David C. Jennett's

INVESTMENT LETTER

Volume #450 January 31, 2024

It took less than three weeks. What did, you ask? That's all it took to see an online article suggesting the current bull market can climb unabated simply by relying on the "Magnificent Seven." If you have forgotten, the seven stocks that provided all the profit growth for the S&P 500 Index in 2023 were Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla. Their combined success was astonishing, and investors reaped huge rewards. But the "smart money" was already sneaking out of these seven stocks last fall and buying up underperforming names instead. As the new year dawned, Wall Street was all in on small-cap stocks, especially if they were part of the tech sector.

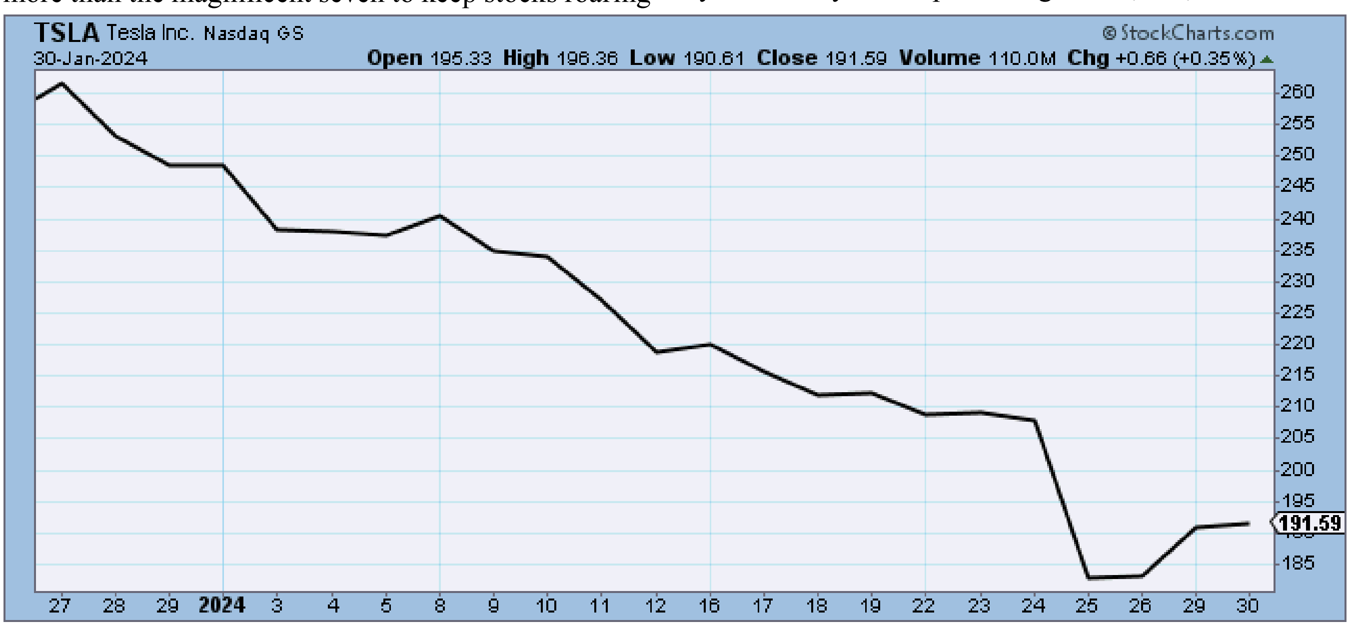
I agreed with those who thought this bull market needed to expand the breadth of winners if it wished to thrive in 2024. I watched as our Vanguard S&P Small Cap 600 ETF (VIOO) holdings rose by 26% from October 26 to December 27. Small caps seemed ready for a breakout year in 2024, and I recommended you expand your holdings of VIOO in our last issue. But as 2024 started, it was as if somebody threw a switch. Suddenly, the small-cap play fell out of favor, and investors hurried back to the stocks that made them so much money in 2023.

For the record, I still believe this bull market will need more than the magnificent seven to keep stocks roaring along. Much of last year's 28% price gain in the S&P 500 did not come from higher profits. Those only climbed an estimated 7.8%, despite the advantage of being compared to the weakest earnings number for the S&P 500 in over two years. The rest of the gain came courtesy of multiple expansions.

