Trend & Cycle: The Long View – January 2024

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All values in U.S. dollars and priced as of market close on December 29, 2023 unless otherwise noted

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Secular trends and the current 4-year cycle

- We continue to view the technical backdrop for equity markets to be positive as outlined in our 2024 Technical Outlook published on December 19, 2023 (link here).
- The secular uptrend for equities remains intact with the underlying 16-18 year generational market cycle supportive of further upside into the mid 2030s with potential for the S&P 500 to trend toward 14,000. Until we see evidence that the uptrend, defined by the 4-year moving average, is at risk of being broken, we encourage investors to remain optimistic.
- More importantly, the 4-year cycle backdrop remains positive following the cycle low that was established in Q4 2022 with a growing list of markets, sectors and industry groups incrementally resolving broad 2+ year trading ranges to the upside. In addition, many of the lagging areas of the equity market, notably cyclicals and mid and smaller-cap stocks, are showing evidence of completing cycle lows after trading in 12-18 month choppy sideways patterns, many above rising 200-week moving averages.
- Granted, a pullback in Q1 appears likely given most intermediate-term (weekly) indicators, tracking 2-4+ month swings, moved from deeply oversold levels heading into Q4 toward overbought levels moving into Q1. In fact, with 2024 being the 4th year of the election cycle, history suggests the first half of the year may be choppy, which would be consistent with a tactical pause/pullback moving into Q2.
- However, while sentiment surveys have transitioned from excessive pessimism in early Q4 to more elevated bullish readings with stocks becoming overbought tactically, we would view a pullback to be a healthy technical development.
- **Bottom line**: We view weakness in Q1 as an opportunity to increase exposure to an improving market cycle.

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Interest rates

- The path of interest rates remains one of the more important macro factors for equity markets, with the recent pullback from critical resistance near 5% by the US 10-year yield the primary catalyst for the recent rebound in equities. With long-term monthly cycle momentum indicators turning down from overbought levels, we believe interest rates have established their highs for the current cycle which in turn should remain a tailwind for the improving 4-year equity cycle.

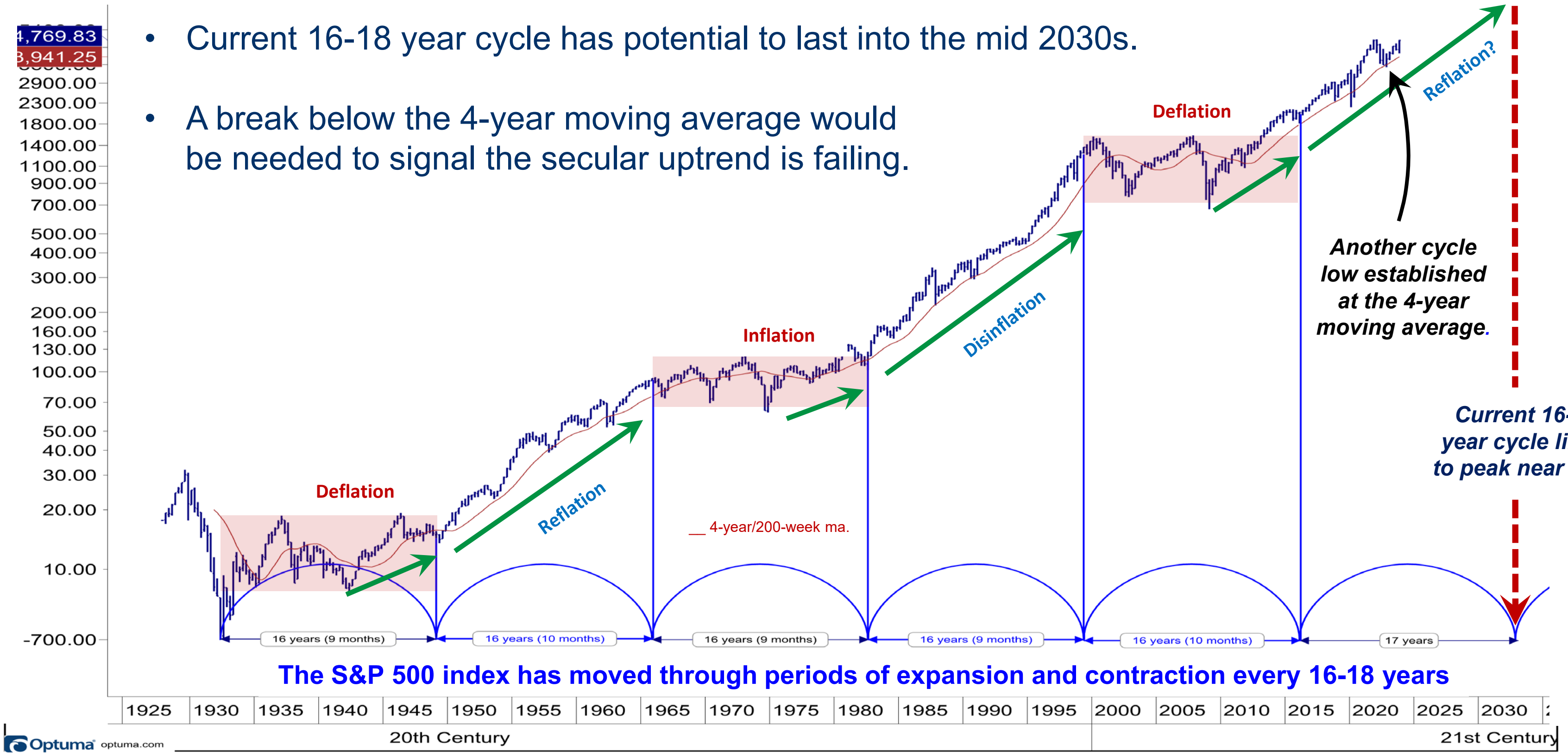
- From a tactical perspective, similar to our expectation for equities, intermediate-term/weekly momentum indicators are likely to become oversold in Q1 after peaking at overbought levels in mid Q4. In short, while it is early to state a tactical low is in place, our expectation is that 10-year yields are likely to stabilize/bottom from a tactical, multi-month perspective moving through Q1.

