IM&R Economic and Market Review Q4 2023

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WEALTH ARCHITECTS

Economic Review

Prepare for landing. At their latest policy meeting, The Federal Reserve signaled that they may have finished their tightening campaign. The target interest rate has remained at 5.25%-5.50% since July. The question now is when will the first rate cut come? Over the next three months, the high inflation prints of last January, February and March will roll off the annual CPI calculation, supporting a lowering of core inflation closer to the Fed's 2% target. The markets are currently pricing in a 79% chance of the first cut coming as early as March 20. The updated Summary of Economic Projections "dot plot," a chart indicating where each Fed official sees interest rates in the future, points to three 25 basis point rate cuts next year.

Inflation continues its descent toward the Fed's target. The Bureau of Labor Statistics (BLS) November Headline Consumer Price Index came in at 3.1%, compared to 7.1% for the 12 months prior. The Core CPI (not including food and energy) has been stickier but has slowly dropped to 4.0%. Shelter prices increased for the 43rd consecutive month and posted substantial year-over-year growth of 6.5%.

Real gross domestic product (GDP), a key indicator of economic activity, increased at a robust annual rate of 4.9% in the third quarter, according to the Bureau of Economic Analysis. The latest Atlanta Fed GDPNow model estimate for fourth quarter GDP is at 2.3%.

The Conference Board Leading Economic Index (LEI) provides an early indication of significant turning points in the business cycle and where the economy is heading in the near term. The LEI fell again in November. The LEI suggests a downshift in economic activity ahead. The Conference Board forecasts a short and shallow recession in the first half of 2024.

The unemployment rate edged down to 3.7% in November, according to the BLS. The number of unemployed persons showed little change at 6.3 million. The labor force participation rate was little changed at 62.8% in November and has been essentially flat since August. The Job Openings and Labor Turnover Survey (JOLTS) showed a drop to 8.7 million job openings, indicating there are still about 1.4 jobs available for every unemployed worker.

Consumers ended 2023 with a surge in confidence and renewed optimism for 2024 according to the Conference Board *Consumer Confidence Index*.

Financial Markets Review: Domestic Stock Market

Stocks saved the best for last, with the S&P 500 closing the year at 4,769.83. The impressive 11.69% fourth quarter return left the index within 1% of its all-time high. The NASDAQ rocketed 14.60% to 15,011.35 in the quarter and the Dow Jones Industrial average reached a new high in the final three months, ending up 13.09% at 37,680.54.

As a group, the technology stocks regarded as the "magnificent seven" have gained an average of 111% for the year and now represent about 26% of the S&P 500 market cap. Six of the seven "magnificent seven" were higher in the quarter with Amazon leading the pack, up 19.52%, while Tesla fell -0.70%.

DJIA top performers for the quarter included Intel, up a staggering 41.70%, followed by Boeing with a stirring 35.99% gain and Salesforce climbing 29.77%. The worst performers for the quarter were Chevron, dropping -10.05%, Cisco, losing -5.30% and Walmart down -1.07%.

Of the 11 S&P 500 sectors, only energy was in the red for the quarter, down -6.94%. Consumer staples gained 5.54% and health care was up 6.41% to round out the bottom three sectors. The top three sectors included real estate vaulting 18.83%, information technology jumping 17.17% and financial services rising 14.03%.

Among industry groups, top performers included banks (+22.39%), semiconductors and equipment (+21.43%) and consumer durables and apparel (+21.42%). Laggards included energy (-6.94%), autos and equipment (-0.53%) and food beverage and tobacco (+2.43%).

According to FactSet, analysts are projecting a year-over-year earnings increase of 2.3% for the fourth quarter. For the full year 2023, earnings are projected to grow 0.6% on revenue growth of 2.3%. For 2024, analysts are currently projecting strong earnings growth of 11.5% and revenue growth of 5.5%, with most of that gain in the second half of the year.

The current outlook is that a recession will be avoided in 2024, inflation will fall and the Fed will engineer a soft landing. U.S. stocks are typically choppy through the U.S. presidential primary season, but the markets have often bounced back strongly afterward. The S&P 500 has only had negative performance in two of the last 20 election years (2000 and 2008) and both of those were from shocks unrelated to the political cycle. With a still healthy labor market, improving corporate profits and falling interest rates, the economy remains in good shape. Areas of concern include rising debt and deficits, stretched consumers, reflation and geopolitical risks in Europe, the Middle East and Asia.

