Tuesday January 2, 2024

SUMMARY-

I. Fed's conclusion to long hiking cycle sparks year-end rally.
II. Disinflation, banking crisis, concentration, and A.I. drive markets in 2023.
III. 2024 could see weaker economic growth and rate cuts.
IV. Lower interest rates should help laggards in 2024.

Good morning:

As we start a new year, we wanted to take some time and review 2023, one of the most interesting, and often surprising years in recent memory for the markets. Last year began on the heels of 2022; one of those rarely seen years when both stocks and bonds posted double-digit percentage losses. Cash was the only the asset class that year that finished in the black. With the Fed early in their aggressive monetary tightening campaign, nearly universal calls for a 2023 recession were everywhere. Inflation had started to recede but was still 6.5% causing many Americans to reduce discretionary spending after paying for their basic family living expenses.

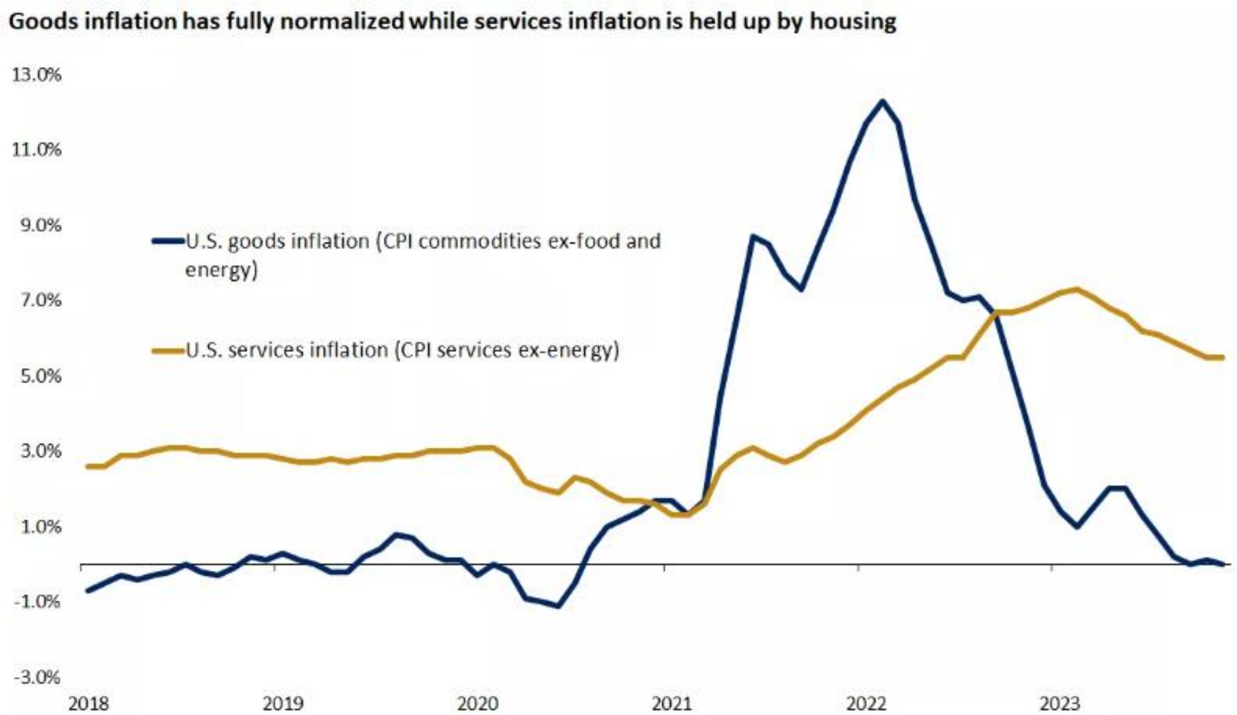
In an effort to keep the spike in the inflation rate (that they themselves allowed to take hold by keeping rates near zero for too long) declining towards their 2.0% target rate, the Fed hiked rates four more times in 2023 despite CPI data continuing to ease. Since the start of this cycle, the federal funds rate was increased 11 times for a total of 5.00% in hikes. With the CPI closing 2023 near 3%, inflation now seems to be under control prompting expectations of rate cuts later this year.

