C Y P R E S S

ASSET MANAGEMENT, INC.

MARKET COMMENTARY **January, 2024**

	2023
S&P 500 Total Return	**26.29%**
NASDAQ	**44.70%**
Dow Jones	**16.18%**
Russell 2000	**16.93%**
World ex. US	**16.21%**
Oil	**-11.40%**
Long Term Treasury	**2.74%**
As of December 31, 2023	

2023 was a banner year for stocks, confounding the experts and consensus opinion who were apprehensive about geopolitical uncertainties and global conflicts, a hawkish Fed and its struggle against the worst inflation in 40 years, rising interest rates and the likelihood of a recession. Instead, both the equity market and U.S. economy proved remarkably resilient. As we enter a historic presidential year in the U.S., geopolitical risks have only increased as both Europe and now the Middle East are in warfare. We seem to have entered a global cold war with China and both Taiwan and the Korean Peninsula pose dangerous flashpoints. Other developments have been more favorable. After driving long term rates to the highest level post the 2008 financial crisis, the Fed has ended its hiking cycle and will began to cut rates later this year. Inflation has moderated significantly and is trending down. While growth is expected to decelerate, confidence has increased that we can avoid a recession.

Where Are We Headed in 2024?

From a market perspective 2024 looks like a year with a lot of crosscurrents: we are in a period of higher - but historically normal - interest rates and lower liquidity, but entering a period of lower rates and more liquidity (more on this dynamic later). The transition will probably come mid-year, and there could be some market volatility as it navigates the transition. We remain relatively constructive on equities in 2024. There are several positive trends in 2024 capable of driving further gains. These include a more friendly Federal Reserve, strong corporate balance sheets and cash flows, AI and a boom in productivity-enhancing technology spending and investment, and the "reshoring" of manufacturing as we seek to regain control over supply chains and strengthen national security by moving production and supply back home and to other friendly shores.

We have written previously about the end of Globalization as we know it. The security of supply chains and national security have replaced the post WWII paradigm of free trade and comparative advantage. As the U.S. and China decouple, trading blocs are developing based on geopolitical considerations. We will trade and invest more with allies and friends going forward. This is already well underway with increasing economic ties and investment in India, Japan, Vietnam and developing Asia. It also involves onshoring of important manufacturing, protecting critical technology, developing a secure supply of strategic resources and materials and avoiding dependence on China for critical rare earth minerals, antibiotics and pharmaceutical ingredients and smartphones, other electronic components and devices. The U.S. semiconductor industry has begun a generational reshoring investment boom, and our allies in Europe, South Korea and Japan are also moving rapidly to build new production capacity. Similar developments are playing out in other industrial and technology sectors including medical devices and equipment, pharmaceuticals, agriculture, and resources.

From an economic standpoint these trends away from globalization and toward reshoring and trading blocs will bring costs and benefits. Standards of living and wages can rise for American workers and jobs will increase. We will also see higher cost for certain goods and products in our economy. Over time if AI and other productivity enhancing technologies are able to "replace labor", margins could hold steady and then increase. America's technology giants appear to be in a historic sweet spot. If you can substitute technology for labor or physical assets, return on assets and profit margins will go up - the corporate holy grail. This is what companies are focused on today. The convergence of these trends means we could be in the early innings of a pretty epic technology-driven spending and investment boom.