	Total Returns* (12/31/23)			Annualized Returns (12/31/23)		
Category/Style	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
S&P 500	11.69	26.29	26.29	10.00	15.69	12.03
S&P Midcap 400	11.67	16.44	16.44	8.09	12.62	9.27
S&P Small Cap 600	15.12	16.06	16.05	7.28	11.03	8.66
Russell 1000 Large Cap Growth	14.16	42.68	42.68	8.86	19.50	14.86
Russell 1000 Large Cap Value	9.50	11.46	11.46	8.86	10.91	8.40
Russell 2000 Small Cap Growth	12.75	18.66	18.66	-3.50	9.22	7.16
Russell 2000 Small Cap Value	15.26	14.65	14.65	7.94	10.00	6.76

Source: Standard and Poor's, Frank Russell Company * returns include reinvested dividends

International Stock Markets

S&P Global Flash PMIs point to widening divergences among the major developed economies at the end of 2023, with the Eurozone in decline but modest growth in the UK and Japan.

The MSCI EAFE Index of developed markets gained -10.42% in the fourth quarter and 18.24% for the year. MSCI Emerging Markets Index advanced 7.86% for the quarter and 9.83% for the year, and MSCI Frontier Markets were higher by 3.97% in the quarter and 11.63% for the year.

In the Eurozone, business activity continued to contract at a sharp rate at the end of the fourth quarter. The Eurozone has likely been in recession since the third quarter, but firms are looking more optimistic about the year ahead. Euro area inflation dropped to 2.4% in November and 3.1% in the European Union according to Eurostat, the statistical office of the EU. Most markets experienced healthy single digit gains in the quarter with the Stoxx Europe 600 Index rising 5.32% to 474.17. In local currencies, Germany's DAX Index gained 8.87% to 16,751.64, France's CAC-40 was 5.72% higher to 7,543.18 and the United Kingdom's London FTSE 100 edged up 1.64% to 7,733.24.

In Asia-Pacific markets, Japan PMI surveys indicate an increase in business activity in the fourth quarter. Japan's Nikkei stock index rose 5.04% for the period to 33,464.17.

In emerging markets, the Chinese economy shows some signs of recovery with the China Caixin General Manufacturing PMI showing the highest reading since August. Supply chain performance improved for the second month in a row and sentiment advanced to a four-month high. The China Shanghai Composite Index slipped -4.35% for the quarter to 2,974.93. In India, the S&P Global India Manufacturing PMI showed factory activity increasing for the 29th straight month and employment increased for the eighth month. The S&P BSE Sensex Index advanced 6.60% to 72,240.26.

The U.S. Dollar Index (DXY) crashed -4.59% in the fourth quarter to 101.34. The dollar fell -5.58% against the yen to $141.03 (JPY/USD) and was -5.05% lower vs. the euro at $1.1038 (USD/EUR).

World Bond Markets

In the U.S., the 3-month/2-yr. treasury spread and 2-yr./10-yr. treasury spread remain inverted, at 1.10% and 0.39% respectively. These inversions have historically been precursors of pending recessions. The 3-month T-bill ended the quarter at 5.35%. With the Fed signaling a likely end to its tightening cycle, significant declines were seen in the 2-year note which fell to 4.25%, and the U.S. 10-year treasury bond which dropped to 3.86% at year end.

With falling rates, bonds posted strong returns in the fourth quarter. The Bloomberg Aggregate Bond Index rose 6.82%. Likewise, the Bloomberg Municipal Index was up 7.89% for the quarter and the Barclays U.S. Treasury TIPS Index was higher by 4.71%. Money market yields were pretty much unchanged at 5.19%, as reported by the Crane 100 Money Fund Index.

According to Value Line, yields on 10-year government bonds ended the quarter lower in the UK (3.66%.), Canada (3.14%), Germany (2.02%) and Japan (0.57%).

Commodities

Commodities dropped in the fourth quarter by -4.49% to close at 957.80 according to the DJ Commodity index. Oil prices collapsed by $19.14 (21.08%) to $71.65/barrel. And according to AAA, consumers had a welcome relief at the pump with the national average price of gas 72 cents lower to $3.10/gallon representing a drop of -18.84%. Gold rose above $2,000 to $2,062.40/troy oz., for a quarterly gain of $214.30, or 11.60%.

Mutual Funds/Exchange-Traded Funds

According to the Investment Company Institute December release, the combined assets of the nation's mutual funds increased by $1.87 trillion over the past year to $24.70 trillion. Net inflows to mutual funds were $386 billion in 2023 compared to outflows of -$1.06 trillion in 2022. Money market fund assets comprised $5.89 trillion of the total and have grown by 3.8% over the same period, as investors moved bank deposits into higher yielding funds during the year. Assets in exchange-traded funds (ETFs) rose to $7.63 trillion, a gain of 13.0% over the past year. The growth in the number of ETFs continues, finishing the year above 3,000 at 3,076.