I have long believed that this bull market cannot continue to rely on rising multiples to fuel its gains.

Frankly, the fact that many investors are counting on the same seven companies that carried stocks up in 2023 to do it again is not a ringing endorsement of this market. To make matters worse, one of the seven stocks Wall Street is counting on to carry us this year is Tesla. That company had a year for the ages in 2023. Its stock price nearly doubled as revenue and profits climbed 19%. However, the company has warned that volume growth will slow in 2024 as China's economy struggles and American consumers lose their appetite for expensive electric cars. As you can see from the chart below, over the past 30 days, the stock price has dropped nearly 30%.

Apple is not starting the year off looking like it will repeat its stellar 2023 performance either. The stock is down 2.3% for the year after climbing 50% last year. Analysts are predicting that it, too, will feel the



pinch caused by a slowing economy in China. Revenue estimates for 2024 suggest Apple could see revenue growth of less than 5% and profit growth of around 7%. These are not the kind of numbers that fuel a roaring bull market.

For those counting on a "Return of the Seven" sequel in 2024, it is still too early to rule it out. Tesla and Apple could find fresh wind in their sails if the Chinese Communist Party follows through on promises to inject massive amounts of stimulus into the Chinese economy this year. It's important to note that the other five stocks in this group are doing well. Nvidia's stock price is already up 26.5% this year, and Meta Platforms is up 13%. Microsoft (+8.7%) and Alphabet (+4.6%) are outperforming the S&P (+3.3%) year-to-date, while Amazon (+3.2%) is holding its own.

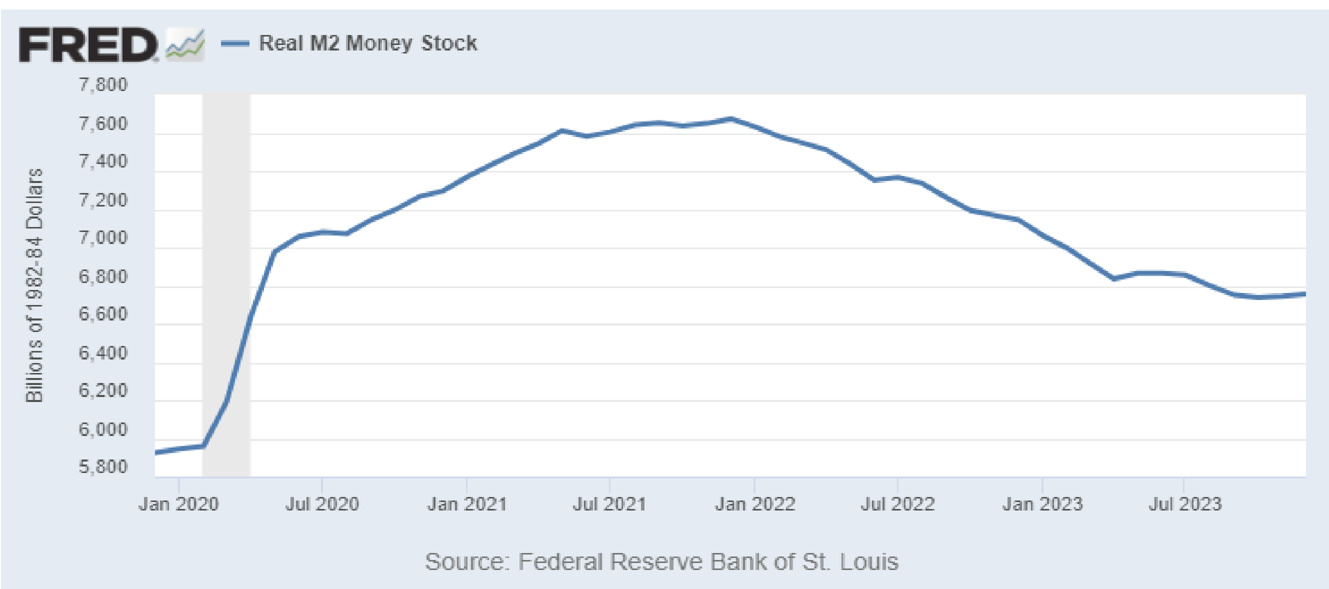
Still, I can't help but think that these stocks can only carry the market so far. Any impartial observer is bound to conclude that the economy is slowing. Unlike the politicians vying for power in Washington, DC, I don't need to find a way to blame anyone for this. The simple truth is that the US economy shouldn't be growing 5% a year. That kind of growth only happens in mature countries after they emerge from a recession or when a reckless central bank embraces what Progressives refer to as "New Monetary Policy" and what old-timers like me remember as Keynesian pump-priming. Whatever you call it, it is the kind of one-off growth you get when the central bank funds massive deficit spending to boost consumption. History teaches (at least some of us) that such efforts only provide a temporary bounce in growth and a somewhat longer-lasting period of inflation.

