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B Capital Commentary and Outlook Update 1Q 2024

"The stock market is a device for transferring money from the impatient to the patient." - Warren Buffett

As we embark on a new year, here is an update on recent market movements in the last quarter of 2023 and our outlook for markets in 2024.

In the fourth quarter of 2023, global equities gained 11% while bonds rose 6.8% as inflation forecasts moderated and the Federal Reserve signalled an eventual pause in interest rate hikes. This renewed optimism followed a testing but ultimately very positive year for portfolio returns. Once again it was a story of staying the course and avoiding market timing, and to a large extent, not listening to the consensus opinions of doom and gloom.

The year began with widespread expectations of a US recession and corporate earnings decline triggered by the Federal Reserve's aggressive tightening campaign. But strong economic growth prevailed, propelling US stocks to robust double-digit returns. Relief over America's resilience helped offset lingering concerns about Europe's near-recession and the uneven pace of China's post-lockdown reopening.

We suggested a year ago that a slowdown might mean a mild recession but only a flat or shallow trough that meant holding onto stocks and not heading for the exits. This was the right call.

By late summer, horizon-scanning investors had switched focus to peak inflation and the prospects of Fed easing, sparking a blistering "everything rally" in November and December. The S&P 500 gained 25% for the year, while tech stocks saw even stronger advances.

However, the rally was uneven - about a third of S&P 500 components actually fell in 2023. And while mega-cap tech surged, many sectors underperformed. Outside the US it was more pronounced for indexes that lacked sufficient tech weighting such as the UK where most UK blue chips lagged - the export-heavy FTSE 100 rose just 4%.

Morningstar Sector Indexes

	Performance (%)	
Cyclical	**Q4 2023**	**2023**
Basic Materials	11.05	14.96
Consumer Cyclical	12.35	39.47
Financial Services	14.61	16.09
Real Estate	17.89	11.76
Sensitive		
Communication Services	11.67	54.45
Energy	-6.64	-0.55
Industrials	13.55	20.90
Technology	17.23	59.06
Defensive		
Consumer Defensive	5.80	2.37
Healthcare	6.81	2.22
Utilities	8.65	-7.04

Fig 1 - Sector Performance 4Q23 and FY23
Source* - Morningstar

Big Tech

We have suggested clients have a separate 'Big Tech' strategy to complement our core portfolios for many years and we continue to believe that this is a wise allocation and a constant driver of long-term returns. With the advent of commercial AI in the sector we propose that the tech-driven economy will continue to boom, albeit with bouts of volatility. It's not too late to start a 'Big Tech' portfolio today. Here is a little bit more about the leaders that dominate. A group of 7 technology stocks coined the "Magnificent 7" by Bank of America strategist Michael Hartnett have emerged as the most dominant companies in the S&P 500 index based on their outsized 2023 returns and future growth prospects.

Specifically, the Magnificent 7 consists of Apple, Alphabet, Microsoft, Amazon, Meta Platforms, Tesla, and Nvidia.

In 2023, these stocks generated an average return of 111%, nearly 5 times the 24% return achieved by the broader S&P 500 benchmark.

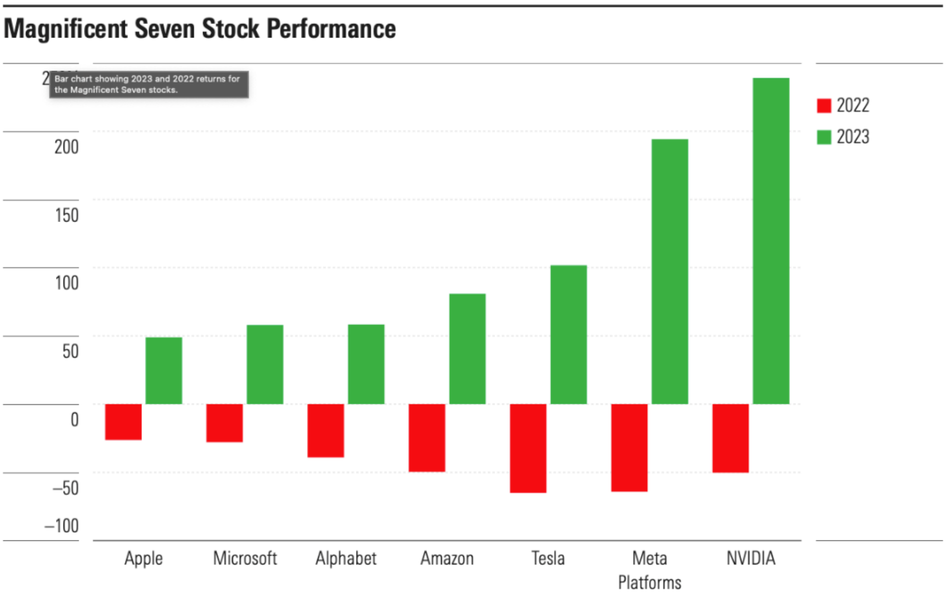

Fig 2 - 2023 Performance 'Magnificent 7'
Source* - Morningstar

Fuelled by leadership in pivotal technology areas such as artificial intelligence, cloud software, e-commerce, social media, electric vehicles, and advanced computer components, the Magnificent 7 represent the pinnacle of scale and influence in modern corporate America.

