THE BOSTON FAMILY OFFICE
INVESTMENT SERVICES

Market Update

Fourth Quarter 2023

The S&P 500 spent the last few days of the year trading just below a new all-time high, but ultimately failing to broach its January 3rd, 2022 record close. The stock market's price action over the last two years, and the news in the world in general, has been nothing if not interesting. A 25% price drop by mid-October of 2022, 5.25% of Fed rate increases, the onset of two ongoing wars, a banking crisis, an averted possible default on US Treasury debt, and a slowdown-turned-recession in China have all tested investors' mettle, making the 26% total return in 2023 for the large-cap index all the more welcome.

One notable dynamic of last year's stock market was the narrow leadership, with a small number of mega-cap technology stocks responsible for a significant part of the overall returns. The year-end rally did eventually broaden out to include other sectors and smaller companies, but the concentrated leadership goes a long way towards explaining why for much of the year one might have wondered why "the market" was doing so well, when things in the economy perhaps seemed somewhat uncertain - the average company's stock was in fact not necessarily doing that well.

Equity Markets (Total Return)	4Q'23	1-Year
Dow Jones Industrials	13.1%	16.2%
S&P 500	11.7%	26.3%
S&P 400 Mid-Cap	11.7%	16.4%
S&P 600 Small-Cap	15.1%	16.1%
MSCI All-Country World	11.1%	22.8%
MSCI Foreign Developed Markets	10.5%	18.9%
MSCI Foreign Emerging Markets	7.9%	10.3%
US Bond Markets (Total Return)	**4Q'23**	**1-Year**
Bloomberg US Treasury	5.7%	4.1%
Bloomberg US Municipal	7.9%	6.4%
Bloomberg US Corporate Investment Grade	8.5%	8.5%

Most of the items listed in the first paragraph would at least collectively, if not even just individually, seem like major headwinds yet here the S&P 500 sits just short of an all-time high. The strong returns in 2023 may have been more a reflection of what *did not* happen than what did. While bond yields traded through a wide range over the course of the year, the Fed's rate increases probably have come to an end for now, and the 10-year Treasury yield ultimately ended up about where it started, so we did not have a second year with a significant reset in the level of rates. Most importantly, while there have been pockets of economic weakness that have come and gone, the US did not have the broad-based recession that was considered a foregone conclusion a year ago.

History shows that past efforts by the Fed to rein in inflation through monetary tightening have usually led to recession. Blithely suggesting that "this time is different" and ignoring historical precedent tends to be a recipe for disaster, but perhaps this time really is. For example, frequent comparisons to the pre-conditions and context for inflation in the 1970s may have turned out to be not very relevant. Our economy is much less reliant on oil now and thus less vulnerable to price spikes, and union contract-driven cost-of-living wage increases are less prevalent. The idiosyncratic contributors to inflation's rise over the last several years (from supply chain issues to consumers' penchant for goods purchasing

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during the pandemic) have reversed course, and inflation seems on a path to reach the Fed's 2% target before too long. Whether the Fed's response deserves all, some, or no credit for the retreat probably does not really matter, but investors are anticipating that the Fed will be able to become more accommodative with monetary policy in 2024 than had been feared.

The S&P 500 did suffer a 10% correction from late July to late October, as 10-year Treasury yields rose from about 3.8% to just over 5.0%. At that juncture the Bloomberg Aggregate bond index was on track for a third consecutive year of losses on a total return basis, and only the sixth negative year since 1976. The latter part of the increase in yield came after the Israeli/Palestinian conflict had started, when one might have expected a flight to safety to drive Treasury yields down. Yields did almost completely reverse course though fueling the year-end rally in stocks. As quickly as yields rose to 5.0% no systemic cracks appeared in the financial system as they had in March, when a few relatively large banks failed. While higher rates have negatively affected many borrowers, there has been an offset in that higher rates are also now being earned on bond investments and cash holdings. This income tailwind built quickly in 2022 but from a very low base, so 2023 was the first full year in many when savers and investors could collect healthy amounts of income throughout the year.

Looking forward to 2024 and beyond, here are some risks worth considering. The possibility of a large-scale conflagration in the Middle East seems greatest in recent memory even if it has been near the top of most investors' list of risks for decades. The Russia/Ukraine war is at something of a contained stalemate, but the China/Taiwan situation sems to be gradually devolving. At home, so far the after-effects of office real estate demand drying up in the pandemic have been moving very slowly through the financial system with values down and loans under water but could accelerate with negative effects on mid-to-smaller-sized banks. There is always uncertainty about future policy direction with an election upcoming, and the Presidential election year tends to have the weakest returns in the stock market of the four-year cycle. Finally, while a year ago investors were collectively too certain that a recession would materialize, sentiment may now have swung too far in the other direction, possibly setting the market up for at least a weak start to the year.

All of these are legitimate concerns. However, think not only of the worrisome developments of the last two years mentioned in the first paragraph, but everything that has transpired over the last five. Despite all of it, aside from 2022's negative 18% S&P 500 total return, the other four years have produced total returns between about 18% and 31% (yes, even including 2020 when the pandemic hit). Staying consistently invested in an allocation to stocks appropriately sized for you is the key to achieving long-term growth goals, regardless of what might seem certain to happen in the world or markets.

The information contained in this market update has been taken from sources which we deem reliable. We do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed herein reflect our judgment at this date and are subject to change.

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