



January 2024

Economic Update

A Review of Fourth Quarter 2023

The U.S. economy held up much better in 2023 than many expected it would. For instance, at the beginning of the year the Organization for Economic Cooperation and Development (“OECD”) was calling for only 0.5% U.S. GDP growth during 2023 in their OECD Economic Report. Now that same group estimates that actual GDP growth was about 2.4% during the year.

While an upcoming recession is not completely off the table, it is possible that the Fed has managed to engineer a soft landing for the economy despite raising rates significantly over the past few years. The Fed is now signaling that the key interest rate is at its peak and the next move will be a cut as opposed to the steady stream of increases that we have seen as of late.

The U.S. stock market seems to have heard that signal loud and clear as it surged over 11% during the fourth quarter to complete a strong year of performance overall. The S&P 500 index, including the reinvestment of dividends, finished up 26.29% during 2023.

U.S. Economy

The current Fed rate range now sits at 5.25 to 5.5%. The Fed expects that range to decrease to 4.5 to 4.75% by the end of 2024 for a total of three cuts during the year. However, they have not given clear guidance about exactly when those three rate cuts will occur. The current futures market consensus is that the first cut will happen in March, but the futures market has been a poor forecaster as of late. The exact timing will likely be based on upcoming inflation and jobs data during the first part of the year.

After peaking at 8.9% year over year in June 2022, inflation has been in a downtrend trend since then. The most recent reading as of November was 3.1%. Note that while this is getting close to the Fed’s long-term target rate of 2.0%, we are not quite there yet so we do expect the Fed to still be a little careful about cutting rates too soon.

This is especially true if the labor market continues to be strong. Per the Bureau of Labor Statistics, the U.S. economy added 105,000 net jobs during October, 173,000 in November and 216,000 in December. They also reported that the total number of unemployed persons is 6.3 million and the unemployment rate is 3.7%. The participation rate for adults aged 25-54 is now fully recovered to pre-pandemic levels. The participation rate for adults aged 55+ has remained low, but that likely is due to our aging baby-boomer population, as this group continues to permanently leave the workforce.

Despite good recent economic data and a surging stock market, consumer sentiment remains relatively pessimistic. While the latest reading of University of Michigan Consumer Sentiment remains in an uptrend, registering 69.7 in December, this still represents a fairly low reading by historical standards as it is well below the 100.0 level normalized in December 1964.



International Economy

Euro area developed markets continue to be hit hard by higher energy prices and the war in Ukraine. The OECD estimates a sluggish 0.6% GDP growth during 2023 followed by estimates for 0.9% GDP growth in 2024. This is consistent with the composite PMI surveys, which are a measure of economic health for the manufacturing and services sectors. This data shows a reading of 47.0 for the Euro Area during December. Readings below 50.0 represent a suggestion of future economic contraction.

Similar to the U.S., futures markets in both England and Europe are also currently predicting that the next central bank rate moves will be cuts. However, unlike the U.S., neither the Bank of England nor the European Central Bank have explicitly signaled that to be the case. In fact, European Central Bank President Christine Lagarde said that there is currently “no discussion taking place about cutting rates” and also notes that wages continue to be rising faster than expected and therefore she expects inflation in Europe to rebound a bit in the months ahead. The ECB’s current benchmark rate is 4.0%. The Bank of England’s current benchmark rate is 5.25%.

