HIGHTOWER
Westchester

Market Commentary Q4 2023

Financial markets underwent a sizeable shift in the fourth quarter. Treasury yields, which spiked in the third quarter, reversed lower as inflation eased and the Federal Reserve ("Fed") hinted at interest rate cuts in 2024. The decline in interest rates was a significant tailwind for stocks and bonds. The S&P 500 gained +11.6% during the quarter, and bonds produced their best quarterly return since the second quarter 1989.[1]

Leading US Indices (Total Return)	2Q'22	3Q'22	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23 (sorted)	TTM
S&P 600 Small-Cap	-14.1%	-5.2%	9.2%	2.6%	3.4%	-4.9%	15.1%	16.1%
Russell 2000	-17.2%	-2.2%	6.2%	2.7%	5.2%	-5.1%	14.0%	16.9%
Nasdaq	-22.3%	-3.9%	-0.8%	17.0%	13.1%	-3.9%	13.8%	44.6%
S&P/Citigroup Value	-11.3%	-5.8%	13.6%	5.2%	6.6%	-4.1%	13.6%	22.2%
S&P 500 Total Return	**-16.1%**	**-4.9%**	**7.6%**	**7.5%**	**8.7%**	**-3.3%**	**11.7%**	**26.3%**
S&P 100 Mega-Cap	-16.9%	-5.4%	5.6%	10.1%	11.1%	-2.8%	11.7%	32.9%
S&P 400 Mid-Cap	-15.4%	-2.5%	10.8%	3.8%	4.9%	-4.2%	11.7%	16.4%
S&P/Citigroup Growth	-20.8%	-3.9%	1.4%	9.6%	10.6%	-2.6%	10.1%	30.0%

Strategas Securities, LLC – 1/8/2024

Investors went into 2023 worried about inflation and expecting a recession by the second half of the year. Instead, the stock market climbed the wall of worry to impressive gains in 2023.

The question heading into 2023 was whether the economy could withstand the effects of higher interest rates. The Fed aimed to cool inflation by raising interest rates and reducing demand, and the central bank appeared to be well on its way toward accomplishing its goal. The cost of capital was rapidly increasing. The housing market and home construction activity were slowing. Shipping rates were falling as freight demand declined and supply chains normalized. While portions of the economy slowed in 2023, the broader economy displayed remarkable resilience, even as the Fed continued to raise interest rates.

Inflation came down and the economy remained on solid footing despite the first-quarter regional banking crisis. While the Fed raised interest rates four times throughout the year, at their December meeting, officials signaled that no additional rate increases are expected, and they could potentially lower rates in 2024.

Multiple factors contributed to the above-average growth, including consumer spending, government investment at the federal and state levels, and companies restocking inventories. We witnessed a surge in U.S. home prices during the pandemic, as factors like remote work, low mortgage rates, and rising wages boosted home demand. Meanwhile, U.S. unemployment rate remains below 4%, a level that is low by historical standards and showcases the labor market's strength.

While these economic factors are lagging and reflect past performance, they underscore the economy's resilience. They also indicate that higher interest rates aren't having the impact that many, including us, thought they would up to this point in time. With inflation falling and the economy growing, investors are starting to believe that the Fed can achieve its goal of lowering inflation without negatively impacting the economy, in other words, a "soft landing!"

Bolstered by the combination of a solid economy, better-than-expected corporate earnings, and an apparent end to the Fed's interest rate hikes, stocks (S&P 500) rallied approximately 25% in 2023.[1] Technology stocks (and growth stocks more broadly) jumped thanks to expectations of multiple Fed rate cuts in 2024, along with the emerging boom in artificial intelligence technologies. Meanwhile, bond investors breathed sighs of relief after avoiding an unprecedented third straight year of losses.

After the Silicon Valley Bank failure in March 2023, big banks came to the rescue to stabilize the industry and protect depositors. Large banks are well protected due to regulations and diversified exposures.

FED AND TREASURY QUICK TO STOP ANY BLEEDING IN 2023

1/8/2024

A notable shift occurred in November, setting off a sharp reversal in Treasury yields. Investor worries about increased Treasury bond issuance were alleviated as the U.S. Treasury revealed plans to slowly increase bond issuance. The market felt there would be enough demand to absorb the new bonds, lowering the probability that too much bond supply would cause yields to

rise. In addition, data showed that inflation continued to decline even as the economy continued to exceed expectations. Investors' fears about persistent inflation and high interest rates faded from view, and yields declined.

