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Setting Realistic Expectations for 2024

By Mike Skoric

The 2023 Holiday Season brought happiness and joy to many. Fortunately, unlike last year, we can say that investors were included in that sentiment. In December, we received more good news on the inflation front as the Consumer Price Index (CPI) showed a slow but steady reduction in the level of inflation (disinflation). Even better news was the Fed's favored inflation metric, the Personal Consumption Expenditure Price Index (PCE). Unlike the CPI which simply showed that inflation was slowing, the PCE showed that prices dropped 1/10th of a percent in November, which hasn't happened since April 2020. So, in just a few months we appear to have gone from disinflation to deflation, where prices have started falling.

This information is important as it provided the Fed with proof that inflation has now been largely brought under control and that they can stop their aggressive tightening campaign. In turn, the broader investment community quickly shifted the narrative from a "high for longer" rate forecast to one where the Fed is expected to start cutting rates in the first half of 2024. And while the Fed signaled a possible three quarter-point cuts, investors appear to be betting on as many as six quarter-point cuts for a full 1.5%. This added more fuel to the pre-existing rally in the equity market; meanwhile gold and nearly every other asset class also rallied. Thanks to the suddenly attractive yields, but more recently fueled by the expected end to the Fed's rate-hiking cycle, bonds also ended up having a good year.

Unlike a rare 2022 where both major asset classes experienced negative returns, 2023 shaped out to be the complete opposite. Looking out to 2024 though, we can say that "cautious optimism" is the best description of our investment sentiment. Despite some signs of damage to the economy due to aggressive rate hikes, it appears that the Fed may actually achieve the much vaunted "soft landing" – completing the tightening cycle without pushing the economy into recession. The economy should be able to grow as much as 2% in 2024 while corporate earnings are expected to return to positive growth. However, after the great equity market returns of 2023, the domestic stock market is now anything but cheap with a forward Price/Earnings ratio of over 21x, well above the long-term average, and even more unfavorable for tech stocks. Given this reality, we are not expecting returns to be anything like what we experienced in 2023. At best, we can see long-term average returns in the 5-10% range (including dividends). Meanwhile in the fixed income space, we are still finding historically higher yields. In addition, with rates expected to come down further, bond returns should see an additional kick from the price return.

Putting all of this together, we continue to look for ways to better diversify portfolios, not only for downside protection but also for improving risk-adjusted returns. While we have primarily relied on commodities such as gold (up around 13% in 2023), we will be increasingly focused on the use of private equity strategies as a means to provide better risk-adjust returns when compared to public equity markets. This will continue to be a key topic during client discussions in the coming weeks and months.

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