Weekly market wrap

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‹ Weekly market wrap

2023 in review: From a bumpy star

to a strong finish

2023 started with depressed expectations and fears of a recession but ended with optimism and strong performance across most asset classes that make up a well-diversified portfolio. There was plenty of suspense and roadblocks for investors that included the highest borrowing costs in more than two decades, a regional bank crisis, and geopolitical uncertainty. But economic resilience, a trend of disinflation, the end of Fed tightening, and excitement around artificial intelligence (AI) more than countered those headwinds, reminding investors of the merits of a disciplined investment approach in times of uncertainty.

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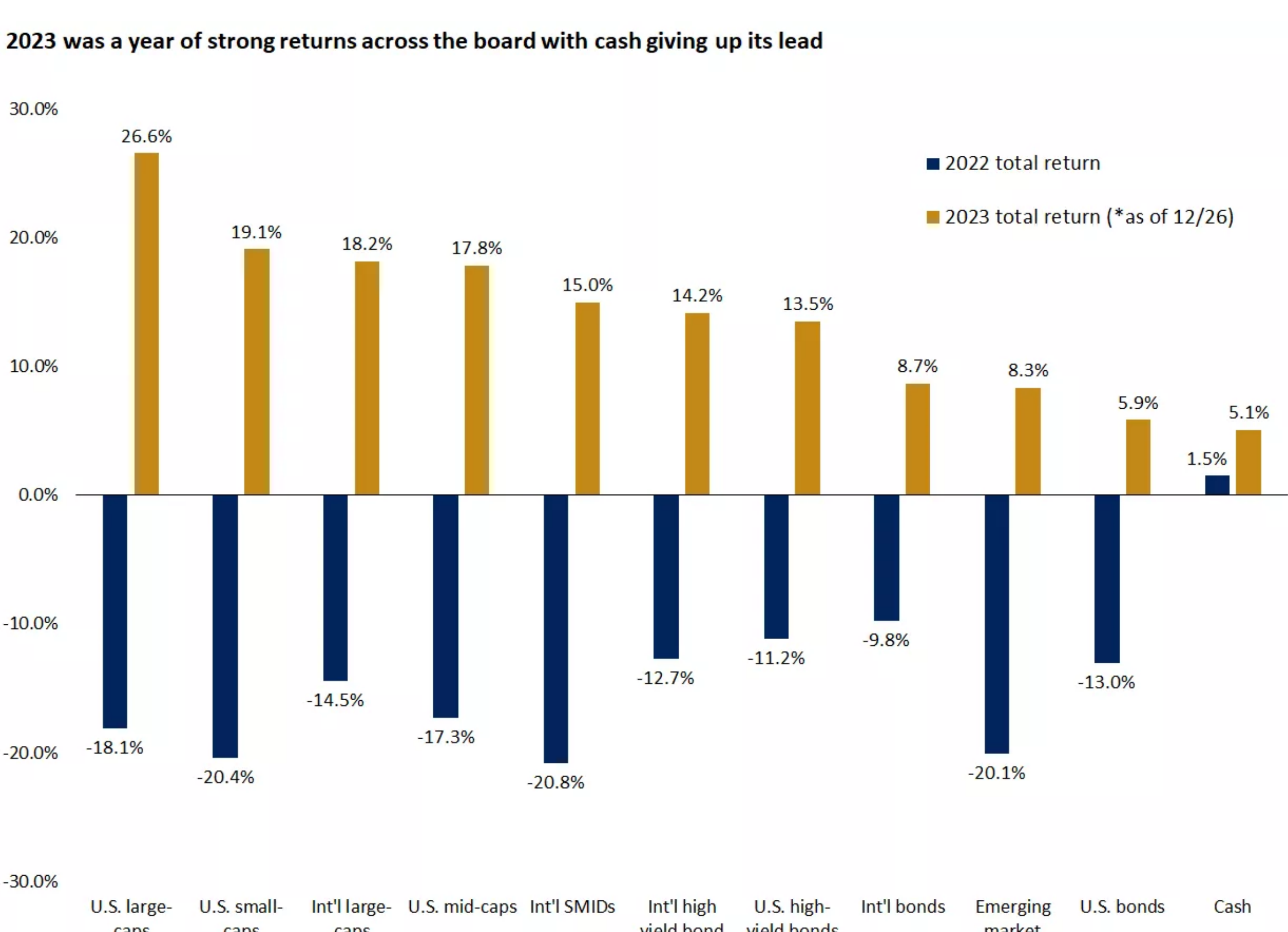
The change of the calendar presents an opportunity to reflect and review some of the milestones that defined the economy and the markets over the past 12 months, along with our views on their potential implications for 2024.



