Monthly Market Insights

Data and opinions as of January 31, 2024

Markets mixed in January

Following the “almost everything rally” that characterised the final few months of 2023, performance across asset classes was mixed in January. In the U.S., the S&P 500 Index was propelled to record highs as optimism around a potential soft-landing scenario continued the rally in the mega cap stocks. Meanwhile, good news was bad news on the fixed income side with strong economic data pushing yields higher, proving a less positive environment for fixed income. Global bonds returned -0.2%, while Canadian bonds returned -1.5% for the month. While the S&P 500 returned 2.9% in January, Japan’s TOPIX Index was the best performing equity market, up 6.0% for the month, continuing the strong performance seen last year. The S&P/TSX Composite Index posted a small gain of 0.5% while emerging market equities were down -3.3%, driven by continuing concerns about China.

The NEI perspective

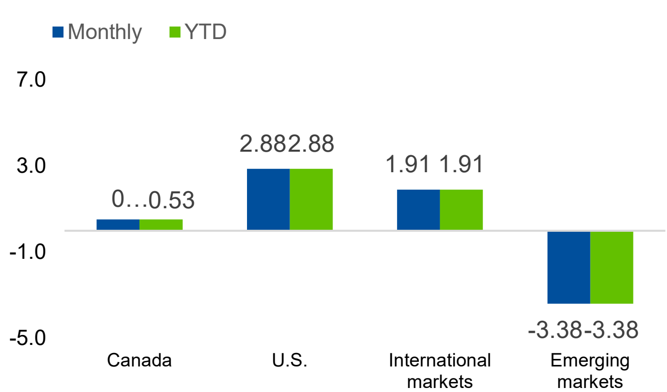
Conflict and political uncertainty haven’t had much of an impact on markets yet, but as conflicts in the Middle East rage on with the increasing probability that other countries may be involved. Concerns around the outcome of major elections including the presidential election in the U.S. will likely increase volatility in 2024.

Interest expectations remain key driver of markets as continued uncertainty around the path of inflation and economic growth have contributed to volatility in yields. Over the past few months, the yield on 10-year U.S. treasuries have bounced between 5% and 3.8%, while climbing back to 4% by the end of January.

Asian markets are diverging as China’s stock market continues to struggle amid contracting pricing that could lead to a deflationary cycle, while Japan’s stock market continues to be a top performing market relative to other emerging and developed markets.

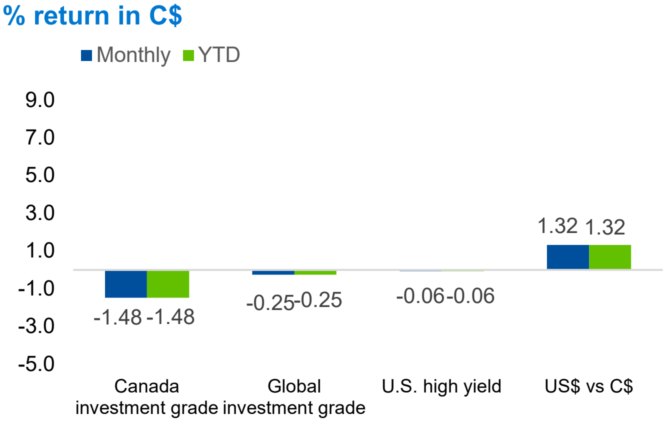
From NEI’s Monthly Market Monitor for January. Read the full report for more insights.

Equity
% return in C$



Canada: MSCI Canada; **U.S.:** MSCI USA **International:** MSCI EAFE; **Emerging markets:** MSCI Emerging Markets. Source: Morningstar Direct

Fixed income and currency
% return in C$

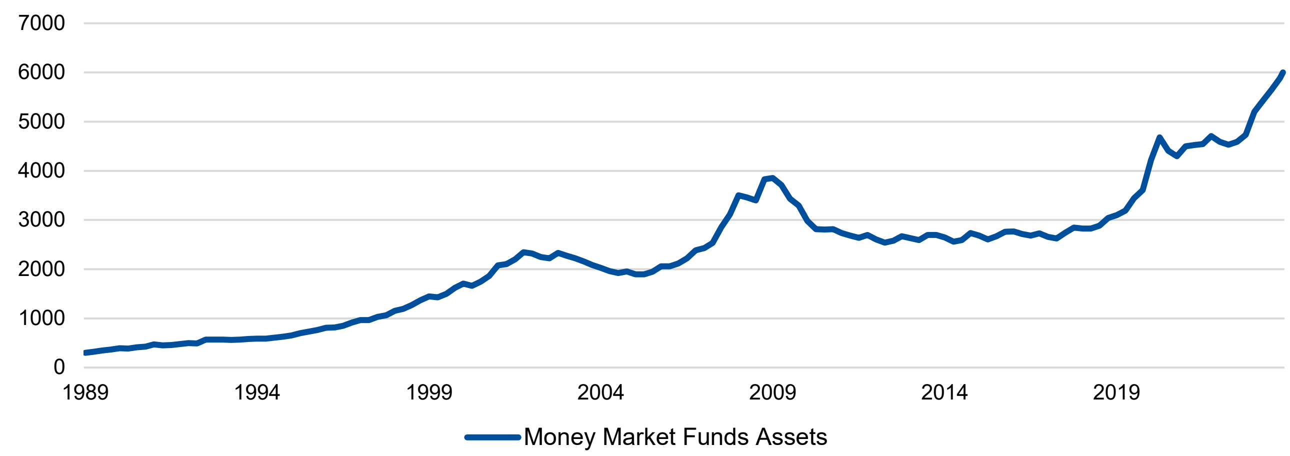


Canada investment grade: Bloomberg Barclays Canada Aggregate; **Global investment grade:** Bloomberg Barclays Global Aggregate; **U.S. high yield:** Bloomberg Barclays U.S. High Yield. Source: Morningstar Direct

Investors still sitting in cash

With GIC maturity dates approaching for many investors and GIC rates coming down, investors are likely to start reinvesting the money that has been on the sidelines back into the market.

