January 2024

From the front page of Thursday's WSJ:

Fed Hints Rate Cuts Are Not Imminent

Central bank holds steady, suggests it will lower if inflation risks have receded

BY NICK TIMIRAOS

The Federal Reserve signaled it was thinking about when to lower interest rates but hinted a cut wasn't imminent when it held rates steady at its first policy meeting of the year on Wednesday.

The central bank held its benchmark federal-funds rate steady in a range between 5.25% and 5.5%, the highest level in more than two decades, as it awaits more convincing evidence that a sharp downturn in inflation at the end of last year will endure.

"It's a highly consequential decision to start the process" of lowering interest rates "and we want to get that right," Fed Chair Jerome Powell said at a news conference.

For most of January, investors in interest-rate futures markets have put a roughly 50% chance on a central bank rate cut at its March 19-20 meeting. But Powell volunteered on Wednesday that a cut then wasn't expected.

"I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting" to justify a rate cut, "but that's to be seen," he said.

Stock indexes fell in response. The Dow Jones Industrial Average on Wednesday declined 317 points, or 0.8%, and the S&P 500, which on Monday closed at an all-time high, fell 1.6%, its largest one-day percentage decline since September. (While the S&P 500 finished the month up 1.6%, its average stock was down 0.8%. The small-cap Russell 2,000 was down 3.9%.) Yields on the 10year Treasury note declined 0.091 percentage point to close at 3.965%. (The 30 year fixed-rate mortgage stood at 6.8% last week, down from an October high of 7.9%.) ...

Markets have rallied notably over the past two months as investors have anticipated cooler inflation would allow the central bank to dial back rate hikes this year. Investors expected the Fed to cut rates by nearly 1.5 percentage points in 2024, or the equivalent of a quarter-point rate cut at six of the Fed's seven meetings later this year.

At their prior meeting in December, most officials anticipated they could cut rates three times this year if inflation continued to decline gradually to its 2% target and economic growth was steady but unspectacular. They only issue such forecasts every other meeting. ...

The Fed doesn't expect to lower rates "until it has gained greater confidence that inflation is moving sustainably toward 2%," the statement said.

Powell said Wednesday the Fed might be slower to cut rates or drag out the process if inflation proved to be more persistent. It could cut rates sooner and faster if the labor market weakened or there was "very, very persuasive lower inflation," he said.

The Fed has held its benchmark federal-funds rate steady at four consecutive policy meetings. Officials began raising rates from near zero in March 2022 and lifted them at the fastest pace in 40 years to combat inflation that also soared to a four-decade high.

One year ago, many economists anticipated that Fed officials would have to raise rates to levels that would create enough slack ... to significantly slow inflation. But healed supply chains and an influx of workers into the labor force curbed wage and price increases in the second half of last year without causing broad weakness.

Economic growth has been stronger in recent months than Fed officials anticipated, which could make some of them cautious about declaring victory on inflation. But price pressures and wage growth have cooled even with better growth, suggesting stronger growth might not necessarily be a headwind to further cooling of inflation.

Wage growth slowed at the end of 2023, the Labor Department said Wednesday.

The employment-cost index, which the Fed considers the most comprehensive measure of pay growth, showed private- sector pay rose 4.3% in the fourth quarter from a year earlier, the mildest gain in 2½ years.

Inflation excluding volatile food and energy prices fell to 2.9% in December from a year earlier, using the Fed's preferred gauge. The improvement has occurred faster than many officials anticipated ....

"We want to see more good data. It's not that we're looking for better data," Powell said. "Are the last six months flattered by factors that are one-off factors that won't repeat themselves? We don't think so. But that's the question… we have to ask." ...

From Morningstar:

Want to Lose Your Money? Listen to Millionaires.

Along with anybody else who attempts to forecast the investment future.

John Rekenthaler Jan 4, 2024

A Failed Prediction

In November 2022, CNBC asked 761 people who owned at least $1 million in investment assets how stocks would perform during the next year. Fifty-six percent of them responded that U.S. equities would lose at least 10%. Over the previous half-century, stocks had declined by that much only 6 times. Either most of the survey's participants were unusually insightful, able to predict an event with a 12% probability before it occurred, or they were blithering idiots.

Hmmm. About that. What's more, the last time that the poll's respondents were so bearish was in 2008. Which gives the millionaires a perfect record. Whenever they heartily dislike stocks, U.S. equities promptly gain 26%.