As a result of the Treasury yield's reversal from the previous quarter's rise, bonds traded higher in the fourth quarter. The Bloomberg U.S. Bond Aggregate, which tracks a broad index of U.S. investment-grade rated bonds, produced a total return of +6.7%.[1] This shift in investor sentiment toward bonds can be attributed to several factors, including two themes we've already discussed. Inflation is falling, and the Fed is expected to start cutting interest rates.

After weathering an extended period of negative returns as the Fed raised interest rates, bonds are now experiencing a resurgence in popularity. Investors have been trying to time the top in Treasury yields, and as sentiment improved and rates declined in the fourth quarter, investors rushed to lock in yields. It's a dynamic that's played out in recent quarters, which has contributed to the increased bond market volatility. The question is whether investors have accurately picked the peak in yields. The answer will be determined by the trajectory of inflation and the Fed's interest rate cuts.

What a difference a year makes. Following a challenging 2022, the municipal bond market is stabilizing, while it continues to offer attractive investment opportunities. In a welcome reprieve for income investors, high grade municipal bond yield levels are at or near their highest levels in a decade. With a market largely comprised of tax-backed state and local debt issuers and essential service providers, we believe municipals are an

attractive late-cycle asset class. Many municipal issuers prudently restored their emergency reserves and reduced liabilities following a few years of strong revenue collection. We believe positive credit trends and, for those managers who have taken advantage of the opportunity, the attractiveness of current income streams will continue to anchor the municipal market during the year ahead.

In the fourth quarter, international stocks underperformed U.S. stocks for the third consecutive quarter. This underperformance can be attributed to multiple themes. First, international stock market indices lack exposure to leading artificial intelligence companies. Second, as discussed above, the U.S. economy has displayed resilience to higher interest rates. In contrast, some countries and regions outside the U.S. are already showing the impact of higher interest rates.

International Indices (Price Chg)	2Q'22	3Q'22	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23 (sorted)	TTM
Bovespa (Brazil)	-17.9%	11.7%	-0.3%	-7.2%	15.9%	-1.3%	15.1%	22.3%
Bolsa (Mexico)	-15.9%	-6.1%	8.6%	11.2%	-0.7%	-5.0%	12.8%	18.4%
OMX Stockholm 30 (Sweden)	-10.6%	-2.3%	11.7%	8.8%	3.9%	-6.7%	11.2%	17.3%
Sensex (India)	-9.5%	8.3%	5.9%	-3.0%	9.7%	1.7%	9.7%	18.7%
MSCI AC World	**-14.1%**	**-5.3%**	**7.0%**	**6.5%**	**6.0%**	**-2.9%**	**9.0%**	**19.5%**
DAX (Germany)	-13.8%	-5.3%	14.9%	11.9%	0.3%	-4.7%	8.9%	16.5%
All Ordinaries (Australia)	-13.4%	-1.0%	8.1%	2.1%	0.4%	-2.1%	8.0%	8.4%
Kospi (South Korea)	-15.4%	-7.6%	3.8%	10.8%	3.5%	-3.9%	7.7%	18.7%
S&P/TSX (Canada)	-13.8%	-2.2%	5.1%	3.7%	0.3%	-3.0%	7.3%	8.1%
IBEX 35 (Spain)	-4.1%	-9.0%	11.7%	12.2%	3.9%	-1.7%	7.1%	22.8%
CAC 40 (France)	-11.1%	-2.7%	12.3%	13.1%	1.1%	-3.6%	5.7%	16.5%
Nikkei 225 (Japan)	-5.1%	-1.7%	0.6%	7.5%	18.4%	-4.0%	5.0%	28.2%
MSCI EAFE	**-8.8%**	**-4.3%**	**8.4%**	**6.7%**	**3.2%**	**-1.9%**	**4.6%**	**13.0%**
FTSE 100 (UK)	-4.6%	-3.8%	8.1%	2.4%	-1.3%	1.0%	1.6%	3.8%
Swiss Market Index	-11.7%	-4.4%	4.5%	3.5%	1.6%	-2.8%	1.6%	3.8%

Strategas Securities, LLC – 1/8/2024

China's disappointing post-COVID recovery has raised significant doubts about the foundations of its decades of impressive growth and presented Beijing with a tough choice for 2024 and beyond: take on more debt or grow less. The expectations were that once China ditched its draconian COVID rules, consumers would burst back into malls, foreign investment would resume, factories would ramp up and land auctions and home sales would stabilize. Instead, Chinese shoppers are saving for rainy days, foreign firms pulled money out, manufacturers face waning demand from the West, local government finances wobbled, and property developers defaulted.