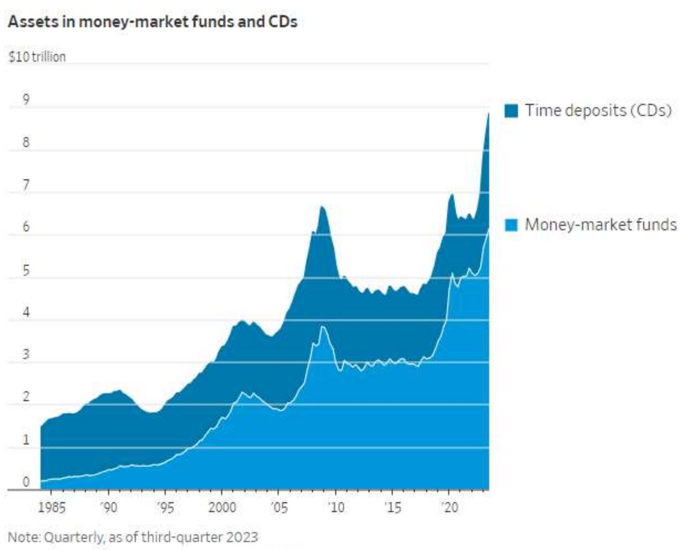
Can the Market Broaden in 2024

The stronger the economy and the greater the confidence that we avoid recession, the more the rally in stocks should broaden in 2024 and market performance should be less concentrated in the magnificent seven and top dozen or so names of the S&P 500. The key to better performance for the rest of the market is economic growth and earnings. The Fed is no longer the risk, so the stronger the economy and earnings the better most stocks will do. Housing, transportation and shipping, portions of manufacturing, finance and real estate have all experienced some version of rolling recessions. As some of these sectors recover, the market will broaden and more stocks participate. The renewed interest in the rest of the market, however, will fade fast if recession fears return.

Flow of Funds and Market Dynamics

2023 was a year of "cash sorting." Short term interest rates drove up yields in money market funds (MMF) and CD's. In droves, consumers and institutions moved cash sitting in very low yielding accounts into money market funds to take advantage of short-term rates in the 4 and 5 percent rate range. By year end, there were $8.8 trillion in money market funds and CD's, according to the Wall Street Journal. In fact, the torrent was so huge that fourteen money market funds each took in over $20 billion in 2023. Last year, the top twelve money flows into mutual funds went into money market funds. Indeed, the top 25 of the top 30 flows from mutual funds were into money market funds. Ironically, we would be remiss if we didn't note that money flows into funds yielding four or five percent occurred during a year where equities returned over 20 percent!

We view the horde of money market funds as just another longer-term potential liquidity for the equity markets. The market isn't dependent on these flows into equities but it represents another powerful source of funds for stock investments.



Brian Belski, equity strategist at BMO, recently reflected on this potential cash to equities flow. In 2008, when the market bottomed and the Federal Reserve initiated a phase of lowering interest rates, Belski was the strategist at Merrill Lynch. He observed the buildup of money market funds and then redistribution into bonds, then equities, as investors essentially extended duration as rates declined. In the fourth quarter of 2008, as rates peaked, according to Belski, the Merrill network witnessed the largest and fasted buildup of money market funds ever in their system's history. When the Fed initiated lower rates in 2009, investors moved out of money market funds and extended their duration in bonds, again, in the fastest move in company history. Finally, in the second quarter of 2009, investors massively moved funds into equities after the market bottom. While the market never completely repeats itself, it feels like the money market to bonds to equities flow of funds cycle might be repeated in 2024.

Best in Class Assets

Another important fact that bolsters our outlook for the equity market is American corporate liquidity and profitability. Large American corporations have highly liquid balance sheets and their aggressive refinancing activities during the low interest rate environment of 2020-2022 timeframe gives them relative protection from current higher interest rates and higher costs of capital in 2024. (Contrast this with the federal government who did nothing to extend the duration of its debt during this time and now faces devastatingly high interest expense on its debt after the fastest rise in rates in 40 years.) Moreover, many of the largest corporations carry very significant net cash on their balance sheets, money they utilize as ballast in rough seas, income production in a higher interest environment and liquidity for opportunistic acquisitions.

Company	Cash & Investments ($ billions)
AAPL	$166
BRK.B	$157
GOOG	$149
MSFT	$144
UNH	$92

Likewise, American corporate profitability continues to blossom as favorable trends continue. Corporate cash flows were a record $3.4 trillion for the 3Q 2023. The biggest and best positioned American companies are best in class assets and their competitive advantages seem to be increasing over time. Many are experiencing a virtuous trend of expanding addressable markets and profit margins. Margins are benefitting from cost cutting and rationalization, productivity investments and technology. And they will earn more on their considerable cash reserves in 2024. Margins could improve further as input costs decline over time with ongoing recovery and investment in supply chains, and if the dollar weakens, with lower rates. Although we believe that the top American companies are the best asset class in the world, it is worth noting that the market, and particularly its leading companies, is not currently cheap with price-to-earnings ratios around 20.

