverable that goes, it's the process. Being able to spend the time in reflection of what took place, what was wrong in our thinking, where we want to modify thinking going forward, the perspectives that are necessary thematically to properly steward client capital in the year ahead.

It's a very significant task. It's one I take very seriously and honestly want to have a lot of fun with. And now is the time where we want to bring you some of those Final takeaways from the process at this point, I think everyone's aware that 2023 ended up being a phenomenal year for risk assets.

There were moments in the year where it didn't always feel like that. The day-to-Day. Volatility in markets is definitely higher, particularly in the bond market, than it has been over the last several years. It's higher than it had been in a lot of the years. Let's say from about 2010 to about 2020, there was a real.

Diminished intraday volatility with markets for a while intraday volatility is a bit higher, not back to financial crisis levels, but overall on the year, you basically had one of those years where almost all asset classes were positive and risk takers were rewarded. Irony of 2023 is not just, I'm about to go through some of the numbers, the S&P was this and the Dow was this and the bond market was that.

It's that you really only could have lost money, have gone backwards, have done poorly with behavioral mistakes. Simply being invested in X instead of Y, X could have been up less than Y, but more or less it wasn't security selection or asset allocation because the vast preponderance of asset classes were in positive territory.

The only way to have gone backwards was to have not been invested. And who was not invested last year? There's the eternal category of people that are overly paranoid listening to doomsday errors. But even within that, there was a real movement last year of market timers. You had celebrity hedge fund guys going on TV saying, we're getting out.

We think this is about to be terrible. And anyone trying to trade around these things could have possibly gotten their face ripped off. They certainly diminished their opportunity for a positive return. When the market churned at the end of the year, it was coming off of a period where things looked very negative in both stock markets and bond markets.

And you want to say very negative. It wasn't like we were down 20 and then all of a sudden we went up 30. The markets were still up. They had a drawdown. They have a drawdown every year. The S& P at one point dropped something in the range of about 10%. That's not even like it's normal median level of an intra year drawdown.

But again, with the way 2022 went for a lot of index investors, with the way the bond market's been behaving, the macroeconomic concerns about recession potentially coming, and the accurate awareness that the Fed was putting on significantly tight positions of financial conditions, anything was possible.

And those trying to time their way around it very likely ended up hurting themselves and those who didn't were rewarded. And that's what I mean. It was a behavioral year. So that wealth management process that brings disciplines and behaviors and best practices to particular objectives around accumulation, withdrawal, transfer of wealth, of capital.

This was a year for wealth management to be mature to drive the boat and to not allow behavioral mistakes to throw people off. Now, what do more specifically within markets? I don't want to spend a ton of time with the redundancy. If you look back over the sequence of the year, we're aware of what took place back in, March when all in one weekend, Silicon Valley Bank and Signature Bank in New York went down and then it started a process by which First Republic ended up going down a few weeks later.

And if you look back to, things started off in January, negative. Because we were carrying over from the sentiment of 2022 markets are expensive and the Fed was tightening and they're probably going to cause a recession. It was about 85 percent implied probability of recession. It was closer to 100 percent economists who are predicting one and.

Then by the end of January markets were performing better, but it was very selective. It was big tech. It was what they call this magnificent seven, a certain grouping of names that kind of became more attractive to investors after some of them had gotten hammered the year before. Had gone down, but not as much, but you had an interruption to those good times February and March.

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And it appeared okay, now we have our culprit that we've been talking about the fed breaking something. Maybe we're going to go into recession. Everyone has been wondering what is going to come up from beneath the surface that proves to be dead and is a commercial real estate.

We knew it was residential housing in 2008. Is it going to be the Nasdaq again? Is it going to be this or that? And it was regional banks. And they said, okay. We're going to provide insurance coverage above and beyond the FDIC limit to all the depositors of Signature Bank and Silicon Valley.

