Investor Insights & Outlook

January 2024 1st Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

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Is the economy in good shape, gliding towards the 'soft landing' so many of the prognosticators and various economists hoped would be the case with the Federal Reserve Board's actions over the last 18 months or is the US at the precipice and about to collapse under the weight of massive debt obligations, higher interest costs, and a revaluation of every asset class? Depending on who you ask, you'll get various different opinions.

For the 'good shape' crowd, pretty difficult to argue with a robust real GDP number in the 4th quarter of 3.3% following the Q3 number of 4.9%. Increased consumer spending in both goods and services, increases in state and local government spending and nonresidential fixed investment, and increased federal government spending led the way. Gross nominal GDP for the trailing 4 quarters was just a shade under $28 trillion. Inflation rate increases have subsided and that gave a boost to real disposable personal income increasing 2.5% for the quarter. Overall real GDP for 2023 was up 2.5% after an increase of 1.9% in 2022. Nominal was up 6.3% in 2023 after a 9.1% increase in 2022. If we review consumer balance sheets, specifically the liabilities, 66% of debt outstanding are mortgages and 90+% of those are still at the historically low rates of previous years indicating consumers are not feeling the pinch of higher interest rates. The robust nominal GDP numbers have actually caused the Debt to GDP percentage to decrease the last couple of years, even with massive annual deficits (meaning the US has more borrowing capacity). The increased interest rates, that we will discuss from a negative point of view below, have actually provided additional income to investors in the form of higher return on cash balances, no doubt appreciated by our readers.

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Domestic Economic Overview (continued)

For the 'at the precipice' crowd, lag effects from the increased interest rates are knocking at the door. Job openings are down from 12mm to 8.7mm between March 2022 and this past October, the maturing debt issues related to nonresidential real estate are going to come to a head this year, nominal outstanding federal debt increased to $33 trillion after the US government ran up another $1.6 trillion deficit for the fiscal year ending 9.30.23 (and spending is locked in for 2024 which means the US will have close to $35 trillion in debt obligations outstanding by the end of this year), inflation, while slowing its growth, has made everything 40% more expensive in nominal terms over the last few years. Although consumer spending continues to power the US economy, there are hints that the strong momentum will fade this year. The personal savings rate fell from 4.1% to 3.7% in December, indicating that consumers dipped into their savings to fuel their consumption. The tailwind from excess pandemic savings is fading. And while the labor market is still resilient, the job openings rate and hirings rate are both falling, signaling that labor demand is weakening. Eventually, this will push up unemployment and weigh down on consumption.

Clearly there are arguments for both directions of domestic economic performance. Last year we wrote that we expected a bumpy first half of 2023 with the second half of the year showing stabilization. 2024 is an election year so we expect things to remain unpredictable even though the political noise is going to increase throughout the year and therefore we are remaining in a defensive posture.

International Economic Overview

Broadly speaking, given the events occurring throughout the globe, the fact that the international economy has not ground to a halt is relatively impressive. A current list of international issues:

- Israel-Hamas conflict
- Russia-Ukraine war
- China and US tensions around Taiwan
- Potential Korean peninsula issues
- Collapsing demographics of China, the main driver of global consumption
- Generally a shifting landscape on geopolitical powers and trade relationships.

So how is the international economy doing given the above concerns? Growth is moderating and, in certain pockets, concerning. Economic activity in the Euro area is negative, with France leading the way and Germany in a close second. France and Germany's composite purchasing managers index (which combines manufacturing and services) came in at 43.7 and 46.7, respective, and France's index is as negative as Q1/Q2 of 2020.

Southeast Asia is going to continue being a concerning point on the globe for the foreseeable future. China's growth problems are well documented and their real estate sector specifically is tipping over. They were the driver of global consumption over the last 20 years and that trend has reversed. Commodity exporting nations are having to look elsewhere for growth. The one bright spot in the area is India, their real GDP growth for 2023 was over 6% and that growth is expected to maintain for the next 5 years. They will add over 92 million working age people between now and 2033 while China will shed approximately 39 million. That amount of workforce change in both countries has profound growth implications, in opposite directions, for the two countries.

