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Santa has been good to investors

Key takeaways

- Stock investors are wondering whether there will be a “Santa Claus rally” to finish out the year.
- We may finish this year near current levels, but we think the market will struggle to post gains early in 2024.

For the past four weeks or so, the financial media have been bringing up a topic discussed every year starting in early December, no matter what stock-market performance has been over the prior 11 months. Whether the market has been naughty or nice really doesn’t make any difference. Every year, stock investors ponder the question of whether there will be a “Santa Claus rally” to finish out the year.

Technically, the “official” timeframe for a Santa Claus rally is the week of trading between Christmas Day and New Year’s Day. So we are in the thick of it right now. But let’s face it, the equity market has been throwing a pretty good party for the past two months. The S&P 500 Index has rallied nearly 16% since the late-October lows and is up more than 24% on a year-to-date basis at the time of this writing. So, one could easily argue that Santa came early this year. And that has certainly happened quite often in the past. December, according to the Stock Trader’s Almanac, is the third-strongest month on average for stock-market performance looking back over the past 70 years. Additionally, note that the three-month period from November 1 through the end of January tends to be seasonally a good time for equities.

And, right now, we really do not want to step in front of Santa’s gift-laden sleigh. It appears the rally could very well put the S&P 500 Index at or very near an all-time record high as we close out the year. What we can say is that based on our analysis, at this point in time, the S&P 500 Index is well ahead of what we consider fair value as it trades near the top of our 2024 year-end target range. Current valuations, based on our earnings estimate for next year ($220), are quite stretched.

Do we look for higher stock prices in the coming 12 months? As far as the S&P 500 Index goes, we think the market will struggle to post meaningful gains in the first part of the year while the economy continues to slow and before it bottoms out, which we believe will happen in 2024. We also believe that the market consensus for five or six Federal Reserve rate cuts starting in March is too optimistic. We believe these two factors likely will produce volatility until the consensus accounts for these negative trends, which appear to be at the bottom of Santa’s sleigh heading into year-end.

We continue to focus on domestic over international exposure and quality large-cap stocks over mid and small caps. We favor the short-term and long-term segments of the fixed-income market. We suggest trimming exposure down to recommended allocations in the Information Technology, Communication Services, and Consumer Discretionary sectors and putting those funds to work in the Health Care, Industrials, and Materials sectors.
Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio’s vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

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