GNH CAPITAL GROUP of Wells Fargo Advisors

Q1 2024 — STRATEGY & MARKET UPDATE

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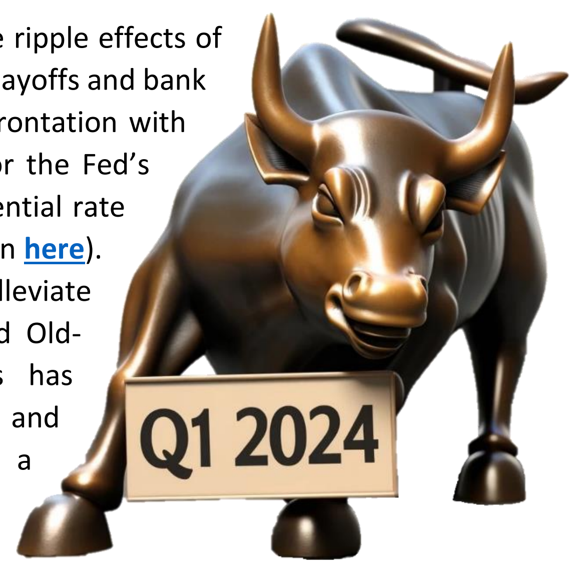
[This year, we've started publishing fresh, timely research and topical market commentary on **LinkedIn**. Subsequently, select pieces are circulated via email to our investors and followers and archived on our **website** for reference. We invite you to follow our LinkedIn page and share this valuable content with your investor network.]

EXECUTIVE SUMMARY

- The market advanced vigorously in Q1, with Growth, Quality, Momentum, Large Caps, and Innovation issues leading.
- Although we believe the market regime is bullish and investmentworthy, our research highlights three main risks, two of which are inherent in the current landscape: the **Fed's ill-conceived rate crusade** and **the market's hyperconcentration**.
    - After engineering a sizeable correction in 2022, the ripple effects of which substantially roadblocked the Fed policy (via layoffs and bank failures), the market has now largely won its confrontation with the central bank. It has compensated investors for the Fed's pressure and stands to benefit further from a potential rate cut in the second half of 2024 (we explain the reason **here**).
    - Additionally, March saw the market's attempt to alleviate some of its hyperconcentration risk as Value and Old-Guard sectors experienced a resurgence. This has broadened the front of the market's advance and increased its resilience. Our strategies maintain a predominant allocation to the ongoing leadership with a minority exposure to risk-mitigating assets.



- The third risk is not a market feature but rather an unforced error committed by investors adhering to outdated advice—a mistake we believe is not mirrored by our strategies. Traditionally, mature investors with income needs, shorter personal investment horizons, and lower risk appetite are advised to rely on bonds and income-heavy securities within so-called 'Conservative' portfolios. However, we believe this formulaic approach has been out of sync with the market in recent years, potentially increasing the risk of shortfall. We explore this further in our recent three-part research post (linked **here**), which we highly recommend sharing with your investor friends.

Q1 2024 – THE QUARTER IN REVIEW

Market Up, Pundits Down.
The first quarter proved notably strong, marked by significant gains across the broader indices. The MSCI World ex-USA index rose by +4.88%, the Dow by +5.62%, and the S&P 500 by +10.16%.

Once again, these advances caught many Wall Street pundits by surprise. As recently as in early December last year, the median 2024 S&P 500 target forecast provided by the strategists of the largest firms stood at a pessimistic 4,725, yet the index concluded March at 5,255—a remarkable +11% higher than forecast![1]

Taken aback by such a miss, Wall Street strategists have been actively revising their targets. Now, while most predictions cluster around 5,200 (which matches the S&P 500's current level), they range widely from 5,500 (suggesting a modest headroom) to…4,200 (forecasting a sizeable drop)[2]!

What has Wall Street so confused? What are they missing?

The Market's Health.
Wall Street broadly adheres to the antiquated view that the market is a passive arena of prices shaped by external factors like corporate earnings, the economy, central bank decisions, or geo-/politics.

*Wall Street broadly adheres to the antiquated view that the market is a passive arena of prices shaped by external factors and currently assesses those influences pessimistically. We disagree, seeing **the Market as a Regime in a Bullish trajectory.***

Currently, Wall Street assesses those influences pessimistically: Earnings are seen as overextended or strained. There is still talk about a possible recession. The consensus is that the Fed is not satisfied with inflation's drop and needs to keep administering the medicine of higher interest rates for longer. Plus, most pundits have a negative view of geo-/politics.

Readers of this series and followers of our work are familiar with our consistent critique of this viewpoint. As we have argued, this mechanistic approach struggles to account for market crises (including the veritable bears of 2000 and 2008 or the non-bearish crash of 2022). Moreover, it fails to appreciate the market's remarkable resilience, which, as we assess, has persisted interruptedly since 2009.

