Q1 2024

Quarterly Outlook

Perspectives on Markets and Economic Conditions

Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.

Is a Soft Landing in Sight?

Main Takeaway

The Federal Reserve may be getting closer to hitting its goal of taming inflation, and attention is turning toward whether it will begin cutting rates this year. Its rate hike campaign has proven effective: money flow has declined, and businesses and consumers have less access to credit. The job market has been feeling the impact, too. Compared to earlier in the year, unemployment has risen, job openings are down, and fewer people are quitting their jobs. Consumer spending has also slowed.

Top Risks

While the outlook for a soft landing — or cooling the economy without causing a recession — is looking more promising, the sharp rise in rates continues to pose challenges. Higher rates reduce the value of banks' long-term holdings and put stress on consumers. Meanwhile, the government's expansionary fiscal policy increases federal debt, and higher rates raise its debt servicing costs, compounding the nation's debt problem. Inflation could also resurge in 2024, and the Fed may not be able to cut rates as aggressively as the market currently expects.

Sources of Stability

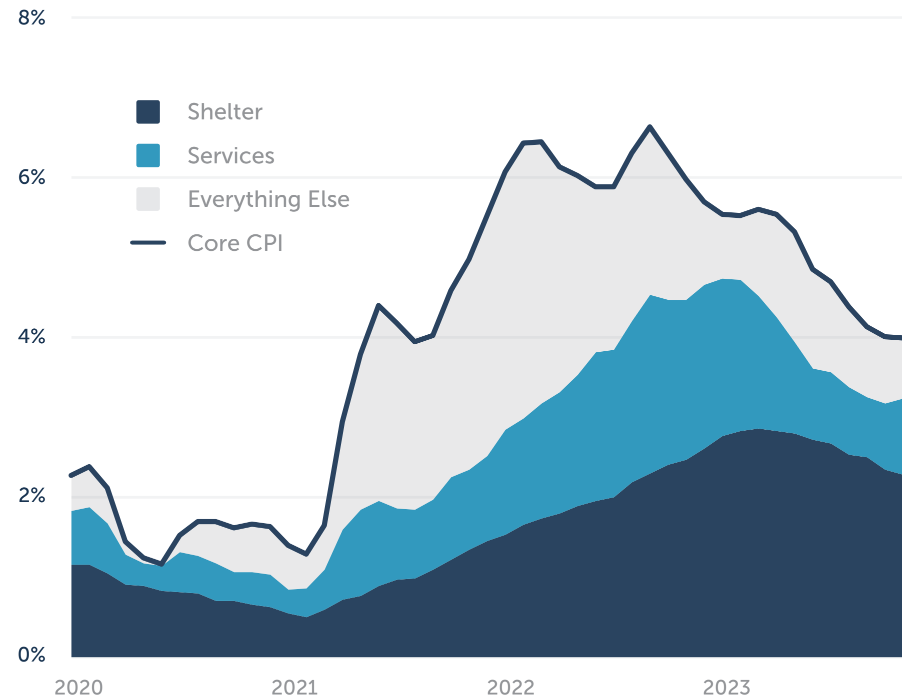
Although economic growth is forecast to slow in 2024, most professional forecasters are not expecting a recession. At their December meeting, the Fed's policymakers clearly signaled that they would begin cutting interest rates this year. Lower interest rates could boost the more interest rate-sensitive areas of the economy, such as housing, manufacturing and banking. For both inflation and consumer confidence, the sharp decline in oil prices has been a big positive.

ECONOMIC SPOTLIGHT:

What Might it Take to Bring Inflation Down to 2%?

History tells us that once inflation reaches high levels, it tends to stay higher for longer. One 2022 study[1] looked at the behavior of inflation across 14 developed economies to see how quickly it would retreat after reaching various thresholds. When inflation crested between 8% and 10%, as it did in June 2022, it took roughly three to four years to get back under 3%.

Headline inflation, as measured by the consumer price index (CPI), is on the cusp of falling below the 3% threshold already. However, core CPI, which excludes the more volatile food and energy prices, remains closer to 4%. The rising costs of both services and shelter have been driving inflation coming out of the pandemic. Given the typical lease period of a year or more, rent adjustments tend to take time to work through inflation, so the fact that rents are growing slower is a good sign. The Fed will continue to watch the cost of services, but policymakers don't necessarily need prices to fall — they just want to see prices grow slower. Although the Fed has taken a more dovish tone recently, expect the Fed to keep rates higher until there is overwhelming evidence that inflation is fully contained, or the economy is turning downward.



