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summaries

SIGMA INVESTMENT COUNSELORS

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MARKET COMMENTARY

After a challenging market environment in 2022, investors were rewarded for staying the course in 2023. The S&P 500, led by the "Magnificent 7" tech stocks, posted strong gains and finished the year within striking distance of its record high reached on January 3rd, 2022. After stocks and bonds simultaneously experienced large drawdowns during 2022, many market pundits declared the traditional 60/40 portfolio dead. The famous quote from Mark Twain appropriately characterizes the 60/40's triumphant return in 2023: "the reports of my death are greatly exaggerated."

The S&P 500 increased 26.3%, while mid cap and small cap U.S. stocks were up 16.4% and 16.1%, respectively. Returns were also positive overseas, as developed markets were up 18.2%, and emerging markets gained 9.8%. The Bloomberg U.S. Aggregate Bond Index was up 5.5% for the year, with bonds providing meaningful income for the first time in years.

The recession of 2023 was the most anticipated recession ever according to economists, though it failed to materialize. While consumers pulled back in some areas and traded down, and despite numerous headwinds including the resumption of student loan payments, the wind down of excess savings accumulated during the pandemic, smaller tax refunds, and tighter bank lending standards, the consumer continued to spend. This was especially true for travel and entertainment, as air travel returned to pre-pandemic levels, and Taylor Swift's "The Eras Tour" provided a measurable boon to local economies.

Markets in 2023 were supported by a strong economy, better-than-expected corporate earnings, and a likely end to the Federal Reserve's (Fed) aggressive rate hiking campaign. March saw a regional banking crisis that resulted in the failure of several small-to-mid size lenders, though the markets largely shrugged this off once the situation appeared to be contained. Inflation, though still above the Fed's 2% target, continued to retreat from its June 2022 peak. Fed officials increased the federal funds rate by 0.25% in four separate meetings to arrive at a range of 5.25% - 5.50% by the July meeting, and then held rates steady for the remainder of the year. At the December 13th Fed meeting, officials penciled in three 0.25% rate cuts in 2024, and Fed Chairman Jerome Powell made a dovish pivot in his post-meeting press conference. This sent the markets higher, adding to gains that had already taken place since the year-end rally that began on October 27th.

While markets were largely driven by expectations for Fed policy, there were several notable themes that also drove markets in 2023. Artificial Intelligence (AI) took center stage with the unveiling of ChatGPT in late 2022, and AI mania kicked into high gear in late May when Nvidia (NVDA) reported earnings and guidance that shattered analysts' already lofty estimates for the company. While NVDA was the best performing stock in the S&P 500 (+239%), other companies that stand to benefit from the AI theme also performed very well in 2023. GLP-1 weight loss drugs were the major healthcare theme, as

investors contemplated what this development would mean not only for other healthcare stocks (health insurers, elective surgery providers, glucose monitoring device makers, etc.), but also for other industries such as snack foods. Organized labor also scored some big wins in 2023, with notable strikes in Hollywood and in the auto industry dominating news cycles.

Looking ahead to 2024, there are numerous potential risks for the markets. While the economy has largely weathered the fastest rate hiking campaign in four decades, economic growth is likely to be slower in 2024, even if the Fed is able to pull off the often elusive "soft-landing." This is sure to be a tumultuous presidential election cycle, as two of the least popular candidates in recent history are likely to meet head-to-head for the second time. Numerous wars are ongoing (Russia/Ukraine, Israel/Hamas), and there is the potential that these could spill over into wider regional conflicts. China's economy has also been struggling, making it unlikely that the country will provide the same support for global growth that it has during past cycles.

While there are always potential risks, there are also reasons to be optimistic. Markets tend to climb a "wall of worry" and can perform well even amid myriad risks. Markets are forward looking, and many of these risks are already reflected in stock prices. In addition, company earnings are what ultimately drive the stock market, and many companies have healthy balance sheets as they were able to take advantage of the low interest rate environment during the pandemic to lock in favorable rates. Even if the U.S. is not able to avoid a recession in 2024, a potential recession is expected to be mild. Inflation continuing its decline will also give the Fed the ability to lower rates to support growth if the economy slows more than expected. And as a result of higher interest rates, not only do bonds now provide meaningful income, but they should also act as a diversifier again during potential periods of stock market weakness.

The future is always unknown, which makes a sound and disciplined investment strategy all the more important. Regardless of the environment, staying the course and sticking to the plan are always key to long-term financial success.

We appreciate the opportunity to serve as your investment advisors, and we wish you and your families a happy and healthy 2024!

David Drogheo, CFA
Director of Research

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