

Clients and Friends,

On October 12, 2022, the stock market as measured by the S&P Index closed at 3,577 before rallied into the end of 2022. In my yearend commentary written in early January 2023, I made the following statement:

“The main theme of my July (2022) commentary was that the end of the 2022 bear market was imminent. I discussed numerous reasons that included: 1) Maximum “stretch” to the downside, 2) Evidence of institutional “buy” programs, 3) Abnormally bearish investor sentiment, 4) Continuous stream of bad news (always present at bear market bottoms), 5) Panic and fear levels were abnormally high. As of the end of 2022, it is not clear that a brand-new bull market has yet started, although we may be in the early stages of a new bull market if the October 13th low is not broken.”

As it turned out a bull market **WAS** validated when the advance from the October 12th low finally exceeded 20% on June 8th 2023. On that date the S&P 500 closed at 4294, exactly 20% higher than the October 12, 2022 close.

As happens in all bull markets, the earliest rise in prices is met with total disbelief. The overall tone of news is bad. “So how can a bull market be in place?” the skeptics ask. This is the prevailing psychological attitude early in new bull markets, which Joe Granville labelled “Bull Phase I”. It is also in this phase that profit potential is the highest of the 3 bull market phases.

Evidence of the emergence of Bull Phase II is a growing recognition of the progressing bull market. After all, if the averages have now climbed more than 20% from a low seen nearly one-year ago, it is hard to continue to cling to the bearish case. Along with recognition of the bullish trend, economic data improves during this phase. A notable drop in inflation and expectations of a loosening in the federal reserve board’s tight monetary policy is certainly good news. Unemployment remains quite low and the economy continues to grow at a moderate pace.

Phase II is interrupted by “the decline that fools the majority”. This is a nasty mid-phase correction that convinces many market participants that the old bear market is back, and it is right to be bearish again. That majority-fooling decline might very well have been the 11% September/October correction that dampened investors’ spirits. But it was not to be for the bears, as the rally soon resumed. The market rallied in “straight-up” fashion from early November into yearend.

BULL MARKET SCORECARD

This bull market has been unusually “narrow”. By this I mean that the rise in the major market averages has been powered by an unusually small number of stocks. In other words, all boats are not rising. As an example, the so-called “magnificent seven” (Meta, Microsoft, Nvidia, Apple, Amazon, Google and Tesla) have accounted for much of the rise in the S&P 500 since the Oct. 2022 bottom. The so-called “diversified portfolio” consisting of nine equity asset classes and a fixed income component has underperformed since only a couple of those nine asset classes performed well in 2023. And until just recently the fixed income component of the typical diversified portfolio has also performed poorly as interest rates rose. In summary, so far, the performance of this bull market has been sub-par as compared to bull markets past.

OUTLOOK

As 2023 came to an end, the market as measured by the major indices, the Dow Jones Industrial Average, and S&P 500 Index, was in furious rally mode since early November. By almost any measure that I track, the market is overbought to an extreme, and investor sentiment is really getting euphoric. The angle of ascent of those averages is “straight-up”, or parabolic. The market screams for a pullback as parabolic chart patterns break to the downside.

After the market’s overbought condition is worked off, I expect the bull market to continue to progress according to script. Psychological Phase III should be the most exciting part of the entire bull market, and the trickiest. This phase is the “speculative phase” characterized by even lesser participation but notable in that an investment theme emerges, front and center. It could be a continuation in the AI (Artificial Intelligence) mania, or bitcoin, or IPOs, or some as yet identified theme. We’ll see.

RANDOM THOUGHTS

There’s no shortage of possible things that can go wrong in 2024. It’s a target rich environment for identifying possible surprising events. Here are some possibilities:

- Expansion of the Middle East Crisis. Israel is reported to have been attacked from seven different locations. And US assets in various military bases have also been attacked, not to mention the 25 attacks of shipping vessels in the Red Sea. A lot could go wrong here.
- Budget Deficit. The United States budget deficit for 2023 was \$2 Trillion dollars as compared to \$1 Trillion in 2022. The trajectory for 2024 and future years is “off the rails”, so to speak. The deficit could hit \$2.5 Trillion or higher in 2024. This being an election year, expect absolutely zero conversation by either party to seriously address this issue. In the short term, large deficits can be extremely stimulative for the economy. But they could have a very negative effect on the trend in interest rates if 2024 auctions of US Treasury securities to fund the deficit are unsuccessful. This is a very big deal sooner or later.
- Inflation/Interest Rates. In November and December, the stock market’s rally was “straight-up” in response to a perception that inflation and interest rates had peaked. It’s only a matter of time that rates head down again, right? Not so fast, I think. The last thing the Fed wants is for a runaway stock market that runs into bubble territory, as consumer spending would no doubt spike and revive inflation as a result.
- Political Turmoil. Although political events generally do not directly influence the stock market, it could be different this year. There is a school of thought that one or both of the leading presidential candidates will not be the final candidates on election date. The process leading up to that potential outcome could be volatile.

In summary: a bull market is in process and is transitioning from psychological phase II to phase III. Phase III is the most speculative phase of the entire bull market. The market ended 2023 in an overbought condition arguing for corrective action early in 2024. In spite of occasional corrections which are normal in any bull market, the market will eventually progress to new all-time highs. The all-time high in the Dow Jones Industrial Average recently reached a new high of 37,715 on January 2, 2024; the all-time high in the S&P 500 index was 4,797 reached on January 3, 2022.

HAPPY NEW YEAR!
21ST CENTURY EQUITY ADVISORS CORPORATION January 4, 2024

614-487-8873
614-487-1173 (fax)

749 Terra Ct
Worthington, OH 43085

3765 Montreux Ln, 1-102
Naples, FL 34114

Investment Advisory Services
Financial Planning