Q1 2024 NEWSLETTER

IMPACT

FINANCIAL STRATEGIES

January 3, 2024

Nobody Likes an Eeyore

"Sure is a cheerful color. Guess I'll have to get used to it." – Eeyore**

Eeyore is distraught; he's lost his tail! Christopher Robin and Piglet have an idea to attach a wonderful red balloon to solve the problem. True to form, and instead of being happy with everyone else, Eeyore delivers the quote above. As a kid, I loved The Mini Adventures of Winnie the Pooh; who didn't? But in real life, who wants to hang around or listen to an "Eeyore." And that truism made this Newsletter intro particularly difficult to write. I try to have an outlook more like Tigger, less like Eeyore, but lately, I'm not feeling so blindly optimistic. The market is like the Red Balloon; it sure is cheerful; with the Dow reaching new highs while everyone cheers. What's priced in? Near perfection, no recession, immaculate disinflation, and smooth sailing with 6 anticipated rate cuts this year! Of course, *I want* the markets to always go up, but unlike Pooh's world, that's not reality. I feel a bit like Eeyore when I push back and say that I still don't fully believe it. The S&P is telling me I'm wrong.

Maybe its because this year I turn 50, Maybe its because I'm now going to all those "doctor appointments," that used to be the burden of others. Maybe it's that Alzheimer's and Brain Dementia are playing an ever-increasing role in my life. I know for certain that I'm dreading another round of election noise, anger, and vitriol. Regardless of the why, I am spending more time than ever trying to make sense of the economy and the markets and how and where to best deploy your capital (and mine). It's especially difficult to chase risk when Money Markets are paying so well to sit on the sideline and observe this economy. It has never been harder.

All that being said, there are more opportunities in this market than I have seen in a very long time. Valuations are not stretched everywhere, we just need to be patient to see that the economic indicators verify what the market is currently telling us: that we are *out of the woods*. There are some positive signs, with inflation easing and a still strong labor market, but there is not enough clear evidence yet. When there is, we will be ready, and I will act. Being a bit conservative for a bit longer will position us better than ever to take advantage of these opportunities. I am truly excited for what the next cycle has in store. However, even with some major problems seemingly avoided, I'm not sure we are there yet.

Ok… I suppose I'm probably just crabby because I'm doing "Dry January" for the first time; it's not very fun, and I do like fun… But I know that is something that will get better in February (Cheers!), and hopefully, *so does the data*. And that, my friends, will make for a good 2024! Stay warm and stay safe!

I hope you enjoy the rest of this newsletter, please reach out if you have any questions or comments,

Justin

Quarterly Insights – January 2024

Powell Pivots. Markets Ignore Warning Signs. Magnificent 7 Rip Higher.

Markets staged an impressive reversal in the fourth quarter thanks to a surprise dovish pivot by the Federal Reserve, which combined with solid economic activity and declining inflation to push stocks sharply higher and send the S&P 500 to two-plus-year highs, resulting in the best annual return since 2021.

The strong fourth quarter performance somewhat obscures the fact that stocks and bonds started the fourth quarter under significant pressure. First, Treasury yields continued to move higher in early October which weighed on stocks and bonds, just like in the third quarter. Then on October 7th, Hamas soldiers infiltrated settlements in Israel, killing and kidnapping more than 1,200 Israelis in the worst attack on Israel in decades. The market fallout was immediate, as oil prices spiked on fears a broader regional war would ensue between Israel, Hamas, Lebanon and, potentially, Iran. Higher oil prices fueled a further increase in Treasury yields as investors priced in a possible oil-driven bounce back in inflation. Those factors, combined with a lackluster earnings season, resulted in the S&P 500 falling to the lowest levels since mid-May while the 10-year Treasury yield touched 5.00% for the first time since the mid-2000s. However, markets reversed when Fed Governor Chris Waller made comments that implied rate hikes were over and rate cuts may be coming in 2024. The market reaction was immediately positive as stocks and bonds rallied hard into month-end to finish well off the lows and with just a 2% decline.