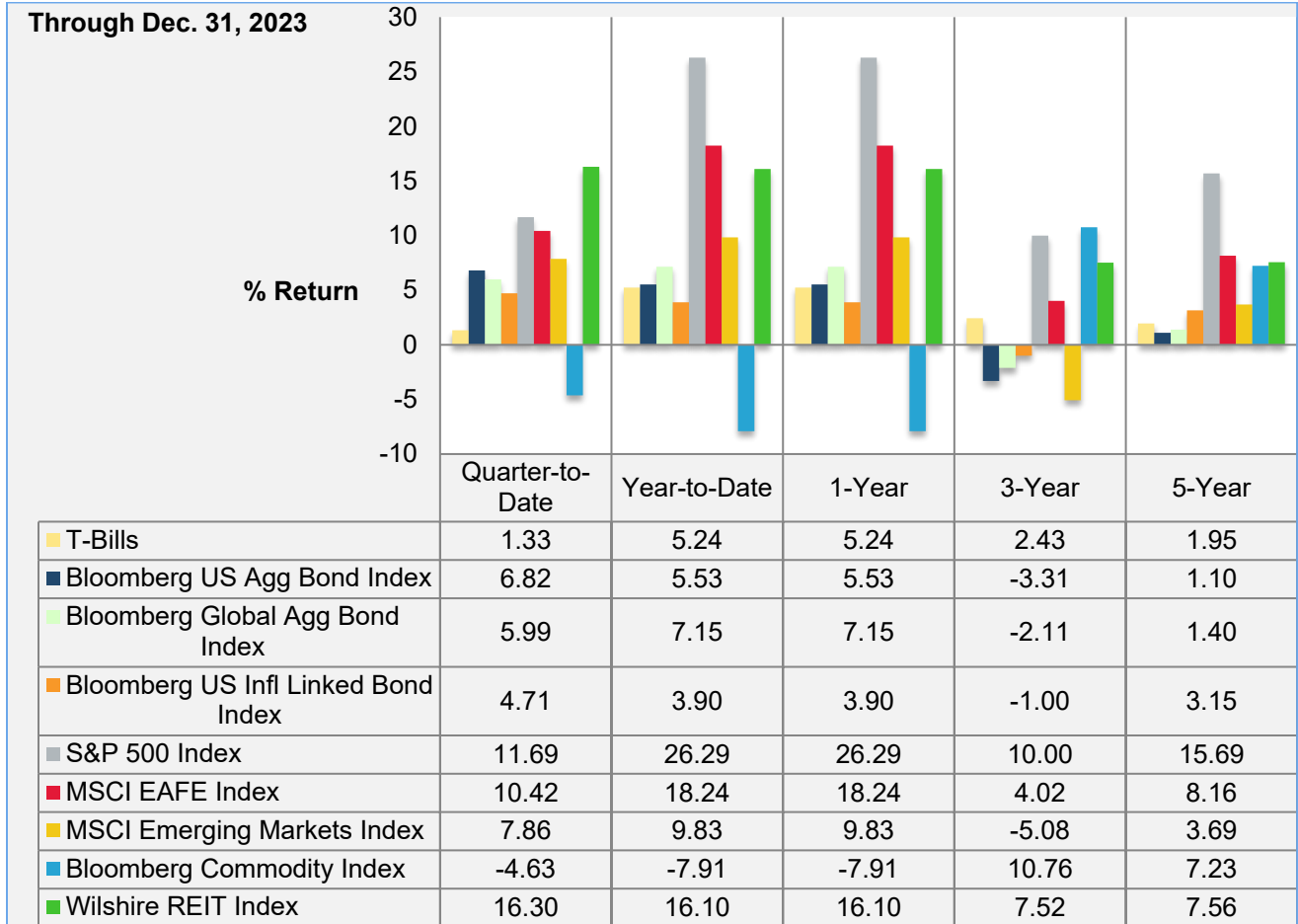
While developed market countries have been contending with inflation, China has had the opposite problem as of late. That country has been struggling with deflation, with a November reading of -0.5% inflation year over year. Falling prices appear to be in large part due to troubles in the property market. Significant declines in property prices have caused a decline in household wealth, which in turn has hampered consumer spending. A relatively weak global economy has also not helped. Per Markit, producer prices fell 3% in November versus a year earlier, reflecting both weak demand and excess supply.

Markets

Equity markets rebounded from a poor third quarter to post strong gains for both the quarter and the year as a whole. U.S. large-cap equities, as represented by the S&P 500 Index, gained 11.69% during the quarter and were up 26.29% for the year. Developed international equity markets, as represented by the MSCI EAFE Index, were up 10.42% for the quarter and up 18.24% for the year. The Wilshire REIT Index finished particularly strong as interest rates moderated, posting a 16.30% gain during the last three months. That index finished the year up 16.10%.

