CURBSTONE FINANCIAL
MANAGEMENT CORPORATION

From the Curb

Letter to Clients
Quarter Ending December 31, 2023

Markets staged an impressive reversal in the fourth quarter that resulted in a very strong year for both stocks and bond returns. Thanks to a surprise dovish pivot by the Federal Reserve, combined with solid economic activity and declining inflation, the S&P 500 soared to a two-plus year high and bonds posted very strong positive returns on the expectation of lower rates.

The strong fourth quarter performance somewhat obscures the fact that stocks and bonds came into the last quarter of the year under significant pressure. Interest rates were trending higher, weighing negatively on stocks and bonds. The war between Isarel and Hamas added uncertainty and the market fallout was immediate, as oil prices spiked on fears that a broader conflict could ensue. Treasury yields rose as investors priced in a possible oil-driven bounce back in inflation. Those factors, combined with a lackluster earnings season, resulted in increased volatility in both the stock and bond markets. However, markets calmed when Fed Governor Chris Waller made comments that implied rate hikes were over and rate cuts may be coming in 2024. The market reaction was positive as stocks and bonds rallied.

Several factors fueled continued forward momentum. First, numerous Fed officials echoed Waller's commentary and investors priced in rate cuts beginning as early as May 2024, substantially sooner than previously expected. Additionally, the Israel/Hamas conflict remained contained causing oil prices to decline thus easing inflation concerns. Finally, broader inflation metrics continued to soften. The year-over-year increase in the Consumer Price Index dropped to 3.14% which further supported investor expectations that rate cuts would come in the first half of 2024. The result sparked a favorable seasonal "Santa Claus Rally."

The Santa Clause rally accelerated in mid-December courtesy of the Fed. At the December 13th FOMC meeting, Fed officials clearly signaled that rate hikes were over and forecasted three rate cuts in 2024, one more than previously forecasted. Additionally, Fed Chair Powell did little to push back against the markets' expectations for rate cuts. The Fed surprisingly pivoted to a neutral policy stance, fueling a continuation of the rally that started in late October. The S&P 500 rose to the highest level since January 2022 while the Dow Industrials hit a new all-time high.

In sum, 2023 was a year of surprises for the markets as the expectations for a recession never materialized, inflation fell faster than forecasts, corporate earnings proved resilient and the Fed surprised markets by pivoting to a more dovish future policy. The result was substantial gains for the major averages.

At this time last year, the S&P500 had just logged its worst annual performance since the financial crisis, the Fed was in the midst of the most aggressive rate hike campaign in decades, inflation was above 6% and concerns about an imminent recession were pervasive across Wall Street. In other words, 2023 opened on a very gloomy note.

Now, as we begin 2024, the market outlook is positive and investors are optimistic. The Fed is done with rate hikes and cuts are on the way, possibly as early as mid-year. Economic growth has proven more resilient than most could have expected and fears of a recession are all but dead. Inflation dropped substantially in 2023 and is not far from the Fed's target while corporate earnings growth is expected to

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resume in the coming year. Undoubtedly, we're in a more positive environment for investors compared to the start of 2023. But, just like overly pessimistic forecasts for 2023, we must guard against overly upbeat prospects for 2024 as both stocks and bonds have already priced in much of the potential upside for the coming year.

Consistent with our discipline and in alignment with your specific investment objectives, we remain invested in the middle of our stock and fixed income ranges. While there are many positive underlying fundamentals to drive returns, we acknowledge that this is an election year with several unresolved military conflicts around the globe. We are focused on managing both risks and return potential along with market surprises and related bouts of volatility.

As long-term investors, we believe in adherence to a plan that is unique to you and reflects an asset allocation based on your financial position, risk tolerance and time horizon will ultimately drive the successful achievement of your financial goals. Rest assured that our entire team remains dedicated to helping you navigate this year's market environment and stands ready to serve as a resource as you address life's decisions.

We welcome all inquiries and questions. And, we're always happy to schedule personal reviews at your convenience.

Wishing you a joyous year ahead filled with possibilities!

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