

The Capital Markets

The stock market enjoyed a strong rebound in 2023, putting 2022 — a year that many investors were eager to forget — firmly in the past. The S&P 500 rose 24% in 2023, as enthusiasm around artificial intelligence and, more recently, the prospect of interest rate cuts drove the index to a near all-time high.

As impressive as broad index performance was, a recap of equity returns would not be complete without highlighting the fact that a small handful of technology stocks did most of the heavy lifting. The concentrated leadership observed in these companies: (Apple, Microsoft, Amazon, Meta, Nvidia, Alphabet, and Tesla) was reminiscent of the dot-com days and masked weakness in other corners of the market for much of the year. The “Magnificent 7,” as the group came to be known, returned 107% and accounted for more than 60% of total index performance.

It was not until November that most other stocks began to show signs of life. The average stock, represented by the S&P 500 Equal Weight index, finished the year up 11% after trading in negative territory throughout much of 2023.

Performance in 2023 was as much about what didn’t happen as what did. Last January most, including the Fed, believed a recession was a strong possibility following the most aggressive policy tightening in 40 years. Long known for tightening policy until something breaks, a series of regional bank failures in March led many to fear the day of reckoning had finally come. However, despite the banking scare, forecasters received a healthy dose of humility as the “most widely anticipated recession of all time” failed to materialize.

The “Magnificent 7” (comprised of Apple, Microsoft, Amazon, Alphabet, Nvidia, Tesla & Meta Platforms)

Newsletter Highlights:

Stock Market enjoyed a strong rebound in late 2023.

The “MAG 7” led the way as enthusiasm rose around AI

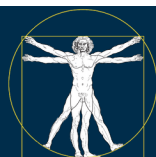
Large companies drove the rally in equities, with the 10 largest stocks in the S&P 500 accounting for roughly 80% of total gains.

The economy has shown impressive resilience despite the most aggressive monetary tightening in 40 years

Recent jobs data suggests the labor market remains strong.

Inflation has cooled but high prices still effect households

The Fed has reigned in prices without disrupting the labor markets



Time will tell whether last year's forecasts of a recession were early or just plain wrong. For now, investors are enjoying a favorable backdrop in which inflation is moderating towards more normal levels and the labor market appears healthy. These conditions have helped support consumer spending, a category which accounts for roughly two-thirds of total U.S. economic activity.

Although the economic landscape has improved, all is not as rosy as it appears.



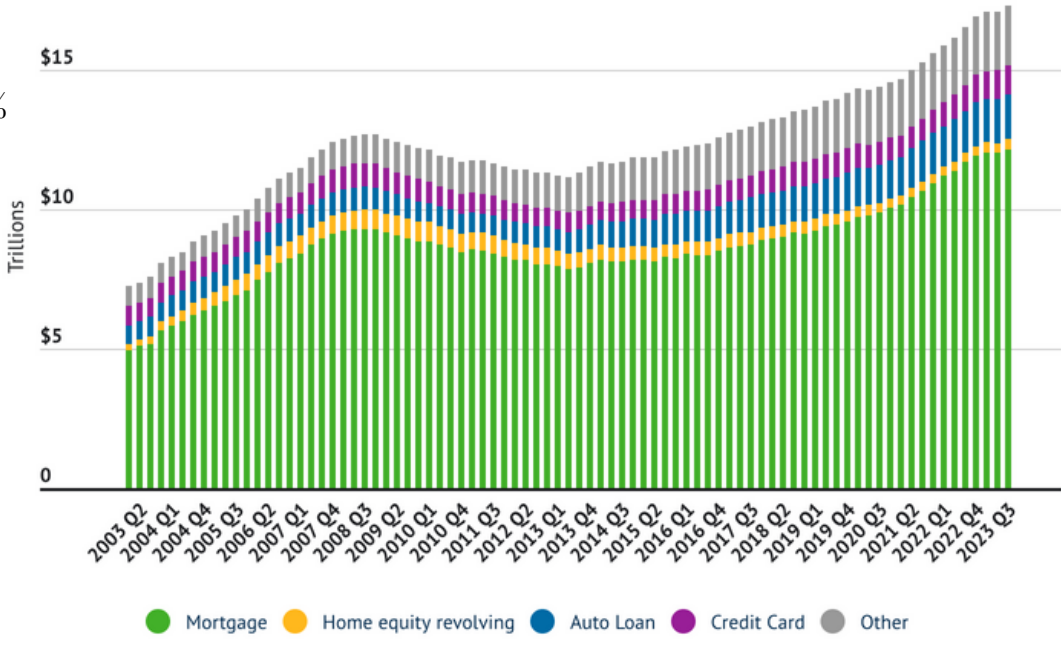
Source: Wall Street Journal

Inflation has Slowed but Higher Prices still affect Households

While Wall Street is celebrating the fact that annualized price growth has stabilized, Main Street is focused on the fact that overall price levels remain nearly 20% above their pre-pandemic levels. The lasting impact of recent inflation can be observed in spending data, which reflects a growing reliance on credit card debt coupled with rising delinquency rates.