While most "experts" insist that rising personal income and continued deficit spending from Washington, DC, will reignite inflation, we know that's not true. Only if the Fed creates money out of thin air and buys this new debt does inflation rear its ugly head.

As you may have heard, the nation's money supply is currently at the same level it was in September 2021. On an inflation-adjusted basis, the money supply equals April 2020 levels. This is why inflation is returning to the Fed's target rate of 2%. This is why the economy is returning to its long-term growth rate of 2.0%.

I don't believe the decline in the M2 money supply must lead to a collapse in economic activity. Those sounding the alarm ignore the historic amounts of money created between February 2020 and May 2021. As you can see from the chart on page two, even when adjusted for inflation, plenty of money is still available for economic expansion in 2024. Far from being harmful, this gradual removal of money from the economy is the primary reason for slowing inflation.

We must continue to pay close attention to the money supply. If this decline continues, it will eventually impact growth. But the possibility of a new recession seems too remote to warrant some fundamental rethink about how to invest in America right now. Yes, the



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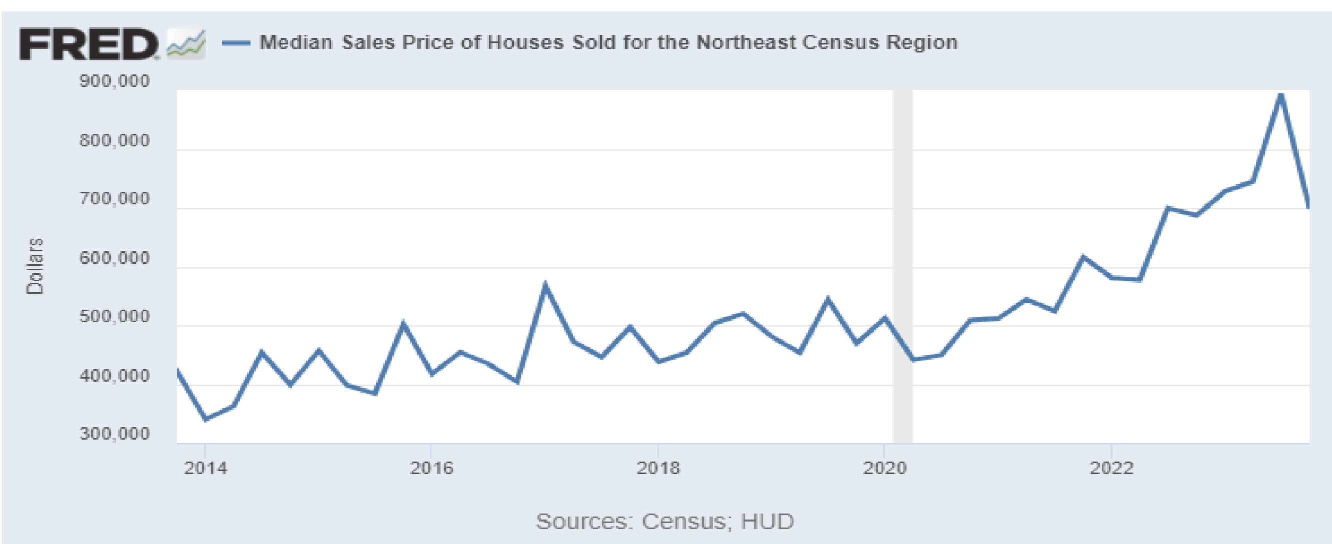
economy is slowing, but that is not necessarily a bad thing. Don't equate slower growth with lower profits. When it comes to earnings, we don't need to see a 10% rise in sales to produce a 10% increase in profits. Take IBM as one example. Last year, the company saw revenues climb 4%, but it reported a 14% rise in net income and a 13% rise in earnings per share. For the year, the company's stock price jumped 16%. This means IBM delivered a 16% annual profit for investors without expanding its price/earnings ratio, which remains at 23-to-1.

