

Market commentary notes

Monthly call notes
Monday January 8, 2024



Wealth
Management

Eric A. Stubbs
Senior Vice President –
Financial Advisor
Senior Portfolio Manager –
Portfolio Focus

1211 Avenue of the Americas
Suite 3300
New York, NY 10036

(212) 703-6165
eric.stubbs@rbc.com

Key issues last month and this month:

Just listen to what the Fed says — According to the recent mid-December FOMC meeting minutes, the Fed believes that market participants were expecting that Fed rates have peaked and would start falling before May, to decline about 1% during 2024. Recent yield curves are even more aggressive, implying an expectation that the FFR would be about 3.7% in a year and 2.75–3% in 2 years. Fed staff expects that 2024 PCE inflation would be “somewhat below 3%.” The Governors believed that progress had been made toward the 2% target but that the economy wasn’t there yet. It was notable to me that they believed that supply disruptions were cured and that labor supply increases were coming to an end, meaning in their view that further inflation reduction would come from maintaining restrictive monetary policy. “Several participants assessed that healing in supply chains and labor supply was largely complete, and therefore that continued progress in reducing inflation may need to come mainly from further softening in product and labor demand, with restrictive monetary policy continuing to play a central role ... Participants continued to be resolute in their commitment to bring inflation down to the Committee’s 2 percent objective.”

Regarding prospects for reducing the Funds Rate, “their baseline projections implied that a lower target range for the federal funds rate would be appropriate by the end of 2024 ... Several also observed that circumstances might warrant keeping the target range at its current value for longer than they currently anticipated.” [<https://www.federalreserve.gov/monetarypolicy/fomcminutes20231213.htm>, Jan. 6, 2024].

I read that to mean that they aren’t going to be in a hurry to reduce interest rates even if their base case is some reduction in 2024. They also pointed to the need to reduce the Fed’s balance sheet, which means net sales of bonds, meaning longer term rates might rise a bit in 2024.

Inflation — The 12-month all-item CPI was up +3.1% as of the end of November 2023. All-item, less food and energy was up 4.0% [<https://www.bls.gov/news.release/cpi.nr0.htm>, Jan. 6, 2024] [<https://www.bls.gov/cpi/latest-numbers.htm>, Jan. 6, 2024]. The Personal Consumption Expenditures Price Index (PCE PI), which the Fed watches, was up 2.6% in November versus a year ago. Core (excl. food and energy) was up 3.2% That compares to +4.2% in July versus July 2022. So, inflation is moving in the right direction and continues to drop at a fast pace. [<https://www.bea.gov/news/2023/personal-income-and-outlays-november-2023>, Jan. 6, 2024].

The Federal Shutdown — Mid-January replay? My guess is that one way or another the House will avoid a shut down, as they did in November. Based on

Investment and insurance products offered through RBC Wealth Management are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, or guaranteed by, a bank or any bank affiliate, and are subject to investment risks, including possible loss of the principal amount invested.

market reactions to previous shut downs, there's a good chance that even if there is one, the markets will take it in stride.

December ... that went well — After a three-month global stock market decline in August through October, U.S. and most global stock markets recovered aggressively in the last two months of the year to close out the year well into positive territory.

Total return for the S&P was + 26.3% (+9.6% if you exclude the top 7 names). Small Caps and Mid Caps did their best to catch up, with +16.4% and +16.0% respectively. International indexes lagged but turned in respectable numbers nonetheless. Some of the was probably due to (misplaced) excitement over the possibility that the Fed would start cutting interest rates in early 2024 and some perhaps due to relief that so far, we've avoided a recession and government shutdown.

On the bond side, hopes for Fed moderation also spurred a big bond rally. The Bloomberg intermediate index rose another 3%, putting it near 5.2% for the year Gold was up 14.6% for the year, while most other commodities dropped in price in 2023. Oil (WTI) finished the year about where it started, in the low \$70's.

