

## Fourth Quarter 2023 Market Commentary

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### “The Recession That Never Was”

#### The Economy

In October 2022, Bloomberg Economics predicted the odds of a recession in 2023 at 100%. And most Wall Street observers were pessimistic about the prospects for the US economy in the following 12 months. After all, the Federal Reserve raised interest rates seven times in 2022 (with plans for further rate hikes) to tamp down inflation, and the resulting increase in borrowing costs for businesses threatened to stifle business investment and crush consumer spending.

But the US economy proved far more resilient than almost anyone expected. Growth in the first three quarters of the year averaged an annualized 3.2%, with a further 1.3% expected for Q4. Inflation weakened to 3.1% through November (see more below), and unemployment has remained surprisingly low. Economist Mark Zandi of Moody’s Analytics was the rare optimist who was confident in a soft landing for the US economy. Zandi noted that recessions are typically unexpected, and that there was a very good chance the Fed could drive down inflation without dramatically slowing the economy. Four gold stars for Mark!

Overseas, the Eurozone economy is expected to grow only slightly next year, despite wages rising faster than inflation for the first time since the pandemic began. A solid majority of economists surveyed by the Financial Times believe the EU is already in a recession – typically defined as two consecutive quarters of declining GDP. The same survey indicated that the respondents expect the economic contraction to be shallow and short-lived, with positive growth resuming in Q1 2024.

#### Inflation & Interest Rates

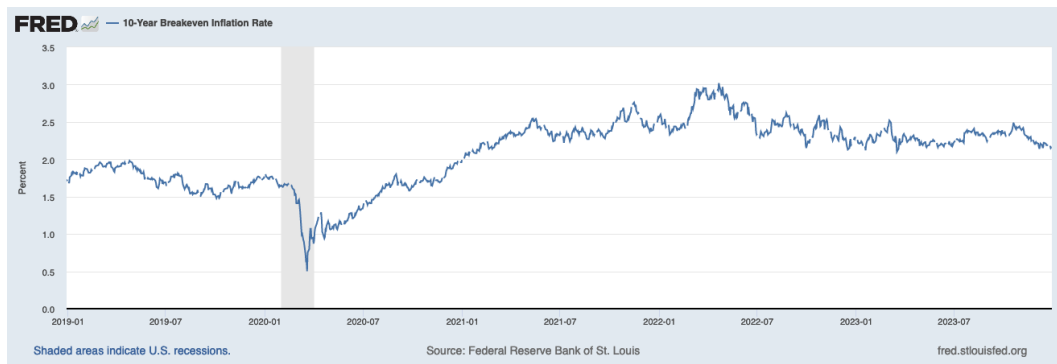
The Fed’s determined efforts to bring down inflation from its recent peak last year continue to bear fruit.

The US core PCE price index, which excludes volatile food and energy prices and which is the central bank’s preferred gauge to measure inflation, rose by 3.2% for the twelve months through November 2023, less than the market’s 3.3% expectation and down from October’s revised 3.4% annual rate.



Source: [Trading Economics](https://tradingeconomics.com)

The markets are still anticipating that the Fed will succeed in getting domestic inflation down close to its long-term target of 2% per year, with the 10-year breakeven inflation rate recently dipping below 2.2%.



Source: [Federal Reserve](https://fred.stlouisfed.org)

In the Eurozone, the inflation rate fell to 2.4% in November 2023, the lowest level since October 2021 and in line with the market’s expectation. Inflation peaked in the Eurozone at over 10% in late 2022 and is now only slightly above the 2% ECB target. The ECB has raised its deposit rate from minus 0.5% last year to its highest ever level of 4%, in response to the biggest surge in consumer prices for a generation.



Source: [Trading Economics](https://www.tradingeconomics.com)

### Mortgage Rates

The average rate on a 30-year fixed mortgage was 6.61% as year-end, the lowest level since May, falling for the ninth consecutive week. The drop mirrored the sustained decline in long-term Treasury security yields in recent weeks, and driven by expectations of multiple rate cuts by the Federal Reserve in 2024. One year ago, the average rate on the 30-year fixed mortgage was 6.42%.

