ARGUS
Wealth Management

Market Review

as at December 31, 2023

In its December meeting, the U.S. Federal Reserve ("the Fed") signalled a move away from aggressive interest rate hikes and indicated a more dovish or accommodating stance. It also chose not to raise interest rates and held the federal funds rate steady at 5.25-5.5%, a move now referred to as the "*Fed Pivot*."

While the Federal Reserve did not explicitly commit to immediate rate cuts but predicated at least three rate cuts in 2024, with a quarter-percentage-point decrease each time for a total of 75 basis points, investors have interpreted this change in stance to suggest that the next likely move would be a reduction in interest rates occurring as soon as in March 2024, and as many as six cuts in 2024, particularly if inflation continues to show signs of declining.

Equity Market Returns

Global equity markets experienced robust growth in 2023. The MSCI World Index saw a notable increase of 22%, surpassing the 15% rise in the Bloomberg European 500 Index. The S&P 500 Index also showed impressive growth, climbing by 26%. A significant contributor to growth in the US market was the 45% surge in the NASDAQ Composite Index, driven by heightened investor interest in companies developing artificial intelligence applications.

The Nikkei 225 Index of Japanese stocks rose by an eye-catching 33%, its best yearly performance in 33 years. Foreign investors returned to invest in Japan's stock market mainly due to its better fundamental economic conditions, reasonable earnings growth, and cheap world-class company valuations. Favourable conditions in the currency market further fueled the rally. Additionally, reforms by the Tokyo Stock Exchange aimed at enhancing market liquidity and compelling underperforming companies to improve capital strategies contributed to the market's attractiveness.

Rate Cut Hopes

Much of these stellar returns in global equities were caused by falling inflation in the major Western economies over the year, with markets hoping this may lead to the end of this hiking cycle.

The US consumer prices increased by 3.4% in December 2023, a steep drop from the 9.1% rise in the 12 months to June 2022. Eurozone inflation was reduced to 2.9%, while UK inflation decelerated to 4%.

At the end of 2023, traders factored in six rate reductions by the Fed by the end of 2024, a drastic change from previous concerns of persistently high borrowing costs that led to heightened volatility in the stock market and a global bond market downturn in autumn.

However, more official voices caution that financial markets may be overly optimistic by anticipating rate reductions in early 2024. Loretta Mester, the Cleveland Fed President, who will be a voting member of the Federal Open Market Committee in 2024, emphasised that the central bank is unlikely to swiftly shift to reducing borrowing costs. This stance aligns with views from other voting FOMC members, John Williams and Raphael Bostic, who recently indicated that rate cuts are not on the immediate horizon.

Mester commented: *"The next phase is not when to reduce rates, even though that's where the markets are at. It's about how long do we need monetary policy to remain restrictive in order to be assured that inflation is on that sustainable and timely path back to two (2) percent."*

Fed Remaining Vigilant

The main word here is "sustainable." There are plenty of potentially disruptive factors still at play. Problems with global supply chains can unpredictably shift costs, directly influencing inflation. Geopolitical events and varying policy decisions can add layers of uncertainty, affecting economic stability and inflation. Additionally, the perceptions of businesses and consumers about future inflation can lead to anticipatory financial behaviours, further impacting inflation trends. These elements intertwine, complicating the Fed's journey towards the target inflation rate of 2%.

Recent U.S. economic data, notably the addition of 216,000 jobs last month (Source: Bureau of Labor Statistics), has reinforced this stance by Fed officials on exercising caution on implementing interest rate cuts. The stronger-than-anticipated December employment report, with job additions surpassing forecasts and maintaining a steady unemployment rate at 3.7%, suggests a labour market that, while perhaps 'normalizing' to a degree, may not yet be doing so to a degree conducive to the Fed quickly pulling the trigger on rate cuts. Moreover, hourly wages rose by 4.1% year-over-year, outpacing the personal consumption expenditure inflation rate of 2.6%.

That said, Loretta Mester, for example, is among the Fed officials to forecast three quarter-point rate cuts in 2024, given her prediction that inflation would continue to moderate as growth cooled further. Therefore, a reasonable base case for the investor would be to expect rates to fall, though perhaps not as soon as the market expects them to.

Favourable core personal consumption expenditure readings in early 2024 are vital for gauging the Fed's capacity to reduce rates in the spring, signalling a potential soft landing – an outlook that's grown more likely thanks to recent core inflation trends.

As reflected in the S&P 500's valuation at 26 times (trailing 12-month) last reported earnings, the equity market seems to have already factored in a considerable portion of this optimistic scenario (of a soft-landing). In stark contrast, the bond market, particularly evidenced by the significant decline in the 10-year Treasury yield and the inversion of the yield curve, is signalling caution, pointing towards a recession. This dichotomy between equities and bonds paints a picture of divergent expectations about the economic future.

