Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management

Quarter 4, 2023

by John Mullen and Ruth Mullen

Please note our new office address as of October 1, 2023.

Animal spirits were alive and well in the fourth quarter, driving the NASDAQ and Dow Jones indices to record highs while the S&P500 finished the year just shy of its own all-time high. The quarter-end rally was ignited by a late October announcement from the Treasury that it would largely fund the Federal debt in the short end of the market. The policy shift capped longer-dated rates and sent interest rate-sensitive stocks flying. The Santa Claus rally was in full effect with a December announcement from Fed Chairman Powell that inflation was all but beaten and opening the door to rate cuts in 2024, although there is a clear divergence from what the Fed telegraphed and what markets are interpreting. Growth stocks were again the dominant driver of performance in the quarter. For the year, growth bested value by over 30 percentage points, with the Magnificent 7 (mega-growth stocks like Apple, Amazon and Tesla) providing a huge boost to returns. In an indication of just how concentrated the market was in 2023, the spread between the S&P500 index and the S&P500 equal-weight index (where each stock has the same weight, versus the traditional index which is weighted by company size) was the largest since the years leading up to the dot com bust: 68% of the traditional S&P500 return came from the largest 10 stocks. The Emerging Market index continued to stand out for all the wrong reasons, but much of the relative performance lag stemmed from poor performance by Chinese stocks. The price returns from Bitcoin show just how "risk-on" investor appetite was.

Data as of December 31, 2023	Dec '23	Qtr. 4 '23	YTD '23
S&P 500	4.54%	11.69%	26.29%
MSCI AC World Index (incl. US)	4.84%	11.15%	22.81%
MSCI EAFE (Europe, Asia, Far East)	5.33%	10.47%	18.85%
MSCI EM (Emerging Markets)	3.95%	7.93%	10.26%
Russell 1000	4.94%	11.97%	26.55%
Russell 1000 Growth	4.43%	14.16%	42.68%
Russell 1000 Value	5.54%	9.50%	11.46%
Russell Midcap	7.73%	12.82%	17.24%
Russell 2000	12.22%	14.03%	16.93%
Bitcoin	12.07%	56.72%	155.42%

Data provided by Tamarac Inc.

Fixed Income Markets

There was a seismic shift in fixed income returns in the fourth quarter. Since 2022, longer-dated bonds had consistently lagged the Aggregate Index, as a combination of increased supply and an expectation for higher rates impacted that maturity basket the most. With the late October declaration from Treasury Secretary Yellen that the majority of debt issuance in the immediate future would come from short-term issuance, longer-dated yields were capped. The yield on the 10 Year fell by over 90 basis points in the final two months of the year to end 2023 at 3.88% driving a return for long bonds of 12.69%, nearly doubling the Aggregate Index's return of 6.82%.

PARSONS
Capital Management, Inc.

www.parsonscapital.com

Corporate Headquarters
40 Westminster Street, Suite 400
Providence, RI 02903
Phone 401.521.2440
Fax 401.521.4870
Toll-Free 888.521.2440

Florida Office
11450 SE Dixie Highway, Suite 205
Hobe Sound, FL 33455
Phone 561.868.2440

