Janney

INVESTMENT PERSPECTIVES

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Key Takeaways —

- A look at the key drivers in the surge for copper demand.
- What will dominate the bond markets in 2024?
- In the long run, earnings are what really matter.

COPPER IS SEEING RED

Mark Luschini, Chief Investment Strategist

A couple of months ago, in this publication, we wrote about the prospects for uranium in the context of the almost ubiquitous employment, or at least acceptance, of nuclear energy as a means to solve the world's need for plentiful, consistent, and clean energy. We referenced the years of underinvestment in uranium mining that is complicating the ability to fulfill the existing demand without consideration for future developments that could lead to supply imbalances for years to come. We also mentioned copper being in a similar position.

As one of the red metals, which include brass and bronze, copper (atomic number 29, and symbol Cu on the chemical periodic table), is a soft element renowned for its conductivity. Historically, it has been referred to as "Dr. Copper" due to what many consider, perhaps somewhat tongue in cheek, that it is the only metal with a PhD in economics. The title infers an academic ability to provide unusual insight into the health of the global economy. Why? Because copper possesses the ability to transmit electricity efficiently and is widely utilized in the early stages of almost all industrial activity and construction, both of which are barometers of economic fitness.

Recently, it was announced that Chile's state-owned company, Codelco, has seen its output fall to the lowest in a quarter century, and this follows several years of below-trend production. Chile is the world's largest producer of copper, accounting for approximately 30% of global copper mining output, followed by Peru at roughly 10%, so Codelco's struggles impart a non-trivial and negative impulse into the copper supply chain. As an aside, Peru's bout of political instability last year, whereby the President-elect was removed amidst protests that curbed mining production, represents an ongoing wild card compounding the supply issue. In sum, this illuminates the risk of having a disproportionate supply of copper dependent upon just two Latin American countries.

Meeting the secular demands presented by an organic level of industrial activity, let alone that which is necessitated by the ongoing energy transition via decarbonization and electrification, will require a more predictable and growing investment in mining to meet these obligations.

The International Copper Study Group (ICSG) estimates the copper market was in a hefty deficit throughout most of 2023. To be sure, lower demand from China, the world's largest consumer of copper using more than half of the global supply, due to its troubled real estate market, has effectively capped copper price appreciation in spite of the supply/demand imbalance. In fact, the ICSG forecasts a surplus emerging in the next year, given the lingering weakness in China's property sector. Still, the adoption of solar power, electric vehicles (EVs), and other copper-intensive technologies have a strong secular tailwind that will likely produce an increase in demand over the coming years, eventually overcoming these near-term concerns.

Many countries are investing to develop renewable energy, including solar and wind power, and to increase EV adoption, importantly the United States and Europe. As a result, these two are becoming key drivers in the

incremental surge in copper demand. For example, in the U.S. the Inflation Reduction Act provides tax credits to buyers of EVs, and projects the possibility that in 2030, as much as 50% of all new cars sold domestically could be powered by electricity. Meanwhile, Europe should realize an increase in demand for copper for its automotive industry just the same but also as part of its accelerated shift to renewables to detach itself from energy supplied heretofore by Russia.

According to the International Energy Agency (IEA), annual global copper demand is expected to double by the end of this decade. Despite a highly volatile spot price, a characteristic shared by the publicly traded copper miners whose common stocks trade on the major exchanges, the longer-term prospects for the copper metal and mining complex look attractive. ■

4 KEY ISSUES FOR 2024

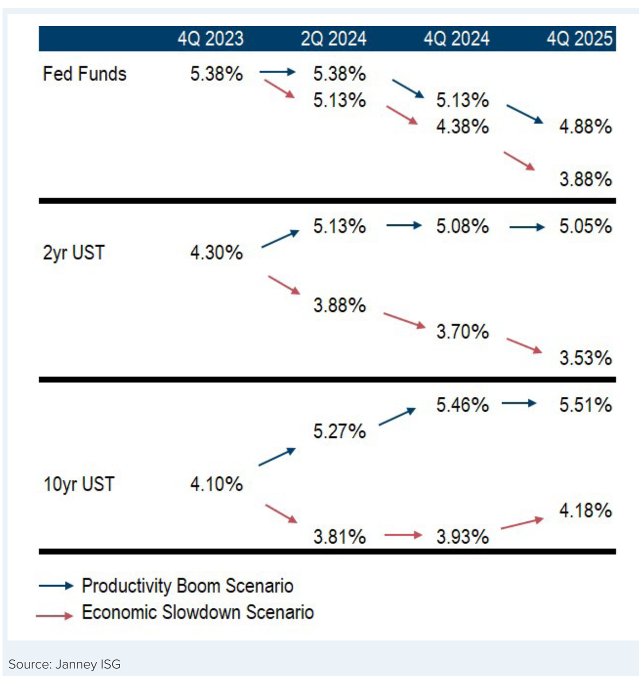
Guy LeBas, Chief Fixed Income Strategist

As an annual follow up to Investment Perspectives' "Year in Review," this second issue of 2024 will focus on four key themes that we believe will dominate the bond markets for the remainder of the new year.

