Investment Committee Video Discussion: Charting the Financial Course in 2024

Richard Brown:

Hello, I'm Richard Brown, Chairman and CEO of JNBA Financial Advisors in Minneapolis, Minnesota. We're recording this discussion on January 9th, 2024. Joining me for today's discussion are Mark Rosenkranz, an Investment Strategist, and Michael Bilotta, Senior Advisor and Investment Strategist. As we kick off the new year, let's dive into the key highlights of 2023 that impacted diversified portfolios. Mike, what are the significant takeaways from 2023 for our JNBA Investment Committee?

Michael Bilotta:

Hey. Good morning, Richard. 2023, like many of the years before it, it did what financial markets often do. It's the old saying, financial markets will do whatever it takes to confound the greatest number of people, and 2023 was certainly no exception to that. Going into the year, a recession was pretty much a foregone conclusion. The only issue was at what point is it going to happen during the year, early in the year, midyear later in the year, but it was going to happen.

It was just how severe was it going to be, were the markets already priced for it and so on. And most of that was due to the massive fed tightening that was happening at the time and the historical track record of the Federal Reserve typically hiking interest rates until the point where it pretty much crushes the economy and throws us into a recession ultimately.

We were on the most aggressive rate hiking campaign since Paul Volcker in the 80s where he took the interest rates into double digits. And while we certainly didn't hit that high of a level, the relative increase from zero to five and a half had a pretty profound effect. Also, in addition to that, leading economic indicators were declining nearly every month of the year in one way, shape or form.

There were some positives in there, but by and large it was, "Hey, it appears we might be in a recession already." And as a result of that, the Federal Reserve Board of Philadelphia has a survey of professional forecasters, and they came in with the highest probability of recession in 45 years. So, with all of that swirling around, it was pretty easy to see that 2023 was shaping up to be a bit of a tumultuous year, or at least so we thought going into it.

As a result of that, the S&P was also in danger, again, projecting to take out the October 2022 low. In fact, another survey, the first time since the inception of it in 1999, sell-side equity analysts had their median estimate price target for the S&P 500 actually ending the year lower than where it started. And Mark might get into this a little bit in his as we look to 2024, but now it appears like they're overcompensating the other way. And we'll find out where that reconciles.

It was definitely a year of fits and starts for both stocks and bonds. Once everything was said and done, however, we ended up with global stocks up 22%, bonds up about five and a half percent. We talked at different points throughout the year about the advance being a bit narrow and it was. And we say that it's a very small number of stocks were responsible for a large portion of the index's total return.

If you looked, only 29% of individual equities actually outperformed the index itself, which is the lowest number since 1998. So that means the average stock basically did not do as well as the index. The index was being pulled along by the seven or eight or 10 stocks that were at the top. The third thing was with the recession at hand and a declining stock market, the Fed was certain to cut rates during the year.

Again, there too, it was just a matter of when and how much. And in fact, not only did they not cut rates, they raised rates by a quarter percent in February, March and finally in July where they ended up at five and a half percent. So, it wasn't cutting rates, it was raising rates four times. And if you recall, this created a bit of a bank crisis in the spring as a couple of banks, a little more specialized banks, but had some liquidity issues where money was looking to leave faster than they could produce it.

And so there had to be some backstops put in and things along those lines. But just another reason for concern. Again, through all of that, once all was said and done, the 10-year treasury basically ended the year where it started. Even though in October the last quarter of the year, the 10 year treasury was as high as 5%, which is the highest it's been since before the financial crisis. We ultimately ended up the year back down in the high threes, but the path to get there was sporadic at best.

Finally, the one thing from 2023 was, one other thing that was a "Certainty," and I say that in air quotes, was that the 60/40 portfolio was basically defunct. No reason to invest in a 60/40 portfolio anymore. You weren't going to get the returns you needed. And that was true in 2022 when stocks fell double digits, bonds fell double digits, and I think people came to automatically bring that forward to 2023.

And the issue was is that if any time, once rates are already higher, it's a good time to have a 60/40 portfolio or a 60/40 diversified mix because you're getting returns from both the stock side and the bond side. And at the end of all of this, again, consensus proved wrong and diversified, balanced 60/40 type portfolios had returns into the double digits.

