JOURNEY WEALTH

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JOURNEY WEALTH
Quarterly Market Commentary

January 2024 Q1

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Market Recap

2023 went out with a bang from an investment perspective, with broad upswings across equities and fixed income. Domestically, the economy continued to hum along, as unemployment remained low and GDP growth remained resilient. Equity markets broadened out in the fourth quarter, with value and small-cap equities participating in the upside. For the year overall, large-cap growth equities generated the bulk of the market's gains. Fixed income yields have fallen from their peak in October, but remain at exciting levels, likely with little upside risk to rates.

Looking Ahead

The Fed seems to have capitulated on rate hikes. However, financial conditions are expected to remain tight due to a confluence of slower lending and a shrinking Fed balance sheet. Markets anticipate approximately six rate cuts in 2024. In our view, the Fed is unlikely to cut rates so drastically, barring substantial deterioration in economic conditions. Equity performance was more broad-based in the fourth quarter but there remains a distinct gap in valuations between domestic large-cap growth equities and the rest of the market. We believe fixed income continues to offer an appealing risk-reward tradeoff.

Leading Topics

Recession Risk – Predicting recessions is almost impossible and for investors focused on the long term, nearly irrelevant. While we may or may not see a recession in 2024, a slowing of growth is probable. 2024 will likely be a year of difficult choices for consumers and governments. Higher rates have had more time to impact behavior and that will likely slow spending in the coming year. Household finances have weakened considerably over the past year, as debt service payments and revolving credit balances have increased. As the Treasury issues larger quantities of bonds at higher rates and the US debt service continues to rise, that expense is likely to crowd out government spending on GDP-expanding projects such as infrastructure. While the US may avoid a recession in 2024, below trend growth is a strong possibility, driven by higher rates, weaker consumers and a federal government lacking in stimulative capacity.

Federal Reserve/Inflation – The Fed expects monetary policy to remain restrictive through at least the end of 2025 to rein in inflation and anticipates about three rate cuts in 2024. Inflation has improved considerably over the past year, largely driven by declines in energy and used vehicle prices. Shelter remains the hottest component of inflation but also the most lagging portion. Policymakers indicate that there will be no further rate hikes, which should reduce downside risk for fixed income going forward. Although rate hikes may be off the table, the Fed has been clear in its intent to leave rates higher for longer, raising the cost of capital and exerting pressure on valuation multiples.

Fixed Income – Higher rates have shifted the asset allocation dynamic to a degree. A few years ago, bonds provided little yield and served primarily to mute volatility, whereas they now offer real yield as well as an avenue for capital appreciation. This shift, in conjunction with lofty US equity valuations, has compressed the equity risk premium. While higher rates have been painful in the short term, the opportunities present in fixed income are worth considering. The risks of extending duration have been reduced as the likelihood of more rate hikes has declined.

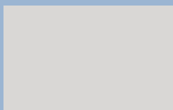
Value – 2023 saw one of the widest performance gaps between US Value and Growth equities in history. In addition to the relatively attractive multiples for value equities, they also tend to outperform their growth counterparts when rates are high. While growth has dominated the past decade, the decade ahead may look quite different. Higher rates are unlikely to go away any time soon, increasing the importance of dividends and multiples. Investors now have alternatives to equities and as such, can and should be more discerning when it comes to valuations.

See Disclosures on final page

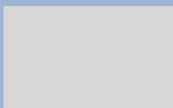
Pete Franz, CIO

On The Horizon...

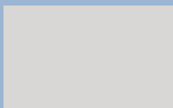
Journey Wealth is excited to announce our upcoming insights and events focused on providing market commentary and analysis. Join us as we explore the latest trends, strategies, and opportunities to help you navigate the complexities of today's financial landscape.



Mid-Quarter Insights
February 29th, 2024



Mid-Quarter Insights
May 30th, 2024



Semi-Annual Insights
July 2024

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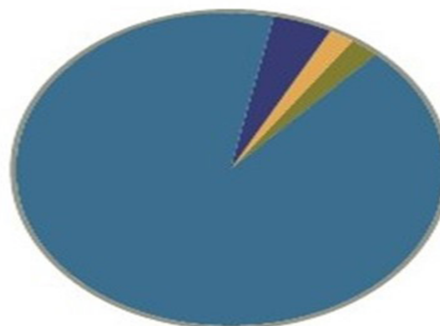
Asset Allocation

Our job is to allocate assets based on the requirements of your individual plan...