Fed Rate Hikes 2022-2023: Taming Inflation

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
July 26, 2023	+25	5.25% to 5.50%
May 3, 2023	+25	5.00% to 5.25%
March 22, 2023	+25	4.75% to 5.00%
Feb 1, 2023	+25	4.50% to 4.75%
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.50%
June 16, 2022	+75	1.50% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

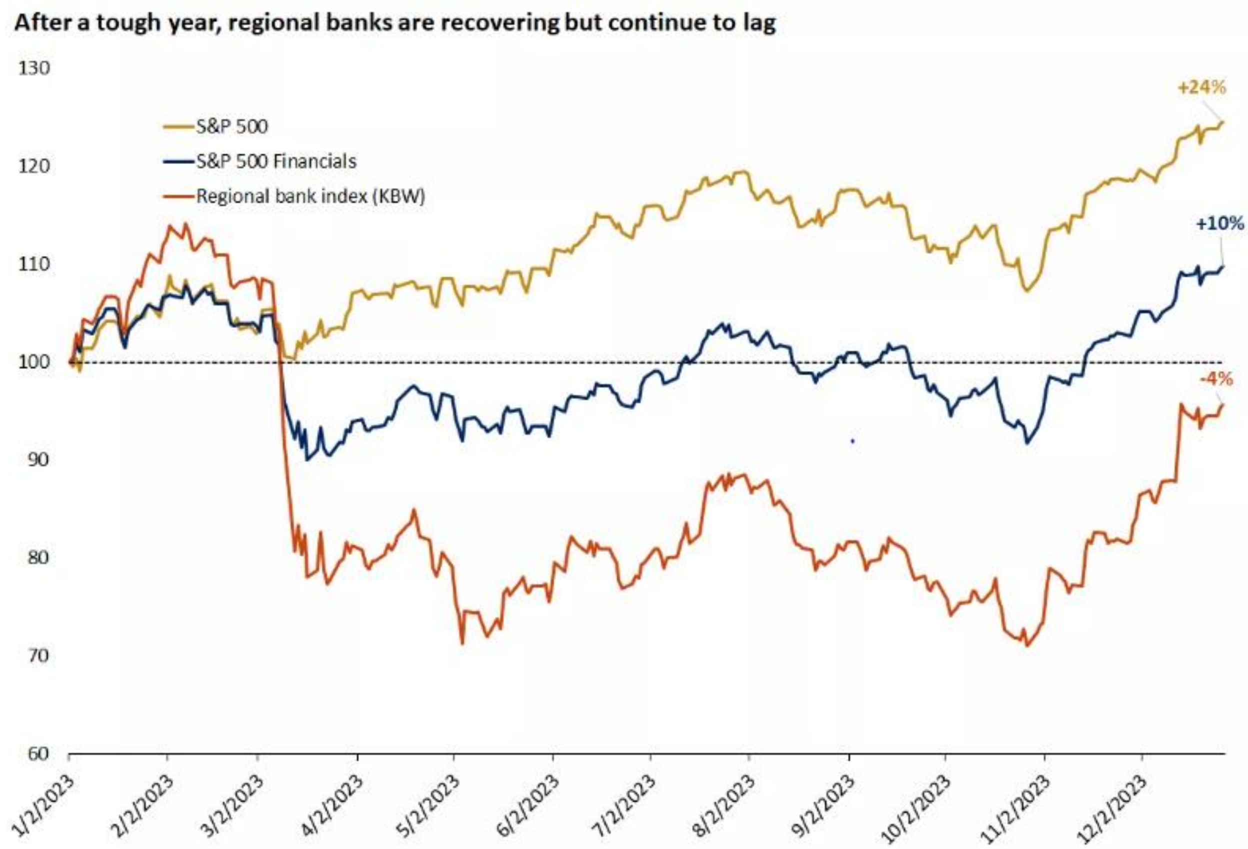
Source: Forbes

After hitting a peak of 9.1%, inflation's significant decline was aided by lower oil and gas prices last year. Supply chains that were disrupted during the pandemic have also continued to normalize, allowing prices to decline. Inflation in the services sectors remains elevated but is also on a declining trajectory. In fact, inflation amongst U.S. goods has already declined to the Fed's 2.0% target level. With softening wage growth and easing housing & used car inflation expected in 2024, the expected Fed rate cuts should be justified and prove supportive to both stock and bond returns.