Equity leadership

- While many investors characterized 2023 as a year with narrow equity leadership confined to only handful of large-cap growth stocks, we continue to see evidence that breadth/participation is broadening within the equity market, notably small/mid-cap stocks many of which are more economy sensitive/cyclicals. Here again, after an impressive surge over the past 2 months, a pullback appears likely moving though Q1, which we expect will be an opportunity for longer-term investors to build exposure.
- Interestingly, as noted above, the price patterns of many of the lagging areas, such as small-caps indices, are tracking the pattern of cycle lows developing at longer-term uptrends defined by rising 4-year/200-week mas that should support further upside over the coming 1-2 years.
- While patience is likely required in Q1, overall, we view a portfolio containing greater exposure to growth and cyclical stocks over more defensive areas such as utilities and staples to be well positioned for an improving market cycle. In our opinion, industrials, followed by select financials and consumer discretionary are sectors to be accumulating during weakness in Q1.

S&P 500 – Generational cycles lasting roughly 16-18 years

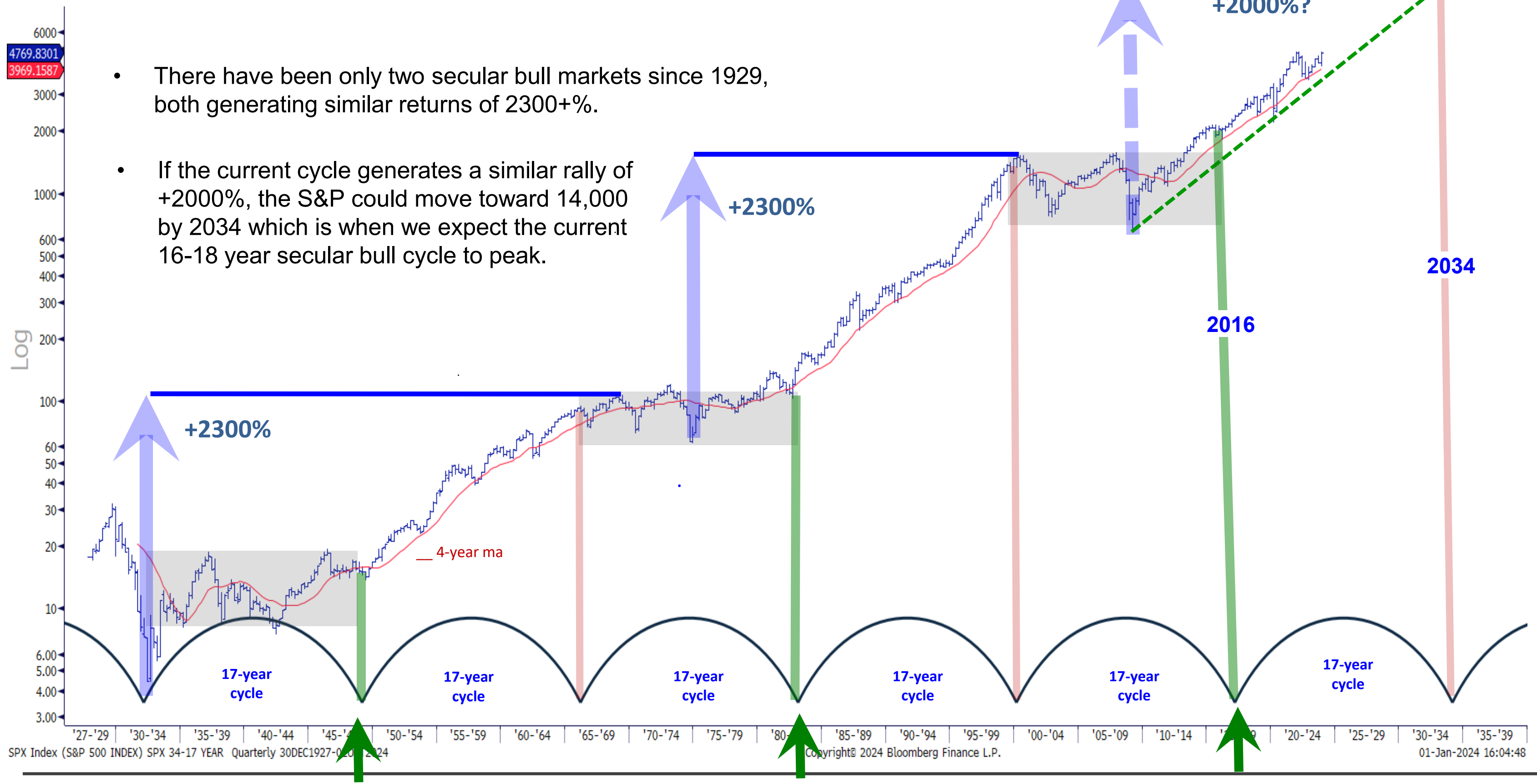
- Current 16-18 year cycle has potential to last into the mid 2030s.
- A break below the 4-year moving average would be needed to signal the secular uptrend is failing.