and not allow the swings of the market to direct our approach. Investors tend to focus on the risks in front of them, when often the most significant risks are those that are less apparent. Geopolitics are always concerning but are not often a reason to change your long-term approach. Many investors are easily enticed by near-cash vehicles with attractive yields. These instruments are appealing due to their liquidity and lack of duration risk. Duration risk is simply an investment's sensitivity to interest rates. Holding outsized amounts of cash or money markets comes with its own risk – reinvestment risk. If rates decline, those yields are the first to drop. It is important to view risk holistically. We believe that your planning needs should dictate cash reserves, not yields. While bonds bear price risk, we believe that locking in meaningful yields is a prudent choice, when it fits within your individual plan. Please don't hesitate to reach out to your advisor to schedule time to discuss your financial plan, including your goals and planning assumptions. Letting planning drive the investment approach helps ensure that your portfolio remains aligned with your vision for the future.

Asset allocation: the most important determinant of variance in portfolio performance

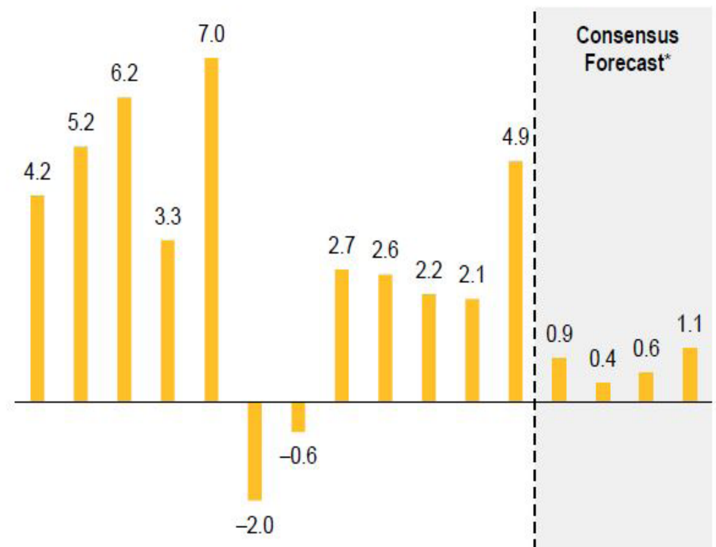


- 91.5% Asset Allocation
- 4.6% Securities Selection
- 1.8% Timing
- 2.1% Other Factors

Source: Brinson, Hood & Beebower, Financial Analysts Journal, 1986
Brinson, Singer & Beebower, Financial Analysts Journal, 1991

However, Growth Is Expected to Slow in 2024 as Consumer Strength Wanes (Percent)

WSJ Survey of Economists



Recession Risk

Predicting recessions is almost impossible...

and for investors with a long-term focus, nearly irrelevant. While we may or may not see a recession in 2024, a slowing of growth is probable. 2024 will likely be a year of difficult choices for consumers and governments.

US recessions (and growth) are typically driven by consumer behavior. Consumption represents almost 70% of US GDP. While spending levels don't yet reflect weakness, consumer finances have begun to deteriorate. Household debt service costs, credit card balances and early delinquencies have ticked up sharply over the past year. These trends are likely to continue as the impact of higher rates flows through to consumer behavior.

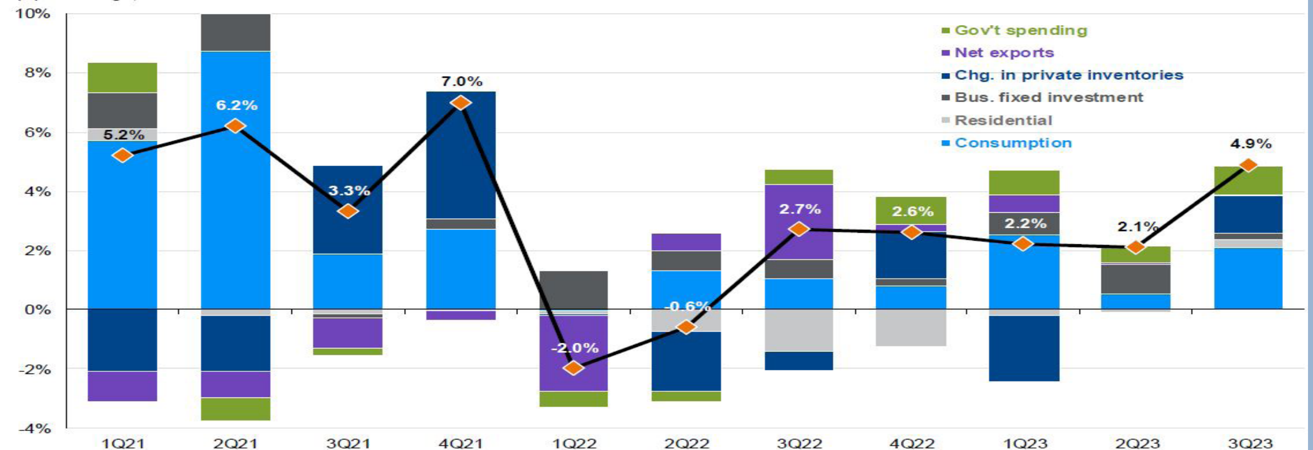
While GDP figures towards the end of 2023 were impressive on the surface, a substantial proportion was driven by government spending and inventory buildup, hardly sustainable growth drivers.

