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MARKET VIEW QUARTERLY

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Coming into 2023, for the first time since 1999, the average strategist's S&P 500 forecast for the end of the year was negative.[1] Analyst predictions reflected deep uncertainty over U.S. monetary policy, corporate profits, and a wider debate over whether the economy would fall into recession. Not only did the U.S. avoid a recession, but the S&P 500 returned more than 20% for the third time in the last five years.[1] A key driver behind the recent broadening market strength was the Federal Reserve (Fed) December meeting, which affirmed that rate hikes are over and rate cuts could begin in 2024. With inflation cooling, yields falling, and strong consumer spending supporting the economy, markets have much to celebrate this holiday season. Moving into 2024, bouts of volatility are likely; however, we still see opportunities in asset classes that did not participate in this year's rally to play catch-up in the year ahead.

DOMESTIC EQUITIES

Rebounding from one of the worst years for U.S. equity indices since 2008, markets in 2023 staged a stark reversal and finished the year up 26.29%.[2] At the sector level, Technology, Communication Services, and Consumer Discretionary outperformed most of the market significantly, returning 53.27%, 44.43%, and 40.42%, respectively.[2] This year was defined by a very narrow market breadth with concentrated returns in seven mega-cap Tech stocks, often referred to as the 'Magnificent Seven' (Apple, Microsoft, Google, Amazon, Tesla, Nvidia, Meta). These seven stocks, constituting 31% of the S&P 500's total market capitalization, led indices higher and accounted for over 100% of index-level, calendar-year S&P 500 returns.[2] As a group, they returned a staggering +109.22% in 2023.[2] Meanwhile, the remaining "S&P 493" was negative, and returned -0.02%. At the final tally, growth stocks were up 42.68%, while value equities only returned 11.46%[2]. This concentrated performance also skewed returns by market cap, as shown by the substantial outperformance of large-cap equities over small-cap stocks, 26.53% vs 16.93%.[2] However, since the end of October, underperforming areas of the market have flipped the script. The equal-weighted S&P 500 Index outpaced its traditional, market cap-weighted counterpart, 16.62% vs. 14.09%,[2] demonstrating broadening market leadership, which was, in large part, spurred by a shift away from the "higher rates for longer" narrative and the hope that the Fed can successfully maneuver a soft landing. Since the start of November, interest rates have declined, which increased equity valuations and earnings forecasts for 2024. The S&P 500's gangbuster performance brought the overall index level back within 1% of its record high set at the start of 2022, while the Dow Jones Industrial Average and NASDAQ both closed the year at record highs.[2]

INTERNATIONAL EQUITIES

International equities underperformed U.S. equities in 2023, as the S&P 500 returned 26.29%[2] while the MSCI EAFE Index returned 18.24%.[2] International Developed markets struggled with higher inflation, more restrictive central bank policies, and heavy reliance on manufacturing, which experienced a contraction in 2023. The U.S. equity market is more growth-oriented than most foreign markets due in part to its significantly larger Tech sector, which accounts for roughly 24% of broad domestic indices compared to just 11% for developed international markets.[1] Geopolitical risks also posed a headwind as the Russia-Ukraine war raged on, and Hamas's attack on Israel sparked further uncertainty about the risk of a broader regional conflict in the Middle East.

The MSCI Emerging Markets Index, which posted a positive return of 9.83%,[2] lagged developed international and U.S. equities as the Chinese economy faced severe headwinds from an unwinding property market crisis, demographic changes, and geopolitical uncertainty impacting foreign investment. Chinese stocks, which comprise 26% of the Emerging Markets index, declined -11.20% as measured by the MSCI China Index, plumbing depths not seen since 2017.[2]

FIXED INCOME

Investors will likely remember 2023 as one of the most volatile years for bonds in recent history. The yield on the 10-year Treasury fluctuated between roughly 3.3% and over 5.0% throughout the year. Even so, rates began 2023 at 3.87% and ended the year at 3.87%, coincidentally resulting in no change.[2] Yields are inversely correlated with returns, meaning a rise in yield implies a drop in price for a bond and vice versa. Although we saw volatility in yields over the last twelve months, higher initial yields at the outset of the year delivered more robust income than bonds have had in the last decade. As a result, the Bloomberg U.S. Aggregate Bond Index returned 5.53%[2] on the year, avoiding a third consecutive year of losses, which has never occurred since the inception index in 1976. A positive year for bonds in 2023 was the result of a strong end to the year. The 10-year yield peaked in mid-October, briefly trading above 5.00% intraday. The year's final two months were characterized by a gradual softening in economic data, primarily, disinflation that saw the Consumer Price Index (CPI) cool to 3.1% in November, down from the 9.1% peak in June 2022.[1] This prompted the Federal Reserve (Fed) to make a dovish pivot from their previously hawkish rhetoric and they now anticipate 0.75% worth of cuts in 2024.[3] The idea that economic conditions had become restrictive enough to discontinue further monetary tightening sparked a bond rally that drove the 10-year yield below 4% for the first time since July.[1] As rates will likely continue to fall throughout 2024, in line with Fed funds rate cuts, bonds are set to deliver more robust income than the asset class has provided in years and potential price appreciation and should have a meaningful position in nearly every investor's portfolio.

