Q4 2023

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Retirement Market Recap

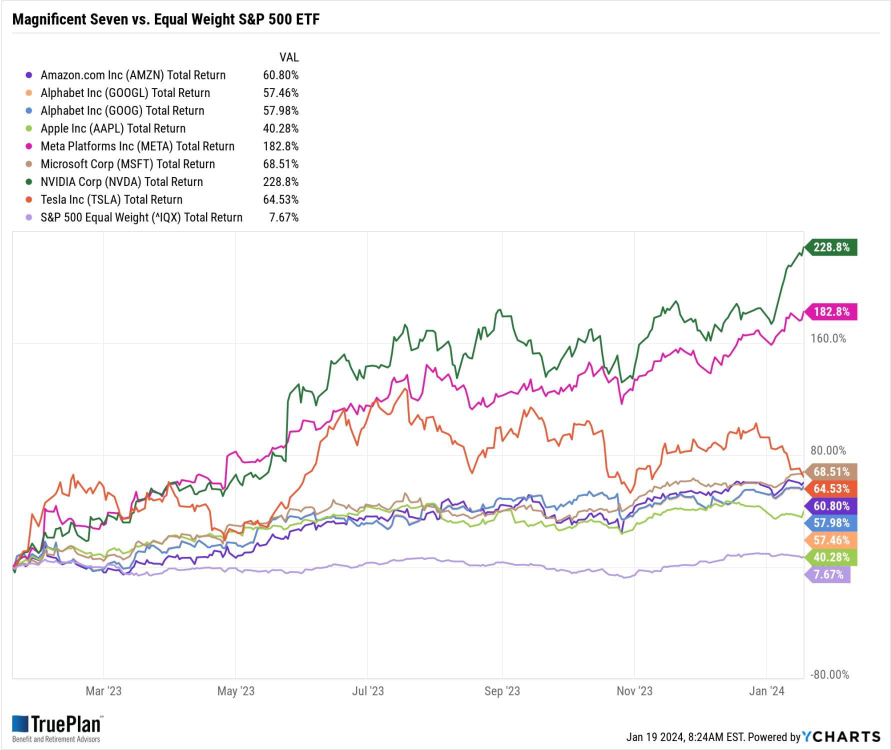
2023 IN REVIEW: WHAT RECESSION?

After facing dismal performance across most asset classes in 2022, investor sentiment entering 2023 was bleak. The S&P 500 declined by more than 18% in 2022, while the Bloomberg US Aggregate Bond Index declined by over 13%. Inflation appeared sticky, the labor market was strong and a hard landing by the Federal Reserve (the Fed) culminating in a 2023 recession seemed imminent.

WHAT A DIFFERENCE A YEAR MAKES.

The strong performance of equity and bond markets in 2023 was undoubtedly a surprise for many investors. The equity market rally erased the lows of October 2022, with the S&P 500 gaining 36.09% by the end of 2023 since the trough on Oct. 12, 2022. Extremely strong performance in the fourth quarter (+11.69%) was an outsized contributor to the index's gain (+26.29%) in 2023. The tech-heavy Nasdaq performed even better, gaining 13.79% in Q4 and 44.64% in 2023, in no small part due to the excitement, bordering on mania, around artificial intelligence and its potential capabilities.

Investors were encouraged by the strong performance of major equity market indices; however, the rally's concentration paints a less rosy picture than the broader index performance numbers show.



The "Magnificent Seven," a collective name for seven large, tech-focused components of the S&P 500,[1] carried much of the returns in 2023. As seen in the chart, the performance of the Magnificent Seven in 2023 was nothing short of, well, magnificent, with the seven stocks returning an average of 105.02%. However, when viewing the performance of the S&P 500 in an equal-weighted format, the return is much lower, at 13.87%. Whether this considerable concentration in the large cap equity space continues will be top of mind for investors as they attempt to reconcile the intrinsic value of these names and where to strategically deploy capital.

The year 2022 was notoriously difficult for fixed income assets, driven by the combined effects of inflation and the unprecedented velocity of interest rate hikes. However, 2023 proved to be a stronger year for the asset class, with the

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[1]The "Magnificent Seven" stocks are Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla.

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Bloomberg US Aggregate Index gaining 5.53%. This gain was driven entirely by Q4, when the index returned 6.82%, leading to a substantial decline in the yield of the US 10-year Treasury, which closed 2023 at 3.86%. This is a sizable decline compared to its peak of 4.98% on Oct. 19, 2023. Yields increase as bond prices decrease, highlighting the significant positive gains in fixed income assets seen in Q4.

The high-yield bond market, comprised of non-investment grade rated corporate bonds, was an outsized performer in 2023. The Bloomberg US Corporate High Yield Index saw a 7.16% gain in Q4 and a 13.45% gain for the year. The high-yield bond market tends to exhibit a higher correlation with equity markets than other fixed income assets and therefore was able to meaningfully participate in the rally of riskier assets in 2023. However, high-yield bonds tend to carry more default risk than their investment grade counterparts. Should a recession take place in the near term and corporate defaults rise, the asset class may face headwinds as a result.

While 2023 appears to have reversed much of the losses of 2022, investors are still uncertain about the future. Moving into the new year, focus remains on the possibility of a recession. However, based on current economic data, inflation appears to be moderating. As David Harrison and Amara Omeokwe of The Wall Street Journal explain, "The Fed's preferred inflation measure, the personal-consumption expenditures price index, fell 0.1% in November from the previous month, the first decline since April 2020, the Commerce Department said Friday. Prices were up 2.6% on the year, not far from the Fed's 2% target."[2]

With the Fed holding the terminal rate steady at a range of 5.25% to 5.50%, key inflation measures declining and expectations of multiple rate cuts in 2024, the gloominess of 2022 has dissipated. Moreover, investor sentiment is improving. For example, a study from the University of Michigan indicated that a measure of consumer sentiment rose 14% to a five-month high in December from the previous month, as households brought down their expectations for inflation next year.[3]

While there are positive economic signals that could lead to a potential soft landing, the labor market continues to be an area of concern for investors. A softer labor market, marked by fewer new jobs and a higher unemployment rate, would help reduce demand, mitigating further price increases. However, the November jobs report showed nonfarm payrolls increasing by 199,000, again exceeding expectations of 190,000. The unemployment rate also declined in November to a historic low of 3.7%, with average hourly earnings rising 0.4%, demonstrating the resilience of the labor market.[4] The labor market will continue to be a key indicator driving monetary policy for the Fed in 2024.

Moving forward to 2024, Americans appear to be in a much better financial position than they were a year ago. The outcome of this market cycle will become more apparent in the coming months and while the Fed has not yet fully created a soft landing, the probability of this outcome is significantly higher than it was a year ago.

[2]Harrison, David & Omeokwe, Amara (December 22, 2023) Prices Fell in November for the First Time Since 2020. Inflation is Approaching Fed Target. *The Wall Street Journal.* https://www.wsj.com/economy/what-to-watch-in-fridays-spending-report-inflation-closing-in-on-feds-target-0778037d?mod=economy_lead_pos5

[3]Ibid.

[4]US Department of Labor (November 2023) News Release – Bureau of Labor Statistics, November 2023. https://www.bls.gov/news.release/pdf/empsit.pdf

EQUITY AND RETIREMENT INDICES	3 MO	1 YR	3 YR	5 YR	10 YR
S&P 500 TR USD	11.69%	26.29%	10.00%	15.69%	12.03%
Russell 3000 TR USD (Broad Market)	12.07%	25.96%	8.54%	15.16%	11.48%
Russell 1000 TR USD (Large Cap)	11.96%	26.53%	8.97%	15.52%	11.80%
Russell Midcap TR USD	12.82%	17.23%	5.92%	12.68%	9.42%
Russell 2000 TR USD (Small Cap)	14.03%	16.93%	2.22%	9.97%	7.16%
MSCI EAFE NR USD (Int'l Equity)	10.42%	18.24%	4.02%	8.16%	4.28%
MSCI Emerging Markets NR USD (E.M. Equity)	7.86%	9.83%	-5.08%	3.69%	2.66%
S&P United States REIT TR USD (Real Estate)	16.04%	13.77%	7.17%	7.22%	7.50%
Morningstar Lifetime Mod. TR 2020	8.86%	11.31%	0.34%	6.15%	5.00%
Morningstar Lifetime Mod. TR 2040	10.90%	16.34%	3.51%	9.29%	6.95%

FIXED INCOME INDICES	3 MO	1 YR	3 YR	5 YR	10 YR
ICE BofA 3M US Trsy Note TR USD	1.37%	5.03%	2.18%	1.92%	1.28%
ICE BofA 1-3YR US Trsy TR USD	2.49%	4.26%	-0.04%	1.30%	1.05%
BBgBarclays Long Term US Trsy TR USD	12.70%	3.06%	-11.41%	-1.24%	2.28%
BBgBarclays US Aggregate Bond TR USD	6.82%	5.53%	-3.31%	1.10%	1.81%
BBgBarclays US Treasury US TIPS TR USD	2.60%	4.57%	2.32%	3.37%	1.98%
BBgBarclays High Yield Corp TR USD	7.16%	13.45%	1.98%	5.37%	4.60%
BBgBarclays Global Aggregate TR USD (Global Bond)	8.10%	5.72%	-5.51%	-0.32%	-0.38%

ICE BofAML – Intercontinental Exchange Bank of America Merrill Lynch; BBgBarc – Bloomberg Barclays; S&P 500 – Standard & Poors; MSCI – Morgan Stanley Capital International
Sources: Morningstar as of Dec. 31, 2023

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