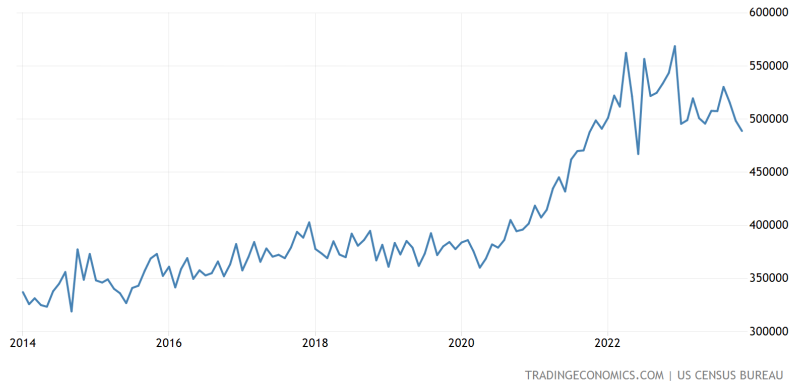
The chart below shows the benchmark 30-year fixed mortgage rate over the past ten years.



Source: [Trading Economics](https://www.tradingeconomics.com)

### The Housing Market

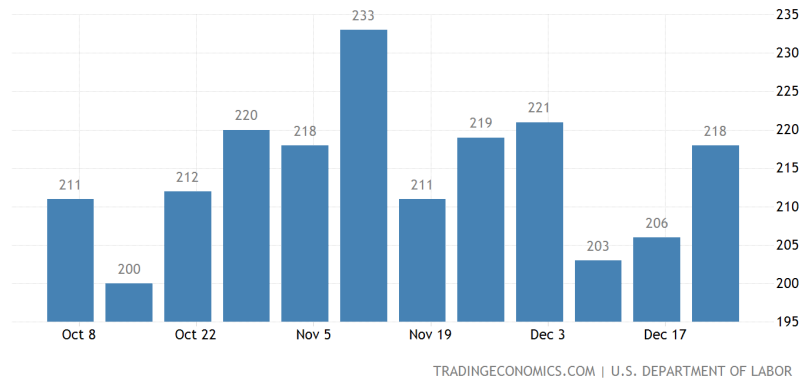
The average home price fell slightly to \$488,900 in November 2023 from \$498,500 in October. Home prices rose from just under \$220,000 in 1975 to nearly \$570,000 in December 2022, before declining in the face of an unprecedentedly rapid rise in mortgage rates.



Source: [Trading Economics](#)

## The Labor Market

The number of Americans filing for unemployment benefits rose by 12,000 to 218,000 for the week ended December 23. The figure was above the market's expectation of 210,000 and suggests a welcome softening of the US labor market at the close of the year.



Source: [Trading Economics](#)

## The Markets

### US Stocks

US stocks closed down on the final trading day of the fourth quarter and the year, but recorded significant annual gains as inflation trended down, the economy proved resilient, and interest rate cuts appeared likely.

The benchmark S&P 500 index - a proxy for large US companies - closed down 0.3% on Friday. Over the past month the index was up 4.4%, and over the past year it was up 24.2%.

The chart below shows the performance of the S&P 500 index over the past year.



Source: [Trading Economics](https://tradingeconomics.com)

The tech-heavy Nasdaq closed down 0.4% on the final trading day of 2023. Over the past month the index fell 5.4%, but over the past year it was up 53.6%.

The chart below shows the performance of the Nasdaq index over the past year.



Source: [Trading Economics](https://tradingeconomics.com)

### International Stocks

The Stoxx 600 index - a proxy for large European companies - closed up 0.2% on Friday. Over the past month the index was up 3.8%, and over the past year it was up 12.7%.

The chart below shows the performance of the Stoxx 600 index over the past year.