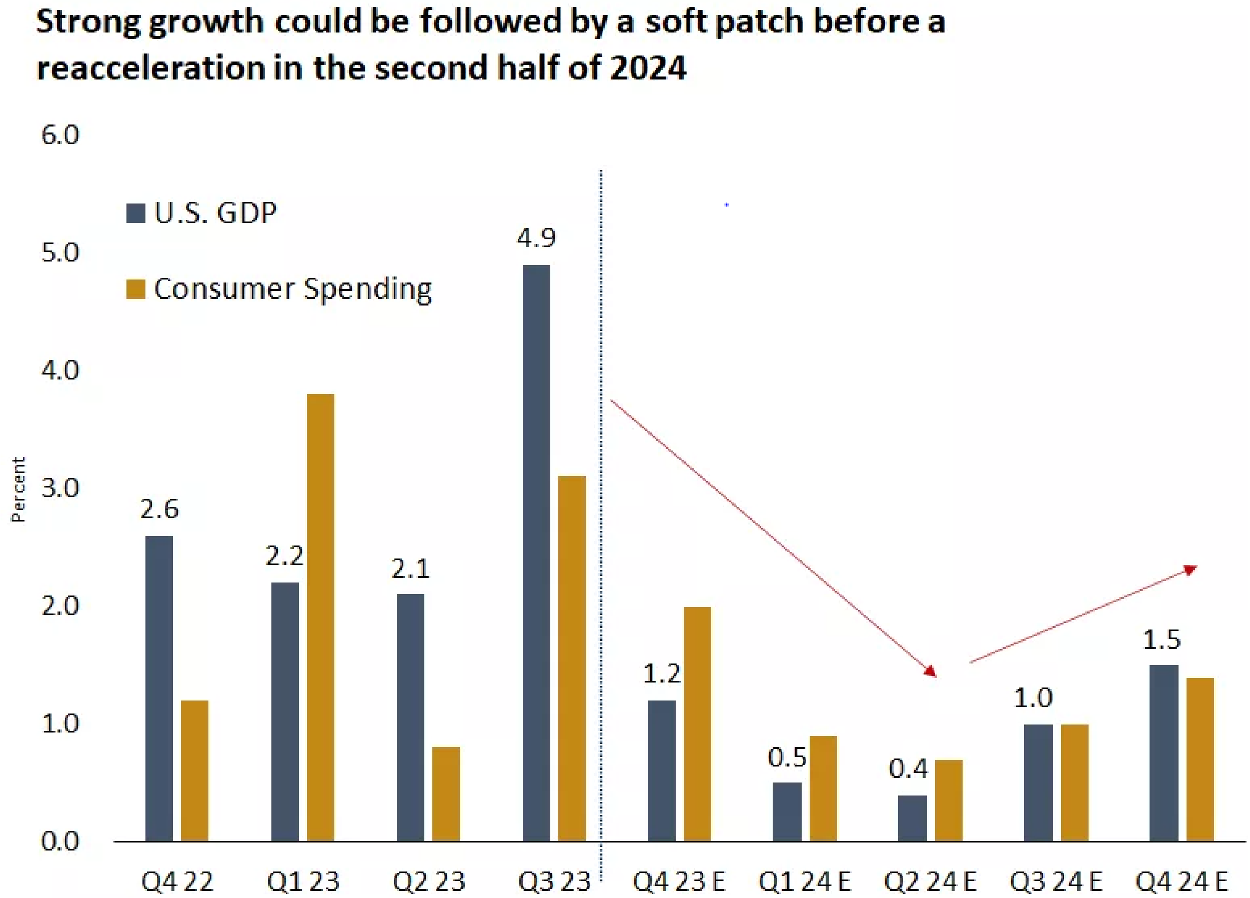
Source: FactSet

With such widespread expectations of economic contraction as we started 2023, only a handful of mega-cap tech stocks seemed to be in favor. The Magnificent Seven as they began to be called became an unexpected safe haven of sorts after they led the market lower in 2022 and were then seen as profitable companies likely to weather the coming recession better than most. Markets then had to contend with a regional banking crisis in March that led to the failure of two well-known banks and the forced merger to two others. Memories of the 2008 financial crisis caused policy makers to take swift action to stop the contagion from spreading and prevent a further run on other banks. With falling bond yields and most banks well capitalized, 2024 should see less stress on the banking sector, although regional bank stock prices have yet to fully recover from last year's dramatic selloff. Larger banks were one of the leaders when the markets finally broadened out in 2023's year-end rally.



