Q4 Market Review

Coming In For Landing

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The U.S. equity market had a strong finish to Q4 2023. News that central banks might cut rates sooner than expected in 2024 led to an end of year Santa Claus rally, capping off what was an unpredictable year for investors. The year kicked off with fears of a recession, followed by a period of resilient growth through most of Q3. The "Higher for Longer" narrative concerning interest rates hit hard in early fall giving Wall Street a reality check. However, the sentiment surrounding future rate cuts helped drive stocks across the Q4 finish line in positive territory. The "Magnificent Seven" again dominated the S&P 500 headlines accounting for roughly 80% of the index's full year returns. Although we did see an increase in other companies participating in the market's returns during the second half of the year, we don't believe it was nearly enough to constitute a healthy and balanced market. As we kick off 2024, we believe there are several factors that will heavily influence the market's performance. These factors include the risk of recession, what type of landing investors can expect from the U.S. economy, consumer confidence, continued expansion of the stock market's breadth, the upcoming U.S. Presidential Election, and – of course – corporate earnings.

Recession Risk

Most economists and investment strategists believe that we have managed to dodge a recession. Their viewpoint makes sense as we are coming off a year of resilient economic growth and are expecting the Fed to cut rates sooner than anticipated this year. A closer look at historical economic cycles, however, indicates that maybe we should not be so certain. According to Deutsche-Bank analyst, Jim Reid, "History suggests that we're still relatively early in the lag of monetary policy. Six economic cycles out of thirteen rolled over between 19-28 months after the first Fed hike. In fact, the risk of a recession is higher now than it was in 2022 or 2023." Reid points to other red flags that could indicate a recession including the fact that personal savings is at its lowest point since 2008, there's been a slowdown in payroll growth, a slowdown in hiring, and the Conference Board's Leading Economic Index is suffering a level of decline only seen in past recessions.

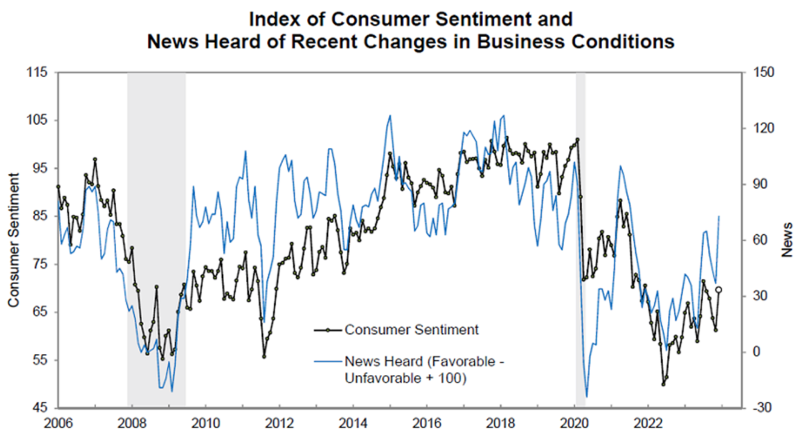
Economic Slowdown

The consensus among those who believe we've avoided recession is that the U.S. economy is headed for a "soft landing" in 2024. That is, a steady shift from a growth economy to a slow or flat economy without a recession. We believe all the elements for a soft landing are certainly in place. The labor market is cooling, consumer spending is decelerating, and inflation is moderating. However, the most recent report from the Conference Board Economic Forecast argues that we may be headed for a "not so soft landing" in 2024. "We forecast two quarters of negative growth that will be broadly felt across the economy. We expect Real GDP to grow by 2.4% in 2023 and to slow to 0.9% in 2024." Citing factors such as high interest rates, elevated inflation, dissipating pandemic savings, and rising consumer debt, the Conference Board predicts that 2024 will be a "bumpy landing" and does not envision that things will start to normalize until 2025.

Consumer Confidence

Per the University of Michigan's Survey of Consumer Sentiment *(Figure 1),* Consumer Confidence jumped 14% in the month of December. The increase was likely propelled by the resilience of steady employment, rising wages and signals from the Fed that inflation appears to be moderating. According to the University's survey, "all five index components rose this month, including age, income, education, geographic, and political identification groups. This broad increase has only occurred in 10% of reads since 1978." Consumer confidence tends to be a reliable indicator of Americans' overall state of mind as it relates to their own financial situations relative to the health of the economy. Although the beginning of an economic slowdown is already underway, an optimistic consumer tends to have positive implications for financial markets.