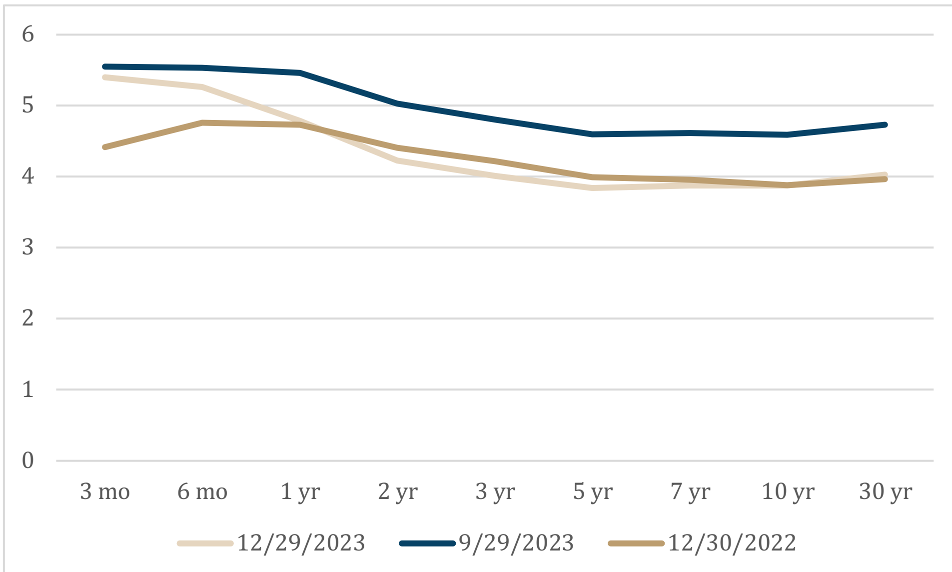
Fed declares victory over inflation…

Pivot sends rates lower across the curve…

Energy prices plunge while gold shines…

US Treasury Yields

As discussed above, Fed Chair Powell all but lit a victory cigar with the December announcement putting rate cuts firmly on the table for 2024. The reaction can be seen below, with a shift lower in yield across the curve when compared to where the quarter began. While the Fed dot plot indicates a path generally consistent with three cuts to the Fed Funds Rate in 2024, investors took the announcement to mean even more rate cuts would happen (currently pricing in five) and would occur earlier in the year. No amount of Fed jawboning in the weeks to close out the year was able to tamp down on the animal spirits running wild through the investment world.



Data from U.S. Treasury

Commodities

Commodities were whipsawed throughout the year, and that remained the case in the final quarter of 2023. The CRB index turned down in the quarter and left the full-year return nearly flat. Weakness in the quarter was found throughout the energy complex. Beyond the plunge in oil prices (which occurred in the face of attempts by OPEC to prop up prices) gasoline and natural gas prices both fell -14% in the quarter.

Gold was a star in the fourth quarter, returning 12%. The price appreciation was in response to the drop in yields discussed earlier and, perhaps, as an increasing hedge to concerns about deficit spending in the United States.

Of note, economic weakness in China was not enough to dent copper, which enjoyed a 4% gain in price to close the year up 3%.

Commodity	Qtr. 4 '23	Year to Date '23
CRB (broad index)	-6.02%	0.02%
Oil	-21.08%	-10.77%
Gold	12.10%	13.45%

PARSONS
Capital Management, Inc.

www.parsonscapital.com

Economic Overview

The most widely expected recession that wasn't…

2023 began with the vast majority of economists expecting a recession in the United States on the back of aggressive tightening by the Fed which began in 2022, with little hope for a soft landing. While there were rolling pockets of weakness seen throughout the year, the domestic economy surprised with its resilience. The U.S. consumer - aided by a strong jobs market, continued growth in wages and an underappreciated new source of income - remained ready, willing and able to spend.

Labor market pressures easing…

A key factor in the Fed's plan to engineer a soft landing for the economy was to create less stress in the job market by lowering job openings without causing a spike in layoffs and unemployment. On that front, 2023 could not have gone much better for the policy makers. In December, the Challenger-Gray measure of layoff announcements fell by 20% when compared to 2022. The final jobs report for the year showed growth of 216,000 jobs in December, although the prior months were revised down by 71,000 and the participation rate ticked lower to 62.5%. Average hourly earnings grew by 4.1% with the greatest gains seen in the lower wage brackets.

A newfound source of income…

Perhaps the biggest support for the consumer came from the Fed itself. The rate hike cycle, which now might be concluded, sent short rates significantly higher, and trillions of dollars found their way into money market funds. The higher yield enjoyed on those monies in 2023 resulted in an increase of $200 billion in the economy when compared to 2022, which more than offset the sunsetting/pausing of Covid era government support.

The consumer has been the bedrock of economic resilience in the U.S. Supporting this strength are indicators that inflation pressures continued to abate, including the CPI and the prices paid ISM survey subindex. Other sectors have experienced rotating pockets of weakness, however. The manufacturing ISM survey remained under 50, indicating contraction, for the 14th consecutive month in December at a reading of 47.4. Earlier in the year, banking was a headwind to economic activity as banks tightened lending requirements in the face of their own industry concerns following the collapse of Silicon Valley Bank, First Republic and Signature Bank. The auto industry was also greatly impacted by prolonged strikes at Ford, GM and Stellantis while housing construction was constrained by higher mortgage rates.