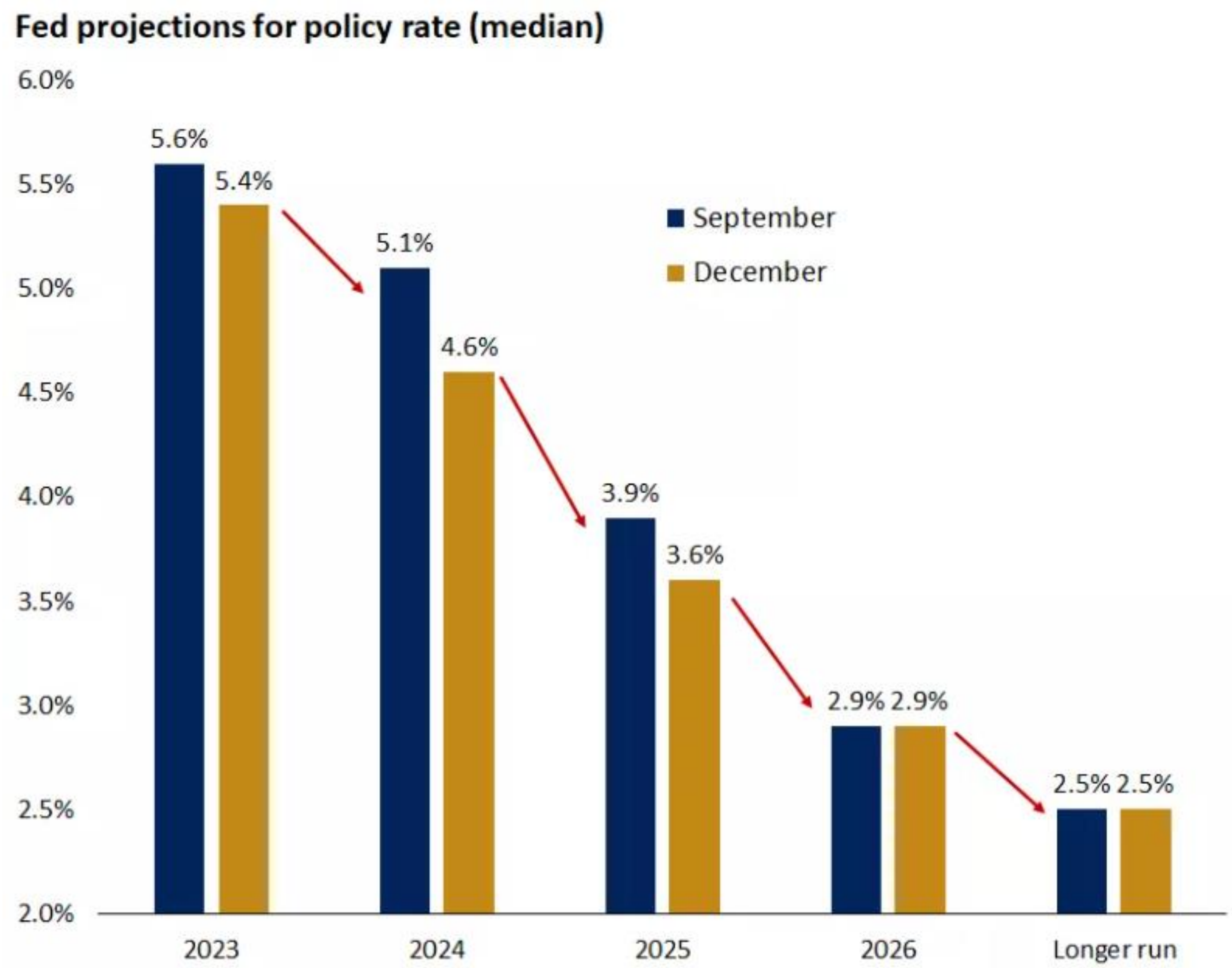
Source: FactSet

Perhaps the biggest surprise of 2023 was the resiliency of both the economy and the U.S. consumer. The widely feared recession never materialized and the labor market remained tight. The unique set of economic circumstances and consumer spending trends coming out of the global pandemic may have contributed to the majority of economists and market strategists being wrong with their forecasts, all likely based on more normal historical economic data. Nevertheless, these effects may not last much longer as conditions continue to normalize. Consumer spending remains the largest component to GDP, accounting for nearly 2/3 of all U.S. economic activity. Current expectations suggest a mild slowdown in growth and consumer spending in the first half of this year before growth reaccelerates in the second half of 2024.



