Quarterly Market Report

Fourth Quarter 2023

Vogel Consulting
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Fourth Quarter Highlights

Sentiment shifted to expect a soft landing with declining inflation and a resilient economy

Financial Markets

- The negative momentum in global equity markets in the third quarter continued in October with major indices entering correction territory. However, markets rallied in November and December with some indices nearing or setting new all-time highs when sentiment shifted away from the higher for longer scenario to investors pricing in more dovish central banks. Small-capitalization (cap) stocks led the rally.
- Bond yields pushed higher in October and prices fell due to higher for longer expectations. U.S. Treasury bond yields hit 15+ year highs. Yields fell abruptly when key inflation measures came in slower than expected and fueled a shift in sentiment to expecting a "soft landing" and multiple rate cuts in 2024.
- In a reversal from the prior quarter, the price of West Texas Intermediate crude oil fell 20% during the quarter. The price of gold rose and the U.S. dollar declined on expectations for rate cuts in 2024.

Overview of the Economy

- Earnings reports for the third quarter were better than expected with a majority of companies beating analyst forecasts but some reported lower unit sales after implementing price hikes to offset higher input costs.
- The U.S. economy continued to show resilience with a 4.9% annualized growth rate in the third quarter, the highest growth in two years, due in large part to a jump in construction spending. The labor market remains tight despite a lower number of job openings. Retail sales grew more than expected. New home sales rose late in the quarter as mortgage rates eased.
- Surveys continue to show weak manufacturing activity around the world but services activity in expansion.

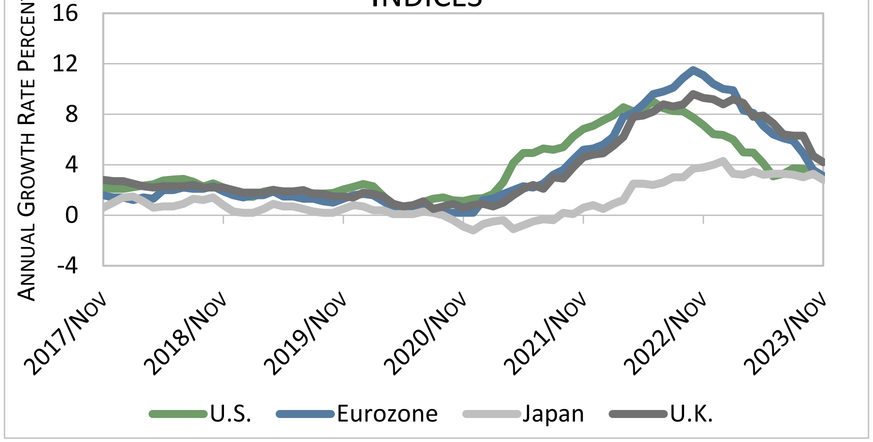
Notable Events

- The Federal Reserve Open Market Committee (Fed) left its rate steady but adjusted its projections to show a lower fed funds rate at the end of 2024 than previously expected. Other central banks also held rates steady.

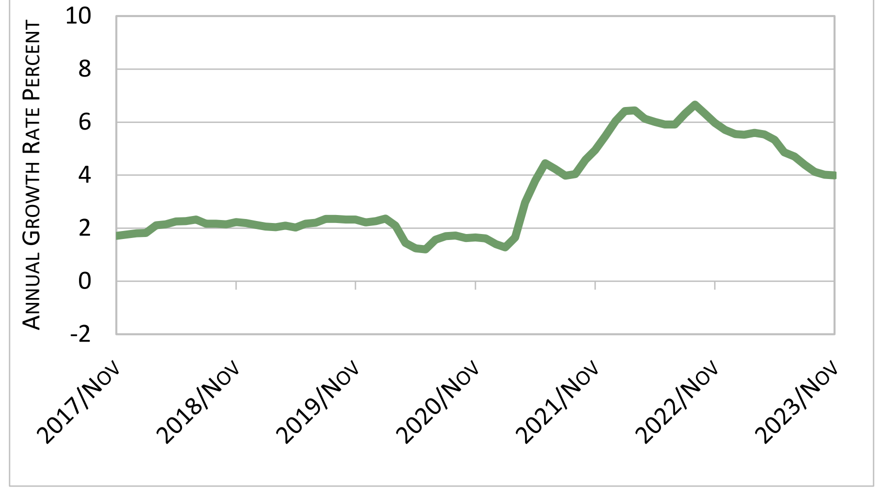
Fourth Quarter Highlights

Cooling inflation fueled soft landing optimism and hopes for rate cuts early in 2024

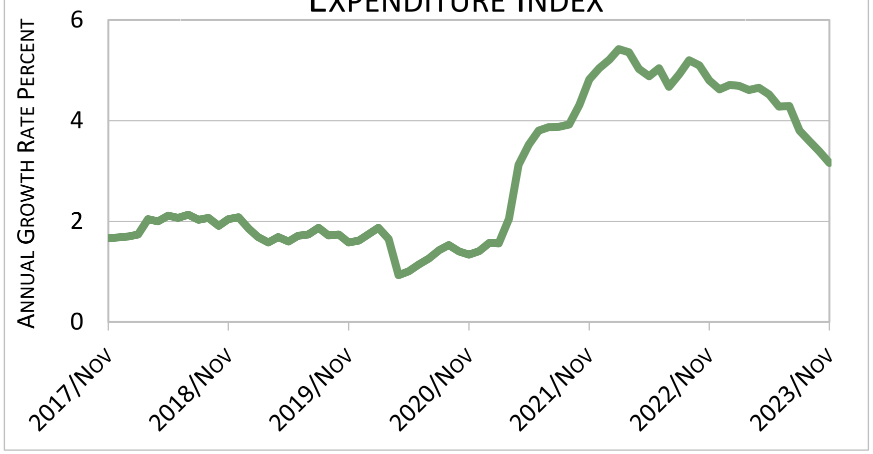
U.S. and International Consumer Price Indices[1,2]



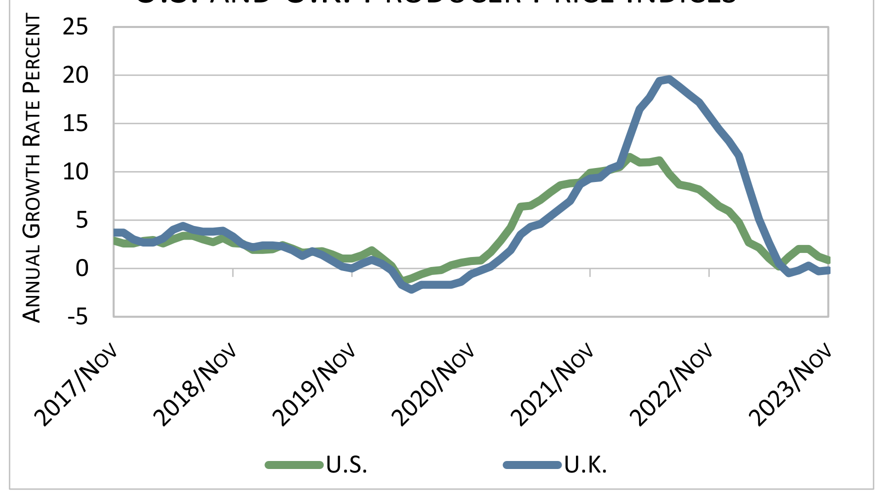
U.S. Core Consumer Price Index[1]



U.S. Core Personal Consumption Expenditure Index[1]



U.S. and U.K. Producer Price Indices[1,3]



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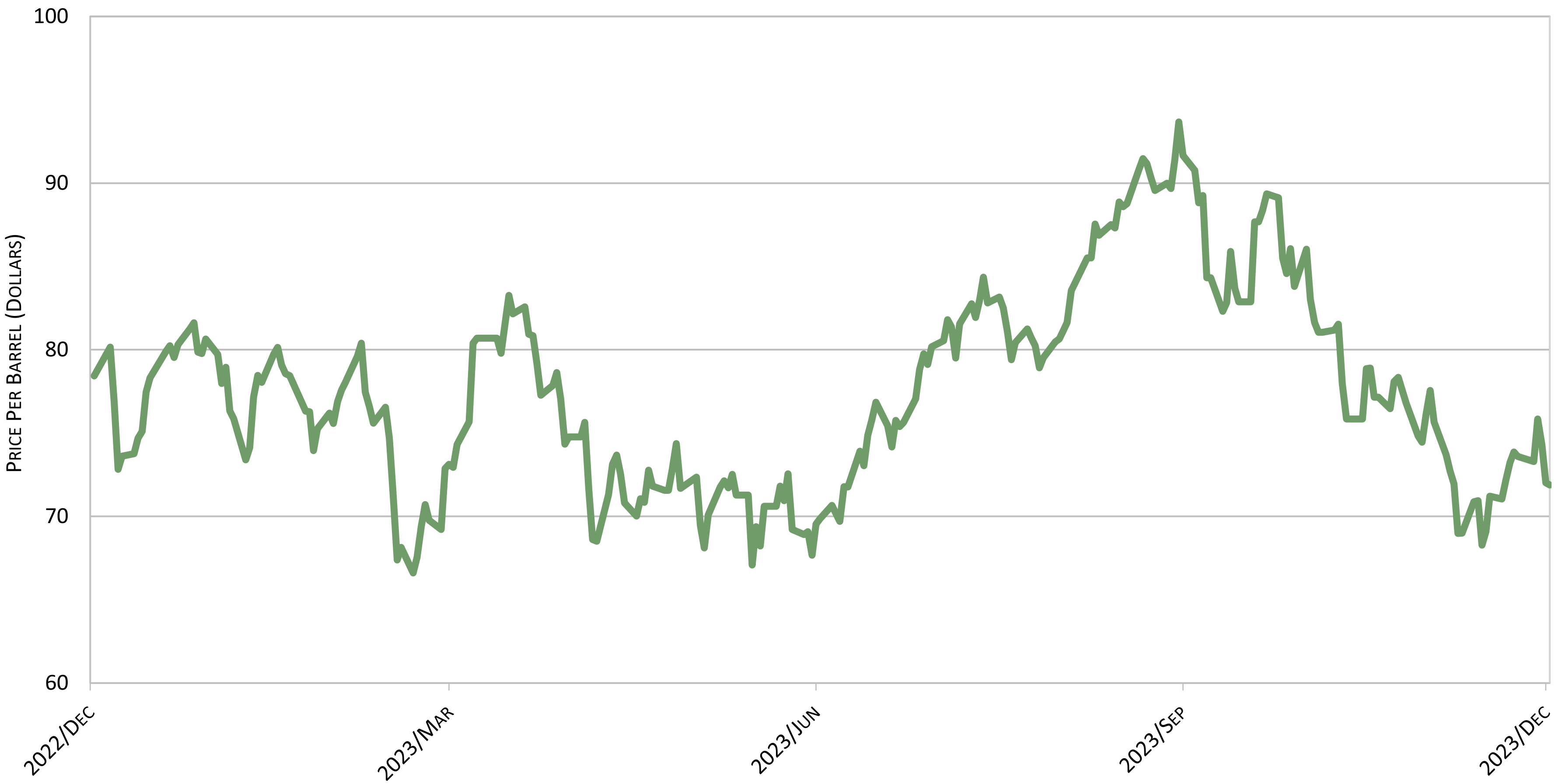
Fourth Quarter Highlights

The price of oil dropped 20% during the quarter, a plus for lowering the rate of inflation

The price of oil declined from highs for the year in September back to lows reached in June. Worries about weak demand in the U.S. and Asia as well as increasing inventories sent prices lower despite potential risks to oil markets and transportation due to the war in Gaza.