That positive momentum continued in November as the S&P 500 posted its best monthly return of 2023, rising more than 9%. There were several factors that fueled this rally. First, numerous Fed officials echoed Waller's commentary and investors priced in rate cuts as early as May, substantially earlier than previously expected. Additionally, the Israel/Hamas conflict did not spread and remained contained between Israel and Hamas and oil prices declined as a result, easing inflation concerns. Finally, inflation metrics continued to decline. The year-over-year increase in the Consumer Price Index dropped to 3.14% and that further fueled investor expectations that rate cuts would come in the first half of 2024. Those factors combined with generally favorable seasonality to fuel a welcomed "Santa Claus Rally."

The Santa rally continued and accelerated in December courtesy of the Fed. At the December 13th FOMC meeting, Fed officials clearly signaled that rate hikes were over and forecasted three rate cuts in 2024, one more than previously forecasted. Additionally, Fed Chair Powell did little to push back against the markets' expectations for rate cuts. Put plainly, the Fed surprisingly pivoted to a more dovish policy stance and that fueled a continuation of the rally that started in late October. The S&P 500 rose to the highest level since January 2022 while the Dow Industrials hit a new all-time high.

In sum, 2023 was a year of surprises for the markets as the expectations for a recession never materialized, inflation fell faster than forecasts, corporate earnings proved resilient and the Fed surprised markets by pivoting to a more dovish future policy. The result was substantial gains for the major averages.

<u>Q4 and Full Year 2023 Performance Review</u>

Stocks enjoyed a broad and powerful rally in the fourth quarter as all four major U.S. stock indices posted strong quarterly gains. Investor expectations for rate cuts in 2024 were a major influence on markets in the fourth quarter as the Russell 2000 and Nasdaq 100 outperformed the S&P 500 over the past three months, as companies in those two indices are expected to benefit most from a sustainable decline in interest rates. For the full year, however, the dual influences of 1) Artificial Intelligence (AI) enthusiasm and 2) Rate cut expectations drove performance as the tech-heavy Nasdaq 100 massively outperformed the other major stock indices, surging more than 50%. The S&P 500 also logged a substantial gain of over 20% thanks mostly to the large weighting of technology stocks in the index. The less-tech-stock-sensitive Dow Industrials and Russell 2000 also enjoyed strong returns in 2023, but relatively underperformed the Nasdaq and S&P 500. Notably, the index performance for the full year 2023 was the opposite of 2022, where we saw the Nasdaq and small caps decline substantially more than the S&P 500 and Dow Jones Industrial Average.

S&P 500 Total Returns by Month in 2023											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
6.28%	-2.44%	3.67%	1.56%	0.43%	6.61%	3.21%	-1.59%	-4.77%	-2.10%	9.13%	4.54%

Source: Morningstar

<u>By market capitalization</u>, small caps outperformed large caps in the fourth quarter thanks to those surging rate cut expectations, as lower rates are typically most beneficial for smaller companies. For the full year, however, large caps handily outperformed small caps thanks to the strength in large-cap tech stocks and as the higher rates in the first three quarters of 2023 weighed on small cap performance earlier in the year.

US Equity Indexes	**Q4 Return**	**2023 Return**
S&P 500	11.69%	26.29%
DJ Industrial Average	13.09%	16.18%
NASDAQ 100	14.60%	55.13%
S&P MidCap 400	11.67%	16.44%
Russell 2000	14.03%	16.93%

Source: YCharts

<u>From an investment-style standpoint</u>, growth significantly outperformed value both in the fourth quarter and for the full year. The reasons were familiar ones: Artificial intelligence enthusiasm powered tech-heavy growth funds early in 2023 while in the fourth quarter expectations for rate cuts were seen as positive for growth stocks. Growth outperforming value is also the opposite of 2022, where higher rates and recession fears resulted in value outperforming growth.

<u>On a sector level</u>, 10 of the 11 S&P 500 sectors finished the fourth quarter with a positive return, while eight of the 11 sectors ended 2023 with gains. Not surprisingly, the dual influences of artificial intelligence enthusiasm and expectations for rate cuts drove sector trading in the fourth quarter and throughout the year. In the fourth quarter, the influence of expected lower rates was dominant as REITs

were the best performing sector, followed by tech. Both stand to benefit from falling interest rates. Cyclical sectors also outperformed over the past three months as expectations for stable economic growth rose as the Fed telegraphed future rate cuts. For the full year, however, the influence of AI enthusiasm was clearly the dominant influence on sector trading, as the three most "AI sensitive" sectors (tech, consumer discretionary and communications services) massively outperformed the remaining eight S&P 500 sectors.

