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2023 Year-End Review and 2024 Forecast

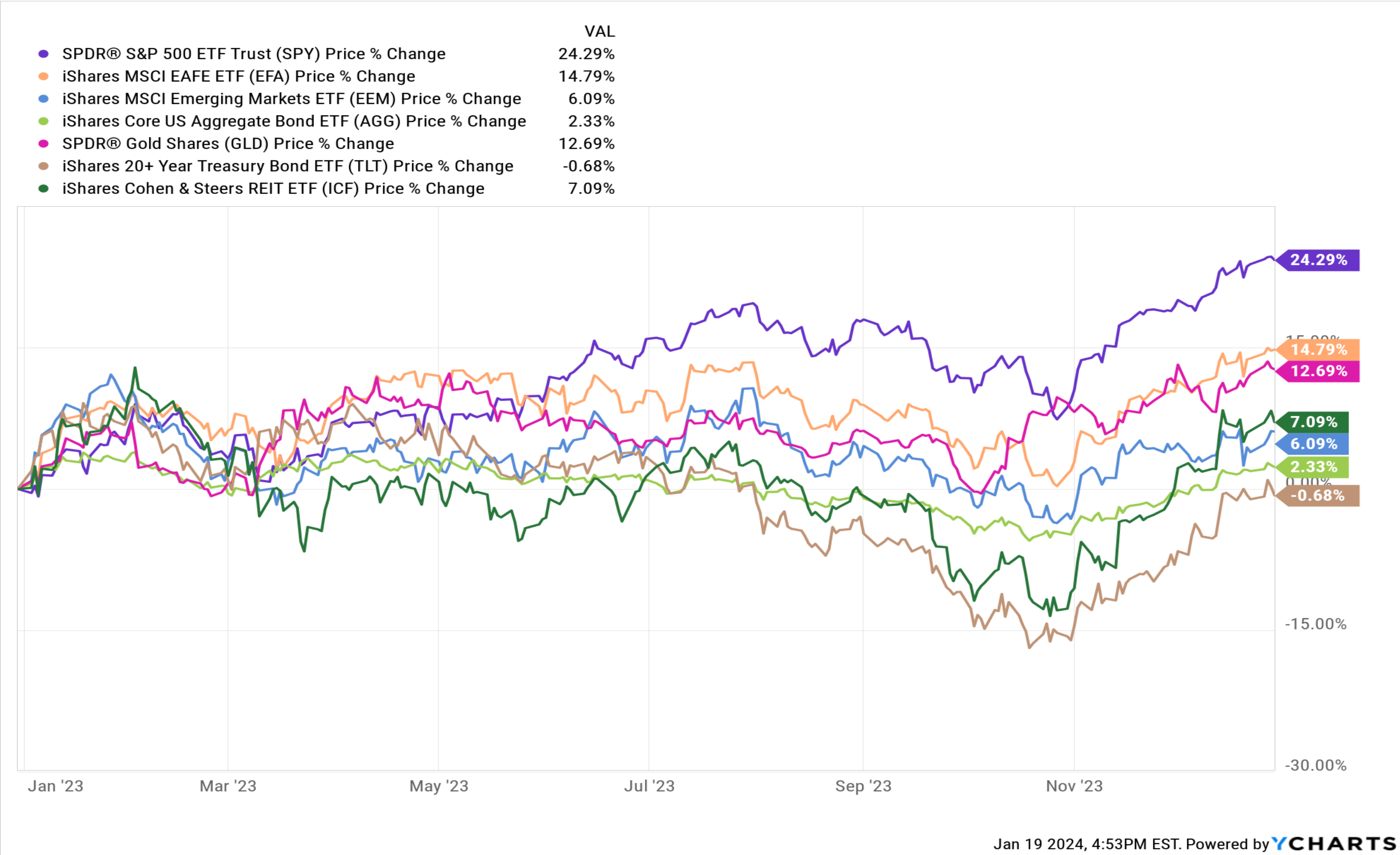
19 January, 2024

I like to start these year-end reviews by looking back at the predictions I made at the beginning of the previous year. Quite often this analysis shows just how difficult it is to predict market and economic events – usually I get some things right and some wrong as well.