And you still had many billions, not tens of billions or hundreds of billions leave regional banks, but you did not have a systemic failure of banks. And First Republic went down with no deposit or losing a dollar. The largest bank in the country, J. P. Morgan, took them in. Equity got wiped away, but basically the systemic concern ended up being contained.

And if you had told me at the beginning of the year, you're going to have three. of the larger regional banks in the country go down, two of them being literally the largest, and that Credit Suisse in Europe was going to go down all in the first quarter of the year. I would have predicted some extremely negative outcomes in capital markets.

But the fact of the matter was that we ended up just humming along and corporate earnings outperformed expectations throughout both the second quarter that was reporting on the first quarter. And then the third quarter that was reporting on the second quarter. And by then projections were such that earnings were picking back higher.

And you say, okay, now we're actually getting upward revisions. So we seem to have hit a cycle low for what earnings were. And that cycle low proved to be about 5 percent lower than they had been the year prior. So granted valuations were still expensive. We had a little bit of revaluation last year when the S and P was down 20, but the markets are forward looking mechanisms.

And if we've seen the worst of earnings that enabled markets to move forward a bit, but the problem was that valuation. The problem was that discount rate. And the bond market was selling off as yields across the curve were continuing to go higher as the Fed was surprisingly continuing to tighten, even after the regional bank issues of March and the complete freeze- up in the housing market, the very high elevated rates in residential mortgage, they started the year at six and a half percent and they ended the year at six and a half, but they hit above 8 percent at one point in the middle there.

And so many people thought the Fed would relax sooner. They kept going. So then we got into this period into the summertime and it lasted basically, let's call it August and September and into part of October, but the second half of summer and the first half of fall where yields kept going higher.

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Bond prices fell, stock prices fell, and the dollar was strengthening, which was of course bringing down emerging markets, certain commodity prices, et cetera. It was a bad period for risk takers, but par for the course and what you would expect of normal volatile risk assets. And that became the key story for 2023 was we weren't apparently having a recession and we were having to reprice in bond markets.

The fact that we weren't having one. Unemployment was staying low, inflation was coming lower, and lo and behold, a negative economic message was turning into a positive economic message. Markets can go down around a negative economic message, but then markets can also go down around a positive economic message when the key issue is bond yields, valuations, and Fed expectations, liquidity in financial markets.

That's really what played out. Until it didn't and basically around the middle of October, there was some point at which markets began to believe the worst was behind. The Fed had now paused. They hadn't cut rates, but they hadn't raised rates two meetings in a row, and there was enough indication that inflation had been cut.

Dramatically decreased and that the fed was comfortable now to relax a bit of monetary policy or at least guide it forward that they would be. And so that generated a pretty positive response in terms of some of the specific numbers, like I said, a 10 percent drawdown. Being the worst level of the year is hardly something to lose a lot of sleep over.

The artificial intelligence evolution has to be thought of as the one thing that was creating a lot of disproportionate upside for certain sectors of the market throughout the year. The big things that lost in 2022, large cap growth, NASDAQ, FANG, Magnificent Seven, all rallied back in, in 2023. And then I think that bond market message has got to be understood.

The 10 year going from the threes up to 5 percent really hurt markets for that period. And then the 10 year ultimately coming from five back to four, actually getting to about three, eight, three, nine by the end of the year created a significant rally. Now what is our take when I summarize what happened in 2023?

About some of those big tech magnificent seven type names, because it's one of my favorite lines in the white paper. I don't want to leave it out for you listening and watching. This notion of if things get really good in the economy and you get a little tailwind, the magnificent seven are all going to benefit.

And if things go really poorly, they're still going to benefit because people will like those names anyways, because they're the only names that are doing big growth. A heads I win, tails I still win

approach is a figure of speech that my friend Louis Gov at GovCal Research put into my Orbit, and I think it's apropos.

