



Seeking a Soft Landing Amid Market Turbulence

MARKET INSIGHTS

Global Financial Markets

Stock and bond markets rallied sharply in the final months of 2023 as the Federal Reserve indicated that interest rate policy could become more accommodative in the not too distant future. Once again, much of the rally in U.S. equities was led by the "Magnificent Seven," a cohort of large, tech-heavy companies, but many other asset classes also performed well. The Bloomberg Barclays Aggregate Bond Index rallied 6.82%¹ in the fourth quarter as optimism for lower rates spurred investor demand for bonds.

U.S. Economy

The U.S. consumer remains resilient. The U.S. Consumer Confidence Index, an economic indicator developed by

a nonprofit research organization known as The Conference Board, increased in December, reflecting levels of optimism not seen since July. Their chief economist, Dana Peterson, noted that the "December's increase in consumer confidence reflected more positive ratings of current business conditions and job availability, as well as less pessimistic views of business, labor market, and personal income prospects over the next six months."

Portfolio Implications

The Federal Reserve's guidance on monetary policy and strength in the U.S. economy have provided the markets with some recent relief. They will continue to remain critical in the year ahead. In our opinion, the most important market factors to monitor include: geopolitical

events, interest rates and monetary policy, inflation, economic growth, and technological advancements.

Of course, it is critical to remember that these factors have always influenced investor sentiment and asset prices, even during periods when they were not repeatedly in the headlines. Overweighting the impact of recent and readily available information is known in behavioral economics as an *availability bias*. The relative importance of each factor may change over time, but as the old Wall Street adage states, "If it is in the paper, then it is in the price." Acknowledging that markets have always had to adjust to these factors and understanding how behavioral biases can affect perception can provide comfort during periods of market volatility.

A CLOSER LOOK

Geopolitical events are likely to remain in focus for the foreseeable future. The Covid-19 pandemic, Ukraine-Russia conflict, tensions in the Middle East, and changes in the strategic relationship between the U.S. and China are threatening to reshape international policy and global economic frameworks. The rising risks of de-globalization must be considered because countries benefit greatly from international trade and cooperation. Geopolitical tensions and de-globalization can dampen economic growth, constrict supply chains, and cause inflationary shocks, particularly in commodities, that can limit the ability of central banks to provide more accommodative monetary policy.

Interest rate policy in the U.S. has far reaching implications for every asset class. While the Federal Reserve has seemingly signaled that it is unlikely to raise interest rates again in the near future, the timing and extent of their shift into accommodative policy remains unknown. Given the unprecedented size of the pandemic-related stimulus measures, the full impact of those policy decisions cannot fully be known. While inflation is

cooling, a tight labor market, elevated housing prices, and renewed consumer confidence could make achieving the Fed's 2% inflation target more difficult than expected. The dream of interest rate cuts amid a "soft landing" for the U.S. economy can only happen without inflationary turbulence.

The U.S. economy remains resilient, but risks to growth remain. Without spending cuts, domestic fiscal policy could slow economic growth as debt and interest payments will make up a larger proportion of the government's budget. An aging population in the U.S. may also temper growth prospects, but this headwind could be offset by increasing productivity, driven by technological advancements and artificial intelligence.

Economic growth outside of the U.S. remains tepid. However, international equity indexes are less concentrated than those in the U.S. and might benefit more broadly if economic conditions become more favorable for supportive monetary and fiscal policies.

GAINING PERSPECTIVE

The U.S. appears to be in a late cycle expansion. This is a phase of the economic cycle where markets can be volatile and fears of a recession will be increasing. This together with unsettling headlines can lead investors to panic. We must remember, though, that “time in the market” is more valuable than “timing the market.” As Vanguard notes, the years after the peak of the financial crisis were full of ominous data and headlines, but investors who stayed the course were rewarded.

Don't rely on headlines for an all clear to invest

Hypothetical \$1 million investment in Standard & Poor's 500 Index at pre-crisis peak, from market bottom in 2009 to breakeven in 2011



Source: Vanguard.

PORTFOLIO REALLOCATION AND REBALANCING

As financial markets have evolved, there has been downward pressure on the cost of owning mutual funds and exchange traded funds and many new products have entered the market. Simultaneously, the composition of the major indexes, like the S&P 500, have become more weighted toward technology stocks as they continue to outperform other sectors. These changes, along with our market outlook, have enabled us to make some beneficial changes to the core model portfolios:

Within our U.S. Large Cap stock exposure, the correlation between the S&P 500 and the Fidelity MSCI Information Technology Index (FTEC)

has made holding a technology-focused fund redundant and unnecessary. Eliminating the Tech Index will reduce expenses and increase diversification. We will maintain our value-oriented philosophy with an on-going allocation to our long-held Vanguard Value Index Fund ETF (VTV) as well as within our emphasis on U.S. Mid & Small Cap and International equities.

For the last few years, First Trust TCW Opportunistic Fixed Income ETF (FIXD) was a staple of our fixed income sleeve. However, Vanguard recently introduced an actively managed exchange traded fund that offers a comparable strategy and highly similar exposure

at a substantially lower cost. We still believe that there is a role for some active management in our fixed income portfolio.

Also in fixed income, we have replaced the iShares Core 1-5 Year USD Bond ETF (ISTB) with Vanguard Short-Term Bond Index Fund ETF (BSV). This change will improve credit quality and may allow for better returns in a falling interest rate environment.

These adjustments are a response to changes in the market and the evolution of investment vehicles, but, most importantly, are rooted in our disciplined investment philosophy.

Our portfolios are designed to meet our clients needs and help them achieve their long-term goals. Please contact your advisor to discuss how we balance risk and reward in your personalized plan.

- NorthLanding's Investment Direction Committee

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