Global stock indexes

Total Index	December %	YTD %	1 yr %	2022 Est PE Trailing/Projected
S&P 500	4.54	26.29	26.29	19.17/17.57
S&P Mid Cap	8.72	16.44	16.44	14.17/13.17
S&P Small Cap	12.80	16.05	16.05	14.94/12.45
FTSE All REIT	8.86	11.36	11.36	
MSCI All Country xU.S.	5.02	15.62	15.62	
MSCI Emerg Mkt	3.91	9.83	9.83	

Source: Morningstar as of December 31, 2023. Estimated PEs are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 30, 2022. Projected PEs are as of December 30, 2022. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	December %	YTD %	1 yr %
Bloom Agg Intermed	2.97	5.18	5.18
ICE BofA U.S. Convertibles	6.15	14.15	14.15
S&P GSCI	-3.31	-4.27	-4.27
Bloom U.S. Corp HY	3.73	13.44	13.44

Source: Morningstar as of December 31, 2023.

Sector performance — In December all but one sector, Energy, were up for the month. The leaders for the month were Real estate (+8.7%), Industrials (+7.0%) and Consumer Discretionary (+6.1%). For 2023, the top three were IT, Communications and Consumer Discretionary. The laggards in 2023 were Utilities (-7.1%), Energy (-1.33%) and Consumer Staples (+0.5%). So we're still largely seeing dividend stocks lagging while growth takes off. [<https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf>, Jan. 6, 2024] [<https://digital.fidelity.com/prgw/digital/research/sector>, Jan. 6, 2024].

Commodities

Commodity and food price changes, current month and YoY.

Total Index	December %	YoY %
Copper	1.4%	-3.2%
Lumber	3.7%	19.7%
Cotton	1.8%	-6.4%
Sugar	-8.2%	11.3%
Coffee	-2.0%	15.5%
Wheat	-2.7%	-17.1%
Corn	-4.7%	-29.4%
Oil	6.0%	-0.3%
NatGas	15.5%	-14.3%

Source: <https://tradingeconomics.com/commodities>, Jan. 6, 2024

Four of these nine major commodities saw prices decline in December. Compared to a year ago, six experienced price declines. It also appears that the variance in price changes is declining—meaning price changes are smoother and more systematic (with the exception of Natural Gas, which continues to be very volatile). Eight of the nine commodities in our table had price changes in the single digits in December. Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 29 of the 48 saw price declines in December, compared to 20 in September and 19 in August. So that indicates that some price declines are still occurring. 34 saw lower prices than a year ago. It was 31 last month. That suggests to me that price declines are still happening. At the front end of the production process, we continue to see price declines. Eventually that should filter through to the consumer as well.

Also, where commodities are concerned, the price level is generally higher now than it was pre-Covid. However, compared to the end of 2022, commodity prices are down 15.4%. That suggests inflation is likely to moderate further in upcoming months. [<https://www.indexmundi.com/commodities/>, Jan. 6, 2024].

The U.S. economy keeps growing ...

GDP estimates

[<https://www.bea.gov/data/gdp/gross-domestic-product>, Jan. 6, 2024] [<https://www.atlantafed.org/cqer/research/gdpnow>, Jan. 6, 2024]. The third estimate for 3Q 2023 GDP increased the estimated real GDP growth rate to 4.9%, which is astonishingly high. Other data suggest that corporate profits are trending upward.

The Atlanta Fed’s GDPNow model to estimate 4Q GDP growth is now estimating a 2.5% growth rate for the quarter we’re currently in. That’s up from 1.2% a month ago. My sense from other statistics like employment earnings, and consumer spending is that this is fairly close to what we’re likely to see in three weeks. Export and import trade are both down this quarter which could reduce GDP figures by one or two tenths of a percent from the current estimate. [https://www.census.gov/econ/indicators/advance_report.pdf, Jan. 6, 2024].

Jobs

The December numbers came out last week at +216,000 new payroll jobs. Primary areas of job growth were in health care, government and hospitality/leisure. [<https://www.cnbc.com/2024/01/05/heres-where-the-jobs-are-for-december-2023-in-one-chart.html>, Jan. 5, 2024]. NFP was up +173,000 in November. For the year, new jobs were up 2.7 million. [<https://www.bls.gov/news.release/pdf/empst.pdf>, Jan. 6, 2024]. Apart from the immediate Covid recovery period, that’s the best jobs growth we’ve seen since 2015 and the fourth-best in 25 years. [<https://fred.stlouisfed.org/series/PAYEMS>, Jan. 6, 2024]. Long-term unemployed are down to 3.8% of total unemployed, indicating that currently unemployment tends to be very short-lived. Looking at total U.S. employment, as of December 2023 that was 157.2 million. Pre-Covid, Dec 2019, it was 151.8 million. In Dec. 2011, during our recovery from the financial crisis it was 132.9 million. So it is up 18% from the Dec. 2011 level and up 4.4% from the pre-Covid level. [<https://beta.bls.gov/dataViewer/view/timeseries/CES0000000001>, Jan. 6, 2024].

