M I D D L E T O N & C O M P A N Y, I N C.

Investment Update

January, 2024

2023 Fourth Quarter Update and 2024 Outlook

Review: Most asset classes delivered positive returns in the fourth quarter, capping a surprisingly strong year. Equities and fixed income rallied as economic data and a shift in tone from the Federal Reserve suggested that rate hikes were likely done and that rate cuts could be coming in 2024. The S&P 500 once again outpaced international equities. Fixed income finished the year in positive territory due to the sizable drop in yields in the fourth quarter, with the 10-year Treasury closing at 3.88% versus 4.57% at the start of the quarter.

	4Q23	3Q23	2Q23	1Q23	2023
S&P 500	11.7%	-3.3%	8.7%	7.5%	26.3%
MSCI EAFE[1,2]	10.5%	-4.0%	3.2%	8.6%	18.9%
MSCI Emerging Markets[2]	7.9%	-2.8%	1.0%	4.0%	10.3%
Bloomberg U.S. Aggregate Bond	6.8%	-3.2%	-0.8%	3.0%	5.5%
Bloomberg Municipal Bond	7.9%	-3.9%	-0.1%	2.8%	6.4%

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

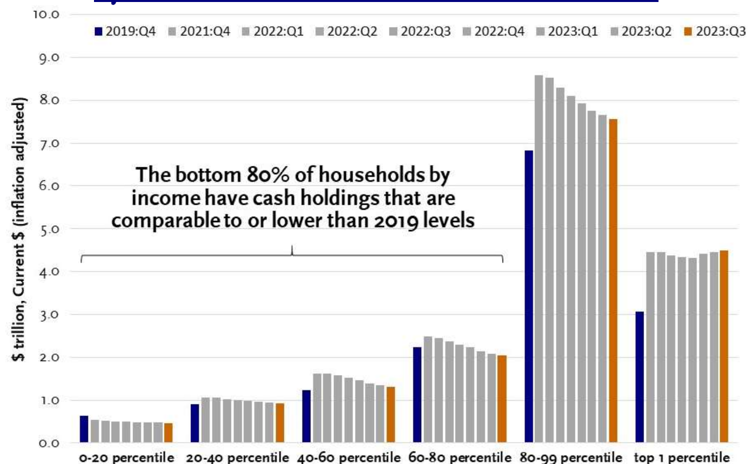
Will US Consumers Remain Resilient in 2024?

In addition to stronger than expected fiscal stimulus, better than expected US economic growth in 2023 was supported by solid consumer spending. Even though the pace of jobs growth slowed during the year, the unemployment rate has remained below 4% and median wage growth has continued to be 5-6%, supporting household spending. Given that personal consumption represents ~2/3 of US GDP, a key question for 2024 is whether consumers will be able to maintain a robust level of spending.

We noted in several quarterly updates last year that consumer debt delinquency rates were rising, albeit from low levels, suggesting growing pressures on households. However, despite this, consumers continued to spend. One explanation for these seemingly inconsistent trends is that households still had excess savings built up during the pandemic, which could support robust spending. Indeed, as the chart on the next page shows, most households started 2023 with more cash available in bank accounts and money market funds than they had pre-pandemic in Q4 2019 (adjusted for inflation). However, as of Q3 of last year, 80% of households had depleted these excess savings.

Spending trends may not necessarily worsen, as previous cycles have shown the tendency of US consumers to continue to spend (and save little) until something changes—e.g. loss of a job or a decline in the stock market. However, it does suggest that it may be more difficult for spending to surprise on the upside.

Household Bank Deposits & Money Market Fund Holdings by Income Percentile (Current $), 2019-23



Source: Federal Reserve

Outlook: US GDP growth is estimated to be 1.3% in 2024, down from the estimated 2.4% in 2023. The probability of an upside surprise similar to 2023 likely depends on the pace of disinflation and strength in the job market. If inflation comes down faster than expected, it is possible that the Fed cuts rates sooner rather than later and that economic growth does not slow too much before it does so. This is the “Goldilocks” scenario that the stock market appears to be pricing in. The inflation and jobs reports over the next few months will be key indicators ahead of the March Fed meeting, which is when the market currently believes the first cut is likely to be announced.

We continue to expect mixed international growth. Europe had lackluster growth in 2023, in part due to a weaker than expected rebound in China, and recent trends do not suggest any improvement in the near term. The US Dollar was stronger than expected due to monetary policy and relative economic strength, and it seems likely that these forces could persist in 2024, at least in the near term.

Strategy: The P/E multiple of the S&P 500 is once again approaching 20x, which seems to imply the market is assuming not only that rate cuts are coming but also that such rate cuts will be coming from a position of strength rather than as a reaction to weaker than expected economic data. While possible, we continue to prefer quality growth stocks trading at reasonable valuations as well as traditionally defensive sectors in the event of weaker than expected economic growth. Fixed income offers a relatively attractive risk-reward, though the volatility in longer maturities seen in 2023 could persist in the near term as the expectations for timing and magnitude of potential rate cuts continue to change with each key economic release or Fed statement.