Higher rates take time to be fully felt by consumers and governments. Most consumers' largest liability, their mortgage, is a fixed rate instrument. The US Treasury finances its liabilities with fixed rate notes, some of which are then shifted over to the Fed's balance sheet. The tightening consisting of a reduction in the Fed's balance sheet and higher rates increases the Government's effective interest burden. As such, the Federal Government will likely be more constrained in their ability to invest in initiatives that spur growth.

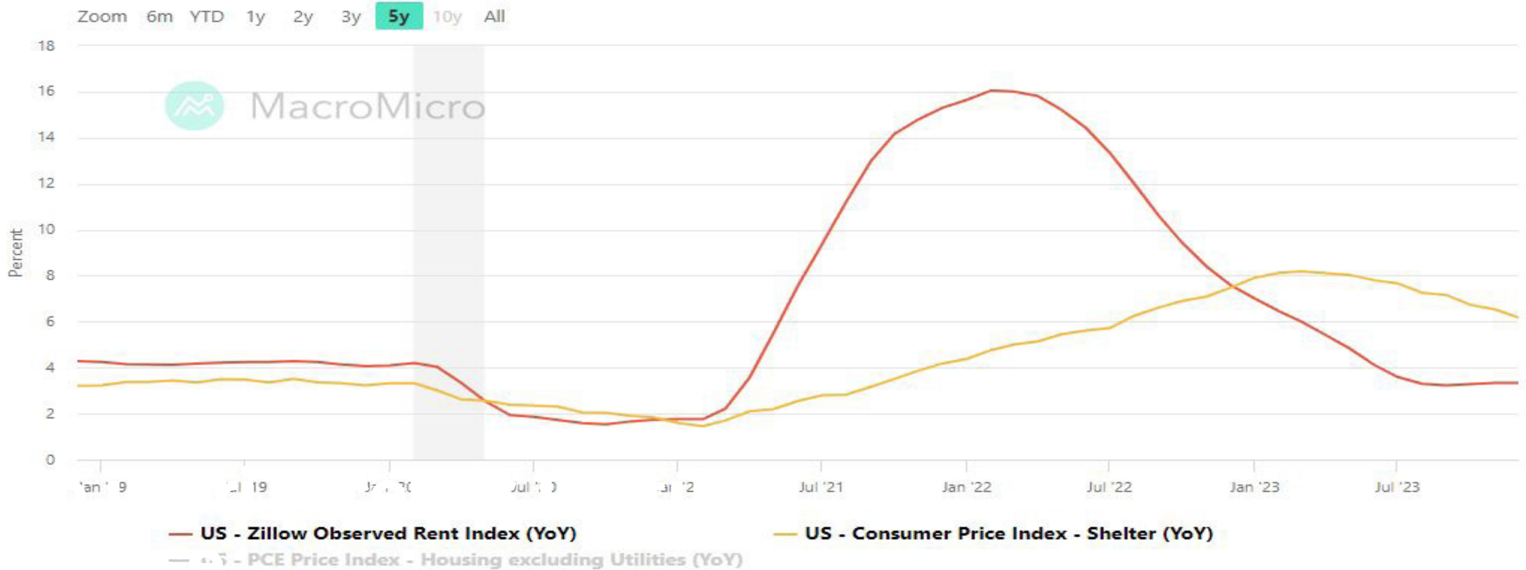
While a recession is possible in 2024, we believe the longer-term path forward is far more important. Investors should plan around the possibility that returns in the next decade may be lower than in the last as a higher cost of capital weighs on growth. Economic turmoil is disconcerting, but don't allow short-term recessionary concerns to get in the way of long-term planning.

