Market View

January 2024

STOCKS REBOUNDED FROM 2022 LOSSES

US stocks lost ground from mid-2023 through the end of October before staging a powerful move higher. Overall, the year produced strong returns that essentially wiped out the losses of 2022. Until October, the market was driven by a handful of very large technology companies. However, in the last two months of 2023, stock market performance broadened—a healthy sign. The capitalization-weighted S&P 500 Index returned +26.3% in 2023, which was notably higher than most other equity indexes, due to the dominance of several larger stocks. China's economic, political, and social stresses led to losses in Chinese equities last year.

Despite 2023 gains, there appear to be reasonable valuations and solid investment opportunities in many market sectors. Exuberance around a small number of very large technology stocks has skewed aggregated market valuations. JP Morgan calculates the 10 largest companies in the S&P 500 trade at an elevated 26.9 times earnings while the remaining 490 companies trade at a more modest 17.1 times—a striking disparity. The even more pronounced valuation gap between very large and small companies could work in favor of small-cap investors over the next several years.

INTEREST RATE ROUND TRIP

The bond market had another volatile year, with medium- and long-term interest rates rising for much of 2023 before a November-December retreat. Declining inflation and indications the Federal Reserve would stop increasing short-term rates were the catalysts for the sharp two-month drop. By year-end, medium- and longer-term rates were very close to year-ago levels. Shorter-term interest rates ended 2023 one-half percentage point higher than at the start of the year. However, investors increasingly believe the Federal Reserve will cut short-term interest rates in 2024.

US RESILIENCY AND INTERNATIONAL UNDERPERFORMANCE

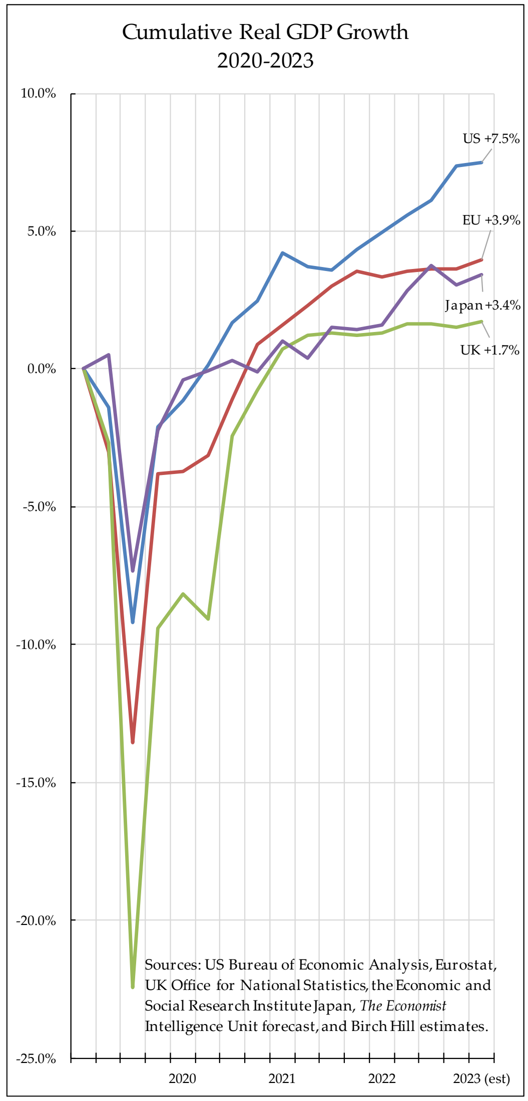
The US economy proved surprisingly resilient in 2023. One year ago, many had expected the economy would gradually cool from 2022's 2.1% growth rate and perhaps sink into recession in the face of rapidly rising interest rates.

Market Indicators		12/31/2023
	TOTAL RETURN	
US Stock Markets	4th Qtr	2023
S&P 500 Index	11.7%	26.3%
DJ Industrial Avg.	13.1%	16.2%
S&P 400 Mid Cap	11.7%	16.4%
Russell 2000 Small Cap	14.0%	16.9%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	10.7%	18.4%
Japan (MSCI Index)	7.9%	20.3%
China (FTSE 50)	-7.0%	-12.4%
Emerging Mkts Index	8.0%	9.0%
US Fixed Income Yields	12/31/2022	12/31/2023
6 Mo US T-Bill	4.76%	5.26%
2 Yr US T-Note	4.41%	4.23%
10 Yr US T-Note	3.88%	3.88%

Birch Hill Investment Advisors LLC
One International Place, Suite 770
Boston, MA 02110
Phone: 617-502-8300
BHBoston.com

Instead, gross domestic product, the widely recognized measure of economic activity, continued to grow at about a 2% pace in the first half of the year before strengthening to 4.9% in the third quarter. That surprising pace seems unsustainable. Most estimates now suggest the economy grew about 2.5% in 2023 as a whole.

As seen in the chart at the right, US economic resiliency is even more notable when considering the post-pandemic difficulties of other developed economies. Rapid and effective policies, combined with flexible and relatively unfettered businesses, helped the US economy recover and grow after the pandemic. For similar reasons, US economic growth was much better than that of other developed economies after the credit crisis of 2008. US stock valuations have benefited, far outpacing stocks in the European Union, the United Kingdom and Japan. Although the basic economic differences remain, lower valuation levels in many overseas equities have begun to look increasingly intriguing.



SHIFTING GEARS IN 2024?

Conditions for a continued expansion of equity valuations in early 2024 appear favorable. Declining inflation and a healthy job market suggest Federal Reserve policies may be achieving the elusive "soft landing." Declining short-term interest rates will likely encourage those holding large money market balances to seek better returns in bonds and, to some degree, stocks.

However, a shift away from the largest technology companies could present a challenge for market progress. US consumers may finally need to slow their spending because debt payments have eaten into their savings. Exogenous risks—risks from outside financial markets— may build during the year. Fifty countries will hold elections in 2024. Politics seldom have a meaningful impact on US stock prices, but 2024 could prove an exception as tensions build leading up to the November elections. China, the world's second-largest economy, will likely continue to face economic challenges.

DIVERSIFYING IN THE NEW YEAR

2023 proved to be an exceptionally good year for stock prices; major indexes recouped the losses of 2022. By year-end, market progress had broadened well beyond the handful of major technology stocks that powered the market in the year's first half. Inflation has declined without a spike in unemployment. The current, nearly ideal conditions for financial investments could be disrupted by exogenous events in the new year. Investors should maintain positions in high quality common stocks and consider additional diversification into major market sectors that offer attractive long-term growth but have underperformed in recent years. Money market yields will likely decline in 2024. Cash balances should be managed accordingly.

Gary R. Mikula, CFA   Robert A. O'Neil, Jr., CFA   Catherine M. Kennedy, CFP®   Timothy M. Malloy, CFP®

Brett A. Mirliani, CFA, CFP®, CPWA®   Adam J. Desjardins, CFA   G. Bowen Cook, Jr., CFA   Christopher P. Mikus, CFA, CFP®