In other words, let's not throw the baby out with the bathwater. We don't need 5% growth to see profits rise. Profits increase for many reasons besides increased revenue. With the economy slowing, many companies think buying back their outstanding shares is better than investing in expanding capacity. Even if profit growth is sluggish, this move helps boost earnings per share.

In addition, many of America's biggest publicly traded companies are trimming their staffing levels. The press delights in equating these cuts with signs of distress, but this is not always so. While we are busy counting the profits made from investing in companies working to develop money-saving uses for artificial intelligence (AI), it is easy to lose sight of how much money is saved by the companies using this new technology. It helps to think of AI as a way to help computers think as efficiently as human beings. In the past, computers could only hope to measure up to the human brain through brute force. If it wanted to beat a Grand Master at chess, it needed enough computing power to imagine every possible move and every possible outcome that move would create. Only then could it hope to achieve victory. AI is a very different approach to computing. Gone is the brute force approach, replaced by algorithms that help computers "think" like the human brain, only much faster.

What do we get from this advance in computer technology? We get computers that can ponder millions of approaches to developing a new drug to fight cancer and then run an analysis to see which ones might work. Most will not, but if it finds one in a million that does, we have a new product that will prove profitable for the company developing it. Of course, the rest of us win because one less disease will remain a threat to the human race.

If you think this is all just science fiction, consider the news from Insilico Medicine. This biotech company uses artificial intelligence to find ways of combating disease. Recently, the company, based in Hong Kong and New York City, announced phase one trials for a new drug designed to help people who suffer from a condition known as Inflammatory Bowel Disease (IBD). Most people have heard of two common forms of this illness: Crohn's Disease and ulcerative colitis. Doctors cannot cure the disease; they can only use drugs to battle the symptoms. For IBD, that means treating with anti-inflammatory and immunosuppression drugs. These treatments have wide-ranging side effects that can produce chronic infections and dangerous tumors. The new drug, discovered using AI-driven research, identified a protein that is overly abundant in people with IBD. The protein regulates the body's "gut barrier protection genes." It then used AI to design a molecule that blocks the creation of the offending protein and stimulates the genes that help protect the intestines. If effective, it will represent an entirely new way of treating IDB, one more accurately called a cure rather than a treatment.



Of course, this story has a long way to go. The treatment becomes the company's fifth drug identified through generative artificial intelligence to enter phase one trials. Phase one trials test the safety and tolerability of a new drug. It will likely be years before we know if the drug is effective.

The same world-changing attributes that hold so much promise for medicine are equally available to companies looking to streamline product development, manufacturing processes, logistical challenges, workforce management, customer service, and much more. The resulting cost savings and streamlined developments regarding new products hold the key to vastly expanded corporate profits.

AI is still in its infancy, and there are few publicly traded companies to invest in if you want to profit from it. Everybody knows about the explosive growth in the semiconductor chipmaking industry thanks to the expansion of AI computing. Most people understand how many of the biggest tech companies are already using AI to help the world's largest companies improve every aspect of their businesses.

