PDS Wealth Management

Quarterly Investment Report – Q4 2023

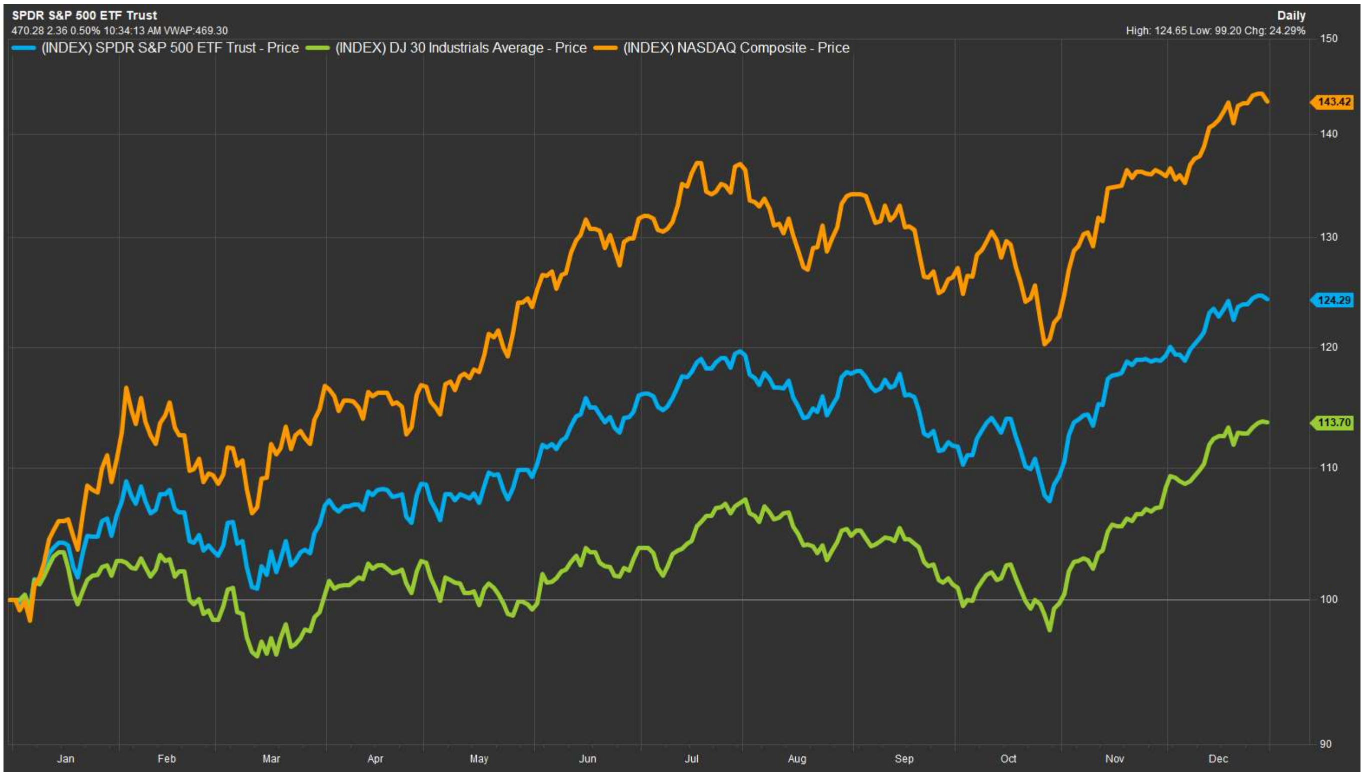
Welcome to 2024, which is already off to an eventful start, especially for a few lucky Alaska Airlines travelers. 2023 was also full of memorable events – a Chinese balloon, collapsing banks, the passing of a Queen, a failed Russian coup, a strike by writers, actors, and autoworkers, and tragedy in the Middle East; not to mention our own domestic fiscal issues and never-ending political shenanigans. At the end of the day, however, 2023 turned out to be a pretty good year for the economy and investors in financial assets.

