

## **JANUARY 2024**

### **MARKET UPDATE**

The rally across capital markets continued largely uninterrupted in December, despite a slight head fake on December 20th. Investors may have feared another bout of volatility heading into fall after the S&P 500 had lost just over 10% from the summer high, only for the index to rally over 15% from October 27th through the end of the year and coming within striking distance of new all-time highs. The S&P 500 ended up gaining 4.53% in December and 26.26% for 2023 on a total return basis. For the month, the MSCI EAFE outperformed while emerging markets underperformed the S&P 500.

Bonds also continued their rally and gained over 9% from their mid-October lows, ending the year up 5.53%. One of the big bond stories of 2023 is the changing consensus around future Federal Reserve actions. As those expectations have shifted, yields on government bonds have come down as well, pushing up bond prices and giving bond investors some relief from recent pain. Heading into the year the thought was a recession was nearly inevitable in 2023 leading investors to think the Fed's policy may change, which turned into a "higher-for-longer" narrative that coincided with the volatility across both bonds and stocks in the late summer and early fall. Currently, the growing consensus is the Fed will pivot in early-to-mid 2024 and begin cutting rates, which has, at least in part, fueled the rally over the last few months.

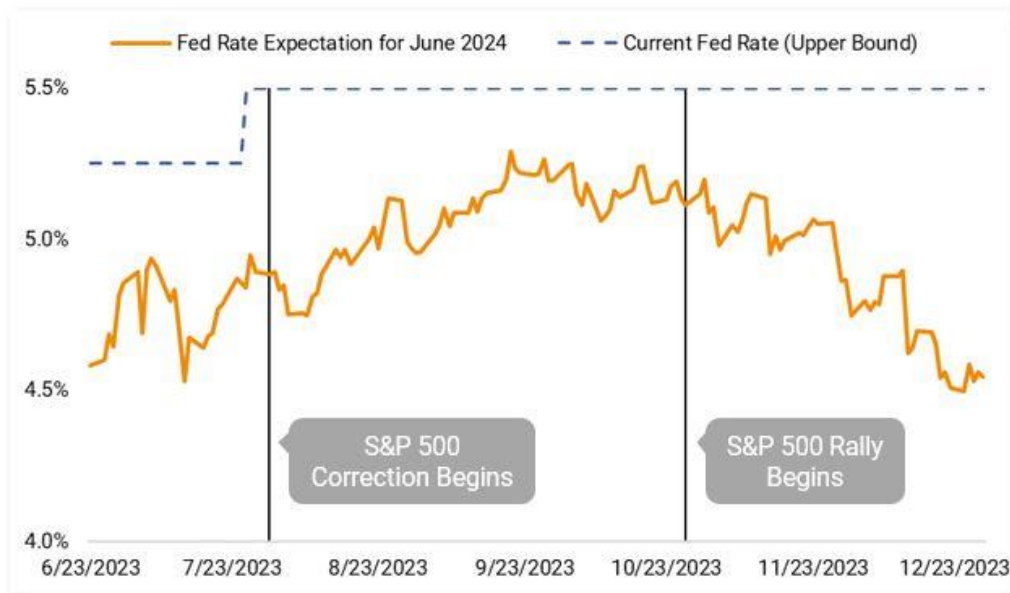
While risks still remain in the economy, the consumer continues to drive the economy forward, supported by a still hot, yet slowly cooling, jobs market and higher income, even after adjusting for inflation. While inflation has come down substantially over the year, it remains above the Fed's target and the third quarter of the year saw some of the improvement reverse. Changing Fed expectations remain the focus of investors heading into the new year and could become a source of volatility if they were to shift again.

### **ADVISORS' PERSPECTIVE**

As the year ended, the S&P 500 Index nearly reached an all-time high. In 2024, equity markets are expected to hit new records if the Federal Reserve achieves a soft landing. Based on press coverage, it may seem obvious that investor expectations around Fed policy have changed substantially over the year. On the graph below, investors can visualize those expectations and how they have coincided with pivot points in the S&P 500. Over the course of the second half of the year, investor expectations increased nearly a percentage point before falling back to slightly below where they were at the end of June.

## THE ROUND TRIP IN THE CHANGING FED EXPECTATIONS

Market implied rate following the June 2024 Fed Meeting



Bonds had a wild ride in the second half of 2023; the sharp rally at the end of the year lifted bonds out of the red for the year. Changing Fed expectations caused the yield curve to shift dramatically over the second half of the year. In the Fall, we saw aggregate bonds quickly sell off, causing many investors to fear what another negative year for bonds may mean for their portfolios. However, the rally from the end of October onward fueled a sharp rally in bonds and yields to come down.. As we head into 2024 there seems to be a growing consensus for the path for the Fed, though that may mean the risk for volatility is greater if those expectations shift again.

The S&P 500's 2023 performance was 26.26%, mainly driven by the so called Magnificent 7 (Amazon, Apple, Alphabet, Meta, Microsoft, Nvidia and Tesla). Through the end of November, a basket of the Magnificent 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 Magnificent 7 stocks has been able to maintain, and slightly expand their lead since then. This will unlikely happen again in 2024, but still a possibility.

The National Bureau of Economic Research (The NBER) evaluates key components such as Real Personal Income, Nonfarm Payrolls, Retail Sales etc... when assessing if we are in a recession or not. At the tail end of 2023, payrolls came in over expectations where the outperformance was driven by gains in government and healthcare, relative to consensus. Also, real personal incomes increased by 0.6%, which is double what real personal consumption increased by, at 0.3%. The three months of accelerating gains in inflation-adjusted income are supportive of the latest consumption and retail sales reports. Looking ahead into 2024 economists are expecting consumer spending to decelerate (but stay positive) across the first half of the year and for industrial production to stay relatively tepid.

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.

**DISCLOSURE**

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