The dashed expectations have partly vindicated those who always doubted China's growth model, with some economists even drawing parallels with Japan's bubble before its "lost decades" of stagnation starting in the 1990s. China is starting 2024 with a weaker economy and facing geopolitical wild cards that have the world on edge. Both could jeopardize Chinese President Xi Jinping's expansive vision for the country.

Much noise, and market performance, has been made about the “Magnificent 7,” as referenced in the media. For most of 2023, equity market performance was driven by a concentrated

group of mega-cap tech names that outperformed and were heavily weighted in the S&P 500. The Magnificent 7 stocks returned an average 111% and drove 62% of S&P 500 performance in 2023.[1] They drove 84% of performance throughout the first three quarters.[1] In the fourth quarter, as market breadth improved in tandem with market fundamentals, namely lower inflation readings and both consumer resilience and confidence, the same seven stocks accounted for just 28% of S&P 500 fourth quarter returns.[1] The indexes ten largest weights maintained their highest level of contribution since 2007.

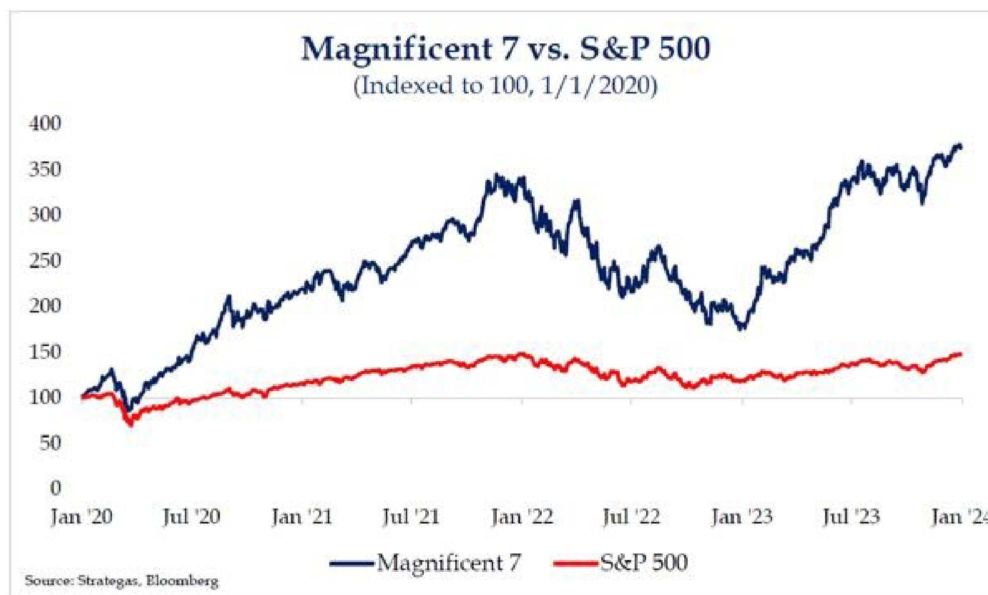
Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2007	78.7%	3.5%
2023	**68.4%**	**24.2%**
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

Data as of 12/31/23

Strategas Securities, LLC

The market cap of the Magnificent 7 is now the same size as the combined market cap of the stock markets in Japan, Canada, and the UK and had an average total return of 107% last year.[1]



1/8/2024

We find a few things notable at this juncture, since rates peaked on October 23rd, the equal-weight S&P has outperformed the Magnificent 7 composite by nearly +5% and since the short-term low in yields was registered on December 27th, the equal-weight S&P has continued to outperform the very top of the market by about +2.5%.[1] Something to continue to watch as we move into 2024.