So again, to kind of sum up, 2023 was a year when the financial markets basically just went opposite of what the consensus seemed to be at most points throughout the year. Shouldn't surprise us that's the way the world seems to be going in different ways these days, but an interesting year in the markets, nonetheless.

Richard Brown:

Yes, great information. Thanks, Mike. Moving into the new year, as markets hit all-time highs, expectations are elevated. Mark, can you provide an overview of JNBA's outlook?

Mark Rosenkranz:

Yeah, thanks. Good morning, Richard. I think Mike did a great job of kind of outlining all the challenges that come with trying to forecast any given year. He talked about a lot of data points of, a lot of recession on the forecast of rates being cut, whatever have you. That was a lot of data out there that was making smart informed decisions, and to Mike's point, a lot of that proved not to happen.

So doing an outlook in any given year it's still a challenge, but I think going into any given year, having a base plan of attack is necessary. But I think one of the learnings that we have, especially from 2023, is to maintain flexibility and be adaptable. You can have your base plan of attack, but as the year progresses, we're going to get a lot of moving factors and it's incorporating that new data, how it fits into year old and if things change going forward.

So, kind of putting that all together, I'd say that the JNBA Investment Committee has a pretty positive outlook for the year overall. On the stock side, we're expecting mid-single digit returns,

give or take, although we are expecting a little bit more volatility. A couple of reasons Mike discussed, but really there has been a lot of damage done from rates increasing, and I think a lot of companies are just simply facing higher borrowing costs regardless of any other external noise that we have throughout the year.

I think that is just a hurdle that's just going to perhaps impact longer term growth rates. On the fixed income side, however, we're starting the year at multi-year highs in terms of the interest rate, just around U.S. treasury bond. So, on the fixed income side, we're projecting again mid-single digit returns, which is much higher than we've seen over the last several years.

And if we see the fed cuts that not only the markets are expecting, but now the Fed is starting to incorporate in their comments, that could be a pretty positive year for fixed income. So, netting it all together, stocks have a pretty favorable outlook, but we could see the volatility and that's where you might see the biggest change to forecast. On the fixed income front, however, we're seeing a lot more attractive environment.

Richard Brown:

Thanks, Mark. Yes, volatility would be interesting to watch in 2024. Mike, could you dive a little deeper and say how the outlook compares to previous years in the market?

Michael Bilotta:

Yeah, I would like to say that a lot of the same issues were facing us in 2023, only we're at a much different stage in the process than we have been. And this is the first year that I can remember when we're actually factoring in either stable or declining interest rates due to more of a normalized type of environment.

If you remember back, there's massive cuts due to first, the financial crisis in 08, 09, and then in the pandemic there were the massive cuts there as well, basically to zero, and that's where rates had been for a couple of years. And now we're starting to see, well, and we started to see it last year, but the conservative portions of the portfolio, the money markets, and bonds and so on be able to carry their weight, if you will, within a portfolio context.

And so, where it had always been before, the acronym TINA (There Is No Alternative) this year, and again, to a certain extent last year, it turned into TARA (There Are Reasonable Alternatives). And so, as the year goes on and rates start to maybe trend down a little bit, there will become a point where this $1.2 trillion in money market assets or whatever the dollar value grew to at the end of all of this, starts to try to look for a different way to maybe get more than three or four percent returns if indeed rates do go down.

Now the reason why rates could go down might be what we alluded to a little bit earlier was there could actually be a slowdown in a recession in the cards, and if so, we would expect the Fed to come in and lower interest rates. What's different there is, while that would probably affect the stock market in a negative fashion, bonds should actually earn a positive return during that process.

You'll continue to get the couple percent interest, but you'll also get a little bit of appreciation for when rates decline, and you have the inverse relationship of interest rates and bond values. So, I think, again, history doesn't repeat itself exactly, but it certainly does rhyme in some cases. And I

think we're just at a different stage of the process than we have been the last two years, and so we're facing a lot of the same or looking at a lot of the same variables.

Richard Brown:

Thanks, Mike. It sounds like there's certainly a lot of moving pieces, especially as we enter an election year. Mark, what are the one or two key things that the team is focused on as we move throughout the year?