Searching online for a list of the ten best stocks to buy in 2024 if you want to profit from this fast-growing field gets you a group of mostly familiar names: Microsoft, Amazon, Alphabet, Nvidia, Salesforce, Advanced Micro Devices, Oracle, Palo Alto Networks, Snowflake, and CrowdStrike Holdings. I'm happy to report that we already have the top four selections in our model portfolio. I'm also pleased to report that the market multiples associated with these four stocks are reasonable. Microsoft sports a multiple of 39, Amazon's is 83, Alphabet's is 29, and Nvidia's is 80. While Amazon and Nvidia might seem high to you, I can only say that both companies are expecting profit increases in 2024 that justify them. As for the rest of the list, only Oracle has a multiple that appeals to me (31). AMD is attractively priced, but with the sector-leading NVDA already in the portfolio, I see no need to double up by adding AMD. The remaining four might be great long-term buys, but I prefer to put my AI-related investments in stocks that don't remind me of the dot-com bubble days. Snowflake and CrowdStrike don't have any profits, so you can't put a multiple on their stocks. And both Salesforce and Palo Alto have multiples north of 100. I note that we have shares in IBM in the portfolio. This excellent AI play carries a very reasonable multiple of 23.

It is important to note that all these stocks are first- or second-generation AI plays. That is to say, they are either the hardware companies that make AI possible or companies using AI to make America's largest companies more profitable. The third-generation stocks have not yet found their way to profitability, probably because they have pushed AI into new fields that have not yet matured. CrowdStrike is using AI to provide more intelligent cybersecurity products. It might be a great long-term buy, but the stock price is too high. The AI hysteria on Wall Street pushed the stock up from $100 a share to $300. I would feel better if the price dropped before I decided to take a position. With Wall Street giving off a cautious vibe, we could see some retracements that bring some high-flyers back down to earth.

As for what I think looks like the best candidates for Gen Four in AI, we must wait for companies like the above-mentioned Insilico Medicine to prove their products work well enough to market to them to

wholesalers or directly to end users. They must also look to go public to cash in on their hard work. This will be the next great investment opportunity for AI investors, and it will be interesting to see just how fast these startups make it to Wall Street. I advise you to keep your mind open to taking a flyer on some of these as they appear. Somewhere out there lurks the next Microsoft, Amazon, or Apple.

Of course, investing in 2024 requires you to keep a watchful eye on more than just the AI story.

I have been a big believer in housing stocks for a couple of years. This faith has been well rewarded as the homebuilding stocks have solidly outperformed the market. But there is possible trouble brewing for the homebuilders. In my last Money Forecast Letter, I noted that new home prices are beginning to fall. Not surprisingly, the median sales price for all houses sold in the US is following suit. Now come reports that rents are falling across the nation. None of this is surprising. But even with the recent declines, the median price of an existing home sold is still 27% higher than before the pandemic struck.

The conventional wisdom regarding housing is that prices cannot drop because current owners refuse to sell, knowing they would need to replace their current mortgage with its 3% interest rate with one carrying a 7% interest rate. In the short run, this has proven to be true. But people can't always choose to hang onto their current house. Job changes, retirement choices, and a decline in the number of people living in the house continue to pile up. Additionally, the home construction boom now rivals past building booms and has expanded the supply of houses for sale. It was always a matter of time before the housing shortage gave way to this reality. That day seems to be here.

As you can see from the chart on page three, home prices in the Northeast dropped dramatically in the most recent quarter. Can this be a statistical fluke? Yes, maybe. But given the absurd price increases since 2020, doesn't it seem like a market correction is in order?

If the homebuilders want to sell homes under these conditions, they will be forced to lower home prices even more. The only way that doesn't translate into lower profits is if they can also demand a lower price for lumber. Unfortunately, lumber prices are up 20% since last September. You can thank the building boom for that. You would expect the free market to make an appearance here soon. Higher prices should spur higher production. It might take a while, but lumber prices will have to fall. I am not yet prepared to say we should abandon the homebuilder stocks; let's wait and see how things play out over the next two quarters.

Lastly, we must talk about interest rates.