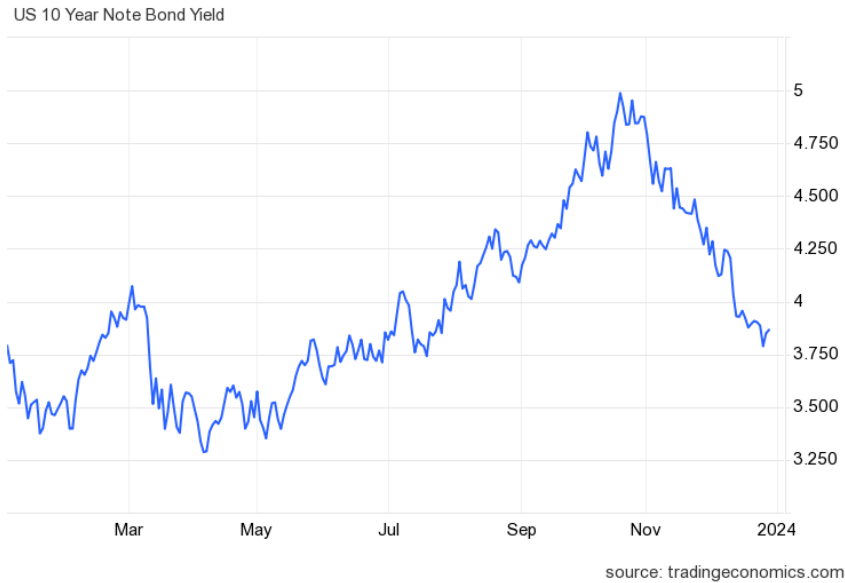
Source: [Trading Economics](https://tradingeconomics.com)

### The Bond Market

The yield on the benchmark US 10-year Treasury note rose slightly to 3.86% on the final trading day of 2023, as the investors continued to assess the likelihood of the Fed's interest rate cuts in 2024. Futures contracts indicate that 85% of the market is anticipating a rate cut by March.

Since October, when the yield on the 10-year Note briefly hit 5%, the yield has fallen by 120 basis points, as investors await the Fed's pivot from its earlier suggestions that rates would have to stay higher for longer.

The chart below shows the yield on the benchmark 10-year US Treasury note over the past year.



Source: [Trading Economics](https://tradingeconomics.com)

### Oil

Prices for the benchmark West Texas Intermediate futures contract closed at about \$71 per barrel on Friday, marking a 6% loss for December and an 11% decline for the full year.

Oil prices experienced short-lived rallies throughout the year, driven largely by OPEC+ production cuts, the Israel-Hamas war, and expectations of interest rate cuts. But growing signs of rising crude production, especially from non-OPEC countries, coupled with an uncertain demand outlook, have driven oil prices lower.

The chart below shows the performance of the benchmark WTI contract over the past year.



source: tradingeconomics.com

Source: [Trading Economics](https://tradingeconomics.com)

### Gasoline

Prices for gasoline futures contracts fell below \$2.15 per gallon on Friday, tracking the decline in oil prices. Prices remain well below the record levels of \$4.00 per gallon seen in the summer of 2022, and closed the year down over 10%.



source: tradingeconomics.com

Source: [Trading Economics](https://tradingeconomics.com)





## Benchmark Returns

For comparative purposes, the S&P 500 index (a proxy for large US stocks) rose 24.2% for the twelve months to December 31, and 11.2% in just the fourth quarter.

The Russell 2000 (a proxy for small US stocks) rose 16.9% for the twelve months to December 31, and 14.0% in the fourth quarter.

The Wilshire 5000 index (a proxy for the broad US stock market) rose 26.1% for the twelve months to December 31, and 12.1% in the fourth quarter.

The MCSI EAFE index (a proxy for large international stocks) rose 15.0% for the twelve months to December 31, and 10.1% in the fourth quarter, as measured in USD. Because the USD weakened during the quarter versus the EUR, the picture was different when measured in the local currency, with the index gaining 11.1% for the 12 months to December 31, and 5.5% for the fourth quarter.

Finally, the MSCI Emerging Markets index rose 7.0% for the twelve months to December 31, and 7.6% in just the fourth quarter.

In the fixed income segment, the Bloomberg Barclays US Aggregate Bond Index returned 5.5% for the twelve months to December 31.

## Looking Forward

According to some psychologists, happiness is the result of reality exceeding expectations. If that's true, then 2023 was a very happy year for investors and economists.

Last year's economic projections were consistently beaten by the actual data. The trends that underpinned that reality also offer plenty of reasons to be optimistic for 2024.

Finally, we remind you that Springwater's investment philosophy is based on decades of robust, peer-reviewed academic research. One of the principles of that philosophy is that, over time, investors can expect to generate higher returns if they tilt their portfolio's equity allocation toward small stocks (the "size" factor) and value stocks (the "value" factor). The important caveat is that these tilts don't consistently deliver higher returns, day in and day out, just as stocks don't always out-perform bonds and cash.

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these days, and by using social media we can share with you our thoughts, observations and ideas in the least intrusive manner possible.

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