Source: Morningstar Direct, Edward Jones.

Chart description

1. **The inflation tide continued to recede**

Undoubtedly one of the biggest drivers behind the year's positive market outcomes was the notable easing in inflation, which provided some breathing room for the Fed and the economy. Since inflation peaked at 9.1% in June 2022, the consumer price index (CPI) has been cut by two-thirds, solidifying disinflation as the key theme for 2023[1].

Lower oil and gas prices helped the headline CPI fall below 3%. But beyond the impact of commodities, price pressures slowed across a growing number of categories. Supply chains continued to normalize from the distortions of the early pandemic days, allowing goods prices to decline. Services inflation remains elevated but is also on a downward path.

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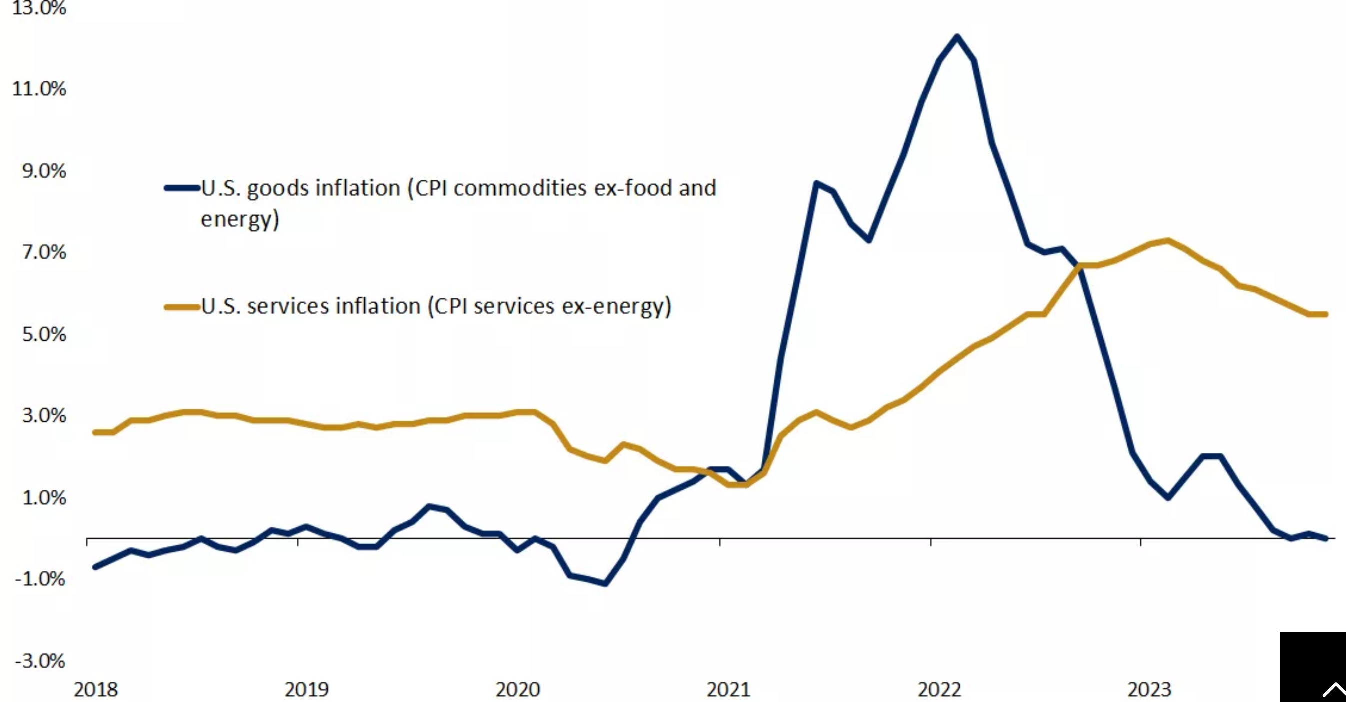
2024 views – We think the disinflation trend will continue as wage growth softens and used car prices, along with housing inflation, cool further. Housing represents about a third of the CPI weighting, the most of any other consumer good or service, and remains by far the biggest contributor to inflation. Without it, core CPI has already reached the Fed's 2%[1]. It might be later in the year, but housing inflation should start moderating at an accelerating pace, as suggested by the more timely data for new leases and home prices.