Problem #1: Recency Bias

Admittedly, the survey was unscientific. How CNBC selected its 761 participants from among the several million possibilities is unclear, but given that the questions were administered online, the result is unlikely to pass academic muster. Besides, most people realize they cannot predict equity returns. Ask the question and they may respond. However, that doesn't mean that they truly believe their answers.

Nevertheless, the exercise was revealing. As with all endeavors, investment predictions are strongly affected by recency bias. After a well-publicized plane crash, airline travelers become warier, with their fears gradually dissipating along with the memory of the accident. Consumers are fonder of large SUVs when gas prices are depressed than when they are spiking. And when asked about the stock market's prospects, retail investors are gloomiest after bear markets.

Problem #2: Group Think

For the most part, professionals avoid such errors. Almost all attended business schools, where they were instructed to avoid recency bias. Also, given the difficulty of making such forecasts, discretion quickly becomes the better part of valor. Their predictions are therefore much steadier than the millionaires' outlooks. Entering 2023, the median projection among 20 Wall Street firms was that the total return for the S&P 500 would be 4.5%—slightly more conservative than usual, but much above what retail investors guessed.

Where professionals run into trouble is with economic forecasts. They are also expected to provide those, and with that task they do not duck the challenge. When asked in October 2022 about the following year's real gross domestic product growth, Wall Street strategists gave a median answer of a puny 0.20%. Only 11 of the 78 respondents predicted a growth rate that equaled or exceeded the 50-year annualized average of 2.6%. Which, in fact, is pretty much what 2023 will record.

Consequently, those who used the economic predictions to guide their investments almost certainly suffered for that decision. Typically, the arrival of a recession is accompanied by bond market strength and stock market weakness, albeit with relatively good showings from recession-resistant equities: consumer staples, healthcare, and utilities. In 2023, the opposite occurred. Long bonds struggled to break even, while equities soared. Conspicuously absent from the stock market rally, however, were businesses from those defensive sectors.

To some extent, the economists' fears were justified. An inverted yield curve caused by rising short-term interest rates, as was the case entering 2023, usually presages a recession. But professional economists are paid to anticipate the exceptions. That so few did owes to the same reason that they missed 2021′s inflationary spike. Collectively, they had their eyes on what others were saying. Their analyses were not entirely independent because of group think.

Problem #3: Wishful Thinking

A long-standing joke of my former boss, Don Phillips, is that portfolio managers inevitably comment that the previous year was dominated by a single simple trend. You will now hear that making money in 2023 merely required owning the "Magnificent Seven": Alphabet GOOGL, Amazon.com AMZN, Apple AAPL, Meta Platforms META, Microsoft MSFT, Nvidia NVDA, and Tesla TSLA. Whereas profiting in 2022 meant avoiding both stocks and bonds, because the Federal Reserve was stifling each marketplace by increasing interest rates. Buying growth stocks sufficed in 2021. And so forth.

