CAPITAL INVESTMENT COUNSEL

The Columns

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I'll be honest, I love election years. I don't care for politics, but elections and markets make a magical combination. I have three favorite things about election years.

1. Election years are positive 74% of the time. This goes all the way back to 1932 and FDR.
2. Election years can be volatile. I'll share the details below.
3. Election years are rich in data.

My love for number 1 is self-evident – who doesn't want a positive return? Number 2 is good for a different reason. If you miss a rally, the volatility may give you another shot to buy. 2012 is the only recent exception, as the market never went negative that year. Finally, large amounts of data may help illuminate the path ahead. The past doesn't repeat but it potentially gives you a heads up on which way things turn next.

2024 roared to life and the market's up nearly 3% year-to-date. The run since Halloween has been incredible, but I wonder if stocks need a rest. We talk often about volatility and its primary indicator, the VIX. The VIX usually ranges between the low teens when complacency is high and the upper 20's to the low 30's when uncertainty and fear is high. Currently, the VIX is barely a teenager – it sits at 13.50, and the euphoria surrounding the new all-time highs has investors feeling flush. A low VIX doesn't mean stocks need to sell off, but it can mean investors are poorly positioned to deal with any unexpected bad news. Which brings us to point 2.

Election years tend be volatile, and the numbers bear this out. The average drop from December 31 of the previous year to the election year low has averaged 8%. Looking back over the last 92 years, the market has historically bottomed in early April. Knowing that a pullback may be coming, I encourage you to plan ahead. Pick out your buy targets and realize that a selloff is an opportunity to buy at lower prices. I love the election year combo of volatility and a potentially positive market tailwind. History shows a 74% chance of a positive finish to the year so keep that in your back pocket. You can buy into the selloff with the odds potentially in your favor. Speaking of potential selloffs, we have a lot of earnings coming out this week. On Tuesday and Thursday, 5 of the Magnificent 7 (Apple, Amazon, Meta, Alphabet & Microsoft) reports. Those 5 stocks make up 25% of the S&P so it should be interesting. I feel earnings will be good. The question is whether that's already priced in for the short term.

The sound of silence is sweet. Especially when it involves the Federal Reserve. I've written before about how nice it would be if the Fed would let interest rates do the talking instead of their opinions. The first Fed meeting of 2024 takes place this week on January 30-31, so we're in the blackout period where Fed officials are "on mute". Let's enjoy it while we can. The good news is that inflation continues to nosedive.

The Fed's preferred measure of inflation is the PCE Price Index, and this recently hit its lowest level since 2021. The PCE currently shows inflation at only 2.9%, but the Fed Funds rate is 5.2%. That premium of 2.3% above inflation makes for the tightest rates in 17 years. The Fed was stubborn in waiting to raise rates until it was too late. I hope they don't make the same mistake about lowering them. Remember this is the bunch who told us inflation was transitory and kept piling on the stimulus even as inflation soared.

Let's review how our 2023 year-end scenario played out. Over the last 123 years, if the S&P was up 10% through October, the market closed the year higher 36 out of 41 times with an average gain of 5%. The S&P needed close at 4223 or better by Halloween to set this in motion. Unfortunately, the S&P didn't make it to 4223 by October 31st. Fortunately, that didn't matter as the market ran past 4223 on November 1st and didn't look back. As of this writing the S&P is 4890.

The Citibank Economic Surprise Index hinted last October that the economy is accelerating, and that trend continues. The Surprise Index results triggered a historical pattern that gave a potential one-year gain of 12%. Stocks are up 7% so far since that trigger, and it appears we may be well on our way to hitting that 12% goal.

Let's finish with another positive. The market is up 3% with 2 trading days to go. I don't anticipate a big drop this week which means January may well finish higher. The S&P database shows a positive January, which means that the rest of the year may be green 80% of the time. Did I mention that I LOVE election years. If you have any comments, feel free to contact me at heddins@capital-invest.com or call at 919-656-0836.