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Maclura Investments

4Q23 Review - Market Outlook for 2024

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The year concluded in extraordinary fashion with nine consecutive weeks of positive returns for the Morningstar U.S. Markets index, returning 26.4% for the year and 12.1% for the fourth quarter. The widely reported S&P 500 index was up 24.2% and 11.2% for the respective time periods. As illustrated in the table below, all market caps and investment style (value and growth) benchmarks as measured by Morningstar had double-digit returns for the year. U.S. bond benchmarks returned mid-single digits for the year. Several megacap technology stocks dubbed "The Magnificent 7," which included Apple, Amazon, Alphabet, Meta Platforms, Microsoft, NVIDA, and Tesla, led the large cap growth benchmarks to recoup most of their 2022 losses. During the last two months of the year, there was a broadening out of the market, and small to mid-cap stocks started to outperform The Magnificent 7.

Exhibit 1. Investment-Style Returns

	Morningstar Index Market Returns	2016	2017	2018	2019	2020	2021	2022	2023 1st Qtr.	2023 2nd Qtr.	2023 3rd Qtr.	2023 4th Qtr.	2023
Growth	U.S. Growth	3.16%	29.52%	0.78%	35.90%	44.65%	24.79%	-36.70%	14.79%	11.64%	-5.92%	14.87%	38.48%
Growth	Large Growth	1.79%	31.15%	2.94%	33.81%	38.86%	21.47%	-40.36%	17.56%	12.80%	-4.04%	15.72%	47.26%
Growth	Mid Growth	6.46%	25.67%	-3.16%	36.01%	46.17%	14.97%	-32.37%	9.71%	6.48%	-6.42%	14.68%	25.38%
Growth	Small Growth	9.61%	23.77%	-5.67%	27.60%	43.52%	-1.00%	-33.13%	10.20%	7.34%	-6.46%	14.47%	26.65%
	US Market	12.44%	21.47%	-5.05%	31.22%	20.99%	25.78%	-19.43%	7.40%	8.49%	-3.19%	12.08%	26.43%
Value	U.S. Value	20.79%	14.23%	-7.51%	25.09%	-1.31%	23.98%	-0.72%	0.18%	3.86%	-1.91%	9.71%	11.98%
Value	Large Value	18.91%	15.09%	-5.90%	25.70%	-0.62%	21.49%	0.26%	0.72%	4.06%	-1.22%	8.02%	11.82%
Value	Mid Value	25.21%	13.02%	-10.63%	24.81%	-3.76%	29.02%	-2.39%	-1.28%	2.50%	-3.92%	14.11%	10.94%
Value	Small Value	27.96%	8.40%	-16.61%	19.96%	1.01%	31.79%	-6.60%	-1.40%	4.01%	-3.18%	15.38%	14.58%

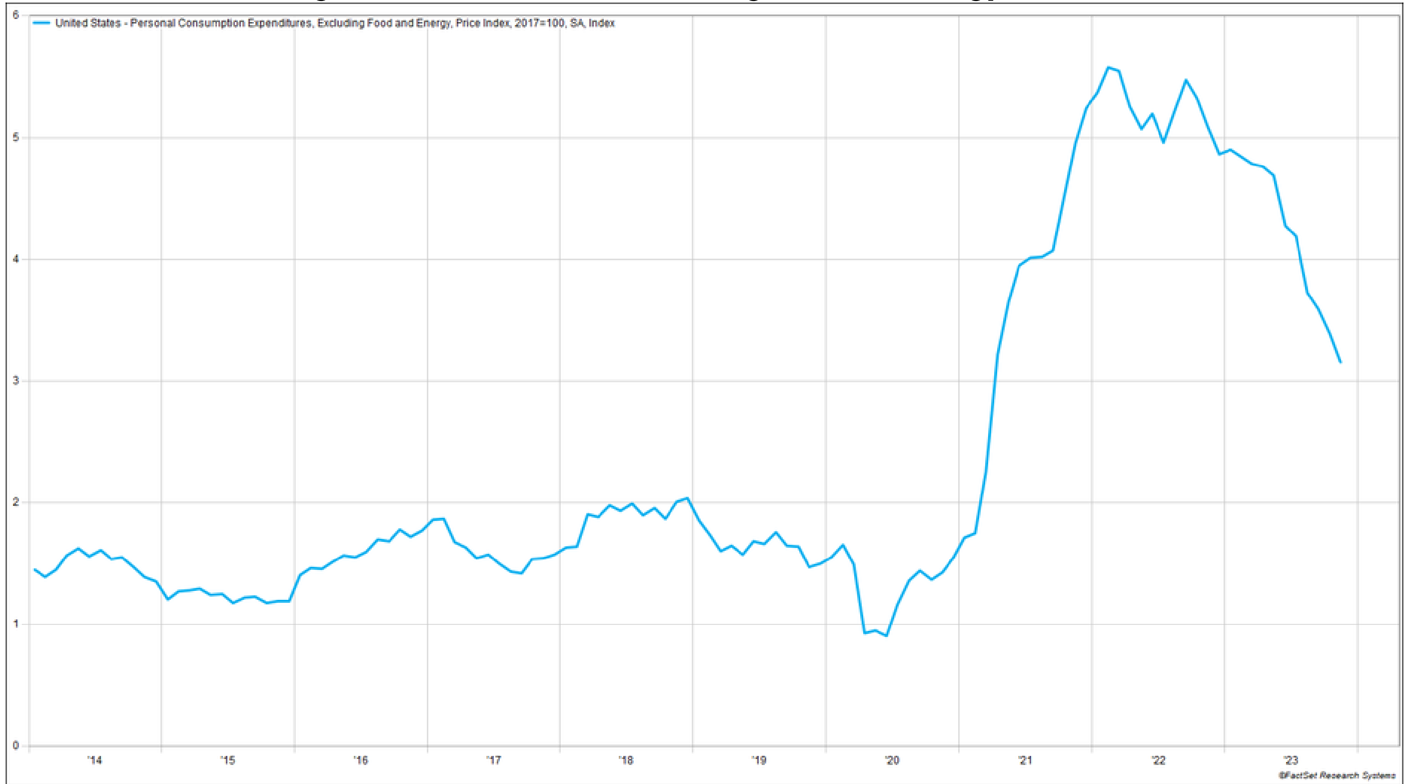
Source: Morningstar

The summary of the year would be vastly different if the year had ended on October 31st when the markets were only marginally up year-to-date after pulling back through the third quarter. This pull back was the result of the market struggling to reconcile between its desire to have short-term rates lowered by the Fed and the Federal Reserve's consistent messaging that rates would likely stay higher for longer.

While the resiliency of the U.S. economy held steady throughout the year, it was the continued downward trend of inflation that resulted in the Federal Reserve finally communicating after its December meeting that the Fed Funds rate was likely at its peak and to anticipate interest rate cuts in the future. The November annualized core Personal Consumption Expenditures (PCE), the Fed's preferred inflation measure that was released in December, was 3.2% and continues to trend towards the Federal Reserve's goal of 2% annual rate, as shown in exhibit 2 on the next page.

Federal Reserve Chairman Jerome Powell signaled during the December Federal Open Market Committee (FOMC) press conference that the Fed may commence easing sooner than previously indicated. The cuts to the Fed Funds rate that will materialize in 2024 are likely not the result of a slowing economy but the deacceleration of inflation as it trends to the optimal 2% annual rate that has been established by the Federal Reserve as an acceptable level of inflation.

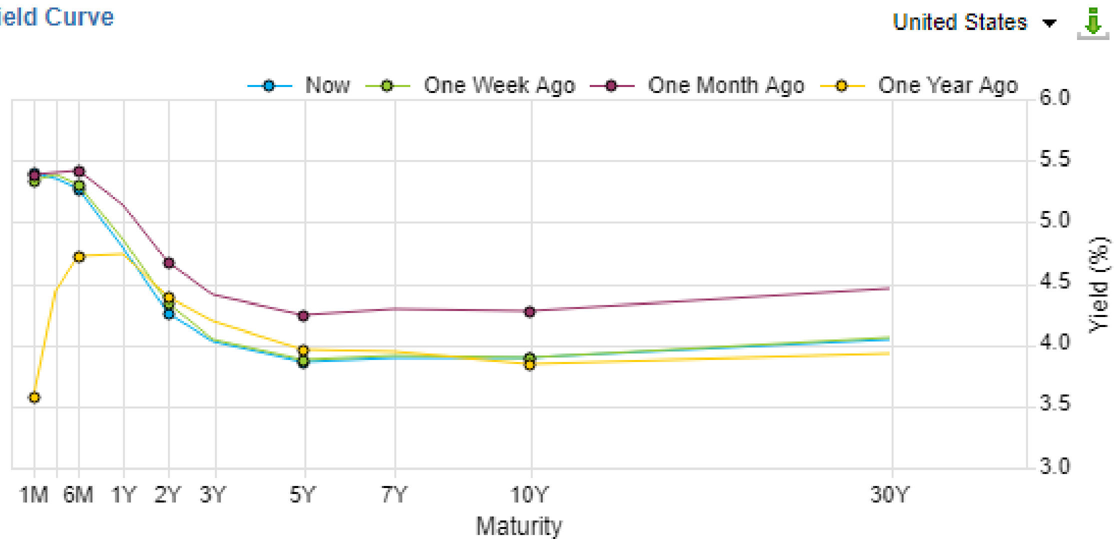
Exhibit 2. Annual Change Core PCE Inflation (excluding Food and Energy)



Source: Factset

Chairman Powell has indicated previously that the Federal Reserve will start to reduce the Fed Funds rate before inflation reaches 2%. Most have forgotten the difficulty that the world's Central Banks had in getting inflation up to the 2% goal after the Great Financial Crisis of 2009, even with unprecedented monetary policies. As evident with the current U.S. Treasury yield curve, current interest rates are back to where they were a year ago, reflecting the anticipated cuts, while the near-term rates will follow the actual cuts when they happen.

Exhibit 3: Current U.S. Treasury Yield Curve



Source: Factset

Outlook for 2024:

Compared to previous years, there are more tailwinds for the economy that should provide a positive backdrop for the market in 2024. The most obvious tailwind benefiting the market is the potential for the Federal Reserve to cut its short-term interest rates in 2024, lowering the cost of capital. Currently, Fed watchers have placed a 70% probability that the first rate cut (25 basis points) will be at the March 20th meeting, which will be the second FOMC meeting in 2024. I would place more credibility on the first cut being announced at the May meeting, but with a data dependent Fed, it will be the data that drives the decision.

With greater confidence in the market now that interest rates have peaked, the year will likely be very active in mergers and acquisitions. Companies and investors are flush with cash, but the willingness of transactions being done over the past year had been hindered by rising interest rates influencing the spread between what the buyers were willing to spend and the price at which companies were willing to sell widened as rates increased. Typically, as interest rates rise, the cost of borrowing capital to complete an acquisition increases, while the valuation multiples on target companies are lowered to levels not compelling enough to incentivize the target management team and investors to sell out. The lowering of interest rates will help on both of those fronts resulting in a narrowing of the gap to get deals done.

Fiscal spending throughout the world should be a positive influence within the world's economy. Although the Acts of Congress can be short-lived in the headlines, the impact to the economy is felt through multiple years. This is partially because the distribution of capital through government channels is fairly complex from establishing the qualification parameters of participation by Corporations, and some of the capital distributions that start at the federal level are then distributed out to the states and then even down to local jurisdictions. Corporations have been patiently waiting for the rules to be established for qualifying for funds, and it appears that capital from the Infrastructure Investment and Jobs Act (IIJA) of 2021, the Inflation Reduction Act (IRA) of 2022, and the CHIPS and Science Act of 2022 (CHIPS) will start to impact the U.S. economy in 2024. The "Build America Buy America" requirements of most of these programs within the fiscal stimulus isn't only a United States phenomenon; countries throughout the world are investing in their infrastructure to bring back manufacturing and realign their supply chain network. This will take multiple years and is already seeing an impact on trade of various products.

As mentioned in the previous quarterly market commentary, crude oil and copper tend to be the two major influencers of an economy after capital. Higher crude prices are typically a precursor to recessions, and copper is an important variable in building infrastructure, so both commodities are worthy of ongoing attention. Both commodities continue to be reasonably priced at levels that should not hinder economic activity: crude oil at $70.38 a barrel and copper at $3.86 a pound, both down from prices a year ago. Though OPEC has tried to manipulate prices by cutting crude oil production, the United States is currently producing more oil than ever before at 13.3 million barrels per day, up from 12.1 million barrels a year ago. Unless the price of either commodity experiences a significant rise, neither should hinder any economic activity in the United States.

The first quarter will also mark a year since ChatGPT and Large Language Models (LLM) became the latest technological advancement to significantly drive investment within the technology sector. While the artificial intelligence hype might be ahead of itself, there is no stopping the massive investment companies are making to implement this innovation into every aspect of consumer and business offerings, providing an additional tailwind to the economy.

The most significant headwind to the economy is the geopolitical uncertainty plaguing various regions throughout the world. According to the International Institute for Strategic Studies' annual review of active conflicts, the number of regional conflicts reached 183 in 2023, a 30-year high. As seen in the Red Sea, regional conflicts can have a significant detrimental impact on trade routes. The Red Sea is a vital waterway for commercial shipping that connects markets in Europe, Asia, and Africa, accounting for an estimated 10 – 12% of global trade. Downward trending inflation throughout the world has been benefiting from the decline in transportation costs. If uncertainties within the global trade routes persist and result in rising transportation costs, then there is a risk of a return of rising inflation.

An additional headwind is more United States centric as 2024 marks a Presidential election cycle. While this is usually a tailwind, the polarization of both parties creates a wide crevasse that likely won't be reconciled by whoever is elected. As the political rhetoric heats up, the truth on most issues will likely be somewhere in the middle of what both parties will spew from their respective platform. Regardless of who is elected as President, the net effect will hardly be transformational and impactful in the long run as both leading candidates seem to be best described as "shouldn't be running and can't win." Meaningful changes in governing likely won't happen until the 2026 or 2028 election, particularly to address the rapid rise in government debt.

Additionally, the sunsetting of the Tax Cuts & Jobs Act (TCJA) will take place in 2026, so the lowered individual tax rates that came with the bill will expire on December 31, 2025. Given Congress' inability to get things done, it will likely be an out-of-sight issue until it becomes a political crisis late 2025 on keeping or winning a Congressional majority during the 2026 election, as pandering to constituents was probably a factor in determining the expiration date in the original bill.

From a stock market perspective, after finishing 2023 with a strong fourth quarter, it is likely that the market takes a break in the first quarter of the new year. Nonetheless, given the tailwinds helping the economy, the market will likely achieve double-digit returns for the year. As experienced in the past year, 2024 will likely produce a wide spectrum of emotions as it vacillates between being up or down. Short-term volatility is always present in the markets. The key to successful investing is not to be consumed by the fluctuations of the market in the short-term but to keep focused on the long-term and work towards your investment goals.

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