Year in *Review*

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Happy New Year! As we enter 2024, we pause to reflect on a challenging yet rewarding 2023. Let's review the data…

Domestic Equities

The S&P 500 closed the year up 24% and sits just 27 points shy of its all-time high of 4,795.56 reached on January 3, 2022. The strength of the large cap market centered on just seven stocks raising concern about the sustainability of the advance due to its narrow breadth. The dovish tone from the Fed coupled with the Fear-of-Missing-Out (FOMO) momentum has provided a tailwind finish to the year.

International Equities

For the U.S.-based investor, international equities logged positive returns. The anticipation of a robust post-covid restart of the Chinese economy faded over the year and weighed on emerging market returns.

Sector Returns

Domestic stock performance was led by pro-cyclical sectors. The so-called "Magnificent 7" stocks (Amazon.com AMZN; Apple AAPL; Alphabet GOOG; Nvidia NVDA; Meta Platforms META; Microsoft MSFT and Tesla TSLA) drove the majority of domestic stock returns. The emergence of Artificial Intelligence as an investable theme has piqued interest in these names. On the flip side, defensive sectors lagged as optimism for a 'soft landing' broadened.

US Treasuries

The U.S. Treasury curve steepened slightly over the year with short rates down and long rates up. The 10-year ended where it started, masking a tumultuous move to 4.99% in October before retreating to 3.88%. The 2/10 year segment of the curve remains 'inverted' by 37 bps which is widely interpreted as a recessionary signal.

Data Dashboard

Index	**2023 Return**
S&P 500	+24.2%
S&P 500 Equal Weighted	+11.8%
Dow Jones Industrials	+13.7%
Russell 1000 Growth	+41.9%
Russell 1000 Value	+ 9.2%
S&P Mid Cap 400	+14.5%
Russell 2000	+15.1%
NASDAQ	+43.4%
MSCI EAFE	+13.62%
MSCI Emerging Markets:	+ 4.63%

S&P 500 Sector Performance:

Outperformers:	
Technology	+56.40%
Communication Services	+54.36%
Consumer Discretionary	+41.04%
Underperformers:	
Utilities	(10.20%)
Energy	(4.80%)
Consumer Staples	(2.16%)

Maturity	**Yield**	**2023 Change**
2-year	4.25%-	17 bps
10-year	3.88%	no change
30-year	4.03%	+ 7 bps

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The Federal Reserve
The Fed's dual mandate of low inflation and full employment appears to be approaching stable footing. The current preferred measure of inflation, Core Personal Consumption Expenditure (Core PCE) is at 3.2%. The reading has been falling steadily toward the target of 2.0%.

The Federal Reserve is slowly reducing the size of its balance sheet which reduces the demand for fixed income instruments. At a pace of $95B per quarter, it is projected to reach pre-pandemic size in 2026. The excess liquidity has been supporting the valuations of risk assets.

The Chicago Mercantile Exchange's FedWatch tool indicates a 70.6% probability that the Fed will lower rates by 25 basis points in May and by year-end, a 71.6% probability of rates in the 3.50%-4.00% target range versus the current 5.25%-5.50% range today.

The Fed raised rates 11 times since March 2022, the most ambitious rate hike campaign in the past four decades, raising concern that they moved too aggressively. The lagged and varied effect of the Fed's actions on the broad economy are often known only in hindsight and can be uneven. This phenomenon is an overhang for 2024.

The robust employment backdrop has provided the Fed room to move. The November read of unemployment was 3.7%.

Inflation Year-over-Year

	Nov 2023 vs	Dec 2022
CPI	+3.1%	+6.4%
Core CPI	+4.0%	+5.7%
PCE price index	+2.6%	
Core PCE price index	+3.2%	target = 2.0%

	Nov 2023 vs	Dec 2022
Unemployment rate	+3.7%	+3.5%

	Nov 2023 vs	Dec 2022
Labor-market differential (jobs plentiful vs jobs hard to get)	+27.5%	+34.5%

Fed Balance Sheet

Pre pandemic	$3.9T
Peak pandemic	$8.9T
Current	$7.7T

Fed Rate Moves

Date	Change	Target
2022		
Mar	+25 bps	0.25 – 0.50
May	+50	0.75 – 1.00
June	+75	1.50 – 1.75
July	+75	2.25 – 2.50
Sep	+75	3.00 – 3.25
Nov	+75	3.75 – 4.00
Dec	+50	4.25 – 4.25
2023		
Jan	+25	4.50 – 4.75
March	+25	4.75 – 5.00
May	+25	5.00 – 5.25
July	+25	5.25 – 5.50

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Broad Economy
The U.S. economy showed strength in both growth rate and productivity gains. The third quarter was robust at approximately 5% on both measures.

Retail sales remain relatively strong, driven by a healthy consumer.

Consensus analyst estimates forecast U.S. real gross domestic product (GDP) for the full year 2023, 2024, and 2025, at 2.4%, 1.2% and 1.8%, respectively. Modest, yet positive expansion.

