

10 Predictions for 2024

Goldilocks Remains a Fairytale



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What's Inside

| | |
|---|--------|
| 2023 Review | Page 1 |
| 10 Predictions for 2023: Scorecard | Page 2 |
| 2024 Outlook | Page 4 |
| 10 Predictions for 2024 | Page 5 |
| Focus Five: 2024 | Page 7 |
| About Crossmark | Page 8 |

Bob is a financial services industry veteran, with over 40 years experience managing large-cap equity strategies, as well as long and long-short equity strategies. His weekly, quarterly and annual investment commentaries focus on key themes and risks driving equity markets, monetary policy, and the global economy. Bob is a regular guest and contributor to multiple media outlets such as CNBC, Bloomberg TV, Moneywise, and Fox Business News.





2023 Review






The U.S. economy avoided a much-anticipated recession in 2023 and made significant progress toward a soft landing. The key surprise was much stronger-than-expected economic growth as the labor market continued to rebalance and inflation continued to fall. In the U.S. and across many parts of the world, inflation declined, approaching but not reaching central bank targets, while importantly (and amazingly) avoiding a major slowing of growth or a pickup in unemployment. As we exit 2023, the risks are more symmetric: the risk of inflation remaining sticky and above target, and the risk of weaker economic activity.

2023 was a year of valuation expansion, which is unusual for the late stages of an economic cycle. Market optimism was related to above-expected economic growth, fiscal stimulus, consumer spending, expected Fed rate cuts, and AI. Earnings actually fell somewhat short of expectations, so P/E expansion led by mega cap stocks (especially the Magnificent Seven) was the story. The average stock trailed the major averages by more than 1,000 basis points despite market broadening toward the end of the year. August to October recorded a slightly-above 10% correction that was followed by a 15% rally into mid-December. Overseas, India passed China as the world's most populated country and the Indian economy trounced China.











The key economic question for 2024 is whether central banks can continue the “landing of the plane” (soft landing) without a crash (recession). The consensus view of 2024 is a “Goldilocks” environment; i.e., not too hot and not too cold. Expectations include a soft economic landing, a continued decline in inflation toward targets, and double-digit earnings growth. We think that is unlikely, meaning either 1) the economy weakens enough for a bumpy ride (perhaps a recession) and earnings fall short (most likely), or 2) the economy remains strong enough to support double-digit earnings growth at the risk of little progress on inflation and Fed rate cuts. It is with this backdrop that we proceed as usual with fear and trepidation (and hopefully some good educated guesses) to unveil our prognostications for 2024 in the form of the 10 Predictions.

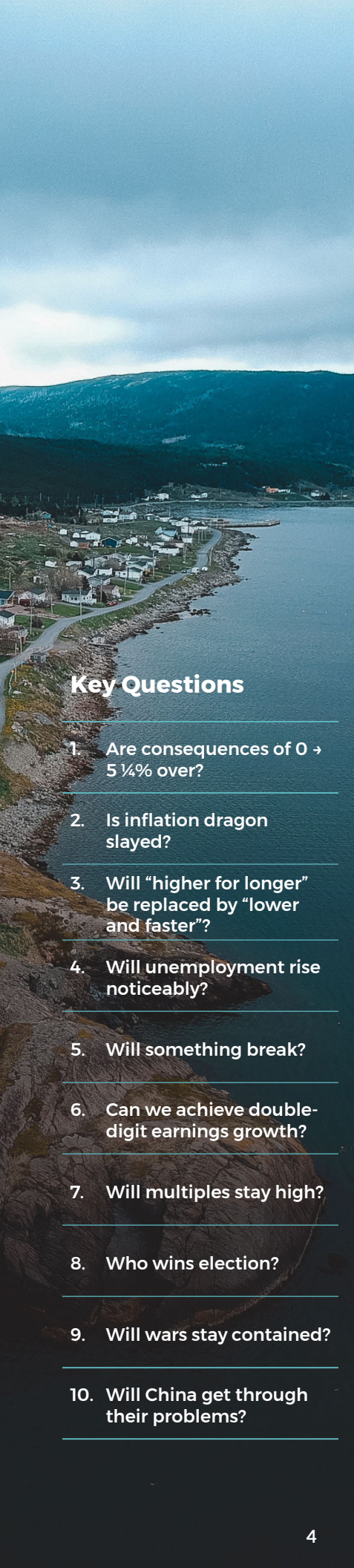
10 Predictions for 2023: Scorecard

We achieved a 5 correct/5 incorrect record for 2023 predictions, one of our worst years and well below our long-term average of 7.0-7.5. Here is a brief rundown of the 2023 predictions.

