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INVESTMENT COMMENTARY & OUTLOOK

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The good news is the stock market has responded positively to the fact that since October 19th, the 10-year Treasury bond yield peaked at 4.99% and has since fallen dramatically. Furthermore, at the December Federal Open Market Committee (FOMC) meeting, the Fed revealed that the "dot plot" from all 17 FOMC members is signaling three rate cuts in 2024. Additionally, three to four rates cuts are anticipated in 2025 until key interest rates hit 3.5% to 3.75%. So in total, the FOMC dot plot revealed six to seven key interest rates cuts are planned for 2024/2025.

What is really happening is the Fed has already hit its 2% inflation target. The Labor Department announced that the Consumer Price Index (CPI) rose 0.1% in November and 3.1% in the past 12 months. The CPI should be at the Fed's 2% range no later than by June 2024. How do we know that? Well, because the monthly CPI increases from December 2022 to May 2023 are 0.4%, 0.41%, 0.45%, 0.38%, 0.41% and 0.44%, respectively. Once these large monthly gains are removed from the 12-month CPI calculation, the monthly gains only range from 0.1% to 0.3%, so the annual rate will naturally decline. If we look at the CPI in the past six months, it is already within the Fed's 2% target range.

Furthermore, the Fed announced that its favorite inflation indicator, the Personal Consumption Expenditure (PCE) index declined -0.1% in November, which is the first monthly decline since Apri1 2020. In the past 12 months, the PCE decelerated to a 2.6% annual pace in November, down from a revised 2.9% annual pace in October. In both October and November, the core PCE, excluding food and energy, rose only 0.1%. The core PCE in the past 12 months, rose at a 3.2% annual pace through November. However, the core PCE in the past six months is running at a 1.9% annual pace, so the Fed's 2% inflation target is finally within sight.

The December FOMC minutes revealed that, "Participants viewed the policy rate as likely at, or near, its peak for this tightening cycle." The FOMC minutes also "reaffirmed that it would be appropriate for policy to remain at a restrictive stance for some time until inflation was clearly moving down sustainably." These FOMC comments occurred before it was announced that the November personal consumption expenditure (PCE) index declined -0.1%. Furthermore, the ISM manufacturing prices component decreased by 4.7 points in December, which is indicative that deflation on the wholesale level may persist and appear in the December Producer Price Index (PPI).

Crude oil prices remain firm for a variety of reasons. First, the Energy Information Administration (EIA) reported 5.5-million, 6.9-million and 7.1-million barrel weekly declines in crude oil inventories during the past three weeks. Secondly, India's imports of Russian crude oil in December plunged to the lowest level in 11 months after six Russian crude oil tankers could not deliver due to tighter sanctions and payment issues. Thirdly, Libya's largest crude oil field that produces 300,000 barrels per day was recently shut down due to protests. Fourthly, the tension in the Middle East continued to rise after the U.S. Navy sank three Houthi rebel ships in the Red Sea in response to a distress call from a Maersk container vessel.

The chaos in the Middle East has effectively forced the insurance industry to redirect ships away from the Red Sea, which is now raising the price of LNG and container goods. Iran has threatened to "close" the Mediterranean Sea if the fighting persists in Gaza. Iranian proxies have been very busy attacking Israeli and U.S. facilities in the Middle East. British and U.S. warships, as well as cargo ships, have been fired on in the Red Sea by Houthi rebels in Yemen. Now Iran has dispatched its Alborz warship in the Red Sea, so tensions remain high.

So you might wonder with all the chaos around the world, why are we so optimistic about 2024? Well, the U.S. is an oasis, since we are food and energy independent, while China, Japan, Britain and the European Union are much more dependent on food and/or energy imports. Secondly, the U.S. is naturally entrepreneurial because our 50 states are competing with one another, no matter who we elect President.

Louis is on record saying that the Fed will cut key interest rates more than the three times they signaled for 2024 in their "dot plot." The primary reason is the Fed is currently well above market rates and will have to continue to systematically cut key interest rates to get in-line with market rates. These Fed rate cuts will help stimulate the U.S. economy and coax much of the cash on the sidelines to pour back into the stock market.

Inflation is fizzling fast and U.S. economic growth is expected to resurge in 2024 due to falling interest rates and growing economic optimism. The other reason for our optimism is that the stock market has very favorable year-over-year comparisons for the next three quarters, so these earnings announcements will help to compress price to earnings ratios further and propel wave after wave of earnings surprises.

Naturally, since 2024 is a Presidential election year, the stock market traditionally rallies right up to the November election, since the candidates tend to lift both consumer and investor confidence with their endless promises. Since Robert F. Kennedy, Jr. is running as an independent, the winning candidate is not anticipated to receive 50% of the overall vote. The attempts to block former President Trump off state ballots are not expected to hinder him, since the U.S. Supreme Court is expected to intervene and these attempts to block him are in blue states where he is not expected to win.