In contrast, we believe that the market's vast complexity and scale endow it with the emerging self-organization and self-regulation of a Regime. As a Regime, the market develops a resilient directional orientation—either Bullish or Bearish—that is sustained homeorhetically against most exogenous forces and shifts on its own weight. In essence, the market possesses its own dynamic, capable not only of accommodating external forces but, more importantly, of assimilating exogenous influences within its own trajectory.

The CoViD crash of 2022 provided a vivid contrast between the two approaches:

The Wall Street mechanistic view declared the CoViD crash as a bear market, citing the massive drawdown (-37%) and the sudden collapse in sales, income, and GDP, which prompted the National Bureau of Economic Research (NBER) to declare an official recession.

But was it truly a bear market?

With the swift rebound that propelled the market to a remarkable gain by year-end (S&P 500 +18%), the CoViD crash certainly did not resemble the veritable bears of 2000 and 2008, leaving investors questioning the guidance of the mechanistic view.

In contrast, as detailed in our quarterly reports, our strategies have not seen a bearish market regime shift since 2009, notwithstanding the CoViD crash. As a result, we have consistently maintained an assertive exposure and positioning for growth while remaining vigilant in navigating the smaller interim fluctuations.

*Our Q1 evaluation across both proprietary research methodologies—focused on the economic backdrop and the market functioning—indicates that **the market remains healthy and investmentworthy**.*

How does our research evaluate the current Market Regime?

Our strategies rely on two proprietary methodologies to assess the status of the Market Regime—its fundamental health and investmentworthiness. We scrutinize **the economy's vitality** across over one hundred variables, synthesizing individual assessments into a comprehensive interpretative summary. Additionally, we utilize a suite of proprietary tools to evaluate **the market's functioning**, including its breadth, path characteristics, orderliness, and premium/discount distribution.

Our Q1 evaluation across both methodologies indicates to us that the market remains healthy and investmentworthy. We see no evidence of an approaching recession and find the market functioning eminently constructive. While our strategies do not forecast specific targets, they seek to track the evolving market trend with poise, adaptability, vigilance, and tax awareness.

Still, as we explain in our recent research post, "**The Most Powerful Equation in Investing**," there is reason to believe that a Fed rate lowering, which we assess to be compelling in the second half of the year, will provide a substantial market tailwind.

The Market's Drivers—Q1's Continuing Trend.
So, what has been driving this market?

Overall, in Q1, we saw the Factors of **Growth** (expanding earnings, revenue, user base, market share), **Quality** (high-ranking profitability, balance-sheet strength, management efficiency, etc.), **Momentum** (robust/accelerating price climb), and **Size** (Large) leading the market higher. US assets outpaced Internationals, and Innovation-oriented/Avant-Garde issues (especially in High Tech and Communications sectors) drove ahead of Preservation-oriented ones.

Q1's Overall Drivers: Growth, Quality, Momentum, Size, Innovation / Avant-Garde.

In the aftermath of the largest bear market in their history, **bonds continued to suffer** courtesy of the still-high interest rates that mostly plateaued in Q1, tracking the Fed's reluctance to unwind its rate crusade.

We have consistently cautioned against the conventional practice that advocates higher bond allocations in portfolios of mature investors. This formulaic association of "shorter personal horizons," "need for income," and "lower risk appetite" with bonds in so-called 'Conservative' portfolios can be a perilous misconception, as we have demonstrated in a recent critical three-part post entitled “Ask NOT what YOUR Horizon is… (Ask what the MARKET’s Horizon is!)” (see **here**). Please (re)read it and share it within your investor circles.

The Market’s Drivers—The March Countertrend.
This was Q1’s “overall” picture of market drivers, but we saw a countertrend developing in March.

In March, Value outpaced Growth, traditional, preservation-oriented issues (many from the old-guard Sectors of Basic Materials, Energy, Industrials, Utilities, and Financials, along with industries like Homebuilders) surpassed for the month their Innovation antagonists. Additionally, foreign stocks overtook domestic ones in March.

March Countertrend: The resurgence of Value and Preservation / Old Guard.

Is this countertrend substantial enough to challenge the post-2022 market leadership and necessitate the repositioning of our strategies?

Our strategies don’t have favors or make bets; they track unfolding trends, with us as managers carefully balancing the dominant trends against emerging countertrends. Already positioned around a 70% alignment with the established trend and 30% with the countertrend, our strategies will maintain their exposure until/unless a more decisive shift occurs.

Still, from our strategies’ point of view, while the March counterwave has not dethroned the ongoing market leadership, it plays a critical role in enhancing the market’s vitality, thereby supporting its prospects. We elaborate on this in the following section.

The Market’s Biggest Risk—And its self-mitigation.
Despite our overall assessment that the market is healthy and investmentworthy, our strategies do not lose sight of its lingering risk—concentration.

In 1999, the top-10 capitalization stocks in the S&P 500 commanded 26% of the index’s value. And we know what happened next (remember the dot.com crash and the bear of 2000?!).

