Palisade CAPITAL MANAGEMENT | Private Wealth

2023 REVIEW AND 2024 OUTLOOK

	4Q23 RETURN (%)	YTD23 RETURN (%)
S&P 500® Index	11.69	26.29
Dow Jones Industrial Average	13.09	16.18
NASDAQ Composite Index	13.79	44.64
Russell 2000® Index	14.03	16.93
VIX Volatility Index	-28.94	-42.55
Barclays U.S. Aggregate Bond Index	6.82	5.53
10-Year U.S. Treasury Yield	-15.12	0.03
Baltic Dry Index – Spot (Ocean Cargo Shipping Rate)	23.10	26.29
Gold ($ per ounce) – NY Spot	11.61	16.18
Oil ($ per barrel – West Texas intermediate)	-20.80	44.64
Bitcoin ($)	56.77	16.93

Source: FactSet Research Systems, Inc.

Putting 2023 in Perspective. 2023 rewarded American investors as richly as 2022 hurt them. The benchmark S&P 500® Index returned over 26% in 2023 *versus* a *20% drop* the prior year. Other U.S. equity indices outshone even the S&P 500®, such as the technology-focused NASDAQ, which rose by 45% after a miserable 2022 (down 33%).

Yet, last year was only the fifth-best year for the S&P 500® in this still-young century. The *real surprise* of 2023 is that the market's strong performance was unexpected by Wall Street's brightest forecasters. Most strategists predicted a recession – or at least a serious slow-down – for the U.S. economy in 2023. Just the reverse of that happened. The economy picked up steam within the year; real gross domestic product rose from 2.2% in the first quarter to 4.9% in the third period. Inflation fell, too, from nearly 9% a year-and-a-half ago to 3.1% by year-end 2023. The Federal Reserve passed up the chance to raise rates in the final quarter, and the yield on the 10-year government bond fell from nearly 5% at its height in October to 3.9% at year-end. And all of this has occurred as unemployment remained at the historically low level of 3.7% at year-end. Few of these things were predicted by most strategists a year ago. Investors – and many strategists – have abashedly changed their views on the U.S. economy (and the financial markets) from gloomy to sunny. In fact, a soft landing (no recession) for the U.S. economy in 2024 now appears to be the consensus among strategists.

But can we trust the consensus? Events and sentiments sometimes move too fast for Wall Street strategists to capture important nuances in their well-articulated reports; they cannot keep pace with the real world. And is the current consensus any more reliable now than it was a year ago? Is *The Economist* magazine right that investors have gone out on a bridge too far? Whose view can investors trust?

To help make sense of things, we crafted the following "balance sheet" of the current economic and investment environments. We start with the consumer; that's key since consumption is 68% of the American economy. We then look at policy and, finally, the American stock market. The list presents a nuanced portrait, which we find to be a net positive, but which also hints at shifts taking place under the hood. The U.S. equity market of 2024 will likely be different – maybe more balanced – than the market of 2023.