Figure 1



	Dec 2023	Nov 2023	Dec 2022	M-M Change	Y-Y Change
Index of Consumer Sentiment	**69.7**	61.3	59.8	+13.7%	+16.6%
Current Economic Conditions	**73.3**	68.3	59.6	+7.3%	+23.0%
Index of Consumer Expectations	**67.4**	56.8	60.0	+18.7%	+12.3%

Source: University of Michigan

Stock Market Breadth

Over the past few quarters, we have addressed our concerns over the dominance of the "Magnificent Seven" – Apple, Amazon, Alphabet, Meta Platforms, Microsoft, NVIDIA, and Tesla – and the mega cap leaders' outsized share of the S&P 500's returns. Despite recessionary fears and rising interest rates – factors that normally have a negative impact on growth sectors of the economy – these seven stocks managed to defy odds in 2023 and garner significant investor demand. While we hold several of the Mag 7 names in our client portfolios, we continue to believe that this highly concentrated focus on 7 companies leaves the market quite vulnerable. Fortunately, in Q4, we began to see signs of the market's breadth improving. Morgan Stanley's Chief Investment Officer, Mike Wilson, claims that "December was arguably the best stretch of breadth improvement we've seen in 2023 – 78% of S&P 500 stocks traded above their 200-day moving average, a level that returns to its highest mark for 2023." *Figure 2*, shows the S&P 500 sectors' 1 Year and Q4 2023 performance. As you can see, additional sectors – primarily Industrials, Financials, Real Estate, Healthcare and Consumer Staples – began to generate significant momentum through the fourth quarter.

Figure 2

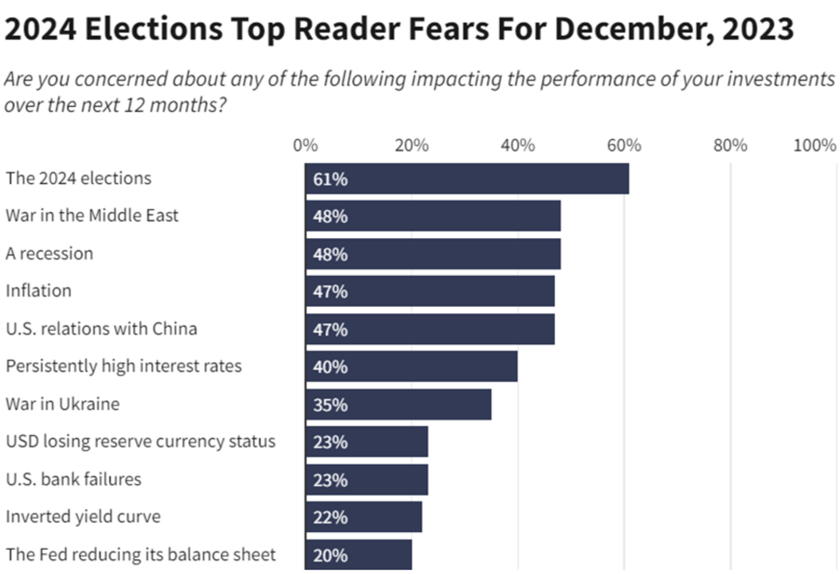
Sector	*1 Year Return	*Q4 2023 Return	Mag 7 Stocks
Technology	+54.7%	+17.4%	Apple, Microsoft, Nvidia
Communication Services	+51.4%	+10.8%	Google, Meta
Consumer Discretionary	+38.4%	+11.1%	Amazon, Tesla
S&P 500	**+24.3%**	**+11.2%**	
Industrials	+16.1%	+12.4%	
Basic Materials	+10.2%	+8.9%	
Financials	+9.9%	+13.4%	
Real Estate	+8.5%	+17.6%	
Healthcare	+0.4%	+5.9%	
Consumer Staples	-3.4%	+4.7%	
Energy	-4.2%	-7.3%	
Utilities	-10.2%	+7.5%	

