



WALKER, HIGGINS & ASSOCIATES
WEALTH MANAGEMENT, LLC

Quarterly Market Review and Outlook

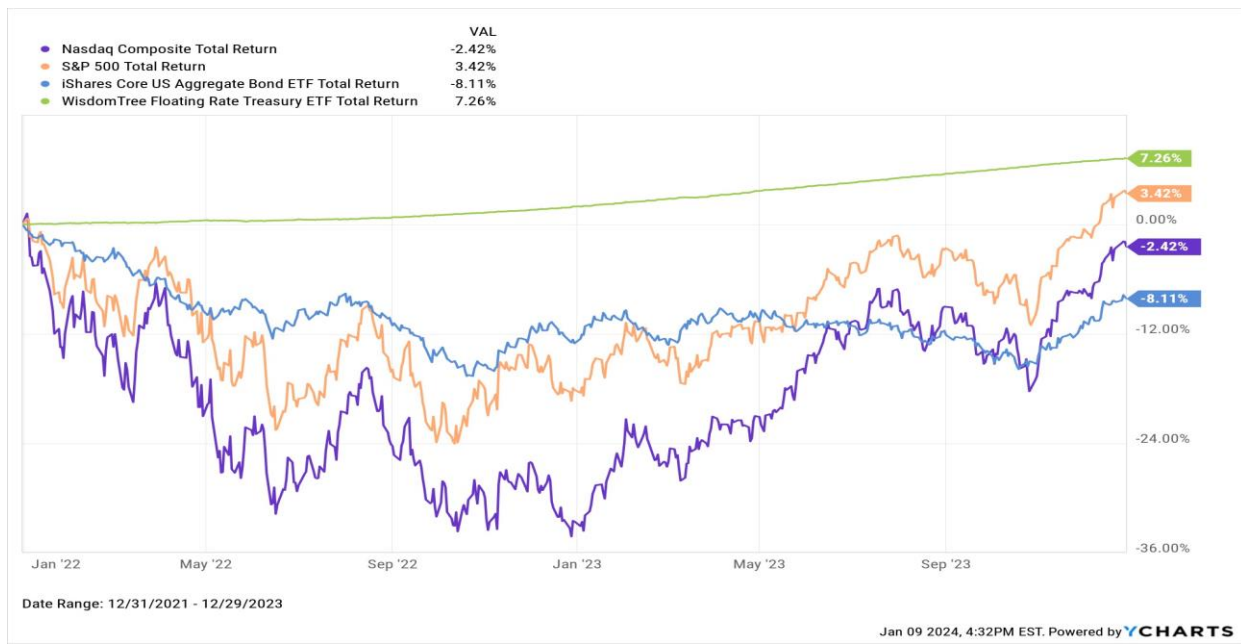
2023 Market Re-Cap

The recession projections of 2023 that the entire economic and financial community expected, did not come to fruition. Still, 2023 was a frustrating year for U.S. stocks in that the “magnificent seven” (the 7 largest companies in the S&P 500 index—all technology companies) had a very good year but the overall market did not. The S&P 493 (the S&P500 without the magnificent 7), returned less than 5% in 2023.ⁱ Generally speaking, stocks across in the U.S. and across the globe remain below their all-time highs set in early 2021. In other words, stocks have still not completely recovered from their decline in 2022.

The U.S. bond market was unimpressive this year until the 4th Quarter, when Fed controlled interest rates stabilized, and long-term rates began to decrease. For 2023, the U.S. bond market returned 5.6%, almost all of which occurred in the 4th quarter.ⁱⁱ Still, bonds took a beating last year and remain well below their all-time high.

Additionally, we’d point out that while interest rates did decrease during the 4th Quarter, the short end of the interest rate yield curve (i.e., cash equivalents and maturities of less than 12 months) continues to offer yields in excess of 5%.ⁱⁱⁱ Because of this low-risk alternatives to the stock market remain as competitive as they have been in two decades.^{iv}

The chart below illustrates the fact that the last two years have been very difficult ones in the U.S. financial market. The total return of the S&P500 index over that period was 3.42%--not per year, but over the two years. The NASDAQ lost 2.42% and the bond market was down by 8.11%. The only thing that looked attractive was cash at 7.26%.



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Economic Outlook & Beyond

Soft Landing or Splat?