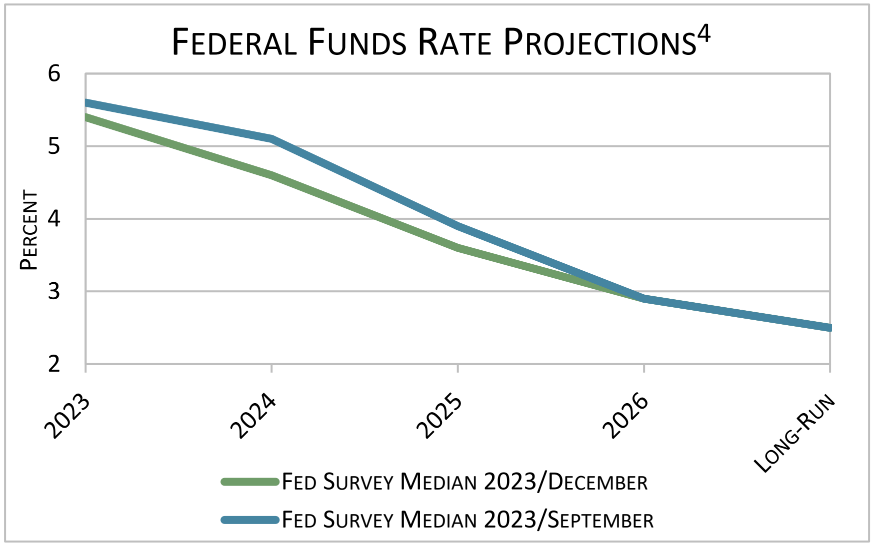
West Texas Intermediate Crude Oil Spot Price[1]

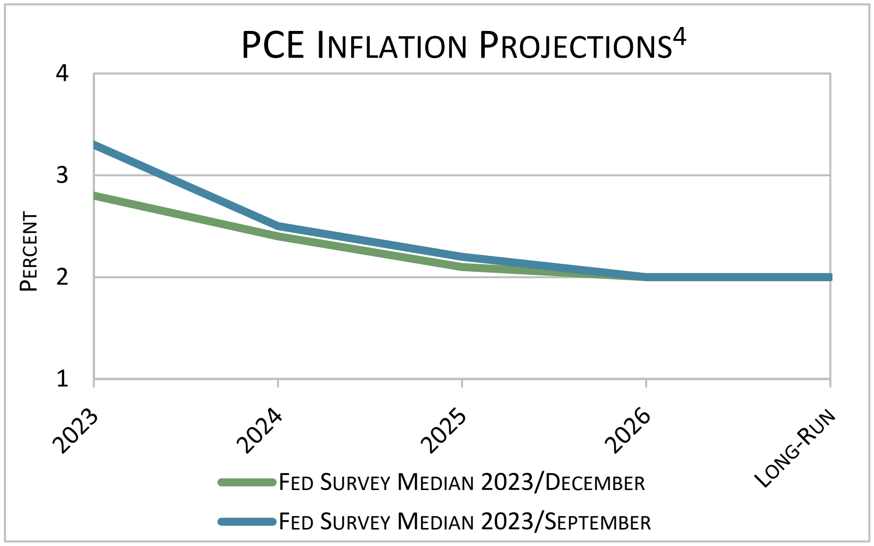


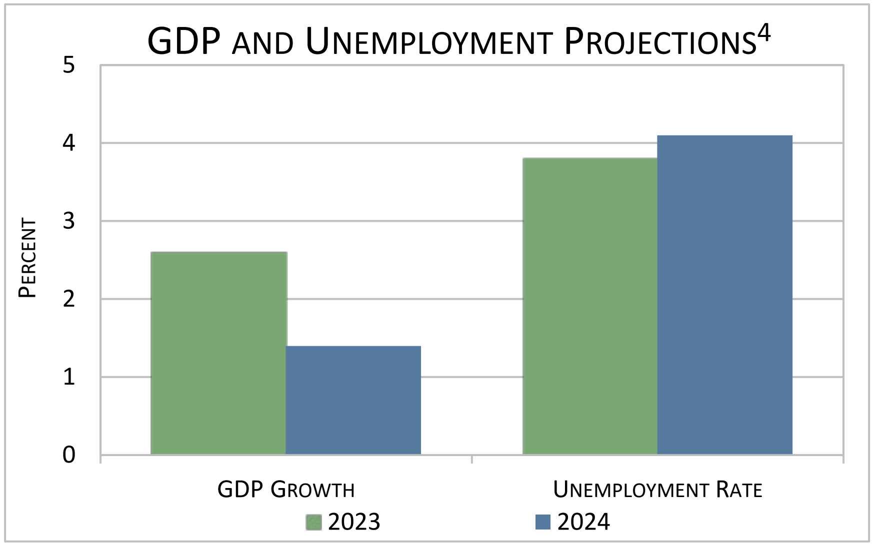
Fourth Quarter Highlights

New Fed projections point to lower inflation and interest rates which set off a rally

December meeting projections and comments indicated a pivot by the Fed toward less restrictive policy. The median forecast of Fed members pointed to lower inflation rates and fed funds rates in 2024 and 2025 than in the prior forecast. The pivot set off a "buy everything" rally across financial markets. The "soft landing" view got a boost since the Fed's forecast shows slower economic growth and a pick-up in the unemployment rate in 2024 but not enough of a slowdown to cause a recession.







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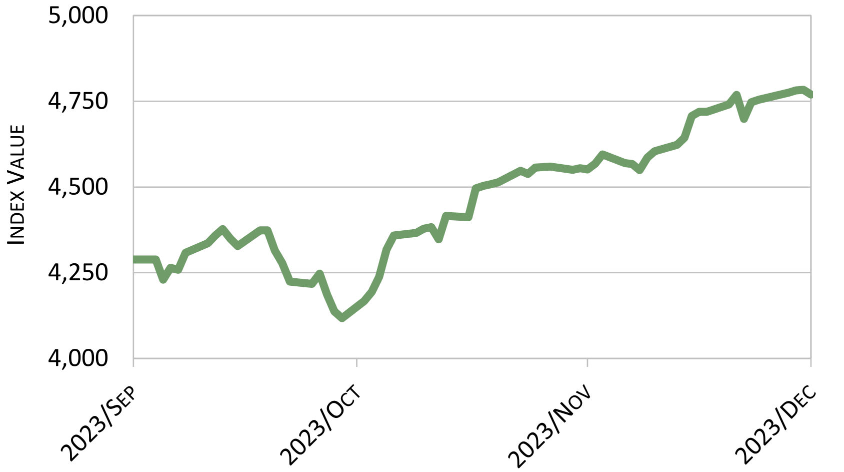
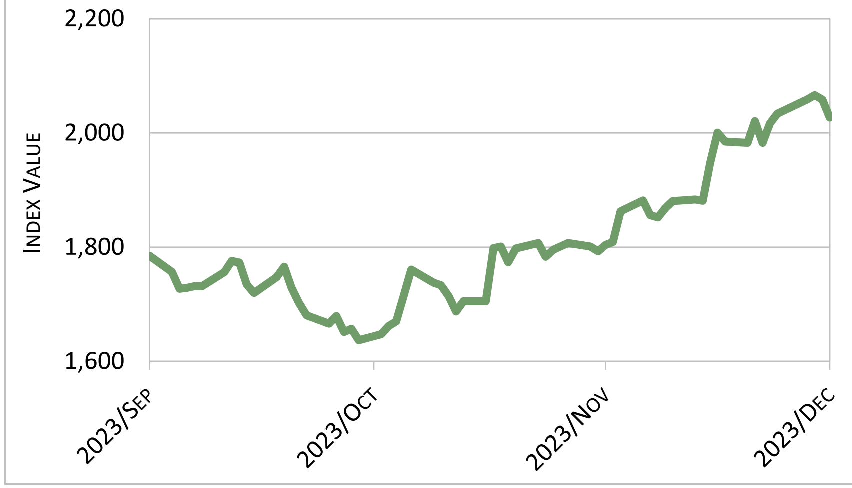
Fourth Quarter Highlights

After a weak October, most equity markets rallied in the last two months of the year

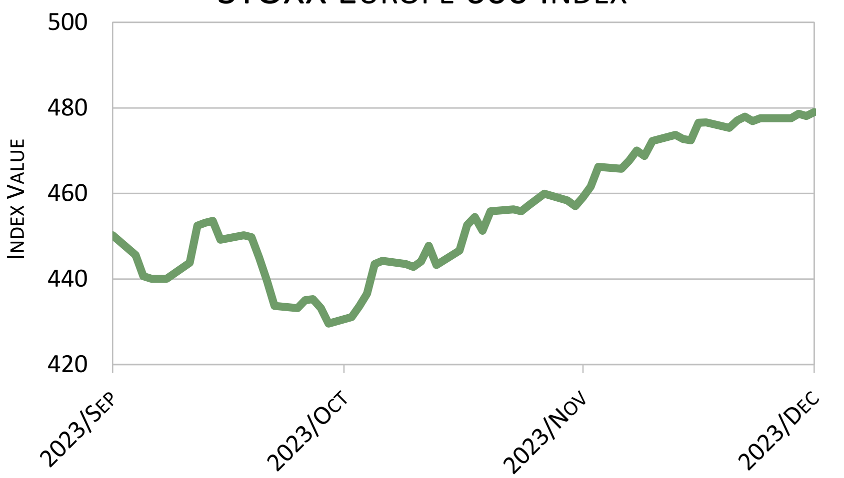
S&P 500 Index[1]



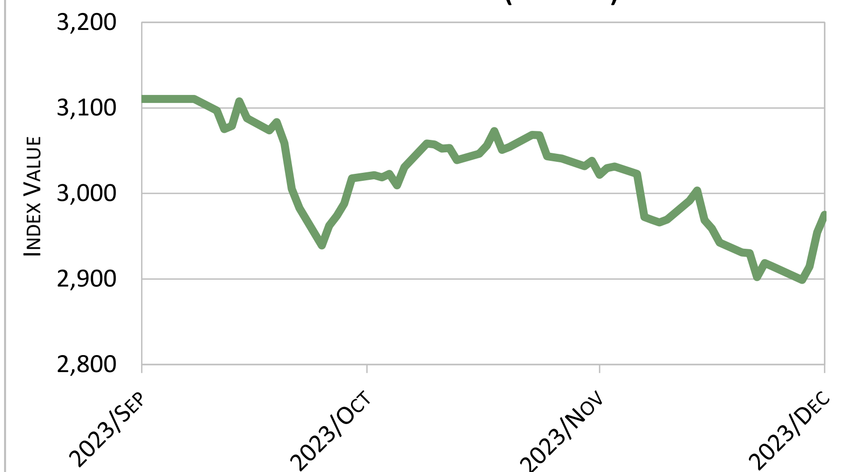
Russell 2000 Index[1]



STOXX Europe 600 Index[1]



SSE Composite (China)[1]



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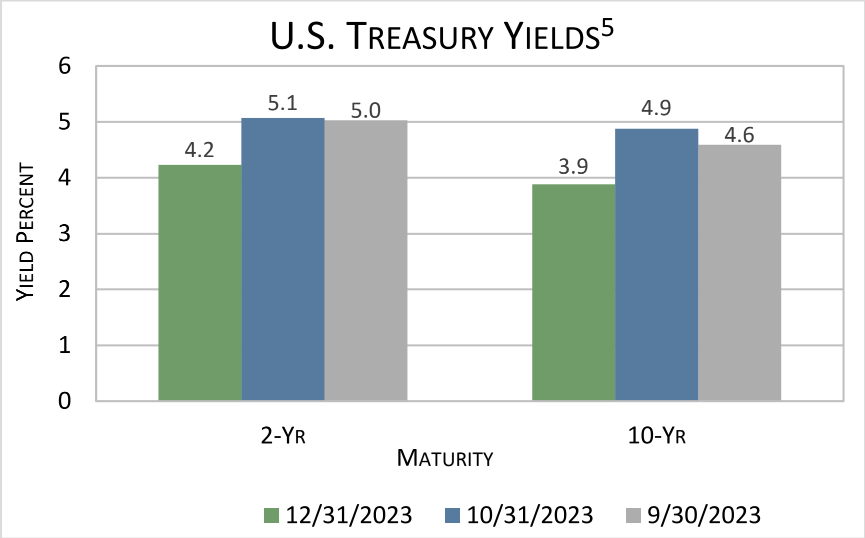
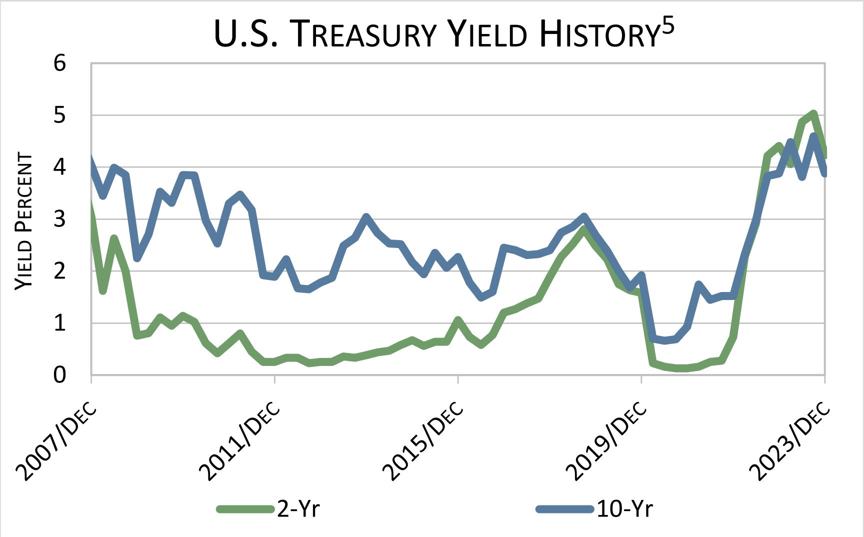
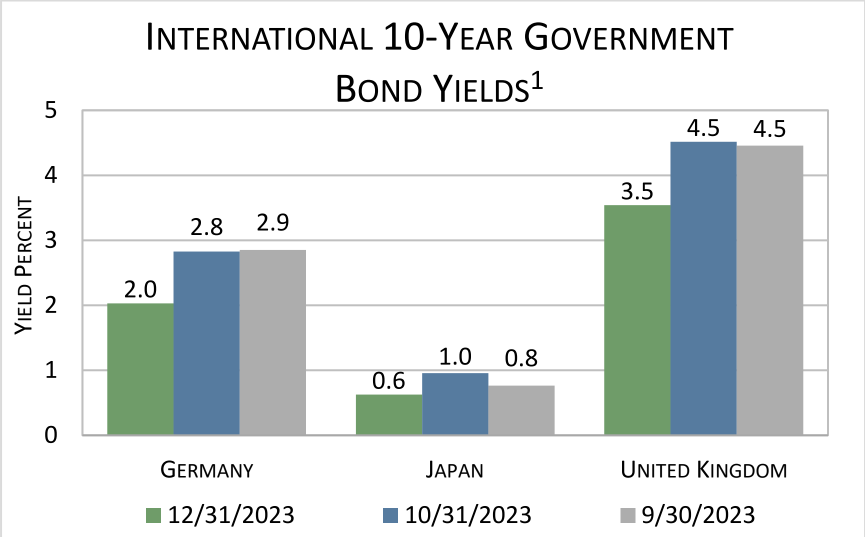
Fourth Quarter Highlights

