INVESTMENT STRATEGY UPDATE

MARKET REPORT
JANUARY 2024

ASCENTIAL WEALTH ADVISORS

MARKETS RISE WITH FALLING INFLATION

Markets ended 2023 on a high note after a strong fourth quarter rally. After inflation figures showed a significant slowing in Q4, in December the US Federal Reserve changed its interest rate outlook from "higher for longer" to the possibility of multiple rate cuts in 2024. Despite softening in some areas of the economy and falling inflation, the US economy and labor market remained strong through 2023, with unemployment holding below 4% and wage growth finally outpacing inflation. Economic growth is expected to slow in 2024, but the market rose based on optimism that the Fed may reach its 2% inflation target without causing a recession.

In the US, stock performance was broadly positive, but returns were uneven. After posting the worst returns in 2022, technology companies saw the largest increases in 2023 driven by the profitability potential of artificial intelligence. The NASDAQ rose 43.4% for the year, with the big tech names also driving a large portion of the S&P 500 Index return. Stripping out the outsized impact of the big tech names in the market capitalization weighted index, the "equal weighted" S&P 500 Index was up a more modest 11.6% for the year.

International equities were also positive for the year and in line with broader US markets. Although with a lower technology weighting, foreign indices lagged the S&P 500 and the NASDAQ. With a 9.8% return for the year, emerging markets were the overall laggards primarily due to weakness in China.

Bonds also got a boost from falling inflation with the Bloomberg US Aggregate Bond Index gaining 6.8% in the fourth quarter and turning positive for the year. The 10-year US Treasury yield fluctuated dramatically throughout the year on interest rate uncertainty, ending 2023 where it started at 3.9% after hitting almost 5% in October. Absent a resurgence of inflation, it appears that interest rates may have peaked for this cycle. While the Fed has stated rate cuts are likely in 2024, markets are now pricing in more significant rate cuts than the Fed indicated.

Index	*2023 (through 12/31)*
S&P 500	+26.3
Dow Jones Ind. Avg.	+16.2
MSCI EAFE	+18.2
BC US Aggr. Bond	+5.5

Dow Jones Relative Risk Benchmarks	
Conservative	+6.9
Moderate	+12.7
Aggressive	+19.0

Even with the late rally, bonds and most equities ended 2023 still below their January 2022 highs. As we look ahead to 2024, we are conscious of lingering recession and geopolitical risks, and mindful of potential heightened market volatility due to the US presidential election. However, for diversified portfolios fixed income now offers attractive income and should provide a buffer against equity volatility, and in time markets and portfolios will recover fully to their 2022 highs.

OUR VIEW

FIXED INCOME:
Bond investors may be rewarded in 2024 after a painful period of rising interest rates that began at the end of 2021. After peak interest rates, bonds historically have experienced a period of strong returns. At the end of 2023, short term yields remained higher than long term yields with the anticipation of falling interest rates in 2024. Yields on cash ended 2023 at decade long highs, however cash yields are likely to fall quickly as rates come down. There is likely better long-term opportunity in other fixed income at this point, and we recommend starting to shift cash to more diversified options that appear to have better long-term return prospects.

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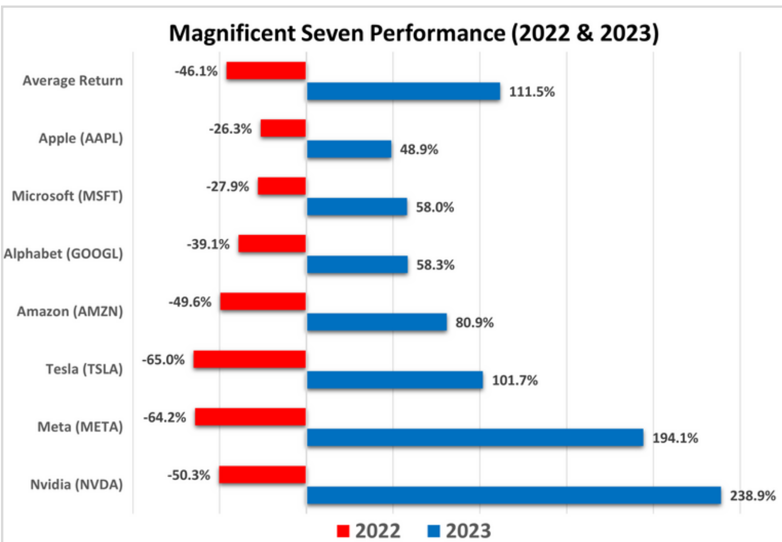
US EQUITY:

The expansive fourth quarter rally lifted most stock indices to their annual highs. The biggest returns of 2023 were concentrated in a handful of technology companies, and while those companies now appear somewhat expensive, there are many others with lessfrothy valuations. The price to earnings ratio of the top 10 companies in the S&P 500 ended 2023 at around 27 times earnings. However, the 490 other stocks in the index were trading around 17 times earnings. (JP Morgan, Dec 2023) We remain in favor of defensive positioning in stocks, with a focus on large, quality companies, and lower exposure to small and mid-size companies. We also recommend adding higher income generating investments which can provide returns if markets trade sideways in a volatile election year.

INTERNATIONAL EQUITY:

Foreign equities also rode the rally wave in the fourth quarter despite a new conflict breaking out in Gaza and the ongoing war in Ukraine. Japan was the top performer for the year, with inflation and higher interest rates helping pull its economy from a decade long slump. Equity markets in emerging countries such as India, Brazil, and Taiwan posted strong gains as well. However, the broad emerging market index was weighed down by negative returns in China where the economy has continued to struggle with problems in its real estate market. A decline in the US dollar at the end of 2023 helped to boost foreign returns as well. Even after the recent rally, foreign stocks are cheaper than US stocks and carry higher dividend yields. We feel there is more room for recovery in foreign stocks and should geopolitical risks moderate, we would be in favor of increasing allocations, but recommend maintaining current exposure at this time.

MAGNIFICENT SEVEN MAGNIFIED IN 2023



Source: Morningstar, 2023

The S&P 500 Index is a market capitalization weighted index. Concentration in the index has increased recently as performance has been dominated by a handful of large companies.The top 10 stocks, representing 2% of the 500 companies, now account for 32% of the index calculation. These large companies did exceedingly well in 2023, treating index holders to big gains. However, concentration poses risk as well, and results for these giants could just as easily skew to the downside.

Seven of the top 10 names in the S&P 500, coined the “Magnificent Seven”, are technology companies, adding additional risk from sector concentration. After delivering some of the worst returns in 2022, the “Magnificent Seven” stocks significantly outperformed in 2023.

Historically there has been a significant correlation between high concentration in the market capitalization weighted S&P 500 and subsequent outperformance of the equal weighted S&P 500 Index over the following 5-year period (Hartford, December 2023). Investors should be aware of current index concentration and consider widening exposure, either through broader, non-market capitalization weighted index funds or more active investment management.

11 E Superior St, Suite 500 | Duluth, MN 55802 | 218.336.2500 | 888.840.8299
AscentialWealth.com