U.S. PMI statistics

The U.S. Manufacturing PMI for December dropped back a little to 47.9. It has been in the 46 to 49 range for six months now. The U.S. Services PMI—80% of our economy—is still in positive territory and up a little at 51.4, indicating continuing moderate growth. [Trading Economics, PMI statistics Jan. 6, 2024]. [Trading Economics, <https://tradingeconomics.com/country-list/services-pmi> Jan. 6, 2024].

When we look at GDP, Jobs, production statistics, productivity—all of them point to a U.S. economy that continues to grow at a moderate rate as we enter 2024. From a markets standpoint, I don’t think this is the consensus yet, meaning market investors seem skittish

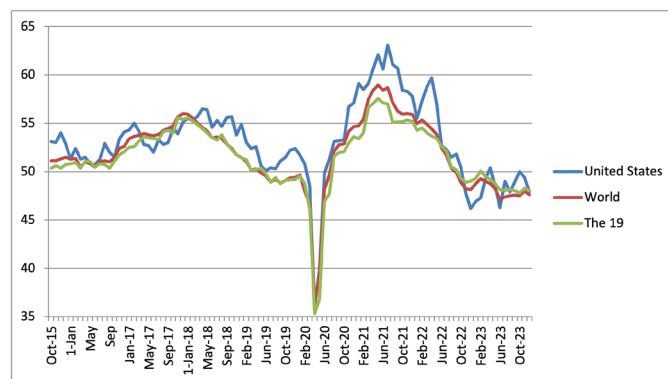
about 2024 growth (and therefore corporate earnings.) What this could mean is that they are overestimating the chances and extent of an interest rate decline and underestimating earnings growth. Taken together, that would lead me for now to wait with longer term bond purchases and probably feel comfortable with U.S. equity. Corporate profits are still about 2% short of their peak a year ago, but they’ve been in growing every quarter of 2023. [<https://tradingeconomics.com/united-states/corporate-profits>, Jan. 6, 2024]. If the trend continued into the 4th Q of 2023 (I expect that it did) we could match or exceed the best quarterly profits of last year, which historically, were the best profits on record.

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. This month, once again, 12 of our 38 countries came in with Manufacturing PMIs above 50. China stayed in the modest growth category at 50.8 and the EU rose slightly to 44.4. Germany appears to be gradually improving with a 43.3 versus 42.6 last month and that accounts for most of the EU’s increase this month. EU’s Services PMI also rose to 48.8, and Germany to 49.3. Overall, our weighted world index dropped a little to 47.6. In the big picture, there hasn’t been much change in these production growth numbers in about a year. [<https://tradingeconomics.com/country-list/services-pmi>, Jan. 6, 2024].

Here’s our updated graph of Manufacturing PMIs:



Source: Author’s calculations based on published PMI statistics, as of January 6, 2024.

Table summary

Region	Manu PMI	Last Month	12 mo. Ago
U.S.	47.9	49.4	46.2
19 majors	48.0	48.3	49.0
38 world	47.6	48.0	48.1
EU	44.4	44.2	47.8
China	50.8	50.7	49

Source: Author’s calculations based on published PMI statistics, January 6, 2024

2024 Market estimates

It's time to outline what I think 2024 might bring us as underpinnings to our investment strategy. The following tables outline some implications:

Estimates for 2024

Category	Our estimates (GTAS, Y-Gen)
U.S. Real GDP	+2.8 %
Inflation	2.0–2.5% EOY Core CPI
Unemployment	3.9%
Fed Rate	450 bp
USD FX	Trade-weighted appreciation +5%.
Global GDP	+2.4%
U.S. Equity (S&P)	S&P 500 +9%. Ending approx. 5240+ MC>SC>LC
Developed Intl Equity (USD)	+8%
Emerg Mkts Eq	6% unhedged basis
U.S. Bonds – Yield Curve	10 yr 3.8%. TR +3.8%
U.S. Bonds – Credit	Hi Yield, bank Loans 4%
Real Estate	+8%
Gold	-4%
Commodities	Agric and base metals -5%
Oil	\$55 to \$65 eoy

