Insights: January 2024

Market Overview and Performance

Unequivocally, 2023 exceeded all expectations for investors across the risk spectrum. At the conclusion of 2022, both equities and fixed income investments had declined by double digits, and virtually all credible sources with insights into the future economic landscape, from Bloomberg to Jamie Dimon to Jeff Bezos to Jeffrey Gundlach, had expressed the view that a recession was "100%" lying in wait for 2023. Instead, investors received an astounding amount of positive economic developments even as the Federal Reserve relentlessly raised interest rates to over 5% throughout the year. Punctuated by the recent Q4 US GDP reading of a remarkably high +3.3%, Fitch Ratings remarked, "Whichever way you slice it, this report caps a year of stellar economic growth performance, particularly with the backdrop of the Fed's aggressive monetary policy tightening cycle. The momentum of economic growth going into 2024 is looking very good and presents an upside risk to growth going forward, despite widespread expectation of a slowdown in 2024." As equities declined -10% from August through October of 2023, few anticipated a positive outcome into year end, however, when Fed Chairman Powell suggested in late October that "our policy rate is likely at or near its peak for this tightening cycle", markets interpreted this as a strong risk on signal and equities moved aggressively higher while interest rates moved rapidly lower. While the widely exalted "Magnificent 7" garnered a good deal of the attention, many investors remained skeptical regarding the prospects for future gains. Yet as we write this, the S&P 500 is up roughly +19% since the October 2023 lows as market breadth has expanded notably to other areas of the market. Despite the fact that the geopolitical environment continues to erode, the fundamental backdrop for economic expansion and profitability particularly with the US, appears robust. And now, with consumer sentiment turning sharply higher, the engine of growth within the US may provide further tailwinds. Thank you for taking time to read our market Insights.

	Quarter to Date December 29	***Year to Date December 29***
Equity	***Total Return % (USD$)***	***Total Return %***
S&P 500 Index	11.69	26.29
Russell 2000 Index	14.03	16.93
MSCI EAFE Index	10.42	18.24
MSCI Emerging Markets Index	7.86	9.83
Fixed Income		
Barclay's U.S. Aggregate Bond Index	**6.82**	5.53
Barclay's U.S. Aggregate Credit Index	**13.71**	10.73
Barclay's U.S. Aggregate Corporate High Yield Index	7.16	**13.44**
Barclay's Municipal Bond Index	**7.89**	6.40
Macro Measures		
Gold	**11.55**	**13.40**
Crude Oil	**-21.08**	**-10.73**
CBOE Volatility Index	**-28.94**	**-42.55**
USD Dollar Index	**-4.60**	-2.12

Current Theme – Fed Signaling an End to Rate Hikes Ignites Strong Performance Across Asset Classes in the Final Two Months of 2023

After a Challenging Late Summer Period, Stocks, Bonds and Commodities Including Gold Rallied Aggressively into the Year End as Interest Rates Retreat

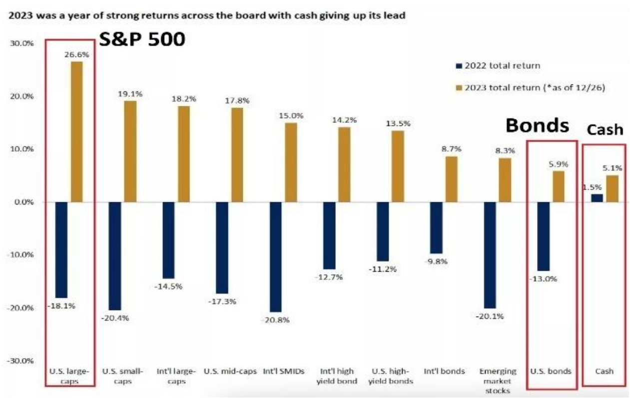
While one can debate the nuances of market performance in 2023, it certainly can't be denied that the largest components of the market dominated results. As seen below in the chart from JP Morgan, the Top 10 largest names within the S&P 500 shot +62% higher in 2023 while the remaining 490 companies rose just +8% over the same time period.

S&P 500 Top 10 Up +62% in 2023, Rest of Market Up +8%

Source: JP Morgan Asset Management

As a result, Index level returns ended up around +20% which goes a long way to ease the bitter taste of 2022 when every asset class outside of cash fell by double digits as highlighted in the graph below. While this creates some angst regarding "too far too fast", consider the two-year return in the next chart above.

