January 2024

CAPSTONE PACIFIC
INVESTMENT STRATEGIES INC

THE CAPSTONE QUARTERLY

Happy New Year! With the turn of the calendar, we ring in a new year with a sense of refresh and renewal. A strong finish in December in the markets, and one of the busiest travel seasons in years gave investors the confidence they needed in this ever-changing economic environment. In this newsletter, Bryce gives an overview of 2023 and Casey focuses on a recap of our economy over the last quarter.

BRYCE'S POINT OF VIEW

Bryce Pease, CFP®

2023 Year in Review

Every January, it's customary to look back on the year that was. What were the highlights? What were the "lowlights"? What events will we remember? Most importantly, what did we learn?

As you know, many noteworthy and historic events happened in 2023. Conflicts in Gaza, Ukraine, and Sudan. India surpassed China as the most populous country in the world. New temperature records were set all around the globe. The use of "artificial intelligence" exploded and turned multiple industries on their heads. Chinese spy balloons and deep-sea submarines grabbed the headlines.

But in some ways, one of the most notable occurrences of 2023 is actually what didn't happen: We never entered a recession. When 2023 began, the fear of a recession was so widespread that it almost seemed inevitable. According to one survey, 70% of economists expected a recession to hit the U.S. in 2023.[1] Another survey found 58% of economists believed there was a more than 50% chance of a recession.[1]

For politicians, pundits, and analysts, it was practically all they could talk about. But it never happened. Instead, the economy grew by 2.2% in the first quarter, 2.1% in the second, and 4.9% in the third.[2] (As of this writing, the numbers for Q4 are not yet available, but it's expected to go up again.) None of this is to say that our economy is perfect, or that we won't have a recession in the future. But for 2023, thankfully all the gloomy forecasts simply didn't come to pass.

Now, let's be fair to all those economists who got it wrong: They had very good reasons for expecting a recession. Reasons based on data, logic, and history. You see, when the year began, the U.S. was coming off a nasty 2022. While consumer prices were already coming down from their earlier highs, the national inflation rate was still 6.5%.[3] Interest rates, meanwhile, had risen dramatically, from just above 0% at the beginning of 2022 to over 4% by the end.[4] It was already the highest level we'd seen in fifteen years – just before the Great Recession, in fact – and every indication was that rates would continue to rise higher.

All this economic pain was reflected in the stock market. The S&P 500, for example, dropped over 19% in 2022.[5] For economists, all this data seemed to point a clear way forward. The Federal Reserve is mandated to keep consumer prices as stable as possible (Its target has long been to hold inflation to around 2%). When inflation runs hot, the Fed's main tool for lowering it is to raise interest rates. Higher rates often lead to lower consumer spending. Lower spending, in turn, prompts businesses to decrease the cost of the goods and services they provide. Essentially, higher rates create an environment where supply is greater than demand, thus cooling inflation.

Remember that past performance is no guarantee of future results. You've heard us say this line in the past, and 2023 is a great example of why. Just because rising interest rates have sometimes led to recessions in the past doesn't mean they always will. Just because the markets went one direction yesterday doesn't mean they'll go the same direction tomorrow. While history is a great resource to draw from when making decisions, it's just a guide, not a guarantee.

At the same time, don't anchor to the present. As humans, we have a natural tendency to think that the way things are today is how they'll be tomorrow. When 2022 ended, many investors felt that 2023 would be much the same. Now, we run the risk of thinking that just because a recession didn't happen last year; it won't happen this year.

Again, it all goes back to planning and preparation. Here at Capstone Pacific, we will continue trying to prepare for all possible outcomes. We'll plan for how to reach the outcomes we want and how to avoid the ones we don't. But instead of predicting, instead of assuming, instead of anchoring, we will accept that the future is written in clay, not stone. Only when it becomes the past does it harden. So, when you get right down to it, the lesson of 2023 is this: The future is flexible, and so we must be flexible, too.

Did you know?

The limits for contributing to your employer retirement plan like a 401(k), 403(b) and Thrift Savings Plan (among others) have increased for 2024. For those under age 50, the limit is now $23,000 and those over age 50 can contribute $30,500. Make sure to update your paycheck deduction to take advantage of the increase. The limits for Traditional & Roth IRAs have also gone up. You can now contribute $7,000 for the year, unless you are over age 50 and the limit is $8,000.