| Prediction / Score | Explanation |
|--|---|
| 1  The U.S experiences a shallow recession as real GDP is in bottom ten of last 50 years. | Needless to say, the much-anticipated recession failed to materialize. The typical lead indicators of recession (yield curve, LEIs, and money supply) are still flashing caution. It is possible (and perhaps even likely) that the maximum impact of the 18-month 0% to 5.25% Fed funds rise has yet to be felt. A stronger-than-expected consumer, fueled by a strong (but weakening) labor market and leftover cash resources from the Covid period, kept the economy growing. |
| 2  Inflation falls substantially, but remains above Fed's target. | Our view at the beginning of the year was that if the Fed really did insist on 2% inflation, a recession would develop. While inflation has fallen from its peak by a large magnitude, the decline from 3-4% to the Fed's 2% goal remains elusive. |
| 3  Fed funds reaches 5% and remains there for the balance of the year. | This was a rather bold prediction at the beginning of the year and was tested several times, especially during the spring banking crisis, when the consensus call was for three Fed cuts by year-end, not a rise to 5.25%. This will be a variable carefully watched and discussed as we enter 2024. |
| 4  Earnings fall short of expectations in 2023 due to cost pressures and revenue shortfalls. | Earnings were one of the fascinating items in 2023. For the first three quarters, earnings came in less bad than feared. However, during the interim periods, estimates kept falling as cost pressures made it difficult for companies to meet earnings targets despite legitimate pricing power. |
| 5  No major asset class is up or down by a double-digit percentage for only the fourth time this century. | We warned ourselves at the start of the year that this prediction only comes true about 20% of the time. Nevertheless, our thought that markets would be more range-bound proved inaccurate as stocks catapulted higher, led by the Magnificent Seven. If we had said the "average" stock, instead of the cap-weighted index, we would have scored on this one. |

10 Predictions for 2023: Scorecard (Continued)

| Prediction / Score | Explanation |
|---|---|
|  6  | As stated in our quarterly reviews of the 10 Predictions, this one was way off the mark. Not only did growth beat value, but technology and communication services were the two best sectors, while energy and consumer staples were two of only four sectors that were down for the full year. Not making excuses, but the Magnificent Seven sure skewed sectoral performance. |
|  7  | Again, the strength of the Magnificent Seven, the severe underperformance of the average stock, and active managers trending toward more equal than cap-weighted portfolios rendered this prediction incorrect early in the year. |
|  8  | The sharp outperformance of mega-cap growth (U.S.-centric) and the rally in the dollar, along with economic weakness in many parts of the globe caused another inaccurate prediction. |
|  9  | Thankfully, India came to our rescue, surpassing China as the world's most populous country early in the year. China's difficulties with real estate, an aging population and slowing growth were contrasted by India's strong economic growth and continued ascendancy. |
|  10  | A double-digit number of presidential candidates materialized on the Republican side alone. While the election is still nearly a year away, it is hard to believe (and disappointing to many) that it could be Joe Biden vs. Donald Trump again. |



Key Questions

1. Are consequences of 0 → 5 ¼% over?
2. Is inflation dragon slayed?
3. Will “higher for longer” be replaced by “lower and faster”?
4. Will unemployment rise noticeably?
5. Will something break?
6. Can we achieve double-digit earnings growth?
7. Will multiples stay high?
8. Who wins election?
9. Will wars stay contained?
10. Will China get through their problems?

2024 Outlook

As noted in the introduction, the main focal point for 2024 is likely to be whether or not investors can enjoy a Goldilocks (or Nirvana) environment: namely, further significant progress on inflation, decent economic growth and double-digit earnings growth. As explained in the 10 Predictions, we are skeptical. Either 1) we get a noticeable slowdown/recession and earnings fall short, or 2) double-digit earnings growth materializes, probably requiring stronger economic growth, less progress (if any) on inflation and a Fed that is boxed in.

The long-predicted recession will likely materialize in 2024, although it most likely will be brief and shallow. The main arguments for a recession are the lagged effects of monetary tightening, both via the Fed and long-term interest rates. While the absence of a recession thus far has increased market expectations for a soft landing, historical comparisons point out that a recession prior to this point would have been on the early side compared to history. Also, after the largest growth in the money supply since WWII (due to COVID), we are now experiencing the biggest decline since the 1930s. Can a productivity boom rescue the U.S. via AI, automation and robotics? Only time will tell.