	Negatives	Positives
Consumer Spending	Consumers are grumpy. Inflation still being felt. Housing and rent “unaffordable.” Savings rate low at 4.1%.	Inflation dropping, especially gasoline. Unemployment rate 3.7% near 50-year low. If people are employed, they will spend money.
Inflation	Sharp increase in minimum wages on Jan 1 in 22 states; federal government plus big labor settlements with UAW and other unions could push up product and services inflation.	CPI has dropped from 9% 18-months ago to 3% today; wage growth now outpacing consumer inflation. High visibility items – gasoline and some grocery items – are beginning to drop in price.
Interest Rates	Significantly elevated from two years ago. Home mortgage rate 6.5% up from +/-3%.	Rates appear to have crested especially on the long end; mortgage rates are beginning to drop.
Manufacturing/Industry	Shortages of skilled workers continue to plague many industries.	Post-pandemic recovery has legs. Most of the infrastructure spending authorization (2021/22 bills) has yet to be spent. Supply chain snarls improving.
Federal Reserve Bank / Monetary Policy	Many bond market observers believe the Fed will cut its “policy rate” (federal funds rate) by 5 or 6 times in 2024. **This belief seems misplaced and could prove disappointing** if it does not materialize.	The Fed is determined to bring inflation to 2% – and to avoid the disappointing outcomes of prior decades where erratic Fed policies failed to squash inflation. The Treasury is injecting liquidity into the economy. The Fed’s bond liquidation program (“QT”) going better than feared.
International	Risk of widening conflict in the Middle East. Russian and Chinese aggression ever present and perhaps growing threat.	Weakening dollar good for U.S. exports and competitiveness of U.S. manufacturers. We believe China economy likely to rebound.
Financial Markets	U.S. stock market (S&P 500®) is expensive by historical standards. Now trading at nearly 24x trailing EPS vs. an average of 19x over the last 20 years (source: FactSet). Valuations skewed to a few mega-cap tech stocks.	Equity investors finding good companies at attractive valuations in mid-cap/small cap value stocks in U.S. and abroad. U.S. bonds now offer positive real returns for first time in years.

We cannot precisely predict changes in the markets in 2024, but we think we see the broad outline of some trends:

First, it seems unlikely that the so-called “Magnificent Seven” stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) will continue to suck all the oxygen out of the U.S. stock market. These megastocks rose by 75% last year (on a capitalization-weighted basis) and accounted for approximately *two-thirds of the total* increase in the value of the S&P 500® Index last year. At the end 2023, the Magnificent 7 stocks’ average forward P/E ratio was 33 times versus 21 times for the rest of the S&P 500® average. These tech-focused companies enjoy high financial returns and near-monopolies in their businesses (*e.g.*, search related advertising, AI chips, etc.). But capitalism abhors monopolies, as do regulators.

Second, straws in the wind hint at a widening out of the U.S. equity market in favor of value vs. growth. For example, in the December quarter, for the first time in several quarters, the *equal-weighted* S&P 500® outperformed the capitalization-weighted S&P 500® (the one that is reported daily in every media outlet). This means that smaller cap stocks were starting to gain on the likes of the trillion-dollar behemoths that dominate the S&P 500® Index.

Finally, if the mega-cap Magnificent 7 stocks mark time or even stumble this year, then more diversified equity investments (think “value” and “small cap” stocks) may outperform the S&P 500®.

The U.S. economy is slowing but is not slow. Inflation is easing but is far from the Federal Reserve’s 2% target. Short-term interest rates, which are controlled by the Federal Reserve through the Federal Funds rate, are not going higher, but, in our view, expectations of five or more cuts in 2024 seem overly optimistic. **With a backdrop of higher rates for longer, profitable, fairly priced stocks regardless of market cap could be the pathway for performance in 2024.**

Thank you for allowing us to manage your investments. We aim to reward your faith in us for years to come.

Palisade Capital Management

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The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance, based on the market capitalizations of 500 large companies having common stocks listed on the NYSE or NASDAQ. The S&P 500® Index does not have a defined investment objective, nor does it charge fees and expenses.

The Dow Jones Industrial Average (The Dow), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock market.

The Russell 2000® Index (the "Index") measures the performance of the small-cap segment of the U.S. equity universe. It consists of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Source: London Stock Exchange Group plc and its group undertakings (collectively, the “LSE Group”). © LSE Group 2024. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trade mark(s) of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group, nor its licensors, accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor, or endorse the content of this communication.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500® Index options.

The Bloomberg Barclays U.S. Aggregate Bond Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

The Baltic Dry Index (BDI), is issued daily by the London-based Baltic Exchange. The BDI is a composite of the Capesize, Panamax, and Supramax Timecharter Averages. It is reported around the world as a proxy for dry bulk shipping stocks, as well as a general shipping market bellwether.

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing and is the underlying commodity of the New York Mercantile Exchange’s oil futures contracts.

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