Monday December 18, 2023

SUMMARY-

I. Fed remains on hold and surprises with dovish remarks on rates.

II. Stocks and bonds both rally in response as they advance further.

III. Previously lagging stocks and sectors continued to outperform.

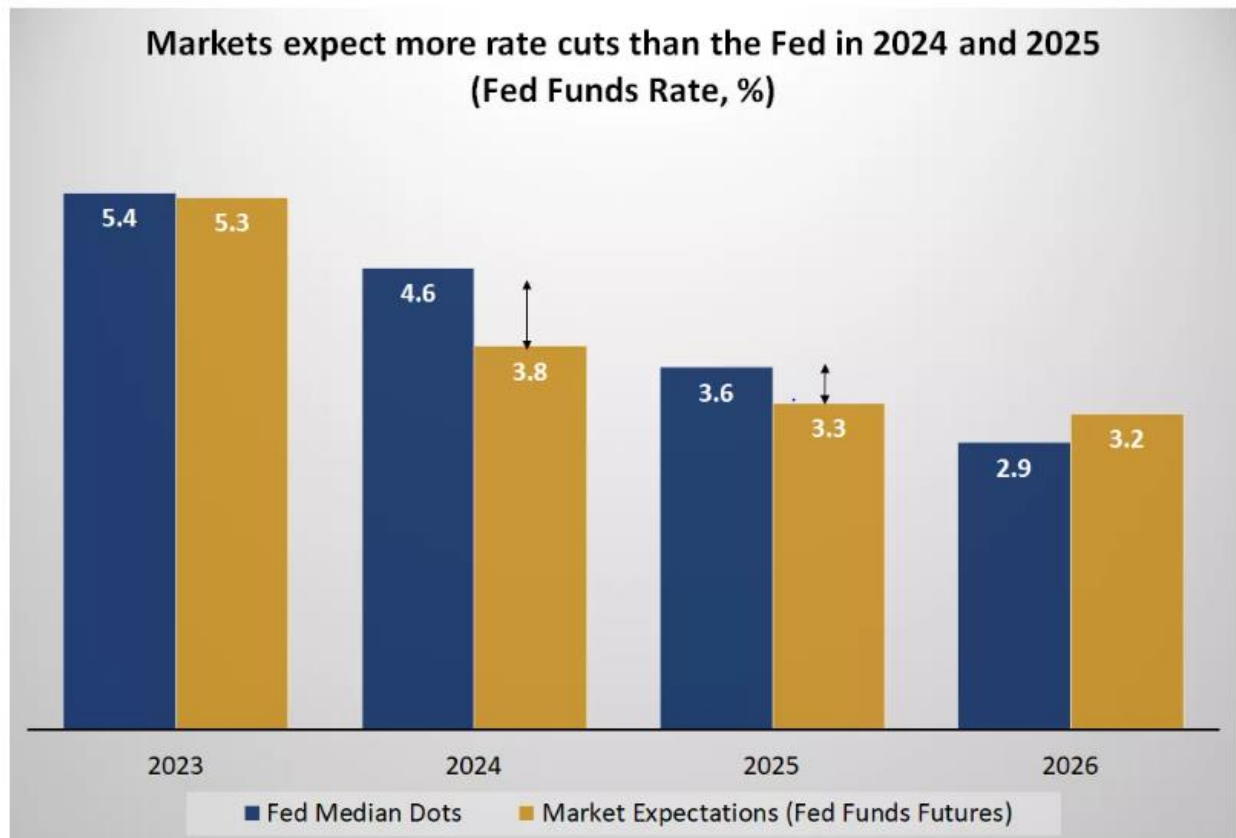
IV. Declining cash yields and improving fundamentals could help 2024.

Good morning:

Cooling inflation data on Tuesday set the stage for last week's FOMC meeting where the Fed again left rates unchanged but then went on to make some extremely bullish remarks causing both stocks and bonds to rally. Among Chairman Powell's most important comments were those focused on the Federal Reserve's willingness to cut rates even if the U.S. economy doesn't dip into a recession in 2024. "It could just be a sign that the economy is normalizing and doesn't need the tight policy," he said. While the fight to get inflation down from its current 3.1% rate to their 2.0% target will continue, the Fed has now acknowledged that additional hikes are "not likely," inflation doesn't have to actually fall to 2.0% before they may ease, and they will now include rate *cuts* in their conversation.

Their remarks have also resulted in noticeable further bullishness in the interest rate market. Currently, the Fed Funds futures market (that enables mostly institutional investors to hedge or speculate on the direction of short-term

