The Everything Rally Extends into Extra Innings
Haven Global Partners, LLC.
Market Outlook: 1st Quarter 2024

2023 was a year that defied expectations. First, the most anticipated recession in the history of the world never happened and then stocks went on a massive runup. Well, apparently the ride is not over yet because aside from ushering in the beginning of the 145th Major League Baseball season, the end of the first quarter also witnessed a continuation of what has come to be called the "Everything Rally." Not only were US stocks, led by Mega cap tech names, driven to record highs, but so too were stock markets in South Korea, Europe and Japan. Much of the credit for the global stock market rally should go to the world's central banks. Primary among them would be the United States Federal Reserve Bank which after hiking rates at an unprecedented pace relented late last year and has now assumed a decidedly more dovish approach.

The Fed Chairman Jerome Powell is convinced he has done what few others in his position have ever done, that is successfully execute a "soft landing" by raising interest rates just enough to stop the rampant rise of inflation but then stopping the rate hikes just in time so that the economy doesn't fall into a recession. The US Fed raised its policy rate by more than 5% in 500 days! Yet the US economy just keeps chugging right along with a real growth rate which has averaged around 3%. A true "Everything Rally" would need more than just the US Fed to be on board, and so the Fed's counterparts at the European Central Bank and Bank of England have also given hints that they too intend to join the Fed in ending interest rate raising regimes. The Swiss National Bank actually surprised markets with a rate cut right at the end of March. The Bank of Japan allowed its rate to rise recently, but they are on an entirely different page in Japan, having had negative interest rates for the better part of a decade. Not to mention this was Japan's first rate hike since 2007. Hence, monetary policy in Japan has been very accommodative for a very long time. Emerging Markets central banks have also been involved. In fact, the case can be made that in Latin America, at least, they are ahead of the Developed Markets in the easing of policy rates. Brazil, the biggest market in Latin America, is leading the way. Interest rates in Brazil peaked almost exactly a year ago, and the Central Bank of Brazil has cut rates four times since then.

Thus far that paints a pretty pleasant picture in terms of the outlook for global equity markets, but as usual there is the possibility of a spanner in the works. Market participants have gotten ahead of themselves with the anticipation of rate cuts and driven stocks to what many believe are unsustainable highs. More accommodative financial conditions which are brought about by higher stock market values (making investors feel more wealthy) in combination with lower yields, the US Treasury 10-year yield peaked last fall ~5% but has this year fallen back below 4%, (which make financing projects less expensive) are more likely to lead to more favorable outcomes for economies in a macroeconomic sense and then companies in a microeconomic sense. So, investors are buying stocks around the world with a seemingly unquenchable desire. Whenever that happens the risk of a significant correction occurring increases. Be on the lookout!

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High valuations are not the only problems facing global stock markets. Eleven (yes 11!) Fed rate hikes have made bonds an asset class again, and that is bad for stocks everywhere! A thing so basic as asset allocation may represent the biggest risk to the recent runup in stock prices. Some readers may remember the phrase TINA. An acronym for There Is No Alternative (to equities) the phrase was used over the past decade since interest rates were driven to all-time lows in many markets. The implication was that with interest rates on bonds at such low levels an allocation to fixed income didn't seem to make any sense. Investors all over the world were seemingly forced to buy equities because with bonds providing virtually zero return they had no choice but to buy stocks. Without the income reasonably priced bonds provided stocks with high dividends became a replacement of sorts for bonds. Many investors felt compelled to buy stocks. With the US Treasury 10-year yield back up to its long-term average yield that is no longer the case. There IS now an alternative, and that has to drive down demand for stocks.

Geopolitics is a risk to stock markets all over the world, as well. The threat that the current regional wars will in Europe and the Middle East could spread and become a greater threat is a real concern and could impact global markets in many ways, and almost all of them are bad. Upheaval in the Middle East almost always causes disturbances in the global oil market, although the fact that the United States stepped in last year to increase production and export of a record amount of natural gas might literally have saved our European allies from terrible outcomes as they cut off their use of Russian oil & gas.

For political reasons, U.S. businesses are seeking to decrease their dependence on China. The U.S. government has also intervened to try to cut China off from leading edge semiconductor technology. These efforts have had mixed results at best. But there are still massive U.S. commercial interests in China. China remains one of the most profitable foreign markets in the world for U.S. companies, especially in consumer goods. U.S. firms have begun to diversify their supply chains away from China. This "near shoring" move has increased U.S. business in Mexico for example but finding alternative sources of demand for U.S. goods may not even be possible.

With this as a backdrop, the conflicts between the two superpowers may escalate by necessity. In this event, owning stocks in Chinese companies may not be the best way to gain exposure to the world's second largest economy. It may be necessary for investors to try and capture a share of this growth another way.

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