Bond yields hit highs in October then dropped sharply as sentiment shifted

Yields rose in October to multi-year highs. The 10-year government bond yield in the U.S. hit a 16-year high, in Germany hit a 12-year high, and in Japan hit a 10-year high. Resilient economic data, sticky inflation, and hawkish central bank comments fueled the "higher for longer" view and drove yields up. But that view quickly shifted to expecting rate cuts after softer than expected inflation data in the U.S. and Europe. Dovish policy guidance from the Fed in December accelerated the bond market rally driving yields down significantly in a short time period. Interestingly, the 10-year Treasury ended 2023 at the same level as the at the end of 2022.







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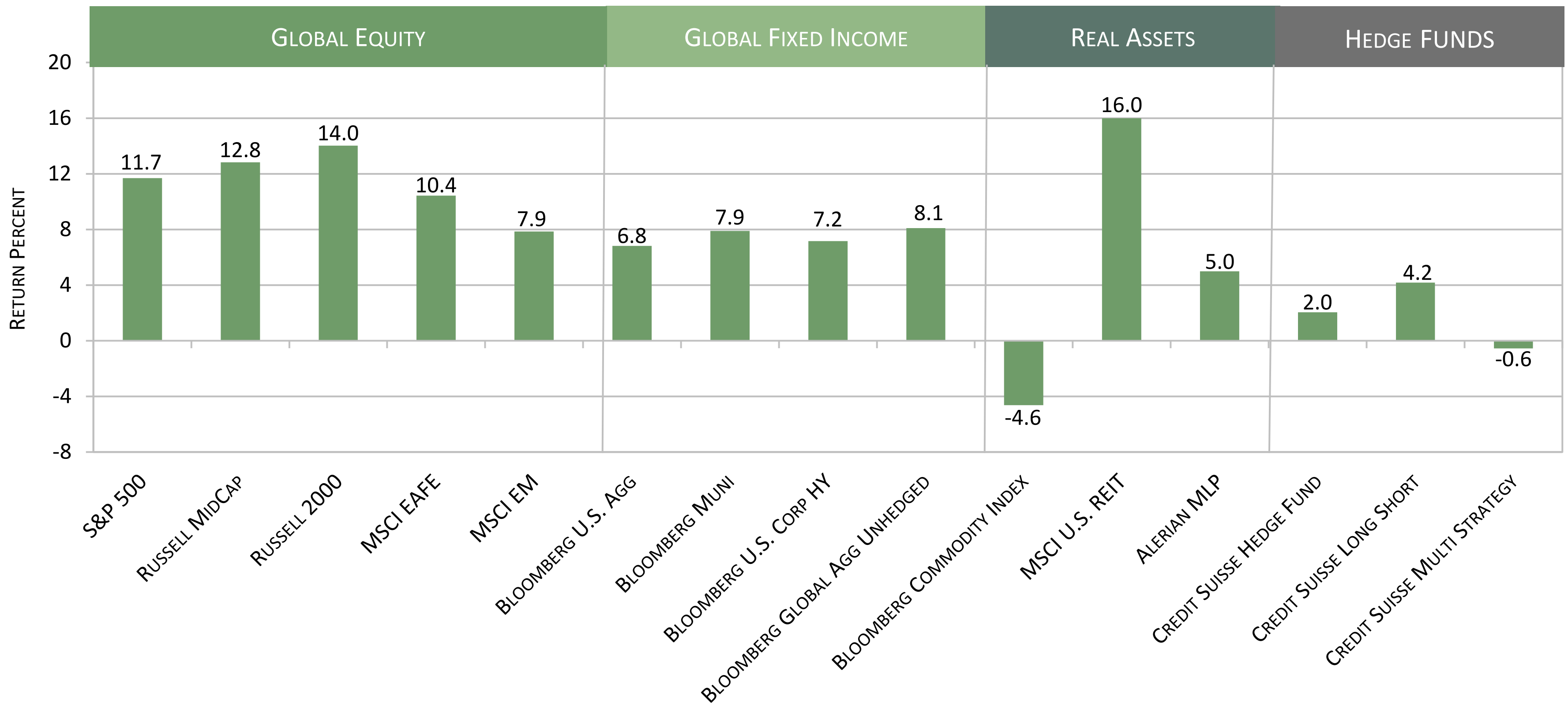
Fourth Quarter Highlights

Interest rate cut hopes set-off an "almost everything rally" in the fourth quarter

Most asset classes rallied as investor sentiment soared in reaction to declining rates of inflation in the U.S. and other major economies along with the possibility of interest rates cuts in 2024. Oil, other commodities, and the U.S. dollar were the main exceptions. REITs and small-capitalization stocks had the top returns for the quarter as lower rates are seen as particularly beneficial to these sectors.

Market Returns: Fourth Quarter 2023[6]



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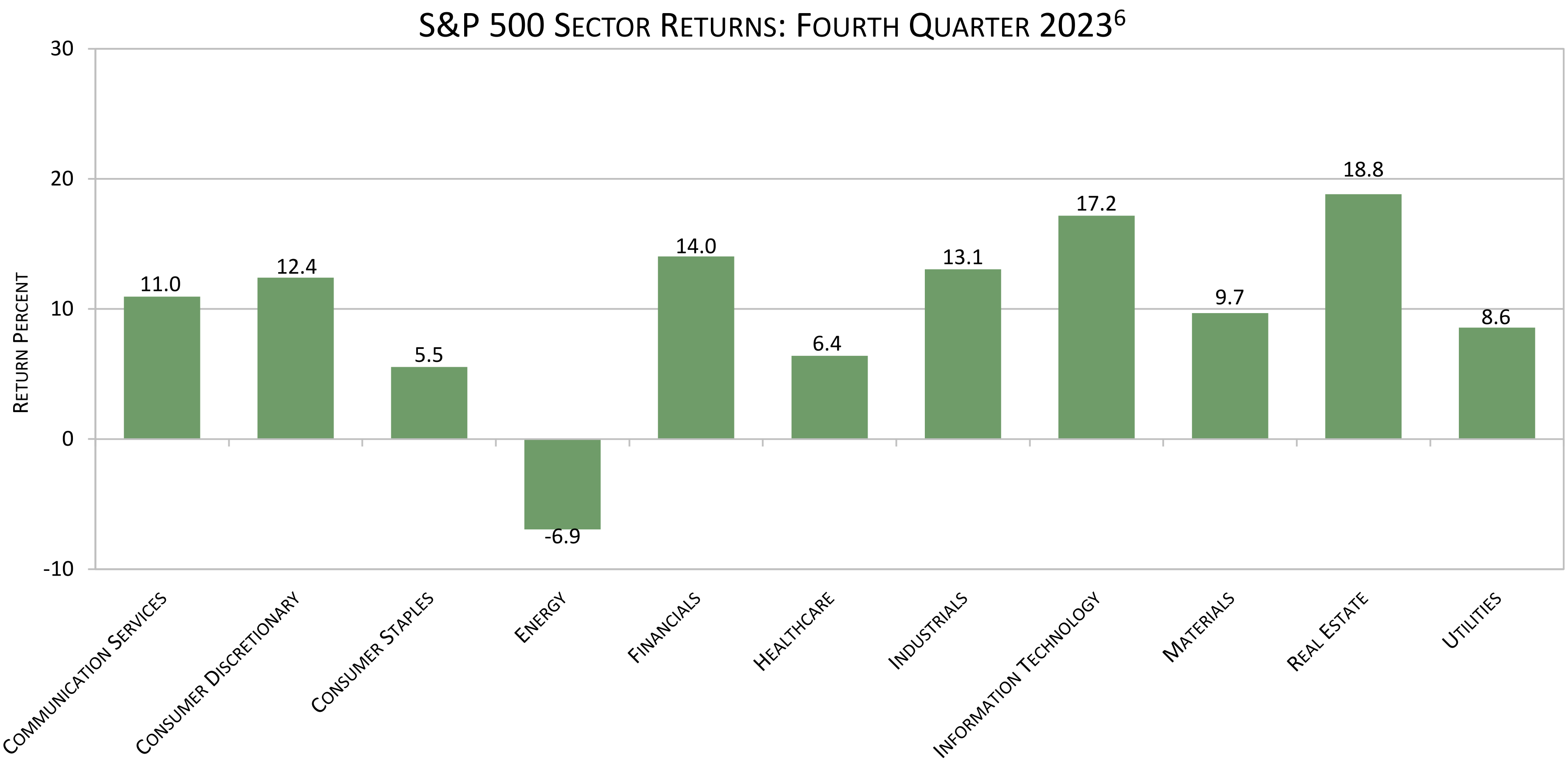
Fourth Quarter Highlights

Growth and interest rate sensitive sectors led with double-digit gains on rate cut optimism

Real estate had the top return for the quarter propelled by the apparent end of interest rate hike headwinds. Growth stocks also had double-digit returns as sentiment shifted to "risk-on" mode. Defensive sectors had positive, but lower returns. Energy was the only sector to post a negative return for the quarter hurt by falling oil prices and demand concerns.



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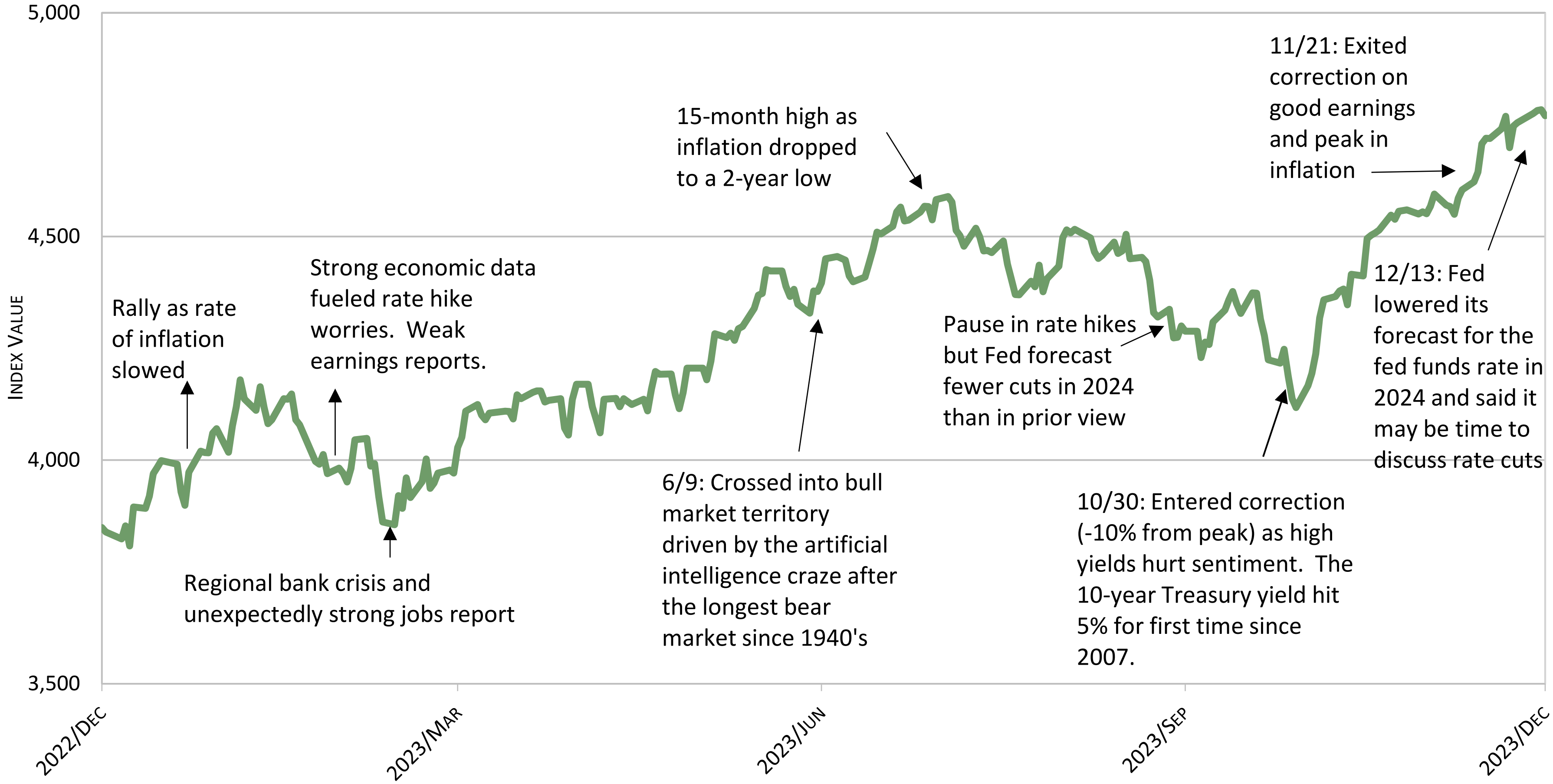
Fourth Quarter Highlights