Source: U.S. Bureau of Labor Statistics, retrieved from Federal Reserve Bank of St. Louis (FRED). See appendix for more information.

Key Areas to Watch

Economic Growth

Although the manufacturing industry continues to contract, the services sector remains strong. While economic growth is likely to slow, there are no excesses of the type that led to the 2008 financial crisis nor any excesses in inventories. The Philly Fed's latest survey does not predict negative growth in any quarter in 2024, indicating a low probability of a recession.[2] However, households are running out of excess savings and student loan payments have restarted, putting pressure on consumer spending.

Inflation Trajectory

Through November, headline CPI increased 3.1% on a year-over-year basis, down from 3.2% in October.[3] Core CPI (which excludes the more volatile food and energy sectors) grew 4.0%, unchanged from October.[4] The shelter index – a measure of costs associated with housing – increased 6.5% over the last year, accounting for nearly 70% of the total increase in the core CPI. Falling prices in China have helped suppress global inflation, but inflation forecasts for 2024-2025 are still above target.

Monetary Policy

Although inflation is slowing, CPI remains above the Fed's long-run 2% target. The Fed continues to shrink its balance sheet by approximately $100 billion every month through quantitative tightening, effectively draining liquidity from the system and pushing rates higher than they otherwise would be. However, the Fed appears to have raised its target rate as high as needed, with the range left unchanged at 5.25%-5.5% at its final meeting of 2023, and the Fed's "dot plot" shows the central bank could cut rates by 0.75% in 2024.[5]

Fiscal Policy

Economists continue to raise concerns that the U.S. government debt burden is reaching unsustainable levels, with the U.S. debt-to-GDP now exceeding 100% and forecast to continue rising. The risk of a government shutdown could become an ongoing threat to the economy. The next few years will include several predictable fiscal policy deadlines that will force congressional action. Addressing the deficit problem will require significant increases in taxes and reductions in benefits, a tough order for politicians.

Key Areas to Watch (Cont.)

Labor Market

Labor markets show more signs of softening: companies are adding jobs at a slower pace; wage growth has decelerated; and the quits rate has dropped – all of which are leading to some pullback in consumer spending and likely slower economic growth. The unemployment rate crept up from a low of 3.4% in January 2023 to 3.9% in October before dropping to 3.7% in November.[6] The CBO expects the rate to rise to 4.7% by the end of 2024.[7]

Consumer Spending

Consumer spending, which represents about two-thirds of GDP, is slowing.[8] Post-COVID-19 savings — the main driver of GDP growth in 2023 — were expected to run out by the end of last year, and the restarting of student loan payments has put further stress on the 40 million people who have student loans. Credit card debt increased by $48 billion in the third quarter to $1.08 trillion,[9] and credit card delinquencies rose. Credit has also become harder to obtain.

Housing Market

Housing construction as a share of GDP is near all-time low levels (and about one-third of what is was 60 years ago).[10] At the same time, mortgage rates are high, resulting in October existing home sales falling to the lowest level in 13 years, on track for the worst yearly performance since 1992.[11] However, the inventory of homes for sale is very low, keeping prices up. If we do see lower mortgage rates this year, that should help unfreeze the resale market. Thus, the downside risks to the economy from housing are low.

Global Economy

The U.S. is grappling with several geopolitical concerns around the world, including conflict in Ukraine, Israel and ongoing tensions with China. Rising nationalistic policies and political tensions increase the risk of a trade war. That would not only slow global growth but also increase inflation through tariffs and other trade impediments. Government incentives that favor domestic purchases over international trade would likely lead other nations to respond similarly.

Economic and Market Snapshot

Stock and bond markets rallied in December on the prospect of potential Fed rate cuts in 2024. The Magnificent Seven* stocks, buoyed by the potential of artificial intelligence, now comprise roughly 30% of the value of the S&P 500. Fortunately, the rest of the market valuations are much closer to their historical averages.

