J.W. Burns & Company
Investment Counsel
Quarterly Update and Annual Outlook
January 2024

Expect A Choppy Market As We Put The Odds in Your Favor

"May the odds be ever in your favor!"
- Suzanne Collins, Author, The Hunger Games

Dear Clients and Friends,

What a difference a year makes.

The title of my January 2023 client letter – "A Forward Looking Mechanism With History On Its Side" – says it all.

At the time, bearishness among investors was near an all-time high after a sharp market decline in 2022. In fact, the vast majority of economists and

market strategists were predicting a recession to unfold by midyear.

Yet, my rationale for being bullish was based on a few crucial historical patterns and trends. Specifically, I cited that markets rarely double down on yearly declines and that the third year of the presidential election cycle was far and away the strongest year for stocks. I also stated that inflation would likely continue to fall, the Fed would eventually pause, and that economists had consistently underestimated the underlying strength of the U.S economy.

Check on all of the above.

For the full year of 2023, all major market indices generated double-digit returns. The S&P 500 Index was up 26.3%, the Dow Jones Industrial Average was up 16.18%, mid-cap, small-cap and international stocks were up around 16%, and bonds clocked in at 5.9%.

"My rationale for being bullish on 2023 was based on a few crucial historic trends: markets rarely double down on yearly declines, inflation would continue to decline and the Fed would pause."

We were pleased with our investment performance, as we had a solid representation in the "Magnificent Seven" mega-cap technology stocks which drove the outsized performance of the S&P 500 Index, relative to most other indices. However, it should be noted that the powerful year-end rally of 2023 "lifted all boats" as the saying goes. Returns began to broaden out beyond mega-cap tech and included various sectors and market capitalizations. ***This is a welcome and bullish signal for 2024.***

So yes, what a difference a year makes. At this time last year, most investment firms were preparing for a recession and a potential retest of the October 2022 stock market lows. Yet, the overwhelmingly negative consensus about the economy and the markets turned out to be overwhelmingly wrong. The

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"Magnificent Seven" carried the market for the first nine months of the year as artificial intelligence (AI) became the biggest paradigm since the internet.[1] A recession never materialized, inflation cooled substantially, and despite higher rates, the economy held up quite well. And stocks benefited.

Wonderful, you may be saying, but what is your plan for my hard-earned money in 2024?

First, we intend to keep you invested in great stocks. I believe 2024 will be another good year for equities. The economy remains resilient with continued wage gains, and real household income is getting better each month as inflation continues to cool. The earnings picture for the S&P 500 companies also looks healthy.

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Second, please do not underestimate the power of election cycles. You have to go all the way back to 1952 to find a presidential reelection year where the S&P 500 Index finished the year in the red.[2] Furthermore, over the last 70 years, when a sitting president is up for reelection, the average return has been 12.8%.[3]

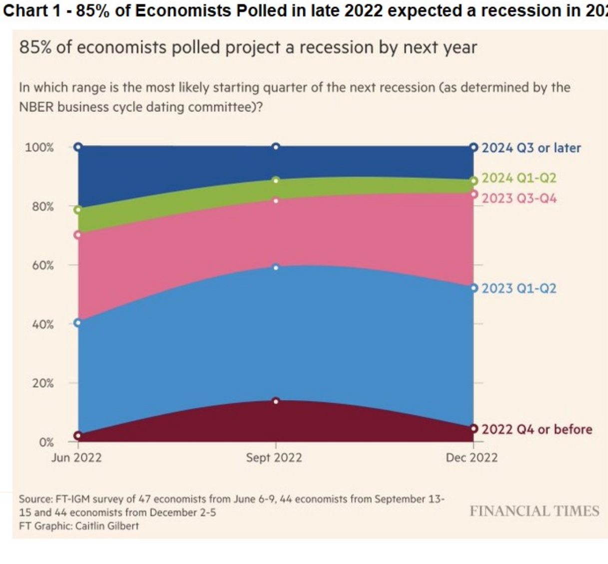
The key questions for financial markets in 2024 will be the direction of inflation and pace of interest rate cuts. Our view is that the risk of a recession is higher than a resurgence of inflation. Indeed, markets have priced in six quarter-point rate cuts for this year. I believe the economy is stronger than this implies, and a more likely outcome is three to four rate cuts. Regardless, we do not see a significant recession unfolding, and if the 10-year Treasury yield remains below 5%, stocks can have a nice year.

