BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, JANUARY 2024

Happy New Year and best wishes for the coming year.

We hope the holidays brought you an abundance of joy. There's little doubt that last year's market performance provided much in the way of happiness to investors at large. The beginning of 2023 was an anxious time following the poor performance of almost every asset class in the prior year. As it turned out, predictions that the Federal Reserve's fight on stubbornly high inflation would distress the U.S. economy were incorrect as equities once again rose despite worries.

The market was led by the stocks of the "Magnificent Seven" (Microsoft, Amazon, Meta, Apple, Nvidia, Tesla, Alphabet) amid persistent optimism that Artificial Intelligence would transform these companies' profits well into the future. The equity indices registered spectacular gains and closed the year at or near all-time highs. The Mag-7 representing 30% of the total value of the S&P 500 Index collectively returned 75% last year while the other 493 stocks only gained 12%. Despite the volatility of the past 2 years, equity markets have merely 'roundtripped' and are essentially back to the record highs first reached in January 2022.

Early in the year numerous economic forecasts were calling for a recession, and along with fears of high inflation, many investors chose to sit on the sidelines missing a tremendous stock rally. The fixed income markets also gained ground in the 4th quarter following perceived dovishness by the Fed that they had completed their campaign to raise interest rates. Focus has now shifted to the prospect of a soft landing for the economy rather than an imminent recession. To this point, the Fed is not yet claiming victory in the battle against inflation, which we think may take longer than markets are predicting.

The economy is still growing, albeit at a slower pace; employment is strong, and consumers continue to spend robustly. Despite a strong economic backdrop and inflation remaining above their 2% goal, market indicators project the Fed will make 6 rate cuts in 2024. In our view, that is unrealistic and we will take the Fed at its word that they have plenty of time to begin cuts, and we also sense they will show added restraint in a presidential election year.

We are also mindful of events presently playing out which could escalate and affect the Fed's inflation objectives as well as market outcomes. Current shipping and supply chain disruptions in the Middle East are causing prices to spike and if inflation does not drop towards the Fed's target, the stock market might lack the near-term catalyst it needs for continued appreciation. As investors, we tend to be bullish over the long term and more cautious in the short run and given last year’s significant rally and noted economic headwinds, we think it will be difficult for markets to continue their outsized returns.

Here are a few things we are watching closely in the coming year. The momentum and concentration embedded in the top mega-cap tech stocks is not the foundation for a healthy stock market because it adds risk and potential volatility to indexes and the broader market. The global economy is expected to continue growing despite current geopolitical risks including concerns about the health of China’s economy. The U.S. budget deficit continues to grow with an alarming increase of $510 billion in just the last quarter (a number that was unfathomable only a few years ago.) A divided Congress and contentious elections make it unlikely that we will see any progress towards lowering the deficit and, if the U.S. were to enter a recession, the government would find itself in the difficult position of adding more stimulus or spending to boost the economy while trying to balance the risk of fueling inflation once again.

As we begin a new year and navigate the opportunities and challenges ahead, we continue to believe a diversified and well-balanced portfolio is best suited to preserve your capital and grow it over the long term.

Thanks for your continued trust and partnership!

Best regards,

Scott, John and Dave