Source: RBC Wealth Management, Bloomberg, Optuma

S&P 500 – Could the S&P rally to 14,000?

- There have been only two secular bull markets since 1929, both generating similar returns of 2300+%.
- If the current cycle generates a similar rally of +2000%, the S&P could move toward 14,000 by 2034 which is when we expect the current 16-18 year secular bull cycle to peak.

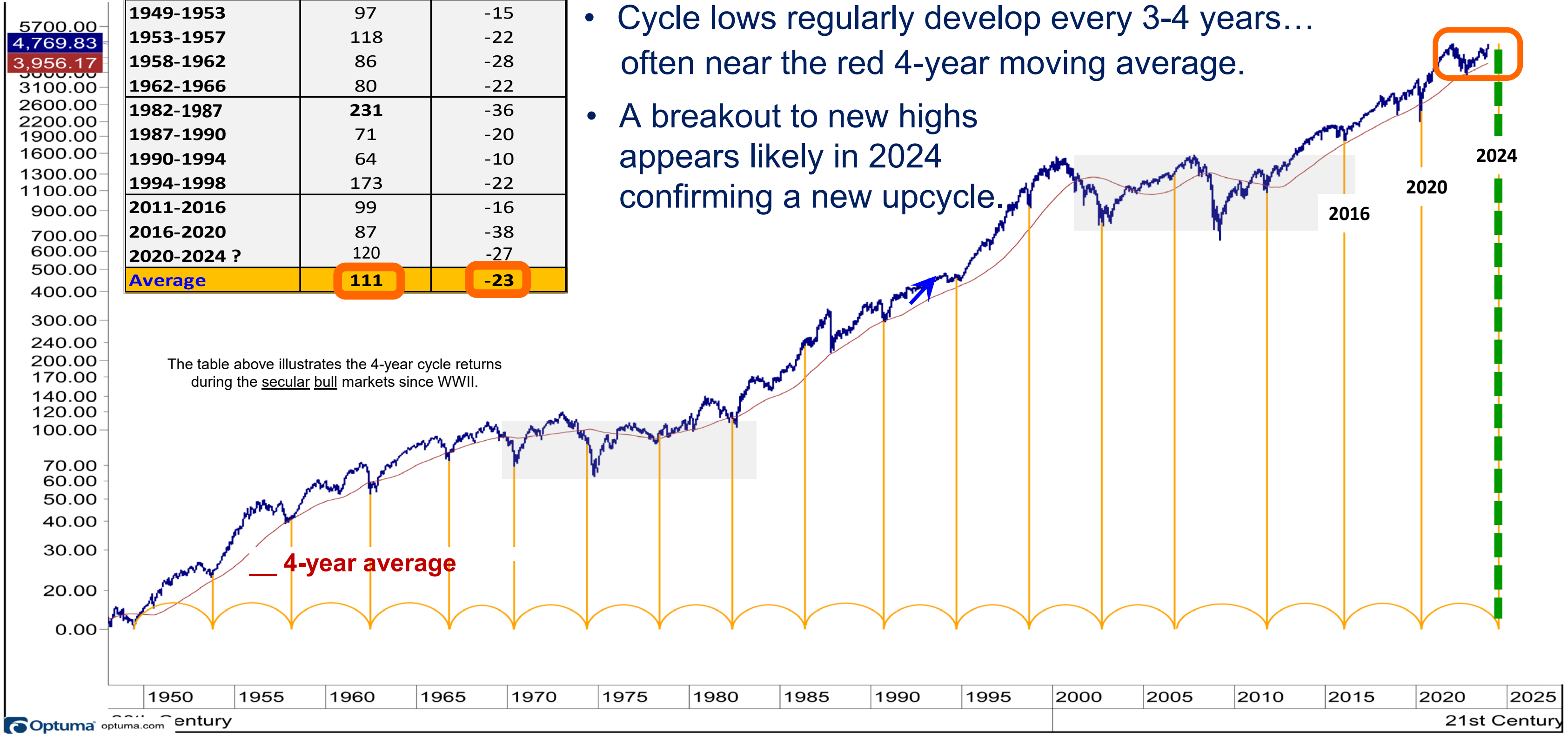


Source: RBC Wealth Management, Bloomberg, Optuma

S&P 500 – A repetitive 3-4 year cycle driven by central bank **liquidity** and economic **growth**

4 Year Cycle	% Rally	% Correction
1949-1953	97	-15
1953-1957	118	-22
1958-1962	86	-28
1962-1966	80	-22
1982-1987	**231**	-36
1987-1990	71	-20
1990-1994	64	-10
1994-1998	173	-22
2011-2016	99	-16
2016-2020	87	-38
2020-2024 ?	120	-27
Average	**111**	**-23**

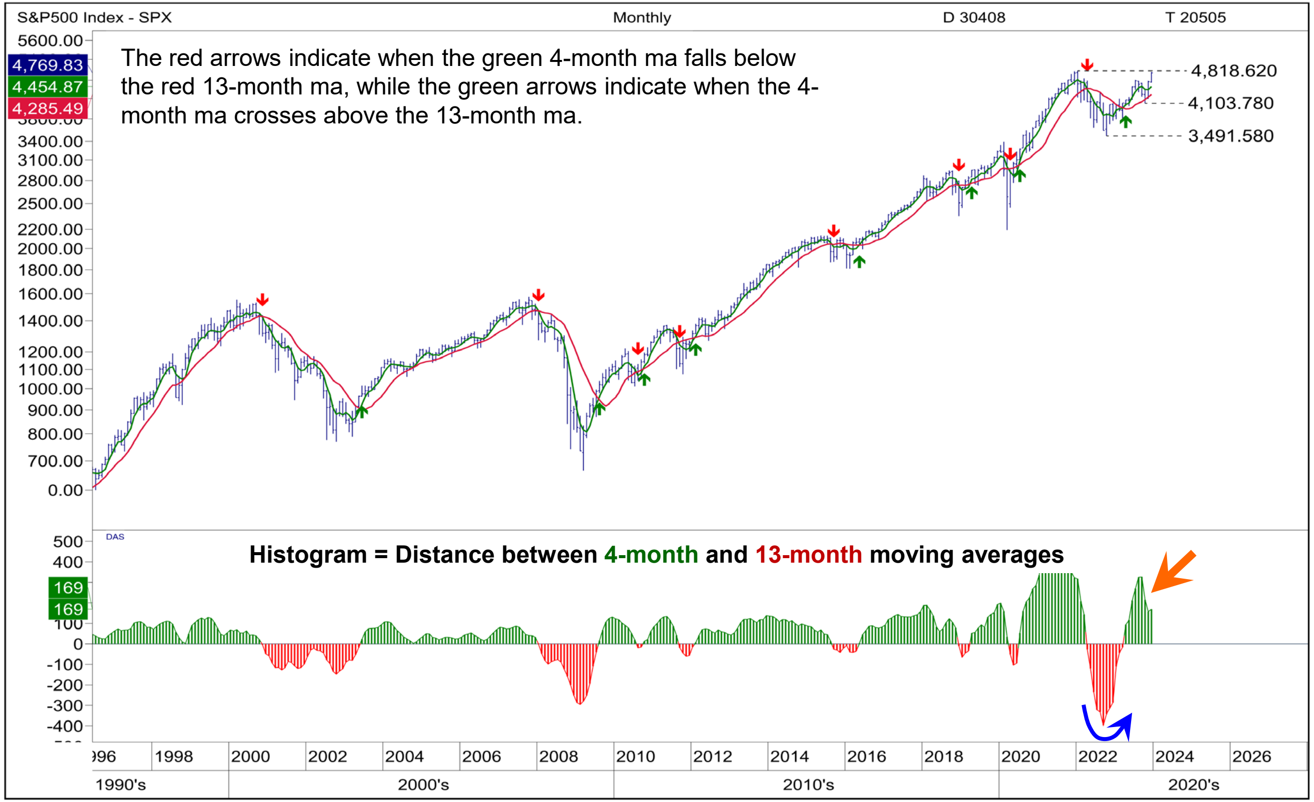
- Cycle lows regularly develop every 3-4 years… often near the red 4-year moving average.
- A breakout to new highs appears likely in 2024 confirming a new upcycle.



The table above illustrates the 4-year cycle returns during the secular bull markets since WWII.

Source: RBC Wealth Management, Bloomberg, Optuma

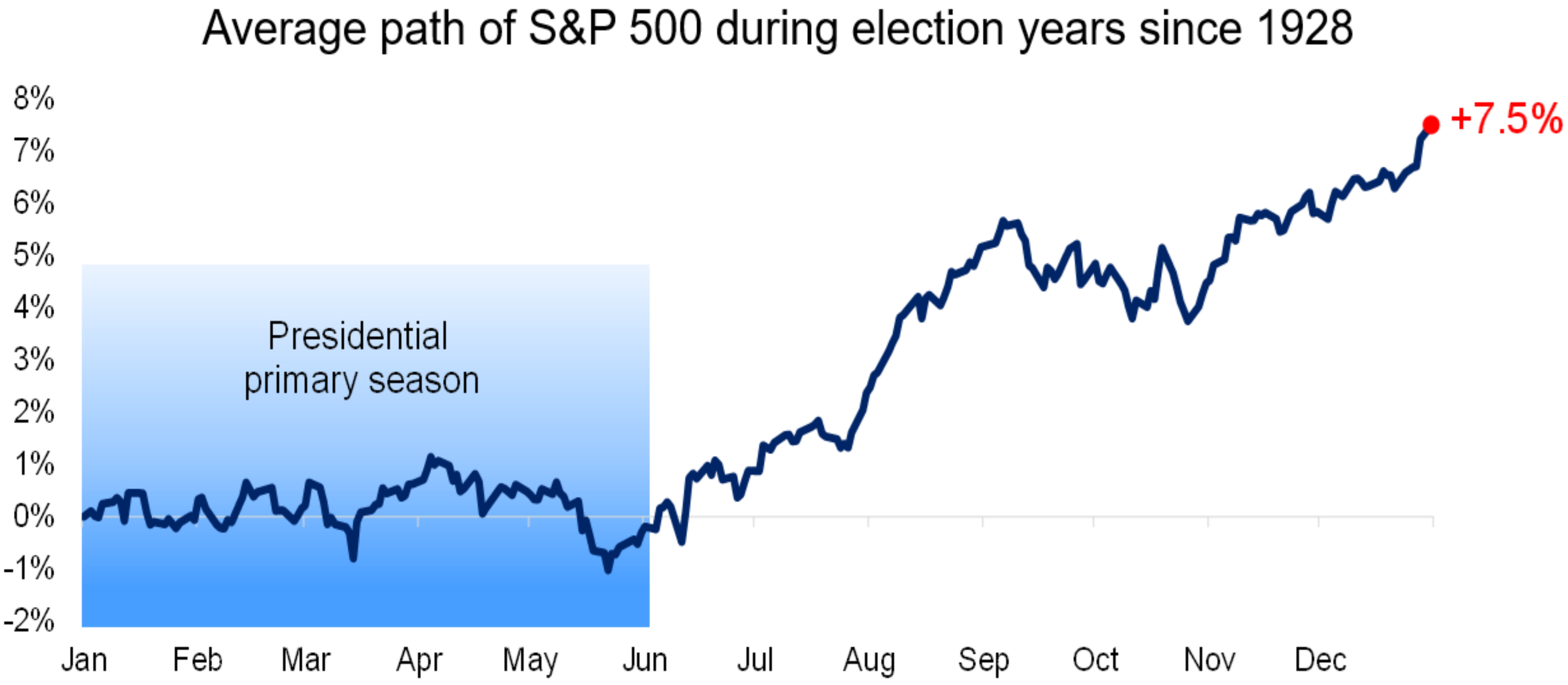
S&P 500 Index



Source: RBC Wealth Management, Bloomberg, Optuma

- One technical tool to monitor the trend of a market is to compare its shorter-term trend, measured by the green 4-month moving average (ma), to its longer-term trend, measured by the red 13-month ma.
- Another way to track the relationship between these two moving averages is to measure the vertical difference between the two and plot the difference as a histogram, as illustrated in the bottom panel.
- This indicator bottomed in Q4 2022, built positively into the summer of 2023 and then began to decelerate/ stall as the S&P 500 pulled back.
- We viewed the Q3 pullback to be consistent with seasonal weakness into Q4 with the S&P again rallying from its uptrend.
- A break below 4100-4000 would be needed to suggest the current cycle is at risk of failing.

Year 4 (election years) of the presidential cycle have been choppy during 1H



Source: RBC Wealth Management, Bloomberg, annual data through 2022

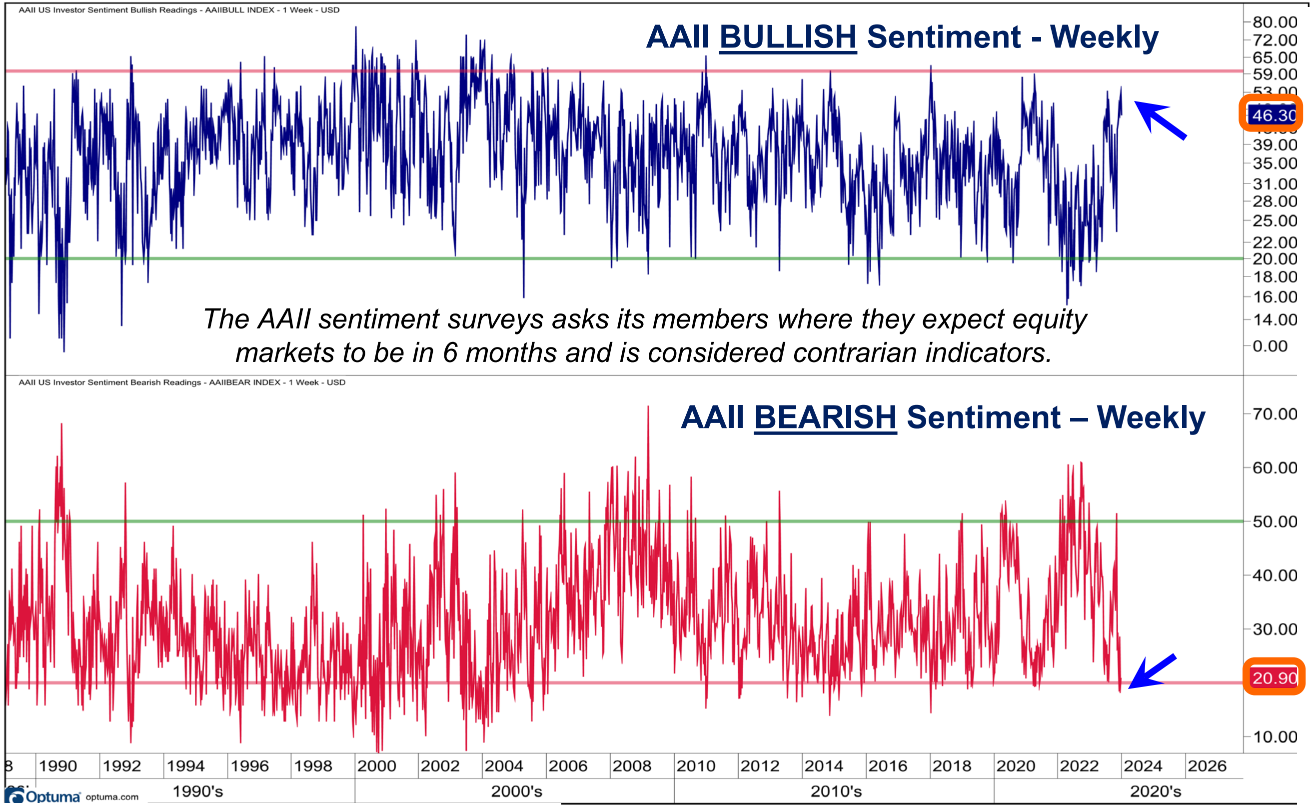
S&P 500 with weekly Quadrant Balance likely to peak by mid-late Q1

Source: RBC Wealth Management, Bloomberg, Optuma

Tactical concerns:

- The trend for the S&P remains positive with a break to new highs likely in Q1 2024 consistent with an ongoing 4-year cycle improving from the Q4 2022 lows.
- However, by mid-late Q1 our weekly Quadrant Balance indicator, tracking the percentage of stocks with rising weekly momentum (bottom panel), will likely begin to show evidence of peaking and turning down.
- **Although this indicator can remain elevated/overbought in strong trend markets, our expectation is that many stocks will be in need of a pullback heading into earnings season following impressive surges from their Q4 lows.**

AAII US Bullish and Bearish Sentiment – Supportive of a Q1 equity pullback



Source: RBC Wealth Management, Bloomberg, Optuma

- Sentiment has snapped back to relatively high levels of AAII bullish sentiment (top panel) and low levels of AAII bearish sentiment (bottom panel).
- While it is premature to conclude a peak in equities is developing, the sentiment backdrop is less supportive of stocks than it was in early Q4 suggesting investors remain more selective when adding equity exposure.
- We view the sentiment backdrop to be consistent with the overbought weekly momentum backdrop suggesting equity markets are likely to pause and pull back in Q1 into Q2.

S&P/TSX Composite – Monthly

- Monthly cycle momentum continues to build to the upside as the TSX successfully retests support coinciding with the 4-year/48-month moving average and the uptrend line that began in 1977.
- Our view is that the TSX is completing a secondary low with potential to break out above key resistance at 22,217 in 1H 2024 with 24,884 the next key resistance level.
- Relative performance versus the S&P remains flat to weak and would need to push above the 2020-2022 highs to support overweighting the TSX vs the S&P 500.

Source: RBC Wealth Management, Bloomberg, Optuma

MSCI EAFE – Monthly with relative performance vs the S&P 500

EAFE (Europe, Asia and Far East)

- EAFE remains range bound longer-term testing next tactical resistance at 2227.
- Further upside is likely in Q1 but with 2416 heavy resistance that will need to be exceeded to suggest any change in EAFE's secular trading range.
- Relative performance versus the S&P 500 remains in an established downtrend with no meaningful change in trend to support overweighting EAFE.

Source: RBC Wealth Management, Bloomberg, Optuma

US 10-year yield: Cycle peak likely in place under at a critical level of 5%

Source: RBC Wealth Management, Bloomberg, Optuma

US 10-year yields (red) and CPI Inflation YoY (blue)

- CPI inflation (blue) has peaked, pulling back to 3.2% while the 10-year yield is showing early evidence of pulling back from a key level at 5% with potential to move lower.