Records amount of cash sitting on sidelines

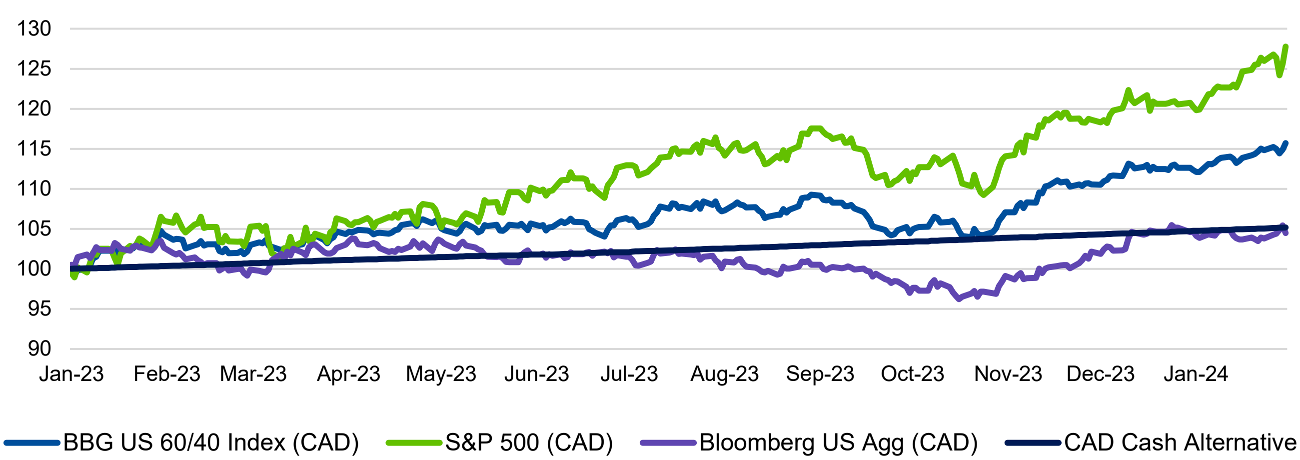


Source: Bloomberg, NEI Investments

As short-term rates fall, money market instruments will become increasingly less attractive compared to fixed income and equities. This is an opportune time for investors to get off the sidelines and to redeploy capital back to risky and growth assets, which may provide a strong technical boost to drive markets higher.

The traditional 60/40 portfolio performed well in 2023, and with higher yields and end of monetary tightening, we believe it is well positioned for 2024 as well. This demonstrates the opportunity cost investors face when sitting on the sidelines.

Performance: Investments vs Cash Alternatives



Source: Bloomberg, NEI Investments

Magnificent 4 drive S&P 500 to new highs

Bullish sentiment continued in January, helping the S&P 500 reach a new record with the tech sector driving most of the gains. The recent earnings reports point to a “Magnificent 4” more than a “Magnificent 7” as Nvidia, Apple, Microsoft and Alphabet were responsible for the majority of returns in the fourth quarter of 2023.

The dispersion between these stocks and the rest of the market is again increasing, defying concerns about concentration in certain shares.

But is there dispersion between these stocks' earnings and the earnings of the remaining 493? Yes. Mega cap tech broadly beat consensus 4Q revenue estimates with an average positive surprise of 1.3%. The seven stocks generated $523 billion in sales during 4Q representing a year/year increase of 14%. Revenue growth for the remaining 493 stocks was a comparatively paltry 2%. Margins for the seven stocks expanded by nearly 750 bp year/year to 23% vs. a 110 bp contraction to 9% for the remaining 493 stocks in the S&P 500.

Q4 Results: "Magnificent 7" vs the market

Q4 2023 Results				
	Sales		Net Margins	
Ticker	**Level ($bn)**	**Y/Y growth**	**Level (%)**	**Y/R growth**
Nvidia	$20	233%	51%	2775 bp
Meta Platforms	$40	25%	35%	2048 bp
Microsoft	$62	18%	35%	412 bp
Alphabet	$86	14%	24%	594 bp
Amazon	$170	14%	6%	606 bp
Tesla	$25	3%	23%	1619 bp
Apple	$120	2%	28%	276 bp
Mag 7	**$523**	**14%**	**23%**	**747 bp**
S&P 493	**$3,398**	**2%**	**9%**	**(110) bp**
S&P 500	**$3,921**	**3%**	**11%**	**671 bp**

Source: Bloomberg, NEI Investments

Don't lose sight of earnings and valuations

With 67% of companies in the S&P 500 having reported this far, S&P 500 companies have reported actual earnings that have exceeded estimates by 7.6% during this period. The earnings growth, which troughed about a year ago, seems to be on a steady recovery trend.

Forward guidance typically plays an important role in investor sentiment. However, forward guidance has tended to be too optimistic over the past few years with negative changes in earnings revisions in the first two months of the quarter. This year is starting off on a better note than historical trends; however, with 2024 earnings revisions only being revised by about half of a typical year's revisions at this point in the year.

With S&P valuations near historical peaks, overly optimistic forward guidance may present a risk for equities. Although markets are pricing in a soft landing, and sentiment is strong, potential slowdown is still on the table, and could cause further volatility and pullback in equity markets in late cycle. In addition, bifurcation of the markets has caused lower beta, and defensive companies to be very attractively valued compared to history and relative to growth companies.