BCN ADVANTAGE: 2023 ANNUAL REPORT

February 2024	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	12.38% [1 2 3]	17.62% [1 2]	11.24% [1 2]	4.85% [1 2]
Jan ' 97 = $100,000 [4]	$1,165,120	$892,665	$480,697	$180,615
Beta (2023):	0.54	1.00	0.50	0.00
Risk Adjusted Return:	13.02%	17.62%	11.24%	4.85%

1 Performance results are based on the Fidelity Mid-Cap Stock Fund (11.0% for 2023), the Vanguard Index 500 Fund (26.1% for 2023), the Fidelity Diversified International Fund (17.7% for 2023) and an average money market return of 4.85%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.
2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.
3 Performance results are net of BCN Financial management fees.
4 BCN Financial Inc. is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2023 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2023	40%	60%
2	02/01/2023	40%	60%
3	05/01/2023	40%	60%
4	07/20/2023	60%	40%
5	11/01/2023	60%	40%
6	12/31/2023	60%	40%
	Present	60%	40%

Two Years To Get Even

For 2023, the S&P 500 rose +24.2% to 4,770, the Nasdaq +43.4% to 15,011, and the Dow +13.7% to 37,690. The IBD Mutual Fund Index gained +18.21%. A strong year – but far less impressive once the 2022 decline is factored in:

The S&P 500 began 2022 at 4,766 – leaving the key index effectively unchanged after 2 years. The Dow also remains flat while the Nasdaq is still negative. Even worse is the performance of the IBD Mutual Fund Index (which tracks bellwether growth funds). After 2 years, the index remains deeply negative following its -35% decline in 2022.

How have BCN Advantage clients fared? On average over the same 2-year period they've easily outperformed the major indexes. Especially noteworthy: our clients have done so while maintaining an average cash (risk-free) allocation of 55%. Exceeding the S&P 500 while reducing risk has always been our *long-term* goal.

For 2023, total federal debt increased by $1.70 trillion – and has now surpassed $34 trillion. By comparison, GDP increased $1.61 trillion (2.5% vs 1.9% in 2022) to $27.36 trillion. Unemployment ended the year at 3.7% (3.4% in 2022), with the labor force participation rate ticking up slightly to 62.5% (62.4% in 2022), still below pre-pandemic levels.

"Soft Landing" – The Bullish Case

Since July, the Fed has left rates unchanged at 5.25% to 5.50%. They hiked in response to the post-pandemic inflationary shock, as PCE spiked from 1.75% in February 2021 to 5.6% by February 2022. The Fed signaled a "pivot" following their December meeting, when they projected 3 rate cuts in 2024 – with GDP growth slowing to 1.5% and unemployment rising slightly to 4.1% as core PCE falls to 2.4%. Core PCE (the Fed's preferred inflation gauge) ended 2023 at 2.9%.

The markets expect 6 cuts in 2024 – beginning in May – with rates at 3.73% by year end. Given the Fed projects 3% rates by 2026, this assumes the Fed will ease much faster to prevent recession. Initial claims for unemployment are the key leading indicator. For now, initial claims are low, near the 200K level. If initial claims move sustainably above 250K, the probability of recession increases significantly.

Recession – The Bearish Case

Though always widely anticipated, “soft landings” are historically elusive. It usually takes 24 months for higher interest rates to fully impact the economy. The initial rate hike was March 2022. History also shows that a recession usually occurs about 15 months from the time the yield curve inverts (with the lag varying from 10 to 24 months). The spread between the 10-year and 2-year went negative in July 2022 – the longest inversion since 1980.

In the wake of their most aggressive rate hikes ever, the Fed’s own model shows a 70% probability of recession, the highest in 40 years. The ISM Manufacturing Sector has been in contraction for 14 consecutive months. Since 1968, there have been two such periods: 2000-02 and 1981-83. The ISM Services Employment Index recently plummeted to levels not seen outside the pandemic, Great Recession and Tech Bubble. The index has never fallen this rapidly without an economic downturn. Are reliable indictors wrong this time? Or have lag effects simply taken longer to resolve – the result of massive fiscal stimulus and continued deficit spending post-COVID?

“Stagflation” – The Wildcard

The Fed projects GDP growth will slow to 1.5% in 2024 – despite their rate cuts. The Atlanta Fed’s Sticky Price CPI tracks goods and services (like housing and health care) that change in price less frequently. Sticky Price CPI currently sits at 4.6%, more than twice the desired target. A resurgence of inflation would delay rate cuts already priced in by the markets. Or worse, force the Fed to lower rates even though inflation remains stubbornly high – both to avoid recession and allow for manageable payments on our rapidly growing national debt.

At current rates, borrowing costs on $34 trillion balloon to $1.7 trillion – expanding faster than annual GDP. It’s not clear who will be buying the projected $2 trillion in treasury debt needed to finance the 2024 deficit. Likely it won’t be the Fed, which has quietly trimmed $1.25 trillion from its balance sheet since April 2022 – “quantitative tightening” from an all-time high of $8.95 trillion in the aftermath of COVID.

Will Markets Remain Patient?

Many believe stocks will explode higher once the Fed begins lowering interest rates mid-year. But the markets are already priced for a perfect scenario: the S&P 500 is currently trading at 20.5x estimated 2024 earnings – right at its 5-year average. So, what happens during the second half of 2024?

The rally in 2023 was primarily seen in 7 technology stocks: Apple, Amazon, Alphabet, Nvidia, Meta, Microsoft, Tesla. Investors are still chasing the A.I.-theme. Microsoft co-founder Bill Gates believes artificial intelligence models (like the one running ChatGPT) are the most important advancement in technology since the personal computer. Narrow markets are fine – until they aren't. The unwinding of the 2000 Tech Bubble began with a Yahoo earnings miss. Similarly, an earnings miss for stocks like Nvidia could derail this market. Nevertheless, 55% of companies report increased investment in generative A.I., with spending on A.I.-centric systems expected to surpass $300 billion in 2026.

Election years have seen few declines. Since the inception of the S&P 500 in 1927, there have been only 7 down years across 24 election cycles (29%) – including the Great Depression. And money market funds could serve as a strong backstop for stocks as rates come down in 2024. The allure of 5% interest has led to a surge in cash on the sidelines, with money market assets up 24% from last year to a record $5.88 trillion.

But commercial real estate poses a significant threat to markets in 2024, with over $6 trillion in debt outstanding. Commercial real estate prices fell an estimated 20% last year, with few of these properties likely to recover their pre-pandemic value any time soon. The hybrid workplace is now commonplace and companies are downsizing this cost. According to the Mortgage Bankers Association, there's about $1.2 trillion in commercial mortgage debt set to mature from now to 2025.

The critical message is not to forget there is still substantial risk underlying the economy and the markets. What will be the “biggest driver” of equity prices in 2024? According to a recent survey of professional money managers, it won’t be fundamentals or corporate earnings. 59 percent said “the Fed.” And we’re not alone in suspecting the summer’s overly anticipated rate cuts may not materialize as expected.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.