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FOURTH QUARTER MARKET REVIEW

A Year of Surprises..... Now What?

2023 will go down as a very strong year for stock markets and also a positive return year for bond investors. The big stories of 2023 included: the battle against inflation, the no-recession surprise, and the performance of the "Magnificent Seven."

Inflation was the biggest driver of markets, both stocks and bonds, in 2023. The battle to calm inflation levels not seen since the 1980s created a high level of scrutiny regarding the actions of the U.S. Federal Reserve. Stocks were rallying aggressively off a very negative 2022 as inflation data seemed to begin cooling. Then, summer and fall 2023 had a period of stasis in inflation trends along with continued aggressive commentary from the Federal Reserve. By the end of October this led to a stock market correction and a bond market in negative territory for the year. Then, everything changed. Inflation levels continued to decline, and the Federal Reserve had a pivot in commentary that provided investors with confidence that interest rates were more likely to fall, rather than rise, in the future. This led to a furious rally in November and December for both stocks and bonds.

Second, the surprise of continued economic growth contributed to the positive market performance in 2023. At the end of 2022, there was broad consensus that the U.S. economy was likely to experience a recession in the next 12 months. Economists were pointing to the inverted yield curve, the aggressive actions of the Fed to slow inflation and the economy, and the negative performance of the market in 2022 as

signs of pending recession. Instead, U.S. GDP not only didn't contract, but growth accelerated as employment demand remained robust and consumer spending was resilient.

Third, the extremely positive performance of the "Magnificent Seven" was a significant driver to overall stock performance in 2023. The "Magnificent Seven" are very large U.S. growth stocks: Apple (AAPL), Microsoft (MSFT), Amazon (AMZN), Alphabet (GOOGL), Meta (META), Tesla (TSLA), and NVIDIA (NVDA). The importance of these stocks was two-fold. First, their relative size in the S&P 500 is significant and their performance had an outsized impact on the index performance. Second, these stocks all rebounded from a difficult 2022 and increased significantly in 2023, with some even doubling in price over their end of 2022 levels. As a result, these seven stocks drove a substantial amount of the overall S&P 500 performance in 2023, while the average performance of stocks outside this group was less robust.

As we enter 2024, the big question investors are facing is "can we keep this going?" It is human nature, especially given the see-saw nature of the markets in the last two years, to believe hard times are coming based only on the good performance we had in 2023. This is not a certainty. Stock market rallies can last significantly longer than anticipated, and performance can be positive even coming off a high performing market the year prior. When we look to bond and stock markets in 2024, we continue to look at economic and business fundamentals to drive our decisions.

On the economy, many recessionary indicators used in the past remain in place today. The yield curve is still inverted (short-term rates are higher than long-term rates) and leading economic indicators suggest a higher probability of recession. The biggest difference between the beginning of 2023 and 2024 is sentiment. Last year, economists were convinced of a pending recession – now the outlook is more mixed with some suggesting that we can avoid a recession altogether. Our current baseline assumption is a slowing economy with a lower probability of a mild recession. Currently, we do not see a reason for significant contraction in the U.S. economy.

We believe that jobs are still the key. A U.S. consumer that feels good about keeping their job, or finding a new one, will continue to spend

money. Consumer spending is the lifeblood of our economy. It is our expectation that U.S. jobs will remain relatively healthy, but we do expect a higher unemployment rate in 2024. Even a moderate increase in unemployment only gets us back to long-term averages (we have very low unemployment now) and we do not expect significant job loss in 2024 like we saw in 2008 or 2020.

We believe inflation is on the path to normalization and will be less of a story in 2024. We don't see a real reason for a dramatic re-rise of inflation, but we would caution investors to understand that it could happen. Based on the inflation rate falling, we expect the Federal Reserve is done raising interest rates, but we also believe the current expectations regarding the level of interest rate declines may be too aggressive. We only see the Fed making aggressive downward rate movements as a result of worsening economic trends, and we are not calling for that currently.

For bond investors, a positive year (albeit a very volatile year) for bond performance was welcomed after a very difficult 2022. While interest rates have fallen from the highest levels in fall 2023, bond yields still remain relatively attractive for long-term savers and are certainly higher than the zero-interest rate world we were living in prior to 2022. Bond market volatility has been extraordinarily high since 2022; unfortunately, we don't see this changing in 2024 as investors continue to monitor the economy and Fed actions closely.

For stock investors, we follow corporate earnings growth as the primary driver of long-term returns. Right now, corporations are discussing pockets of slowing, but we aren't seeing widespread declines in their earnings estimates or in their outlooks. The January 2024 earnings reports usually provide insight into how companies are positioning for the upcoming year, and we will monitor these items closely. As we see it now, we believe current expectations of double-digit earnings growth may be too high. We believe a mid-to-high single digit growth level is achievable and that would be a positive backdrop for stocks. From a valuation perspective, or what we are paying for stocks right now, the S&P 500 is slightly elevated versus historical long-term averages. Valuation tells us little about short-term market performance – cheap can always get cheaper and expensive can always get more expensive. Over longer-term periods, however, what you pay for stocks matters. So, while stocks are

not cheap, we believe that they are at levels that could continue to provide positive performance for investors in 2024.

With all this said, we know only one thing with near certainty: markets will change and some of these baseline assumptions will be proven wrong. We also have several known catalysts for change including continued geopolitical conflicts with uncertain endings and an upcoming U.S. presidential election. These will no doubt have an effect on short-term market performance as sentiment ebbs and flows. Lastly, it's the unknowns that spring up that usually create the most consternation about the future trends in markets.

Markets are extraordinarily difficult to predict with perfect accuracy. Understanding this is why we are advocates of planning for the long-term and being prudent with asset allocations. We believe in having a well-defined investment plan that is based on the goals of your money, the time required to get there, and an investor's tolerance for risk.

Diversification can make one feel foolish in the short term – safe assets were underperformers in 2023 and growth assets looked terrible in 2022 – but diversification among safe and growth assets that fit your investment plan allows investors to stay invested and remain flexible to the opportunities that stock and bond markets can provide over time. These actions do not require prediction, but rather plan for the unforeseeable events that do, and will, occur during your investment lifetime.

Markets By The Numbers					
US Stocks			Bonds		
	1m Returns	Last 12m Returns		1m Returns	Last 12m Returns
S&P 500 Index	4.54%	26.29%	Bloomberg Barclays Aggregate Index	3.83%	5.53%
Dow Jones Index	4.93%	16.18%			
Nasdaq Composite	5.58%	44.64%	Interest Rates		
Russell 2000 Index (US Small Cap)	12.22%	16.93%		Current Rate	Rate 1 yr Ago
			2yr US Treasury	4.23%	4.41%
			10yr US Treasury	3.88%	3.88%
International Stocks			Alternatives		
	1m Returns	Last 12m Returns		1m Returns	Last 12m Returns
MSCI EAFE (Intl Developed)	5.31%	18.24%	Gold	1.02%	13.09%
MSCI EM (Emerging Markets)	3.91%	9.83%	U.S. Real Estate	8.86%	11.36%

Data as of 12/31/2023. Following Data Sourced from Morningstar: S&P 500 Index represents S&P 500 Total Return, Dow Jones Index represents Dow Jones Industrial Index, Nasdaq Composite represents NASDAQ Composite Total Return, Russell 2000 Index (US Small Cap) represents Russell 2000 Total Return, MSCI EAFE (Intl Developed) represents MSCI EAFE Net Return, MSCI EM (Emerging Markets) represents MSCI EM Net Return, Bloomberg Barclays Aggregate Index represents Bloomberg Barclays US Aggregate Total Return, Gold represents LBMA Gold Price AM USD, U.S. Real Estate represents FTSE Nareit All Equity REITs Total Return. Following Data sourced from Treasury.gov: 2yr US Treasury represents 2yr Treasury Rate, 10yr US Treasury represents 10yr Treasury Rate.