We believe the earnings power of your portfolio companies are higher than the market as a whole, and your companies are well positioned to capitalize on the powerful productivity benefits that artificial intelligence will provide. The major economic challenge that companies face right now is a skilled labor shortage, and AI will help dramatically increase their efficiency. Needless to say, productivity gains are crucial for companies to generate higher profits over the long term. Thus, we want you, our valued clients, to not only own the dominant AI players but also the companies most levered to improve profitability with AI's rise.

This is an important focus of our investment work whether assessing current or potential new portfolio additions.

If you told me that at the beginning of 2023 the Fed would hike interest rates four more times, reduce their balance sheet by $850 billion, and there would be a regional banking crisis, I would have been hard pressed to believe the market would generate 20%+ returns. Add to that a worsening geopolitical environment. But there is good instruction here. Markets have always climbed a "wall of worry" and with a highly divisive election taking place in 2024, we encourage our clients to keep their eye on the ball ***– that is, staying invested for the long run in great-growth companies.***

Chart 1 - 85% of Economists Polled in late 2022 expected a recession in 2023



No doubt, politics makes for great theater. And the elections in 2024 will have all of that, especially with the likely Biden-Trump rematch. But from our vantage point, markets ultimately focus on the economy, interest rates, and earnings. At this time, we are cautiously optimistic that the backdrop in all three of these areas remains constructive.

Of course, beyond election rancor, many risks remain. The escalation of war, a deeper-than-expected recession, inflation/interest rates moving unexpectedly higher, or some other unpredictable "black swan" events could derail stocks. On a long-term basis (and maybe even in the short run), our nation's unsustainable fiscal path could eventually lead to sharply higher interest rates. However, in my 37 years of investment experience, I have found it is foolish to bet against American innovation. I'm not going to start now.

So, my best guess is that stock market returns for the full year will be in the 7-9% range with much of those gains coming post election. In other words, expect 9-10 months of choppy, and at times, turbulent market action, followed by a nice advance towards the end of the year. This is, in fact, very much in line with historical patterns during major election years. So put your seatbelt on, but I think we're going to end the year higher.

I know some clients have commented that I always seem to be bullish. That may be true, but my reasoning is well grounded. After all, going back over a century, stocks are up about 70% of the time with an average return of 8-9%.[4] So, it seems obvious to me that we should put the odds in your favor and generally stay bullish.

Even with the strong stock market of 2023, I am aware stocks are just about where they were at in November 2021, the previous market high. But we believe the trend is upward and your portfolio companies, on the whole, continue to report record profits.

As you know, we conduct intensive fundamental research and are always on the lookout for compelling growth-oriented investments. Interestingly, I recently went back 5, 6, 7 years ago and reviewed a sampling of client portfolios, and there are a good number of new names purchased and changes made since. While we don't trade often, it is our job to follow emerging trends and profitable opportunities. And we are doing all of that.

Thank you for your continued confidence, and here's to a healthy, happy, and prosperous 2024!

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

P.S. As a reminder, clients custodied at Charles Schwab (formerly TD Ameritrade) will likely receive two 2023 1099's this year for their accounts: one for the period prior to the merger and one for post merger. Please keep an eye out for these, and make sure your accountant is aware of the same. We expect the 1099's to start being released sometime next month. If you have not done so already, we encourage you to get set up with online access for Schwab Alliance, where you can readily view your account balances, statements, tax documents, etc.

P.S.S. I'm pleased to introduce to you our newest hire Carole Suarez. Carole joined us back in September and brings over 30 years of knowledge and experience as a former legal assistant where she worked in the areas of family law, real estate transactions, and litigation. She now plays an integral role in assisting our Director of Operations, Kellie Wheeler, and is available to assist our clients with their administrative questions in a professional and easy manner.

As many of you know, we are very selective in our hiring process at J.W. Burns & Company and are thrilled to have such a highly qualified new member of our team. Welcome Carole!

1,2,3 *Bob Pisani, CNBC*

4 - *NerdWallet - "What is the Average Stock Market Return?"*