MORSE ASSET MANAGEMENT, INC.

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2023 Q4 Investment Commentary

2023 closed in spectacular fashion with U.S. Markets reaching new highs for the year, with the Dow and NASDAQ making all-time highs, followed by the S&P500 last week. The S&P 500 posted nine straight weeks of positive returns in the fourth quarter, the longest stretch since December 2013. The "Magnificent Seven" stocks and mega caps continue to lead, but breadth has significantly improved and remains strong.

A dovish pivot by the Federal Reserve on their expected path of interest rates and better-than-expected inflation reports lifted both stocks and bonds. Positive trends and the weight of the evidence remain supportive. A soft landing remains our base case in 2024. The delayed impact of tight monetary policy, fading excess pandemic savings, rising delinquencies, and geopolitical risk are likely to weigh on GDP this year and keep markets in check. However, a recession is not imminent, nor likely. This supports positive economic growth, near or below-trend (~2%), and continued disinflation, which is consistent with above-average equity returns.

The U.S. economy and job market remain strong. The Atlanta Fed's GDPNow model currently estimates the U.S. economy grew +2.4 percent in the fourth quarter of 2023, slowing from the very strong +5% in Q3. Retail sales continue to rise more than expected. Industrial production is stabilizing. The labor market remains tight with initial claims for unemployment of 187,000 in December, below the consensus of 208,000 and the four-week average of 203,250. This was the lowest level since September 2022 and the second lowest figure dating back to 1969. The unemployment rate held at 3.7% as payroll growth continues to hold, supporting a positive outlook for consumer spending and economic expansion. Consumer sentiment also continued to improve at the start of 2024 rising to the highest level since July 2021, but is far from extreme. (Chart 1)

CPI inflation ended 2023 at 3.4% with a continued drop in core goods leading the way. However, inflation is still above the Fed's target. Given risks from home prices, tight labor markets, and geopolitical conflicts impacting transportation costs and supply chains, the disinflation path ahead will likely be slower and choppier. Nevertheless, inflation has made sufficient progress toward the Fed's target to justify rate cuts later this year.

Real rates (adjusted for inflation) are positive, confirming that Fed policy is restrictive. If inflation continues trending lower without rate cuts policy will become increasingly restrictive and risk overtightening. The data indicates the Fed will need to cut this year, but we expect rates will be held higher longer than the market is currently pricing (Chart 2). Meanwhile, other tools are available to ease and release some pressure. In the last Fed meeting, the case was presented, and echoed by members since, to slow their balance sheet reduction, a sign that the Fed will end quantitative tightening and resume easing with signs of trouble.

The current cyclical bull market has played out roughly on track with past examples. We are currently exiting the early sentiment-driven phase of anticipating recovery and will now need to be supported by earnings growth to continue. P/E expansion is common during the first year of bull markets, as stock prices rise faster than earnings. As earnings growth gains momentum, multiples tend to flatten and keep valuations in check, in line with current expectations. (Chart 3)

For Q4 2023, according to Factset's January 19th *Earnings Insight*, the expected year-over-year earnings decline for the S&P 500 is -1.7%, an improvement from -4.1% decline in Q2. Revenues are expected to grow for the 12th consecutive quarter. Margins have continued to pull back from extremes but are expected to return to longer term averages in the coming months. Looking ahead, analysts expect earnings growth of 5.4% for Q1 2024 and 10% for Q2 2024. For the calendar year 2024 analysts are calling for earnings growth of 12.2%, continuing into 2025. (Chart 4) The 12-month bottom-up target price for the S&P 500 is now 5233, which is 9.5% above Friday's close. Estimates are supportive of higher prices.

The strong message from technical indicators supports the case for the secular bull market to continue into 2024 and beyond. The broad and intense buying seen in Q4 signals strong momentum. Consolidation or pauses along the way will be healthy. It would not be unexpected to chop for the first half of the year as gains from 2023 are digested, sentiment retreats from extremes and earnings catch up. This would also be in line with past election years, which historically have been positive for markets (Chart 5). Further, the continuation of the current cyclical bull market empirically confirms the potential to continue the secular bull market which began in 2013 (Charts 6). This provides healthy context but not a prediction.

Elections years bring change, and we are optimistic. Moderate economic growth, an earnings tailwind and a more normalized rate environment should support a continued broadening of equity market returns and positive performance. Employment, and thus consumer spending (2/3 of GDP), continues to be the key economic barometer to follow.

Our playbook continues to focus on significant secular, cyclical, and structural trends. Innovation and progress continue to march forward. We favor high-quality growth at reasonable prices and businesses with stable free cashflow and healthy balance sheets. We will continue to balance growth and value and are prepared to shift defensively if necessary.

We will respect the current trends and cautiously await further confirmation. Trust, but verify!