I don't think investments that take on a heads I win, tails I still win disposition, it always ends very well. I don't think history's been kind to that level of thinking. But nevertheless, those were big winners last year. And on the year in the economy, we ended up at a, what appears will be 2. 4 percent real GDP growth, far below our 3.

1 percent historical average, but far above negative number that one would have expected if we were to go into recession. So when you look at the overall markets on the year, I want to just try to cover some of the major highlights. We have a chart in the white paper of all the major asset classes, and it is true if you're looking for something negative, the yen, if you were trading yen currency was negative against the dollar, the Chinese stock market, the Shanghai A shares were negative.

A diversified basket of commodities was negative as you had significant disinflation last year. The dollar basically was just a tiny bit negative. But when you start looking at the Euro, the 10 year inflation protected bonds, copper, Emerging markets, longer dated bonds, European, global, high yield, gold, mid cap, small cap, all the way up into the big cap stuff that is the S& P 500, the Nikkei in Japan was up 28%, the S& P 100, the kind of top heavy did very well, and of course the Nasdaq had a huge very much.

very much. Recovery within that, the sectors technology was up 55 percent communication services up 52 after getting walloped last year, consumer discretionary, which you think would be a lot more susceptible to high interest rates with a lower quality and more leverage in the balance sheets. It was up 39, almost 40%.

The only sector that was really down. Was utilities down seven consumer staples, basically flat energy, basically flat. And yet even within energy, you had midstream the pipelines for oil and gas up roughly about 15 percent or more on the year. Financials ended up double digit, positive real estate after a monstrous fourth quarter, publicly traded REITs ended up double digit positive.

Same for materials very hard to not make money. In 2023 and where it happened around behavioral issues. How did our own report card go? I'm going to get to that in a second. A couple of key themes real quick. It was a top heavy year in the market, but less top heavy by the end of the year.

There was one point at which seven companies were making up over 100 percent of the market return of 500 companies, the S& P 500. But we still ended the year with 72 percent of the companies in the index underperforming the index itself. That's very high, and it spoke to the top heavy nature of the market.

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The resilience of the labor market was a big deal. There's less new jobs being created, but there's still net new jobs being created that were unexpected for those with the recessionary outlook. I don't think it was a great year for government. 1. 7 trillion deficits being run. In a time of economic non recession coming off a big deficits that had been run throughout the COVID years.

So you, you did not have great activity on the balance sheet of governmental entities, and yet you did have a pretty Healthy management of both the balance sheet and the P and L from the private sector. Households reasonably behaved when mortgage rates got high and housing prices stayed high. You had a lot less housing prices indicating a lot less people stretching.

You don't see a ton of mortgage equity extraction. There was some healthy. Elements of the household sector, but, and even the corporate sector behaved well, they didn't need a lot of new borrowings because they had appropriately borrowed at a lower rate environment a few years ago. There's exceptions to that, of course, but the general systemic trend was a good year for humanity, corporate and household and a bad year for government.

My fourth point I want to make about 2023. that disasters were really averted. That regional bank story from March didn't become contagious. The commercial real estate sector didn't get significantly worse and that was a big surprise. I think for the most part, there's a lot more protective equity than people realized and there is a lot more diversification within the commercial real estate world where a lot of these different categories of commercial real estate assets do not necessarily behave in concert with one another.

And I think that the notion of a big systemic drop in something was averted, at least for now. But then number five, the thing I have to point out, it maybe seems like it's pouring a little water on it. The S& P still is not back to its high level of late 21. The NASDAQ is quite a bit away from it. It's caught up, made up a lot of ground, but when you look at the 27 percent return in the S& P, the 45 percent return NASDAQ and realize that on a two year basis from the late 2021 highs, they're still underwater.

It speaks to the range bound theme that we've had for quite some time, that we expect to be in a choppy. Market for the foreseeable future. That's reasonably range bound. You can have 10 percent rallies up, 10 percent rallies down, but we're in a period of time because of the valuations in the market that we expect indexes, even with decent earnings growth, when multiples are this high, it's very hard.

