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AGAINST THE WIND

Following one of the worst years ever for diversified stock and bond portfolios, history will likely characterize 2023 by the return of exuberance in the markets. This year's market rebound may come as a surprise, considering the sour taste investors carried over from 2022 and the litany of economic headwinds investors faced in 2023. It is true that a few of this year's headwinds carried over from 2022. Namely, U.S. companies experienced negative earnings growth for the 2nd consecutive year, and the Federal Funds rate continued to increase – rising 100 basis points over the year. Unique to 2023, however, was the regional banking crisis we experienced early in the year. This "mini" crisis could have been much worse had the Federal Reserve not backstopped banks' securities portfolios.[1] To put the severity of these bank failures into perspective, the three at-risk banks; First Republic, Silicon Valley Bank, and Signature Bank held more assets combined than the 25 U.S. banks that collapsed in 2008. The typical wisdom is that when you see these types of events occurring in tandem, you can expect a bad year for risk assets. It seems investors shared this expectation broadly, as evidenced by the $6.1 trillion of cash held in money market funds. Despite this unique combination of headwinds and overall weary investor sentiment, the U.S. stock market has risen 21% year-to-date through December 13th.

Why did the recession that was predicted by many at the start of the year fail to materialize? We believe that economic growth remained resilient in 2023 due to a few key reasons. First, although higher interest rates negatively impacted some parts of the economy, they had minimal impact on consumers and corporations, which, as a whole, had refinanced and termed out their debt in 2021. Secondly, higher interest rates benefited savers. Using money market fund data, we estimate that monthly income from savings is running at more than $25 billion per month. Furthermore, Uncle Sam increased its deficit at rates that are typically associated with recessions. The U.S. budget deficit increased by $800 billion in 2023, driven almost entirely by lower taxes and higher spending. Lastly, President Biden's decision to lower the Strategic Petroleum Reserve, which now stands at its lowest level since 1983, benefited the consumer through a decline in gas prices and ultimately lower inflation.

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ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor.

As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results. FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

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Although it is beneficial to review what happened in the markets during the year, it's more important to look forward into 2024 and what could be the driving forces in the new year. While the drumbeat for a recession has not faltered, many investment firms are simply shifting that call to future quarters. However, while we expect to see some softening in growth, it is not our baseline scenario that we will see a recession in 2024. For one, recessions are relatively rare. Since 1980, there have been 5 recessions, or one every 9 years. This is in part driven by our economy which is more consumption and service-driven which tends to not have the booms and busts that were the norm until the 1980s. With the unemployment rate at 3.7% and over 1.1 million jobs created over the last 6 months, this should be supportive for the economy. We are watching unemployment claims closely and, as of now, do not see a harbinger of job losses coming in 2024. Secondly, our economy is very complex, and there have been some industries and sectors that have experienced recession-like pressure, such as real estate construction, while others like hospitality are growing at close to all-time highs. This type of scenario could be labeled a "rolling recession," where different industries and sectors are impacted separately over time, but not all at once.

Contrary to a scenario where there is no recession, we should not reactively expect sizable gains in the U.S. stock market. For one, forward valuations remain elevated. Secondly, it appears that some of the gains in the market in the last two months may be pulling forward returns. Third, it is difficult to see robust earnings growth in 2024 especially with GDP growth moving back to its normal trend. For example, in 2023, the US economy had nominal GDP growth rise 6%, yet earnings growth was flat for the year. For 2024, the Federal Reserve is expecting nominal GDP growth to rise 4% and Wall Street expects earnings growth to increase 12% for the year. According to Ned Davis Research, Wall Street typically overestimates earnings growth by an average of 8.5%. Furthermore, we are seeing some cracks in U.S. consumers' health. While the retail sales numbers were robust for Black Friday and Cyber Monday, according to Adobe, "Buy Now, Pay Later" financing was up 47% compared to last year. Although the rate of inflation is declining overall, prices are still rising in some areas, and some of these are very large increases. For example, inflation rates for car insurance , rent ,and food away from home are up 19.2%, 6.9%, and 5.3% respectively on a year-over-year basis. The impact is automobile and credit card delinquencies are rising, while the resumption of student debt payments will add further pressure on the consumer.

As we survey the market and economic landscape, we continue to use a data-driven approach to inform our views of how portfolios should be positioned. The FSA Market Tracker, which encompasses economic fundamentals, employment, credit, as well as equity momentum and technicals is currently signaling that we maintain a Neutral approach for our asset allocation. This means that investors should keep close to their long-term targets for stocks and bonds. With the current strength in the markets over the last two months, we believe it is prudent to have some higher-than-normal cash balances, given the rates on cash. However, we are mindful of opportunities to enter the market when opportunities exist, while remaining true to our overall neutral portfolio allocation. Our primary goal continues to be constructing portfolios which meet our clients' long-term goals. Lest we forget, those goals happen over longer periods of time and are less impacted by the day-to-day noise of the news cycle. As the sun sets in 2023, we look ahead to which way the winds will blow in 2024, letting the data tell us if we should be running with or running against the wind.

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