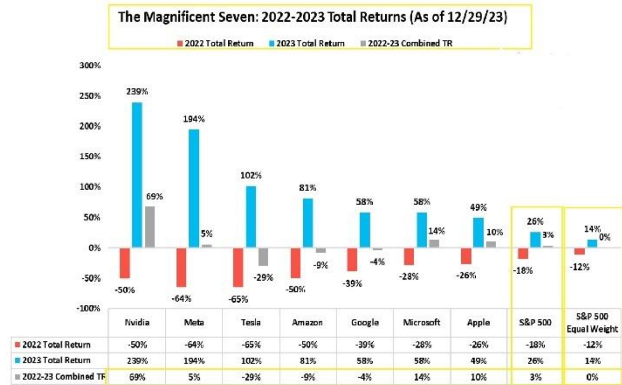
2023 Asset Class Performance was Mirror Image of 2022



Source: Eric Soda

Although the much lauded "Magnificent 7" large cap technology companies had an extraordinary 2023, investors are quick to forget how painful the returns were for holders of the same names in 2022. As seen below, the S&P 500 was flat over a two-year period (Jan 5, 2021 close 4700, Jan 5, 2023 close 4697), while the Magnificent 7 names have produced subdued cumulative two year results following declines ranging from -26% for AAPL to -65% for TSLA in 2022.

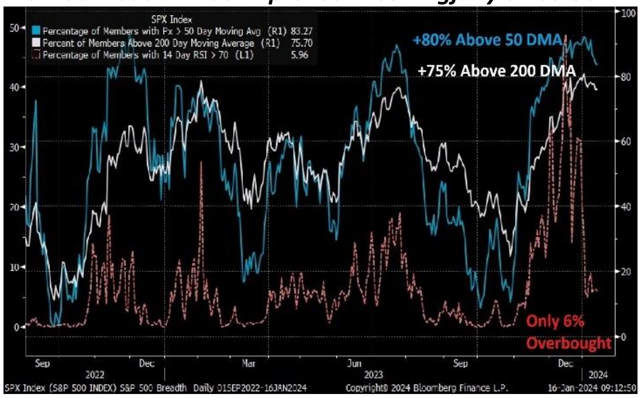
Large 2022 Drawdowns Mute Mag 7 Two Year Returns



Source: Charlie Bilello; Creative Planning

Importantly, many have been looking for market leadership to rotate away from a handful of large cap tech names out to the broader equity market.

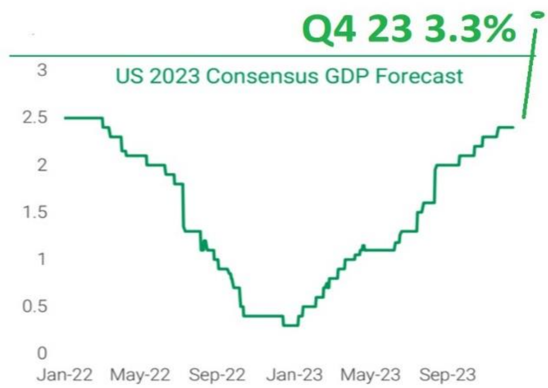
Market Breadth Mas Improved Meaningfully Since Oct



Source: Liz Young; Bloomberg

Thankfully, we have begun to see some evidence of just such an expansion of breath which is generally viewed as the only way to sustain a sharp market upturn. As seen above, as of mid-January, over 80% of S&P 500 stocks were trading above their 50-day moving average and over 75% were trading above their 200-day moving average. At the same time, only about 6% were "overbought" as measured by their Relative Strength Index (RSI). This is indisputable evidence of broad market strength rather than a market being led by just a narrow subset of stocks.