We expect a more challenging backdrop for stocks in 2024, with softening consumer spending at a time when investor sentiment has turned bullish. Equities are richly valued, with volatility near historic lows, even as geopolitical and domestic political risks remain elevated. We expect the 2023 momentum and Fed cut euphoria to fade early in the new year, resulting in lackluster earnings growth and downside risk to equities as 2024 unfolds.

At some point, the political dysfunction in Washington, D.C., and record non-recession, non-war deficits will pile up even as interest expense takes an even larger share of governmental spending. As such, we believe markets are excessively focused on monetary policy and are almost ignoring fiscal policy.

10 Predictions for 2024

Theme: Goldilocks Remains a Fairytale

| | Prediction | Explanation |
|---|---|--|
| 1 | The U.S. economy experiences a mild recession as the unemployment rate rises above 4.5%. | We believe the long-awaited recession will materialize in 2024. The lagged impact of higher Fed funds and bond yields is still to be felt. Along with banks tightening lending standards, high retail inventory levels, a still inverted yield curve, and a savings shortfall in low to middle income households, a mild recession or at least a noticeable economic slowdown is likely. We expect the unemployment rate to rise above 4.5% (still a historically low level). Credit card and loan delinquencies are of increasing concern. Importantly, the amount of time that has passed since the Fed started raising rates and the yield curve inverted is only about average for the start of a recession. |
| 2 | The 2-3% inflation ceiling of the 2010s becomes the 2-3% inflation floor of the 2020s. | Is it possible that the inflation ceiling of the 2010s (2-3%) becomes the inflation floor of the 2020s? Inflation is clearly still falling cyclically as a result of noticeable tightening. But we are concerned that while headline CPI inflation had declined to nearly 3%, core CPI inflation remains at 4%. (The difference has been primarily the 5% dip in energy prices over the last 12 months.) Even though inflation is slowing, consumers are still upset because prices remain “high”. |
| 3 | The Fed cuts rates fewer than the six times suggested by the Fed funds futures curve. | As noted in prediction number two, we expect inflation to continue to fall, but not to reach the Fed’s 2% target. With core inflation still 4%, the Fed is unlikely to cut rates six times in 2024 as suggested by the Fed funds futures curve. An unlikely repeat of a 5% decline in energy prices over the next 12 months and somewhat stubborn wage inflation suggest to us fewer/slower cuts in rates in 2024. Finally, the Fed’s attempt to engineer a soft landing could keep enough stimulus in the system to make six cuts unlikely. |
| 4 | Credit spreads widen as interest rates decline. | Credit spreads have tightened noticeably as the economy has not succumbed to recession. Economic slowdown, some credit concerns, and supply all suggest to us some widening in credit spreads over the next 12 months. Investment grade spreads have narrowed 30 basis points, and high yield spreads by 75 basis points since the mini-banking crisis last spring. A reversal of that magnitude (or more, should a recession materialize) is possible. Along with a view that rates out the curve have fallen too fast, we would suggest neutral duration, a quality focus, and use of municipals where tax conditions permit. |
| 5 | Earnings growth falls short of the double-digit percentage consensus expectation. | The consensus view is that the three-quarter earnings recession ended with the second quarter of 2023. While possible, it is unlikely that the double-digit earnings advance projected by the consensus will materialize. A mild recession would certainly cause an earnings decline; even a modest slowdown will result in a single-digit percentage gain. Sales growth is slowing, and margins are likely to struggle with cost pressures and slowing of pricing power. The best earnings gains are likely to come from healthcare and technology, with materials, real estate, and consumer staples the most challenged. |