A Cautionary Tale

The internet tech boom of the late 1990's was one that our generation will never forget. While it all ultimately played out beyond even the most bullish expectations, spending and internet hype and valuations got so far ahead of themselves that the Nasdaq crashed in epic fashion in March of 2000. Much of the blame can be attributed to the IPO phenomenon of 1998-1999 which saw internet related companies coming public almost weekly without a viable business, in some cases nothing more than a story, who then proceeded to spend their funding and go bankrupt. Technology spending raced far ahead of true underlying demand. History would later prove the size of the market was greater than almost anyone imagined, but not before the bubble of Y2K and the pretenders were purged. Then before the market could heal, we experienced the attack of September 11, 2001 and the tense buildup to war in Afghanistan and Iraq. These brutal events led to a short recession in 2000-200l. We are nowhere near the valuations, the hype, or the IPO mania of the 1990's internet bubble, but it remains a cautionary tale.

POSITIVE	NEGATIVE
• Inflation Cooling Down	• Israel - Hamas War
• Fed Policy Working	• Widening Conflict Threatens Global Supply Chain/Red Sea Chokepoint
• Expected Fed Rate Cuts	• Geopolitical Tensions with China
• Resilient Growth	• M2 Money Supply Growth Negative/Monetary Tightening Lag
• Recession Probability Lowered	• Recession Still a Threat
• AI & Technology Investment Spending Boom	• US National Debt at Record High Level ($34T), @1.24x Greater than Nominal GDP

Global Economic Outlook & S&P Earnings - January 2024

Global Economic Outlook & S&P Earnings - December 2023 (S&P 500 @ 4,769)	2019	2020	2021	2022	2023	2024e
Global Real GDP Growth (y/y rate)	3.1%	-3.2%	5.9%	3.6%	3.1%	***2.8%***
U.S.	2.3	-2.8	5.9	1.9	2.4	***1.7***
Euro Area	1.2	-6.1	5.2	3.4	0.5	***0.4***
Japan	0.7	-4.3	2.2	1.1	1.8	***0.8***
Developing Asia	5.2	-1.1	6.8	4.2	5	***4.8***
China	6.1	2.2	7.9	3	5.1	***4.7***
Latin America	0.8	-6.2	6.8	4	2.2	***2.0***
Emerging Market & Developing Economies	3.7	-1.5	6.7	4.2	4.2	***4.1***
S&P 500 Aggregate EPS	165	140	208	218	225	***240***
Earnings (y/y rate)	1.9%	-15.2%	48.6%	4.8%	8.2%	10.1%
PE Ratio (December 2023 price @ 4,769)	19.6	26.8	22.9	17.6	21.2	*19.9*

Sources: IMF, ISI Group, BAML

Federal Funds Target Level

2023

Date	Increase	Decrease	Level (%)
7/27	25	0	5.25-5.50
5/4	25	0	5.00-5.25
3/23	25	0	4.75-5.00
2/1	25	0	4.50-4.75

2022

Date	Increase	Decrease	Level (%)
12/15	50	0	4.25-4.50
11/3	75	0	3.75-4.00
9/22	75	0	3.00-3.25
7/28	75	0	2.25-2.50
6/16	75	0	1.50-1.75
5/5	50	0	0.75-1.00
3/17	25	0	0.25-0.50

2020

Date	Increase	Decrease	Level (%)
3/16	0	100	0-0.25
3/3	0	50	1.00-1.25

2019

Date	Increase	Decrease	Level (%)
10/31	0	25	1.50-1.75
9/19	0	25	1.75-2.00
8/1	0	25	2.00-2.25