Looking at sector laggards for the fourth quarter and for the full year, defensive sectors including consumer staples and utilities lagged as economic growth was more resilient than expected while higher rates (for most of 2023) reduced the demand for high dividend yielding sectors. Consumer staples and utilities posted negative returns for 2023 after being the best relative performers in 2022.

Internationally, foreign markets lagged the S&P 500 in the fourth quarter thanks mostly to muted gains in the emerging markets following increased geopolitical tensions in the Middle East and on continued lackluster Chinese economic growth. Foreign developed markets outperformed emerging markets in Q4 on better-than-expected inflation readings and rising expectations other major central banks will follow the Fed's lead and cut rates in 2024. For the full-year 2023, foreign developed markets registered solidly positive returns but handily underperformed the S&P 500 thanks primarily to the large gains in U.S. tech stocks.

International Equity Indexes	Q4 Return	2023 Return
MSCI EAFE TR USD (Foreign Developed)	10.47%	18.85%
MSCI EM TR USD (Emerging Markets)	7.93%	10.27%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	9.82%	16.21%

Source: YCharts

Commodities declined broadly in the fourth quarter as weakness in oil, which was driven by reduced geopolitical fears and rising global economic growth worries, offset a solid gain in gold. Gold rallied on a falling U.S. dollar and hit a new all-time high in early December. For 2023, commodities saw modestly negative returns as concerns about economic growth, especially from China and parts of Europe, weighed on commodity demand expectations. Gold, however, did finish the year with a solidly positive return thanks to the fourth quarter dollar decline.

Commodity Indexes	Q4 Return	2023 Return
S&P GSCI (Broad-Based Commodities)	-10.73%	-4.27%
S&P GSCI Crude Oil	-21.29%	-11.17%
GLD Gold Price	11.55%	13.11%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a positive return for the fourth quarter and for the full year as falling inflation and expectations for rate cuts in 2024 pushed bonds higher.

Looking deeper into the fixed income markets, longer-duration bonds outperformed those with shorter durations in the fourth quarter as bond investors reacted to lower-than-expected inflation and priced in future Fed rate cuts. For the full year, however, shorter-duration debt outperformed longer-term bonds as high inflation readings through the first three quarters of 2024 weighed on the long end of the yield curve.

Turning to the corporate bond market, both high yield and investment grade bonds posted sharply positive returns for the fourth quarter as investors embraced the idea of lower interest rates and reduced recession chances. For the full year, high yield corporate bonds posted a very strong return and outperformed investment grade corporate debt as the resilient economy pushed investors to embrace more risk in return for a higher yield.

US Bond Indexes	Q4 Return	2023 Return
BBgBarc US Agg Bond	6.82%	5.53%
BBgBarc US T-Bill 1-3 Mon	1.38%	5.14%
ICE US T-Bond 7-10 Year	6.42%	3.38%
BBgBarc US MBS (Mortgage-backed)	7.48%	5.05%
BBgBarc Municipal	7.89%	6.40%
BBgBarc US Corporate Invest Grade	8.50%	8.52%
BBgBarc US Corporate High Yield	7.16%	13.44%

Source: YCharts

Q1 and 2024 Market Outlook

What a difference a year makes. The question is: were we wrong? Or just too early?

At this time last year, the S&P 500 had just logged its worst annual performance since the financial crisis, the Fed was in the midst of the most aggressive rate hike campaign in decades, inflation was above 6% and the most widely anticipated imminent recession were pervasive across Wall Street.

Now, as we begin 2024, the market outlook couldn't be much more positive. The Fed is done with rate hikes and cuts are on the way, likely in early 2024. Economic growth has proven more resilient than most could have expected and fears of a recession are seemingly dead. Inflation dropped substantially in 2023 and is not far from the Fed's target while corporate earnings growth is expected to resume in the coming year.

Undoubtedly, that's a more positive environment for investors compared to the start of 2023, but just like overly pessimistic forecasts for 2023 proved incorrect, as we look ahead to 2024, we must guard against complacency because at current levels both stocks and bonds have priced in a lot of positives in the new year.