Their $11 trillion combined market valuation is equivalent to over 20% of total S&P 500 earnings. Microsoft, Apple, Amazon and Alphabet alone comprise the 4 largest public companies by market capitalisation.

Given their vast resources and exposure to critical secular growth trends, the Magnificent 7 are positioned to drive outsized index returns for years to come. For equity investors, understanding and tracking the performance of these stocks will remain imperative given their market dominance. Their progress spearheading technology innovation merits close monitoring as a barometer for the overall markets.

Higher Yields Captured

Fixed income assets also staged a dramatic rebound after a painful year of rising yields, with the November-December bond rally rating as the strongest on record. But some strategists warn 2024 consensus views may prove overly optimistic if growth or inflation falter. We still believe that interest rates will be maintained at this level for some time before potentially moderate cuts if the employment market cools and GDP shows weakness. This is a normal response and essentially the global economy is now in a more normal era of not insignificant yields where the cost of capital will help to improve business decisions and support good companies while reducing the number of unprofitable enterprises.

In the second half of 2023 we actively managed bond exposure to capture the highest yields seen for 15 years and to lock these in for portfolios. We have extended maturities from short term to longer duration, targeting 5-7 year issues by the last quarter of the year. This is finally a chance for fixed income allocations to meaningfully contribute to portfolio returns and smooth volatility through diversification. We think that the market had become overly fixated on yields falling hard on the long end and while we believe that inflation will cool rates, it will not be dramatic. Yields of ~6% in senior Investment Grade issues for the next half-decade are welcome.

Geopolitics in 2024

According to our analysis, 2024 will see elections across 76 countries, including major votes in 8 of the 10 most populous nations. While many established democracies will hold free and fair elections, concerningly nearly 40% fall short of essential democratic conditions.

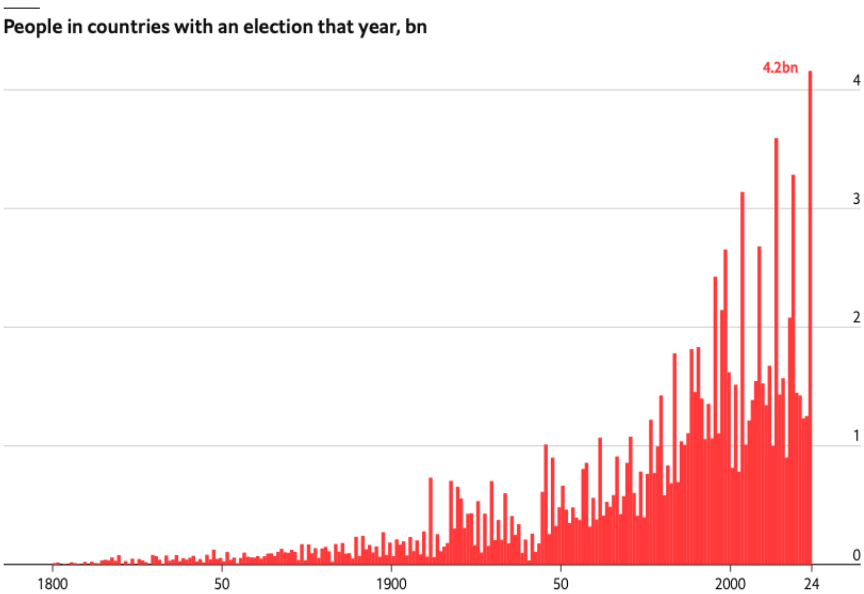

Fig 3 - Populations Facing Elections, 1800 - 2024
Source* - The Economist

Key risks include destabilising rhetoric or contested outcomes in major countries like Brazil, India, and especially the polarised 2024 US presidential race. Heightened global tensions, protectionism and supply chain uncertainty could ensue depending on various election scenarios. It looks likely that Donald Trump will re-enter the White House at the end of 2024.

However, investors should view political events in context. Sound portfolio construction means avoiding reactionary moves to isolated geopolitical events. Stocks trend upwards over time despite periodic turbulence. While sensational headlines may spur market anxiety, underlying economic fundamentals and corporate earnings matter more.

Yes, pockets of global instability driven by electoral politics could contribute to periodic equity volatility in 2024. But investors should stay invested in quality companies with pricing power, strong secular growth and geographic diversification. Tuning out short-term noise is often the wisest move rather than letting emotion dictate investment decisions.

With balanced portfolios, patience and a long-term perspective, the year ahead will likely reward investors even if political strife grabs occasional headlines. Sticking to strategies through temporary bouts of market unease is usually the right call.

Lorne Baring
Managing Director