Contributors to real GDP growth

q/q % change, annualized rate



Source: BEA, FactSet, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of December 31, 2023.



Source: MacroMicro.com

Inflation

Decoding Inflation: Balancing Growth, Unemployment, and Shelter

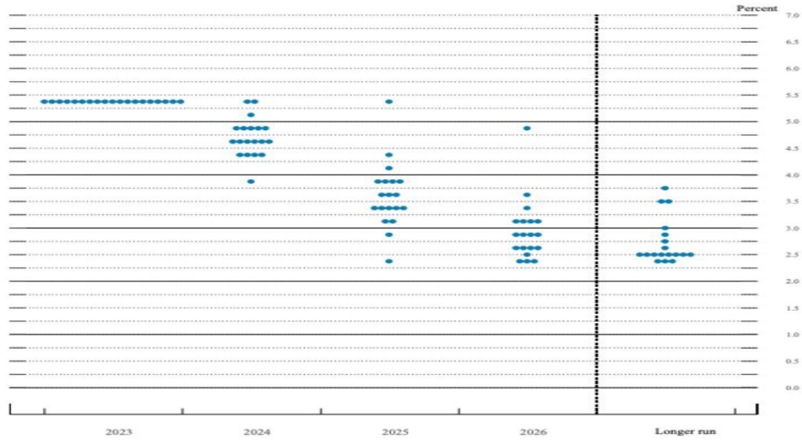
Inflation has moderated substantially from the near double digit year-over-year prints we saw in 2022. CPI has come down over the past twelve months from the mid-6% to about 3.4%. This has been accomplished without a significant increase to unemployment or a dramatic slowdown in economic growth, at least not that we've seen thus far. However, the monthly pace of inflation is still well above the Fed's target. Key drivers include the labor market, which has remained tight, and shelter costs.

Shelter inflation accounted for about two thirds of the CPI increase over the past year. On the shelter side, the pace of rate hikes is a double-edged sword. While higher rates slow housing activity, they can also constrict supply. Homeowners with 3% or 4% mortgages now face higher barriers to moving given the current rate environment. The measurement of the shelter component of CPI is complex. The CPI uses leases in place, regardless of when they were signed, to measure shelter costs. The Zillow Rent Index uses new leases and indicates that shelter inflation may be considerably lower.

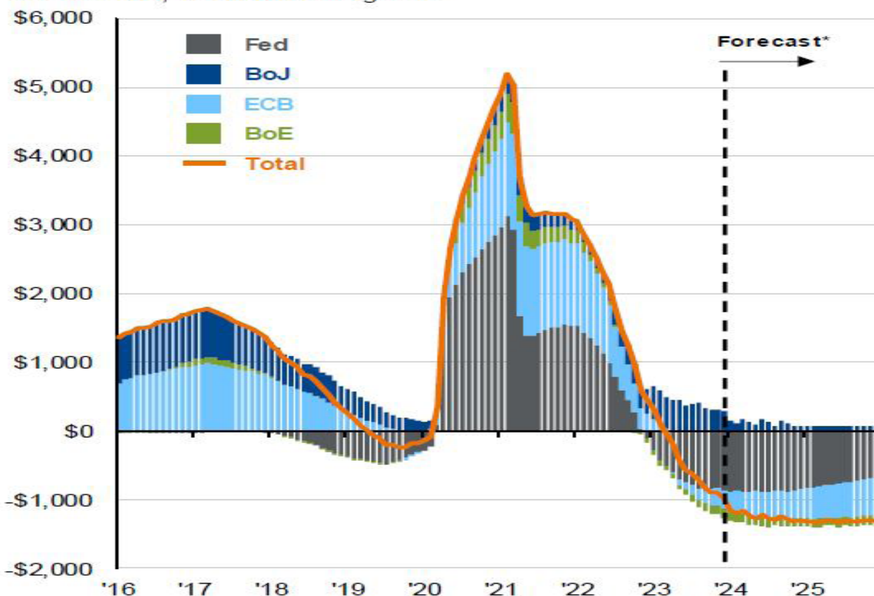
> "Volatility is often a symptom of risk but is not a risk in and of itself. Volatility obscures the future but does not necessarily determine the future. – Peter Bernstein

Federal Reserve

Rate Riddles: Navigating the Fed's Tightrope



Fed policymakers expect about three rate cuts in 2024 and for policy to remain restrictive through at least 2025. Per the September Fed minutes, balance sheet reduction is likely to continue but the likelihood of additional rate hikes is minimal. Although rate hikes may be off the table, the Fed has been clear with its intent to leave rates higher for longer, raising the cost of capital and exerting pressure on valuation multiples.