In this missive, we attempt to maintain focus on financial matters of the last year and quarter. We trust you will hear about the non-financial news elsewhere. Speaking of, did you know that 2024 is an election year? Cling tightly to your noise cancelling headphones.

Markets Review

Stocks

US Stock Indices YTD – S&P 500, Dow Jones Industrial Average, Nasdaq Composite



Source: FactSet; as of December 31, 2023

Following a modest decline in stocks during October, markets rebounded strongly in November and December and finished the year on a high note, rising for 9 weeks in a row! For the fourth quarter, the Dow Jones Industrial Average rose 12.5%, the S&P 500 gained 11.7%, and the Nasdaq Composite added 13.8%. For the full year, those indices delivered a total return (including dividends) of 16.2%, 26.3%, and 44.6%, respectively.

In a reversal of trends from 2022, growth sectors far outpaced value sectors in 2023. Leading the charge higher were Communications Services and Technology, both of which enjoyed gains of over 50% for the year, followed closely by Consumer Discretionary with a 42% rise. Industrials posted a +18% return while Materials, Financials, and Real Estate (the best performer in Q4) tacked on ~12% apiece. Returns for Healthcare, Staples, and Energy (the worst performer in Q4) hovered between -1% and +2%. Utilities were the worst performing sector with a -7% drop for the year.

What will 2024 hold for stocks? Investors were feeling sour in early 2023 after a dismal 2022 during which stocks fell 18%. The mood now is more ebullient than last year as investors cheer for a "soft landing" and eye potential interest rate cuts in 2024. Time will tell if markets continue the party or fail to deliver on more lofty expectations this year.

Ryan Detrick of Carson Investment Research points out that following a year of 20%+ gains, stocks typically experience some weakness early in the following year before resuming their march higher. That pattern also jives with the historical returns observed during election years, Ryan says.

Bonds

Following a dismal 2022, bond prices remained under pressure for most of 2023 as interest rates marched higher. The trend reversed in October, however, and bonds rallied alongside stocks to close out the year higher than where they started. The Bloomberg Barclays US Aggregate Bond Index returned 5.5% for the year.

The 10-year Treasury Note yield finished 2023 at 3.88% - the exact same level at which it began the year. But as the chart below shows, yields were anything but placid during the year. The 10-year rate moved steadily higher (prices lower) into Q3, spurred higher by the Fed's steady hikes to the Fed Funds rate. After piercing 5% to the upside in early October, however, rates fell sharply as the Fed rate hiking cycle officially entered the rearview mirror.

10-Year US Government Note Yields

Source: FactSet; as of January 8, 2024

Corporate bonds enjoyed positive returns as well in 2023. The S&P 500 Bond Index delivered a total return of 8.4% while the S&P US High Yield Corporate Bond Index added 12.9%. JP Morgan points out that high yield spreads of 3.77% remain subdued relative to the long run average of 5.6%, reflecting a sanguine near-term outlook amongst investors.