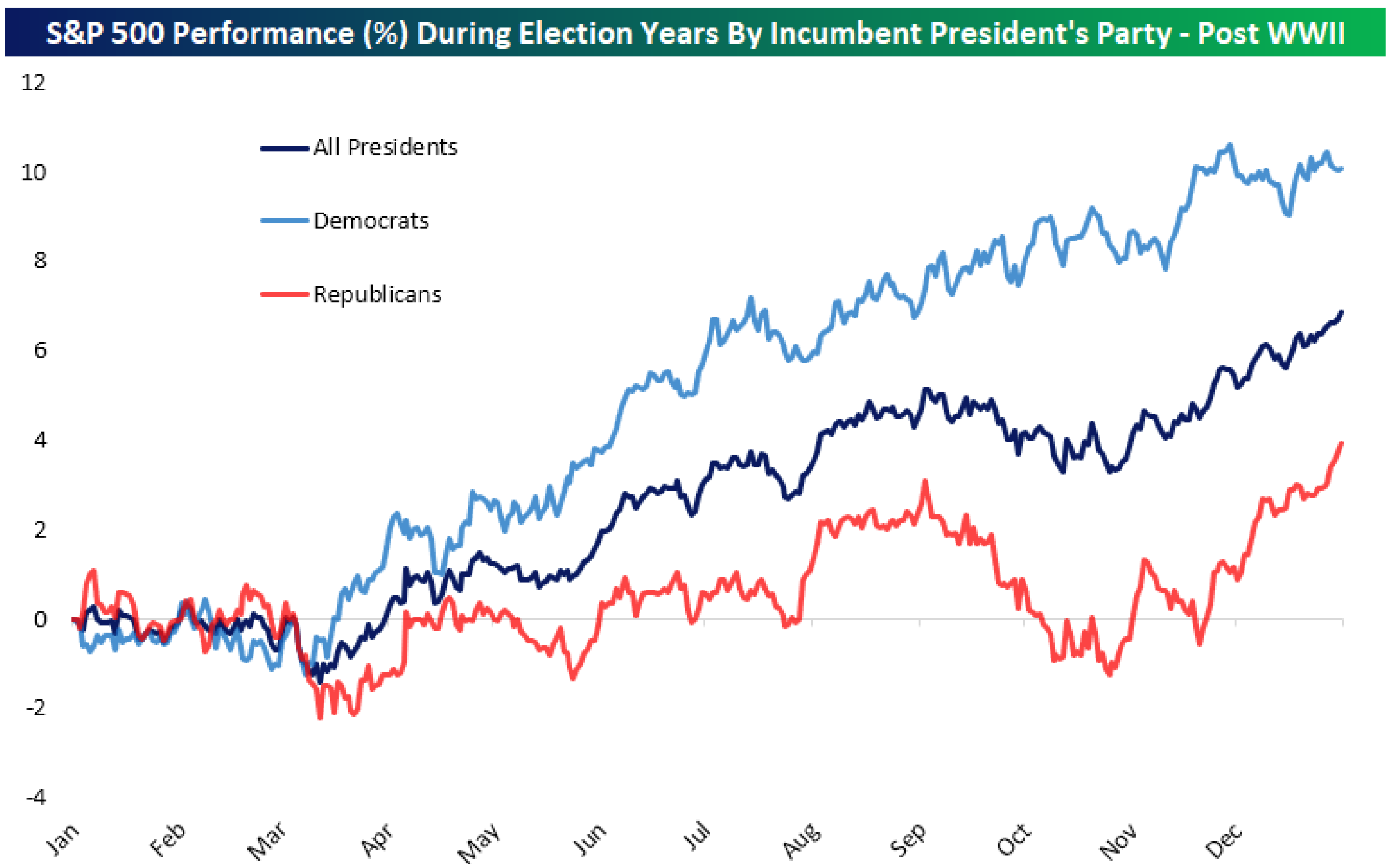
Thus, Bank of America's investment strategists currently claim that 2024 will be a "stock picker's paradise." Meanwhile, BlackRock's chief investment officer of global fundamental equities (the company's active-management group) says that 2024 is shaping up to be a "bonanza" for "stock pickers," and Leon

Cooperman states that we are entering a "stock picker's market." Toronto's Dennis Mitchell claims the same for the Canadian marketplace.

No doubt there is actual analysis intermixed with the wishful thinking—but don't overlook the powerful influence of the latter. It is for that reason that I routinely discount forecasts of economic booms from growth-stock managers and economic busts from bond-fund leaders (case in point: Bill Gross' downbeat prognosis of a slow-growth "New Normal" that would allegedly depress equity returns, made just as stocks entered a huge bull market), along with complaints about overpriced stock markets from those who run value funds. In the words of the philosopher Paul Simon, "a man hears what he wants to hear." ...

From Bespoke on 1/24:

The 2024 Presidential Election is just 286 days away .... The chart below ... shows how the S&P has done throughout Election Years depending on whether a Democrat or Republican is currently in the White House leading up to Election Day. ...



Follow-ups

From January 25th's WSJ, a better late than never death knell:

SEC Wants More SPAC Disclosures

New rules aim to make deals more like traditional IPOs, curbing speculation

BY PAUL KIERNAN

WASHINGTON—The speculative bonanza in special-purpose acquisition companies, better known as SPACs, appears to be dead. Gary Gensler wants to make sure it doesn't come back to life.

The Securities and Exchange Commission, which Gensler chairs, voted 3-2 Wednesday to adopt rules that seek to make it clearer to SPAC investors if they are getting a raw bargain. Once the rules take effect in about five months, according to lawyers familiar with the deals, they will likely drive another nail into the coffin of a recent Wall Street fad fueled by market froth and regulatory arbitrage.

Also called a blank-check company, a SPAC is a shell firm that lists publicly with the sole intent of merging with a private company to take it public. After regulators approve the deal, the company going public replaces the SPAC in the stock market.

"Just because a company uses an alternative method to go public does not mean its investors are any less deserving of time-tested investor protections," Gensler said Wednesday.