Source: FactSet, Edward Jones.

Chart description

2. **A regional-bank crisis was met with a forceful policy response**

In March, investors' and policymakers' attention shifted temporarily from inflation to financial stability concerns. Confidence in the banking system was shaken after the failures of Silicon Valley Bank (SVB) and Signature Bank, which then spread to First Republic Bank and Credit Suisse.

In the financial crisis of 2008, the culprits were excessive risk-taking and credit losses from bad loans and derivatives as the housing bubble popped. In contrast, this time the rapid rate hikes by the Fed depressed the value of bond securities that banks hold as part of their funding for their loan books. This happened as smaller banks with a concentrated customer base faced a liquidity crisis when many depositors wanted their money all at once, a classic bank run.

The developments briefly erased the S&P 500's gains for the year, but swift action from policymakers helped limit fears of a contagion. The Fed, Treasury and FDIC backstopped all depositors at the failed banks, including customer deposits above the FDIC insurance limit of $250,000. The Fed also set up a new lending facility to provide loans to help ensure banks can meet their depositors' needs.

2024 views – Though short-lived, the stress in the banking sectors was a reminder that restrictive Fed policy tends to uncover vulnerabilities lurking in the financial system. Since March, the deposit outflows have stabilized; bonds yields are falling, lessening the pressures on bank balance sheets; and bank shares are recovering. We think that the U.S. banking system is sound and resilient, but we favor the large banks over regionals, and we recommend investors underweight the financial services sector. Concerns about commercial real estate loans remain, credit losses are rising, and the likelihood of more burdensome regulation around capital requirements could dampen profitability.

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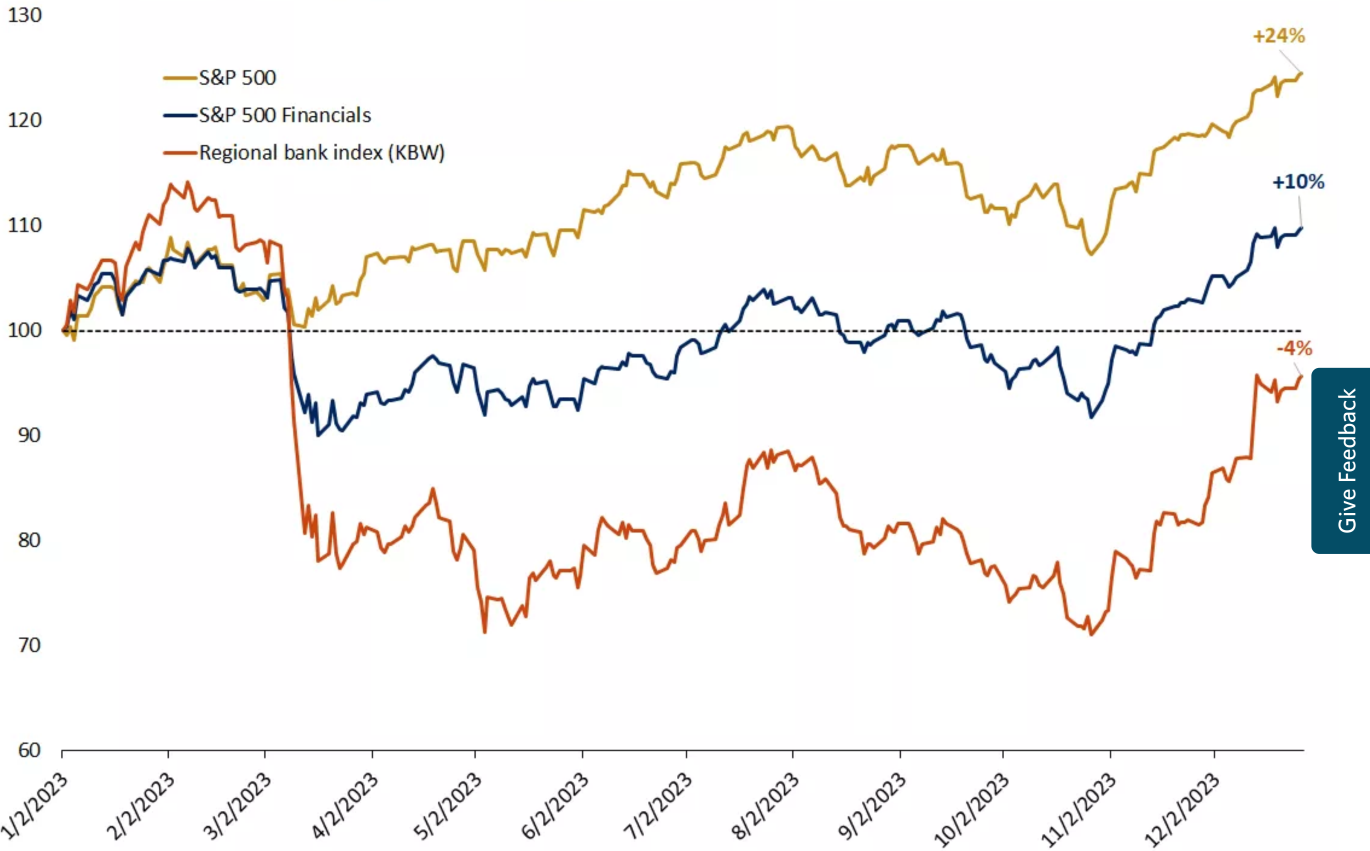