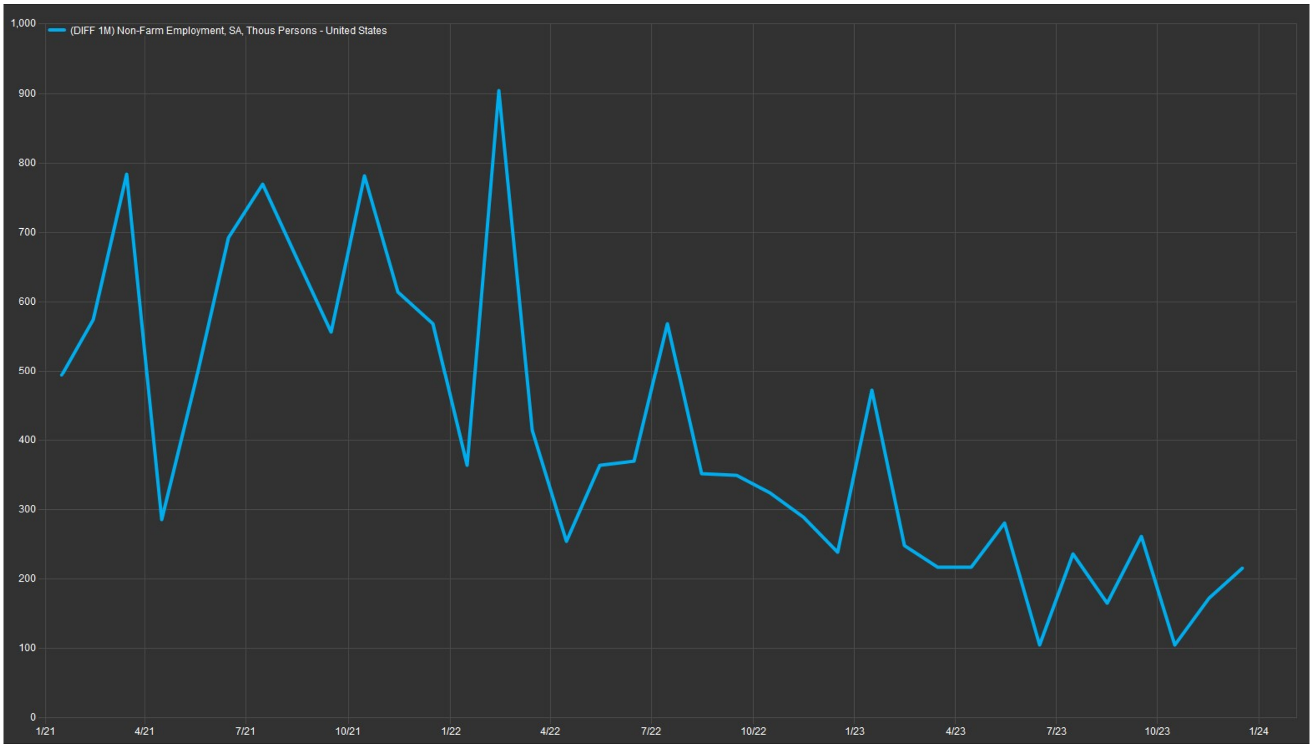
Economic Review

The prevailing view amongst investors and many economists at the beginning of 2023 was that higher interest rates would lead to a recession. Like the title character in the play, *Waiting for Godot*, the recession didn't arrive. At least it hasn't yet. In fact, GDP growth continues to outpace expectations – the preliminary estimate of real (inflation-adjusted) GDP for the third quarter of 2023 measured 4.9% vs the 3.8% estimate. The Atlanta Fed's GDPNow estimate for Q4 '23 is +2.2%, compared with economists' estimates of ~1% growth. Might the "long and variable lag" of monetary policy still be working through the system with economic weakness to arrive in 2024, or are we still waiting for Godot?

While the Federal Reserve made no changes to policy during Q4, Chair Powell did pivot to a more dovish tone during his December 13th press conference which added fuel to the rally in stocks and bonds. There is growing consensus that the US economy is heading for a "soft landing" and that the Fed will cut interest rates in 2024 (3 cuts is the Fed's own forecast). Whatever they decide, their maneuvers will need to be precise lest they be accused of political interference, from one side or the other, heading into the election.

Job growth has held steady in recent months at around ~200k/month (chart below) and the unemployment rate is holding steady below 4%. Any sudden downward moves in employment growth could get the Fed cutting rates sooner….