My central expectations were that the Fed would stop raising rates around 400 bp. It's worth noting in that respect that the inflation rate peaked and started to fall when the FFR was only 175 bp. Second, I thought stocks would outperform bonds—which happened to a much greater extent than I would have guessed. Also that international stocks would outperform U.S. stocks, which happened in the first half of 2023, but then U.S. stocks caught up. I didn't expect much from gold, oil or other commodities. Two out of three isn't bad.

2024 Market estimates

How'd we do in 2023? (and Why?)

Category	Our estimates for 2023	2023 Actuals	Critique
U.S. Real GDP	+2.5%	2.7% (est)	A
Inflation	4–5% EOY	4% (Core CPI)	A
Unemployment	3.3%	3.7%	B
Fed Rate	400 bp	525 bp	C
USD FX	Trade-weighted depreciation -3%.	-3% (based on FRED stats)	A
Global GDP	+3.1%	+2.7% to +3.2%*	A
U.S. Equity (S&P)	S&P 500 +9%. Ending approx 4200+ SC>MC>LC	S&P: +26% (ended 4783) MC: +16.4% SC 16%	C
Developed Intl Equity (USD)	+12%	+15.6%	B
Emerg Mkts Eq	14% on unhedged (currency) basis	+9.8%	B
U.S. Bonds – Yield Curve	10 yr 3.4%. TR +5.5%	10-Yr Tsy: 3.88% yield. Total ret +3.9%	B
U.S. Bonds – Credit	Hi Yield, bank Loans 6%	+13.4%	C
Real Estate	+8%	+11.4%	A
Gold	+5%	+14.6%	C
Commodities	Agric and base metals +5%	Agric: +2.1% Base metals -down	B
Oil	\$65 to \$75 eoy	\$71.65 (WTI)	A

*Conference Board assesses at 3.2%. U.N. assesses at 2.7%

What mattered and didn't

Three things were important in determining global returns last year and only one of them concerned fundamentals:

- The Federal Reserve continued to raise rates—more than I expected.
- Despite decent U.S. growth, Large Cap did better than Small- and Mid-, mostly because of the “Magnificent Seven.” Taking them out, the other 493 stocks rose 9.94%, putting them behind SC and MC for the year. [<https://www.spglobal.com/spdji/en/commentary/article/us-equities-market-attributes/>].
- After a promising start in 2023, international stock markets faded relative to the U.S. in the second half of the year

What was surprising in the economics of 2023

- The U.S. did not enter a recession in 2023 and does not show signs of recession in 2024, so far.
- Europe, (mostly Germany) on the other hand, didn't pull out of its weakness.
- OPEC lost control of global oil supply and pricing.
- The Fed was as aggressive as it was in raising rates.
- Inflation in the U.S. fell rapidly through the year after peaking in early summer 2022.
- 2022 was all about the Fed. 2023 was all about the Fed and the Magnificent Seven stocks.
- Gold was up a mere 3% in 2022 amid the global uncertainty and up nearly 15% in 2023.
- Muni's bonds were a good deal for high-tax-bracket investors versus taxable bonds.

What did the 2023 year require of investors?

- Staying the course through the August-to-October stock market decline.
- Listening carefully to what the Fed was actually saying and not the hopeful (and wrong) interpretations.
- Understanding that historical correlations do not predict future causation—especially where alleged recession predictors are concerned.
- Reassessing personal risk preferences now that bond yields are noticeable.
- Overcoming fear after 2022.

Investment strategy

I'd say that I am guardedly optimistic for 2024. By that I mean that my central case is that 2024 will be okay for equity with U.S. markets up 6–12%. Bonds may return about the yield, so 4.5% or so; less for Treasuries.

What are the major dependencies?