As you can see from the chart on page four, investors remain convinced that the Fed must eventually bow to public pressure and reduce the fed funds rate from 5.5% to at least 4.0%. Because of this conviction, the 10-year bond seems permanently stuck at 4.0%. Despite multiple denials by the Fed, Wall Street is still convinced there is a good chance we could see the first cut after the Fed's March meeting. From there, it's "Katy bar the door time." Once they start cutting, the Street will expect at least a quarter-point reduction after every meeting for the rest of the year. For those keeping score, that would send the fed funds rate down to 3.75% by Christmas Day. But don't expect this to satisfy those longing for the good old days of pre-COVID America when the Fed had the fed funds rate down at 1.5%. There is no earthly reason for interest rates to be that low again, but this Fed has a well-deserved reputation for caving to those who want interest rates as close to zero as possible. Until it learns to say no, we will continue to see long-term rates struggle to climb above short-term rates.

The belief that they will eventually cave to the bond vigilantes is why investors continue to embrace an overvalued stock market. Time will tell if they are right. Much will depend on corporate America's ability to maintain margins in an age where disinflation seems likely to persist.

I, too, want to be all out bullish, and there are some reasons to be so. But high market multiples and my unease about relying on a handful of stocks to carry this market higher have me listening to an inner voice that says a measure of caution is warranted. I find it worrisome that the S&P 500 Equal-Weighted ETF is up just 5.1% over the past year, while the market-cap-weighted S&P 500 Index is up 20.1%. Since January 1st, the equal-weighted index is up just 0.4% compared to 3.3% for the market-cap-weighted index. Historically, this gap has been far smaller. The easiest way to close this gap is for more stocks to join the earnings parade. Until there is clear evidence that the rest of corporate America is enjoying an earnings renaissance, I will tread lightly in this market.