Source: Bloomberg

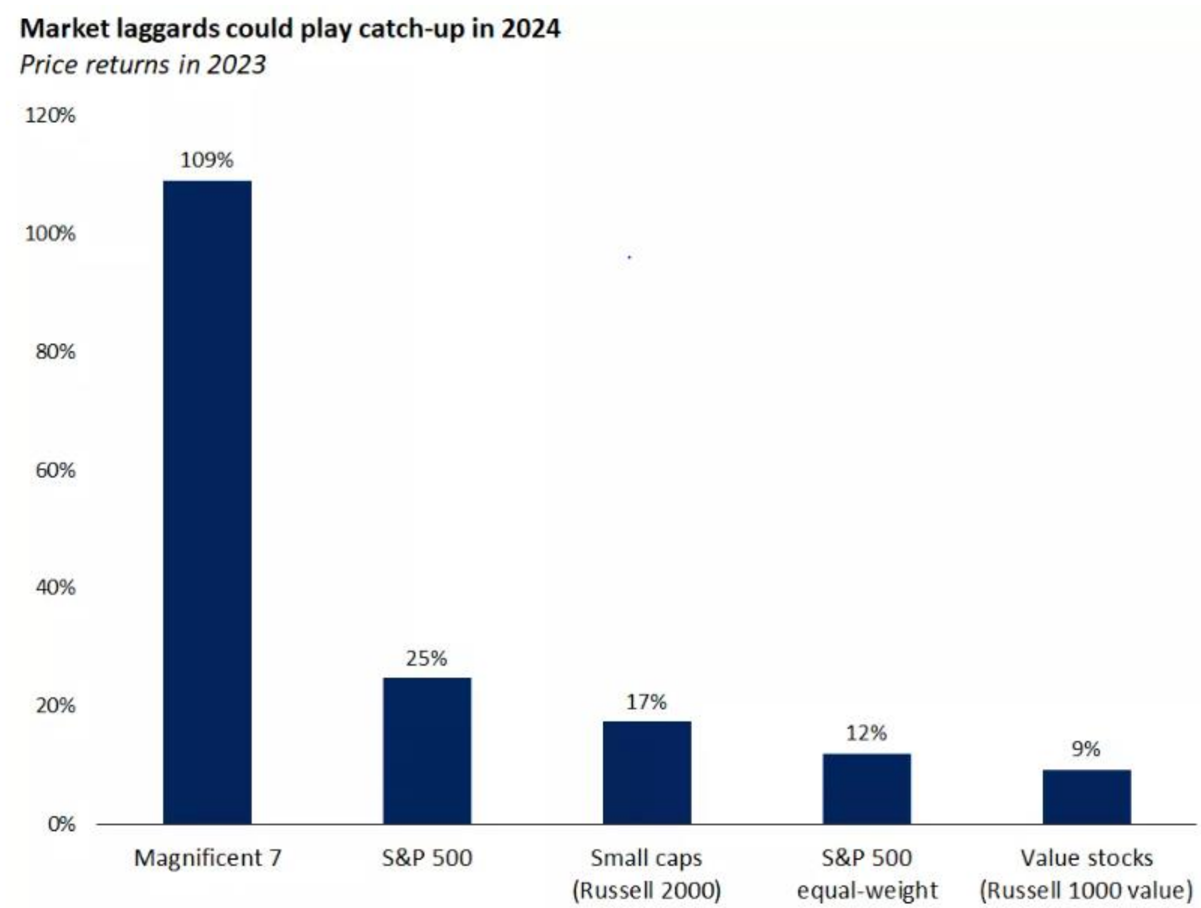
As yields on bonds have already started to project, interest rates are expected to decline steadily over the next couple years. While markets predict six rate cuts and the Fed only three this year, the important thing for all investors is the general direction. A lower borrowing cost for both businesses and individuals is perhaps the most critical factor to economic growth. The anticipation of these better growth conditions was the biggest catalyst to the equity markets' rally over the past two months.



Source: FOMC projections.

The narrow market leadership seen in 2023 for much of the year prompted many investors to become impatient or even start to chase the Magnificent Seven stocks that seemed unstoppable (Amazon, Apple, Alphabet, Meta, Microsoft, NVIDIA, & Tesla). By the end of Q2 last year, excitement about artificial intelligence enabled these 7 stocks to be responsible for 90% of the S&P 500's advance. Until mid-November, much of the rest of the stock market was flat on the year before the Fed's pivot on rate policy prompted renewed interest in most of the lagging equity areas.

We see this trend continuing in 2024 as valuations for lagging sectors like small-caps, high-quality dividend stocks, cyclicals, and value-style investments remain attractively priced. The prudent approach to investment portfolio management of broad diversification that we deploy for our clients appears poised to extend its recent good results as last year's laggards continue to play catch-up in 2024.



Source: Bloomberg

Unlike 2022, 2023 proved to be a positive year for investors with respectable gains in all asset classes. Remaining invested, as well as dollar-cost-averaging, once again proved far more effective than trying to time the market's volatility by jumping in and out. 2024 will undoubtedly have its own unique market-moving events and challenges in addition to being a presidential election year. However, with Fed rate cuts on the docket, inflation still in decline, and corporate earnings rebounding, this year appears poised to be another good year for investors.

Please keep an eye out for a separate email from us designed to help us better plan our client events and reviews for 2024. We are excited about beginning a new year with you as your financial advisors!

Have a great week & Happy New Year 2024!

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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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