Total household debt by type

Although the rate of price growth has moderated, overall price levels (measured by the Consumer Price Index) have increased by roughly 20% since the end of 2019. Evidence of the stress this is causing on households can be seen in the sharp rise in revolving credit and suggests consumers are increasingly relying on credit to support their spending.



Source: Data source: Federal Reserve (2023)

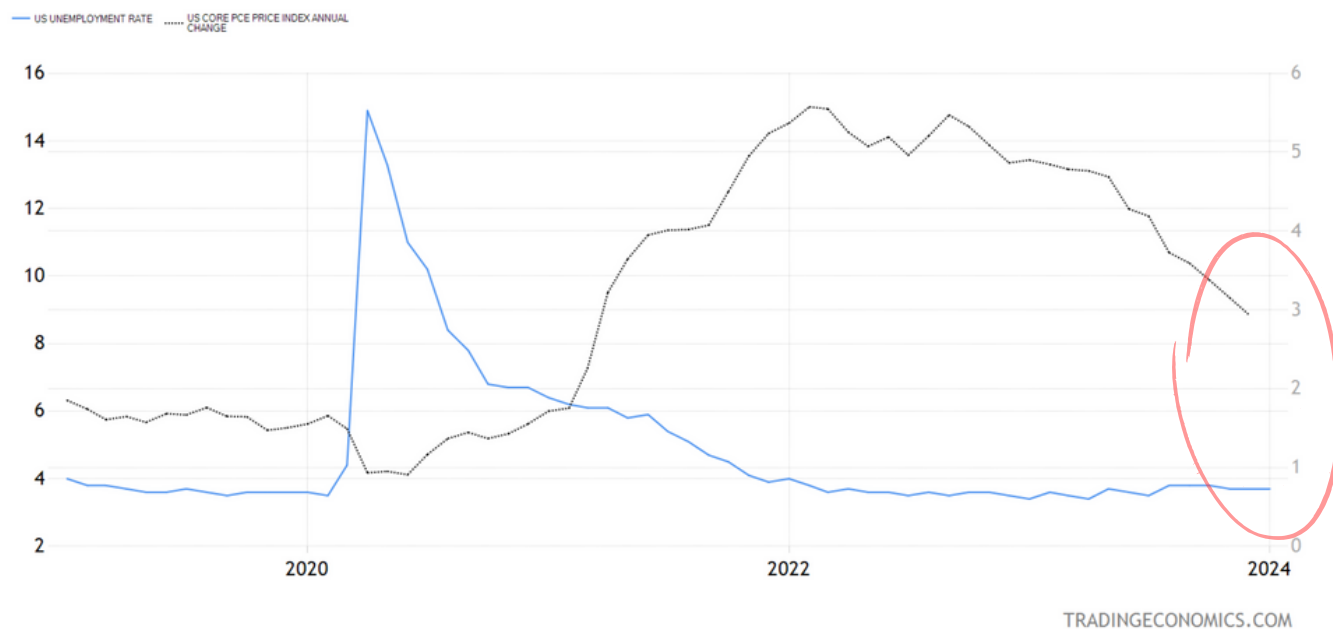
For its part, the Federal Reserve seems pleased with the results of its work to rightsize the economy, recently suggesting it could cut rates multiple times in 2024. Many have interpreted this as a victory lap, confirming that we are now at peak policy rates. The Fed's shift towards a more accommodative policy stance changed the consensus outlook overnight and ignited animal spirits among investors in the year's final weeks. As we turn the page to a new year, our outlook can be best described as cautiously optimistic.

History tells us it is risky to bet against the Fed when it has made its intentions clear, and its intentions are certainly bullish for the market. However, we must be mindful of what current valuations tell us about market expectations, and here the market's recent advance suggests there is little room for disappointment. It is fair to celebrate the recent progress seen on inflation, which is trending steadily towards more normal levels since peaking in mid-2022.

