

December saw a continuation of the positive upward trend we began experiencing in November. For example, the U.S. stock market, as represented by the widely followed S&P 500 index, had a phenomenal nine-week win streak - which ended last week.

Why have the markets done so well? I believe it is because we have finally moved away from the 'rates will go higher for longer' narrative to a new 'rates will be going down in 2024' narrative. There is still much debate as to the extent and speed of the expected decrease in central bank rates. But the fixed income/ bond market has not been waiting to find out. The fixed income/ bond market has moved up as the 10-year government bond rate declined about 1% over the past two months. The rate on the US 10-year Treasury bonds has dropped from about 5% to about 4%. The rate on the Government of Canada 10-year bonds have also dropped about 1%.

A decrease in rates has a direct positive impact on bond prices. And it usually has an indirect net positive impact on stock prices. Holding stocks is riskier when rates are going up, especially as investors start paying more attention to the low-risk returns available on GICs. This was the case from late 2021 until mid-October 2022. But as the rates on GICs start to come down, investors become more risk tolerant and will search for opportunities in riskier asset classes such as the stock market. Positive money flows into stocks have led to higher stock prices over the past two months.

Will it just be 'Rainbows and Unicorns' in 2024? Most probably not. The markets cannot go up in a straight line. Expectations over the speed and extent of central bank rate declines will vary, and those changes in expectations will affect the markets. Geo-political events may affect the markets. The U.S. presidential election cycle might affect the markets, but maybe not as much as the media will surely lead us to believe.

From what I have read, a strong annual performance for U.S. stocks (as in 2023) has often carried over into the following year (source: Globe and Mail, Jan 1, 2024. 'History shows strong 2023 could keep U.S. stocks on track for new year gains').

A year in which a U.S. president seeks re-election is typically also a good year, regardless of who wins. Whether one studies these past historical patterns or not, I do believe that there will be a downward trend in interest rates over the next two years and that inflation is getting more under control. The end result should be higher stock prices. I also believe that the stock market rally should broaden out over different sectors, as opposed to just being heavily concentrated in the U.S. tech stocks with high exposure to Artificial Intelligence - the so-called Magnificent Seven.