Morse Asset Management Investment Team

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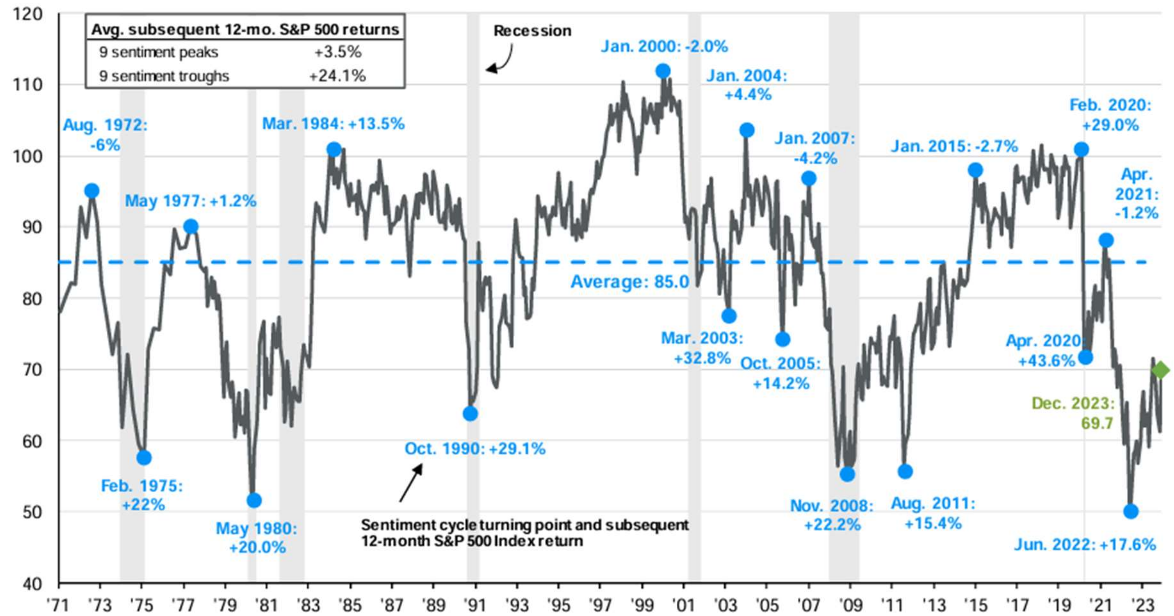
1.

Consumer Sentiment Index and subsequent 12-month S&P 500 returns

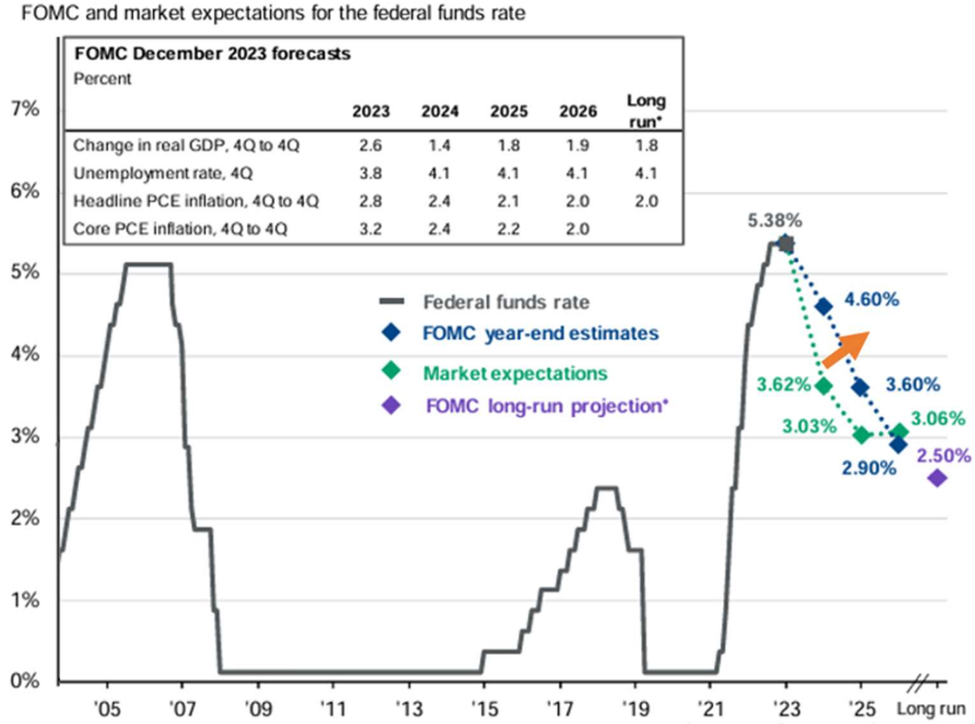


Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.