Source: BIS, Bloomberg, Factset, JPM, BOE, BOJ, ECP, Fed Reserve, JPM GER

The Five Pillars of Due Diligence

1 Firm

2 Philosophy

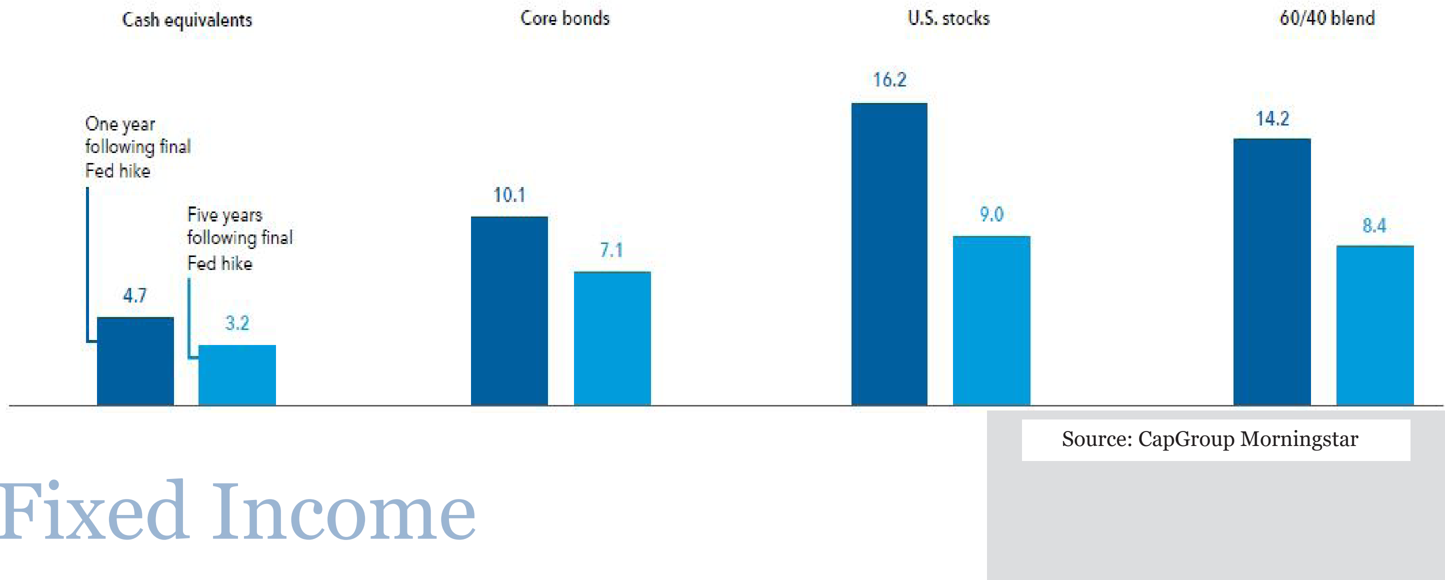
3 Process

4 Performance

5 Access

After Fed hikes ended, stocks and bonds have historically outpaced cash

Average annual return (%)



Fixed Income

Per the Fed Funds futures curve, US short-term interest rates are at or near peak levels. While the path forward for rates remains uncertain, most agree that the longer-term expectation for short-term rates is downward. Most fixed income segments boast yields well above their 10-year averages, although they have retreated somewhat from the yields seen at the end of the third quarter of 2023.