Outlook

The global economy exceeded our expectations in 2023, with stocks and bonds providing positive returns for investors. As we start the new year, there are several reasons to be optimistic. Inflation continues to moderate, consumer spending has increased, and corporate earnings are expected to improve as the year progresses. Investors also hold high conviction that the Fed will soon achieve a soft landing and start to cut interest rates. However, we believe that 2024 may bring its own twists and turns, especially with elevated geopolitical risk and the upcoming U.S. election. Timing the market is almost impossible. Instead, investors should continue being cautious and humble about the macroeconomic uncertainties, following a diversified and risk-conscious investment approach across all asset classes.

Macro Indices Report as at December 31, 2023 (percent)

	DEC	NOV	OCT	Q4 2023	YTD	2022	Annualized 3 Years	5 Years
GLOBAL EQUITY								
MSCI AC World Total Return	4.8	9.2	-3.0	11.0	22.2	-18.4	5.7	11.7
MSCI EAFE	5.3	9.3	-4.0	10.5	18.9	-13.9	4.6	8.8
NORTH AMERICA EQUITY								
S&P 500 Total Return	4.5	9.1	-2.1	11.7	26.3	-18.1	10.0	15.7
DOW JONES INDUSTRIAL AVG	4.9	9.2	-1.3	13.1	16.2	-6.9	9.4	12.5
S&P 400 Net TR	8.7	8.5	-5.4	11.5	15.8	-13.5	7.6	12.1
NASDAQ COMPOSITE	5.6	10.8	-2.8	13.8	44.7	-32.5	6.1	18.8
RUSSELL 2000 INDEX	12.2	9.0	-6.8	14.0	16.9	-20.5	2.2	9.9
S&P/TSX COMPOSITE INDEX	3.9	7.5	-3.2	8.1	11.8	-5.8	9.7	11.3
EUROPE EQUITY								
BLOOMBERG EUROPEAN 500	3.6	6.5	-3.8	6.1	14.8	-10.0	8.3	9.6
FTSE 100 INDEX	3.9	2.3	-3.7	2.3	7.7	4.6	10.1	6.7
CAC 40 INDEX	3.3	6.3	-3.5	5.9	20.1	-6.7	13.9	12.9
DAX INDEX	3.3	9.5	-3.7	8.9	20.3	-12.3	6.9	9.7
ASIA EQUITY								
MSCI AC Far East Ex Japan	2.3	6.9	-4.1	4.9	0.4	-23.6	-11.6	-0.2
NIKKEI 225	0.0	8.5	-3.1	5.2	30.9	-7.3	9.0	13.0
HANG SENG INDEX	0.2	-0.2	-3.9	-3.9	-10.5	-12.6	-11.6	-4.9
S&P/ASX 200 INDEX	7.3	5.2	-3.8	8.6	14.0	0.5	10.8	11.7
SHANGHAI SE COMPOSITE	-1.7	0.4	-2.9	-4.2	-1.0	-12.8	-2.6	6.2
SOUTH AMERICA & EM EQUITY								
MSCI EM Net Total Return USD Index	3.9	8.0	-3.9	7.9	9.8	-20.1	-5.1	3.7
S&P LATIN AMERICA 40	7.4	12.7	-2.9	17.5	34.2	11.4	9.3	5.6
BRAZIL IBOVESPA INDEX	5.4	12.5	-2.9	15.1	22.3	4.7	4.1	8.8
S&P BSE SENSEX INDEX	7.8	5.0	-2.9	10.0	20.3	5.8	16.2	16.3
FIXED INCOME								
ICE BoA 1-3 Year US Treasury Index	1.1	1.0	0.3	2.5	4.3	-3.6	0.0	1.3
BLOOMBERG US Agg	3.8	4.5	-1.6	6.8	5.5	-13.0	-3.3	1.1
BLOOMBERG Multiverse (Unhedged)	4.1	5.1	-1.2	8.1	6.0	-16.0	-5.3	-0.1
Citi World BIG US Hedged	3.5	3.8	-0.9	6.4	6.9	-13.1	-3.0	1.0
ICE BoA US High Yield Index	3.7	4.5	-1.2	7.1	13.5	-11.2	2.0	5.2
JPM EMBI Global Core – US$	5.0	6.0	-1.5	9.7	10.8	-18.4	-11.4	8.8
JPM EM Global Cove – Local	2.3	5.2	-0.7	6.9	10.9	-10.2	-9.6	3.0
COMMODITIES								
BLOOMBERG Commodity Index	-3.1	-2.7	-0.2	-5.9	-12.6	13.8	8.1	5.2
GOLD	2.1	1.9	6.8	11.1	14.6	0.4	10.1	62.5
OIL (WTI)	-5.6	-5.8	-8.7	-18.8	-3.8	27.6	25.8	1.2

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