Check us out on social media!

Follow us on LinkedIn®:
www.linkedin.com/company/capstonepacific

Facebook®: @capstonepacific or
www.facebook.com/capstonepacific

CASEY'S CORNER

Casey Morris, CFP®

4th Quarter Market Recap

Coming off a gloomy September, market volatility continued in the 4th quarter. Towards the end of October, a combination of interest rate anxiety, higher bond yields and anything remotely uncertain drove the S&P 500 briefly into a market correction. A market correction is when the markets decline 10% or more from a recent peak. In the S&P 500's case, the "recent peak" was on July 31, when the index topped out at 4,588.[6] On Friday, October 27, the index closed at 4,117 – a drop of 10.2%.[6]

The reason for this correction? While inflation is much lower than last year, prices have actually ticked *up* slightly in recent months. The inflation rate in June was 3%, and in September it was 3.7%.[7] As a result, investors were anticipating that the Federal Reserve would keep interest rates higher (and steady) for longer, which they have so far through the end of 2023.

Seeking to take advantage of the higher interest rates, many investors have moved some of their money (us included, for our advisory clients that have selected to have bonds in their portfolio) into US Treasury bonds. This move drove the yield on 10-year bonds to its highest level in 16 years. Since bonds are often seen as less volatile than stocks, when we feel we can get a decent return with less volatility, we have often looked toward US Treasuries to provide this.

The market's dip into correction-territory was brief and the S&P actually regained a bit of ground in the following days. In October, inflation fell back slightly to 3.2%, which was mildly better than expected, and helped to give the markets a little boost.[7] It also might mean that the Federal Reserve will not raise rates in the foreseeable future since it appears that inflation isn't currently running out of control.

Investors have also been keeping their eye on holiday spending. Afterall, consumer spending is the lifeblood of the economy. If higher interest rates put a winter chill on holiday spending, investors may take it as a sign of an economic slowdown. That would certainly affect the markets negatively. On the other hand, if spending goes up, or at least remains stable, we may see this market rally continue. Either way, we should be prepared for more volatility in the months ahead.

The markets are like a swinging door right now. As we enter a new year, we must continue to be mindful so that we never get taken by surprise…or hit square in the face.

FINALLY…

Casey loves the opportunity to educate people on financial topics, whether that be in client meetings or with her occasional government contracting. Toward the end of 2023, she had the chance to travel to North Dakoka and Nevada teaching civilian employees for the Department of the Air Force and the Department of the Army respectively. Kicking off 2024 she will be doing a couple quick trips to Andalusia, AL and Sacramento, CA to teach the Department of Agriculture and the Wildland Firefighters. Educating government employees of all agencies has become a passion of hers, helping them to understand their benefits package and prepare for a successful retirement. If you happen to have a friend or family member or know someone who is a federal employee be sure to send them her way! Most federal employees we meet have questions about how their Thrift Saving Plan, FERS pension, or life & health insurance work – she is always happy to answer and try to help.

Sincerely,

The Team at Capstone Pacific

265 S. Randolph Ave, Suite 240
Brea, CA 92821
626-915-7006
bpease@capstonepacificinc.com
cmorris@capstonepacificinc.com

P.S. If you ever run across anyone who could use our services or is unhappy with their current adviser, we always appreciate it when you pass on our name.

1 "Top US economists are often wrong – should we trust their predictions?" The Guardian, www.theguardian.com/business/2023/nov/19/useconomists-wrong-predictions
2 "Annualized growth of real GDP in the United States," Statista, www.statista.com/statistics/188185/percent-change-from-preceding-period-inreal-gdp-in-the-us/
3 "United States Inflation Rate," Trading Economics, https://tradingeconomics.com/united-states/inflation-cpi
4 "Federal Funds Effective Rate," St. Louis Fed, https://fred.stlouisfed.org/series/FEDFUNDS
5 "S&P 500 Historical Annual Returns," Macrotrends, https://www.macrotrends.net/2526/sp-500-historical-annual-returns
6 https://fred.stlouisfed.org/series/SP500
7 https://tradingeconomics.com/united-states/inflation-cpi