DECEMBER 2023

MARKET UPDATE

Capital markets rallied following the recent lows in the S&P 500 toward the end of October. Earnings growth returned to the S&P 500 across the third quarter earnings season and investors turned to expect a more dovish path for the Federal Reserve for the rest of the year and next. The S&P 500 regained much of what it had lost over the course of the preceding three months and nearly surpassed its year-to-date high from July 31st. The rally was fairly broad-based with the relative laggard of the major equity styles gaining "only" 7.54% for the month.

The yield curve moved significantly on the back of shifting Federal Reserve expectations as well. This caused the yield on 10-year US government bonds to fall over 60 basis points over the course of the month and provided upward movement in bond prices. The Bloomberg US Aggregate bond index was able to gain over 4.5% in the month, while long duration bonds gained over 8.6%.

The third quarter GDP report was revised upward to a 5.2% annualized rate of growth. Typically, GDP revisions don't get a lot of attention, but two things caught the attention of markets and pundits. First, the original report already showed growth well beyond expectations, so the news that the economy ran hotter than the first report was notable. Second, the report showed that while consumer spending was a bit less rosy than originally reported, growing at a 3.6% rate, business investment was revised upward. This was notable since business investment has been tepid lately, while consumer spending, albeit slowing by some measures, has been the engine of the economy.

ADVISORS' PERSPECTIVE

The S&P 500 rallied sharply from late October through most of November, nearly regaining all the ground it had lost since late July. Sentiment, at least in the short term, has noticeably shifted over the last few weeks as investors grow more confident the Federal Reserve is likely done raising interest rates. Furthermore, broad economic data remains strong enough to support the economy but soft enough to concern the Fed. Nearly all the S&P 500 constituents have reported their Q3 results, with an aggregate sales surprise of 0.95% and earnings surprise of 7.68%. Over 80% of the companies in the S&P 500 beat analyst earnings estimates, higher than the longer-term averages of the mid-to-upper 70% range.

In November, yields across the curve fell dramatically, with intermediate- to long-term yields falling the most. The downward shift pushed up bond prices and led to the surge in fixed income performance across the month. The 60-basis point drop in the 10-year yield marked the 23rd largest single-month drop going back to 1962 and only the third time a drop that large has happened since the turn of the century (the other two happened in 2008). On the other hand, short-term yields experienced fewer fluctuations, with the 1-year yield falling just over half of what the long end of the curve experienced.

Access to credit is getting more difficult. The proportion of consumers that are reporting it is "much harder" to get access to credit has risen to nearly 20%, up from 13% at the start of the year and 8% in December 2021. However, the number of respondents reporting that it has gotten "somewhat harder" rose substantially last year and has slowed since then. Delinquency

rates in credit cards have started to climb yet remain below pre-pandemic averages. As credit tightens it could put a substantial dampening impact on consumer spending and sentiment.

One of the most significant stories this year in equity markets is the outperformance of the Magnificent 7 stocks. Through the end of November, a basket of the Mag 7 stocks has outperformed the S&P 500 by over 70 percentage points. Most of the outperformance was generated through the first half of the year, when the outperformance grew to nearly 65 percentage points, but the Mag 7 stocks has been able to maintain, and slightly expand their lead since then. The Magnificent 7 consist of Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla.

Oil and gas prices fall further from their September highs. OPEC+ agreed to cut another 900,000 barrels a day that are planned to take effect in January. Meanwhile, oil prices have fallen due to traders remaining skeptical on whether it will be fully implemented or not. Gas prices have either fallen or remain steady for 10 weeks straight now, where the national average price is $3.25, though 16 states now pay less than $3 per gallon. Consumer demand for gasoline has dropped over 60 cents per gallon now, further below average fall levels; in part due to higher-than-usual prices, persistent inflation pressure on disposable household incomes, and less overall demand during the winter months.

We remain cautiously optimistic and continue to use a quantitative investing approach. In times of uncertainty, it is more important than ever to follow the data and not make decisions based on emotions. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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