MUTUAL FUNDS OVERVIEW AS OF DECEMBER 31, 2023

	Total Returns			Annualized Returns		
Category	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
Municipal Bond Interim-Term	6.35	5.60	5.60	-0.49	1.87	2.36
Short-Term Taxable Bond	3.35	5.71	5.71	0.11	1.86	1.59
Intermediate Taxable Bond	6.46	5.60	5.60	-3.24	1.07	1.66
Long-Term Taxable Bond	12.23	9.26	9.26	-6.67	2.10	3.58
High Yield Bond	6.19	12.08	12.08	1.87	4.71	3.70
Global Bond	7.90	6.66	6.66	-4.34	0.00	0.05
Small-Cap Blend	12.74	16.14	16.14	6.29	10.86	7.17
Mid-Cap Blend	11.48	15.97	15.97	6.85	11.96	8.27
Large-Cap Blend	11.28	22.38	22.38	8.85	14.28	10.56
Global Stock Large Blend	10.49	18.19	18.19	5.31	10.59	7.23
Foreign Large Blend	9.73	16.25	16.25	2.40	7.62	3.97
Natural Resources	4.73	7.25	7.25	10.76	12.32	4.82
Real Estate	15.68	12.01	12.01	4.64	6.81	6.80

Source: Morningstar Category Returns, Morningstar, Inc.

Important Definitions and Disclosures

The opinions and material presented are provided for informational purposes only. No person or system can predict the market. Past performance is no guarantee of future results. This material includes forward-looking statements that are subject to certain risks and uncertainties. Actual results, performance or achievements may differ materially from those expressed or implied. No predictions or forecasts can be guaranteed. Companies mentioned are for informational purposes only. It should not be considered a solicitation for the purchase or sale of the securities. Any investment should be consistent with your objectives, time frame and risk tolerance. Neither asset allocation nor diversification guarantee a profit or protect against a loss. All investments are subject to risk, including the risk of principal loss. There is no assurance that the investment goals and process described herein will consistently lead to successful investing. The investment return and principal value of an investment will fluctuate, and an investor's shares, when redeemed, may be worth more or less than their original cost. Funds that invest in stocks of small-cap or mid-cap companies involve additional risks. The securities of these companies may be more volatile and less liquid than the securities of larger companies. Funds that invest in international securities involve special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investment in emerging markets may accentuate these risks. Alternative strategies, including those used in mutual funds, have risks that may substantially increase the potential for loss. Bonds are subject to interest rate risk. Bonds have interest rate risk and credit risk. As interest rates rise, existing bond prices fall and can cause the value of an investment to decline. Changes in interest rates generally have a greater effect on bonds with longer maturities than on those with shorter maturities. Funds that hold bonds are subject to declines and increases in value due to general changes in interest rates. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and/or interest payments.

The information shown does not constitute investment advice and does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact with respect to any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation. Nothing contained herein should be construed as a recommendation to buy or sell any individual securities. It should not be assumed that an investment in any of the securities identified was or will be profitable.