Consumer
With the economy close to full employment, and the tailwind from covid-era stimulus savings, the U.S. consumer has been a key driver of economic growth. Consumer balance sheets remain relatively strong but are weakening. For the full year, the average hourly earnings increased at a rate less than the headline inflation, leaving many to feel like they are losing ground. Increasingly, consumers are tapping savings and revolving credit to fund expenses. The data indicate that the personal savings rate fell to 3.8% in October from a peak of 5.3% in May 2023. Consumer Net Worth retreated by $6T over the past two quarters, to end the 3Q23 at $142T. Notably, over the past year U.S. consumer credit expanded at the fastest rate since the end of 2007. Total credit card balances increased to $1.079T, the highest since the New York Fed began tracking in 1999. Real Household Consumption Growth has fallen from 2.5% in 2022, to expectations of 2.2% in 2023 and 1.1% in 2024. Higher borrowing costs are slowing the consumer.

GDP annualized pace
Q1 +2.2%
Q2 +2.1%
Q3 +4.9%

Productivity annualized pace
Q1 (0.6%)
Q2 +3.4%
Q3 +5.2%

Retail sales
+4.1% y/y through November report
+4.4% during the holiday shopping season

	Dec 2023	Dec 2022
Consumer Sentiment	69.7	59.7
Consumer Confidence	110.7	109.0
Expectations Index	85.6	77.9

Mortgage Rate, 30 Year Fixed 6.95% vs October peak of 8.09%

	Nov 2023	Dec 2022
New Home Sales	590k	636k
Median Home Price	$435k	480k
Median Existing-home Price	$388k	367k

	Nov 2023	Dec 2022
Average Hourly Earnings	$34.10	$32.82

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The Forward View

Equities

Consensus earnings growth estimates for S&P 500 companies is 10.9%, which should provide the catalyst for continued share price increases. While the current price-earnings ratio is elevated relative to history, it is supported by the downward path of interest rates. As reported by FactSet, year-end 2024 price targets recently published by 10 strategists imply an average call for 3.5% gain in the coming year. The dispersion is wide, from -11.9% by JPMorgan, to +6.9% by both BMO Capital Markets and Deutsche Bank.

Fixed Income

We expect the short end of the curve to fall in lock step with the Federal Reserve's rate cuts. The result should be a steepening of the curve throughout 2024. The Federal Reserve Open Market Committee's (FOMC) Summary of Economic Projections forecasts 75 basis points (0.75%) of cuts to the Fed Funds Rate, which should provide a tailwind for growth.

Credit Spreads

Credit spreads tightened during December, indicating that market participants remain confident the economic outlook and creditworthiness of borrowers. The outlook is driven by healthy corporate balance sheets and the strong US consumer.

Option Adjusted Spreads (OAS) over treasuries for high yield debt remain well below those experienced during times of economic stress (363 bp vs 1000 bps).

S&P 500

Consensus Earnings	Estimate	Price/Earnings
2023	$220	21.7x
2024	$244	19.5x
2025	$275	17.3x

S&P 500 12/31/23 closing price = $4,770

	2024 Target	% from 12/31
BMO Cap Markets	5,100	6.9%
Deutsche Bank	5,100	6.9%
Bank of America	5,000	4.8%
RBC	5,000	4.8%
Barclays	4,800	0.6%
Goldman Sachs	4,700	-1.4%
Stifel	4,650 (mid-year)	-2.5%
UBS	4,600	-3.5%
Morgan Stanley	4,500	-5.7%
JPMorgan	4,200	-11.9%

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Investor Sentiment
The Association of Individual Investors (AAII) Bull-Bear Spread has a bullish bias of 21.2% above its long-term trend of 6.5%, indicating that there is optimism over the next six-month investment horizon. However, this indicator is considered to be a contrarian view.

CBOE VIX Volatility Index
The Chicago Board Options Exchange (CBOE) VIX provides a view of the market's near-term volatility expectations based on the options market for S&P 500 contracts. It is commonly referred to as a Fear Index. The higher the reading, the higher the fear. Readings above 30 indicate extreme uncertainty. The reading on December 28th was 12.45, indicating a calm outlook.

AAII Bull-Bear Spread
(source: AAII.com)

Dec 28th Survey Results		Long-term Ave
Bullish: 46.3%	- 6.6 points	37.5
Neutral: 28.6%	+ 2.4 points	31.5
Bearish: 25.1%	+ 4.2 points	31.0
Net: Bullish 21.2%		6.5

As we look ahead to 2024, we believe the table is set for modest, but positive equity and fixed income returns. The uncertainties surrounding the lagged and varied effects of 2023 Fed Policy, coupled with growing geopolitical unrest (Ukraine/Russia, Israel/Hamas, China/US) and a US election cycle will result in price volatility throughout the year.

We believe that the best defense to market uncertainty is a solid offense in the form of a formal financial plan. If it has been a while since you reviewed your plan, we encourage you to give it a fresh look and discuss it with your MidWest*One* team. If you don't have a plan in place, we can help you craft a comprehensive, customized plan.

We wish you a healthy & prosperous 2024!