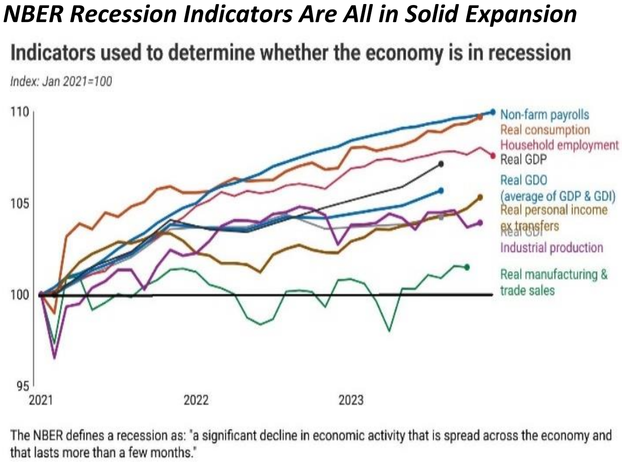
GDP Growth in 2023 Far Exceeded Recession Calls



Source: GlobalData TS Lombard; Bloomberg

We also now have strong indications the the elusive "soft landing" of the economy may be at hand in 2024. As seen in the chart above, expectations for growth were essentially non-existent at the start of the year as the recession call was fully embraced as the consensus view. Yet, Q3 GDP exapnded at 4.9% and the Q4 reading just came in at 3.3%. In fact, the US ecconomy is now experiencing record levels of consumer disposable income, record levels of job satifaction and near record lows of jobless claims and unemployment which is a historcially low 3.7%.

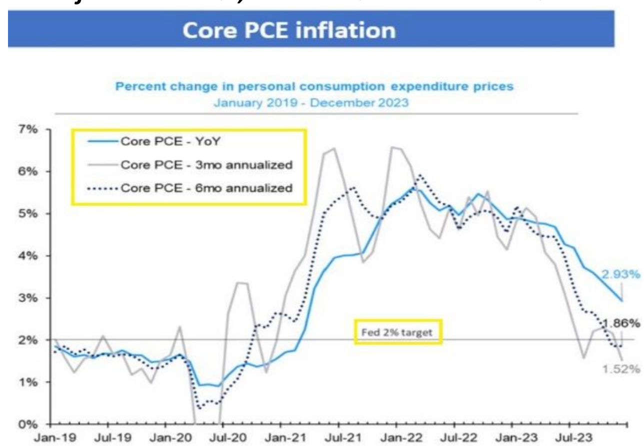
NBER Recession Indicators Are All in Solid Expansion



Source: Justin Wolfers; NBER

As a result of the economic momentum, the majority of indicators utilized by the Nation Bureau of Economic Research, the arbiters of when the US is or is not in a recession, have risen substantially over the past three years and show little signs of abating. To be fair, many of these indicators of overall economic health are somewhat removed from the day-to-day life of consumers – the engine that drives the US economy. Thankfully, more immediately tangible factors are present which help boost consumer confidence.

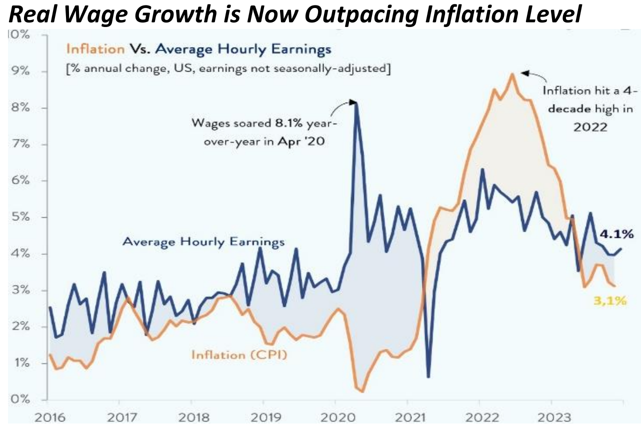
YoY Inflation at 2.9%; 6M at 1.9% and 3M at 1.5%



Source: Greg Daco; BEA; EY-Parthenon

The chart above is an important one. Despite fears to the contrary, inflation levels have receded back to normalized levels. On a one-year basis, Core PCE inflation, the Federal Reserve's preferred measure, is growing at just 2.9% and higher frequency measures like 3 and 6-month rates, are both solidly below 2% which is the Fed's stated long-term target for inflation.