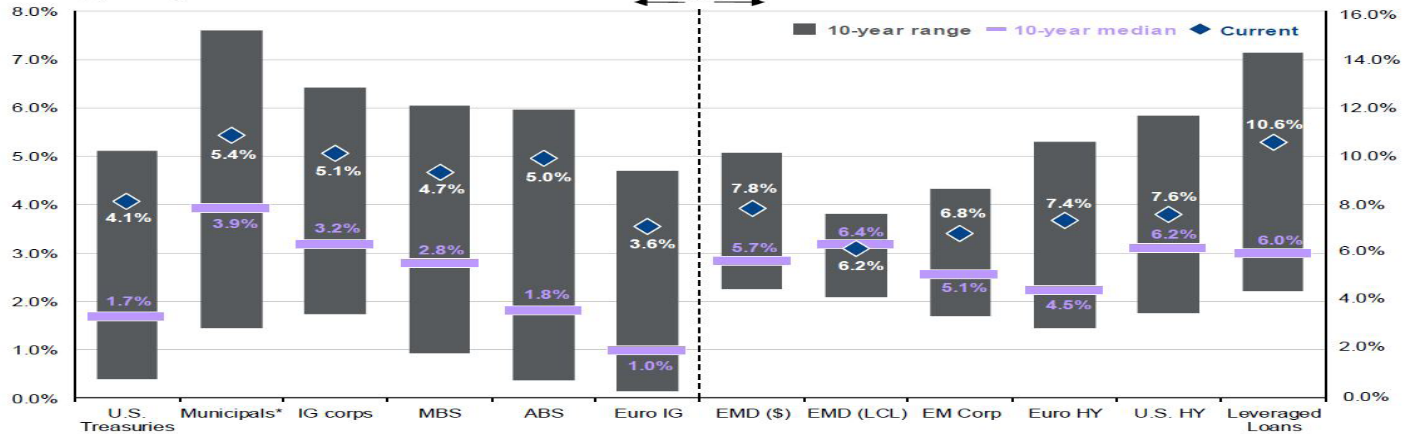
Higher rates have shifted the asset allocation dynamic to a degree. A few years ago, bonds provided little yield and served primarily to mute volatility, whereas they now offer real yield as well as an avenue for capital appreciation. This shift, in conjunction with lofty US equity valuations, has compressed the equity risk premium. The risks of extending duration have also been reduced as the likelihood of more rate hikes has declined.

While investment timing is not something we advocate for, the relative entry point for longer-term fixed income is hard to ignore.

It's easy to fixate on short-term cash yields over five percent. However, these rates typically fall quickly when the Fed cuts interest rates. Both equities and fixed income tend to healthily outperform cash and cash equivalents in the years following the final rate hike. While the path forward for inflation and the Fed are uncertain, the upside risk for interest rates has diminished substantially over the past six months.

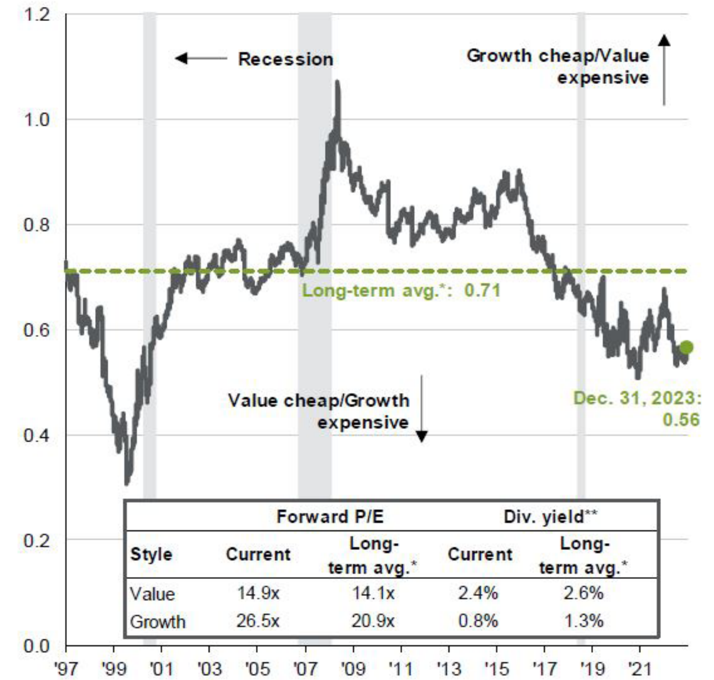
Yield-to-worst across fixed income sectors