The market has been hyper-concentrated, but March’s broadening out of the advance is alleviating some of this risk.

After years of plummeting in between, this figure recently surged to over 33%, reaching a multi-decade high. Whether it was last year’s “Stupendous (aka Magnificent) Seven,” this year’s “Fabulous Five,” or Europe’s “Elite Eleven” (aka “The Granolas”), the market is hyper-concentrated. This presents an elevated risk that our strategies have been vigilantly tracking.

Hence, March’s countertrend serves as a welcome indicator that the market’s advance is broadening. This may (at least temporarily) detract from the momentum of the ongoing leaders but undoubtedly increases the overall advances’ vitality and viability.

Wall Street—Ghost Chasing.
Post-CoViD Wall Street has been entrenched in two Donquixotian camps. On one hand, there is constant talk about a ‘soft vs. hard landing’ amidst fears of a ‘looming Recession.’ Simultaneously, there is unending praise for the Fed’s interest rate campaign, albeit accompanied by the fear that it may be necessary to remain in place.

Our research opposes this ghost-chasing.

As avid readers of this series know, we have found no evidence that a genuine recession gripped the economy during the CoViD crash, notwithstanding NBER's official declaration. This flash-in-the-pan recession, which was supposed to have lasted only days to weeks and was immediately followed by an economic resurgence, defies economic reality and historical precedent. Moreover, the market activity during and following that episode contradicts this notion. As we have consistently detailed in our reports, our comprehensive economic radar screen (monitoring 100+ variables) has found no signs of a looming recession. The market seems to agree, which is the investors' actual litmus test.

Our research also diverges from the Wall Street consensus on the efficacy and desirability of the Fed's campaign.

We find our inflation to be primarily supply-driven, precisely the variety that is not amenable to monetary treatments embraced by the Fed. This primary inflation is not an enemy of the market. Remember that inflation rose nearly 6-fold during 2021, while the Fed remained on the sidelines (inflation was deemed…" transitory"!), alongside the S&P 500, which advanced +28%.

We continue to find no evidence of a "looming recession" and find the discussion of "soft/hard landing" to be idle talk.

In previous reports, we have chronicled how the market only started falling in 2022 in protest to the start of the Fed's ill-conceived campaign. Its fall concluded in October 2022, when it had erected sufficient barriers (including a surge in high-earner layoffs and several bank failures) to curtail the Fed's rate crusade. Since then, the market has rallied as the Fed's campaign plateaued despite some uptick in inflation readings.

Still, while the market continues to rise, the Fed's reluctance to lower its benchmark rates poses a significant risk to both the economy and the market. Contrary to Wall Street's belief, the Fed policy is creating a secondary inflation pressure of the worst kind—demand inflation. This is registering mainly on two fronts:

First, elevated borrowing costs strain corporate income statements and drain national budgets, which is especially dangerous in an era when the USA and most other countries are grappling with record-high deficits. Additionally, higher Fed rates keep housing costs generationally high, leading to a cascade of adverse effects—prohibitively expensive mortgages turn renters into a captive audience for increases and, with rental costs dictating 'housing inflation,' those increases feed back into the overall inflation statistics creating a vicious cycle.

Far from being an economic stabilizer or a market support, the Fed rate crusade is ill-conceived and represents a real risk for investors and society.

In response to the inflation in housing and necessities (food and energy), a wave of labor pressures has been increasing wages and benefits while depressing productivity, which saw a whopping 30% drop in Q4, the last available reading. Remember that, unlike supply-chain surges, which inevitably subside as supply chains get reinvigorated, labor and benefit increases are largely permanent, feeding demand inflation.

Our research indicates that by keeping the Target Fed Funds Rate +2% above the inflation rate, the Fed is undermining the economy and artificially restraining the market. It's an expensive policy mistake that can have long-lasting consequences. Thankfully, we believe that market pressure has the potential to eventually dislodge the entrenched Fed—an eventuality we are actively monitoring.

LAST WORD

We invite you to spread the word about your GNH Capital Group experience within your circles of influence. The last five years have been challenging for most investors. They have been battered by the historic bond market fall and whipsawed in the steep downdraft of 2018, the crash of 2020, and 2022's rolling turmoil. And throughout the last fifteen years, they have been torn between the Scylla of speculation and greed and the Charybdis of worry and indecision. As our veteran clients have discovered, our strategies' adaptability and risk controls can help provide an antidote to haphazard performance and a booster of investor confidence. Please assist us in spreading the word.

We remain grateful for your trust, loyalty, support, and friendship!

On behalf of GNH Capital Group's entire team with Henrik, Richard, Chad, and Isabel,

Kostas

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[1] Top Wall Street strategists give their S&P 500 forecasts for 2023 By Investing.com
[2] https://www.morningstar.com/news/marketwatch/20240325111/wall-street-revamps-2024-sp-500-targets-after-record-setting-stock-market-rally

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