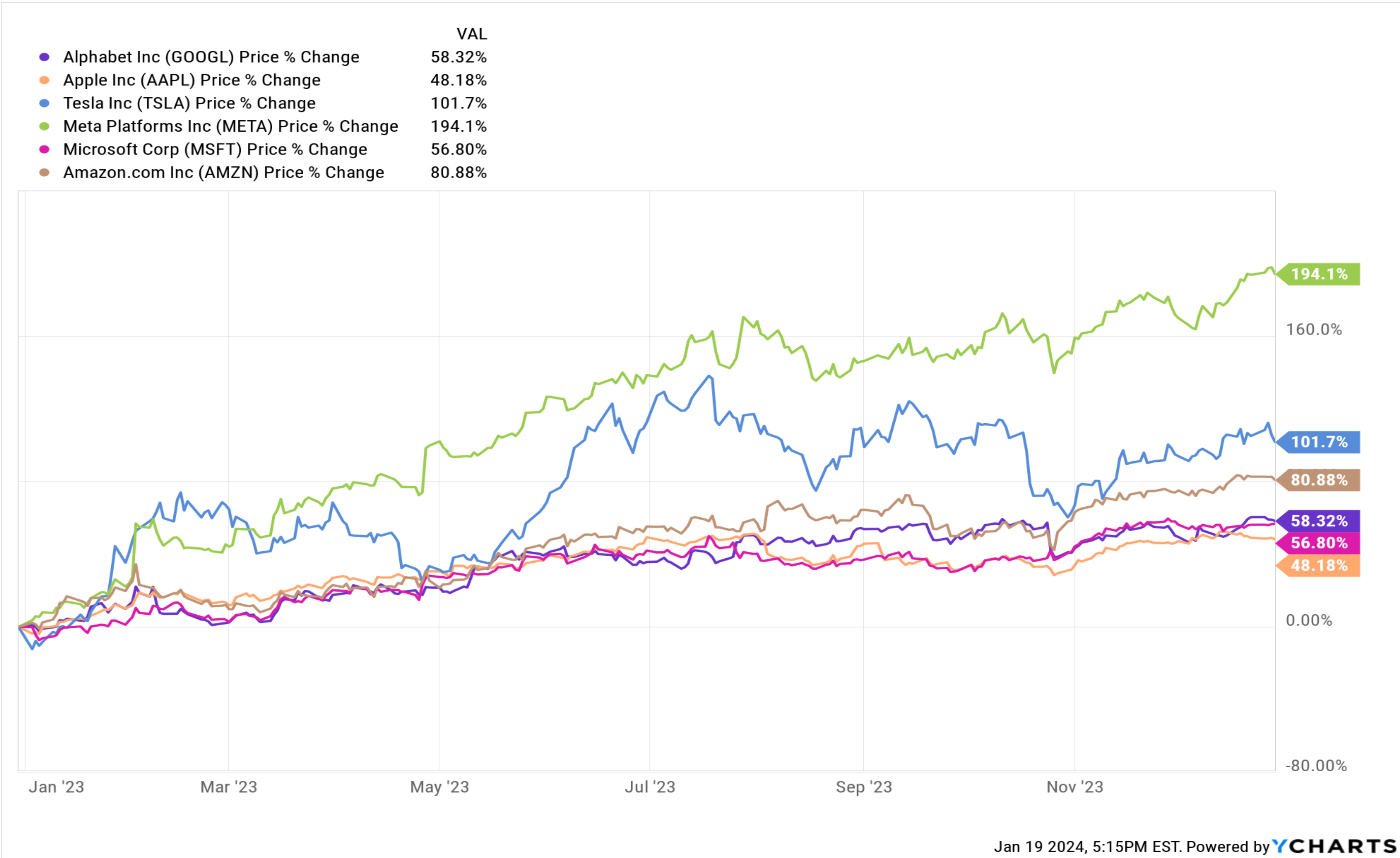
At the beginning of 2023 I was expecting a good year for stock markets in general and expected non-US markets to outperform US markets. I thought that value stocks would outperform growth stocks and that China would bounce back post-Covid. I also expected a good year for bonds and gold once interest rates stopped increasing and inflation was brought under control. I thought that risks of recession, especially in the USA were overblown.

I got the general themes right because in fact it was a good year for stock market investments, the US did not slip into recession, gold did reasonably well, and bond markets rallied towards the end of the year on expectations that interest rate increases had ended and that perhaps rate cuts might happen in 2024.