In 2023, we identified the risk of a policy error ("we have yet to feel the downside from rate hikes"), disinflation ("core CPI could end up running below 2% by late-2023"), construction jobs ("recession is largely contingent on builder layoffs"), and credit confidence ("credit market performance hinges on market confidence") as the major themes for the year. Three of these key themes proved significant, and the fourth was a nothingburger.

Failures of regional banks are arguably the result of policy errors, disinflation is happening in real time, and credit market confidence has returned, driving spreads to their lowest level in a few years. At the same time, residential and commercial construction held up remarkably well, and construction layoffs were a non-event. For 2024, we look to productivity gains in the economy, personal risk aversion of policymakers, the power of CTAs, and the expansion of private credit to drive many of the trends in the fixed-income markets.

Chart 1: Interest Rate Outlook Depends on Productivity Boom



Source: Janney ISG

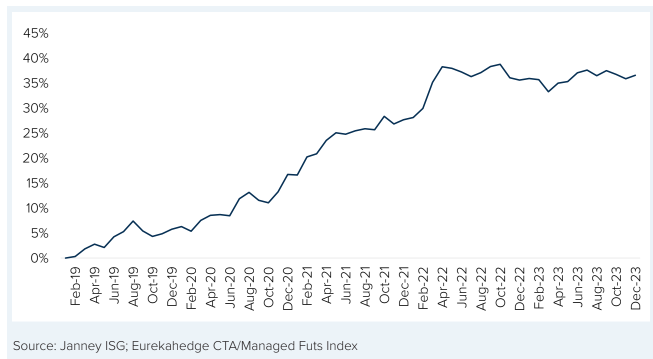
Productivity

The U.S. economy periodically benefits from big leaps forward in economic productivity. There are a handful of periods throughout recent history in which investments in technology paid off, leading to a big 5- to 10-year acceleration in economic growth. The most obvious of these is the late-1990s, in which the desktop computer and internet revolutionized the workplace. Today, there are nascent indications that the U.S. is on the verge of another such experience. We think 2024 will be the year in which these hints of productivity gains either fade or emerge into a full-fledged boom. The difference between these two scenarios is three Federal Reserve (Fed) rate cuts or six, recession or boom, and long-term interest rates falling or rising. It is hard to overstate the importance of these productivity gains for financial markets.

Personal Risk Aversion

Normally, we spend time analyzing economic conditions that give rise to policy decisions. For 2024, however, the economic data are trending clearly towards lowish inflation and stable-ish economic growth. That means Fed monetary, Treasury Department administrative, and Congressional fiscal decisions rest on the personal preferences of policymakers as much as on the economic outlook. Fed Chair Jay Powell is coming up on his professional expiration date, either for post-election political reasons or for personal ones. As implied by a handful of recent comments, Powell's personal focus has shifted to establishing a policy legacy. In our view, his legacy is all about avoiding a repeat of the mid-1970s—suggesting he would pressure his colleagues to be very slow to cut rates for fear of an inflation reacceleration.

Chart 2: Big CTA Returns in 2019 – 2022 Means Sector has More Capital to Deploy & More Influence



Source: Janney ISG; Eurekahedge CTA/Managed Futs Index

Power of CTAs

Commodity Trading Advisors, or CTAs, are a shorthand term for rules-based hedge fund strategies that buy or sell futures contracts. The sector controls roughly $375 billion of capital, and with moderate leverage, has influence in more than $2.5 trillion of notional value of assets. We wrote on the topic extensively in last month's Investment Perspectives, so we won't re-hash the details, but CTAs

have the potential to exaggerate bond market trends in 2024 and possibly beyond, leading to periods of 4-8 weeks of trending interest rates.

Private Credit

Private credit refers to a category of non-bank, non-bond lending that has expanded considerably in recent years. Typically, direct lending to even large public companies was a banking function, but high regulatory and capital costs have pushed some of that function into other private markets. The private credit markets are somewhere around $1.6 trillion in size and growing, with numerous asset management firms rushing to participate in late-2023.

One upshot of this private credit expansion is a big liquidity influx into corporate lending writ large, increasing the odds that even highly leveraged public companies can roll over debt maturities drama-free. In other words, private credit expansion should reduce the probability of default among traditional high-yield bonds, at least in the short term. In the long term, any influx of cash such as this is likely to lead to undisciplined lending, over-leverage, and eventual downside—but that risk is some years away. ■

EARNINGS MATTER

Gregory M. Drahuschak, Market Strategist

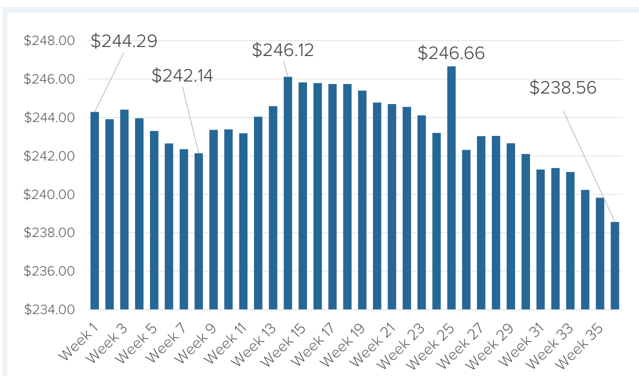
In the short term, the stock market reacts to a wide range of items, but in the long run, earnings are what really matter.

