O'Brien WEALTH PARTNERS
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Dear O'Brien Client –

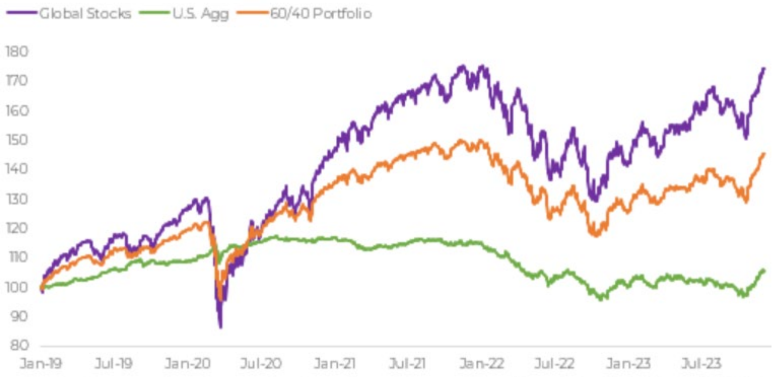
The holiday season proved to be a cheerful time to be an investor. Persistently softer inflation, coupled with a shift in stance by the Federal Reserve (Fed) to an easing bias for 2024, led to a sharp rally in both stocks and bonds during the final two months of the year. Global stocks posted a 22% gain for the year, while the U.S. Aggregate Bond Index (investment grade bonds) returned to positive territory for the first time in three years (up 5.5%).

	4Q	2023	3 Years	5 Years		4Q	2023	3 Years	5 Years
U.S. Large Cap Stocks	11.7%	26.3%	10.0%	15.7%	Real Estate Stocks	18.0%	11.4%	5.7%	7.6%
Global Stocks	**11.0%**	**22.2%**	**5.8%**	**11.7%**	Emerging Market Stocks	7.9%	9.8%	-5.1%	3.7%
Non-U.S. Developed Market Stocks	10.4%	18.2%	4.0%	8.2%	Investment Grade Bonds	8.2%	8.2%	-3.2%	2.4%
U.S. Mid Cap Stocks	12.8%	17.2%	5.9%	12.7%	Municipal Bonds	7.9%	6.4%	-0.4%	2.3%
U.S. Small Cap Stocks	14.0%	16.9%	2.2%	10.0%	**U.S. Aggregate Bond Index**	**6.8%**	**5.5%**	**-3.3%**	**1.1%**
Non-U.S. Stocks	9.8%	15.6%	1.6%	7.1%	Mortgage-Backed Bonds	7.5%	5.0%	-2.9%	0.3%
High Yield Bonds	7.1%	13.5%	2.0%	5.2%	Treasuries	5.7%	4.1%	-3.8%	0.5%
Gold	11.4%	12.8%	2.3%	8.9%	Commodities	-4.6%	-7.9%	10.8%	7.2%

Past performance is no guarantee of future returns. You cannot invest in an index. 3-year & 5-year returns are annualized.
Source: Morningstar Direct, O'Brien Wealth Partners, as of 12/31/23.

Last year's strong performance extends the period of sharp moves – higher and lower – that investors have experienced since the onset of COVID. Within that time frame investors have experienced one 35% decline, as well as a 25% decline. Yet global stocks (the purple line in the chart below) are up 74% since the start of 2019 and a 60/40 global stocks/U.S. bond portfolio is up 45% (orange line below).

Global Stocks, U.S. Bond, & 60/40 Portfolio Performance (Jan 1, 2019 – Dec 31, 2023)



Past performance does not guarantee future returns. You cannot invest in an index. Global Stocks: MSCI All Country World Index. U.S. Bonds: Bloomberg Barclays U.S. Aggregate Bond Index. 60/40 Portfolio: 60% Global Stocks, 40% U.S. Bonds. Source: Bloomberg Finance, LP, O'Brien Wealth Partners, as of 12/31/23.