2.

Federal funds rate expectations

FOMC and market expectations for the federal funds rate

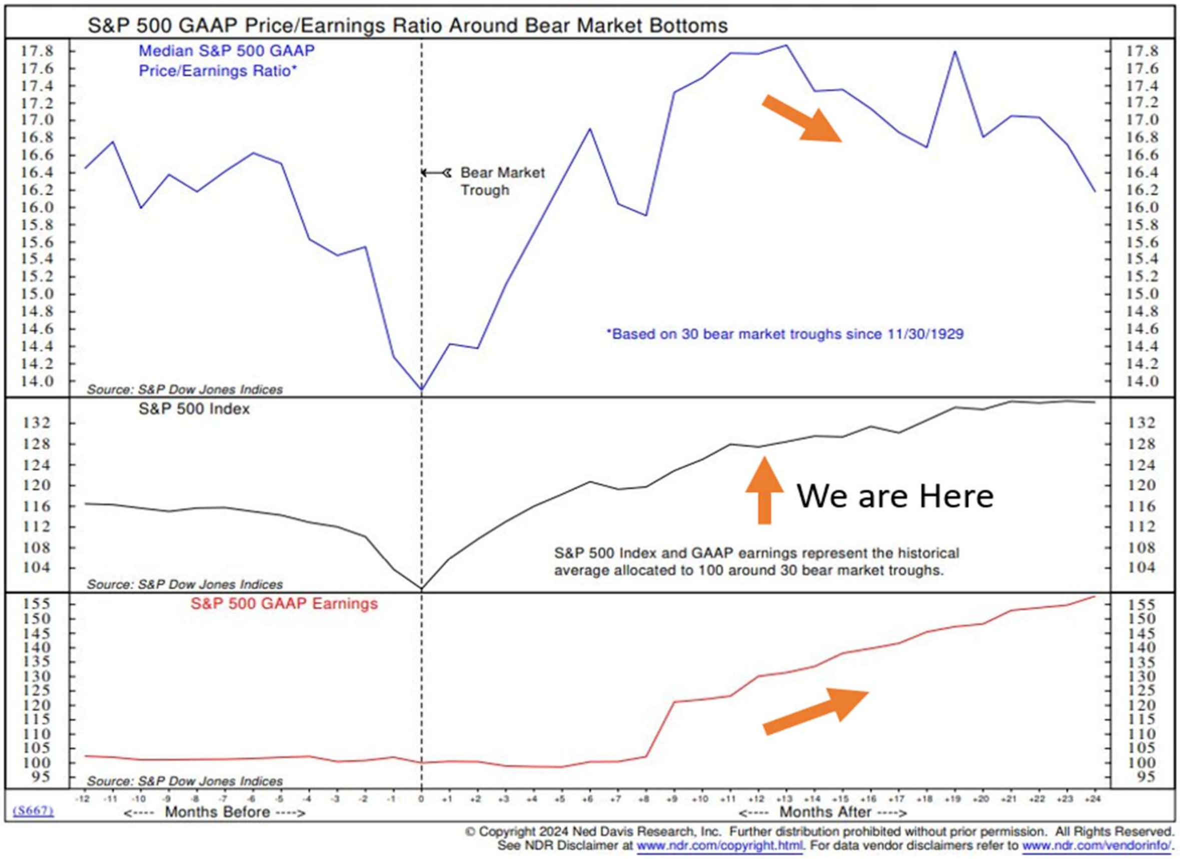


	2023	2024	2025	2026	Long run*
Change in real GDP, 4Q to 4Q	2.6	1.4	1.8	1.9	1.8
Unemployment rate, 4Q	3.8	4.1	4.1	4.1	4.1
Headline PCE inflation, 4Q to 4Q	2.8	2.4	2.1	2.0	2.0
Core PCE inflation, 4Q to 4Q	3.2	2.4	2.2	2.0	

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

3.

