MARKET WRAP MINUTE
WEEK OF JANUARY 1, 2023

MARKET MENTIONS: 2022 vs 2023 and what to expect in 2024

- 2023 started with depressed expectations and fears of a recession but ended with optimism and strong performance across most asset classes that make up a well-diversified portfolio. There was plenty of suspense and roadblocks for investors that included the highest borrowing costs in more than two decades, a regional bank crisis, and geopolitical uncertainty. But economic resilience, a trend of disinflation, the end of Fed tightening, and excitement around artificial intelligence (AI) more than countered those headwinds, reminding investors of the merits of a disciplined investment approach in times of uncertainty.
- 2024 Views:

1. Inflation - We think the disinflation trend will continue as wage growth softens and used car prices, along with housing inflation, cool further. It might be later in the year, but housing inflation should start moderating at an accelerating pace, as suggested by the more timely data for new leases and home prices.

2. Regional Banks - Though short-lived, the stress in the banking sectors was a reminder that restrictive Fed policy tends to uncover vulnerabilities lurking in the financial system. Since March, the deposit outflows have stabilized; bonds yields are falling, lessening the pressures on bank balance sheets; and bank shares are recovering. Concerns about commercial real estate loans remain, credit losses are rising, and the likelihood of more burdensome regulation around capital requirements could dampen profitability.

3. Economy - Unique factors for this cycle and pandemic distortions have helped make the economy less sensitive to rising rates, but their effect will gradually fade. We expect U.S. economic growth to soften in the first half of 2024, falling below trend but potentially staying positive, and likely reaccelerating later in the year. As consumption slows, manufacturing and housing could start rebounding, providing a buffer. A slowdown in demand, a better-balanced labor market, and higher productivity should help inflation return to target sooner and support the start of a loosening in Fed policy.

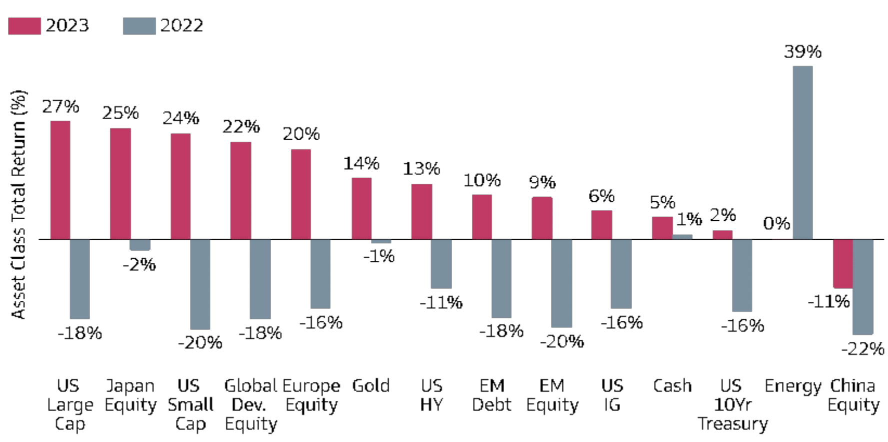
4. Monetary Policy - The drop in yields and rally in stocks the last two months of the year have eased financial conditions, raising the chances of the economy achieving a soft landing. But markets have now gone a step further, pricing in six rate cuts in 2024, which is more than twice as much as Fed officials are projecting. We think that there is some scope for the Fed to cut more than three times, but the push and pull between aggressive market expectations and Fed messaging could trigger volatility early in the year. Nonetheless, the Fed pivot to a more neutral stance is market positive.

5. "Magnificent 7" - Despite the broadening of the rally in December, we think the wide divergence in performance still offers opportunities for long-term investors. Valuations for the lagging segments of the equity market, which include small-caps, bond-proxies like high-quality dividend stocks, cyclical sectors, and value-style investments, are favorable. As the strength and sustainability of the bull market is likely confirmed in 2024, it could provide an opportunity for the laggards to catch up. We think diversification is likely to dethrone concentration in 2024.

CHART OF THE WEEK

Market performance in 2023 marked a clear departure from 2022, with several asset classes performing both better than they did in 2022 and above consensus expectations. We head into 2024 more optimistic on the state of global economies than we were entering 2023, as cooling inflation and the end of monetary tightening will return us to a normalized investing environment.

Source: Bloomberg and Goldman Sachs Asset Management. As of December 28, 2023.



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