The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets January 2024

From: *Philadelphia* Investment Management Group

OVERVIEW

- ***The Federal Reserve is Winning Its Fight Over Inflation.*** *Their preferred inflation measure, the Personal Consumption Expenditure (PCE) Price Index, grew 2.6% year-over-year in December. Core prices, excluding the food and energy categories, grew 2.9%, down from 3.2% from the month prior.*

- ***The U.S. Economy Continues to Add New Jobs in Most Industries, Increasing Employment.*** *As also mentioned in the last commentary, job numbers continue to be a worry for the Fed as they try to figure out when to start reducing interest rates.*

- ***Global Stocks had Their Best Year Since 2019, Lifted by Optimism that the Federal Reserve Will Cut Interest Rates and that Innovations in Artificial Intelligence Will Boost Profits.*** *The MSCI All Country World Index returned 22.2% in 2023.*

THE ECONOMY

When 2023 started, investors steeled themselves for what many took as an upcoming year of pain. For sure, they thought the aggressive rate hike cycle was surely going to put the economy in recession. However, the Fed's pivot policy played a key role in forecasting multiple rate cuts in 2024. Declining inflation and Treasury yields, with stronger-than-expected GDP, coupled with the labor market's resiliency, all led to a soft-landing sentiment and not a recession.

Supply issues seem to have straightened out so now further progress in reducing inflation even more must come from a softening in product and labor demand. The Fed wants a cool down in job openings which will limit upward pressure on inflation without having to create widespread layoffs. Yes, as this letter goes to press, the December reading of inflation came in hotter than economists had expected; therefore, job creation, which continues to rise, continues to influence any Fed decision on lowering interest rates and the timing to do so.

FINANCIAL MARKETS

EQUITIES

At the beginning of 2023, many economists and market strategists were projecting a poor follow-up year similar to the winding down of 2022. More than $70 billion was pulled out of the market in 2023 with only a quarter of fund managers ahead of the market for the year. However, 2023 turned out to be a year of solid evidence that inflation numbers were beginning to come down and talks started about how 2024 could be a year of rate reductions. A recession failed to pan out, large technology stocks took off and the S&P 500 ended up posting a strong 26.29% gain for the year. Small caps, after stumbling into the fourth quarter, rallied off their 2023 lows in October, with the Russell 2000 Index advancing 16.93% to end the year.

	Equity Returns*				
Index	**4th Qtr**	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	**2023**
S&P 500	11.69%	-3.27%	8.74%	7.50%	26.29%
Dow	13.09%	-2.10%	3.97%	0.93%	16.18%
Nasdaq	13.56%	-4.12%	12.81%	16.77%	43.42%
Russell 2000	14.03%	-5.13%	5.21%	2.74%	16.93%

*Total: price change + reinvested dividends

In the fourth quarter, market performance began to broaden out beyond the few big names that led the market throughout most of the year. In addition to Technology, the Real Estate, Consumer Discretionary, Financials and Industrials sectors picked up and outperformed the S&P 500's 11.69% total return, as reflected in the following chart.

	S&P 500		
		Returns*	
Sector	**Weight**	**4th Qtr**	**2023**
• Energy	3.9%	-6.94%	-1.33%
• Materials	2.4%	9.69%	12.55%
• Industrials	8.8%	13.05%	18.13%
• Cons. Discretionary	10.9%	12.42%	42.41%
• Consumer Staples	6.2%	5.54%	0.52%
• Health Care	12.6%	6.41%	2.06%
• Financials	13.0%	14.03%	12.15%
• Info Technology	28.9%	17.17%	57.84%
• Communication Svcs	8.6%	10.95%	55.80%
• Utilities	2.3%	8.56%	-7.08%
• Real Estate	2.5%	18.83%	12.36%

12/31/23
*Price + income
Source: S&P Dow Jones

Global stocks had their best year, with U.S. stocks being the major driver of the rally and that the U.S. economy is headed to a soft economic landing. As mentioned under bullet point 2 at the beginning of this commentary, there are lingering risks which have to do with the job market. Just how serious the new job creation numbers are coming in month after month is for the Fed to decide. Our view is that, at the worst, consumer spending and GDP growth will dampen somewhat if the timetable for rate relief is postponed from where the market expects it to commence.

FIXED INCOME

It was a turbulent year for fixed income markets amid shifting views on the outlook for U.S. monetary policy. The 10-year U.S. Treasury yield fell in March after the collapse of Silicon Valley Bank and concerns as to whether the Fed could head off trouble in the banking sector. Yields climbed through much of the summer. The final twist of 2023 came in the fourth quarter when evidence of slowing inflation rekindled optimism that the Fed could cut rates in 2024. Despite the volatility, fixed income delivered strong returns overall in 2023.

Fixed Income Returns

Index	4th Qtr	2023
Corp/Govt	6.46%	5.52%
Int. Corp/Govt	4.41%	5.21%
Long Corp/Govt	12.53%	6.36%
U.S. Government	5.72%	3.87%
- Intermediate	3.88%	4.19%
- Long	12.04%	2.80%
Corporate	7.91%	8.40%
- Intermediate	5.56%	7.34%
- Long	13.27%	10.66%
- **Quality**		
- AAA	8.42%	6.48%
- AA	7.33%	6.71%
- A	7.65%	7.58%
- BBB	8.24%	9.46%
Municipal	7.62%	6.50%
- Intermediate	4.92%	4.26%
- Long	9.56%	8.09%

Source: ICE BofA

A strong rally, primarily in November and December, helped produce solid results of 5.52% for the Corporate/Government Index in 2023, following a challenging 2022. Corporate returns were particularly strong in the fourth quarter at 7.91% and were not far behind the annual return of 8.40%. The strong rally in the lower quality market resulted from hopes for Fed easing and a soft landing underway. The tax-exempt market closed the year as well on a very strong tone with a return of 6.50%. Yields fell dramatically in the fourth quarter, which pushed them in line with to below year-ago levels across the curve.

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In conclusion, 2023 was a year that surprised many financial analysts, economists and professional managers. We suppose one good reason for this was the terrible 2022 everyone experienced. While we are not out of the woods yet, the economy is in a lot better shape than it was 24 months ago, and this is reflected in the market. While the bond market is still experiencing an inverted yield curve in both taxable and non-taxable issues and job inflation is still worrisome to the Fed, we believe we are on the correct path to the Fed target of two percent inflation while we experience a soft landing.

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