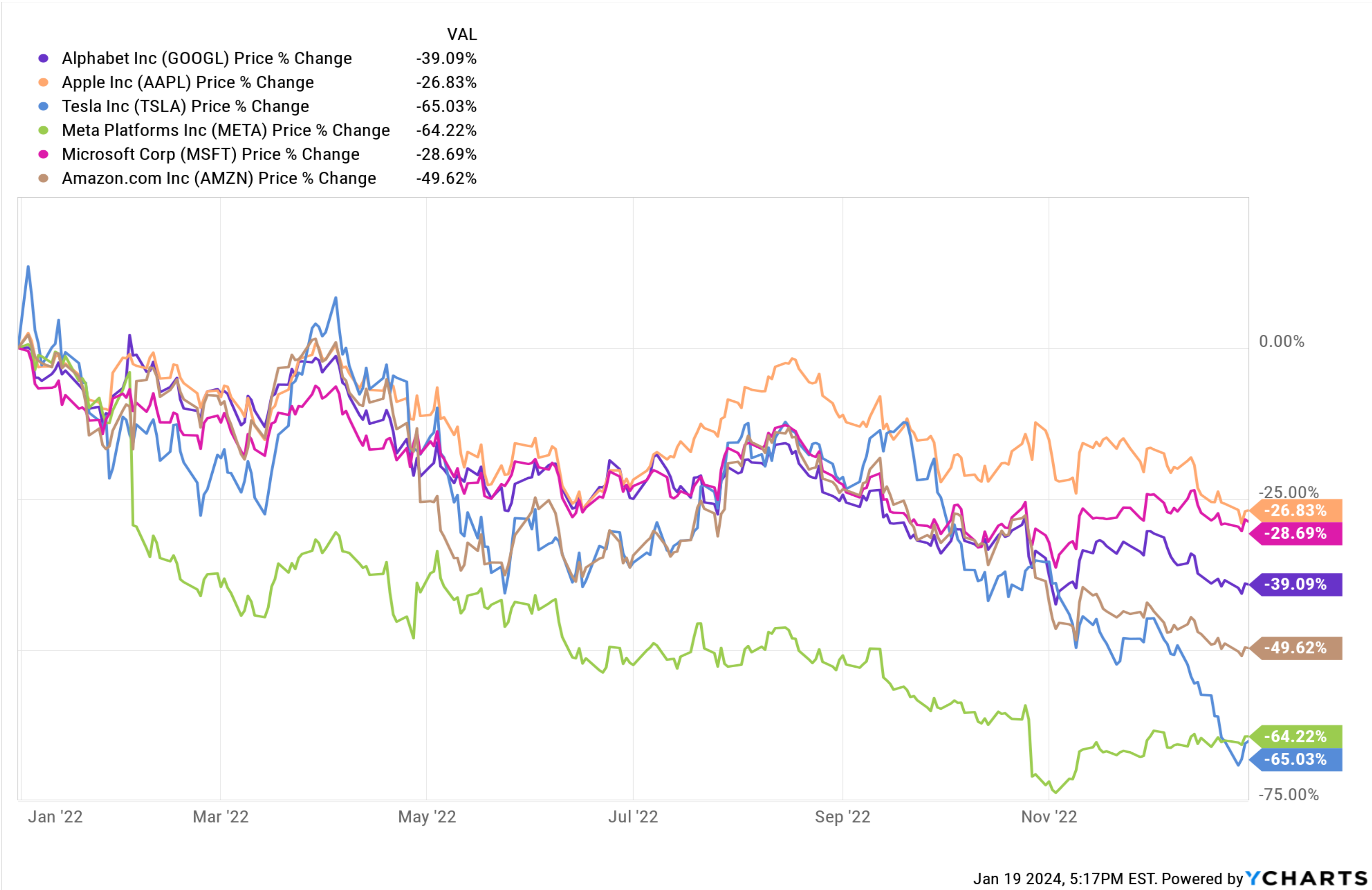
As usual, there were also some misses in the projections: US markets did better than non-US and specifically US growth stocks far outperformed value stocks, although both were up for the year. China did not bounce back as a result of concerns about the property bust in China and how this might affect the banking system. The chart below shows how various asset classes performed in 2023.



It is easy to see why the US stock market outperformed last year, and why growth companies outperformed value. Have a look at the chart below of returns on some of the largest US technology-related companies.



The chart below shows the same companies the previous year, in 2022.



Talk about volatility! Meta (Facebook) down 64% in 2022 and up almost 200% in 2023! It sounds like a lot of upside for Meta over two years but it is important to remember how percentage returns correspond to dollar returns. Consider a $100 investment in Meta at the beginning of 2022. This would have been down 64% by the end of the year and so you would have $36 worth of Meta stock left. Then it would have been up 200% in 2023, but 200% of $36 is $72 so you would have $108 of Meta stock at the end of 2023, for an 8% gain over the two years.

In comparison, the least volatile of these companies over two years, Apple, was down 27% in 2022 and up 48% in 2023. So this would mean that for a $100 investment at the beginning of 2022 you would have had $73 of Apple at the beginning of 2023 and $108 worth of Apple at the end of 2023. about the same as Meta stock but with much less volatility. You would have actually come out a bit ahead with Apple since it also pays a small dividend whereas Meta doesn't.