Source: RBC Wealth Management, Bloomberg, Optuma, Bureau of Labor Statistics, National Bureau of Economic Research

US Dollar DXY Index – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly momentum, which tracks the direction of multi-year cycles, remains negative but is working toward oversold levels.
- Similar to the US 10-year yield, we view the dollar to have established a cycle peak and likely to remain weak with plenty of volatility over the coming year.
- Support remains near 98.7-100.8 with next major support between 93.7-88.7 coinciding with the 50-62% retracement bands.

Canadian Dollar / US Dollar – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly cycle momentum continues to build positively from oversold levels in 2022-2023 reinforcing our view that the Canadian dollar is in a bottoming pattern.
- Overall, the price behavior of the Canadian dollar continues to track that of a completed cycle low above 0.715 support with next key resistance between 0.76-0.77 followed by 0.83-0.84.

WTI Oil Future – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly cycle momentum remains positive as WTI shows early evidence of bottoming.
- After stalling near 93, WTI Oil is showing early signs of establishing a bottom in the mid-low 70s.
- We expect WTI to remain in a broad trading range above the mid-high 70s with heavy resistance in the upper 80s-low 90s.
- Note: For reference, we are using 10 to be the low end of WTI's long-term trading range for the Fibonacci retracements rather than the temporary spike into negative territory at -40.

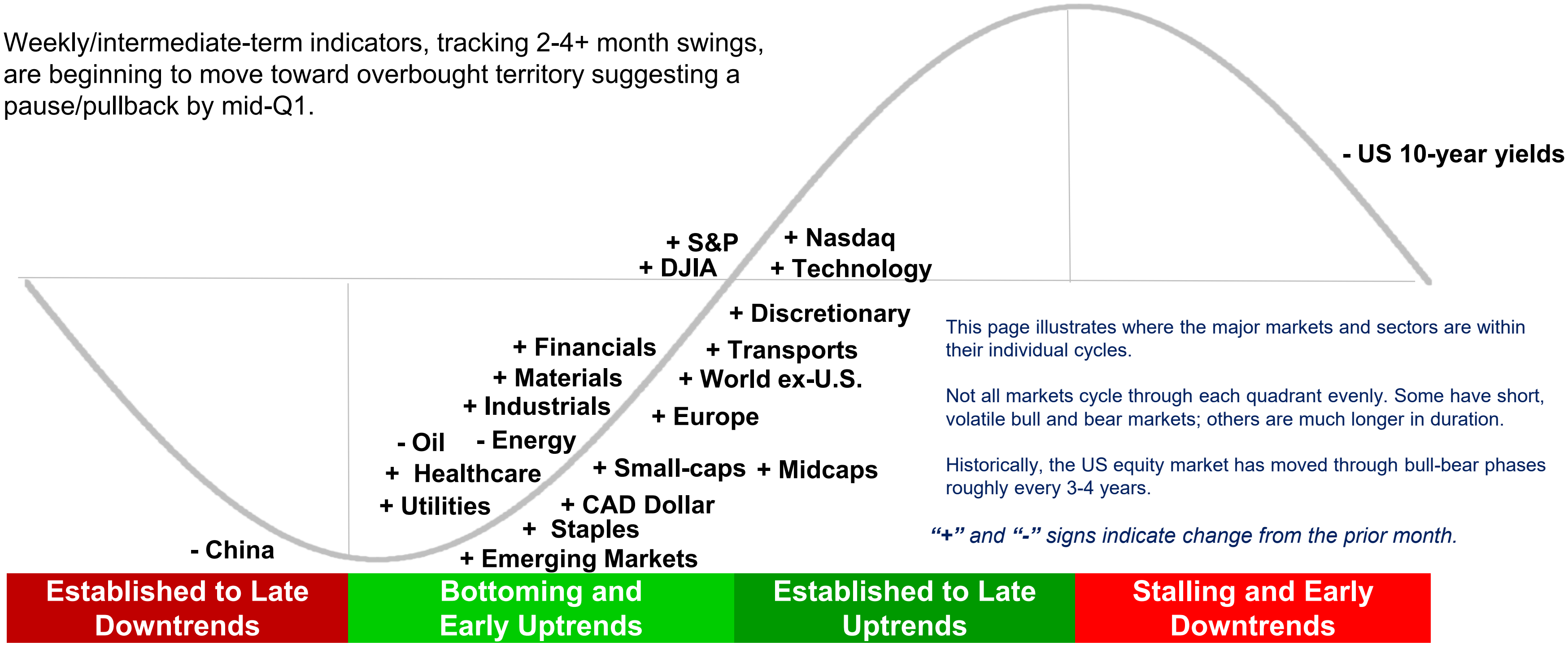
Gold – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- After bottoming near key support at 1800 close to its rising red 200-week moving average, gold has rallied back to resistance between 2000-2075.
- Overall, the longer-term pattern for gold remains positive with a move above 2075 likely in Q1. The next key resistance level near 2359 coincides with the 162% Fibonacci extension of Gold's 2021-2023 trading range.
- Gold would need to break below 1800 (which we do not expect) to suggest the bigger positive pattern is failing.