For the better part of a year, many people, including ourselves, beat the recession drum. As of the end of 2023, a recession has not materialized. The reason why we felt a recession was likely was that the classic patterns from previous recessions were present. We have had an inverted yield curve since October 2022—100% of the recessions in the modern era have been preceded by this. In an attempt to correct an overabundant money supply problem created in the aftermath of COVID, the Fed contracted M2. Corporations have, in many cases, moderated earnings projections. Commercial and industrial loan activity has declined. Even still, other aspects of a classic recession have not materialized like noticeably higher unemployment. Obviously, we do not have a perfect crystal ball, but from a stance of prudence, when we see patterns that are historically consistent with most previous recessions, we are going to take a cautious stance. Additionally, when lower risk assets, like bonds and cash alternatives, offer returns in the 5-6% range, that provides us a good place to “wait it out” while the economy figures out where we are headed.

Have we dodged the recession bullet? Is a recession eminent or are we having a soft landing?

First, we would say that the data that typically precedes many recessions has not changed that dramatically. In fact, some data supports a recession at levels not seen in 40 years.^v There is plenty of evidence that a recession remains a strong possibility.

Second, we would suggest that the impact of the historic money printing that occurred during and after COVID, as measured by M2, has thrown a massive curveball into the analysis of historical data. For the time being, the influx of \$5 trillion dollars plus of stimulus and effectively zero interest rates from 2020-2021 have enabled consumers to weather the storm of high inflation and higher interest rates. For example, when the Federal Reserve cut interest rates to 0% and held them there, this allowed consumers to refinance or purchase homes at record-low rates. This window of low interest rates likely insulated most homeowners with a mortgage from the rapid rate increases that typically cause shockwaves.

The jury remains out if a recession is going to occur in 2024. There is division amongst the economists and market forecasters that we follow. The conventional wisdom as of this writing is that we will have a soft landing.^{viii} If we do, it will be the first soft landing the Federal Reserve Board has ever pulled off—there is a first time for everything we suppose.

We pay close attention to the team of economists at First Trust. In 2022, they were rated as the most accurate forecasters in the U.S. based on their projection of GDP and Inflation. This is from a recent First Trust report, “...we don’t think the economy is out of woods yet. The consensus among economists is now that the economy will continue to grow in 2024, with a soft landing and no recession. We think that’s too bullish and see a mild recession with a -0.5% real GDP print on the way in 2024.”^{viii}

If a recession does materialize, from a historical perspective, stocks will suffer. To us it doesn’t feel like a time to take bold risks.

Fed Pivot

One of the big stories during the 4th Quarter was the idea that the Federal Reserve accomplished the goal of defeating inflation and preventing a recession. As a result, some forecasters have adopted the notion that the Federal Reserve is about to start cutting interest rates. The current projections of some suggest that the first interest rate cut will occur at the March 20th Fed meeting.^{ix}

The Fed has not said rates would be cut in March. The median projection of voting members within the Federal Reserve is that rates end 2024 around 4.75%.^x This would imply only 2-3 cuts in 2024. Further, you can imply from their comments that the rate cuts would come later in the year.

From our perspective, the battle to get inflation under the Federal Reserve's stated target of 2% is not complete. We can buy into rate cuts, but in the 3rd or 4th quarter and not sooner. The cost of money impacts everything so the economy, inflation, and the financial markets will respond, negatively or positively, to the Fed's direction over the next six months.

Election Outlook

In our opinion, it is too early to provide a thorough analysis of likely election outcomes or implications. We will have a much better sense by the end of March when most of the primaries have been decided. However, we have a couple of political related thoughts to share.

First, the budget debate will reappear in mid-January. Just to recount, Congress was supposed to pass a 2024 budget by October 2023. That did not happen. After two rounds of continuing resolutions, they now have until January 19th on some items and February 2nd on others.^{xi} In theory, if a budget agreement isn't passed, then the Federal government will shut down.

Second, we often have clients concerned about stock market performance during an election year. Yes, everyone still remembers the horrors of 2008. However, over the previous 10 presidential election years, the S&P 500 has only produced two negative years (2000 & 2008) and on average, stocks have returned 6.5% over the last 10 election years.^{xii} This is not to say how the stock market will perform in 2024, but rather that stocks do not necessarily perform negatively during election years.

Finally, people tend to say, "this is the most important election in my lifetime". People say that in every election cycle. That could be true in 2024. We aren't advocating for either side, but we have particular concern over the fiscal positions of the candidates running for office.

The U.S. government spent \$6.1 trillion in fiscal year 2023. In 2018, the U.S. spent \$4.1 trillion. In our view, that level of spending is simply not sustainable. In 2023, the interest payments on our national debt was \$659 billion—that's an increase of 39% from the previous year!^{xiii} We aren't in a low interest rate environment anymore and as U.S. government bonds mature and must be reissued, they will be reissued at higher rates. In short, the interest payments that the U.S. government will be required to make will dramatically increase.