Economic picture less rosy abroad…

Looking to the rest of the world, many economies were not as fortunate as our own and struggled through the year.

China, long an important source of growth for the global economy, continued to suffer from a burst property market, debt overhang and the lingering effects of their zero-Covid policy. With its government so far taking half measures to stimulate growth, the rebound has been underwhelming.

European economies were weak for the year, although they avoided some of the worst-case estimates from the beginning of 2023. Of note, the European Central Bank president noted that the Eurozone may have finished the year in recession – pointing to weakness in construction activity, consumer spending and surveys of activity.

PARSONS
Capital Management, Inc.

www.parsonscapital.com

Investment Implications

The only constant has been change…

The last few years have whipsawed investors. At the end of 2021, inflation was widely believed to be transitory and the Fed would have little issue corralling it. By the end of 2022, a brutal sell-off in stocks and bonds left markets believing that inflation was out of control and a recession was imminent due to the aggressive actions of the Fed in a feeble attempt to wrangle inflation lower. Then in early 2023, inflation began to cool, consumers remained resilient, the economy grew. Investors embraced a risk-on rally as an economic soft landing looked all but assured by year end. Along with the changing narrative at the macro level, investor sentiment has seen wild swings from optimistic to despondent to, by the end of 2023, euphoric.

Dramatic swings in leadership…

The seemingly annual divergence from the accepted outlook has also driven dramatic shifts in market leadership. For the year 2023, the seven largest stocks in the S&P 500 had an average return of 105% while in the year prior those same seven stocks posted a -46% return. Going back further, over the years 2021, 2022 and 2023 the Russell Growth index's relative return to the Russell Value has been: +2.43%, -21.60% and +31.22% respectively.

After a year of P/E expansion, hope for EPS growth…

With earnings per share for the full index roughly flat for the year, the S&P 500's nearly 25% price appreciation was essentially entirely due to the expansion of Price-to-Earnings ratios. Such an expansion in the P/E multiple is, perhaps, not surprising when one considers that the American Association of Individual Investors (AAII) final survey of 2023 showed 46.3% of respondents bullish with only 25.1% bearish. This compares to the beginning of the year with only 37.7% bullish and 30.5% bearish, roughly in line with historical averages of 37.5% and 31.0%. Of note, the year high in bearish readings for the survey was at 50.3% on Nov 1, which was right before the market began its melt up into year end.

Headwinds face the market, but supports remain…

Narrow leadership and frothy expectations are two concerns as we turn to 2024, but there remain multiple pillars of potential support. Historically, presidential election years are strong ones for stocks, though the first month or two can be rocky. This intuitively makes sense as the party in charge has an incentive to stimulate the economy, which should aid market performance. Here already we see the White House using the strategic petroleum reserve to blunt a rise in oil prices while also working to help consumers. At the same time Congress is talking about a potential $100 billion in tax cuts.

At the same time, while money flowed into equities during the year as evidenced by the $388 billion in net inflows to equity ETFs (a reading a touch lower than 2022), $1.1 trillion found its way into money market funds and their currently attractive 5%+ yield. If the Fed does begin cutting rates, money market fund yields will fall quickly and investors could be left with a huge amount of dry powder looking to be put to work.

For the economy, while there have been some small cracks in the employment picture (a lower work week, a drop in temporary hiring) the overall picture remains solid. Without a meaningful uptick in firings/unemployment, the U.S. economy is less likely to fall into recession. If that plays out, the expected 10% EPS growth for the index could be achievable and provide support to rising stock prices.

We see a lurking risk to the positive return scenario: with the Federal government running a deficit of 7.5% of GDP, the largest such non-recessionary peacetime deficit ever, interest costs now exceed 16% of tax revenue. Proposed tax cuts and stimulus together have the potential to reignite inflation and again push interest rates higher. These countervailing forces (positive economic environment and historical precedent coupled with structural issues) can be expected to produce continued volatility in stocks and bonds, including more stock market leadership changes, rolling corrections and rates bouncing up and down.

PARSONS
Capital Management, Inc.

www.parsonscapital.com