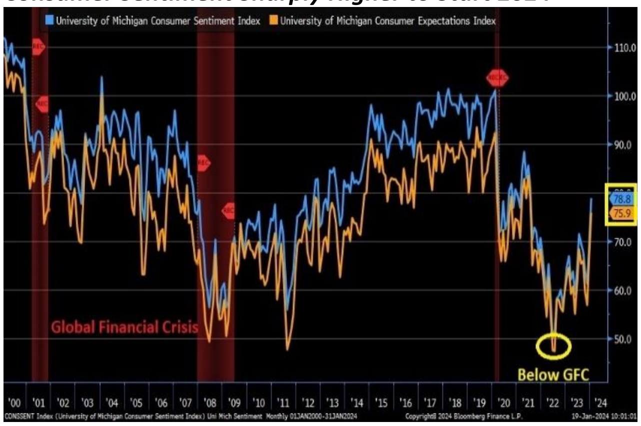
Real Wage Growth is Now Outpacing Inflation Level



Source: St Louis Fed; Chartr

Even more directly pertinent for consumers, real wage growth is above 4% and is exceeding inflation levels by a solid margin. When US consumers see their income growing faster than inflation, it gives them both a sense of security and the confidence to put that money back into the economy. With consumer spending accounting for roughly 70% of US GDP, this is a very important dynamic that appears poised to improve even further as inflation continues to fall.

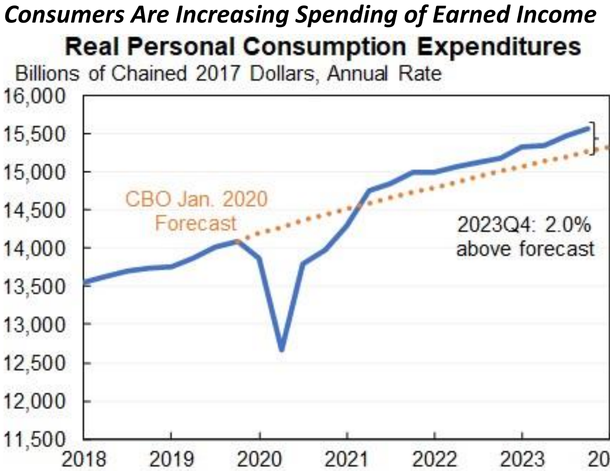
Consumer Sentiment Sharply Higher to Start 2024



Source: Liz Ann Sonders; Bloomberg

Pulling all of these factors together, its not surprising that measures of consumer sentiment have moved markedly higher after being depressed for much of 2023. As seen above, the University of Michigan Consumer Sentiment Index jumped +13% higher in January, the strongest monthly gain since 2006. Its notable that sentiment was so poor in 2023, that the measure fell below levels registered during the highly uncertain times of the Global Financial Crisis.

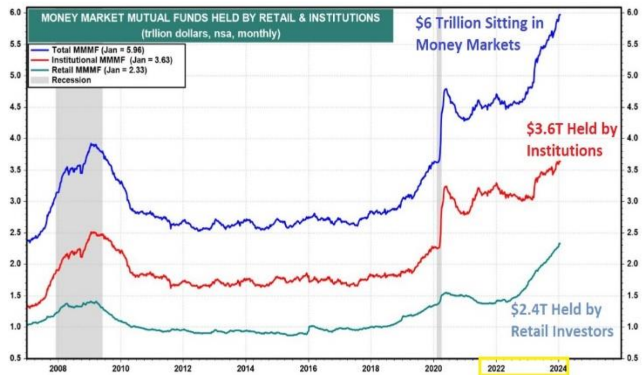
Consumers Are Increasing Spending of Earned Income



Source: Jason Furman; Bureau of Economic Analysis; CBO.

The Michigan Survey also showed a sharp rise in consumer expectations. As we have written about in the past, 2023 was characterized as a year when consumers responded that they actually felt pretty good about their own current situation, but that they had concerns about the future. This dynamic is represented well in the chart above which tracks consumers' real personal consumption expenditures, or the amount people spend on goods and services from their after-tax income. Even if they held concerns, US consumer behavior did not change in 2023 – they continued to spend a lot – maintaining spending growth well above the pre-Pandemic trend.

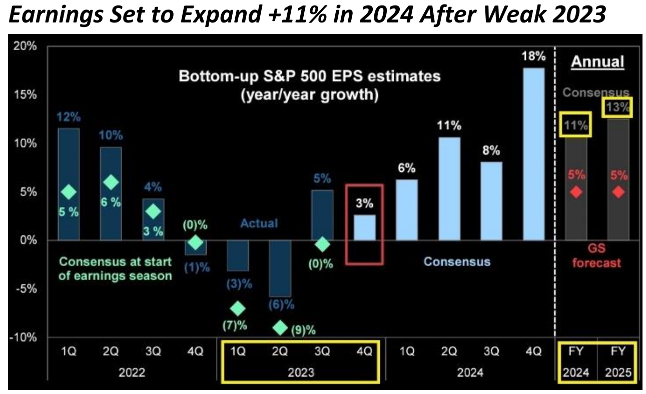
Money Market Fund Assets Balloned to $6 Trillion in '23