With the troubled signs in most developed markets and the absence of the Chinese growth driver, whether due to excesses in its real estate sector or poor demographic trends, that has been a bright spot for several decades, it is difficult to be optimistic in the near term for global growth.

Fixed Income

Q4 contributed to a recovery year in domestic fixed income performance. Despite the rally at year-end and for all of 2023, most investments in traditional bond asset classes reflect total return losses for the combined prior 2 years. This significant shift to higher yields represents what we believe to be a return to more normalized levels when considering current inflation rates and economic growth levels. This change has not only created some total return losses for fixed income investors but has had some impact on equity returns, especially in 2022, as valuation metrics have had to adjust. Real yields (nominal less inflation) on medium term Treasury Notes have turned positive for the first time since 2020.

At the current higher yield levels, medium term Treasuries are relatively attractive and reflect more potential resilience (because of higher current coupons) if rates move higher. Investment grade spreads are narrow historically and make longer term issues less appealing. Less than investment grade (junk) corporates also do not reflect great value, particularly if the economy eventually weakens as has been predicted for over a year. Several strategies and segments in fixed income that we have utilized over the past 2 years (ultra short funds, short callable municipals and convertible arbitrage) are still attractive moving forward. These allocations have outperformed broad bond aggregate indices and medium-term Treasury allocations by significant amounts during the fixed income bear market. Looking to the medium term, one to three years, we believe yields are likely to stay at current levels or move modestly higher as sticky inflation resulting from wage pressure and high government debt levels keep a floor under yields. The strategies discussed above along with exposure to 3-5 year Treasury issues and residential mortgage backed securities reflect a lower risk strategy to achieve competitive cash returns while minimizing credit and duration risk.

Total Returns		
	2022	**2023**
Bloomberg Aggregate	-13.01	5.53
ICE BofA HY	-11.19	13.46
Vanguard I-T Inv Grade	-13.78	8.61
5 year USTN	-9.74	3.93

Source: JP Morgan; US Bank; Vanguard

Equity Markets

In 2023, most segments in the domestic equity market recovered greater than the losses incurred during the bear market of 2022. As a result of the math involved in gains required to recover from prior losses, most equity investment strategies have produced close to breakeven results over the 2-year period. As has been widely highlighted recently in the financial press, a limited number of very large capitalization stocks have driven the bulk of the performance of the widely followed indices. However, particularly in the second half of 2023, several other sectors of the market contributed gains as investors began to doubt the likelihood of a significant economic slowdown in the near future. In particular, many consumer, industrial and financial stocks had strong gains.

As the market stands at calendar yearend, valuations appear full considering the current level of interest rates and what appears to be slowing earnings growth. However, there are always pockets of individual stocks and sectors that represent good value for various reasons and this appears to be the case now. In particular, the energy and healthcare sectors appear to offer some attractive valuations for long-term investors. Many higher yielding stocks also represent good value, however short-term, higher quality fixed income investments now provide legitimate alternatives as bond yields have moved higher over the past 2 years.

Overall, our current equity strategy consists of maintaining an allocation modestly below long-term norms and to focus on individual positions that represent value irrespective of what overall market valuations may suggest. Market leading businesses with management, product, service or cost advantages tend to weather difficult conditions and many times gain market share during those periods.

Equity Performance (%)		
	2022	**2023**
S&P 500	-18.1	26.3
S&P 500 Equal Weight	-13.11	11.6
Large Cap Value	-7.5	11.5
S&P Energy	65.7	-1.3
S&P Healthcare	-2.0	2.1
Consumer Staples	-0.6	0.5
S&P Technology	-28.2	57.8

Source: JP Morgan; US Bank