Mark Rosenkranz:

Yeah. I guess, I'll cheat here and say a little bit of everything. You touched on an election year, which comes every four years and always has new twists and turns throughout the year. Throughout 2023, we try to highlight that we were really focusing on unemployment, inflation, and corporate earnings as kind of the three barometers. But I think especially this year, a lot of variables and data will kind of filter back into one thing, and that's interest rates.

And as Mike talked about, not only is the market anticipating rates declining, but the Fed is starting make some more comments on anticipated cuts coming in 2024. I think the key question for markets for both stocks and bonds in 2024 is not that interest rates are declining if that will happen, but why they're happening. And I think you look at if historical rates declining, and there's really kind of two narratives that could come out in play.

The first is that things kind of stay the course as they were. The Fed raised rates to combat sky-high inflation, and we've seen that inflation come down, unemployment's maintained and held in there. Corporate earnings have been solid. And the Fed could declare their victory over inflation, so to speak, get things to a more normalized level without damaging the economy. In that scenario, you're seeing rates declining what the economy is still holding in there, and that'd be a pretty positive environment for stocks and bonds.

The other scenario where we often see rates decline is when there's weakness in the economy and the Fed is being more stimulative, trying to offset economic weakness. In that environment you're probably looking at declining profitability for companies, maybe unemployment's increasing, something that's causing the Fed to cut rates even more.

The rate cuts will still likely benefit the bond side, but that's where you might see some weakness on the stock side to contend with whatever's going on in the economy at the given moment. So, I think that the "why" of why rates are coming down is really going to be the main topic of focus for markets as we progress throughout the year.

Richard Brown:

Thank you, Mark. Mike, anything you'd like to add?

Michael Bilotta:

Yeah, one thing I'd like to kind of just reiterate is as we've seen the last two years, it's kind of 2022 and three are lessons one A and one B for how years can provide the out of consensus events happening. And we wouldn't expect 2024 to be a lot different just because that's the way the financial markets and things work nowadays. We have certainly the geopolitical environment

is back in focus. Mark mentioned a little bit, we'll touch on this as the year goes on, but it's an election year.

We don't want to make too many conclusions about what that means for the whole year, but what we will say as we sit here today in January is that it will certainly add to volatility at different points throughout the year. And so that's something that we have to acknowledge but really try to look through. And then we talked about the economic growth. One thing that'll be interesting, I say this a little tongue in cheek, but it's in 2024, we won't have the “Swifties” to help carry the economy along here.

As last year, they contributed $5 billion to the economy through the tour, which is really amazing when you think about it. And I say that, as I said, kind of joking, but $5 billion is not a small sum. And then really at the end of the day, it's maintaining a good long-term and sensible strategy.

But the importance, especially in a year like this, and probably now just as we move forward with the world and information and AI and so on, is being flexible and having the ability to be tactical and adapt to the environment where you can either steer away from certain things or steer into what we believe would be opportunities, whether that's over-weighting equities, whether that's moving into cash for a period of time or whatever have you, growth versus value, international versus U.S., is that diversification in itself is a risk management tool.

It can provide smoother returns over time because its goal is to always make sure that you don't have everything going down at the same time. And if you're diversified appropriately, you actually have some things going up. But it can be something that's hard to maintain in a year like last year when we saw such a narrow advance. So, I would say that that's something that we don't want to forget about here in 24, as hard as that might be at times to do.

Richard Brown:

Yes. Thank you. Thank you very much, Mike and Mark, for this great discussion today. And thank you very much for joining us today. We hope you'll visit jnba.com and tune into our other videos and podcasts where we cover both investments and financial life planning topics. Thank you for your continued trust in JNBA, not just as your financial advisor, but also your advocate. Please reach out if you need anything at all. You can find our contact information at jnba.com.

DISCLOSURE:

Important disclosure information. Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk. Therefore, it should not be assumed that future performance of any specific investment or investment strategy, including the investments and or investment strategies recommended and/or undertaken by JNBA Financial Advisors or any non-investment related services will be profitable, equal any historical performance levels, be suitable for your portfolio or individual situation, or prove successful. A copy of our current written disclosure brochure discussing our advisory services and fees is available upon request. The scope of the services to be provided depends upon the needs of the client and the terms of the engagement. Please see important disclosure information at www.jnba.com/disclosure.