Source: Telemet, all data as of 12/31/23 **Total Return*

U.S. Presidential Election

Politics will likely remain a major driver of economic uncertainty in 2024. Especially the U.S. Presidential Election which could influence the wars in both Gaza and Ukraine, international trade relations, and the regulatory environments for multiple business sectors. In a December survey by Investopedia *(Figure 3)*, 61% of respondents cite the 2024 U.S. Presidential Elections as their biggest concern regarding investment performance over the next 12 months. This concern ranked higher than a recession (48%), inflation (47%), and high interest rates (40%). While elections capture a significant amount of news headlines and may seem important, data shows that they have historically had little impact on market performance. In fact, an analysis of past performance during election years shows that markets tend to rise during Presidential Election years. According to *Figure 4 (next page),* the S&P 500 has recorded positive returns in 83% of all election years since 1928. As investors, it's important for us to not allow the emotional nature of an election to cloud our better

Figure 3



Source: Investopedia Survey, December 2023, N=939 judgement. The historical odds are in our favor that regardless of who gets elected – Republican or Democrat – the election process could likely have a positive impact on equity market performance in 2024.

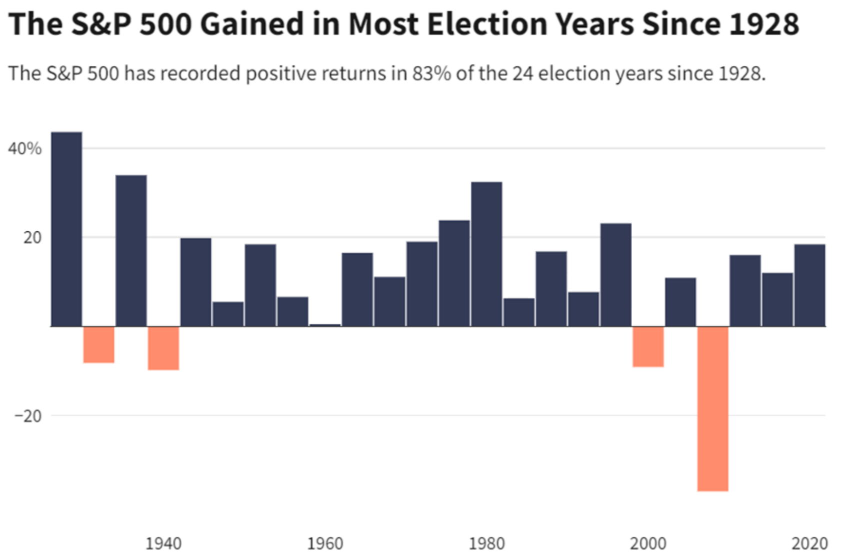
Corporate Earnings

The Analysts' Consensus forecast *(Figure 5)* for S&P 500 Earnings is for a modest 1.2% increase to $221 for last year from $218 per share reported for 2022. Importantly, the S&P 500 Quarterly Earnings decline (from Q4 2022 through Q2 2023) ended in Q3 2023 with a 4.6% increase from the previous quarter. For 2024, the Analysts' Consensus projection is for S&P 500 Earnings growth to pick up steam with an 11% increase to $245 from $221 per share forecast for 2023. In our opinion, this forecast may be reduced by the negative effects from a slowing U.S. economy as 2024 progresses. Nevertheless, we believe that the meaningful earnings per share increase represents a fundamental and important reason to be optimistic about the U.S. equity market prospects for this year.

Expectations for 2024

If you recall, at the beginning of 2023 the experts were certain that the U.S. economy was headed towards recession. This year, the opposite appears to be true with many of the same analysts forecasting a soft landing and a bullish outlook. In our opinion, there are many reasons to be optimistic about as we head into the New Year including higher corporate earnings, the prospects of rate cuts, moderating inflation, a confident U.S. consumer, and a Presidential Election process. Whether we define it as "soft" or "bumpy," the economy is coming in for a landing and we are already beginning to see a 2024 economic slowdown. As investors, it is important that we remain flexible, so we are approaching the New Year with positive but tempered expectations.

Figure 4



Source: First Trust

Figure 5

	Level	YOY %
2022	**218.09 a**	**4.8**
Q1	54.80 a	11.5
Q2	57.62 a	9.6
Q3	56.02 a	4.3
Q4	53.15 a	-1.5
2023	**220.60 e**	**1.2**
Q1	53.08 a	-3.1
Q2	54.29 a	-5.8
Q3	58.62 a	4.6
Q4	54.82 e	3.1
2024	**245.21 e**	**11.2**
Q1	56.66 e	6.7
Q2	60.29 e	11.1
Q3	64.01 e	9.2
Q4	64.76 e	18.1

a = actual, e=estimate
Source: Yardeni Research, Inc. and I/B/E/S data by Refinitiv

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