ALTERNATIVES AND REAL ESTATE

Oil markets were volatile in 2023, driven by a combination of supply and economic growth concerns. Prices were pushed down into the mid $60s in the first quarter,[1] followed by a summer spike into the high $80s.[1] More recently, news of record-setting U.S. production (13.3 million barrels per day) and surprising supply increases in Brazil and Guyana drove prices back to the mid-$70s by year-end.[1] Notably, "not only is the U.S. producing more oil than any country in history, but the amount of oil (crude oil, refined products, and natural gas liquids) that it is exporting is near the total production of Saudi Arabia or Russia."[4] Therefore, geopolitical conflicts in heavy oil-producing countries may not significantly impact prices at the pump. Domestically, gasoline prices neared $4 a gallon[1] in September. But since then, mirroring the decline in oil prices, the national average gasoline price dropped to $3.12 a gallon[1], meaningfully curtailing a largely necessary living expense for most Americans and allowing consumers to save or spend that money on other items.

Homebuyers suffered the double-edged sword of high mortgage rates and limited supply in 2023. The average 30-year fixed mortgage rate climbed from 6.63% to a peak of 7.79% in late October.[1] Fortunately for borrowers, mortgage rates have since dropped below where they started the year to 6.61%. By historical standards, the pace of total existing home sales remains weak, down 7.70% on a year-to-year basis.[1] After spiking in February, U.S. existing home sales have generally trended lower for most of 2023. Critically, the shortage of inventory for sale and strong pent-up demand pushed the median sales price near an all-time high to $410,000 in June of this year. Although prices have fallen a bit since, down to $387,600, the median existing-home sales price is still up 4.0% year-over-year through November.[1]

CONCLUSION

In 2023, we saw the Fed continue to raise rates more than expected, several history-making U.S. bank failures, mortgage rates hit 20-year highs, a looming threat of a government shutdown while national debt levels swelled to record levels, with wars waged in Europe and the Middle East. Despite all of this, markets pushed higher. With the markets able to overcome these obstacles, we believe there are reasons for cautious optimism heading into 2024. Interest rates have likely peaked as the Fed starts paving the way to rate cuts, inflation continues to moderate, and valuations for stocks outside of the heavy-hitting Magnificent Seven remain attractive. We will acknowledge that, more recently, the massive tailwinds of 2023 that underpinned excess demand, resilient markets, and a strengthening economy have faded significantly. Specifically, excess savings are nearing depletion, job openings are falling while unemployment is rising, and capital spending by large corporations has leveled off. That said, with some of 2023's headwinds, like high inflation, expected to dissipate, we should also see new positives emerge. We anticipate slower growth and bouts of volatility to surface in the new year but do not believe we will see an imminent economic recession. Instead, we forecast a reversion to the mean for stock market performance and a meaningful contribution to total portfolio returns from quality fixed income securities.

Economic Definitions

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Existing Home Sales: This concept tracks the sales of previously owned homes during the reference period. Total existing home sales include single-family homes, townhomes, condominiums and co-ops. All sales are based on closings from Multiple Listing Services. Foreclosed homes are only counted in the inventory if the bank is working with a realtor. Foreclosed homes that sell via auction (or other closings outside of the Multiple Listing Services) are not included.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

West Texas Intermediate (WTI): West Texas Intermediate (WTI) is crude stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

S&P 500® Equal Weight Index (EWI): The S&P 500® Equal Weight Index (EWI The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization-weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight — or 0.2% of the index total at each quarterly rebalance.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell 1000 Growth: The Russel 1000 Growth measures the performance of the large-cap growth segment of the US equity securities. It includes the Russell 1000 index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value: The Russell 1000 Value measures the performance of the large-cap value segment of the US equity securities. It includes the Russell 1000 index companies with lower price-to-book ratios and lower expected growth values.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI China Index: The MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 717 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

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Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

Investing involves risk, including the potential loss of principal. No investment strategy can guarantee a profit or protect again loss. In general, the bond market is volatile; bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed-income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Vehicles that invest in lower-rated debt securities (commonly referred to as junk bonds or high-yield bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

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1 Data Obtained from Bloomberg as of 12/31/2023.

2 Data Obtained from Morningstar as of 12/31/2023.

3 CME FedWatch Tool - CME Group.

4 As 2024 Approaches U.S. Leads Global Crude Oil Production - Forbes.

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