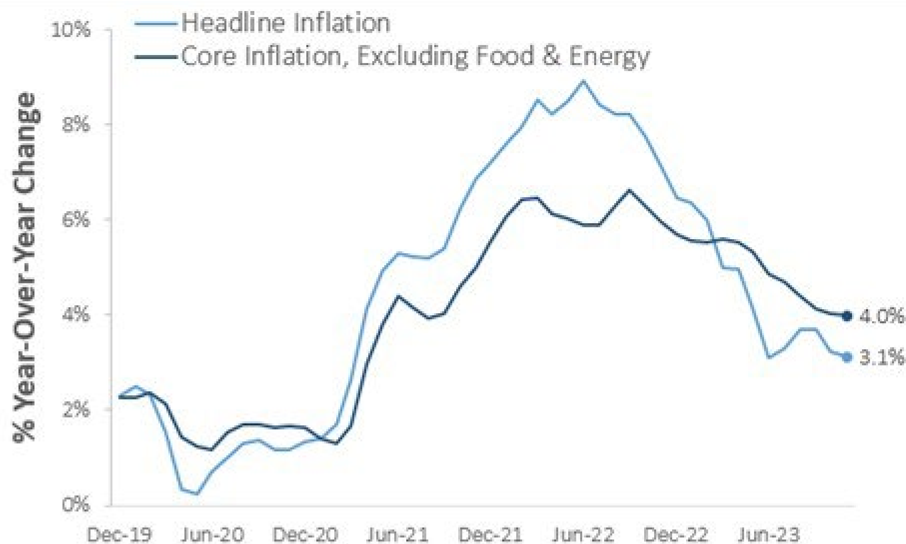
Growth stocks outperformed dividend payers throughout 2023. Dividend payers bear the greatest burden of the higher interest rates in 2023. The slower growth, but steady cash-flow providing stocks took a backseat to the cool "new" substitute, Treasuries. Investors shifted allocations from dividend payers into the Treasury market, which provided similar yields with minimal risk.

While beat up for most of the year, dividend payers perked up alongside higher growth companies at the first sign of a rate regime change in late October.

Under our belief that interest rates have peaked, investors will continue to call back on "Ol' Reliable" for steady income payments in 2024. A critical point here is that many investors dipped their toes into money market securities or short-term Treasuries that will begin maturing. We believe most money will be shifted from the fixed income market and into equities both defensive and growth.

As we moved through 2023, inflation pressures continued to ease. The chart below shows the year-over-year change in headline and core inflation. Headline inflation, which peaked at 9.1% in June 2022, dropped to 3.1% in November 2023. Likewise, core inflation, which excludes the volatile categories of food and energy, now stands at 4.0% after peaking at 6.6% in September 2022. The price declines have been widespread across categories, with price pressures easing across food, energy, airfares, and household furnishings and appliances.

FIGURE 2 – Inflation Pressures Continue to Decline from Peak

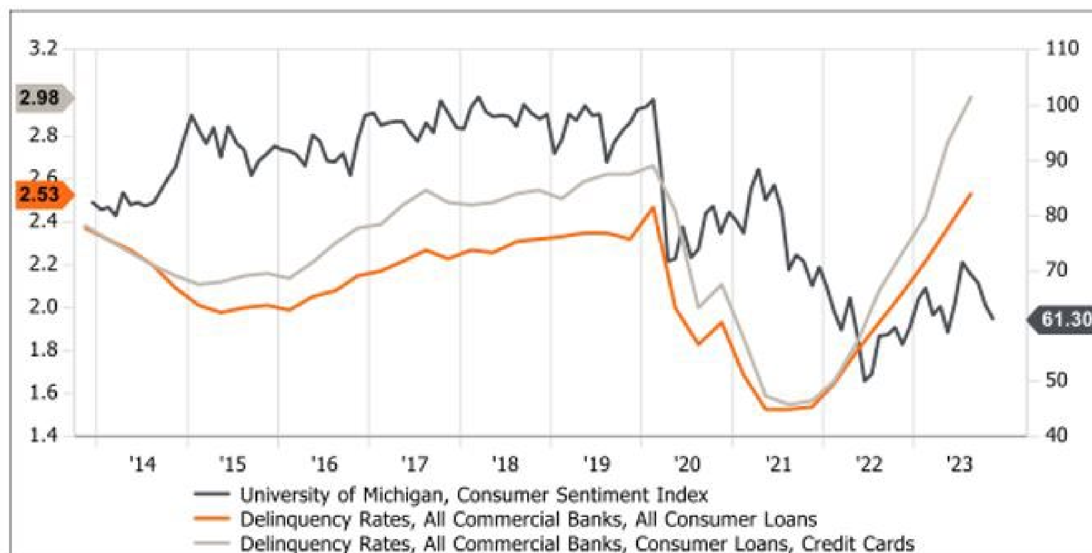


Source: Department of Labor. Seasonally adjusted data. Data as of 12/31/2023.

"Don't fight the Fed" is a common mantra in the investing world. It will be the case in 2024 as well.