The Bureau of Economic Analysis (BEA) of the United States Department of Commerce is a U.S. government agency that provides official macroeconomic and industry statistics, most notably reports about the gross domestic product (GDP) of the United States and its various units such as states, cities, towns, townships, and villages. **Gross Domestic Product** (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. **Real Gross Domestic Product** (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). The **Atlanta Fed GDPNow** estimate is a model-based projection not subject to judgmental adjustments. It is not an official forecast of the Atlanta Fed, its president, the Federal Reserve System, or the Federal Open Market Committee. **The Consumer Price Index (CPI)** measures prices of a fixed basket of goods bought by a typical consumer, widely used as a cost-of-living benchmark, and uses January 1982 as the base year. **Purchasing Managers' Index™ (PMI™)** is a survey-based economic indicator designed to provide a timely insight into business conditions. Flash PMI data are published by S&P Global and are early estimates of the company's final PMI numbers. The Flash PMI data are published approximately one week before final PMI data each month and are typically based on 85%-90% of total PMI responses received each month. Flash manufacturing, services and composite indices are published for: Australia, Eurozone, France, Germany, Japan, United Kingdom, and the United States. **The Conference Board Leading Economic Index® (LEI)** for the U.S. are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components. **Personal Consumption Expenditures** (PCE) is a measure of price changes in consumer goods and services and consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries. A composite diffusion index monitors conditions in national manufacturing and is based on the data from these surveys. The **Federal Reserve System** (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. The Federal Reserve System is composed of 12 regional Reserve banks which supervise state member banks. The Federal Reserve System controls the Federal Funds Rate (aka Fed Rate), an important benchmark in financial markets used to influence the supply of money in the U.S. economy. The **Federal Open Market Committee** (FOMC), a committee within the Federal Reserve System is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). The **unemployment rate** percentage of total workforce who are unemployed and are looking for a paid job. Unemployment rate is one of the most closely watched statistics because a rising rate is seen as a sign of weakening economy that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy, which is usually accompanied by higher inflation rate and may call for increase in interest rates. Labor force participation rate is the percentage of working age population that is part of the labor force. It is a measure of what proportion of a country's population is employed or actively looking for employment. The index of leading economic indicators is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy. **Inflation** is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Moderate inflation is a common result of economic growth. Hyperinflation, with prices rising at 100% a year or more, causes people to lose confidence in the currency and put their assets in hard assets like real estate or gold, which usually retain their value in inflationary times. **Treasury Yield Curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. **The Michigan Consumer Sentiment Index** was created in the 1940s is conducted by the Survey Research Center and consists of at least 500 telephone interviews posed to a different cross-section of consumers in the continental U.S. each month. The survey questions consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy. The **International Monetary Fund (IMF)** is an international organization that was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29-member countries. Each survey contains approximately 50 core questions, and each respondent is contacted again for another survey six months after completing the first one. The answers to these questions form the basis of the index. An **exchange-traded fund (ETF)** is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. Indexes are unmanaged and investors cannot invest directly in an index.

Morningstar Category Returns are composed of the average return for the funds in each Morningstar category over the indicated time period. Categories are defined by Morningstar based on holdings statistics. The category returns are adjusted for survivorship bias, meaning they include all investments even if liquidated, merged or otherwise now obsolete. The returns also include funds that were in a given Morningstar category but have since changed to another category.

Benchmark Definitions

The **S&P 500 Index** is an index of 500 of the largest exchange-traded stocks in the U.S. from a broad range of industries whose collective performance mirrors the overall stock market. The **Dow Jones Industrial Average** is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. The **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. **Russell Large Cap Growth Index** measures the performance of those Russell 1000 Index securities with higher price-to-book ratios and higher forecasted growth values, representative of US securities exhibiting growth characteristics. **Russell Large Cap Value Index** measures the performance of those Russell 1000 Index securities with lower price-to-book ratios and lower forecasted growth values, representative of US securities exhibiting value characteristics. **MSCI EAFE Index** is a market capitalization-weighted index of the leading stocks in Europe, Australasia and Far East. Membership of the index is selected by MSCI and designed for leading stocks roughly to match market sector weights. The **MSCI Emerging Markets Index** is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The **MSCI Frontier Markets Index** provides a broad representation of the equity opportunity set while taking investability requirements into consideration within each market. MSCI classifies 34 countries as Frontier Markets, 26 of which are included in the MSCI Frontier Markets Index. The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The **CAC 40 Index** is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Paris Bourse (now Euronext Paris). The **DAX Index** is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The **FTSE 100** is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The **Nikkei Index** is a stock market index for the Tokyo Stock Exchange (TSE). The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. **S&P BSE Sensex index**, is the benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. **Bloomberg Aggregate Bond Index** is made up of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. The **Bloomberg Municipal Bond Index** is a market value weighted index of investment grade municipal bonds with maturities of one year or more. The **Barclays Capital U.S. Government Inflation-Linked Bond Index** (U.S. TIPS) measures the performance of the TIPS market. TIPS form the largest component of the Barclays Capital Global Inflation-Linked Bond Index. Inflation-linked indices include only capital indexed bonds with a remaining maturity of one year or more. Treasury notes (T-notes) are intermediate securities with maturities of 1 to 10 years. Denominations range from $1000 to $1 million or more. The notes are sold by cash subscriptions, in exchange for outstanding or maturing government issues, or at auction. The **10-year Treasury** Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. The **Crane 100 Money Fund Index** measures the average yield of the 100 largest taxable money market funds. **Barclays Capital Global Aggregate ex-U.S. Index** measures the performance of the global bond market, excluding U.S. securities. **The Dow Jones Commodity Index**℠ is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. The index is designed to minimize concentration in any one commodity or sector. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal and are subject to investment risk. The **Wall Street Journal Dollar Index (WSJ Dollar Index)** is an index of the value of the U.S. dollar relative to 16 foreign currencies. The index is weighted using data provided by the Bank for International Settlements on total foreign exchange trading volume. The index rises when the U.S. dollar gains value against the other currencies and falls when the U.S. dollar loses value against the currencies.