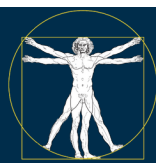
This moderation in price growth is even more impressive because it has so far occurred without a meaningful drop in demand or a spike in layoffs. However, whereas raising interest rates was the obvious policy prescription when inflation was elevated, it is considerably more difficult to know when to start weaning the patient off the medicine.

The Fed (so far) Managed to Reign In prices without Causing Layoffs

The Fed's preferred inflation rate has continued to trend lower in recent months while the labor market remains healthy. Although it is too early for the Fed to consider its mission accomplished, this has increased the probability of a soft economic landing which is boosting appetite for risk assets like stocks.



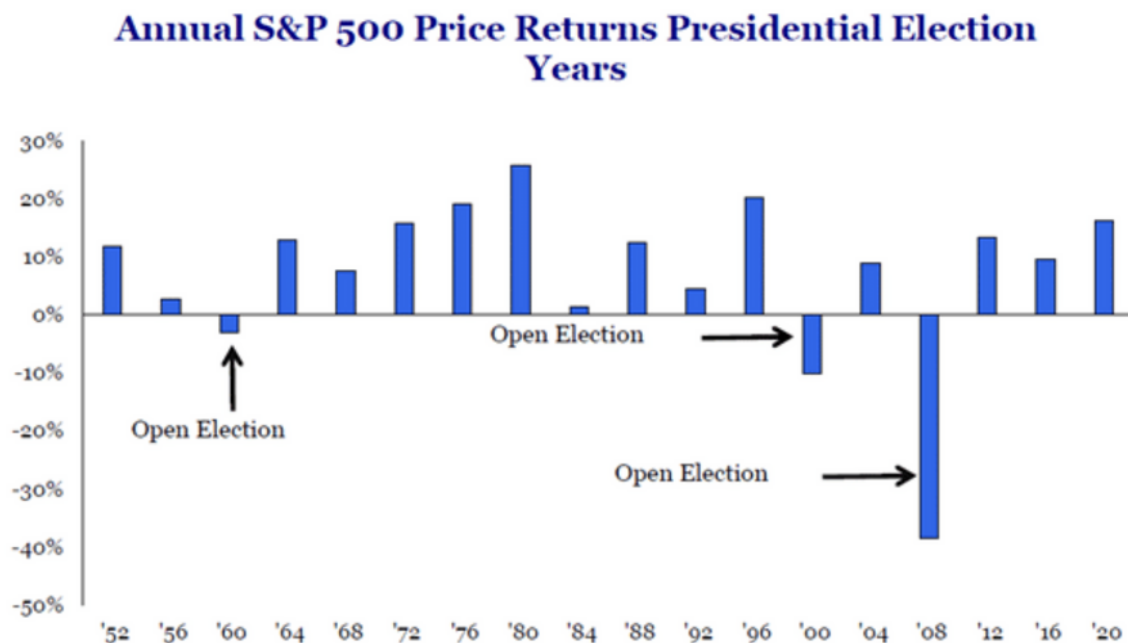
The timing and magnitude of rate cuts will be the focus of much speculation in 2024, but we see no easy decisions for policymakers in the year ahead. The Fed may assume that recent disinflationary momentum is locked in and opt to reduce rates before policy becomes overly restrictive and risks doing more harm than good.



On the other hand, Jerome Powell and his colleagues no doubt want to avoid the cardinal sin of becoming too accommodative too fast, an error that caused a resurgence of inflation in the 1970's and etched the name of then-Fed Chair Arthur Burns in history for all the wrong reasons. As if these decisions were not difficult enough, any policy moves next year are likely to face additional scrutiny because of the upcoming U.S. presidential election. Although the Federal Reserve is an independent government agency, its actions have a meaningful impact on the economy. As the election approaches in November, the Fed will have to manage optics and prepare to respond to those who might accuse it of showing favoritism towards either political party.

While the political environment could make life more complicated for the Fed, it is worth noting that presidential re-election years are generally favorable for investors. The S&P 500 has not declined in a re-election year since 1948, a streak which is owed to the fact that incumbents tend to prime the economic pump with favorable policies ahead of the vote. Although past performance is no guarantee, the economy is expected to enjoy a fiscal tailwind in 2024 in the form of infrastructure spending and the Inflation Reduction Act.

