Marketline December 2023

Stocks:

Investors are fortunate students. Every day is a chance to learn and improve. This year contained many lessons. Let's review:

1. At the end of 2022, most analysts were calling for a recession and a continuation of that year's crummy market, at least through the first half of the year. Score? Zero. We did not have a recession, and the market started strong. In fact, the first half of the year produced a return of 15.9% on the S&P 500. Lesson? Forecasts are useless.
2. Late summer brought a test of staying power – one of the most important behavioral characteristics of successful investors. Between August and the end of October, the S&P 500 fell 7%. Analysts turned bearish. If you sold stocks, you didn't participate in a rally during November and December that brought indices to new all-time highs. Winners *bought* stocks during the early Fall downturn. Lesson? Don't do what everyone else is doing.
3. Interest rates rose during 2023, causing bond prices to fall. Most analysts reckoned that the yield spread for corporate bonds would widen dramatically – but it didn't. By November's end (the latest data we have), investment-grade bond spreads were as low as they were in the spring of 2022 at +110 bps. Abandoning investment-grade corporates – which many investors did, in favor of money market funds – was the equivalent of missing the last two months' rally in the stock market. Lesson: if your asset allocation calls for corporate bonds, stay there.
4. The year was plagued by the continuation of the Russia/Ukraine war and the beginning of a new war between Israel and Hamas, alongside additional eruptions in the political and social scene. Did that prevent the stock market from doing well? Gauging by the 26% total return on stocks – no. Lesson: returns are not dependent on social or political considerations, so listening to the news and allowing it to affect your decision-making is a recipe for poor investor behavior.

Now that we have reviewed the year, let's turn to December. Yes, it was a great month, with the domestic indices rising between 4.5% and 5.6%. Overseas, Mexico was an upside outlier, up 6%! We've discussed Mexico's unique position in the "near-shoring" manufacturing phenomenon – we expect the country to receive increasing attention in the coming years as its economy thrives. Canada was the worst performer on the board, at 3.5%, and Europe was barely better at 3.7%. We look forward to whatever 2024 may bring – up, down or sideways, there's always a viable tactic and we're here to find it.

Bonds:

Last month, we wrote: "…we see plenty of value in company debt these days." We were able, until close to year-end, to add a number of new bonds to portfolios where appropriate. Now, with the decline from over 5% on the long bond just a couple short months ago to 4% now, the pickings are slim again. On the other hand, that move was so fast that we think 2024 will bring at least a small yield rebound. We don't have a forecast (see #1 above) but stand ready to capitalize on a decline in prices should it arrive.

In the short end of the market, yields on the one-year declined from 5.12% to 4.76%. The all-important ten-year – which dictates mortgage rates – sank from 4.32% to 3.88%. Expect to see lower mortgage rates follow in the opening weeks of 2024, giving housing a boost.

What's behind this big bond rally? The Fed sat tight at their last meeting, and analysts ran away with that, forecasting (!) several rate cuts in 2024. Powell had to take pains to clarify that the Committee had only decided to stand pat and had not publicly discussed the timing or number of rate cuts. It's the analyst community's ebullition that leads us to believe that the market will teach yet another lesson about forecasting – giving us yield increases at the outset of the year. We shall see.