This longer-term perspective highlights the importance of staying disciplined and invested in uncertain environments. Since 1992, roughly 80% of the stock market's best days have come during either bear markets or early in bull markets[1]. Not participating in those upswings can dramatically limit the growth potential of investment portfolios over the long term.

[1] Source: Ned Davis Research, Morningstar, Hartford Funds, O'Brien Wealth Partners, 2/28/22.

As we turn the calendar page to 2024, it appears that financial markets have reached the conclusion that the Fed has achieved a soft landing for the economy. U.S. stocks entered the year close to their all-time highs and interest rates have moved sharply lower (pushing bond prices higher).

While that outcome is a possibility for 2024, it is worth noting that 1) professional prognosticators have been wrong before, and 2) history skews against the Fed being able to achieve a soft landing.

More specifically, entering 2023 roughly two-thirds of professional economists surveyed by Bloomberg projected that the U.S. economy would be in recession today. Seven of the past nine Fed tightening cycles also wound up pushing the economy into a recession within a year-and-a-half of their conclusion. And most of those cycles were shallower and longer in duration than what was just experienced.

As such, we enter the year hopeful for a soft landing, but cautious that the market might be signaling all-clear too soon.

One dynamic that is clear is that the U.S. economic expansion is slowing entering 2024. The rapid rise in borrowing costs is taking a toll on the demand for goods, services, and workers. Hiring has slowed from an average of 400,000 workers a month in 2022 to 225,000 in 2023. Wage growth is slowing by extension. For now, inflation is slowing faster than wages, which is positive for consumer purchasing power – roughly 70% of the economy – and helps mitigate the fact that most American households have now exhausted the excess savings they built up during COVID.

As long as hiring continues and inflation cools faster than wages, imminent recession risk is low.

Encouragingly, inflation has slowed to a pace that is in-line with the Fed's goal over the past six months. Moreover, this trend should continue into 2024 given the slower wage growth and the housing market cooldown. These trends have allowed the Fed to shift its guidance toward cutting rates at some point this year.

Ultimately, to feel more confident that the Fed has in fact hit the offramp on a downward trend that could – and usually does – result in recession, growth drivers will need to become more balanced.

Economies with long runways for expansion exhibit growth across a wider variety of sectors (e.g. housing, manufacturing, services, etc.) than what the U.S. is currently experiencing. Some combination of easier access to credit for consumers and businesses, lower borrowing costs, corporate profit growth, subdued inflation, and a still-positive – but not too hot – pace of hiring will likely be necessary for that to happen.

We have seen some progress for those economic drivers over the past several months. The pace of credit tightening by banks has slowed, but they have not yet turned to outright easing. Corporate profits are no longer declining, but they have not yet begun to rise. The Fed is no longer raising rates, but their current policy stance remains restrictive. All while inflation is cooling and hiring remains modestly positive.

In short, economic headwinds are slowing, but they are not yet tailwinds and a wait-and-see approach is warranted.

But our dear friend Mr. Market is again seeing only blue skies and demanding exorbitant prices. Last year's stock market rally was driven by expectations for profit improvement – 2024 will need to be a year where corporate profits rise to justify those valuations. This is not unachievable, but the work needed to do it still lies ahead.

In the interim, the backdrop for bonds is more constructive than it has been in years. Income is available without having to take on significant credit default risk. Inflation is cooling and the Fed is poised to begin reducing rates. Fed rate cuts, in turn, reduce the return potential of cash vis-à-vis bonds. High quality bonds also tend to be better diversifiers of stock market risk in lower inflation environments in the event the economy and corporations fail to meet stock market expectations.

In sum, as we enter 2024 we continue to remain fully invested and well diversified across markets, but we are not adding incremental risk to portfolios as we await more economic clarity.

We hope you are all taking care and staying healthy. If you have questions, or would like to talk, please reach out to your Advisor or any member of our investment team.

Your O'Brien Team

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