Percent, past 10 years



Valuable Opportunities

Value's Comeback: Weighing the Scale Between Growth Glitz and Value Virtue



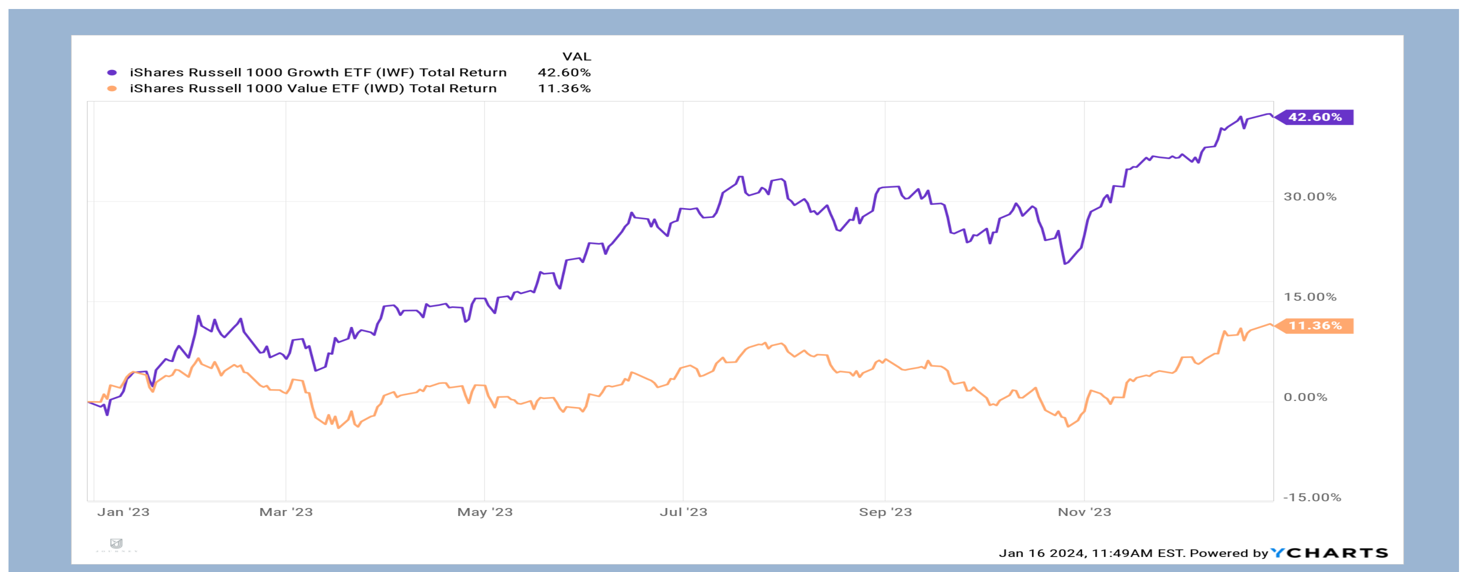
Style	Forward P/E Current	Forward P/E Long-term avg.*	Div. yield** Current	Div. yield** Long-term avg.*
Value	14.9x	14.1x	2.4%	2.6%
Growth	26.5x	20.9x	0.8%	1.3%

Source: Factset, S&P, JPM

Value-style equities are trading at a steep discount to their growth counterparts. After nearly 15 years of growth outperformance, there may be an opportunity for value to catch up. Interest rates play a significant role in the relative performance of growth and value stocks. For the past decade-plus, interest rates in the US have been held near-zero. Growth equities have outperformed value since around 2005. Growth companies typically forecast more of their cash flows further out into the future than value companies and as a result, higher interest rates have a larger impact on growth companies. Additionally, higher costs of capital typically have an inverse relationship with the persistence of growth rates.

Another factor that favors the value narrative is the significance of dividends. Historically, dividends have contributed about 40% of equity total returns*. In recent years, that figure has been significantly smaller. If US growth continues to slow and rates remain higher, value could make up ground as dividends become relatively more valuable. We have reservations about the valuations of some of the largest US companies and believe there are opportunities outside of this narrow neighborhood where equities are reasonably priced and set up well to weather higher interest rates and slower growth.

