The Beckmann Marlow Nuelle Wealth Management Group

2024 Market Update

"Money isn't the most important thing in life, but it's reasonably close to oxygen on the 'gotta have it' scale." –Zig Ziglar

At the start of last year, our team aligned with the general consensus in that the year ahead looked to be a difficult one for investors. We were coming off a tough year in 2022, and even the most bullish of strategists were forecasting mid-single digit returns at best by year-end. The majority of those strategists were confident a recession would take shape at some point during the calendar year. From our perspective, this outlook seemed reasonable at the time. Inflation was top-of-mind for many Americans, and its continued impact on overall consumer spending seemed inevitable. The Federal Reserve (Fed) was still in the midst of an unprecedented stream of aggressive interest rate hikes. Higher cost of capital would undoubtedly impact future earnings. Home ownership began to look unattainable for many people. For these reasons and many more, the market outlook for 2023 was understandably dicey. To nearly everyone's surprise, it turned out to be a noteworthy year for the broad market, although historic disparities were observed among the major market sectors. More on that later. Bonds also managed a comeback from the prior year, avoiding a third consecutive year of losses. As 2023 rolled on, disinflation continued and the Fed finally pushed pause. Conversations about the real possibly of rate cuts in the second half of 2024 pushed the market even higher during an eight-week rally to cap off the year. As we move into the New Year, strategists and economists continue to debate whether or not we'll fall into a recession, whether or not major inflation indicators will continue to moderate, earnings will soften, and whether or not the Fed will eventually lower rates as aggressively as they raised them over the past couple years.

I. Key Themes in 2023

One noteworthy feature in 2023, was the stark gap between the performance of growth-oriented companies (namely technology and communication services) and value-oriented companies (think utilities, consumer defensive, and energy). After a rough go in 2022, 2023, was truly a

banner year for growth. In our 2023 mid-year update we discussed the historic difference in return among sectors. At the year's end, the so-called "Magnificent Seven" (Apple, Google, Microsoft, Amazon, Meta, Tesla, and Nvidia) had contributed nearly half of the stock market's overall gain. Growth blew value away by 36 full percentage points, providing the second biggest advantage for growth in 25 years. (CNBC) Even though dividend (value) stocks lagged the broader market, the eight-week rally at year-end gave way to a rotation that allowed dividend payers to close the gap to a certain degree. Higher interest rates were a meaningful headwind for dividend payers throughout the year. Those companies tend to hold more debt on their books and ultimately incur a higher cost of capital with a prolonged move up in rates. The other issue in play was the "substitution effect." Dividend paying stocks were no longer the only option for investors to capture yield. For the first time in well over a decade, short-term fixed income had become a very viable option, offering a comfortable 5% return with very little risk involved.

With inflation registering at 3.1% in November and 3.4% in December, talk of rate cuts began to really take shape for 2024. While the Fed's target inflation number remains at 2%, enough progress had been made for the Fed to push pause on any additional rate increases for the time being. In December, the Fed released an updated Dot Plot. This report is a chart showing where each Fed member thinks interest rates are headed in one, two, and three years' time. The medians of this report show rates dropping 75 basis points in 2024, 100 basis points in 2025, and another 75 basis points in 2026. This represents a total of 250 basis points over that span of time, or roughly 2.5%. (FederalReserve.gov) As always, these forecasts are entirely data dependent and subject to change at any point in time. That said, we think it is reasonable to assume the next move in rates is more likely to be down. Historically speaking, I believe this almost always provides a significant tailwind for equities. From a valuation standpoint, we think value stocks have more to gain at this point in time.

I would be remiss to not mention the Israeli-Hamas war's role in bringing geopolitical risks back to the forefront of conversation in the second half of 2023. While Israel's military has already destroyed much of Gaza in response to the Hamas group's attack on October 7, Prime Minister Netanyahu has indicated military operations may continue well into 2024. The question mark of Iran's overall involvement brings with it the idea of the conflict broadening throughout the Middle East. This would have obvious implications for both global financial markets and the price of oil.

Right now it would seem the base case is Israel will be forced to end its attacks before it can destroy Hamas altogether. Israel has a chance to increase its own security by weakening Hamas in a meaningful way through these targeted attacks. As a team, we view geopolitical risk as an ever-present factor in financial markets. They can quickly disrupt narratives and change expectations for both long- and short-term time horizons. Often times we can take advantage of temporary shifts brought on by various geopolitical events. This all goes back to one of the core themes of how we manage money—dynamic asset allocation and rebalancing over time. This can often reduce the impact and severity of adverse events on the global stage.

On another note, it's been nearly two years since Russia's full-scale invasion of Ukraine. At present, it appears the current situation lies at a stalemate. The two sides have now fought to a temporary draw. Each side appears to have enough troops, missiles, etc. to defend its own position, but not enough to launch a big enough offensive to establish any meaningful momentum. Ukraine's access to Western aid has played a key role in its ability to contain Russia's vast reserves of manpower and industrial capabilities.

II. What Lies Ahead in 2024

Each January, we're often reminded that simply riding what worked last year isn't going to echo in the year ahead. If you looked at the last 12 weeks in a vacuum, you'd be right to assume euphoria on the part of investors as we progress into 2014. However, we think this year could one of tepid growth, and a mild recession still remains a possibility. The yield curve has been inverted for more than a year. Consumer spending is expected to slow as the artificial boost from government actions during COVID (payouts, rental assistance, student loan moratoriums, etc.) finally dries up in 2024. Fortunately, with rates at an elevated level and inflation trending downward, the Fed has the flexibility to shift gears and commence a period of more accommodative monetary policy if need be.

Further complicating things is this year's Presidential Election. To say the current political system is becoming increasingly fractured is almost an understatement. The winner of this election will undoubtedly have fiscal implications and a major impact on the direction of foreign policy.

Biden's approval numbers remain low and there are increasing worries about his advanced age and cognitive capacity. Trump is attempting to win non-consecutive terms against a backdrop of legal issues. Right now he is the odds on favorite. It's conceivable that if nothing material changes, a third party candidate might be a more viable option in 2024 relative to years past.

We continue to think a well-defined strategy and careful stock selection matters now more than ever. The past year's wide dispersion in returns will likely give way to major winners and losers in the coming year as well. Good active management can position portfolios to exploit these opportunities and simultaneously mitigate overall risk. As we build our own individual stock portfolios and evaluate managers in the coming year, we'll do so through the lens of (1) seeking high conviction ideas, (2) taking meaningful position sizes, and (3) ideally purchasing names at a meaningful discount relative to a stock's intrinsic value. Even if volatility accelerates in the coming months, we believe this style of active management will prevail over more passive, "set it and forget it" type strategies.

III. What's New with the Team?

Our biggest news is the birth of Brad and Kelsey's second son, Emmett Roger, in September. Big brother Louis is thrilled to have a new buddy on the scene. This is the third grandchild for Bob and Jackie. Life is good (and chaotic!) with three grandsons under three.

Mark's son Chris proposed to his long-time girlfriend, Danielle, during the fall in Washington D.C. Mark and Tracy are thrilled about the addition of a daughter-in-law in the not too distant future.

Jess's daughter and Molly's twins all started kindergarten this past fall. It's been an exciting new chapter for their families, and as far as we know they've all managed to stay out of the principal's office.

As always, we continue to appreciate your business and friendship! We wish you and your family all the very best in the upcoming year. Please don't hesitate to get in touch with any questions or concerns regarding your portfolio.

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Past Performance is not indicative of future results.

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.