In the bond market, yields remain elevated, although down from the middle of 2023. Bonds continue to offer an attractive yield for high-quality income for investors, and for investors concerned about unexpected inflation, Treasury Inflation Protected Securities (TIPS) offer positive real yields.

Major Asset Class Returns**

Q4 2023

		Quarterly Return	Past 12 Months
Stocks			
U.S. Stocks	▲	12.1	26.0
International Stocks	▲	10.5	17.2
Emerging Markets Stocks	▲	8.0	11.7
Bonds			
U.S. Government Bonds	▲	4.0	4.3
Global Bonds	▲	3.1	5.3

Key Economic Indicators**

Real GDP Growth (%)

Core CPI (%)

Consumer Sentiment

Unemployment Rate (%)

Jobs Added (Thousands)

*The Magnificent Seven stocks include Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta, and Tesla.
**See Appendix on page 8.

Investment Planning Implications

Where do markets go from here?

Profitability will be important. How companies navigate higher debt-servicing costs, higher wages and any slowdown in economic activity will be important to their profit margins. Expect fewer companies to initiate share buybacks due to worries of recession, a new tax on buybacks, and the higher cost of capital.

Expect tight credit conditions. Companies will have more trouble accessing new capital or rolling over existing loans given the tighter credit conditions. The inverted yield curve, where shorter-term bonds pay more than longer-term bonds, hurts banks' profitability, which further strains their ability to make loans. Private credit will pick up some slack but won't fully close the gap in funding.

Risk in the Magnificent Seven. The average price-to-earnings ratio (P/E) of the Magnificent Seven stocks is about $50 per dollar of earnings. Although these high valuations are reminiscent of the dotcom stocks in the early 2000s, the good news is that the rest of the market is much closer to historical averages.

What are the investment planning implications?

Expect volatility. We ended 2023 at very low levels of price volatility for stocks. However, between potential government shutdowns, higher costs of servicing Treasury debt, and ongoing geopolitical tensions, prudent investors will expect more volatility in 2024. The forward-looking nature of stock and markets is such that prices quickly reflect new expectations and the more uncertain the outcome, or the more impactful, the more we should expect prices to fluctuate.

Know how geopolitical risks impact your portfolio. We do not recommend making portfolio changes based on political events, elections or escalating international tensions. However, know that as risks flair, prices tend to fall, reflecting more uncertainty. What matters to the performance of your investments is not whether the news is good or bad, but whether it is better or worse than what was already expected.

Consider alternative sources of risk and return. Investors concerned about volatility and downside risk may want to consider investments with unique sources of risk and return that have historically had low correlation with the economic cycle. Although these investments come with their own risks, they have the potential to provide some stability when other markets are struggling.

About the Buckingham Team

Larry Swedroe

Head of Financial & Economic Research

In his role and as a member of Buckingham's Investment Policy Committee, Larry regularly reviews the findings published in peer-reviewed financial journals, evaluates the outcomes and uses the result to inform the firm's formal investment strategy recommendations.

Kevin Grogan, CFA, CFP®

Chief Investment Officer

Kevin is a member of Buckingham's Investment Policy Committee and helps lead the firm's investment strategy, portfolio management and fixed income teams. He has co-authored three books on investment topics and enjoys educating others on concepts that will have a tangible effect on their financial lives.

Blerina Hysi

Director, Fixed Income

Blerina works with fixed income and advisory teams to help construct and maintain customized bond portfolios, with an eye toward finding the best way to implement comprehensive financial plans. Her duties include fixed income analysis, bond trading and building tailored, client-focused portfolio solutions.

Daniel Campbell, CFA

Investment Strategy Advisor

Dan helps clients and advisors understand and implement an evidence-driven investment strategy. He has a demonstrated ability to understand complex investment topics, but he gets the most energy from conversations with individuals and families in pursuit of financial freedom.

Additional economic and investment resources are available at **buckinghamstrategicpartners.com/perspectives**

Buckingham's Investment Policy Committee (IPC) is a committee for Buckingham Strategic Wealth, LLC and Buckingham Strategic Partners, LLC (collectively Buckingham Wealth Partners) and not a committee for independent members of the Buckingham Strategic Partners community.

