TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

On Our Radar – March 2024

For the first time, the S&P 500 index rallied above the 5000 mark, closing February at roughly 5096, up 5.1 percent. Meanwhile, the yield on the 10-year U.S. Treasury Note ticked up to 4.25 percent from 3.99 percent at the end of January and 3.88 percent at year-end. Additionally, the price of West Texas Intermediate oil rose about 3 percent in the month to roughly $78.50 a barrel.

Inflation as measured by Core Personal Consumption Expenditures (Core PCE) - the Fed's preferred inflation gauge - rose 0.4 percent month-over-month. On a 3-month and 6-month annualized basis, Core PCE increased 2.6 percent and 2.5 percent, respectively. On a year-over-year basis, Core PCE has fallen from a peak of 4.5 percent in late 2021 to 2.8 percent currently, the lowest rate since April 2021.

TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

Minutes of the Federal Open Market Committee (FOMC) meeting held in late January stated that "market participants were placing higher odds on significant policy easing in 2024 than they did just before the December FOMC meeting." With that statement, the Fed seems oblivious to the fact that between December 1, 2023 and the FOMC meeting on December 13, 2023, Jerome Powell's position on interest rate cuts went from "it would be premature to speculate when policy might ease" to interest rate cuts were "clearly a topic of discussion for us at our meeting today."

More troubling was the FOMC's unanimous decision to reaffirm its Statement on Longer-Run Goals and Monetary Policy Strategy without any revisions, despite the problematic outcomes of its flexible average inflation targeting strategy (FAIT), also known as the "inflation makeup strategy." This unanimous decision to maintain the status quo is a stark example of academic arrogance, highlighting a well-observed tendency in Washington to avoid admitting mistakes.

This stance is particularly concerning given that this policy approach was a key factor in allowing inflation to reach a 40-year peak before the Fed opted to increase interest rates. The origins of this policy can be traced back to March 2019, when Jerome Powell spoke on "makeup strategies and other policies" aimed at broadly benefiting the American populace, during a period when the Fed viewed inflation as excessively low, necessitating a radical shift towards an inflation makeup strategy.

That is why with inflation at more than a 30 year high in November 2021, Federal Reserve Bank of Minneapolis President Neel Kashkari said that the Fed "need not overreact to some of these temporary [inflation] factors." It wasn't until inflation escalated to a 40-year high that the Fed finally decided to increase interest rates, embarking on a challenging journey to rectify an inflation issue significantly exacerbated by their own policies.

Valuation

As we anticipate the final few companies to disclose their fourth quarter reports, it's projected that the S&P 500 earnings for the calendar year 2023 will approximate $213.80. This figure signifies an estimated 8.5 percent increase from the $196.95 recorded in 2022. Projections for the calendar year 2024 suggest earnings could reach around $240, indicating a growth of just over 12 percent year-over-year.

Currently, the S&P 500 is operating with a forward Price/Earnings (P/E) ratio of approximately 21.4 times earnings. This level typically places the market's valuation in a neutral position. However, with the Federal Reserve indicating potential interest rate reductions in the future, market observers might shift their focus towards the earnings forecasts for 2025, which are expected to show another increase.

Economic Cycle

The second revision of Gross Domestic Product (GDP) for the fourth quarter 2023 was 3.2 percent, down from the initial estimate of 3.3 percent and lower than the third quarter's pace of 4.9 percent. Despite a 0.4 percent decline in the Leading Economic Index (LEI) in January 2024, the positive performance of six out of its ten components over the past six months has led the Conference Board to dismiss recession fears.

However, February saw a dip in Consumer Confidence to 107.7, down from 114 in January, and the Institute for Supply Management (ISM) Manufacturing index dropped to 47.8. This index has remained below the 50-level, which indicates contraction, for sixteen consecutive months. Additionally, an uptick in delinquency rates for credit cards and auto loans has raised concerns about the resiliency of consumers.

Sentiment

We consider investor sentiment to be a contrary indicator, especially at extreme levels . Prior to the commencement of the stock and bond market rally in late October, less than 43 percent of advisors were bullish, while bearish sentiment had climbed above 25 percent. This was at a time when the yield on the 10-year U.S. Treasury notes surpassed 5.00 percent for the first time since 2007.

Following that period, bullish sentiment has jumped in lock-step with the rising trends of the U.S. equity markets, soaring into the high 50s. Concurrently, the proportion of bearish advisors has fallen to the low 16s, marking its lowest point since the summer of 2021.

Now, with the Bull-to-Bear spread venturing into the low 40s, it increases the probability of a market pause or pullback.

Technical Factors

Similarly to sentiment indicators, at the late October low, the percentage of stocks trading above their respective 50-day moving average fell to around 15, indicating that the market was significantly oversold. While "oversold" market conditions can lead to further declines, it often marks a favorable entry point for investors.

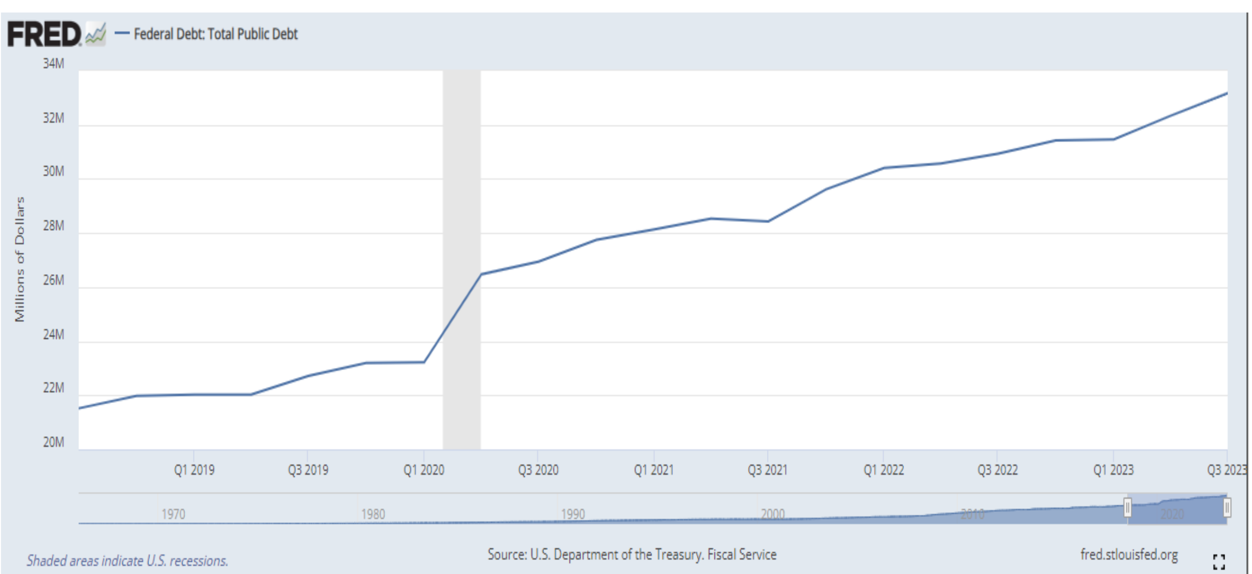
By the end of the year, the percentage of stocks trading above their 50-day moving average had climbed to over 84, pointing to an "overbought" market condition. It's worth noting, however, that overbought markets can still experience upward momentum and often do.

Since that peak, there has been a sort of internal correction beneath the surface of the market averages, with the percentage of stocks trading above their 50-day moving average declining to the mid-50s range.

Outlook

The U.S. equity markets have experienced a powerful rally since last October when the yield on the 10-year U.S. Treasury Note briefly traded over 5.00 percent. This rally gained momentum following Jerome Powell's press conference in December 2023, where the Federal Reserve signaled the possibility of three interest rate cuts in 2024, markedly altering market expectations regarding the Fed's rate policies.

While the U.S. economy has been expanding and corporate earnings remain robust, it's important to acknowledge that a substantial part of this growth has been fueled by deficit spending and a significant rise in federal debt. The U.S. Treasury reports that the federal debt has reached approximately $34.4 trillion, an increase of about $1.3 trillion from $33.1 trillion at the end of the third quarter as seen in the chart below. The cost of servicing this debt now exceeds $1 trillion annually.



Though borrowing can continue for some time, it is not a sustainable long-term strategy, and Congress appears unable to proactively make necessary adjustments. In a recent move, President Biden signed another government funding extension to prevent a partial shutdown for at least another week, marking the fourth instance since September that a shutdown was avoided through a Continuing Resolution.

Amidst these domestic challenges, the Fed is also contending with inflation in an increasingly complex geopolitical landscape. Conflicts in the Middle East and heightened shipping threats in the Red Sea are forcing cargo ships to alter their routes, leading to increased shipping costs and delays. Furthermore, OPEC+ has resolved to maintain oil production cuts through the first half of the year, potentially stalling the downward trend in inflation.

Given that it is an election year, there is a strong likelihood that the Fed will opt to reduce interest rates well before November. The markets are currently factoring in nearly an 80 percent chance of a rate cut by June 2024.

As the markets have come a long way in a short period of time, a pause or pullback would not be unexpected. However, with the economy growing, corporate earnings projected to rise, and a Federal Reserve that is shifting away from restrictive policies, any resulting volatility is likely to present investment opportunities. (3.6.24)

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