Source: Yardeni Research; LSEG Datastream Investment Comp. Institute

With risk assets performing so well and US consumers showing no restraint, a logical question might be whether this behavior pulled gains away from 2024. But we have some evidence that tailwinds might still be in place. Consider the chart above. In 2023, money market funds were flooded with assets as interest rates rose consistently. The total figure sits at an astounding $6 *Trillion* dollars. As we embark on 2024, the exact opposite paradigm may take effect – falling interest rates driving assets out of money market funds and into the stock and credit markets.

Earnings Set to Expand +11% in 2024 After Weak 2023



Source: Goldman Sachs Global Investment Management

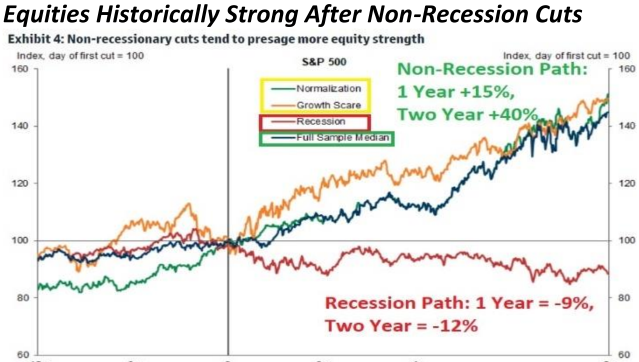
And as we have consistently stated in the past, earnings drive prices over the longer term. Earnings actually fell by about -1% in 2023 mainly due to the impact of high inflation levels. Looking out toward 2024, the compound effects of growing off of a low base combined with improving fundamentals has resulted in expectations of +11% growth in earnings. In addition, current estimates for 2025 show earnings growing by an additional +13%. While those numbers might seems optimistic to some, it is important to remember that the economic backdrop is shifting.

Fed Says Three Cuts in 2024, Market Pricing in Five Cuts

Source: Bianco Research; Chicago Mercantile Exchange; Bloomberg

Following two straight years of increases in the Federal Funds rate to over 5%, The Federal Reserve themselves explicitly stated that they plan to decrease interest rates in 2024. They are suggesting 3 cuts by the end of the year. With rates far above the inflation level, the Market is pricing in a more aggressive rate path to move away from an overly restrictive policy and is pricing in 5 rate cuts by December 2024.

Equities Historically Strong After Non-Recession Cuts



Source: Goldman Sachs Global Investment Management

Interest rate cuts occur for different reasons and it's important to understand the distinction. Typically, the Fed's primary reason to cut rates is because they see the beginnings of a recession and they hope that lowering rates will slow the progress of a slowdown. The other environments have historically been a "growth scare" when momentum slows down in anticipation of a recession that never develops, or a "normalization" when rates are too high given the current conditions, which is what we have now. As one can see in the previous chart, equities have historically fallen after recessionary cuts, but have risen quite substantially in the following 24 months under all other conditions, averaging +15% in year one.

S&P Never Fallen in Year 4 Pres Cycle after +20% Gains

SPX up 100% of the time in Year 4 after a 20%+ Year 3

When Presidential Cycle Year 3 is up 20% or more, which occurred in 2023, Year 4 is up 100% of the time on an average return of 13.4% (12.6% median), which equates to SPX 5400.

Table 3: Presidential Cycle Year 4 after a 20%+ return for the S&P 500 in Year 3

When Presidential Cycle Year 3 is up 20% or more, which occurred in 2023, Year 4 is up 100% of the time on an average return of 13.4% (12.6% median).

Year 3	Year 3 return	Year 4 return	Year 4
1935	41.4%	27.9%	1936
1995	34.1%	20.3%	1996
1975	31.5%	19.1%	1976
2019	28.9%	16.3%	2020
1955	26.4%	2.6%	1956
2003	26.4%	9.0%	2004
1991	26.3%	4.5%	1992
2023	24.2%		2024
1967	20.1%	7.7%	1968
Average	28.8%	13.4%	
Median	26.4%	12.6%	
% of time up	100%	100%	
Minimum	20.1%	2.6%	
Maximum	41.4%	27.9%	

Source: BofA Global Research; Bloomberg

In addition to the declining rate environment, 2024 also brings a US Presidential election. Election years on their own are historically quite strong, however, given the large equity returns experienced in 2023, some may question whether or not that is realistic for 2024. History provides some interesting data here. As seen above BofA Global Research calculated that in the 8 instances when the S&P has been up more +20% going into an election year, that year has been positive 100% of the time producing an average return of 13.4%.