At its December meeting, the Fed stopped just short of saying it is done raising interest rates, and policymakers penciled in rate cuts totaling 0.75% for 2024. Looking ahead to 2024, futures markets currently forecast multiple interest rate cuts, with the first cut as early as March. It's a big change from last quarter, when there was concern that the Federal Reserve would need to keep raising interest rates.

Shifting over to the consumer, where it's a tale of two different stories – effect of rates and employment. The consumer turned out to be rather insensitive to higher rates last year with 80% of homeowners having fixed mortgage rates below 5%.[1] Mortgage rates rise and fall in tandem with the benchmark U.S. Treasury Yield.



Strategas Securities, LLC – 1/8/2024

Consumer sentiment is lower than pre-pandemic, a reflection of cost pressures, interest rate uncertainty, pandemic effects and geopolitical conflict. The lag effect from interest rates is impacting consumers, as shown by rising delinquencies. The delinquencies are mostly impacting those with lower-end incomes, and there is no notable effect on median to higher-income earners.

Meanwhile, there are still plenty of jobs and low unemployment. Initial claims, a leading indicator for the labor market, remains well below recessionary levels. Similarly, lower CPI is supportive for lower consumer costs. Coupled with higher earnings and job availability, the consumer has tailwinds for spending.

Selective and actively managed diversified portfolios should again benefit in 2024. An interesting setup into 2024, that balances the likelihood of rate cuts with near all-time highs across many names. We are looking to capitalize on the resilient U.S. consumer.

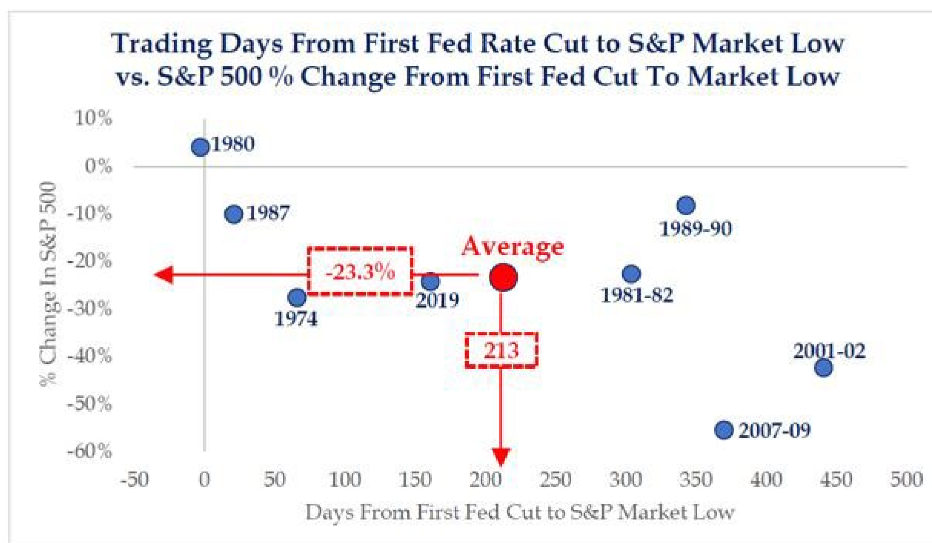
Most of Wall Street agrees that the 2024 stock market outlook is largely dependent on whether the Fed can engineer a soft landing. While there is no official definition of a soft landing, Wall Street is evaluating whether the Fed can keep rates just high enough to slow the economy and reduce inflation without causing a recession. A recession would be a hard landing.

By many measures, the economy is slowing in controlled fashion. Tightening credit conditions, combined with cooler consumer spending and inflation, are expected to slow the U.S. economy. The severity of that weakening will likely shape the stock market forecast for 2024.

We're a bit concerned about the strength of the economy. The data in recent months has been mixed, with some areas like consumer spending coming in a bit stronger than expected, along with solid labor market trends. On the other hand, there is a sense that the toll of rate hikes since early 2022 is finally catching up with other segments already showing signs of cracking.

The market is running with the idea that as the Fed begins to cut rates, this should work as a swooping boost to the economy, curing all ills. We're more skeptical on that point. As you can

see in the chart below, it is not when the Fed pauses that's cause for concern, it's usually after the first rate cut! Interest rate policy tends to work on a 12–18-month lag.



Strategas Securities, LLC – 1/8/2024

In many ways, it's possible bulls and economy optimists are making the same mistake bears and doomers fell for in late 2022. While each rate hike in the cycle didn't "crash" the economy and lead to surging unemployment, as some had predicted, we can flip that around and claim that the rate cuts in 2024 could fail to produce the necessary immediate economic support.

