MARKET REVIEW & OUTLOOK

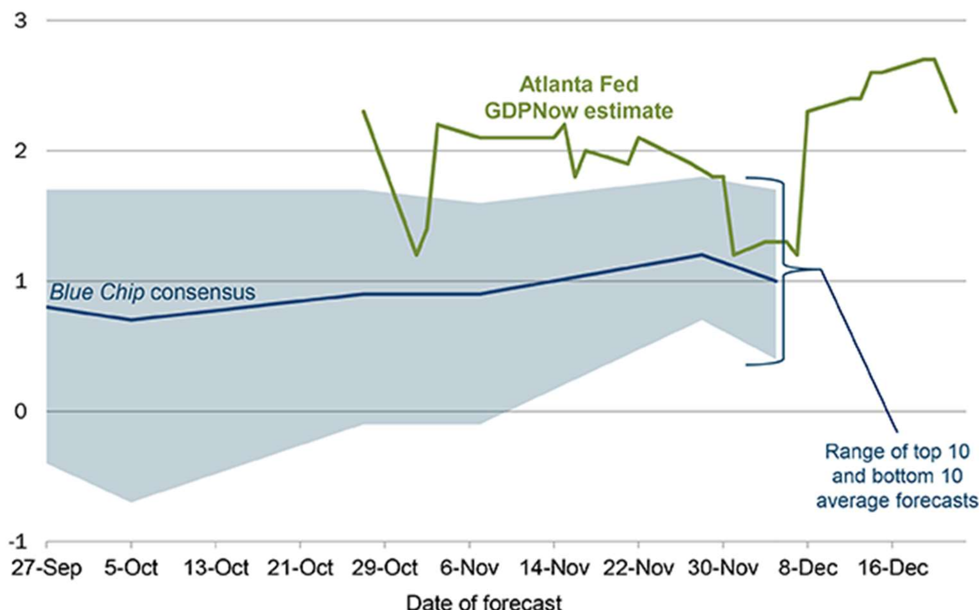
DECEMBER 2023

KEY TAKEAWAYS

- The rally from late October continued unabated through December.
- The continued decline in U.S. 10-year Treasury Yields from near the 5%-mark in October continued into December, now dropping below the 4% mark.
- Tongue-in-cheek final comment last month came through, the Fed lost this game of chicken when it pivoted from higher for longer to lower sooner.

The U.S. Economy

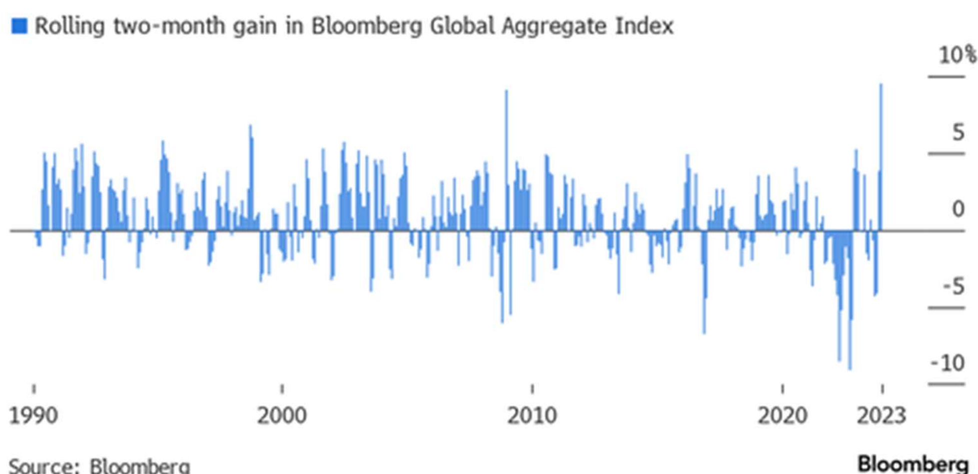
The final look at 3rd quarter GDP came in weaker than expected at 4.9% driven by downward revisions to consumer spending. Additionally, core PCE, the imbedded inflation measure, dropped further to 2.0% from the last reported 2.3%. The 4th quarter estimates for GDP from GDPNow are still around the 2% mark, but with wide swings in expectations. The Blue-Chip consensus forecast firmed right at 1%, as shown in the chart below. Economic activity continues solid though maybe softening to end the year, and the PCE deflator has moderated to the sweet spot of “2%” inflation. The data seems reasonable, but the Fed’s stance has shifted to the markets view of lower sooner, rather than higher for longer.



Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

U.S. 10-year Treasury yields continued to drop from the mid-October highwater mark near 5%. The rally got extra fuel on the back of the Fed's December meeting announcement that it was thinking about when it may be appropriate to cut rates, a mere 2 weeks after announcing it was too early to be thinking about discussing rate cuts. Those words drove yields easily below the 4% mark, which some contend is only sustainable if a recession is nearly insight. The other scuttlebutt is, what does the Fed "know" that hasn't been reflected in the numbers yet? Why the U-turn in such a short period of time? Questions we may potentially get answers to in the coming months. Either way, the rally in bonds was truly historic as the chart below shows this was the largest 2-month rally in global bonds in history going back to 1990. The economic environment still seems too strong for the Fed to start cutting interest rates soon, but again, the Fed has stated they are pivoting to the market's view. The drop in yields created another tailwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF increased +3.34% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.87%, down meaningfully from November's close of 4.35, down over a full 1% from October's close.