Year 1 of bull = PE expansion; year 2 = EPS growth



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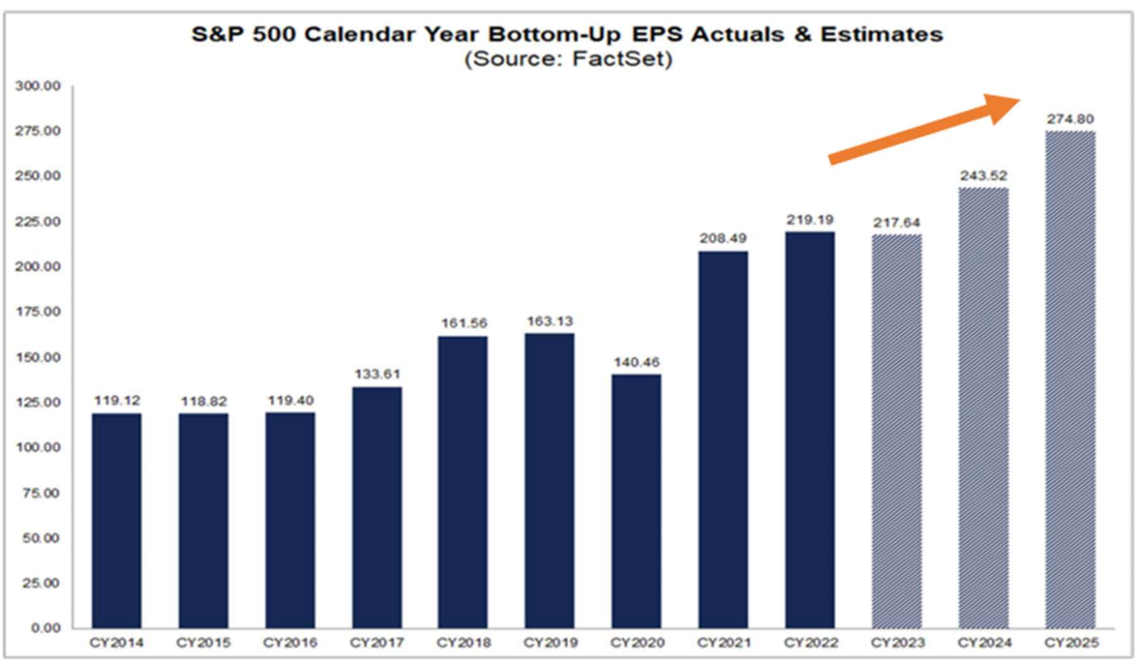

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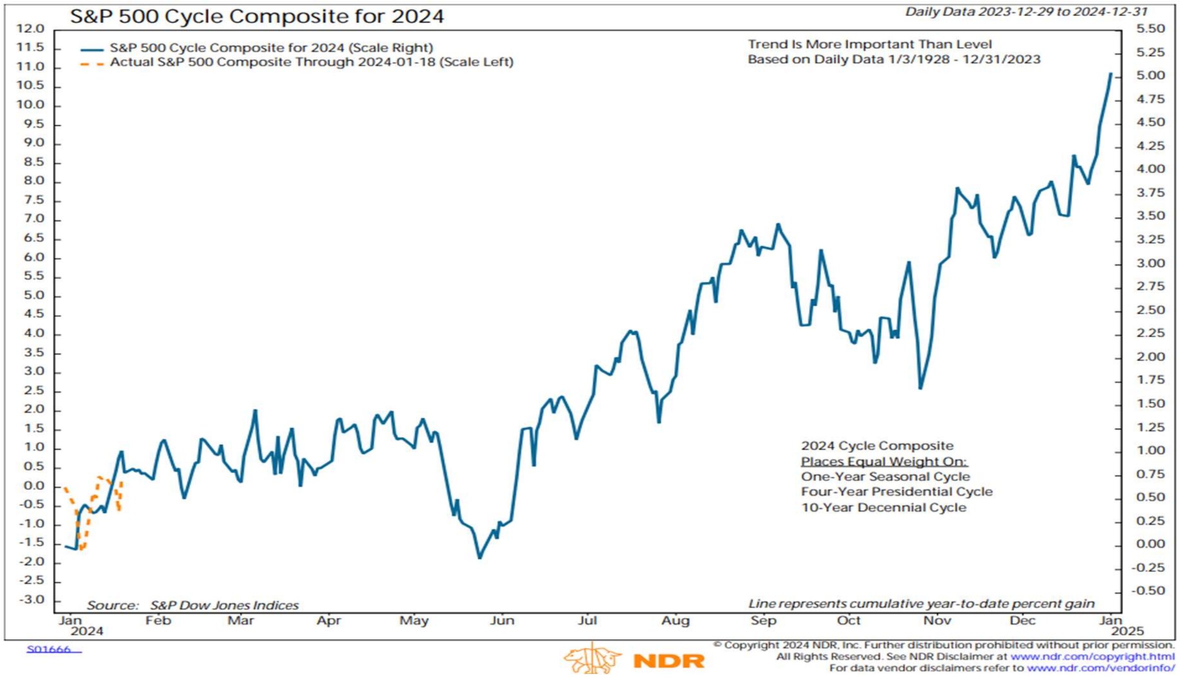

6.

Chart 3: S&P 500 secular bull market roadmap: Monthly chart 1928 to present

In 2024 the SPX will enter the 11th year of its secular bull market signaled on the breakout to new highs in 2023. The current secular bull market from the 2013 breakout above the prior highs from 2000 and 2007 is middle-aged and case last until the late 2020s into the early 2030s.

Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH