Wealth Management

QUARTERLY PERSPECTIVE

WINTER 2024

2023 Year in Review

If you polled a group of economists and market forecasters on what word they'd use to describe the U.S. economy last year, my guess is it would be: Resilient. After all, going into 2023, nearly everyone was projecting significantly slower GDP growth, a jump in unemployment, and a drop off in both consumer and corporate spending– all of which would likely lead to a recession. At the time, the Fed seemed ok with that, as long as it broke the back of inflation. Their own estimates for 2023 were for GDP growth of just 0.5% and unemployment over 4.5%. Yet here we are with solid GDP growth that will likely be in the range of 2.5% for 2023, and unemployment under 4% for 25 consecutive months, a record going back to 1969. It seems that the U.S. economy, with the help of continued strong consumer spending, has avoided the most widely forecast recession in history.

So, the question now is whether we've achieved a soft landing or not. Inflation continues to fall, and while it may take most of this year, or even into next year, to reach their 2% target, the Fed seems to be beginning its pivot with dovish comments following last month's meeting. Questions abound as to the timing of the first cut and how many we may see, with markets hoping for one this spring, while the Fed continues to push back alluding that cuts may not come until much later in the year. Regardless of timing and magnitude, the direction of rates in 2024 seems quite clearly lower.

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Brian is a member of CNB Wealth Management's Investment Committee, where he is responsible for providing the research and analysis necessary to oversee the firm's investment portfolios. Additionally, Brian coordinates the firm's due diligence process, which monitors and evaluates all existing and prospective investment managers.

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2023 Market Recap

Following a very difficult year for both equity and fixed income markets in 2022, expectations were low coming into 2023. Valuations were better following the market sell-off, but the Fed was still raising rates, and most expected at least a mild recession by year-end. Equities got off to a decent start but were then blindsided by the failure of Silicon Valley Bank and the several other banks that followed. This pressured markets, especially financials, as uncertainty around a more widespread issue lingered.

Index Returns as of 9/30/2023	Q4 2023	2023
S&P 500	11.69%	26.29%
Russell 1000 Growth	14.16%	42.68%
Russell 1000 Value	9.50%	11.46%
Russell 2000 Value	15.26%	14.65%
Dow Jones US Real Estate	17.98%	12.25%
MSCI EAFE (net)	10.42%	18.24%
MSCI Emerging Markets (net)	7.86%	9.83%
Bloomberg US Aggregate Bond	6.82%	5.53%
Bloomberg Global Treasury ex. US	9.29%	4.24%
Bloomberg High Yield Bond	7.16%	13.45%

Figure 1 - Source: Morningstar

By mid-year however, the dynamic changed. The banking crisis dissipated after strong action from government regulators, and the artificial intelligence (AI) revolution firmly took hold. AI became the buzzword on company earnings calls, and any technology firm involved in the space garnered significant attention. This led to an impressive rebound in technology stocks, including many of the names that had sold off so dramatically the previous year. It also started the phenomenon known as the Magnificent Seven[1], currently the seven largest firms in the S&P 500, all of which are technology stocks. Their incredible returns drove the S&P 500 Index higher despite lackluster aggregate returns from the other 493 constituents.

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By year-end, the S&P 500 Index was up 26.3%, but returns heavily favored growth components, with the Russell 1000 Growth Index up 42% and the Russell 1000 Value Index up 11.5%. Returns in small cap stocks were weighed down by the heavier influence of interest rates on the sector, along with lingering effects from the banking crisis, but a significant rebound in December helped push returns to 16.9% for the Russell 2000 Index.

International stocks also fared well, up 18.9% for the year as measured by the MSCI EAFE (net) Index. The MSCI Emerging Market Index was up 9.8%, with most of the lag relative to developed markets based on negative returns from China, which makes up over 30% of the index.

After spending much of the year in negative territory, bonds had a year-end rally, and the Bloomberg U.S. Aggregate Bond Index finished up 5.5%. This was a welcome rebound for bond investors who suffered one of the worst years for fixed income in 2022, and many are hopeful that Fed rate cuts by later this year will bring additional gains.

Inflation Measures

	50-yr. avg.	Oct. 2023	Nov. 2023
Headline CPI	**3.9%**	3.2%	3.1%
Core CPI	**3.9%**	4.0%	4.0%
Food CPI	**3.8%**	3.3%	3.0%
Energy CPI	**4.5%**	-4.5%	-5.4%
Headline PCE deflator	**3.4%**	2.9%	2.6%
Core PCE deflator	**3.3%**	3.4%	3.2%

Figure 2 - Source: J.P Morgan

2024 Outlook

Over the last few years, the primary risk to investors was the potential for a policy misstep by the Fed that would lead to a significant downturn in the economy. They had waited too long to start the inflation fight, and because of that had to raise rates higher and faster than anyone anticipated. But with the prospect of rate cuts on the horizon and the real potential for a soft landing, this year will likely see a transition of investor focus away from the Fed and inflation to other areas such as corporate earnings growth and geopolitical issues.

Consensus estimates for S&P 500 earnings growth are a healthy 11.8%[2], a very nice jump after what looks to be flat year-over-year earnings in 2023. With revenue estimates at roughly 6%[2], that means firms will need to expand margins to hit this target and will require wage pressures and other input costs to continue to abate. Additionally, for markets to move higher, there will need to be a broadening of last years' rally to include areas outside of technology. There were signs of this in December, and it will be a key component to watch in 2024.

On the geopolitical front, with a war in Ukraine, a war in Gaza, and the ongoing harassment of shipping in the Red Sea, there is considerable anxiety around the potential escalation in any of these already significant conflicts. Aside from the brutal humanitarian toll, significant disruption to world markets could take place should a breakout in one of these conflicts start to pull in other countries.

On the domestic front, this is an election year, and while markets generally don't care who's in office over the longer-term, the uncertainty over the outcome of an election can sometimes cause investors anxiety, especially in today's hyper-polarized political environment. Here, we would again caution investors to focus on long-term goals and financial planning objectives over worries around a political outcome.

Looking Ahead

As we start 2024, there is a good deal of optimism around markets and the economy. While we're not entirely out of the woods yet, it appears that we may have avoided a recession, the worst of the possible outcomes. GDP growth is slowing but solidly positive, earnings growth is expected to rebound, and unemployment is near historic lows. For investors, the dramatic swings of the last few years have been a rollercoaster ride, and a relatively dull market in 2024 might be welcomed by many. As always, patience is a hallmark of good investing, and it has proven itself over long periods, especially in combination with a well-designed financial plan.

CNB Wealth Management is here to help you design, implement, and track your plan to ensure that it continues to meet your financial goals and objectives. Please contact your advisors if you have any questions or concerns, and we wish you and your family all the best in the New Year.

[1]The Magnificent 7 consist of Apple, Microsoft, Amazon, Nvidia, Alphabet, Meta and Tesla. [2]Earnings and revenue forecasts are consensus analyst estimates provided by FactSet, December 2023. Data as of 12/31/2023. Not intended to be construed as tailored fiduciary advice. Investments are not FDIC insured, not bank deposits, not obligations of, or guaranteed by Canandaigua National Bank & Trust or any of its affiliates. Investments are subject to investment risks, including possible loss of principal amount invested. Past performance is not indicative of future investment results. Before making any investment decision, please consult your legal, tax or financial advisor. Investments and services may be offered through affiliate companies.