Voting against the SEC rule were Republican SEC commissioners Hester Peirce and Mark Uyeda, who accused their colleagues of seeking to regulate away a fundraising model that some companies find useful.

The American Securities Association, which represents small and midsize financial firms, criticized the SEC rules. "They will chill participation in the SPAC market and reduce the ability of private companies to access public capital markets," ASA President Chris Iacovella said.

More than 860 SPACs raised $246 billion in 2020 and 2021, according to the data service SPACInsider, a period that also saw the rise of meme stocks and a cryptocurrency bubble. The blank-check entities bought companies with ideas ranging from flying taxis to small space rockets, essentially allowing them to sell stock to individual investors with few of the disclosures that accompany a traditional IPO.

Since 2022, SPAC fundraising has slowed to a trickle as regulators and courts questioned the model and financial markets sobered up amid higher interest rates. Last year saw just 31 SPAC IPOs raise $3.8 billion, SPACInsider data show. ...

The agency proposed Wednesday's rule change in early 2022. Its goal is to give SPAC investors the same protections that investors in traditional IPOs receive, mainly by requiring more disclosures from companies and making executives liable for them.

Investors can also pull their money out before the transactions close—and often do if share prices are low. That can leave the newly public company with even less cash to grow. It also means there are very few shares available for trading after a deal is completed, a force that often drives the stocks haywire.

This recently occurred with Vietnamese electric-car startup VinFast, which was briefly valued at $190 billion shortly after closing its SPAC deal. That is twice the combined value of Ford and General Motors, despite the company just starting to increase production. Its shares then tumbled.

Ahead of a normal IPO, companies have to be careful about any projections they make regarding their future performance. But SPAC targets— some of which had yet to begin operations—often made wildly optimistic forecasts about their revenue or market share. Regulators worry this encouraged SPAC shareholders to go along with acquisitions without understanding them.

SPAC deals typically include favorable terms for their creators, known as sponsors. They initially put up a small amount to cover expenses before the SPAC goes public and then get a 20% stake at a deep discount if the SPAC combines with another company.

This makes it possible to earn returns several times the original investment—even if the acquisition is a bad deal for other investors.

During the boom, a group of hedge funds known on Wall Street as the SPAC Mafia cashed in by negotiating unique rights given to early investors. For smaller investors, who were sometimes drawn in by participation from celebrities including Shaquille O'Neal, Jay-Z and Peyton Manning, the returns have been dour. Of 401 SPACs that have closed acquisitions since the beginning of 2021, only 27 have seen their share prices rise, according to SPACInsider.

"These vehicles were a road to nowhere for investors," said Michael Klausner, a law professor at Stanford University who has sued several SPAC sponsors on behalf of investors. "They're not going to come back—at least in their current structure."

One reason most SPAC shares have performed so poorly is that their cash is heavily diluted by the time a merger takes place.

After the sponsor's cut, bankers' and lawyers' fees, and warrants held by early investors, a SPAC might only have 50 cents to invest in the target company for every dollar that its shareholders contributed, Klausner said.

Information about dilution in existing securities filings can be confusing and often scattered in different places. That makes it hard for SPAC investors to determine whether they should go through with a merger or redeem their shares beforehand, according to SEC staff.

The rules adopted Wednesday require additional disclosure about the potential for dilution in SPACs. ...

In addition, SPAC acquisition targets that make forward-looking statements will generally have to show the bases for those projections and will be legally liable for their disclosures. SPACs will also have to disclose any conflicts of interest between a sponsor or its affiliates and ordinary shareholders.