— David C. Jennett

INVESTMENT ASSET ALLOCATION

U.S. STOCKS .... 70% **INT'L STOCKS.. 4%**

T-BILLS/BONDS .... 21% **REITs & REAL ESTATE............................. 2%**

GOLD .... 2% **CASH 1%**

INVESTMENT PORTFOLIO

Symbol	Name	Shrs	Paid	ORIGINAL VALUE	1/30/24 PRICE	1/30/24 VALUE	$ Change	% Change	BUY DATE
GOOG	ALPHABET	40	68.67	$2,746.80	$153.05	$6,122.00	$3,375.20	122.9%	1/16/2020
AMZN	AMAZON.COM	30	118.75	$3,562.50	$159.00	$4,770.00	$1,207.50	33.9%	6/17/2021
AMT	AMERICAN TOWER	18	189.96	$3,419.28	$195.56	$3,520.08	$100.80	2.9%	9/22/2020
BUD	ANHEUSER-BUSCH INBEV	100	53.4	$5,340.00	$62.44	$6,244.00	$904.00	16.9%	5/31/2023
AAPL	APPLE	38	101.41	$3,853.58	$188.04	$7,145.52	$3,291.94	85.4%	6/17/2021
AMAT	APPLIED MATERIALS	48	47.2	$2,265.60	$166.24	$7,979.52	$5,713.92	252.2%	9/22/2020
HYLS	FIRST TRUST TACTICAL HIGH YIELD ETF	250	40.44	$10,110.00	$41.18	$10,295.00	$185.00	1.8%	1/31/2023
GE	GENERAL ELECTRIC	51.22	73.53	$3,766.00	$133.93	$6,859.52	$3,093.52	82.1%	2/22/2022
FINX	GLOBAL X FIN TECH	133	26.4	$3,511.20	$24.69	$3,283.77	-$227.43	-6.5%	10/17/2018
HD	HOME DEPOT	17	331.37	$5,633.29	$357.10	$6,070.70	$437.41	7.8%	7/30/2023
ITW	ILLINOIS TOOL WORKS	25	245.54	$6,138.50	$265.81	$6,645.25	$506.75	8.3%	12/3/2023
IBM	INTERNATIONAL BUSINESS MACHINES	28	123.92	$3,469.76	$187.87	$5,260.36	$1,790.60	51.6%	2/22/2022
RSPT	INVESCO SP500 EQUAL WT TECH ETF	150	27.24	$4,086.00	$33.34	$5,001.00	$915.00	22.4%	2/16/2021
EWZ	ISHARES MSCI BRAZIL ETF	144	32.9	$4,737.60	$32.86	$4,731.84	-$5.76	-0.1%	3/16/2021
EWW	ISHARES MSCI MEXICO ETF	38	57.68	$2,191.84	$67.03	$2,547.14	$355.30	16.2%	10/2/2023
ENZL	ISHARES NEW ZEALAND CAP ETF	78	44.15	$3,443.70	$46.95	$3,662.10	$218.40	6.3%	1/22/2017
IWM	ISHARES RUSSELL 2000 ETF	26	162.75	$4,231.50	$197.71	$5,140.46	$908.96	21.5%	10/15/2020
LEN	LENNAR	40	93.49	$3,739.60	$151.07	$6,042.80	$2,303.20	61.6%	9/22/2020
MCHP	MICROCHIP TECHNOLOGY	55	42.2	$2,321.00	$85.96	$4,727.80	$2,406.80	103.7%	8/24/2018
MSFT	MICROSOFT	13	181.08	$2,354.04	$408.59	$5,311.67	$2,957.63	125.6%	9/22/2020
MKSI	MKS INSTRUMENTS	38	93.64	$3,558.32	$110.19	$4,187.22	$628.90	17.7%	10/23/2017
NVDA	NVIDIA	22	62.9	$1,383.80	$627.74	$13,810.28	$12,426.48	898.0%	9/22/2020
PH	PARKER-HANNIFIN	20	285.25	$5,705.00	$477.86	$9,557.20	$3,852.20	67.5%	6/17/2021
RTX	RTX CORPORATION	74	62.79	$4,646.46	$90.60	$6,704.40	$2,057.94	44.3%	9/22/2020
JNK	SPDR BLMBG BARC HIGH YIELD BOND	44	103.61	$4,558.84	$95.13	$4,185.72	-$373.12	-8.2%	8/10/2009
GLD	SPDR GOLD TRUST ETF	20	142.11	$2,842.20	$188.59	$3,771.80	$929.60	32.7%	1/22/2017
XBI	SPDR S&P BIOTECH ETF	32	106.43	$3,405.76	$88.77	$2,840.64	-$565.12	-16.6%	5/15/2020
XHB	SPDR S&P HOMEBUILDERS ETF	92	60.99	$5,611.08	$95.59	$8,794.28	$3,183.20	56.7%	9/22/2020
XOP	SPDR S&P OIL&GAS EXP & PROD	56	107.96	$6,045.76	$136.57	$7,647.92	$1,602.16	26.5%	10/20/2021
TTWO	TAKE-TWO INTERACTIVE SOFTWARE	26	35.4	$920.40	$166.94	$4,340.44	$3,420.04	371.6%	3/28/2016
TOL	TOLL BROTHERS	66	57.95	$3,824.70	$100.15	$6,609.90	$2,785.20	72.8%	9/22/2020
UNP	UNION PACIFIC	24	75.84	$1,820.16	$246.70	$5,920.80	$4,100.64	225.3%	9/16/2010
VIOO	VANGUARD S&P SMALL CAP 600 ETF	80	84.73	$6,778.40	$97.68	$7,814.40	$1,036.00	15.3%	12/31/2023
VZ	VERIZON COMMUNICATIONS	114	55.3	$6,304.20	$42.47	$4,841.58	-$1,462.62	-23.2%	9/22/2020
WMT	WALMART	50	134.91	$6,745.50	$165.59	$8,279.50	$1,534.00	22.7%	9/22/2020
WM	WASTE MANAGEMENT	38	99	$3,762.00	$187.11	$7,110.18	$3,348.18	89.0%	9/22/2020
WDAY	WORKDAY	25	103.65	$2,591.25	$294.86	$7,371.50	$4,780.25	184.5%	7/24/2017
	2-YEAR US TREASURY BILLS (4.6% YIELD)					$60,000.00			12/3/2023
	CASH					$2,629.71			
	TOTAL					$287,778.00			

Value December 31, 2023: $280,807.09 2023 Change: +27.8% S&P 500 Total Return Index 2023 Change: +26.3%

Value January 30, 2024: $287,778.00 2023 Change: +2.5% S&P 500 Total Return Index 2024 Change: +3.3%

Dividends & Interest 1/1/2024 thru 1/30/2024: $377.66