To over a multi year period get the level of return that equals historical averages, let alone the above historical averages indexes have been giving. So I'm going to do very quickly a report card on the 10 themes that we shared with you last year. Because there's some real great calls here and some real F's and we're going to own all of it.

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We said inflation was headed way lower. It was obviously an A plus. Inflation came from 9. 1 down to 3. 1. And if you right size the shelter measurement inflation, you're probably at about 2. 3%. So significant disinflation in 2022, which we were calling for 23 and we're right about. But we also said that the Fed funds rate would be lower at the end of the year.

I thought the Fed would start cutting by the end of the year, and obviously they did not. They raised the rates a few times, some of which shocked me after the regional bank fiasco, and then they stayed flat for the end of the year, so we obviously get an F on that score. We've said that S& P earnings will tell you the truth of the recession.

Put differently, if you don't get a meaningful drop in earnings, you're not having a recession. Obviously we didn't get a drop in earnings and that foreshadowed rightly as we said that there wouldn't be a recession. Now, this call also could have been an A plus if it had gone the other way. If earnings did drop a lot, we did have a recession.

The point of the call was not to say which way it would go. It's to say that they would be bi directionally consistent. And they were. Number four, value over growth. Again, that was a huge call in 2022. Growth got pummeled. Value did well. We repeated the call. We doubled down in 23. Obviously that was an F as growth relative to value reversed significantly in 2023.

Do not underestimate the China reopening. Now, this is a really odd grade that I expect to have people really lash out at me over, but I'm confident that I'm being reasonable because it's a total F the China reopening was massively underwhelming. It did not spike global oil demand. It did not spike global trade.

It did not spike domestic consumption. All things that anyone would have thought of. So why do I give me a C minus for this instead of an F? Because everybody else said the same. And we're grading on the curve of where this China demand story in 2023 was so universally. Wrong. We said emerging markets turn in the sun.

If the dollar weakened pretty much EM in 2023 was in concert with how the dollar went. When the dollar rallied from July to October, emerging markets sold off, then rallied into the end of the year as the dollar weakened. We got that correlation right. Housing. I gave myself a B minus because I did believe it would go lower.

And I don't think that the price has dropped a lot. I think they dropped a little bit. There's some markets that did a little better than others. However, what dropped massively was transactions. There is essentially very little existing home sales taking place for the reasons we've already talked about a lot.

People who own a home already in a low cost mortgage, not wanting to go to a new high cost mortgage and the affordability problem freezing buyers and sellers in place. Sellers don't want to sell lower and buyers don't want to buy at the current level. And so they're, especially around mortgage rates, froze the housing market.

Very much in line with some of our call last year that China and Russia and other geopolitical things would weaken global stability I gave myself an a on that and I hope I don't have to elaborate why? Consensus skepticism on private markets was wrong private markets would do well in 2023 we said and the reason why was the opportunity set expanding a paradigm shift and how capital markets are working high quality underwriting risk takers with appropriate amounts of leverage, private markets, particular private debt did very well.

We gave ourself an A there and finally the energy story, not being dead on one hand, oil prices were lower, but still much elevated from, past years. The broad energy sector was basically flat down less than 1 percent on the year for upstream, but the midstream sector being up 15%, MLPs being up 25 percent for the third year in a row, we feel comfortable taking an A on that.

So then quickly we'll close up with some of our 2024 themes and forecast. I think that we want to be careful about this, that when we talk about themes and forecast, we are not saying the S& P will close at this level. I've never said it. I've never believed in anyone else saying it. I'm not doing it now.

We're more talking about macro themes that we think should shape the way we're thinking about what's happening in the economy, in the world, things to be prepared for things that do play into an asset allocation. In a more granular sense, but are not meant to time the market and are not meant to put a price level on what we think the market will close at.