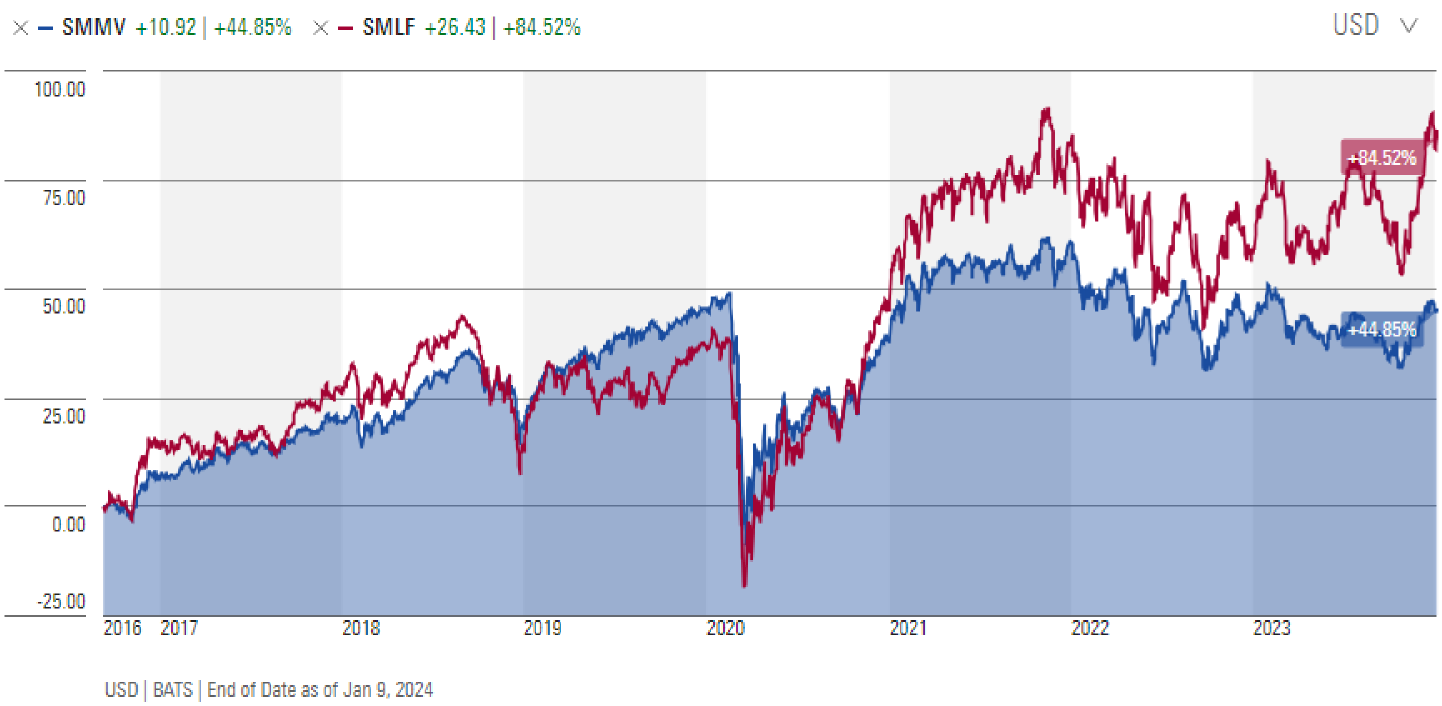
Lawyers say warning statements from the SEC and uncertainty about the timing of Wednesday's rules contributed to the die-down in SPACs because few sponsors wanted to raise money from investors and then face restrictions on how they could use it. Investment banks, which rode the SPAC wave as underwriters, also pulled back starting in 2022.

"Nearly two years after the commission proposed this rule-making, the SPAC market is a shell of its former self," said Uyeda, one of the SEC's GOP commissioners. "The commission intends to never let them return."

Positions

SMMV - When Morningstar's rating, based on past performance, drops to 2 stars we reevaluate. In SMMV's case we determined there were better opportunities, so sold for all 6 clients on 1/9 @ 35.27. Morningstar's chart below compares SMMV's performance since inception with that of SMLF, a core holding for all clients that don't invest in individual stocks.