Election Year Path After +10%; 2 Notable Weak Periods

Source: FundStrat; Bloomberg

The path to those gains matters quite a bit however. As the above chart from FundStrat illustrates, while election year returns in post +10% equity years have been robust, there are two distinct periods of weakness – May through June and September until the election. The other months have seen solid moves higher. History is often the best guide to markets so we will be watching for indications of this pattern playing out once again in 2024.

Going Forward

In many ways, 2023 was as good as it gets for investors yet many market participants remained skeptical even in the face of a near +20% rally to end the year. Despite the pessimism heading into the year, equities, bonds, commodities (namely gold) and even cash delivered positive returns from +5% (cash) to +26% (S&P 500). That kind of widespread increase in asset prices does not happen very often. Unfortunately, many investors did not fully participate in those gains due to the ongoing cautious narrative so prevalent throughout the year. Very few investors will ever be able to keep up with a market where the top 10 stocks accounted for 86% of the market return, however, the weakness of the summer months kept many on the sidelines even after Fed Chairman Powell signaled the pivot to a lower rate policy at the end of October.

As always, we prefer to not take an entrenched view on the market, but rather, adjust allocations and risk as the environment evolves. The Fed pivot was a very significant change in the potential future environment for risk assets. As such, we moved aggressively to put capital to work during the first week of November. After the summer equity peak at the end of July, we raised cash and waited patiently for indications of changes in the investment backdrop. The Fed meeting on October 31st proved to be the concrete evidence that we and many others were looking for. As research firm FundStrat wrote recently, to begin 2024, several tailwinds are now in place that may potentially propel assets prices higher even after such a historically strong year. They suggest that a dovish Fed, lower interest rates, an improving housing market, increased CapEx spending and a reversal of the equity outflows that occurred in 2023 justify a broadening out of market gains.

Clearly, many issues remain, most notably in the form of geopolitical events, but also with a potential return of higher inflation and/or a decline in the remarkably strong US employment situation. With equity markets off to a strong start in January, and with an eye toward historical patterns, we are keenly aware that some give back in the market may take place in the near future. As a reminder, -10% corrections occur every single year on average even in very constructive years like we experienced in 2023. History suggests that this would most likely occur sometime this Spring before a summer rally develops.

Large cap technology names continue to deliver market leading growth in both earnings and revenues so we continue to maintain sizable exposure to the group and will continue to do so. Other areas of focus for us this year are financials and industrials, as well as healthcare and energy. Small and mid-cap companies notably underperformed in 2023 which has left valuations at attractive levels when compared to their large-cap counterparts. In our view, there may be an opportunity for meaningful returns in the smaller segment of equities as we look forward to 2024.

Regions outside of the US have proven to be volatile this year. For the first half of the year, non-US equities outperformed their US counterparts, but they ended up trailing the full-year US equity return as the Dollar strengthened from mid-July through October. Valuations outside of the US are compelling on a historical basis and if improving fundamental data on inflation and growth continues globally, non-US markets could potentially prove to be another area of opportunity in 2024.

Within fixed income, we continue to place our emphasis on shorter duration exposures and unconstrained strategies. We have taken advantage of the climb in treasury yields to allocate a portion of our exposure into laddered short-term treasuries as a way to capture risk-free yield for fixed income portfolios. As rate decreases by the Federal Reserve begin most likely sometime in early Summer, we would anticipate taking advantage of slightly longer duration exposure that stands to benefit from a more stabilized rate environment combined with falling inflation.

We believe that commodity exposure, primarily via gold, but also including agriculture and energy, will continue to be additive in an uncertain macro-economic environment. Although gold has relinquished some of it's year to date gains as a result of the strengthening Dollar, gold has served its purpose as a diversifying asset quite well thus far in 2023 while other assets have become more correlated.

Thank you for taking the time to read our thoughts on the markets and we look forward to speaking soon.