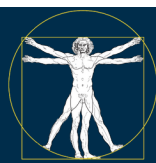
The S&P 500 has posted a positive return in each re-election year since 1952. Performance across all presidential election years tends to be favorable, with notable exceptions being in 2000 and 2008, years which coincided with the dot-com bubble and Global Financial Crisis.



Source: Sequoia-financial

I am often asked what would make us more bullish on our investment outlook, absent an equity market repricing which would result in more attractive valuations. My response is that although we see an opportunity for additional gains in the months ahead, it is important to prepare for various outcomes given the current level of economic and geopolitical uncertainty. We would welcome an easing of geopolitical tensions, whether it was an improvement in the relationship between the U.S. and China or a de-escalation in the war between Russia and Ukraine. Admittedly, neither of these seems likely over the short term.

Within equities, investors must not become too enamored with recent winners. Although the companies that comprise the Magnificent 7 are quality businesses, they represent a small subset of the investable market and should be complemented by companies in other industries that now trade at more attractive valuations and can outperform in different environments. For additional perspective, the combined value of these companies now exceeds the combined market cap of stock markets in Japan, Canada, and the UK.

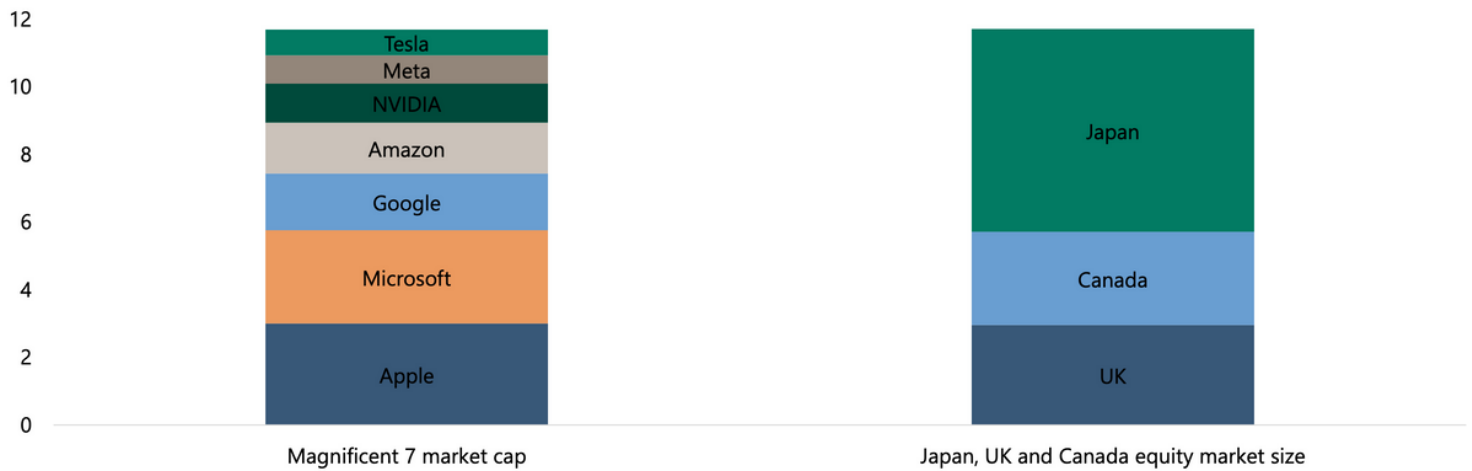


“Diversification is the only free lunch in investing”

Harry Markowitz

Market cap of the Mag 7 is the same as the **combined** market cap of the stock markets in Japan, Canada, and the UK

Magnificent 7 Market Cap vs. Equity Markets of Japan, Canada & UK



Source: Bloomberg, Apollo Chief Economist

After rising more than 105% in 2023, the companies that comprise the Magnificent 7 are now worth more than equity markets in Japan, Canada and the UK combined. Although they are quality businesses, they only represent a small portion of the investable market.

As we bid farewell to the favorable market returns of 2023, we acknowledge the uncertainty that lies ahead. Surprises will no doubt be in store for 2024, but we'll be there to navigate the journey with you. Wishing you all the best in the new year. If you have any concerns about your portfolio, I encourage you to review your financial plan and revisit your individual goals and objectives. This will hopefully give you peace of mind and help you make informed decisions about your investments.

Remember, the financial landscape can be complex and unpredictable, but by staying informed and proactive, you can navigate it with confidence. Don't hesitate to reach out for support and guidance as you work towards your financial aspirations.



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