Clear Point
ADVISORS INC

Quarterly Commentary

Fourth Quarter 2023

Investment Commentary

We've heard the saying that the market climbs a wall of worry. 2023 didn't disappoint, largely reversing the dismal returns from 2022 by the end of 2023. Risk assets ended 2023 on a joyous note with the S&P 500 gaining 26.3%*. The Fed moved toward to the view that inflation is coming down with growth gradually moderating—increasing the chances for a so-called "soft landing."

Markets interpreted the "Fed Pivot" in December as a signal for aggressive policy easing during 2024. Investors voted with their wallets that the November-December stock rally could keep going into 2024, as long as inflation continues to cool.

Although the rally for most of 2023 was mainly led by the "Magnificent 7" stocks, it broadened out in the last few months of the year with impressive increases for small- and midcap stocks, a move not seen for over three years. The S&P 500 reached a new all-time high this past quarter as we headed into 2024. Large-cap Growth outperformed Value by the second widest margin since 1978. For example, the value-oriented Dow Jones Select Dividend Index advanced only 1.5% for the year.

So, while 2023 had periods of volatility, it was a rewarding year for most U.S. stock investors. Overseas, the EFEA international stock index gained 18.1% for the year, while Emerging Markets advanced 9%.

Even US bonds were positive, recovering some of their losses in 2023 with an increase of 5.5%. The Bloomberg U.S Aggregate bond Index was on track to post its third-consecutive negative year, which would have been the first time that's ever happened. But with help from the "everything up" rally, the index posted a positive return of 6.8% for the fourth quarter to end the year +5.5%. This positive number was driven by falling bond yields, as the U.S. 10-year and 2-year bond yield dropped by 0.7% and 0.8%, respectively in Q4.

Are Fed Rate Hikes Working?

There are many signs that the Fed's rate hikes are working to cool the economy. U.S core inflation peaked at 9.1% in mid-2022 and fell to just 3.1% by November 2023. US GDP growth remains strong but is expected to slow in 2024 to just 1.4% according to the Fed's forecast. And consumers are feeling the pinch, with increased delinquencies in credit-card debt and auto loans.

Two other factors driving down consumer spending are not directly related to current Fed policy. As we have noted for this past year, households continue to use up their excess COVID savings, and student-loan payments have just restarted. The combination of these factors increases the odds of a meaningful slowdown in consumer expenditures, a key driver of US growth.

Another factor influencing the Fed's Pivot is that while job creation remains strong with an average increase of 204,000 in total employment over the past three months, it has moderated since early 2023. The unemployment rate, currently at 3.7%, has been below 4% for the past 22 months and remains well below any measure of the natural rate of unemployment. But while the labor force continues to grow in response to higher wages, the lagging impact of tighter financial conditions is also a factor.

Those conditions are likely to affect economic activity and hiring throughout 2024. As a backstop, though, the Fed also believes that since the 2008-2009 banking collapse, its bank reserve

requirements have made the U.S. banking system much more resilient.

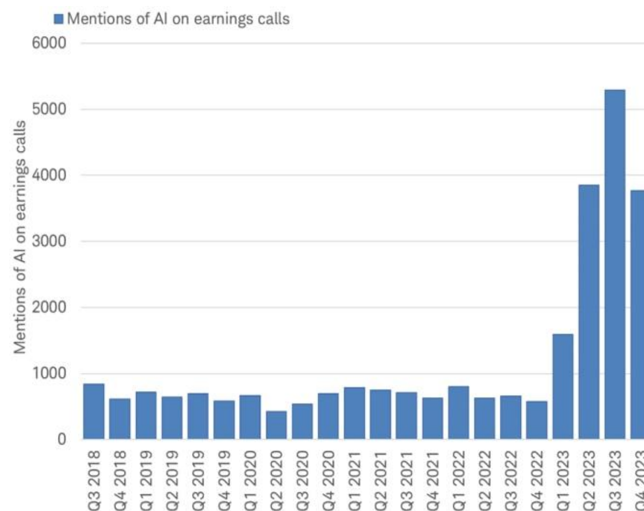
The dramatic turn in just a matter of months in the market's economic expectations proves how difficult forecasting has been in recent years. The "Fed Pivot" underscores the perplexity of looking ahead at the factors that influence rapidly shifting views for both growth and inflation.

While taking a more accommodative tone, the Fed has reiterated that they reserve the right to keep policy restrictive until there are clear signs that inflation is clearly on its way back to its 2% annual target, a job not yet fully accomplished. Heading into the new year, some analysts still believe there remain upside risks to inflation and downside risks to growth. Under this view, interest rates could stay higher for longer. But even if the Fed does cut rates three times in 2024, as signaled on December 13, the fed funds rate would end the year between 4.5% and 4.75%, still much higher than the near zero level when the Fed started its tightening campaign in March 2022.

Commentators see three main factors that could throw off the best laid plans for higher growth but with lower inflation. First, geopolitical risks are elevated. Thus far the markets haven't reacted negatively but multiple conflicts in the Middle East, Russia and potentially China are a threat.

Also, the upcoming elections are filled with uncertainty. Issues surrounding tariff agreements, fiscal policy, budget considerations and border security are just a few that could impact markets.

Another factor may be a productivity boost from Artificial intelligence. Unemployment rates in the U.S. have fallen to lows not seen in 50 years. This threatens to keep labor costs elevated which could slow growth. AI could help manage wage costs by filling the gaps where workers are unavailable and boosting output per worker. Business leaders are increasingly talking to shareholders about AI. The chart below delineates the number of times AI has been mentioned on corporate earnings calls.



The stock market's surprisingly positive performance and bounce back from 2022 this year underscores the challenges of market timing, the importance of a long-term view and the value in staying invested through uncertain periods.

Best Regards,

Clear Point Advisors Inc.

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*All statistical references throughout are sourced through One Blue Window. The chart is from the J.P. Morgan Guide to the Markets.