When considering investment strategies for the coming year, keep in mind that if things continue on the same path, we could see a revived housing market in 2024. Banks also stand to benefit from increased mortgage demand, while business capital expenditures that have been on hold in the current environment should come back online in the year ahead. A normalizing yield curve and interest rate stability will continue to support this broadening performance in equity markets and a strong economy.

Heading into 2024 we are not as bullish on the mega-cap tech companies that were a huge driver of the S&P 500's major rally in 2023. Expectations for many of these companies are at exceedingly high levels. While we still expect them to perform in the future, we don't expect to see a repeat of the outperformance that we saw in 2023.

It's a stretch to suggest a "hard landing" is around the corner, but we'll plant a flag on the hill that the soft landing faces some unexpected turbulence. When we talk about the possibility of a recession, it's going to be in terms of a couple quarters of a technical contraction where GDP comes up against what is a high watermark of comparables from 2022.

The way that could begin to transpire would likely start with the labor market rolling over. While non-farm payrolls averaged around 250,000 jobs added per month in 2023, a few months with a print under 100,000 or even

negative would confirm the shifting environment. Initial and continuing jobless claims are key monitoring points that will identify this key foundation of the economy.

If we had to find a title for our outlook for 2024, we might call it, quite boringly, “more of the same.” We see little reason to change our view, remaining balanced in our approach to asset allocation and diversification. Sentiment, positioning, and near-term-growth expectations are still subdued.

The problem, as we see it, is that while many economic factors appear to be on solid footing, this "soft landing" narrative might already be priced in. Simply put, anyone turning bullish now is likely late to the party.

Our base case is that economic data will remain volatile over the next several months and quarters. There is also the risk that inflation surprises to the upside (as it has in many past inflation cycles), undermining any timetable for the Fed to start cutting rates. In this scenario, renewed volatility in the bond market would likely translate to pressure on equities.

It remains ever important that investors focus on high-quality companies with strong price power, stable earnings, and healthy balance sheets. These types of companies are better able to withstand margin pressure and higher financing costs during higher interest-rate environments.

Looking ahead at the calendar, the 2024 presidential election will grab headlines for most of the year, with the first primary elections taking place in January. It will be a busy time as candidates discuss their platforms. There will be a lot of talk about new policies and big changes, but it’s important to keep the bigger picture in mind. Election headlines tend to be more noise than anything of substance. Elections create uncertainty and volatility, but history shows us that economic growth and corporate earnings ultimately drive markets over the long term.

Heading into 2024, debates are focused on whether the economy will continue to avoid recession, whether inflation will stay on its moderating path, and whether the Fed will cut rates as aggressively as investors currently expect.

As we begin the new year, we want to thank all our clients for entrusting us and express our deepest gratitude for your support as we look forward.

To discuss this commentary further, please contact us at 914-825-8630.

hightowerwestchester.com

---

[1] FactSet - 01/08/2024
[2] Strategas Securities, LLC - 01/08/2024
[3] https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2023 - 01/09/2024
[4] https://www.dol.gov/ - 01/09/2024

Hightower Westchester is a group comprised of investment professionals registered with Hightower Advisors, LLC, an SEC registered investment adviser. Some investment professionals may also be registered with Hightower Securities, LLC, member FINRA and SIPC. Advisory services are offered through Hightower Advisors, LLC. Securities are offered through Hightower Securities, LLC. This is not an offer to buy or sell securities. No investment process is free of risk, and there is no guarantee that the investment process or the investment opportunities referenced herein will be profitable. Past performance is neither indicative nor a guarantee of future results. The investment opportunities referenced herein may not be suitable for all investors. All data or other information referenced herein is from sources believed to be reliable. Any opinions, news, research, analyses, prices, or other data or information contained in this presentation is provided as general market commentary and does not constitute investment advice. Hightower Westchester and Hightower Advisors, LLC or any of its affiliates make no representations or warranties express or implied as to the accuracy or completeness of the information or for statements or errors or omissions, or results obtained from the use of this information. Hightower Westchester and Hightower Advisors, LLC assume no liability for any action made or taken in reliance on or relating in any way to this information. The information is provided as of the date referenced in the document. Such data and other information are subject to change without notice. This document was created for informational purposes only; the opinions expressed herein are solely those of the author(s) and do not represent those of Hightower Advisors, LLC, or any of its affiliates.