The S&P 500 Rebounded in 2023 Despite a Banking Crisis and Decades High Interest Rates

Most major market moves in 2023 were related to inflation data along with changes in expectations for and actual Fed interest rate policy moves. The artificial intelligence boom and resilient economic data helped stock prices overcome worries such as the failure of certain regional banks. After an almost 20% drop in 2022, the S&P 500 ended 2023 within one percent of its all-time high set on January 2, 2022.

S&P 500 Index[1]



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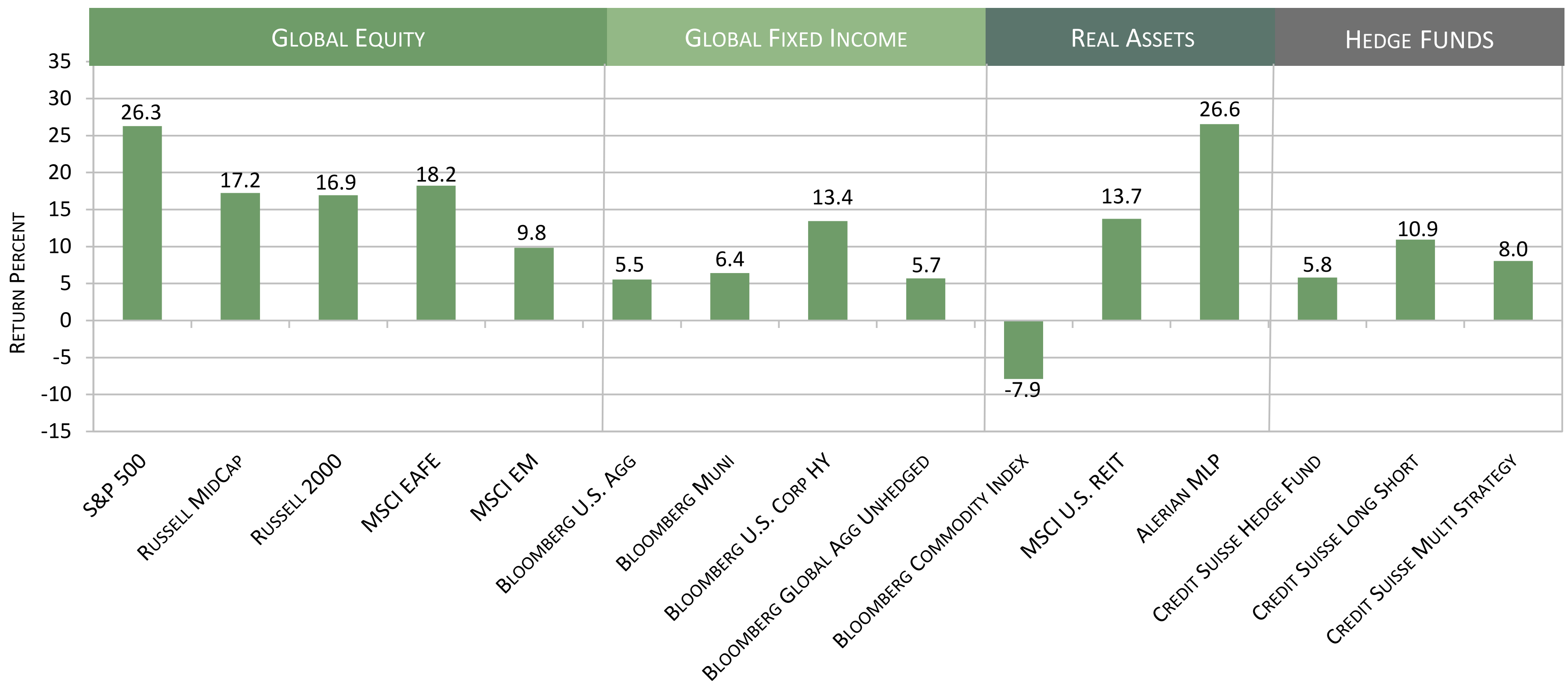
Fourth Quarter Highlights

Almost all asset classes posted strong gains in 2023

Equity prices rose reflecting resilient corporate earnings and excitement about the growth potential from artificial intelligence developments. Cooling inflation rates and expectations for interest rate cuts provided a boost to stocks and bonds. Weakness in the Chinese equity market caused the emerging markets equity index to lag developed market returns. Weakness in China was a main reason for the commodity index's negative return.

Market Returns: 2023[6]



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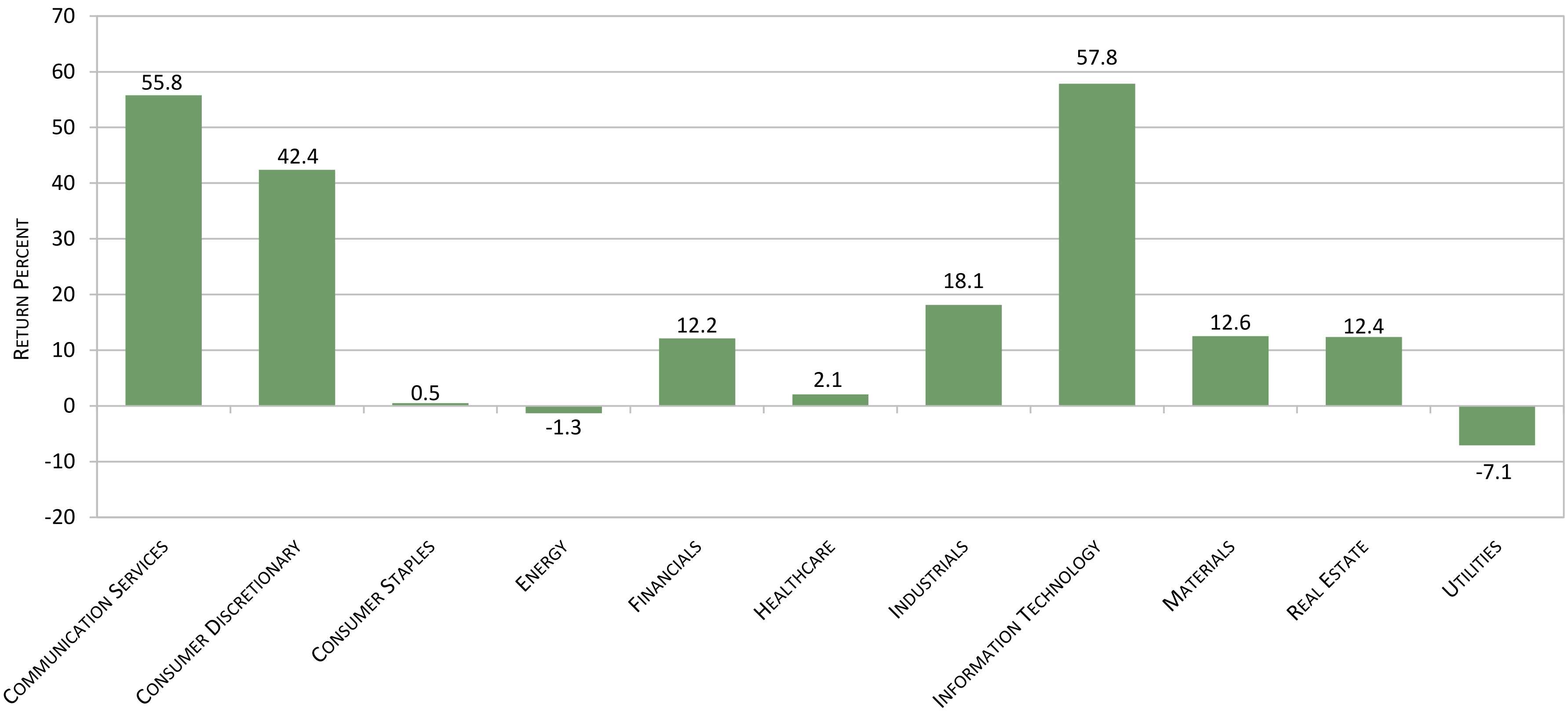
Fourth Quarter Highlights

The Magnificent Seven stocks drove three sectors to widely outperform for the year

The communications services, consumer discretionary, and information technology sectors gained the most in 2023 driven in large part by the expectations for an artificial intelligence boom led by stocks such as Microsoft, Nvidia, Meta, and Amazon. Cyclical sectors also had solid gains as the economy remained resilient. Defensive sectors lagged in the generally up trending market in 2023.

S&P 500 Sector Returns: 2023[6]



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Fourth Quarter Highlights

Stock, bond, and commodity returns reversed in 2023. MLPs led for the second year.

Calendar Year Returns[6]

Asset Class	2019	2020	2021	2022	2023
U.S. Large-cap Stocks	31.5%	18.4%	28.7%	-18.1%	26.3%
U.S. Small-cap Stocks	25.5%	20.0%	14.8%	-20.4%	16.9%
Foreign Stocks	22.0%	7.8%	11.3%	-14.5%	18.2%
Emerging Market (EM) Stocks	18.4%	18.3%	-2.5%	-20.1%	9.8%
U.S. Bonds	8.7%	7.5%	-1.5%	-13.0%	5.5%
Commodities	7.7%	-3.1%	27.1%	16.1%	-7.9%
REITs	25.8%	-7.5%	43.1%	-24.5%	13.7%
Hedge Funds	9.3%	6.3%	8.2%	1.1%	5.8%
Master Limited Partnerships (MLPs)	6.6%	-28.7%	40.2%	30.9%	26.6%

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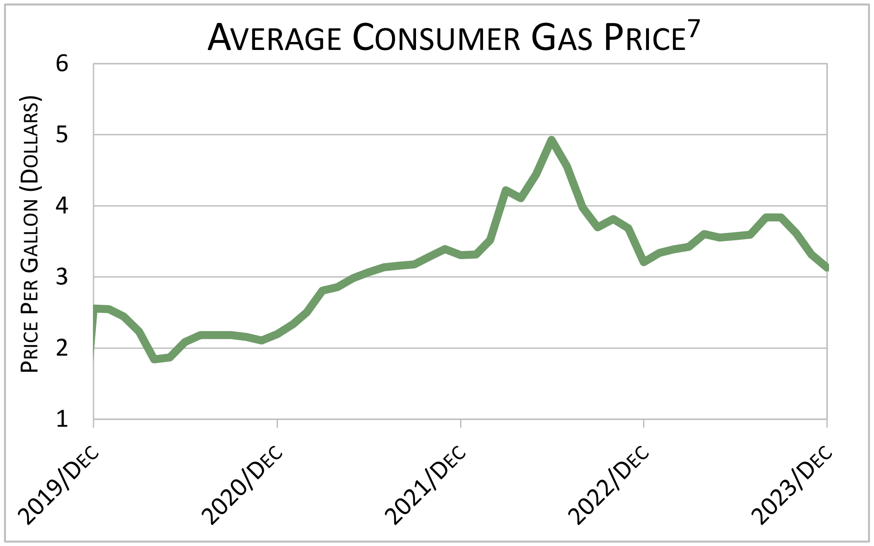
Outlook

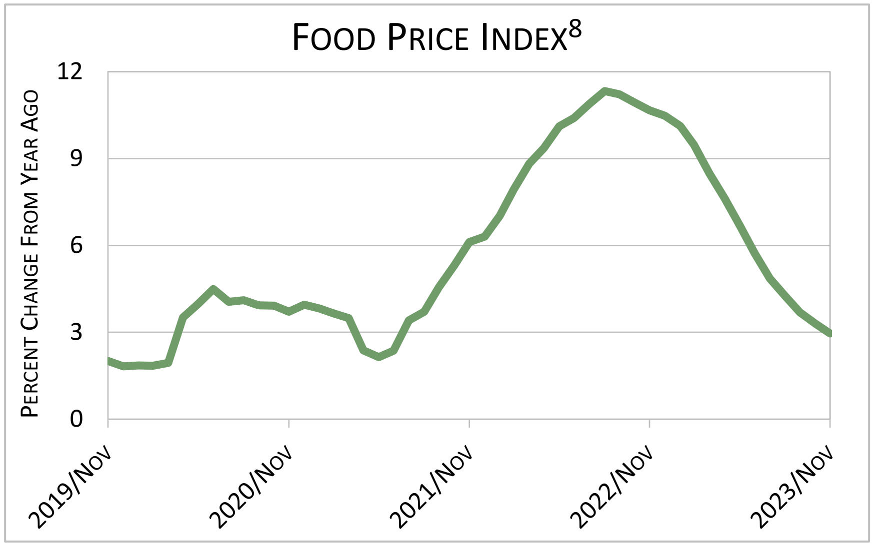
High valuations amid mixed economic conditions likely led to more up and down market moves

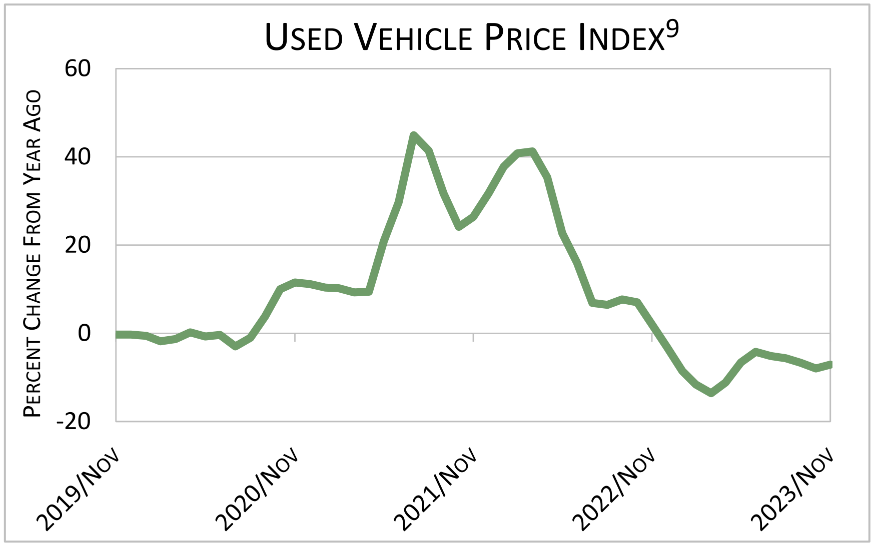
- The slowing rate of inflation is encouraging and likely means interest rate hikes are done. However, the cost of living and doing business remains elevated and interest rates remain higher than consumers and businesses have been accustomed to for many years. These factors could remain headwinds for consumer and business activity as well as a pressure on corporate profits. There are signs that the high costs are stretching some segments, such as rising credit card delinquencies and falling personal savings rates. In addition, the manufacturing sector has been in a contraction for 13 consecutive months. The labor market remains the key bright spot supporting consumer spending, which is the largest part of the economy. With the swift shift in sentiment and the dramatic market reaction in the last two months of 2023, financial market valuations may have gotten a bit ahead of actual fundamentals. Therefore, market participants will likely be focused on signs of a weakening labor market or pressure on corporate profits from reduced pricing power for downside risks or signs of benefits from declining rates of inflation and any rate cuts that actually occur for upside potential.
- These same conditions are in place outside the U.S. particularly in Europe. Japan and India are the primary exceptions where economic growth is stronger due to cyclical tailwinds, such as increasing tourism and exports.
- China's economy continues to be constrained by the debt problems in the property sector that are also dampening consumer sentiment. China's manufacturing sector, and increasingly the services sector, continue to struggle from lower demand due to geopolitical tensions and slowing global growth. The Chinese government has provided only minor stimulus actions to date but may be forced to ratchet up stimulus efforts to improve consumer sentiment and lower unemployment.

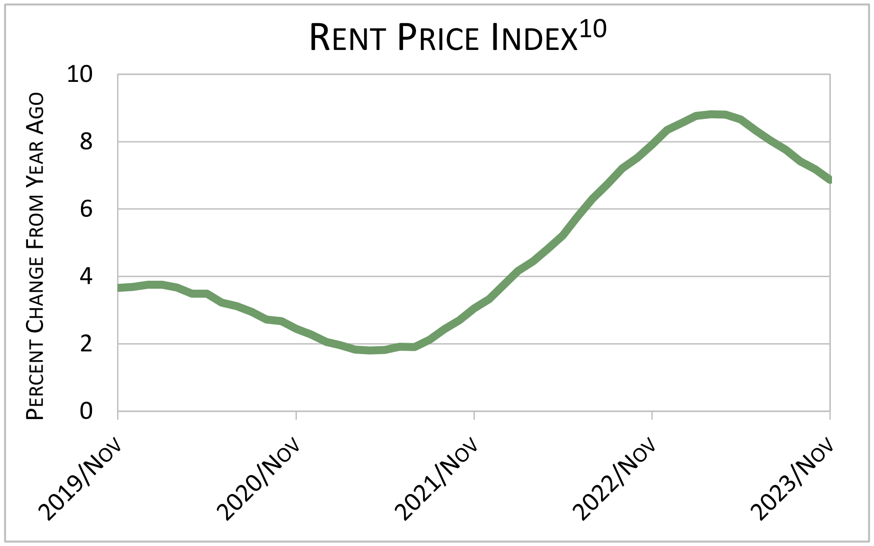
Outlook

Some prices are coming down easing inflation pressures in the U.S.









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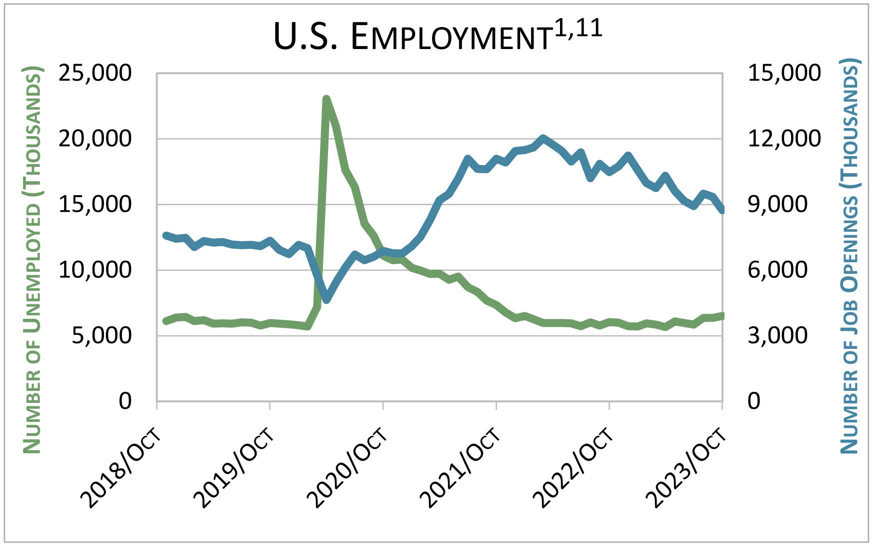
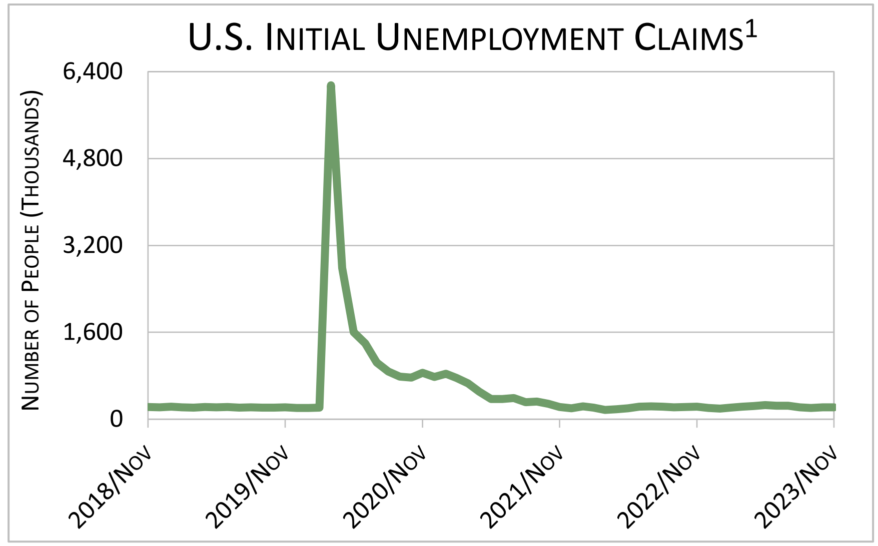
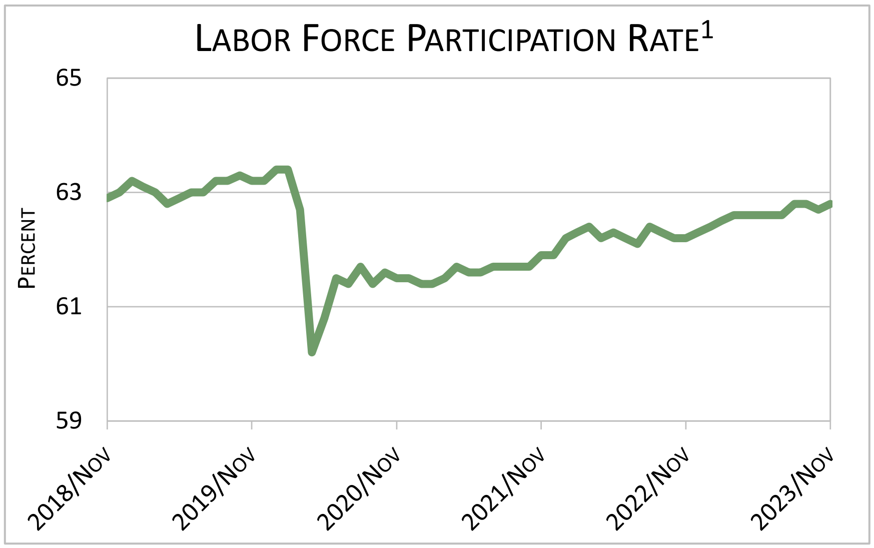
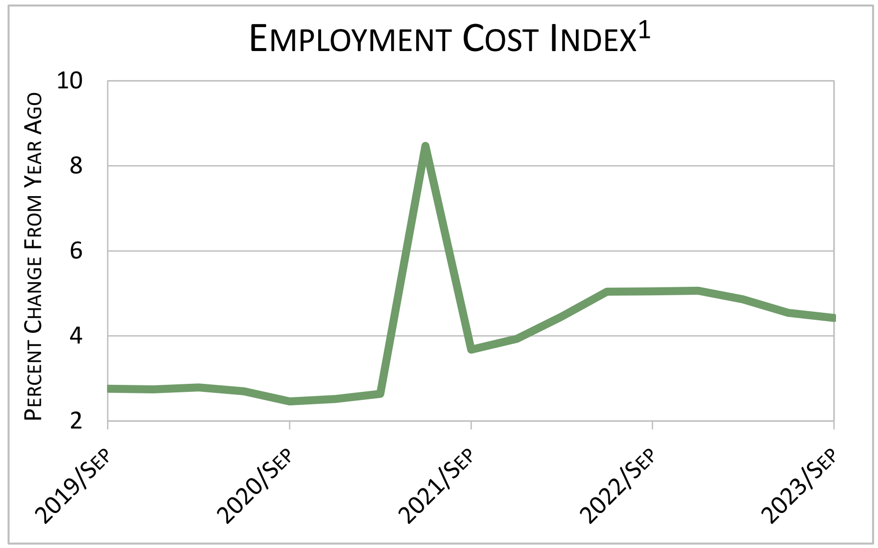
OUTLOOK

THE STRONG LABOR MARKET CONTINUES AS AN INFLATION RISK BUT SUPPORTS ECONOMIC GROWTH









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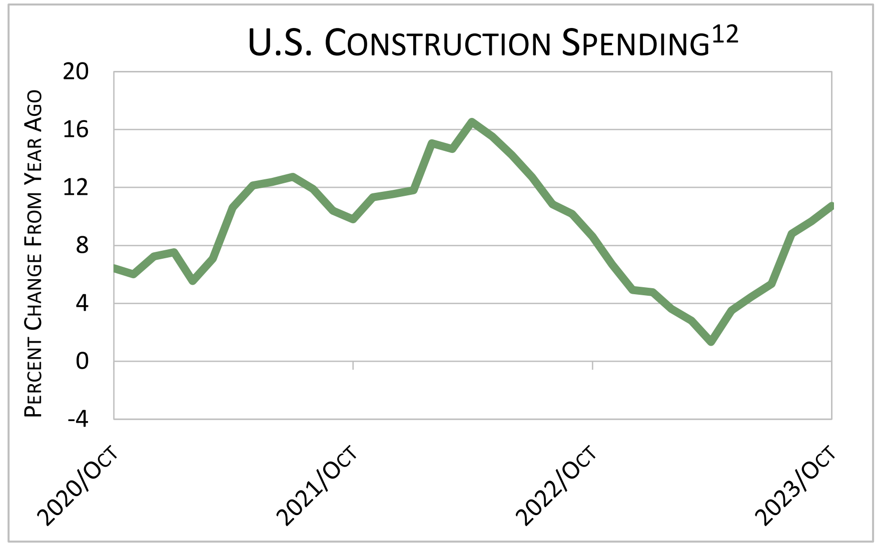
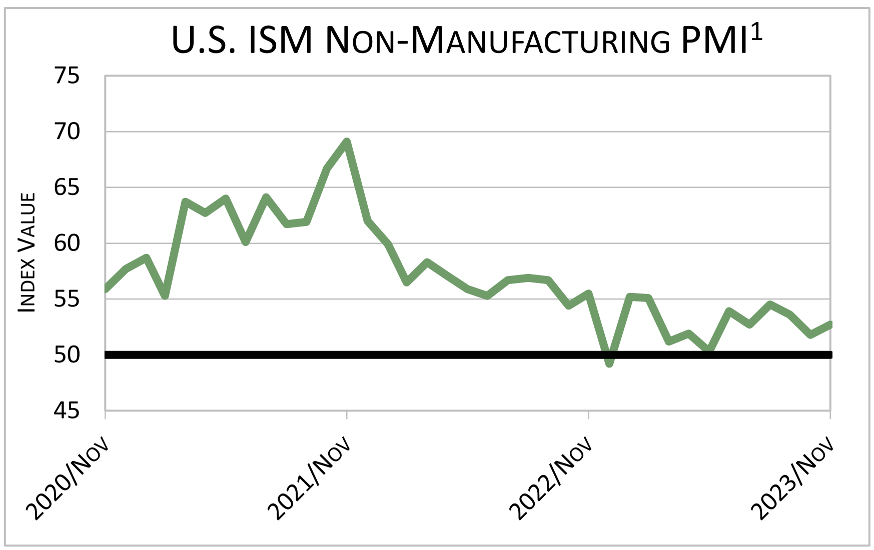
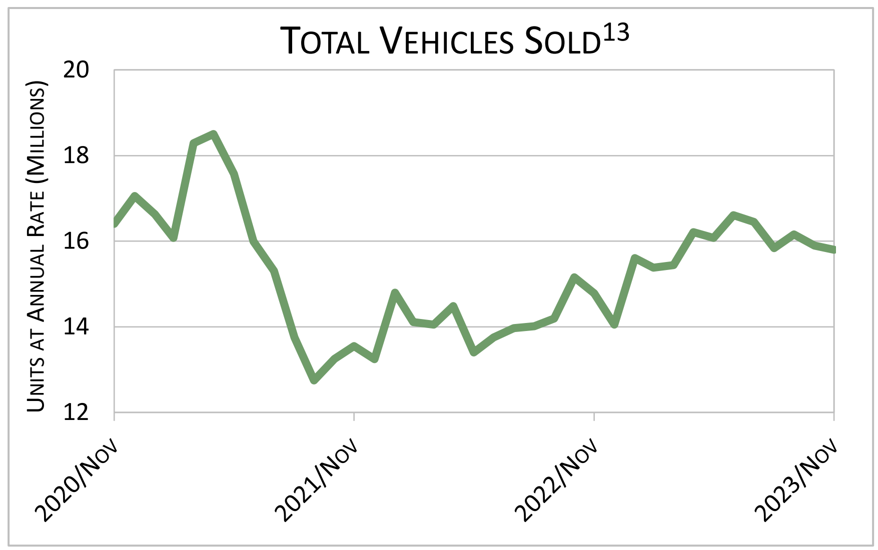
OUTLOOK

SOME ECONOMIC DATA IS SHOWING RESILIENCE LESSENING RECESSION RISK BUT COULD DELAY RATE CUTS







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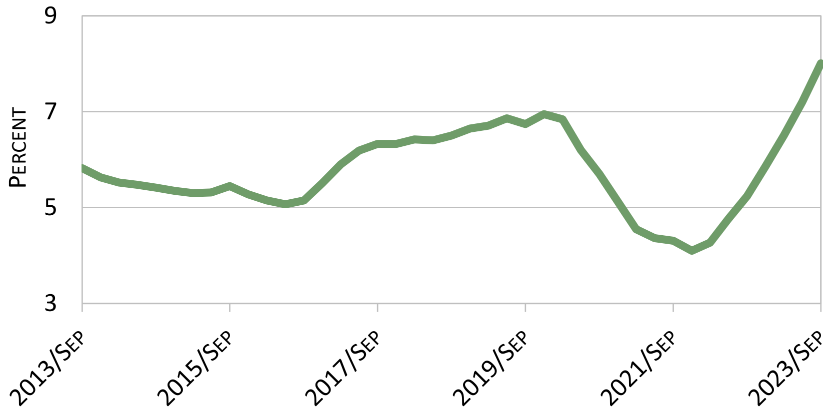
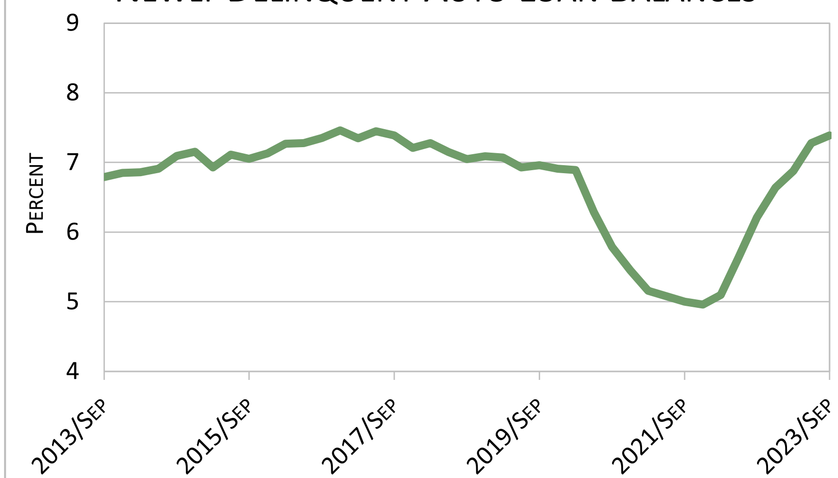
OUTLOOK

CONSUMERS MAY BE BECOMING STRETCHED EVEN WITH THE LOW UNEMPLOYMENT RATE

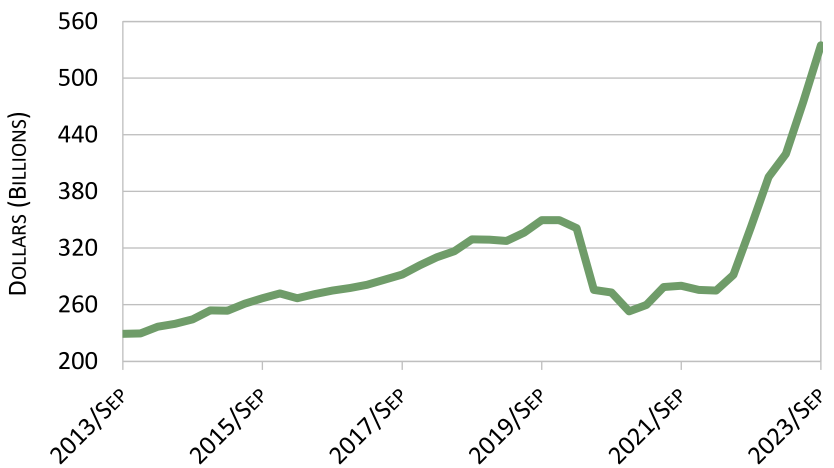
NEWLY DELINQUENT CREDIT CARD BALANCES[14]



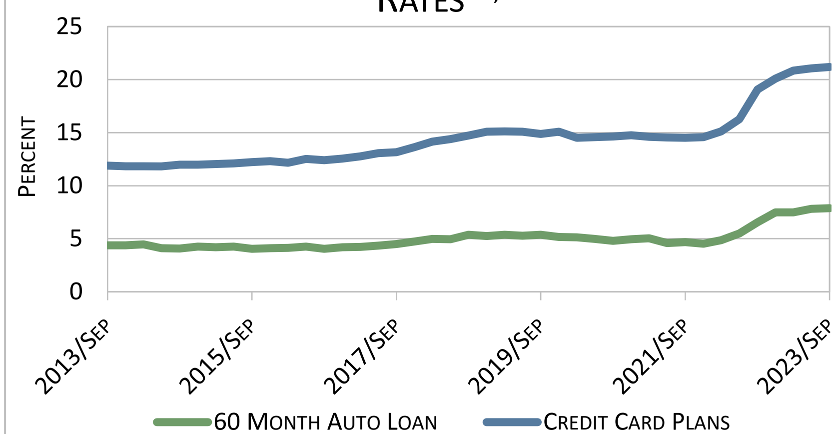
NEWLY DELINQUENT AUTO LOAN BALANCES[14]



QUARTERLY PERSONAL INTEREST PAYMENTS[15]



AUTO LOAN & COMMERCIAL CREDIT CARD RATES[16,17]



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Outlook

Worries persist that rates will remain too high when some business activity is slowing

Manufacturing activity in the U.S. was in contraction territory (under 50) for the 13th consecutive month. Importantly, new orders and backlogs also remained in contraction, pointing to softening economic activity.

U.S. ISM Manufacturing PMI[1]

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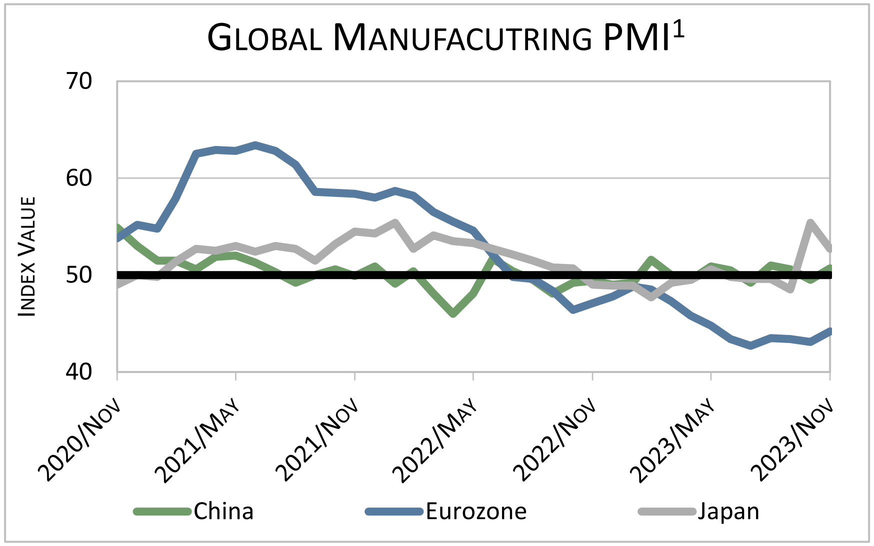
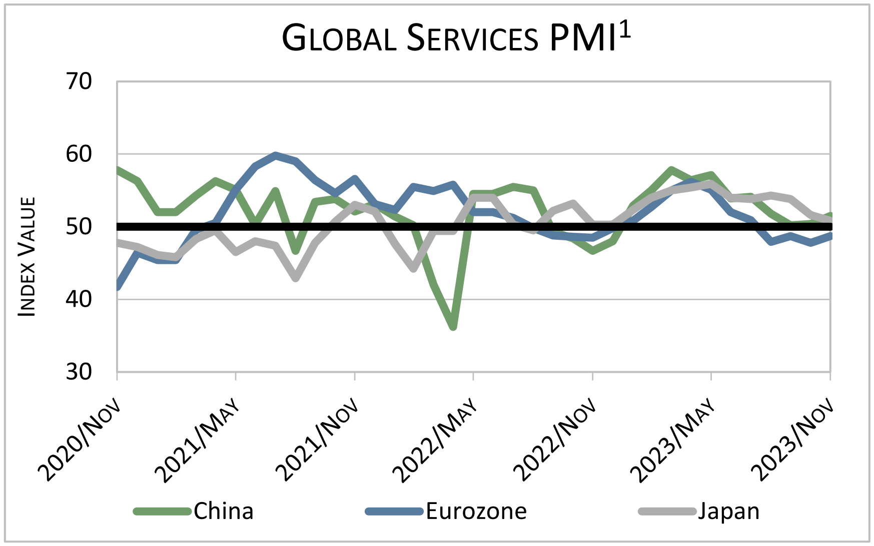
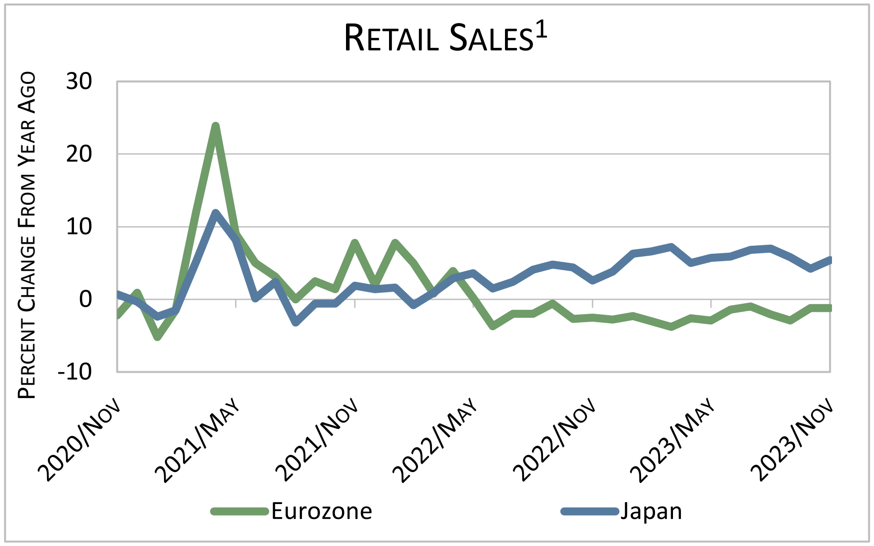
OUTLOOK

ECONOMIC DATA OUTSIDE THE U.S. IS MIXED

Business activity has been slowing in the eurozone hurt by weak demand for exports, high interest rates, and cuts in certain government subsidies. Manufacturing is slowing in China due to weak domestic demand and slowing exports. While services activity in China has been positive, it has been below expectations. Activity in Japan is still benefiting from accomodative monetary policy.







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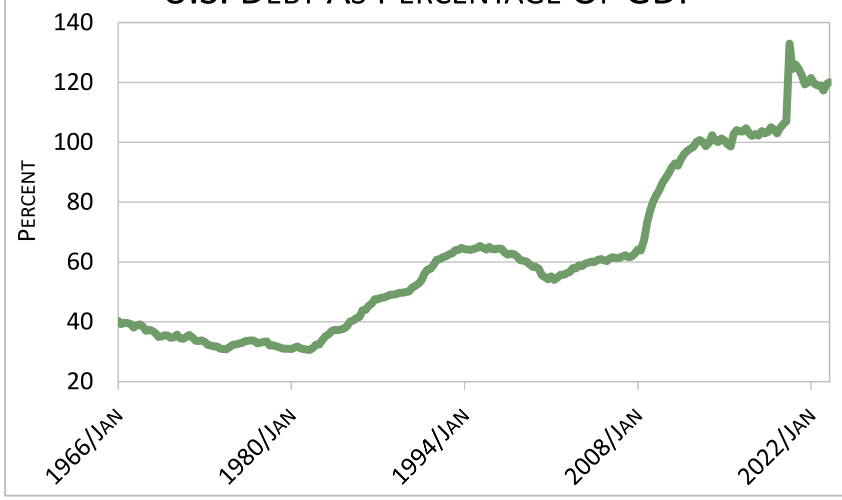
OUTLOOK

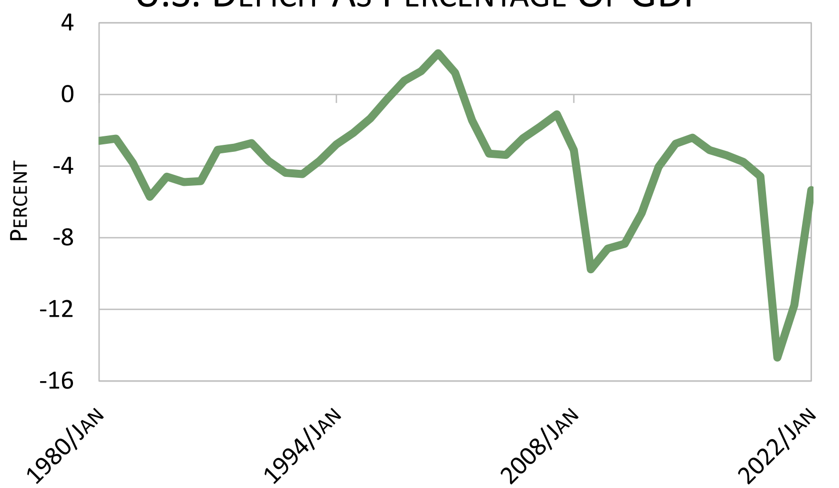
THE NEED TO FUND THE HIGH FEDERAL BUDGET DEFICIT COULD KEEP BOND YIELDS HIGH

The federal budget deficit is now more than 6% of gross domestic product (GDP), which is an historically high level especially when not in a recession. The Federal Reserve, a large and price insensitive buyer, is reducing its balance sheet so is buying fewer Treasury bonds at a time when bond issuance is increasing to fund deficit spending. Some foreign buyers, such as China, are buying less also. Will yields need to stay high to attract enough buyers? The answer to this question has long-term implications since high yields impact stock prices as well as consumer and business activity.

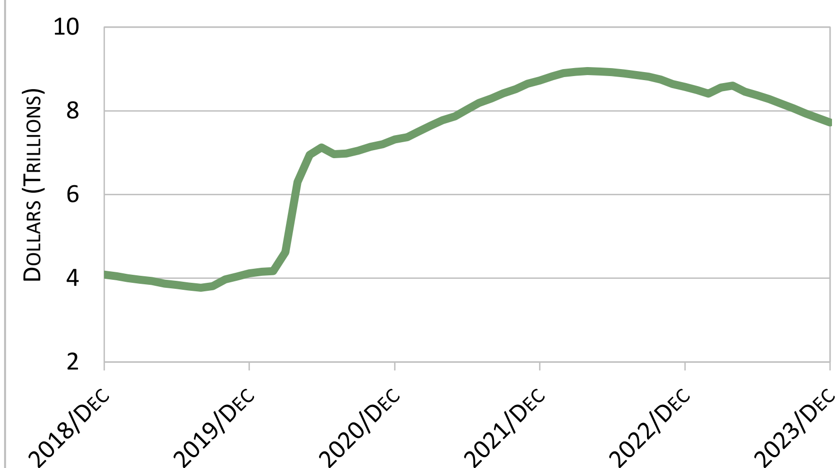
U.S. DEBT AS PERCENTAGE OF GDP[18]



U.S. DEFICIT AS PERCENTAGE OF GDP[19]



FEDERAL RESERVE BALANCE SHEET ASSETS[20]



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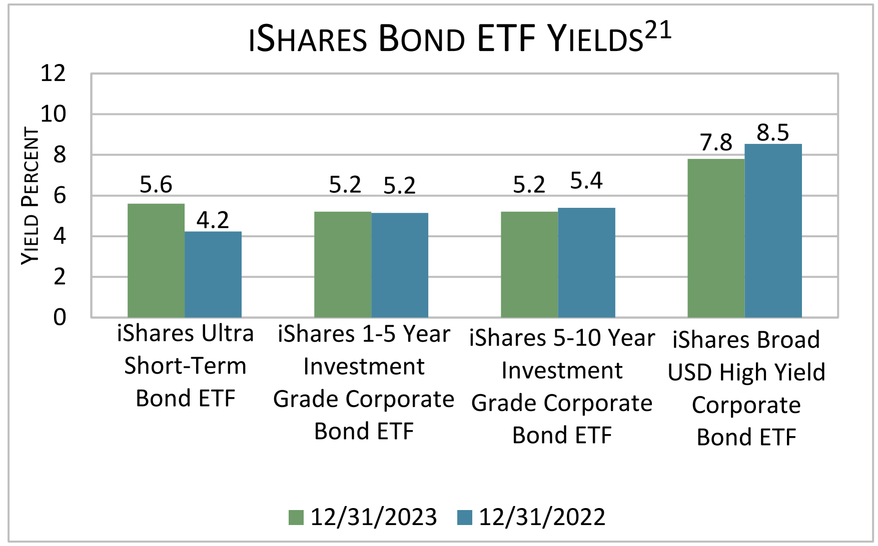
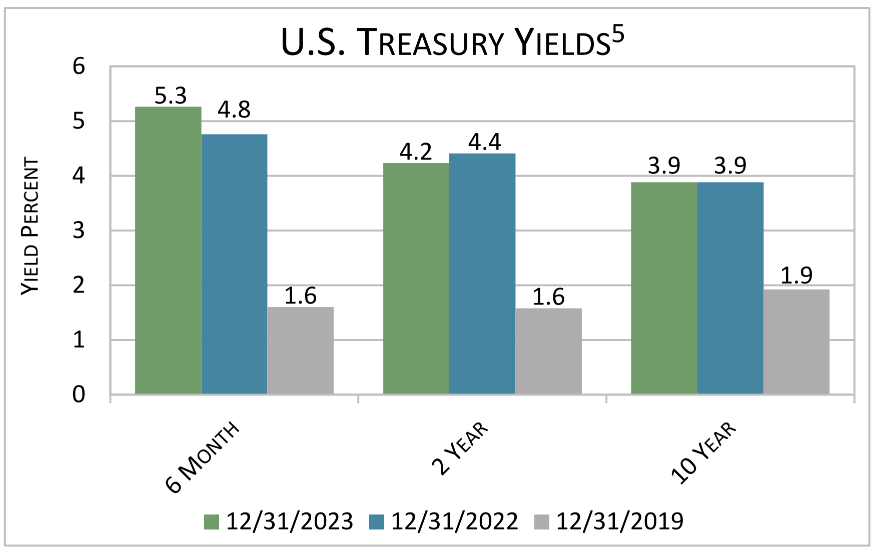
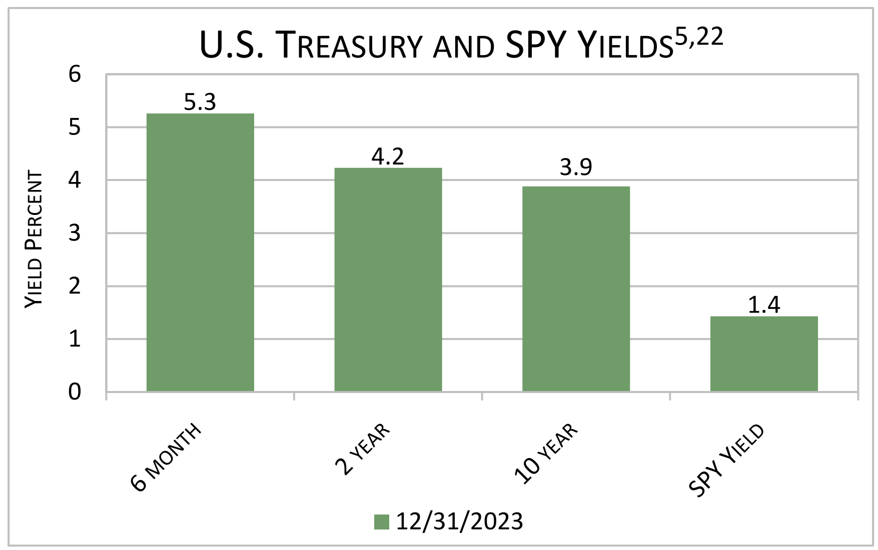
Outlook

Short-term and intermediate fixed income yields are attractive

Bond yields remain attractive relative to yields available in recent years and compared to dividend yields. The dividend yield on the S&P 500 index exchange traded fund (SPY) is only 1.4%.







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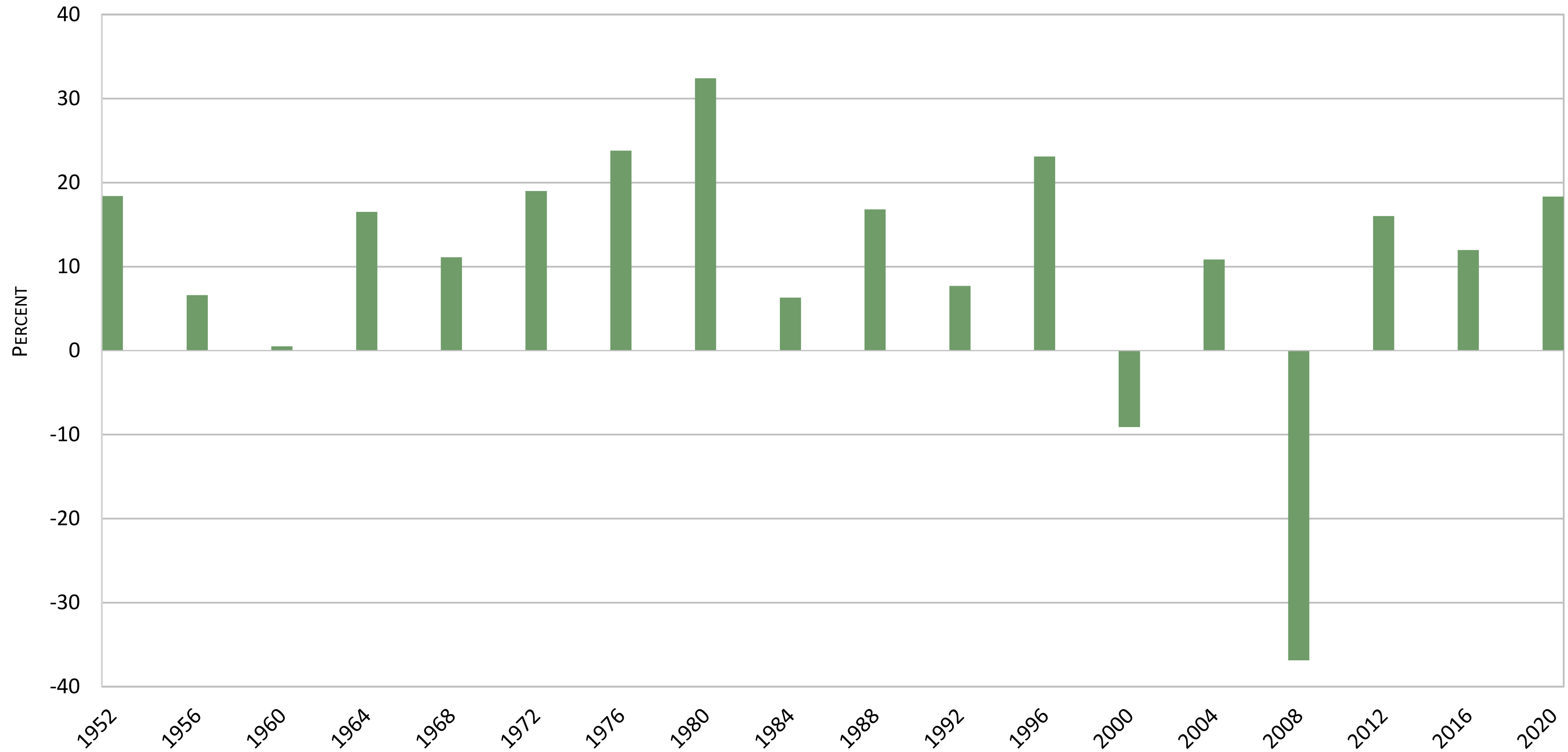
Outlook

The return for the S&P 500 index has typically been positive in a presidential election year

S&P 500 Return in Election Years[1]



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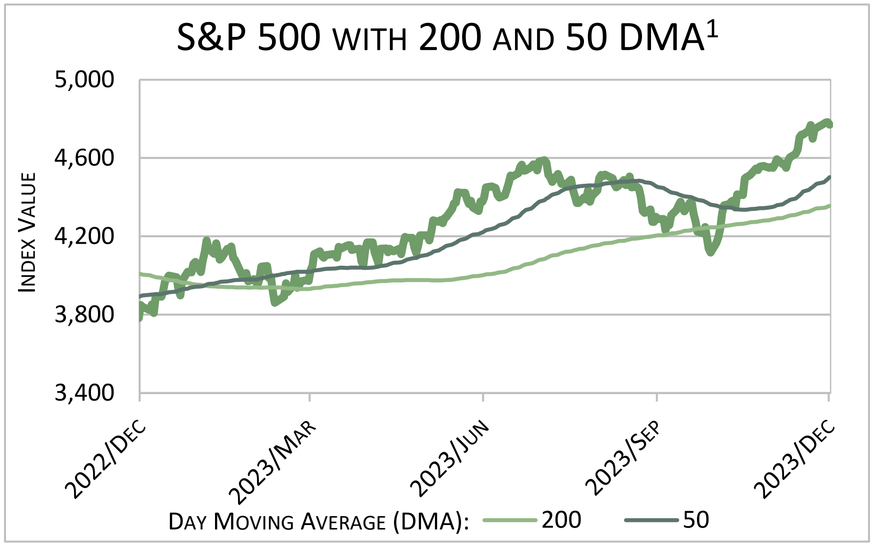
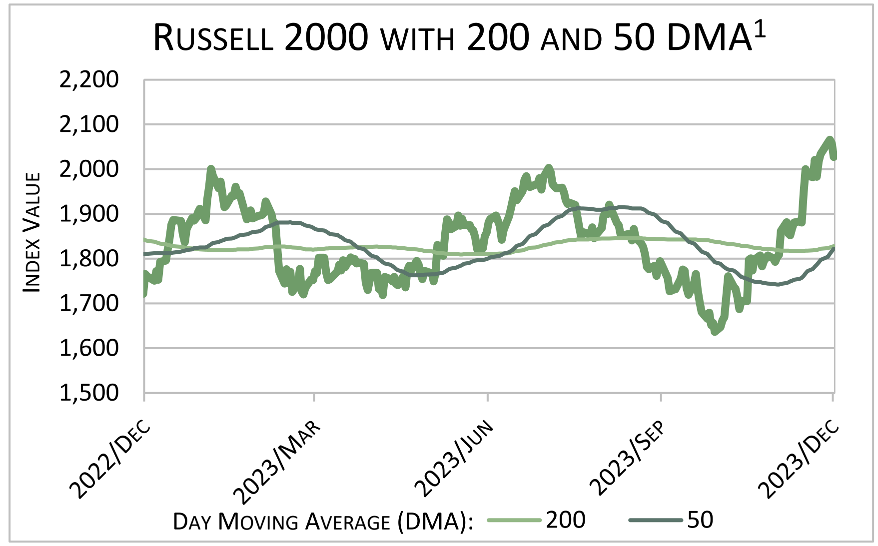
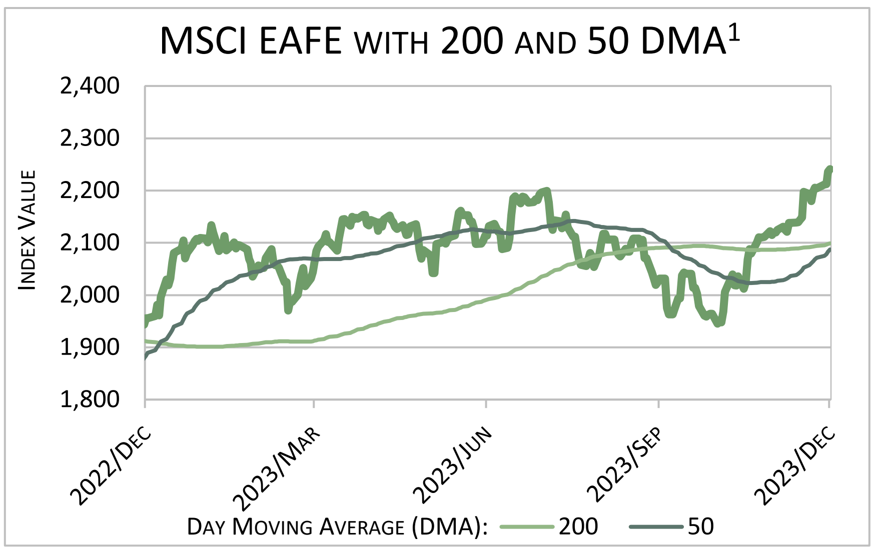
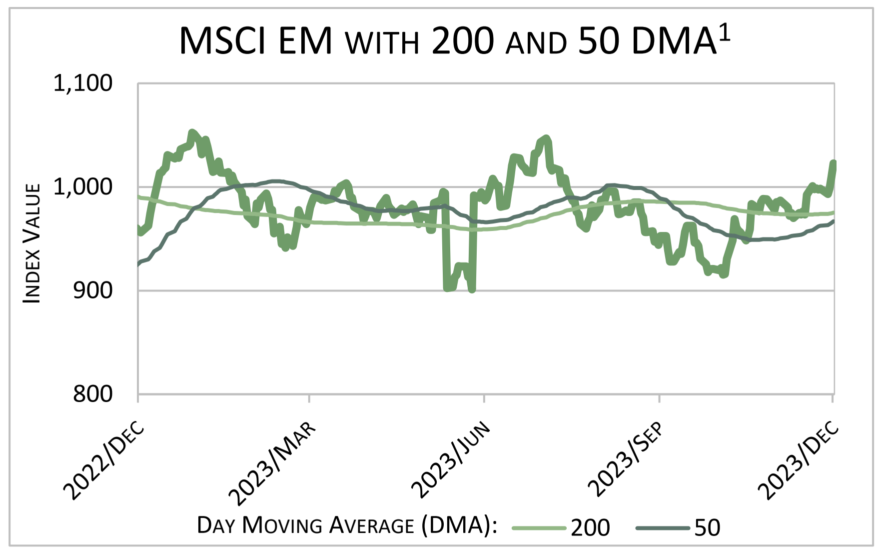
Outlook

Technical indicators are bullish but sentiment indicators point to overbought levels









Vogel Consulting

Vogel Tactical Recommendations

Fixed income yields are attractive. Slower growth a risk to equities. Overweight cash.

Asset Class	Action	Commentary
Domestic Large-Cap Equity	Equal weight	Prices could be pressured if earnings growth slows hurt by the impacts of inflation, high interest rates, and tighter lending. Valuations high.
Domestic Mid-Cap Equity	Equal weight	Prices could be pressured if earnings growth slows hurt by the impacts of inflation, high interest rates, and tighter lending. Valuations more attractive than for large-cap.
Domestic Small-Cap Equity	Equal weight	Wider than average valuation gap with large-cap stock but also higher risk to margins and growth opportunities from increasing cost of financing. Signs of slowing growth could mean wider price swings for small-cap than large-caps.
International Developed Equity	Equal weight	Inflation is slowing so likely rate hikes are done but growth could be subpar since weakness in exports is likely to continue in certain industries. Valuation discount to U.S. stocks. A weakening dollar could boost returns to U.S. investors.
International Emerging Market Equity	Underweight	Weak Chinese economy continues to be a risk. Positives are lower valuations than U.S. markets, catalysts for growth in various regions from moves to diversify supply chains, and rate cycles have peaked. A weakening dollar could provide a boost to returns.
Fixed Income	Equal weight	Yields are the highest in several years so are a source of income and diversification. Could be some price appreciation if the fed cuts rates.
Hedge Strategies	Underweight	The flexibility to position for various risk scenarios can provide return opportunities, but rapid and sharp market swings can be challenging for some strategies. Opportunity set for distressed investing strategies may be improving.
Real Assets	Equal Weight	Attractive dividend yields offer inflation protection. Declining interest rates and low valuations make certain real estate assets attractive.
Cash	Overweight	Keep reserves for liquidity needs since periods of volatility are a risk if consensus expectations are not met. Yields are attractive.

DISCLOSURES

Important Disclosures:
This report is being provided to you for your review and consideration and does not constitute a recommendation to purchase, sell or hold any security, and should not be construed as investment advice. Past financial performance is no guarantee of future results.

The statistical information contained in this report was derived from sources that Vogel Consulting LLC (Vogel) believes are reliable, and such information has not been independently verified by Vogel. The information contained in this report represents the opinion of the author(s) as of its date and is subject to change at any time due to market or economic conditions.

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