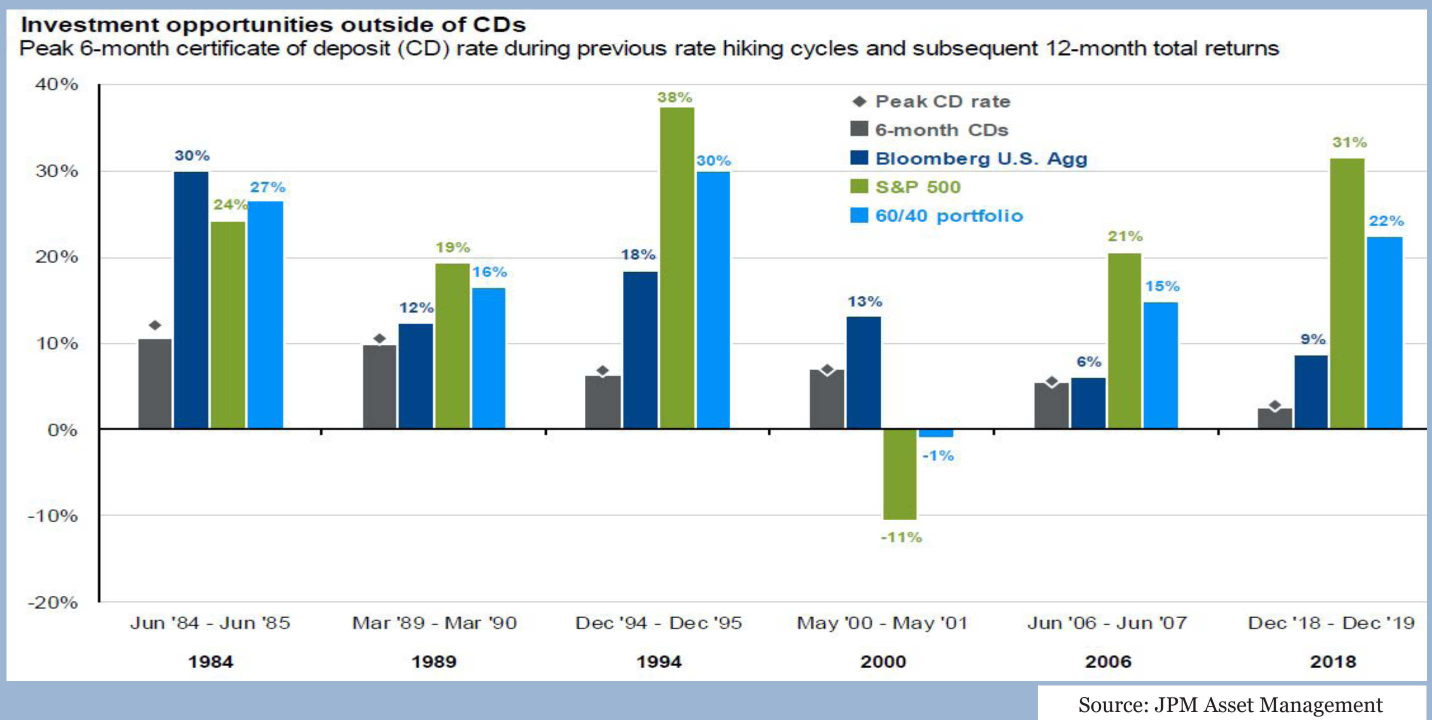
Source: *Per NDR, S&P 500 data for 1930-2021



Behavioral Finance

Riding the Waves: Deciphering Risk and Reward in the Tides of Market Volatility

One of the more nuanced concepts to effectively communicate is risk. When many investors think of risk, what they're really thinking about is volatility. Volatility is just a measure of the smoothness of the ride, whereas risk of loss is the risk that you will lose your investment. In 2022, many bond indices experienced double digit negative returns. However, US defaults were well below pre-COVID levels. The decline was due almost entirely to interest rate movements. This is an example of volatility rather than risk of loss.



Source: JPM Asset Management

Another facet of fixed income risk is the distinction between reinvestment risk and interest rate risk. Some investors are enticed by cash equivalents with attractive yields. These instruments are appealing due to their liquidity and lack of duration risk. Duration risk is simply an investment's sensitivity to interest rates. Holding outsized amounts of cash or money markets comes with its own peril – reinvestment risk. If rates decline, those cash yields are the first to drop. Reinvestment risk is critical if you are investing for the long term, as the prices of longer-term bonds typically move inversely with interest rates. It's easy to think solely about the risk that most recently impacted your portfolio and for many bond investors that was interest rate risk. However, interest rate risk works both ways. When rates decline, higher levels of interest rate risk can be additive to total return. The takeaway is to look at risk holistically when considering your investment allocation. Sitting in cash instruments paying attractive yields seems safe but also carries a high degree of reinvestment risk.

See Disclosures on final page

What's It All Mean...

Slower Growth For All

While we may or may not see a recession in 2024, a longer-term slowing of growth is probable as households and governments deal with the fallout from higher interest rates.

Vanquishing Inflation

The inflation picture has markedly improved, without negative consequences for employment and GDP growth thus far. The CPI is likely overstating the tightness of the current housing market, which makes up a substantial portion of the overall figure.

Shifting Asset Allocation Dynamics

The entry point for fixed income appears attractive as equity valuations have increased and the likelihood of additional rate hikes has declined.

Narrow Markets, Broad Opportunities

US growth equities have driven markets over the past decade but we believe there are opportunities outside of this narrow neighborhood where equities are reasonably priced and set up well to weather higher interest rates and slower growth.

Re-investment Risk is Real

Sitting in cash instruments paying attractive yields seems safe but also carries a high degree of reinvestment risk. It's important to evaluate risk holistically and invest for the long-term. Equities and fixed income typically outperform cash over a market cycle.

Relevant Disclosures

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