Source: Bloomberg

Source : https://www.zerohedge.com/markets/powells-pivot-adds-20-trillion-global-debtequity-markets-2023-fiat-alternatives-fly

The Dow Jones Industrial Average rallied +4.84%, the S&P 500 climbed +4.42%, and the small cap Russell 2000 soared 12.05%. The international markets traded in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index jumped +5.53%, and the MSCI Emerging Markets iShares Core ETF Index climbed +3.66%.

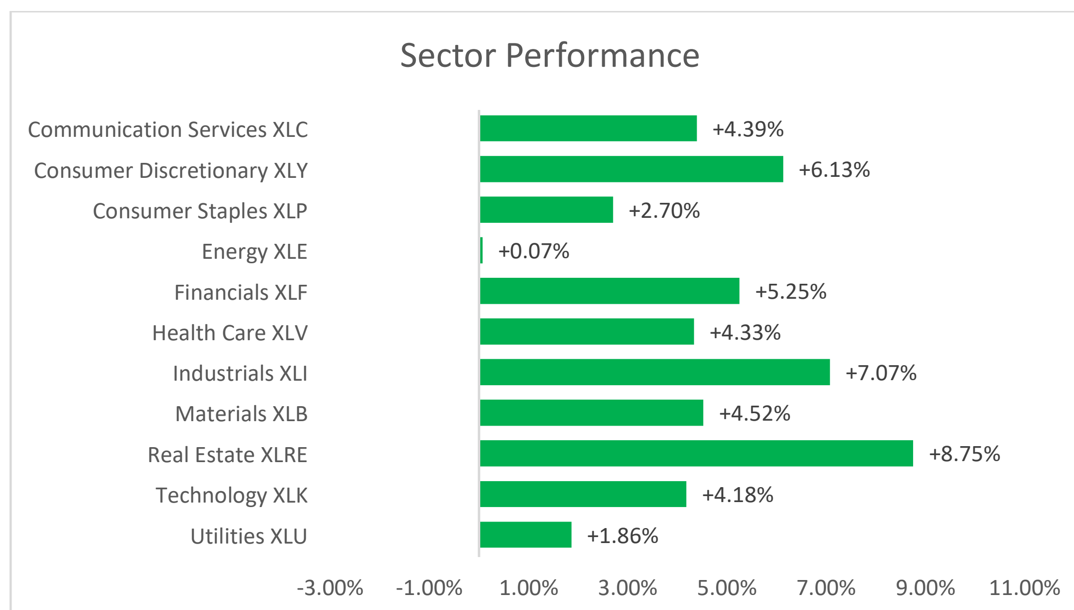
December's performance was a close duplication of November with every sector in the green.

The best performers were everything! This time really…

- Real Estate: +8.75%
- Industrials: +7.07%
- Consumer Discretionary: +6.13%

The worst "relative" performers were…

- Energy: +0.07%
- Utilities: +1.86%
- Consumer Staples: +2.70%



Source: https://www.morningstar.com

Oil Report

The oil market continues trading weaker following the start of the war in Gaza and now the targeting of vessels transiting the Red Sea. Prices continue focusing on the perception that the market will be modestly over supplied in the early parts of 2024. The markets are betting that the continued lack of significant escalation, regionally, outside of Gaza, will continue to allow oil markets to remain well supplied. This seems like wishful thinking given that the conflict does continue to push the envelope outside of northern Gaza and continues reaching further out. The current NYMEX WTI Crude Oil futures settled at $71.33 again posting a loss of over 6% from the prior month's close of $75.96 a barrel. The decrease in crude oil led to additional decreases in RBOB gasoline, which finished with a loss of almost 3% vs November's close. The energy complex continues to trade at odds with the rose-colored glasses experienced by the rest of the market, well at least the equity markets and potentially bonds, though maybe bonds have tricked equities and are singing from the same sheet as the energy markets.

The Rest of the Data

The November ISM Manufacturing Index remained unchanged at 46.7 from October's reading of 46.7. The ISM Services Index increased to 52.7 in November, from October's print of 51.8. The prices paid component for Services remained close to elevated and Manufacturing prices again firmed and are now at neutral levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence jumped to 110.7 in December, which compares to a downwardly revised figure of 101.0 in November. The unemployment rate decreased to 3.7%, while the economy added a solid 199,000 jobs in November, beating expectations of 183,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.1% in November, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate eased to +3.1% on a non-seasonally adjusted basis. The CPI ex Food and Energy remained at 4.0% over the last year. Same news, the economic data remains solid, employment reports are good, and inflationary pressures are trending lower, though higher than the Fed target of 2%. The only real weakness remains in the Manufacturing sector. The market accurately removed rate hike expectations for the remainder of 2023 and is aggressively anticipating rate cuts in 2024, currently projecting a 90% probability of a rate cut occurring in March, with as many as 5 additional rate cuts for 2024. We will continue to monitor economic activity along with inflation reports. As we tongue-in-cheeked last month, "The Fed usually doesn't win. 😊", was proven accurate a mere 10 days after publication, at least according to Fed Powell's press conference.

Summary

This comment was directed at something negative, "Other than something from left field, it seems the markets are free to continue the usual seasonal strength into year end." Didn't realize the out of left field was the Fed quickly caving on the higher for longer mantra. So, the equity markets continued to rally strongly through the end of the year on the back of lower rates, but have rates gotten too low for equites to continue to benefit? Again, the thinking is that 10-year Treasury yields below 4% are only sustainable in a recessionary environment. A recession usually also leads to a sharp drop in earnings and price earnings multiples, resulting in lower stock prices. Clearly, we don't know that answer today, but maybe the bond and oil markets are saying that recessionary storm clouds really will appear this time. If so, equities may have gotten too much of a good thing and got ahead of themselves…

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growth and growing debt, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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