Source: FactSet, Edward Jones.

Chart description

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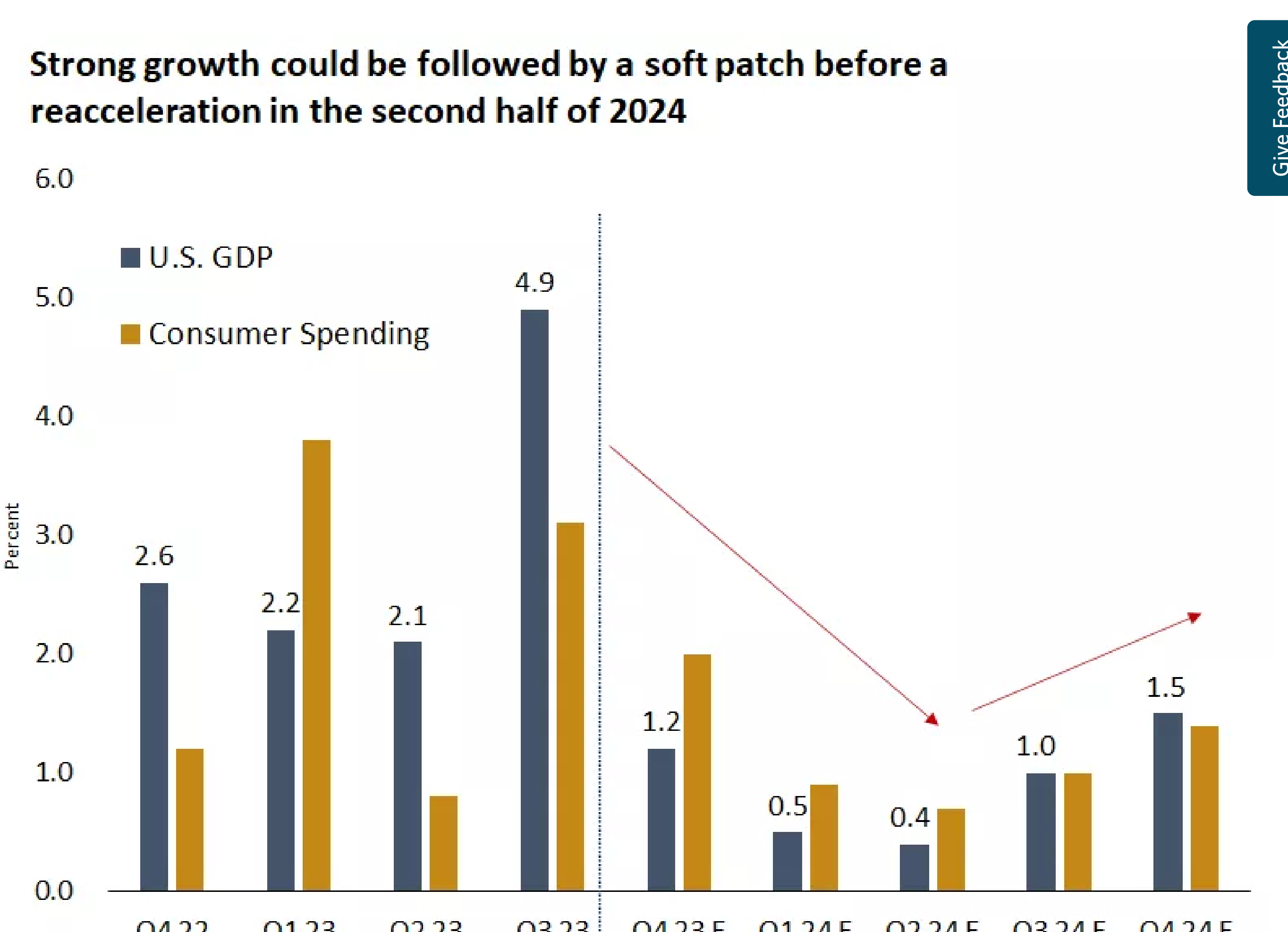
3. **Economy defied expectations for a slowdown**