Who could have called such dramatic swings in these technology companies over two years? It is difficult to time the market and many investors end up selling losers and buying winners, getting out near the bottom and in near the top. Buying good investments that you expect to hold for the long term is a winning strategy for most people. Having said that, there are times when changes need to be made. Sometimes the changes are obvious - like when interest rates are very low and likely to increase, it is a gimmie that bonds will not do well, especially long-maturity bonds. Most times it isn't clear when a change should be made and that is why we don't put all our eggs into one basket and why we cannot be disappointed if we are not always in the best-performing investments.

The other question that comes up is whether it is best to invest in funds or in individual stocks, bonds, etc. In smaller accounts, investing in funds is pretty much a necessity but in larger accounts it is a choice. It is easier to manage a portfolio of funds but we have found that over the years investment selection can be an important value add to a portfolio. Furthermore, this is clearly the case in the broad investment market as private equity funds have generally outperformed public mutual funds.

I think investment selection will be important in the year ahead. It is unlikely that the US market will notch the gains it did it 2023. Also, developed markets as a group will likely face an economic slowdown, and in some places, like Germany, a recession. Emerging markets are a mixed bag, with great concern over China's property and banking issues, but potential in places like Turkey, India, and Indonesia.

The German economy is especially worrying. In 2023 Germany was the worst-performing of the developed market economies according to the International Monetary Fund and things don't look much better so far this year as there is considerable turmoil both in the workforce and politically. There is some hope, however, since inflation has generally come down in Europe and wages have increased - this should be good for consumers and retailers but not so good for manufacturers.

China is another area of uncertainty going into 2024. On the one hand there is recovery post-Covid and economic stimulus, but on the other hand there is clearly a deep property crisis and banking crisis as a result. Growth in China is not at the pace it has been over the last two decades and institutional investors are shying away from the country. We continue to believe that India is a better bet investment-wise than China.

Some other interesting emerging markets are Turkey and Indonesia. Indonesia is one of the largest miners of nickel in the world, which is a key component in batteries for electric vehicles. The Indonesian government doesn't just want to be an exporter of raw materials, they are insisting that companies that want access to its materials build value-add factories in Indonesia to refine the material. Turkey is a bit of a wild card but the recent political climate is encouraging and a large fall in the value of the Turkish Lira over the last few years may reverse, or at least slow, as inflation in that country is brought under control. PIMCO, the large fixed income investment firm, expects that Turkish government bonds could attain an investment grade rating over the next few years. At the moment they are about 4 or 5 notches below investment grade so this would be quite a leap.

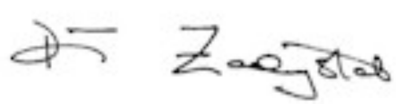
The middle-east situation is another area of concern. There is the current Israel - Palestine/Hamas conflict, which, of itself, would likely not affect most investors. However, there is the risk the conflict could expand; already we see Houthis in Yemen affecting shipping on the Suez Canal route, it is possible Hezbollah gets into the game as well, and then there is the nascent conflict between Iran and Pakistan. It's hard to know how all this will play out but if things go south then that would likely drive the price of oil and gold upward. If things get better, then it is possible the price of oil comes down because in general we have an oversupply of oil at the moment based on robust production in non-OPEC countries.

Crypto has also gone through crazy investment gyrations over the last few years and there has been a bit of a shakeout in the sector. However, the big news in this space is the advent of Bitcoin exchange-traded funds and specifically leveraged funds which track Bitcoin prices up or down at 2x or 3x multiples - as if the price of Bitcoin wasn't volatile enough already, we now have funds that amplify these prices by double or triple. In my view a lot of people are going to lose a lot of money in Crypto over the next few years, and a few will make lots of money. Personally, I am staying out of this.

There are also more focused investments that should be looked at. For example, green energy companies have not been doing well recently despite what would seem to be a long-term trend that should be positive for this sector. With share prices down, now could be a good time to invest. Electric vehicles are also clearly here to stay but the economics are not compelling at the moment for manufacturers. On the other hand, companies like the Chinese BYD, that can source raw materials at a good price locally and have lower labor costs than in Europe for example, are doing well.

Artificial intelligence seems to be the catch-phrase for 2023 and 2024. As usual, there will be investors jumping on this bandwagon but few companies in this space will eventually profit. At the moment, it seems like the big winner from this could be Google. There will also be a number of smaller, more focused, companies that do well but picking them from what will likely be a crowded field will be challenging.

In general, I am broadly positive on investment markets this year although I don't expect as good returns as 2023. I do think there are good opportunities in bonds at the moment, especially US bonds, as I think interest rates have likely stabilized and will come down some perhaps later in 2024. At the moment, there is too much optimism regarding lower rates but perhaps in a month or two this will cool, yields will increase, and that will be a good opportunity to jump in.



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