Bond indexes also benefited from interest rate declines, more than making up for losses realized during the first nine months of the year. The Barclays U.S. Aggregate Bond Index was up 6.82% during the last three months and finished the year up 5.53%. The Barclays Global Aggregate Bond Index gained 5.99% during the quarter and was likewise up 7.15% total for the year. The Barclays U.S. Inflation-Linked Bond Index was up 4.71% during the last three months for a total gain of 3.90% during calendar 2023.

The MSCI Emerging Markets Index also performed well, but not as good as developed markets did during the year. That index finished the quarter with a 7.86% gain and the year with 9.83% gain. Commodities were the only major asset class to struggle during 2023. The Dow Jones UBS Commodity Index lost 4.63% during the fourth quarter and was down a total 7.91% for the year.



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Outlook

Equity markets posted very strong fourth quarter results and consequently investor sentiment seems fairly bullish to start 2024. Note, however, that investor sentiment can change very quickly. In the near term, the market seems to be a running a little ahead of the Fed in terms of both the expected speed and frequency of Fed cuts during the next twelve months. While futures markets have historically been a fairly accurate predictor of Fed moves in the past, that does not seem to have been true during the last few years in that the Fed themselves have consistently been the better predictor during this rate increase cycle.

As of this writing, the market might also be discounting the potential for another government shutdown. While the general consensus is that agreement will be reached, it is still far from a certainly at this point.



As always, we recommend a diversified portfolio containing a reasonable amount of equity exposure for any investor with a long enough time horizon.

Bloomberg US Aggregate Bond Index: The Aggregate Bond Index is a broad-based benchmark that measures the investment grade, dollar-denominated, fixed-rate taxable-bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS. The Aggregate rolls up into other Bloomberg flagship indices such as the multi-currency Global Aggregate Index and the Universal Index, which includes high-yield and emerging markets debt. The Aggregate Index was created in 1986, with index history backfilled to Jan. 1, 1976.

Bloomberg Global Aggregate Bond Index: The Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the Aggregate (USD 300mn), the Pan-European Aggregate (EUR 300mn) and the Asian-Pacific Aggregate Index (JPY 35bn). In addition to securities from these three benchmarks (94.0% of the overall Global Aggregate market value as of Dec. 31, 2010), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300mn), Euro-Yen (JPY 25bn), Canadian (USD 300mn equivalent) and Investment Grade 144A (USD 300mn) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized sub-indices by liquidity constraint, sector, quality and maturity. A component of the Multiverse Index, the Global Aggregate Index was created in 1999, with index history backfilled to Jan. 1, 1990.

Bloomberg Global Inflation-Linked Index: The Global Inflation-Linked Index (Series-L) includes securities that offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. All securities included in the index have to be issued by an investment-grade-rated sovereign in its local currency. The list of eligible currencies is the same set of currencies eligible for inclusion in the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) represents a stand-alone multi-currency index exposed to the real yield curve for each relevant currency. As such, the index does not contribute to the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) was created on Oct. 31, 1997.

S&P 500® Index: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard & Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. The returns presented for the S&P 500 are total returns, including the reinvestment of dividends each month.

MSCI EAFE Index: The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed-market equity performance, excluding the U.S. and Canada. As of April 2002, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

MSCI Emerging Markets Index: The MSCI EMF (Emerging Markets Free) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of April 2002, the MSCI EMF Index consisted of the following 26 emerging-market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

Bloomberg Commodity Index: Bloomberg Commodity IndexSM and Bloomberg Commodity Index Total ReturnSM the DJ-UBSCISM family includes both the BSCISM, which is calculated on an excess-return basis, and the BSCITRSM, a total return index based on the BSCISM. The former reflects the return of underlying commodity futures price movements only, while the latter reflects the return on fully collateralized positions in the underlying commodity futures.

Wilshire US REIT Index: Introduced in 1991, the Wilshire REIT index is intended as a broad measure of the performance of publicly traded real estate equity securities. The index is market-capitalization weighted of publicly traded real estate securities, such as Real Estate



Investment Trusts (REIT), Real Estate Operating Companies (REOC) and partnerships. The index is composed of companies whose charters are the equity ownership and operation of commercial real estate.

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