Starting with Fed policy, Fed officials are forecasting three rate cuts in 2024 but investors are currently pricing in six rate cuts in 2024 with the first one occurring in March or May. That's a very aggressive assumption and if it is incorrect, we should expect an increase in volatility in both stocks and bonds.

Regarding economic growth, it's foolish to assume just because the economy was resilient in 2023 that it will stay resilient. Obviously, that's the hope, but hope isn't a strategy. The longer rates stay high (and they are still high) the more of a drag they create on the economy. Meanwhile, all the remnants of pandemic-era stimulus are gone and there is some economic data that's starting to point towards reduced consumer spending. Point being, it is premature to believe the economy is "in the clear" and a slowing of growth is something we will be on alert for as we start the new year, because that would also increase market volatility.

Inflation, meanwhile, has declined sharply but it still remains solidly above the Fed's 2% target. Many investors expect inflation to continue to decline while economic growth stays resilient, a concept traders coined "Immaculate Disinflation." However, while that's possible, it's important to point out it's extremely rare as declines in inflation are usually accompanied by an economic slowdown.

Finally, corporate earnings have proven resilient, but companies are now facing margin compression as inflation declines and economic growth potentially slows. Earnings results and guidance in the fourth quarter were not as strong as earlier in 2023 and if earnings are weaker than expected, that will be another potential headwind on markets.

Bottom line, while undoubtedly the outlook for markets is more positive this year than it was last year, we won't allow that to breed a sense of complacency because as the past several years have shown, markets and the economy rarely behave according to Wall Street's expectations.

As such, while we are prepared for the positive outcome currently expected by investors, we are also focused on managing both risks and return potential because the past several years demonstrated that a well-planned, long-term focused and diversified financial plan can withstand virtually any market surprise and related bout of volatility, including multi-decade highs in inflation, historic Fed rate hikes, and geopolitical unrest.

At Impact Financial Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even temporary bouts of volatility, or even moderate recessions are unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay prudently invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline. Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment. Please do not hesitate to contact us with any questions or comments.

Sincerely,

Justin

Justin G. Davis, MBA, CFP®
Founder/CEO & Managing Director,
Impact Financial Strategies
3711 JFK Parkway, Ste 340 | Fort Collins, CO 80525
970.829.1240 office | 800.630.2799 toll-free
970.829.0350 fax
Justin.Davis@ImpactFinancialStrategies.com

If you happen to be interested in some additional *"inspiration"* 😊 from Eeyore:
https://youtu.be/CQI0E1WCLMU

DISCLOSURES AND REFERENCES

** https://www.legit.ng/1316419-30-eeyore-quotes-turn-frown-upside-down.html

Any opinions are those of Justin G Davis, MBA, CFP®, CPWA®, CEPA® and may not necessarily express the opinions of Raymond James. Economic commentary courtesy of Seven Seas Report, an independent third party. The information contained in this article does not purport to be a complete description of the securities, markets, or developments referred to in this material. There is no assurance any of the trends mentioned will continue or forecasts will occur. The information has been obtained from sources considered to be reliable, but Raymond James does not guarantee that the foregoing material is accurate or complete. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Investing involves risk and you may incur a profit or loss regardless of strategy selected. Past performance is not indicative of future results.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment..
Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P GSCI is a composite index of commodities that measures the performance of the commodity market. S&P GSCI Gold is an index tracking changes in the spot price for gold bullion. S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil. GLD is a gold index fund based on gold and holds gold and/or cash as its only assets, but shareholders are not guaranteed to receive physical gold in exchange for their shares.

The MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

The MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indices. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) is a free floating-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixedrate taxable bond market.

The Barclays US T-Bill index measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months.

The ICE U.S. Treasury 7-10 Year Bond Index is market value weighted and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than or equal to seven years and less than ten years.
Barclays Capital U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.
The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USDdenominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Diversification and asset allocation do not ensure profit or protect against loss. Holding investments for the long term does not insure a profitable outcome. Investing involves risk and you may incur a profit or loss regardless of the strategy selected. Links are being provided for information purposes only. Raymond James is not affiliated with and does not endorse, authorize or sponsor any of the listed websites or their respective sponsors. Raymond James is not responsible for the content of any website or the collection or use of information regarding any website's users and/or members.