The earnings report barrage this month is critical to the stock market's intermediate-term direction as the earnings bar for some of the market's most prominent names is quite high, especially considering the rise in the price of their stocks in a very short period.

In recent months, the stock market has focused on the potential that 2024 earnings could be up by a low double-digit percentage, but lately that assumption has been questioned.

Earnings expectations begin far ahead of the actual results. For the current year, estimates began surfacing as long as 36 weeks ago with another 47 weeks still ahead before we'd have a final 2024 tally. Nonetheless, earnings expectations exert a significant influence on stock prices.

Chart 3: 2024 S&P 500 Earnings Estimate



Source: Janney ISG

The most recent summary of earnings expectations assembled by CFRA-Standard & Poor's reflects a clear pattern of reduced expectations.

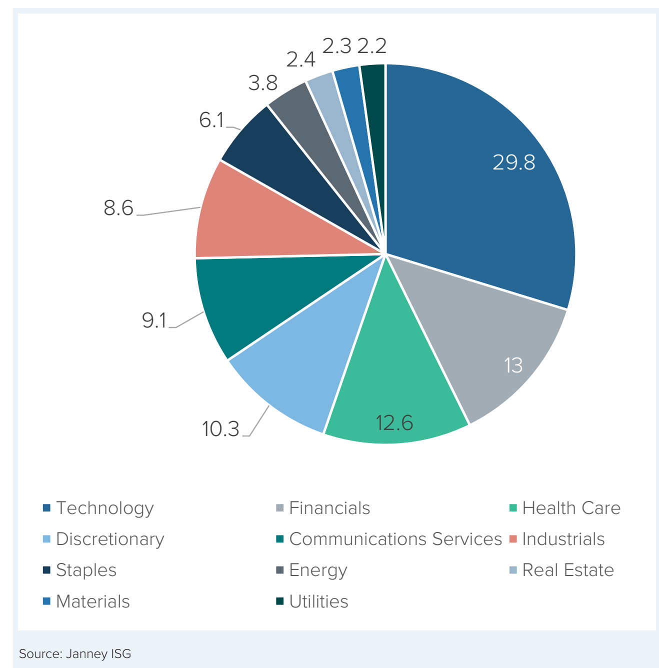
Setting aside what probably was a calculation error 12 weeks ago, the 2024 S&P 500 earnings estimate has fallen in 16 of the previous 23 weeks. By the end of January, this put the S&P 500 at an elevated 20.3 price-earnings ratio.

The evolution of the 2024 earnings estimate largely becomes clear when you dissect the estimate by the 11 sectors within the S&P 500.

It is important to remember that the technology, discretionary, and communication sectors, respectively, are 29.8%, 10.3%, and 9.1% of the S&P 500 capitalization.

Five months ago, these sectors were expected to produce an average 15.56% year-over-year earnings gain. At the end of January, the average expected earnings gain for these sectors had fallen to 12.43%. The drop in earnings expectations for these dominant sectors, combined with even greater percentage declines expected in some lesser represented sectors, led to the combined 2024 S&P 500 earnings growth estimate falling to 9.6% from 12.1%.

Chart 4: Percentage of S&P 500



Source: Janney ISG

In most years, a 9.6% earnings gain would be greeted with enthusiasm, and perhaps it already has been, as the S&P 500 in the previous five months has risen nearly 10%, which might have fully accounted for the lower expected earnings gain.

Chart 5: Weights & % Price Changes S&P Sectors

Weights & % Price Changes	S&P 500		
S&P Sectors	% of 500	MTD	YTD
Communication Services	9.1	8.9	8.9
Consumer Discretionary	10.3	(2.9)	(2.9)
Consumer Staples	6.1	1.0	1.0
Energy	3.8	0.6	0.6
Financials	13.0	2.6	2.6
Health Care	12.6	2.0	2.0
Industrials	8.6	(0.5)	(0.5)
Information Technology	29.8	5.9	5.9
Materials	2.3	(3.6)	(3.6)
Real Estate	2.4	(3.9)	(3.9)
Utilities	2.2	(3.4)	(3.4)
S&P Indexes	**100.0**	**2.5**	**2.5**

Source: Janney ISG

The four weeks of February will see more than 1,300 companies and about 70% of the S&P 500 report results of their most recently completed quarters. The focus will be on whether the recent slippage in expected 2024 earnings can be reversed. However, since the market is always focused on what will be, not on what was, post-release conference calls and the guidance these calls often produce will have the greatest influence on what 2024 earnings will be and in turn what to expect for stocks through the rest of this year.

Keep in mind, however, that just as estimates for 2024 earnings began to be published as early as June 2023, we are not far from when early 2025 earnings expectations will become part of the market's considerations. Reported earnings matter, but the direction often is much more important than the near-term numbers. ■

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