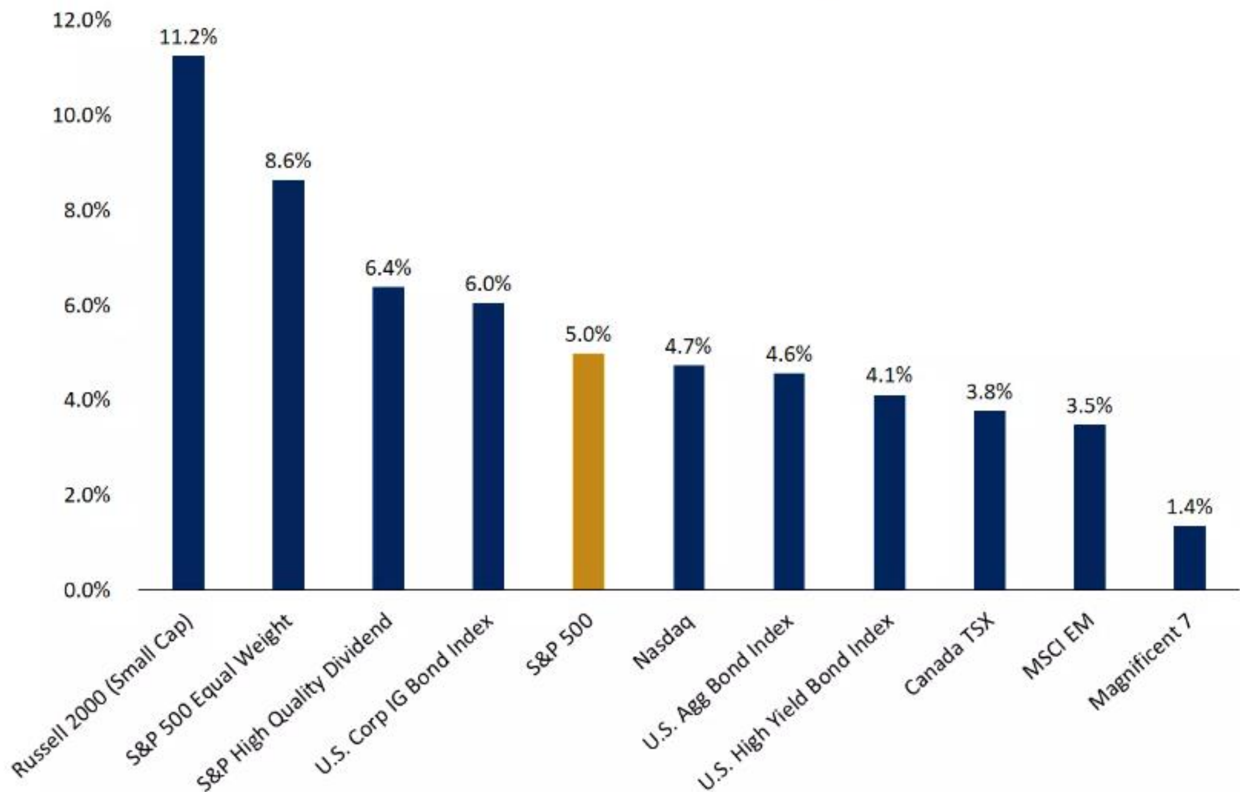
interest rates) now expects even more rate cuts from the Fed in the next two years than the Fed's own "median dot plot" predictions.



Source: Bloomberg

Even markets that were anticipating continued inaction from the Fed were taken aback with the remarkably dovish change to Powell's remarks. The resulting knee-jerk spike higher in stock and bond prices pushed both asset classes to new annual highs. Leading equity averages higher on the week was the small cap Russell 2000 Index that gained 5.55%, while the Dow, S&P 500, and NASDAQ each added 2½ - 3%. The current seven-week equity rally now underway has not changed the fact that the bulk of this year's nearly 23% S&P 500 return is

still attributed to a handful of mega-cap technology stocks. However, as we started to see last month and have highlighted in recent weeks, much of the rest of the equity market has started to play catch-up. In addition to significantly lower valuations of many individual stocks and industry sectors beyond the so-called Magnificent Seven companies, investors are realizing that declining interest rates in the near future bodes well for many of these undervalued companies' businesses and equities in general.



Source: Bloomberg. Magnificent 7 includes Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla.

We felt strongly that prudent time-tested portfolio management tenets that support concepts like diversification (asset class, market cap, sector, style,

etc.), quality fundamentals, and professional money management would prevail long after an enigmatic period where a few stocks garner all the focus and results. Patience and investment discipline to a proven investment strategy during challenging times is generally rewarded on the road to meeting long-term financial objectives. With many of the previously unloved stocks and areas of the market just beginning to wake up from their two-year slumber, we believe odds favor continued recovery next year in areas like cyclical sectors, small & mid-caps, and value style investments. Investment grade intermediate and longer-term bonds should also do much better in a falling rate environment. On the other hand, sidelined cash now enjoying attractive yields in money-market mutual funds will likely mirror the projected decline in short-term interest rates as yields head down in the coming 24 months.

With over $6 Trillion flowing into CDs and money-market funds in 2023, declining rates and better market and economic conditions may compel many investors to redeploy some of these deposits into both equity and fixed income markets in the months to come. This could serve to further bolster 2024 returns among the non-cash asset classes. Of course, it is important to remain cautious and be prepared for unexpected volatility and exogenous world events at any time.

In the remaining nine trading days left in the year, our group remains very busy addressing the many distribution and trading activities for our clients that must be completed by year-end. Should you have any specific questions or requests of this nature, please let us know at this time. We have also recently

completed full portfolio rebalances within many of the model strategies we manage to be well-positioned for the current rebound and the year ahead.

We also want to wish each of our clients and friends a happy and healthy holiday season, along with our many thanks for your continued confidence in our group. It remains our honor and privilege to serve you and your family's financial needs.

Have a great week!

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The Russell 2000 Index measures the performance of the 2000 smallest companies in the Russel 3000 Index, which represents approximately 8% of the total market capitalization of the Russel 3000 Index.

Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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