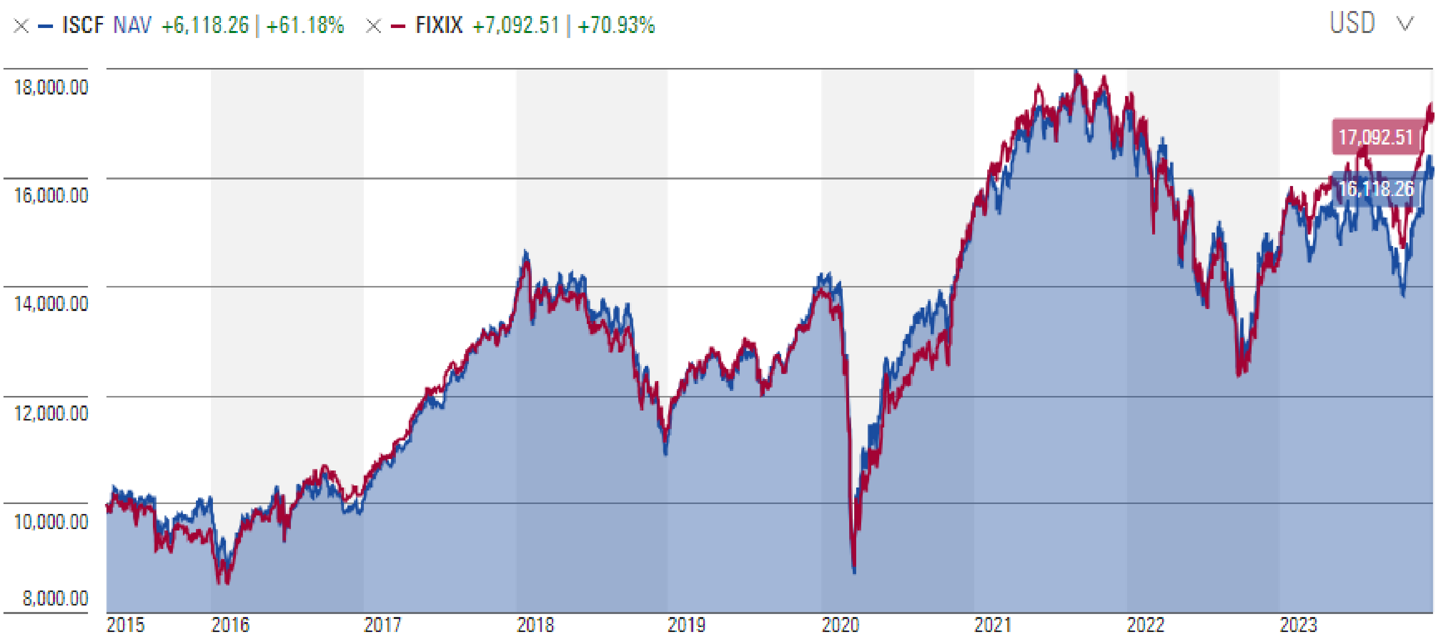
iShares MSCI USA Sm-Cp Min Vol Fctr ETF SMMV ★★



FIXIX - On that same day, we increased foreign exposure for 3 of the above clients by investing in this OEF @ 31.15. Morningstar's chart below compares its performance with ISCF, a core International Small Cap holding for all clients.

Fidelity Advisor® Intl Small Cap I FIXIX ★★★★★

NAV / 1-Day Return	Total Assets	Adj. Expense Ratio	Expense Ratio	Distribution Fee Level	Share Class Type
31.15 / ↓0.64%	4.3 Bil	1.160%	1.160%	Average	Institutional
Category	**Investment Style**	**Min. Initial Investment**	**Status**	**TTM Yield**	**Turnover**
Foreign Small/Mid Blend	Mid Blend	—	Open	1.88%	10%



From its website:

Investment Approach

- Fidelity Advisor® International Small Cap Fund is an opportunistic international small-cap strategy focused on our best ideas across geographies. The fund seeks capital appreciation.
- We favor higher-quality small-cap companies trading at a discount to their intrinsic (fair) value because we believe this combination can lead to outperformance over the course of a market cycle.
- This is a value-oriented approach where the fund looks to optimize the risk/reward trade-off by investing at the intersection of value and quality. Investing in "undiscovered" or "out of favor" securities is the key, in our view, to finding attractive valuations for "quality" businesses.
- Typically, businesses we own require less capital to grow, which leads to strong free cash flow. The combination of strong free cash flow and an unencumbered balance sheet allows astute management teams the flexibility to deploy capital for inorganic (acquisition-driven) growth or returns to shareholders.

VTS - On 1/23 we bought this Non-operating Bakken O&G stock for 6 clients at 20.62. From Z4 Energy Research on Jan. 22: "We added to our Trade Only position in VTS at $20.65. At current levels the name trades at 4x our 2024 Base Case ($80 oil and $3.50 gas) while offering a 9.7% implied dividend yield while sporting a lightly levered balance sheet. The name has ebbed in recent days with oily names and also with thoughts of production disruptions in the Bakken due to cold weather. Our view is these weather events are noise and allow management a virtual “get out of jail free pass” when they occur. Our average cost retreats to $20.69 and you may see more follow on trades near term. ..."

Insider Buying:

Trade Date↑	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
09/14/2023	1	Henderson James		10,000
09/11/2023	1	Gerrity Robert		5,000
09/05/2023	1	Gerrity Robert		5,000
09/01/2023	1	Henderson James		180,000
08/28/2023	1	Gerrity Robert		5,000
08/21/2023	1	O'Leary Daniel		4,000