Major markets and S&P sector cycles

- Almost all markets and sectors continued to strengthen through December, notably smaller-cap and more cyclical sectors.
- Weekly/intermediate-term indicators, tracking 2-4+ month swings, are beginning to move toward overbought territory suggesting a pause/pullback by mid-Q1.



This page illustrates where the major markets and sectors are within their individual cycles.

Not all markets cycle through each quadrant evenly. Some have short, volatile bull and bear markets; others are much longer in duration.

Historically, the US equity market has moved through bull-bear phases roughly every 3-4 years.

"+" and "-" signs indicate change from the prior month.

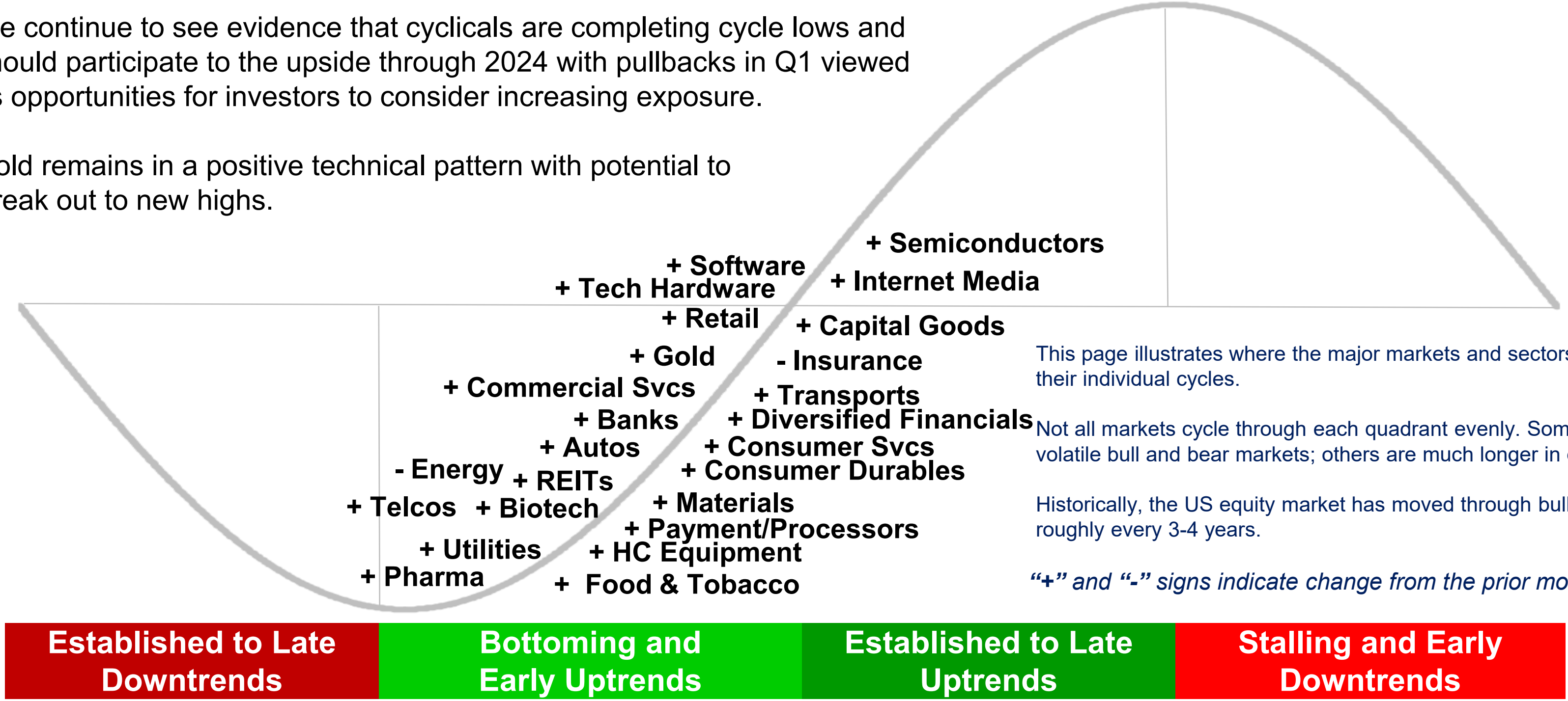
Source: RBC Wealth Management, Bloomberg, Optuma

Industry group cycles

- Most growth and cyclical industries continued to rebound through December while more defensive/safety groups lagged.

- We continue to see evidence that cyclicals are completing cycle lows and should participate to the upside through 2024 with pullbacks in Q1 viewed as opportunities for investors to consider increasing exposure.

- Gold remains in a positive technical pattern with potential to break out to new highs.



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