One of the bigger upside surprises in 2023 was the strength of the labor market and consumer spending. The much-feared recession never materialized, not at least in the traditional way with all sectors of the economy contracting at the same time. Two cylinders of the economic engine have been misfiring. Manufacturing activity has been under pressure for the past 13 months, while housing-sector investment declined materially in 2022 and the first quarter of this year[1].

But as the consumer goes, so goes the economy. Growth benefited from robust spending on services, with the resilience of the consumer traced to excess savings and a tight labor market. The unemployment rate reached a half-century low in the first half of the year, and job openings, while on a decline, continued to greatly exceed the number of unemployed[1].

2024 views – Unique factors for this cycle and pandemic distortions have helped make the economy less sensitive to rising rates, but their effect will gradually fad

We expect U.S. economic growth to soften in the first half of 2024, falling below trend but potentially staying positive, and likely reaccelerating later in the year. As consumption slows, manufacturing and housing could start rebounding, providing a buffer. A slowdown in demand, a better-balanced labor market, and higher productivity should help inflation return to target sooner and support the start of a loosening in Fed policy.



Source: Bloomberg, Edward Jones. U.S. quarter-over-quarter annualized GDP growth.

Chart description

4. **The Fed was first a source of pressure for markets, but later a catalyst for a year-end rally**

The trajectory of Fed policy was once again in the driver's seat for markets this year. In its ongoing fight to tame inflation, the Fed hiked interest rates four times this year on top of the seven rate hikes in 2022, taking its policy rate to 5.25% - 5.5%, a 22-year high[1]. Even though the Fed slowed the pace of hikes and eventually paused, t "higher-for-longer" messaging pushed the 10-year Treasury yield to its highest si

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2007, pressuring equity valuations and bond prices.[1]

But at its last meeting for the year, policymakers signaled a major pivot, first communicating that the tightening cycle is complete, and second, indicating the start of a rate-cutting cycle in 2024. The three rate cuts projected acknowledge the improvement in inflation, which is rapidly moving toward the 2% target despite a strong economy and low unemployment.

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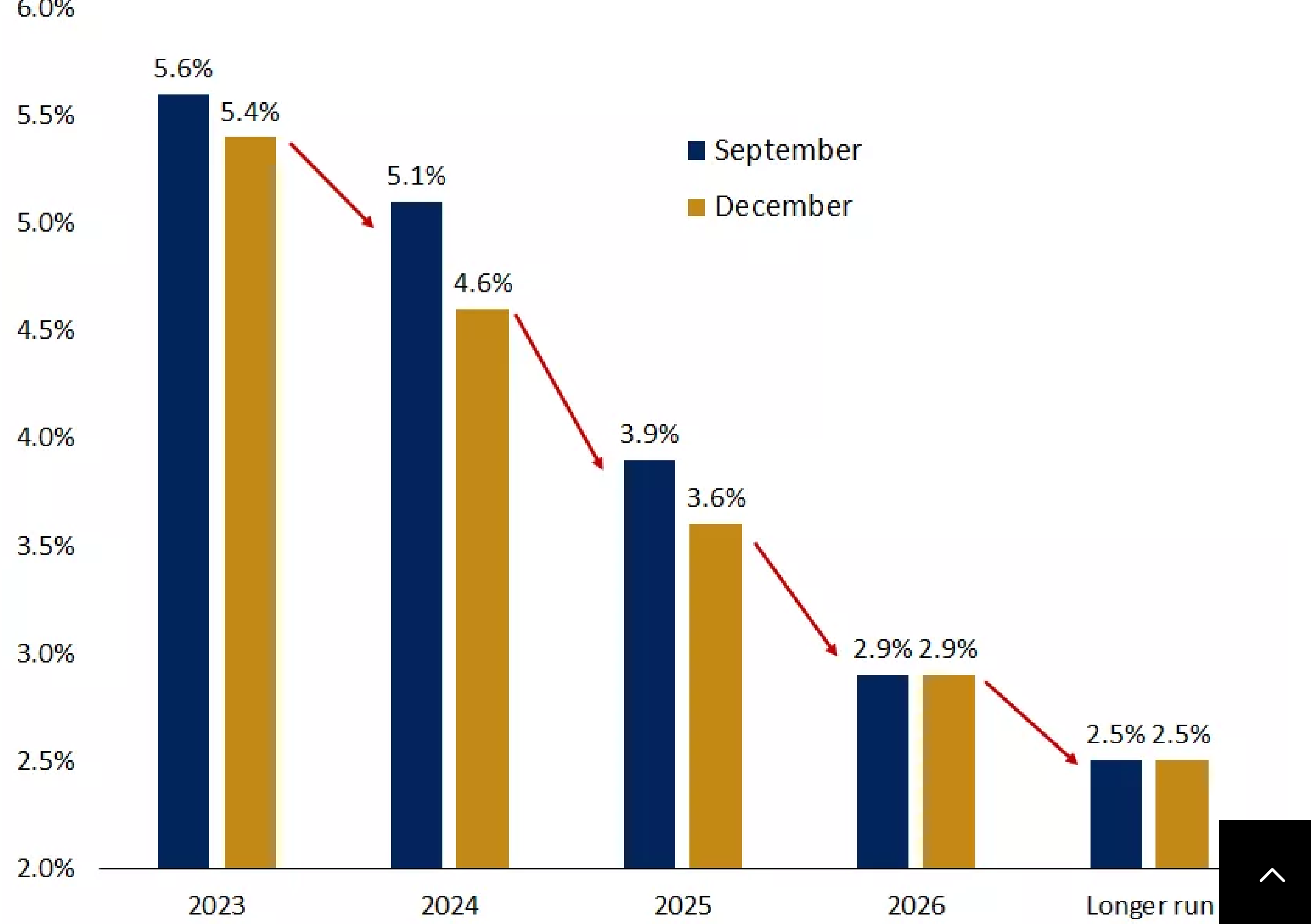
2024 views – The drop in yields and rally in stocks the last two months of the year have eased financial conditions, raising the chances of the economy achieving a soft landing. But markets have now gone a step further, pricing in six rate cuts in 2024, which is more than twice as much as Fed officials are projecting[1]. We think that there is some scope for the Fed to cut more than three times, but the push and pull between aggressive market expectations and Fed messaging could trigger volatility early in the year. Nonetheless, the Fed pivot to a more neutral stance is market-positive.



Source: FOMC projections.

Chart description

5. **The "Magnificent 7" drove the gains, leaving everything else behind**

Narrow market leadership was another major theme in 2023, as the mega-cap technology companies powered the broad market higher. Halfway through the year, the so-called "Magnificent 7" (Amazon, Apple, Alphabet, Meta, Microsoft, NVIDIA and Tesla) were responsible for 90% of the S&P 500 gains, as innovation around AI took center stage and captured investors' interest[1].

However, up until the middle of November, the "average" stock was treading water, weighed by worries about the lagged effects of high interest rates. Showcasing this point, the S&P 500 Equal Weight Index, which assigns the same weight to all the stocks that are included, was flat for the year vs. the 100% gain for the Magnificent 7[1].

2024 views – Despite the broadening of the rally in December, we think the wide divergence in performance still offers opportunities for long-term investors. Valuations for the lagging segments of the equity market, which include small-caps, bond-proxies like high-quality dividend stocks, cyclical sectors, and value-style investments, are favorable. As the strength and sustainability of the bull market is likely confirmed in 2024, it will provide an opportunity for the laggards to catch up. We think diversification is likely to dethrone concentration in 2024.

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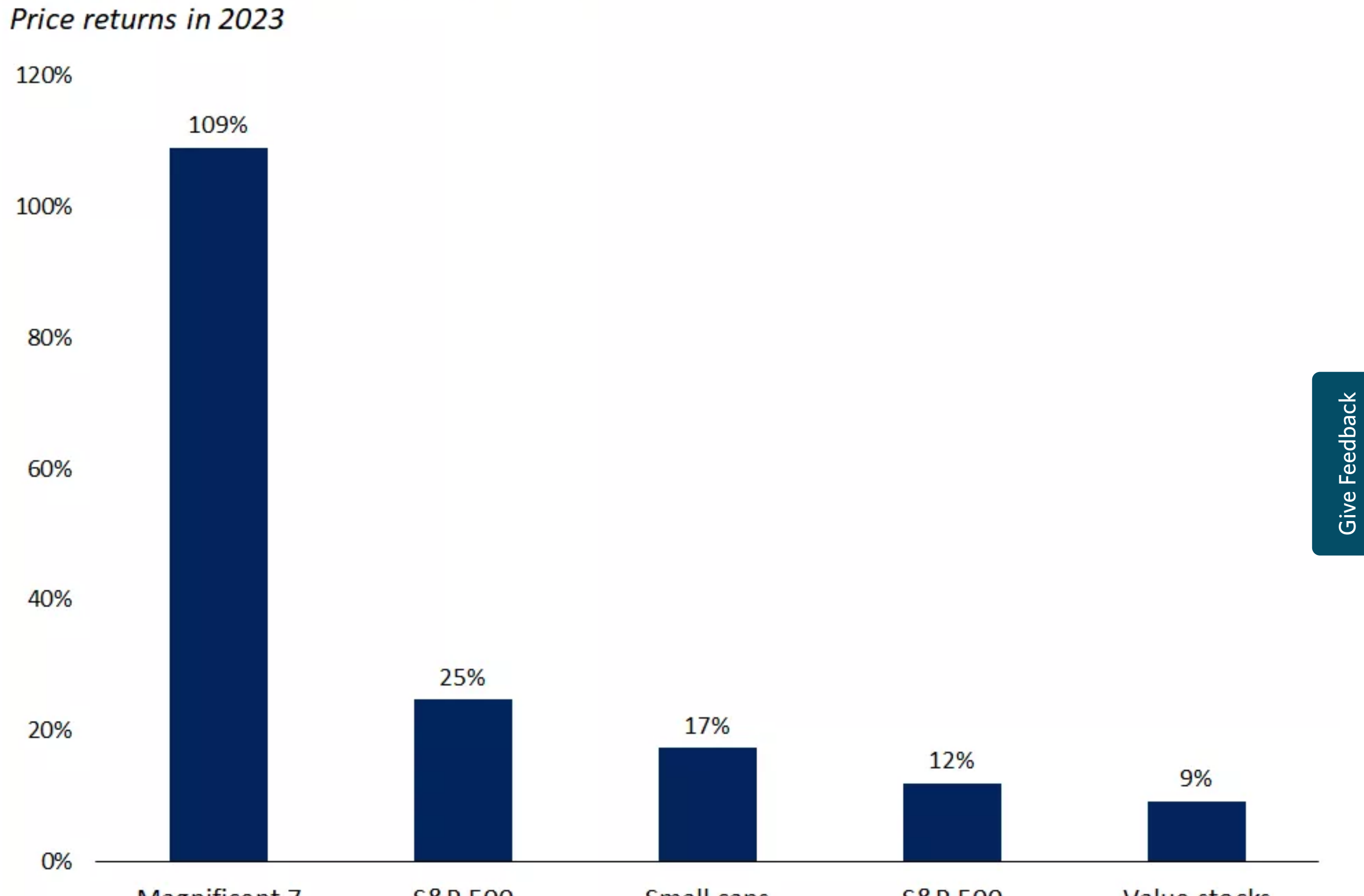

Source: Bloomberg, Edward Jones. Magnificent 7 represented by Amazon, Apple, Alphabet, Meta, Microsoft, Nvidia and Tesla.

Chart description

Farewell 2023, Hello 2024!

By all accounts, 2023 proved to be a positive year for investors, with strong gains across sectors, styles and market caps, a good reminder for investors of the importance and value of staying invested, even as headlines might paint a less-than-rosy picture. Unlike last year where cash was the only positive asset class, this year all 11 asset classes in our framework were positive, with cash giving up its lead[1]. Bonds experienced another volatile year but have been coming back with a vengeance over the past two months, and still offer attractive income and the potential for further price appreciation.

No doubt 2024 will bring its own twists and turns in the market narrative, but there are reasons for optimism as we head into the new year. Interest rates have likely peaked as the Fed starts paving the road for rate cuts, inflation continues to moderate, corporate earnings are rebounding, and valuations outside of the big year-to-date gainers remai

reasonable. To read our full 2024 outlook, head here.

From all of us at Edward Jones, we wish you a healthy and prosperous new year!

Angelo Kourkafas, CFA
Investment Strategist

Sources: 1. Bloomberg

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Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	37,690	0.8%	13.7%
S&P 500 Index	4,770	0.3%	24.2%
NASDAQ	15,011	0.1%	43.4%
MSCI EAFE*	2,241	1.4%	15.3%
10-yr Treasury Yield	3.88%	0.0%	0.0%
Oil ($/bbl)	$71.38	-3.0%	-11.1%
Bonds	$99.26	0.4%	5.7%

*Source: FactSet, 12/29/2023. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance does not guarantee future results. *4-day performance ending on Thursday.*

The week ahead

Important economic data being released this week includes several labor market readings including JOLTS job openings, nonfarm payrolls, and the unemployment rate for December.

Review last week's weekly market update.

Angelo Kourkafas

Senior Strategist, Investment Strategy

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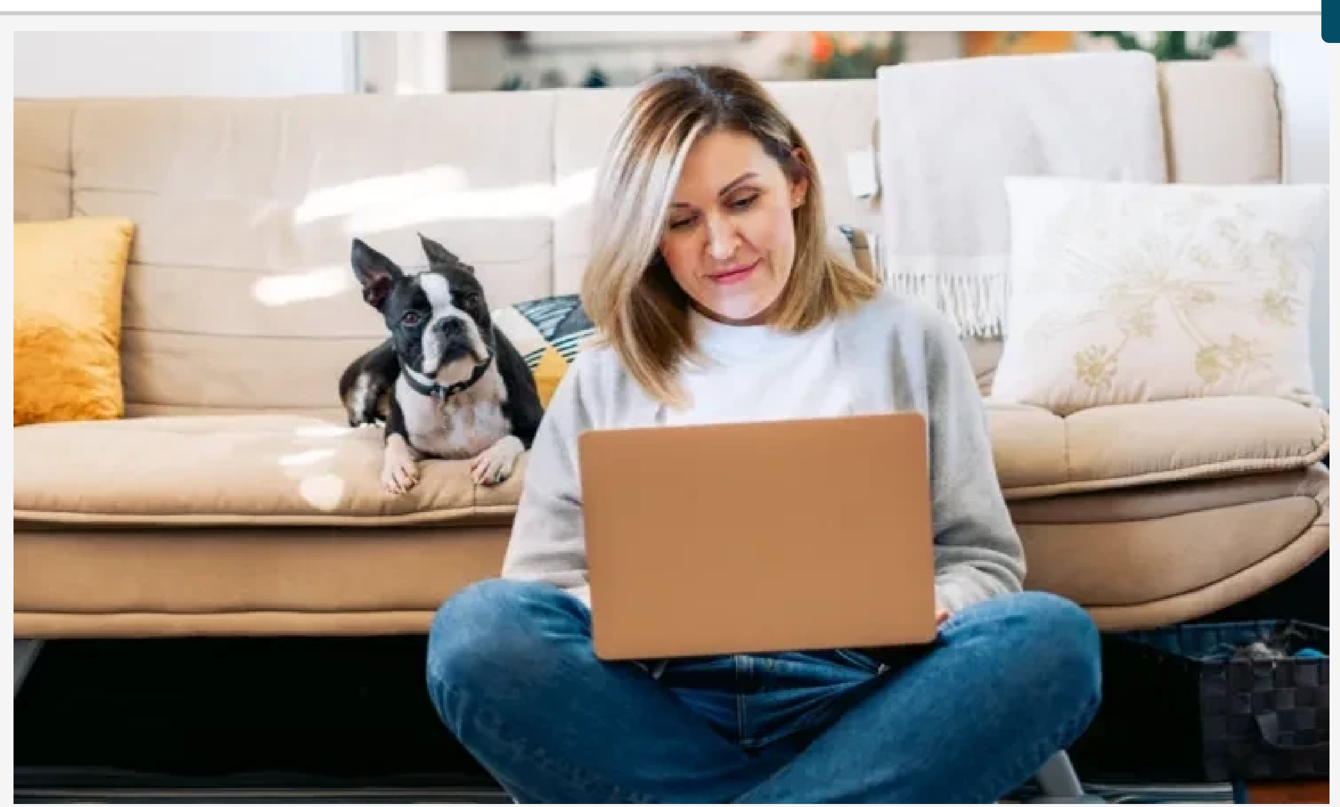

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Market Data

DJIA 37,689.54 ↓ (-20.56)

S&P 500 4,769.83 (0.00)

NASDAQ 15,011.35 (0.00)

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