Stock Market Strategy

As we have written and discussed over the last several years, we have recommended an under allocation to risk. That's a fancy way of saying we recommended under allocating to stocks and over allocating to cash, and more recently, to bonds. That has done a good job of protecting principal and lowering volatility.

Whichever the economy hands us, either a recession or a soft landing, we think that an under allocation to stocks is still prudent. In the short term anyway. However, that won't last forever, and we are thinking a lot about what we will do at some point to lower cash and increase stock allocation.

First, we are highly unlikely to just pull the trigger and do it all at once. A dollar cost averaging strategy makes sense to us where we will make an entry into a stock or ETF with a small amount and increase that over time. That reduces risk and volatility.

Secondly, where it makes sense and where it's consistent with risk tolerance, we are evaluating several areas of the market where we think things are headed. In other words, what are the trends over the next ten years we should be

paying attention to now?

One example of that is artificial intelligence (AI). According to Bloomberg, the total revenue generated from AI (called the generative AI revenue) in 2020 was \$14 billion. Bloomberg thinks the same metric in 2032 will be \$1.304 trillion.^{xiv} This is a trend that we are still in the beginning phases of, and we don't want to miss it. We don't think you should either.

Summary

Charles Dickens famously said, "it was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness..."^{xv} That summarizes the way the last two years has been as we see it. We have gone from the highest inflation in forty years to lower inflation, from low interest rates to high interest rates, from high economic growth to negative economic growth—we can go on, but you get the idea. Foolishness abounds, but wisdom can still be found—that's true in our lives, in our government, in our cherished institutions, and in our economy.

As we see it, our job is to navigate that maze of very complicated factors so clients can find growth where it's available and protection where it's needed and, ultimately, accomplish their goals and objectives. It's our life's work and something we take very seriously as we know it's serious to each of you.

We are believers in the U.S., and we hope our commentary doesn't make anyone think otherwise. Our Constitution, our values, our freedoms and our traditions have made us the best place in the history of the world to raise a family, start a business, and enjoy economic prosperity.

We look at the new year with optimism, with gratefulness of heart for our clients, and with a high degree of energy on how to best navigate this difficult market environment.

We think patience is hard and a rare quality. We intend to exercise patience and discipline this year—we are convinced that will pay off this year.

Finally, we'd mention that the beginning of the year is always a good time to review financial goals, changes in tax laws for the upcoming year and estate plans. We hope that you remember that we serve you as a trusted advisor beyond the management of investment accounts. We are experienced in the areas of financial, retirement, and estate planning—don't hesitate to reach out to us for assistance in these areas.

As always thank you for your continued trust and confidence. We hope that you and your family have a healthy and blessed 2024.

ⁱ <https://blog.rangvid.com/2023/08/27/7-or-493-stocks-what-matters-for-the-sp-500/#:~:text=Leaving%20Mag%20out%20of%20the%20equation%2C%20the%20value,the%20return%20of%20the%20S%26P%20500%20in%202023.>

ⁱⁱ <https://www.morningstar.com/etfs/arcx/agg/performance>

ⁱⁱⁱ https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2023

^{iv} <https://fred.stlouisfed.org/series/fedfunds>

^v https://www.newyorkfed.org/research/capital_markets/ycafaq.html#/interactive

^{vi} "The Kiplinger Letter: Forecasts for Executives and Investors". Volume 100, Number 53. December 21, 2023. Washington, D.C.

^{vii} Siegel, Jeremy. "Weekly Commentary with Professor Jeremy J. Siegel: Wrapping Up 2023". WisdomTree. December 26, 2023.

^{viii} Wesbury, Brian S., Stein, Robert, Elass, Strider, Opdyke, Andrew, Gill, Bryce, Gerze, Nate. "First Trust Monday Morning Outlook: A Mild Recession and S&P 4,500". First Trust. December 26, 2023.

^{ix} <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html>

^x <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html>

^{xi} <https://bipartisanpolicy.org/explainer/a-tale-of-twoish-budgets-congressional-budget-negotiations-in-2024/>

^{xii} <https://www.slickcharts.com/sp500/returns>

^{xiii} Stein, Jeff. "U.S. Deficit Explodes Even as Economy Grows". The Washington Post. 3 September 2023.

^{xiv} Bloomberg Intelligence. "Generative AI to Become a \$1.3 Trillion Market by 2032, Research Finds". June 1, 2023.

<https://www.bloomberg.com/company/press/generative-ai-to-become-a-1-3-trillion-market-by-2032-research-finds/>

^{xv} Dickens, Charles. *A Tale of Two Cities*. Chapter I: The Period. 1859.