The good news is the U.S. economy is the number one election issue, followed by border security and foreign wars. The situation for the U.S. economy is that it is good for the Top 20%, but poor for the Bottom 20%. Essentially, the Top 20% tend to own homes and stocks, which are appreciating, while the Bottom 20% are struggling with inflation and buying a home. Since the Bottom 20% are dominated by younger people and some minorities, President Biden's base has some severe cracks. In the end, we believe, the candidate with the most energy and inspirational message typically prevails.

The small to mid-capitalization rally that started early in November and continued in December, is still underway. Furthermore, the combination of multiple Fed rate cuts and improving earnings from favorable year-over-year comparisons we believe bode well for strong performance in the upcoming year.

The only thing that can go wrong is if the proxy wars around the world, in which the U.S. is entrenched, spreads to America. However, Congress is striving to defund these proxy wars unless border security is restored. This will be an interesting battle, since the Biden Administration and Congress seem not to be cooperating with each other. However, when the federal government is characterized by gridlock, prosperity typically rises, since the private sector tends to prosper when there is minimal government interference.

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The Presidential election should become more transparent by May if former President Trump locks up enough delegates in early states. As the candidates run around and 'suck up' to voters, both consumer and investor confidence typically rises. So, we expect history to repeat itself and for the stock market to rally steadily, right up to election day in November.

SUMMARY

Our fundamentally superior stocks are "locked and loaded" for another quarterly announcement season. Our dividend growth stocks have been especially strong and responding positively to declining Treasury bond yields. A tailwind from lower interest rates and an accommodative Fed should further help to propel stocks steadily higher.

We believe the U.S. will likely escape a recession due predominately to a robust energy sector that is characterized by record production and exports, so the U.S. trade deficit is expected to continue to decline. ISM recently signaled that the service sector expansion is sputtering, so annual GDP growth is apparently running less than 2% per year. However, as inflation continues to fizzle and the Fed becomes more accommodative, the U.S. economy should respond positively.

It will be fascinating if Congress will provide the funding that the Biden Administration wants for paying for multiple proxy wars. Congress is expected to cooperate if the Biden Administration agrees to boost border security, otherwise the risk of a federal government shutdown is possible. The truth of the matter is much of the political posturing this year is ridiculous, since this year is a Presidential election year, where very little is expected to get done. Traditionally, the stock market loves gridlock and rallies when government is deadlocked.

The only severe threat to rising prosperity is deflation, which has enveloped China, appeared in Germany and could spread to other countries. This means than many of the goods that the U.S. imports may fall in price. This deflation will be more apparent in wholesale prices in the upcoming months and should help to convince the Fed to hurry up and cut key interest rates. However, if the Fed does not get on top of deflation by cutting key interest rates and deflation persists, the deflation can essentially become a "black hole" that envelopes more asset classes and causes falling prices. We do not expect this dire situation to ensue, but we will be on guard for deflation risk spreading.

Furthermore, we do not expect these deflationary forces to impact energy markets unless China and Europe fall into a severe recession. The U.S. energy dominance has expanded dramatically due to record crude oil production as well as record exports of crude oil, LNG and refined products. The energy sector will also have more favorable year-over-year comparisons to help boost earnings. Also, boosting crude oil prices will be rising as a result of seasonal demand that should commence in February.

The proxy wars that the U.S. is funding are already an election issue. Inflation and eroding buying-power is the #1 election issue. The U.S. border is also a big issue, even in deep blue cities like Chicago, Denver and New York, since there are not sufficient funds to aid new immigrants. Chaos does not win Presidential elections. Typically, the person with the most inspirational message becomes the next President.

We realize that many Americans are uncertain and worried about the future. The good news is the promises for a better life will be endless this Presidential election cycle. Despite all the problems around the world, the U.S. is an oasis, since we are food and energy independent. Furthermore, our 50 states compete with one

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another and are economic laboratories, so no matter who is President, prosperity can continue to rise in the best managed states. Naturally, that prosperity should also fuel strong sales and earnings growth that we can capitalize on. We want to assure all investors that the combinations of rising earnings, falling interest rates and seemingly perpetual promises from the final three leading Presidential candidates is expected to lift both investor and consumer confidence, so we are expecting 2024 to be a great year!

LOUIS G. NAVELLIER
CEO/Chief Investment Officer

MICHAEL J. BORGEN
Senior Portfolio Manager

MICHAEL GARAVENTA
Portfolio Manager

TIM HOPE
Portfolio Manager

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