10 Predictions for 2024 (Continued)

| | Prediction | Explanation |
|----|--|--|
| 6 | Stocks record a new all-time high early in the year, but then experience a fade. | Short-term momentum trends are positive, and the newfound hope for Fed cuts will likely carry stocks to new all-time highs in the new year. But, if our concerns regarding earnings growth, inflation declines and Fed cut disappointments come to fruition, we think the rally will fade at some point and stocks will be challenged. Slow economic growth, high starting valuation levels, and much more constructive sentiment are not a great combination for a strong stock market. A continuation of market broadening is likely to evidence itself in fits and starts, allowing active managers to do better versus benchmarks in 2024. Historically, stocks have done reasonably well following the last Fed rate increase in a cycle, but not as well when rates start to be cut. |
| 7 | Energy, Financials and Consumer Staples outperform Utilities, Healthcare and Real Estate. | Having had a terrible year in 2023 with our sector prediction, we are largely repeating it. Our favored sectors are energy, financials, and consumer staples; our non-favored sectors are utilities, healthcare and real estate. Energy stocks sold off as the price of oil declined, and we probably need some rise in energy prices for energy stock cheapness and good cash flow to matter. Financials are both cheap and of higher quality than the last several cycles. Utilities are especially expensive relative to bonds, with already high dividend payout rates. Within defensive choices, we prefer consumer staples over healthcare. |
| 8 | Faith-based share of industry AUM rises for the eighth year in a row. | The faith-based segment of the money management industry is relatively small and new but is exhibiting stronger growth than the money management industry in general. As investors – individuals and institutions – attempt to align their investments with their values, faith-based money managers have a good opportunity. For these investors, it is important to focus not just on reducing exposure to companies doing “bad”, but also to emphasize those companies doing “good”. Needless to say, continued growth in this segment will depend, in part, on continued strong investment performance. |
| 9 | Geopolitical crosscurrents multiply but have little impact on markets. | It is hard to imagine a world with more (or more intense) domestic and global hot spots. But the wane of U.S. hegemony and increased political polarization within the U.S. have increased geopolitical crosscurrents. That these issues have not had a significant impact on financial markets has been fortunate. For that to continue, economic growth prospects, somewhat stable oil prices, and reasonable trade patterns need to persist. A significant number of important elections occur in 2024, demanding continued attention and vigilance on these issues. Collectively, these issues have led to de-globalization, which has negative profit margin consequences. |
| 10 | The White House, Senate and House all switch parties in November. | Americans have ditched the party in power in some branch of the Federal government in 8 of the last 9 elections, something that has not happened since the late 1800s. There is a chance, and our prediction is, that the party in power in all three branches (President, House, and Senate) will change. There are myriad issues to be dealt with, but the most pressing is to correct some of the dysfunction in our federal government. Separate, but related, is the impending continued rise in interest expense and federal debt. |

Focus Five: 2024 Factors

| Factor | Key Points | Portfolio Response |
|---------------------------------|--|---|
| 1. Economy/ Earnings | <ul style="list-style-type: none"> • Expect mild recession • Inflation to fall further (but not to 2%) • Fed path critical • Earnings estimates too high | <ul style="list-style-type: none"> • Be flexible • Don't chase returns • Invest if big downdraft • Consider alternatives |
| 2. Fixed Income | <ul style="list-style-type: none"> • Inflation path critical • Enormous supply of government paper • Watch sentiment at extremes | <ul style="list-style-type: none"> • Recommend neutral duration • Focus on quality • Munis attractive (if tax appropriate) |
| 3. Equities | <ul style="list-style-type: none"> • Recession question looms • Earnings risk • Valuations not cheap | <ul style="list-style-type: none"> • Focus on earnings • Tough year to make money • Buy dips/trim rallies |
| 4. Sectors | <ul style="list-style-type: none"> • Generally high quality preferred • Energy and financials laggards can improve • Do small caps have legs? | <ul style="list-style-type: none"> • Overweight energy, financials and consumer staples • Underweight utilities, healthcare and real estate • Own value with a catalyst and inexpensive growth |
| 5. International | <ul style="list-style-type: none"> • Markets significantly cheaper than U.S. • Central banks generally behind U.S. • Finally some dollar weakness? | <ul style="list-style-type: none"> • Slowly increase international weighting |

What to do?

1. Expect choppy markets (buy dips/trim rallies)
2. Focus on earnings growth and free cash flow (not P/E expansion)
3. Own some quality fixed income
4. Diversify across asset classes and geographies (more non-U.S.)
5. Own high-quality value and less expensive growth
6. Consider an absolute return strategy to complement market exposures
7. Be prepared to step up if significant weakness



About Crossmark Global Investments

Crossmark Global Investments is a faith-based firm that creates and manages values-based investment strategies for financial intermediaries and their clients. Founded over 35 years ago, the firm has a rich history of inspiring and equipping its clients to go further in aligning their investments with their values. Crossmark is based in Houston, Texas. For more information, visit [crossmarkglobal.com](https://www.crossmarkglobal.com).

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