Market Commentary

The U.S. (and many global) economies were able to finish out 2023 without the dreaded "R" word (recession) despite the vast majority of economists and strategists calling for one at the beginning of the year. How did this happen when most leading economic indicators and economic models pointed to a hard landing? First, the traditional business cycle, of which many economists built their models and where economic indicators are typically more predictive, was significantly disrupted by the economic shutdown of 2020. We think a more appropriate comparison to our current economic environment is a post-war recovery when the government implements massive stimulus and there is significant pent-up demand coming off such uncertainty in everyday life. Another factor that many forecasters got wrong was the resilience of the U.S. Consumer. Recession predictions relied on rising interest rates that would kill demand for consumer spending and businesses halting capital expenditures. While consumers did spend down their excess savings, given a robust job market and real wages continuing to grow, people did not feel as compelled to change their spending habits because they recognized their personal financial situation as relatively stable.

Markets ended 2023 on a high note with global equities up just north of 11% for the quarter ending December 31st. Even more encouraging was the broad rally we saw in the fourth quarter during which small caps, represented by the Russell 2000, outperformed large caps with a 14%+ return. A major storyline of equity investing this year was the dominance of the "Magnificent 7" (Microsoft, Apple, Amazon, Google, Nvidia, Tesla, and Meta). The index construction of many popular benchmarks (S&P 500, MSCI ACWI, etc.) has led to these few companies becoming massive allocations (roughly 30% for the S&P 500). The contribution of those seven companies to the total return for the S&P 500 was roughly 2/3rds for 2023, so one can see how being underweight, to any degree, in those few names may have led to relative underperformance this past year. Another surprise in the market was fixed income. Coming off its worst year in 2022, fixed income was expected to have a banner year. Interest rates continued to rise throughout the majority of the year, with the 10-year treasury yield peaking at around 5% in the middle of October, before reversing significantly in the last 2 months of the year back to essentially where yields started 12 months prior. While returns were broadly positive for fixed income to the tune of their initial starting yields, 2023 was very much a roller coaster ride for bonds.

Looking forward to 2024, and beyond, we are optimistic about the path for the economy and markets. Inflation continues to cool down and is now close to the Fed's target based on shorter look-back periods. Market and Fed expectations for interest rates signal rate cuts in 2024, which will be a welcomed relief for homebuyers and businesses relying on financing. Earnings are expected to grow in 2024 after broadly contracting in late 2022 and

2023. Given that valuations for large swaths of the market (ex-Magnificent 7) are still reasonably relative to historical averages, we believe 2024 could be a very strong year for diversified portfolios.

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