Appendix

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[1]Study: Arnott, Robert D. and Shakernia, Omid, History Lessons: How 'Transitory' Is Inflation? (Nov. 18, 2022). Available at SSRN: https://ssrn.com/abstract=4305206. The 3-4 years is the median years it took for inflation to fall back to 3%.

Chart Data Sources / Disclosure Information:

U.S. Bureau of Labor Statistics, retrieved from Federal Reserve Bank of St. Louis (FRED). Core CPI reflects the Consumer Price Index for All Urban Consumers: All Items Less Food and Energy in U.S. City Average. The contribution from Shelter is measured based on Consumer Price Index for All Urban Consumers: Shelter in U.S. City Average, which was rescaled to reflect the relative importance of the category reported on October 2023 (35%). The contribution from Services reflects Services, excluding Rent of Shelter, which was rescaled by importance (27.3%) Everything else reflects the cumulative contribution of all other items in the Core CPI basket.

Core CPI: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items Less Food and Energy in U.S. City Average [CPILFESL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPILFESL, Jan. 5, 2024.

Shelter: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: Shelter in U.S. City Average [CUSR0000SAH1], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CUSR0000SAH1, Jan. 5, 2024.

Services: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: Services Less Rent of Shelter in U.S. City Average [CUSR0000SASL2RS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CUSR0000SASL2RS, Jan. 6, 2024.

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[2]Federal Reserve Bank of Philadelphia. Fourth Quarter 2023 Survey of Professional Forecasters. Nov. 13, 2023.

[3]U.S. Bureau of Labor Statistics.

[4]U.S. Bureau of Labor Statistics. Consumer Price Index Summary, November 2023. Retrieved Dec. 28, 2023.

[5]Yahoo! Finance. Fed 'dot plot' shows central bank will cut interest rates by 0.75% in 2024. Dec. 13, 2023.

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[6]U.S. Bureau of Labor Statistics. The Employment Situation — December 2023.

[7]Congressional Budget Office. An Update to the Economic Outlook: 2023 to 2025. July 2023.

[8]Bloomberg. Americans Are Finally Turning Frugal After Splurging Over Summer. Dec. 1, 2023.

[9]Market Business News. US Credit Card Debt Reached Record $1.08 Trillion in Q3 2023. Nov. 8, 2023.

[10]Apollo Academy. Residential Investment as a Share of GDP Is Low. Nov. 16, 2023.

[11]Reuters. US existing home sales slump to more than 13-year low, prices accelerate. Nov. 21, 2023.

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Major Asset Class Returns: The index representation for the Major Asset Class Returns is as follows: U.S. stocks are represented by the Russell 3000 Index, international stocks by the MSCI World ex U.S. IMI Index, emerging markets by the MSCI Emerging Markets IMI Index, U.S. government bonds by the Bloomberg Government Intermediate Total Return Index, and global bonds by the FTSE World Government Bond 1-5 Year Index. Past performance is not a guarantee of future results. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Information from sources deemed to be reliable, but its accuracy cannot be guaranteed.

Key Economic Indicators: Sources: Bureau of Economic Analysis (BEA) for real GDP growth. Real GDP is the annual rate of change of real gross domestic product, seasonally adjusted. Bureau of Labor Statistics (BLS) for core CPI. The core consumer price index (CPI) is the annual rate of change, seasonally adjusted, and excludes food and energy. Consumer sentiment is from the University of Michigan's consumer sentiment index. Unemployment rate is reported by the BLS, and jobs added is based on nonfarm payroll employment reported by the BLS. Retrieved from FRED, Federal Reserve Bank of St. Louis. For all indicators, the boxed number reflects the latest reading, and the line above the box shows the change since the last update. The shaded areas reflect normal readings compared to history (based on the 25th-75th percentile of historical measures), while areas outside the dark blue reflect more extreme readings compared to history. The ranges are based on the percentile values of historical readings for each economic figure. The lowest number reflects the 5th percentile value, the bottom of the blue range reflects the 25th percentile, the top of the blue range is the 75th percentile, and the highest value reflects the 95th percentile. All ranges are based on the full period available. To account for population and employment, the ranges presented for jobs added are based on the percent change in employment numbers, using December 2022 as the base year.

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