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Annual Market Insights & Looking Ahead

The Blockbuster Year Few Expected

A Wall Street Journal article titled "What Did Wall Street Get Right About Markets This Year? Not Much" did a good job summarizing the year.

In December 2022, Moody's Chief Economist Mark Zandi captured the prevailing sentiment at the time.

"Usually, recessions sneak up on us. CEOs never talk about recessions," Zandi said. "Now it seems CEOs are falling over themselves to say we're falling into a recession. ... Every person on TV says recession. Every economist says recession. I've never seen anything like it."

Stock Indices	Q4 2023 Return %*	2023 Return %
S&P 500 (large)	11.69%	26.29%
S&P 400 (midsize)	11.67%	16.44%
Russell 2000 (small)	14.03%	16.93%
MSCI EAFE (intl.)	10.47%	18.85%
Bond Yields	**12/29/2023 Yld. & Qtr. Change**	**December 31, 2022 Yield**
3-month T-bill	5.40% (-0.15%)	4.42%
2-year Treasury	4.23% (-0.80%)	4.41%
10-year Treasury	3.88% (-0.71%)	3.88%
30-year Treasury	4.03% (+0.70%)	3.97%
Commodities	**12/29/2023 Price & Qtr. Change**	**Dec. 31, 2022 Price**
Oil per barrel	$71.65 (-$19.14)	$80.26
Gold per ounce	$2,071.80 (+$205.70)	$1,826.20

*Stock indices include reinvested dividends and are not annualized.

In the absence of a profit-killing recession, a moderation in Fed rate hikes, and a growing interest in artificial intelligence, the Dow Jones Industrials reached a new all-time high in 2023, while the S&P 500 Index ended the year just shy of a record. Concerns about potential market disruptions following the failure of Silicon Valley Bank were unfounded.

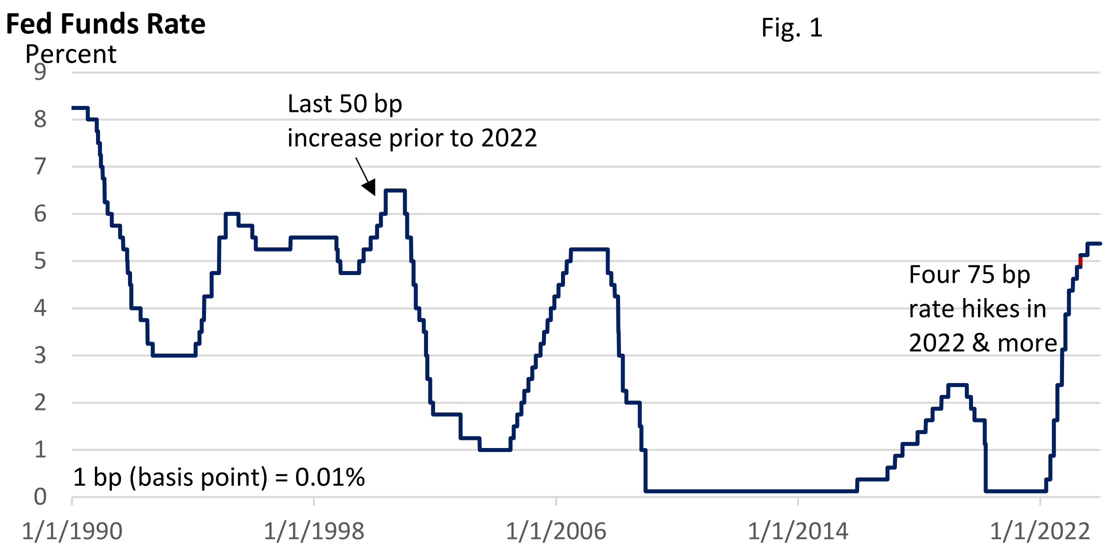
Recession MIA

Projecting turning points in any economic cycle is difficult, and it is not unusual for economists to miss their targets.

Economic models are complex, and each cycle has its own unique characteristics. Only in hindsight do we usually identify them. Without the foresight to recognize the emergence of new economic influences, economic forecasting models can provide false signals.

The Fed Shifts Its Stance

The economic story of 2022 was high inflation and sharply higher interest rates. Both punished stocks. In 2023, the rate of inflation began to slow, and the Fed adjusted its response, raising rates by a total of one percentage point compared to 4.25 percentage points in 2022 – Figure 1.



Data Source: St. Louis Federal Reserve 12/29/2023
Starting 12/16/2008, graphic represents the middle of a 25 bp range for the fed funds rate.

Rate hikes are probably over. While forecasts can change, the Fed projected a total of 75 basis points in rate cuts in 2024 (i.e., 0.75%) when it released its quarterly Economic Projections in December.

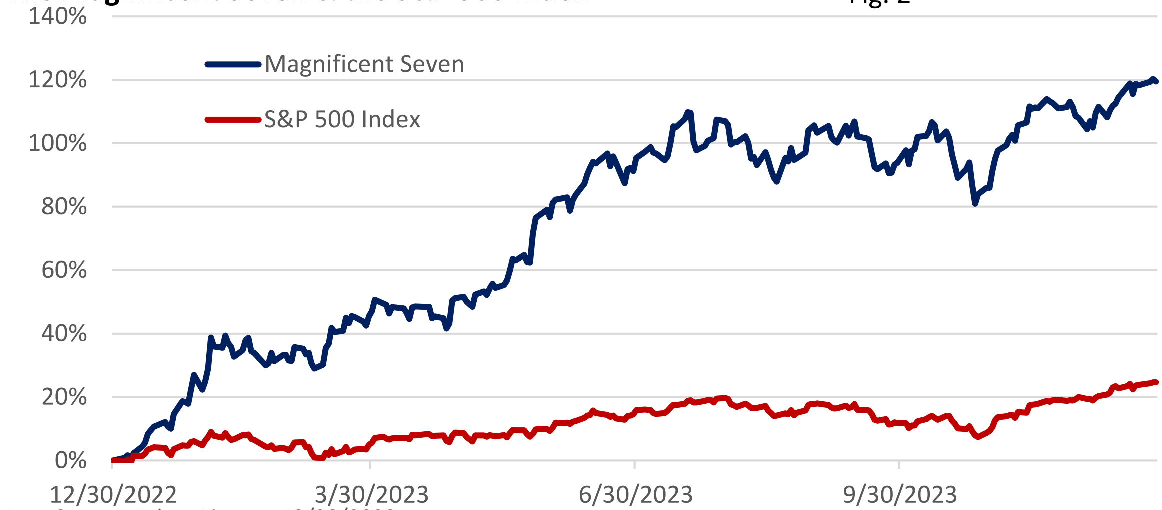
The Magnificent Seven

Not all rallies are created equal.

Coined the "Magnificent Seven" by a Bank of America analyst, Microsoft (MSFT), Amazon (AMZN), Meta Platforms (META, formerly Facebook), Apple (AAPL), Alphabet (GOOG, formerly Google), Nvidia (NVDA), and Tesla (TSLA) significantly outperformed as Figure 2 illustrates. Combined, they returned approximately 111% in 2023.

Collectively, they accounted for about 60% of the performance of the S&P 500 Index. Excluding those seven stocks, the S&P 500's advance would have been almost 11% instead of the 26% return of the total index. In addition, these 7 stocks currently represent approximately 30% of the S&P 500's total market value, which emphasizes their oversize influence on the index.

The Magnificent Seven & the S&P 500 Index Fig. 2

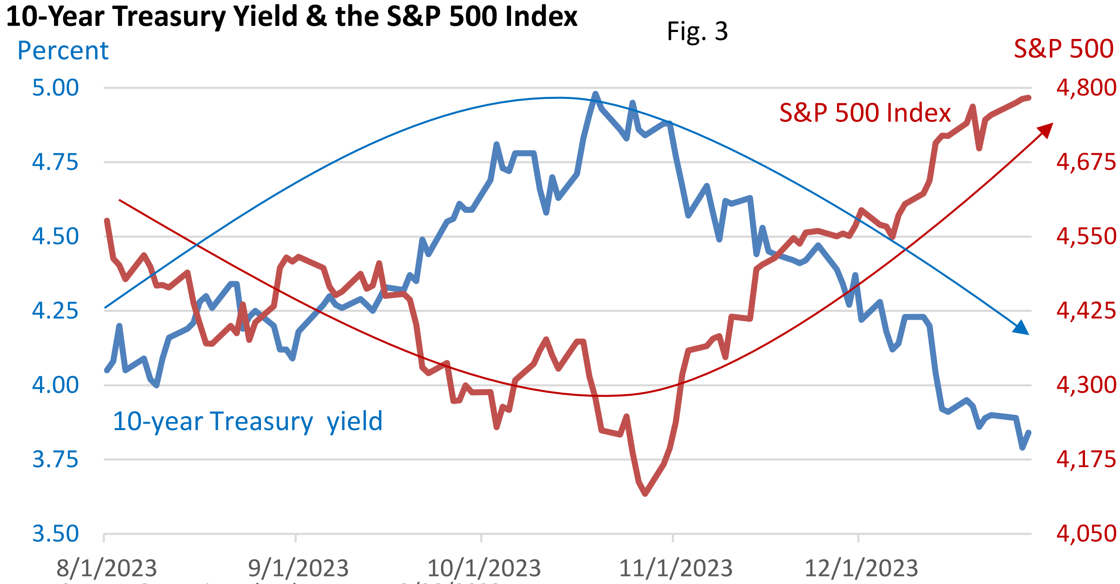


Data Source: Yahoo Finance 12/28/2023
Magnificent Seven and S&P 500 returns do not include reinvested dividends.
The S&P 500 Index is an unmanaged index that cannot be invested into directly.
Past performance is no guarantee of future results.

Yields Turn the Wheels

Figure 3 demonstrates that bond yields have played a crucial role in driving the stock market over the past five months. As yields increased from August into late October, the S&P 500 Index pulled back about 10%. Following the peak in yields, the market rallied.

10-Year Treasury Yield & the S&P 500 Index Fig. 3



Data Source: St. Louis Federal Reserve 12/28/2023
Past performance is no guarantee of future results.

Over time, however, these correlations usually break down.

Treasuries are sometimes viewed as a safe haven in times of economic uncertainty. Treasury bond prices and yields move in the opposite direction, so falling yields simply mean bond prices are rising.

If yields decline too quickly, investors may start to fret over a potential economic slowdown, creating headwinds for stocks.

The preferred scenario for investors is one where economic growth is slow enough to keep inflation in check but not so slow as to noticeably hamper corporate profit growth.

This would likely allow the Fed to slowly reduce rates because it "can," not because the economy slips into a recession and it "must."

A New Year

We have access to the brightest minds on Wall Street. But is it always wise to seek their counsel?

At the end of 2022, many strategists were pessimistic about the upcoming year of 2023. Analysts, on average, were predicting a small decline of about 2% in the S&P 500 Index, according to Bloomberg.

2023 was not the first time the consensus was wrong, nor was it a rare miss. The median annual Wall Street forecast between 2000 – 2020 missed the mark by an average of 12.9 percentage points (CNBC/NY Times).

Notably, last year was the first time that analysts predicted a market decline during the 2000s.

Over the long term, stocks have a solid track record, but progress is uneven. Downturns are to be expected. According to data from Macrotrends, the S&P 500 Index (excluding reinvested dividends) has finished lower (on an annual basis) seven times since 1999.

Market weakness was predicated on a 2023 recession that failed to materialize.

However, let us not completely discount commentary. Strategists bring unique observations to our attention. We are better informed due to their diligence and insights.

They really are brilliant men and women. They grapple with the unknown, however, and no one knows precisely how the future will unfold.

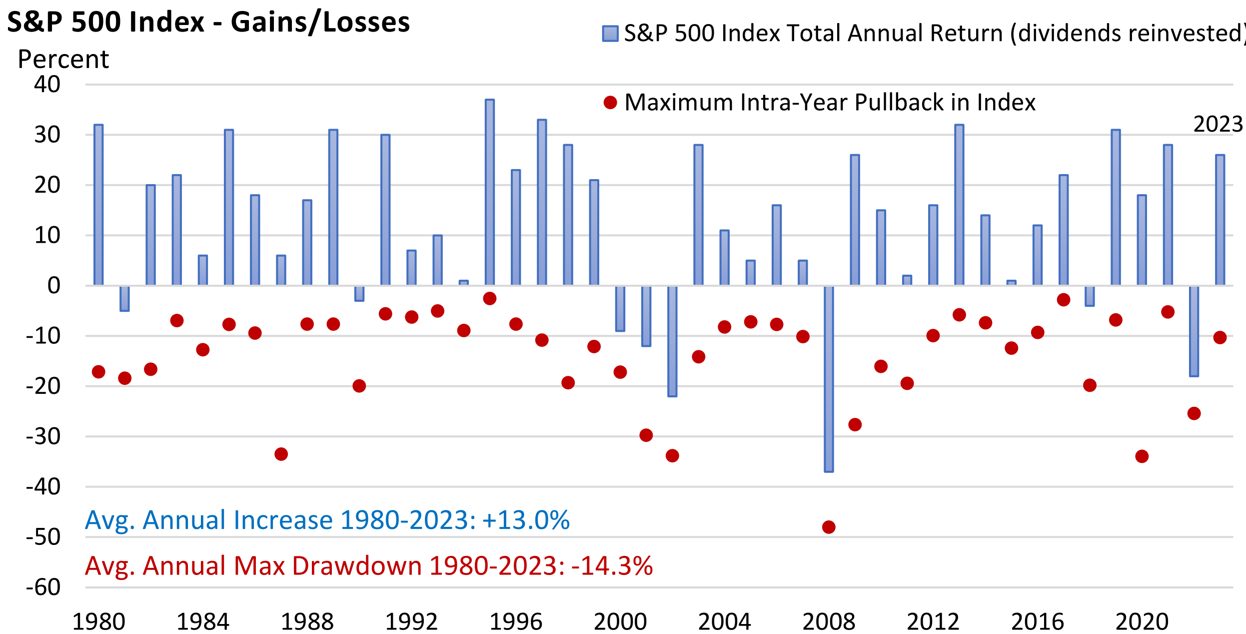
Yet, the unknown encourages us to get comfortable with some degree of risk. It allows us to become better and more disciplined investors.

Figure 4 highlights that stocks have a long-term upward trend, and long-term investment plans are customized to participate in that trend, but pullbacks are common.

Last year, the S&P 500 posted a return of 26% (blue bar, including reinvested dividends). During the period, the maximum pullback was 10% (red dot) – Figure 4.

Since 1980, the S&P 500 Index finished higher 82% of the time. When the index ended the year in positive territory, the average gain was 19%. When the index finished lower, the average loss was 13%.

Figure 4



DATA SOURCE: S&P DJ INDICIES, LPL RESEARCH 12/29/2023
THE S&P 500 INDEX IS AN UNMANAGED INDEX WHICH CANNOT BE INVESTED INTO DIRECTLY.
PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

Final Thoughts

We feel very blessed to work with each and every one of you. Recently, we were recognized in both the ***Washingtonian*** magazine and the ***Washington Business Journal*** as one of the top wealth management firms in the area. This recognition is greatly appreciated but it must be emphasized that none of this would be possible without you. Without you, there would be no business. We take this responsibility very seriously and work tirelessly to be the best firm for you and your family to help you achieve your goals and dreams. Thank you for this honor.

As we bid farewell to 2023, may the New Year bring you excitement, adventure, and fulfillment. May the year create cherished memories and be filled with joy. Happy New Year!

Your Hopwood Financial Team