We think number one, that the fed particulars will end up being overrated. That how important it is that the fed cut this much by this time, we think we'll end up being a lower. contributor to markets than many people think. Number two that the biggest contest of 2024 will be a battle between the forces of de globalization and a productivity boom.

There are certain negatives embedded in de globalization to corporate profits, to increase CapEx, but they also are offset against what may be very well playing out as a better productivity story. There's a real tug of war playing on that. And we lean into the bullish side of a Renaissance capex cycle.

Number three, quantitative tightening is a very underrated story. We do not expect the fed to continue getting a hundred billion dollars, 80 billion a month off its balance sheet. They got over a

trillion dollars off last year. That's more than I would have expected without financial markets tightening up, freezing up.

We think in 2024, they're going to have to hit the brakes on the quantitative tightening. And that could either mean actually reversing and going back into quantitative easing or if nothing else, just. stopping the runoff and sitting still for a bit. What China will end up doing around its Japanification is a huge story.

Will they use fiscal policy to prod along some future growth? Will they advance some form of deregulation? Will they realize on the margin, at least some areas in which the communist nature of the political system is hurting the economic growth? Of their corporate sector. And will they lean into Japan style monetary policy?

My belief is that they'll split the baby, that they will do some pro fiscal, but not the same level of pro monetary that ends up leading to pushing on a string, downward pressure on growth over time that results in a sugar high up front, but then can be damaging later. But that's a huge story that will play out.

We expect to see broader market participation. We do not think five to 10 companies are going to generate all the return of the market that one way or the other, there'll be a higher level of participation in the market than just some of those key companies. There's a chart in the white paper showing that the magnificent seven have a market cap.

Bigger than the size of all Japan, all of Canada and all of the United Kingdom put together. We think that is fully unsustainable. Number six, 2025 earnings expectations will dictate 2024 performance. This is obviously more of a backend call. If you start getting earnings revisions higher for 2025 the second half of 24 we'll price that in very favorably.

And if earnings expectations, which are already set to be roughly 11 or 12 percent next year, and 2025, if you start getting downward revisions in 25, that could really weigh on markets in 24, but 2024s earnings environment will have far less to do with 2024s price performance than 2025s expected earnings environment.

That's a huge theme of ours. The election. Number seven will be the top news story, the 2024, but we think it will be about the fifth place market story as the economy and earnings and CapEx and the Fed and other things will be far more significant than the do's and don'ts of what's taking place in the market.

Excuse me, in the election cycle, political news and so forth. And then finally, I do expect this is our eighth theme. A significant increase in day to day turbulence. I, it doesn't have to be an increase in

the current level, but I don't think it will be a big decrease. I think this is becoming a new norm for the time being that there's a lot of trigger happy investors and very candidly.

We believe that with the Fed not being at the zero rate environment that it was for the decade between the financial crisis and COVID you're not adding trillions to the balance sheet. There's the geopolitical instability, the electoral instability, the Japanification phenomena. The lack of a real significant tailwind that any form of bad news forces immediate reactions in financial markets.

We don't care about this at all. We think it's, if anything, it's opportunistic, but we expect that heightened sensitivity to response to enhance day to day volatility, all the more enhancing the need for behavior, for the right kind of behaviors from investors. So that's essentially our story from 2023 and 2024.

I really appreciate you listening to the the podcast and watching the video. But I will say it's definitely something that I believe you'll be in further edified by reading the actual white paper, printing out the PDF we've made available. You have a lot of charts, a lot of walkthrough of great data, a more granular treatment of some of these subjects than, that I'm able to do here in the podcast format.

So I hope it's benefited. Please reach out with any questions. We look forward to what the journey of 2024 will involve. I'm very committed to Dividend Cafe being better than it's ever been this year. I'm excited for what the year lies ahead. I absolutely love that one of the highlights of my week every week is writing the Dividend Cafe, and I look forward to doing more of that this year.

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