EVANS MAY WEALTH

Market Commentary | December 29, 2023

# 2023 Year-End Market Update

2023 – what a year it has been! After a difficult 2022, the Dow Jones Industrial Average notched an all-time high to end the year and the S&P 500 flirted with achieving an all-time high. Patience was rewarded this year.

So where does that leave us for 2024? We like the setup going into 2024 and believe the stock market will set all-time highs again next year. But don't expect the same level of returns we saw this past year.

We expect inflation, interest rates, and the outlook for the economy to continue to dominate the headlines in 2024, and progress on these fronts will dictate whether returns ultimately come in above or below expectations.

Interest rates and inflation were top of mind for investors in 2023 and will continue to be going into 2024.

2023 was a pivotal year for Federal Reserve (Fed) decisions. With four rate hikes this year, we're now at a fed funds rate target range of 5.25%to 5.50%, and the market believes this will be the peak before the Fed starts cutting rates in 2024.

The Fed's monetary policy is starting to have its intended consequence on the price of goods and services, with the Fed's favored inflation barometer easing to 3.2% year over year. The Fed's annualized target inflation rate is 2% and they have been steadfast in stating that they want to see six months of tame inflation data to be sure the disinflationary trend continues. This is one reason why the Fed opted to hold steady on rates during their most recent meeting in December.

But, if you drill down into the data, you will notice that on a six-month basis, core Personal Consumption Expenditure (PCE) inflation has fallen just below the Fed's 2% inflation target, prompting the market to rally on hopes that the Fed will start cutting rates as soon as March. Currently, the market is pricing in 1.5% to 1.75% worth of rate cuts next year.

We believe the Fed should be focused on not cutting rates prematurely and ensuring that inflation has, in fact, been tamed especially given the resilient job market that has held up the economy in 2023.

The second mandate of the Fed's dual mandate is maximum sustainable employment. The Fed believes this can be achieved with an unemployment rate of 4.1% or lower. The most recent November jobs data came in stronger than expected with nonfarm payrolls hitting 199,000 vs. expectations of 185,000. The unemployment rate fell from 3.9% to 3.7% and average hourly earnings are up 4.0% from a year ago.

The labor market appears to be the key to keeping the economy afloat in the face of one of the most aggressive interest rate hike cycles in modern history. The stock market, and more recently, the bond market reacted favorably to increasing probability that the Fed may have stuck a "soft landing" for the economy.

But let's not forget about the role corporate America has played in the economy. Corporations – the companies we invest in on your behalf – have done a remarkable job at navigating a higher inflationary environment in 2023. This is a great stat that we love to share: S&P 500 earnings-per-share were up 4.5% in Q3 vs. a year ago. Compare this to pre-earnings season expectations estimating a 1.2% year-over-year *decline*. The market clearly underestimated corporate management's ability to navigate a higher inflationary environment.

Looking back at 2023, a couple of themes come to mind. The first theme is the "Magnificent 7". The phrase "Magnificent 7" has become familiar at this point. The "Magnificent 7" consists of Amazon, Apple, Facebook, Google, Microsoft, Nvidia, and Tesla. These seven companies contributed a whopping 100% to the S&P 500's positive return year-to-date through October, which means simply that they kept the stock market afloat for most of the year during very uncertain times – both economically and geopolitically.

The second theme is efficiency. The market significantly underestimated corporate management's ability to navigate a higher inflationary environment. In other words, while corporations cannot necessarily control the prices consumers are willing to pay for products or services, they can control the cost to produce their products or services, and they did a stellar job of this in 2023.

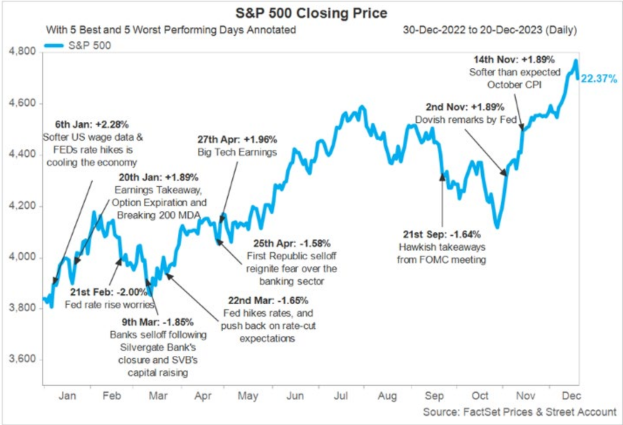
So where does this lead us as we head into 2024?

Looking ahead, we expect the S&P 500 to end 2024 in positive territory, but don't expect the same returns we've seen this year. The bottom-up price target for the S&P 500 in 2024 is 5200 to 5400, which is + ~10-14% from current levels. 2024 consensus earnings growth is +11%, and 2024 consensus revenue growth is +5.4%. This implies that the valuation for the market (currently at ~20 times price-to-earnings multiple) neither expands nor contracts over the next 12 months.

We think these projections are reasonable if a few things hold true:

(1) The market continues to broaden out and the other 493 stocks in the S&P 500 start contributing to the index's performance.
(2) Inflation and interest rates continue to decline at a gradual rate.
(3) Treasury yields, particularly the 10-year US Treasury remain below 4%.

2023 can be summarized as the year that rewarded patient investors. 2022 was difficult but those that stayed the course in 2023 were rewarded. This graphic is a great illustration of how the 5 best and worst days in a stock market are ultimately just blips along a broader secular trend.




Over the next few months, we expect episodic volatility tied to inflation reports, economic data, interest rate decisions, and Fed commentary. The first quarter of the year tends to have some of the largest price movements regardless, so seasonal trends support our thesis for Q1.

With that said, we believe we are still in the midst of a long-term secular bull market that has much more room to run.

As always, thank you for placing your trust in our team. It is a responsibility we do not take lightly. The entire team at Evans May Wealth wishes you and your family a happy holiday and New Year. Cheers to 2024 and a healthy, happy, and prosperous year ahead!

- Evans May Wealth