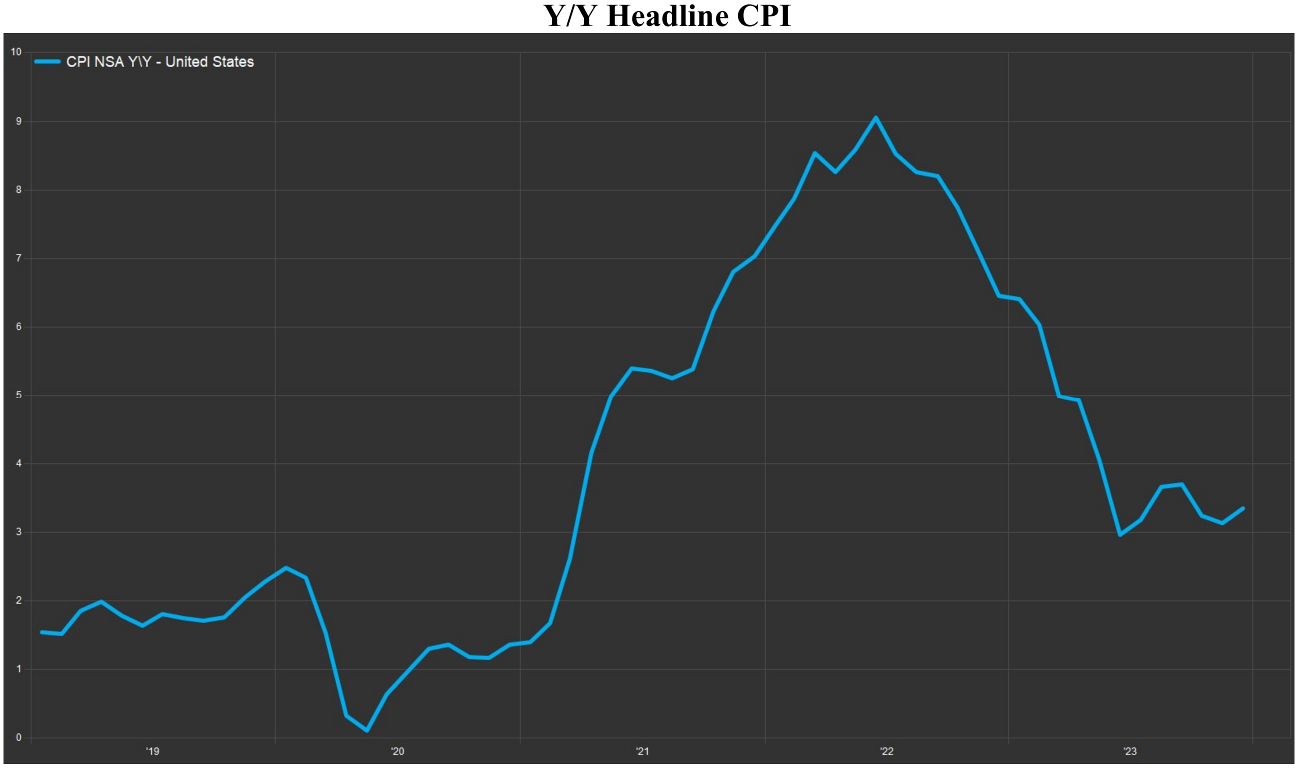
M/M Change in Nonfarm Payrolls



Source: FactSet; as of January 5, 2024

….unless inflation starts a second wave higher, as experienced in the 1970s. In that scenario, hikes, rather than cuts, may be required. The latest CPI reading from December 3.4% (chart below) came in hotter than expectations and sits stubbornly above the Fed's stated 2% target.

Y/Y Headline CPI



Source: FactSet; as of January 11, 2024

Conclusion

As always, there is much to keep our attention and interest in this new year. Please don't hesitate to reach out to our team if we can be of any assistance.

For those of you looking for some New Year's inspiration, we leave you with a quote from Warren Buffet's vice-chairman at Berkshire Hathaway, Charlie Munger, who passed away last November:

"Spend each day trying to be a little wiser than you were when you woke up. Day by day, and at the end of the day – if you live long enough – like most people, you will get out of life what you deserve."

We will keep striving to get a little wiser every day. The team at PDS Wealth wishes you and your family a healthy and prosperous 2024!

Paul Spencer, CFA®

Director