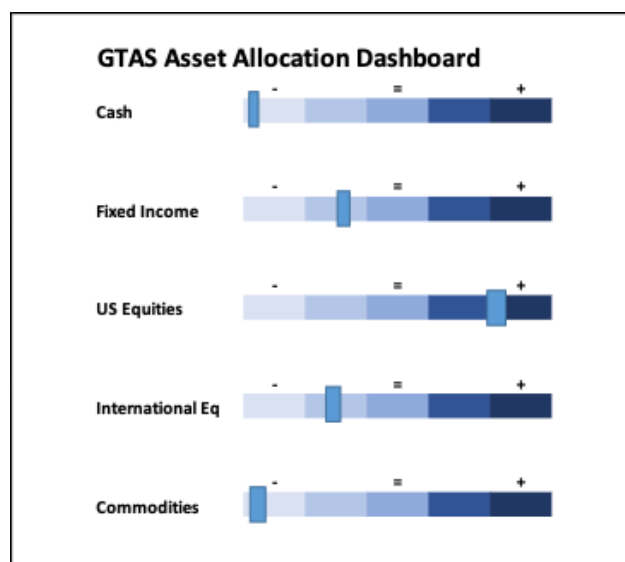
- Recession in the U.S. won't happen or will be mild and short.
- The stock-bond correlation will probably be positive, unless there's a significant recession.
- Corporate earnings will rise 3–6% overall from 2023 levels.
- Europe's economy will modestly recover.
- Inflation will continue to moderate slowly.
- The Fed won't be in a hurry to reduce rates, meaning the USD will stay stronger than anticipated.
- The Israel-Hamas war will continue but not escalate.

- The Ukraine war will continue through most of the year. Perhaps for the entire year.
- No Chinese adventures against Taiwan and modest Asian growth.

How does this differ from what the market is pricing in? That's never certain but I think the market is placing a higher probability on recession, as well as Fed interest rate reductions in 2024. It seems to have backed off from earlier fears of escalation in the Middle East and is already assuming that European growth will pick up moderately.

Taken together, that implies that we should be longer domestic equities and continue to underweight European equities. In this sort of environment, you'd normally expect small cap to outperform large cap although we didn't see that this year. That may be mostly because large cap performance was driven almost entirely by the Magnificent Seven. If not for those seven stocks, large cap and small cap would be neck and neck and midcap would have outperformed both. Bonds form a good income base and can add to overall portfolio stability.

GTAS Allocation Chart



(+/-/=) represents our group's views over a 6 to 18 month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed – Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY – Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of \$100 million, and at least one year to maturity.

FTSE All REIT – FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than \$100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles – ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade, and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. – MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt – MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

S&P 500 – S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI – S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap – S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap – S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.



**Wealth
Management**

The information contained within is the opinion of Eric Stubbs and not that of RBC Wealth Management or its research department. Please be advised that this information may or may not be consistent with the opinion of RBC Capital Markets LLC.

Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Mid- and small-capitalization stocks are subject to considerable price fluctuations and are more volatile than larger capitalization stocks. Bond investors should carefully consider risks such as interest rate, credit, repurchase and reverse repurchase transaction risks. Non-investment grade rated bonds (a.k.a. high yield bonds) tend to be subject to larger price fluctuations than investment grade rated bonds and payment of interest and principal is not assured. International investing involves risks not typically associated with U.S. investing, including currency fluctuation, foreign taxation, political instability and different accounting standards. Commodities may have greater volatility than traditional securities. The value of commodities may be affected by changes in overall market movements, changes in interest rates or sectors affecting a particular industry or commodity, an international economy, or political and regulatory developments. Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws, and interest rates all present potential risks to real estate investments.

The information contained in this report has been compiled from sources believed to be reliable, but no representation or warranty, express or implied, is made by RBC Wealth Management, its affiliates or any other person as to its accuracy, completeness or correctness. It is not to be construed as a representation by us or as an offer or the solicitation of an offer to sell or buy any security. All opinions and estimates contained in this report constitute the author's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility.

RBC Wealth Management does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in connection with your independent tax or legal advisor. Nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients and has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The investments or services contained in this report may not be suitable for you and it is recommended that you consult your Financial Advisor if you are in doubt about the suitability of such investments or services.

The information and services contained herein are intended only for individuals residing in the states that the Financial Advisor is properly registered. This report is not, and under no circumstances should be construed as, a solicitation to act as a Financial Advisor in any state where the Financial Advisor is not registered.

To the fullest extent permitted by law neither RBC Wealth Management nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein.