When you hear something described as "remarkable," you really need to hear a bit more to know whether the thing is remarkably good or remarkably bad. In that spirit, 2023 was a remarkable year for the markets. In some ways, it was remarkably good, and in other ways, it was remarkably bad.

The posted returns of the major index – the S&P 500 Equity Index – were remarkably good. The index was up over 26%. Those positive returns were preceded by 2022's negative 18%, for a cumulative two-year return of 2%. That kind of return is unremarkable.

Similar patterns were seen in the fixed income market index. In 2022, the benchmark index was down almost 14%, and this past year it was down another 3.5%. But since mid-October, the bond index is up over 6%. The volatility in bond returns this last quarter was remarkable for its volatility. Bond rates inch up and down over very long cycles, but the Federal Reserve embarked on its rate-rising policy in early 2022 with speed as never before. Once short-term rates were over 5%, everyone settled in for a long period of no changes until there would begin a slow and steady, step by step, ratcheting down of those rates. Instead, approximately two weeks after messaging "higher for longer," the Fed Chairman announced the Fed might start cutting very soon. Longer rates, which are more controlled by market forces, dropped precipitously – about 10% in four weeks. It was remarkable.

In our work, ZWJ tries to avoid the volatility associated with remarkable investments and fill portfolios with equity and fixed income investments that will perform over the long term. In equity allocations, that has meant buying what we believe are excellent franchises when their stock prices indicate other investors have become disappointed for whatever reason. In bond allocations, that has meant focusing on quality issuers. Because bond rates historically have moved in longer cycles than stocks, we have been keeping our average portfolio bond maturities relatively short. In 2023, as the longer maturity bond rates began to rise to 4.5 or more, we made concerted efforts to extend our portfolio maturities. We bought a lot of bonds with longer maturities in the second half of 2023, and the sudden decline in long rates made those purchases look remarkably prescient for now.

If the Fed were to effect in 2024 the so-called "soft landing," it would be remarkable, for it has happened once in the 13 times it has been tried. In the mid-1990s, after the end of the Cold War, the Fed successfully raised and then lowered bond rates without causing a recession. Markets enjoyed a banner second half of that decade. Other than that one time, Fed policy changes have led to combinations of economic recession and equity market turbulence.

Professional investors implicitly admit the limits of their foreknowledge the moment they buy a second position. Diversification is an admission we cannot forecast the future with 100% accuracy. We make our investment decisions hoping to position our clients so that they won't be terribly hurt if we are incorrect in our thesis or our forecast. Life is dynamic, so all forecasts should be written in pencil, but one can take steps to protect the downside. Among these is an attention to the valuation of whatever one is buying. One senior market analyst noted that stocks and art are the only thing where the line to buy gets longer as the price goes up. We want to buy stocks and bonds as we buy office furniture; it should be good quality but not too expensive.

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Elevated markets are susceptible to re-pricing when something important changes. We have already seen the effect on stock prices when the price of money – as reflected by interest rates – goes up quickly. Outside of fewer than a dozen big technology names, the average stock has been re-priced downwards in response to higher interest rates. After the dramatic change in direction of interest rates during the fourth quarter, the average stock is actually doing much better.

The stock market thinks it heard the Fed Chairman promise to cut rates in 2024, even as many as six times. As a forward-looking instrument, the market is expecting to enjoy a year of strongly positive returns. When one looks at economic data, there is enough to suggest the Fed has beaten down its inflation target and cuts are called for. On the other hand, there is also plenty of data that suggests the economy is not healthy. The big factor difficult to analyze is the amount of debt already outstanding. We spent a lot of money, individually, in corporate offices, and in government programs, over the past three years. It kept our global economy running, and it would be considered by most a successful initiative.

The questions arise when one asks what happens if we do not get the soft landing all the TV talking heads are expecting. What would a hard landing look like, and how would markets respond? It is another election year, and that introduces one more variable. Will we try another monetary or fiscal stimulus? If we do inject money into the economy, how much would be necessary?

We do not have precise answers to these questions. We are admitting our incomplete information, and we are taking pains to protect our clients' assets. First, in the bond allocations: we have been extending but are now generally waiting a bit to see if rates rise back to something above 4%. Receiving 5% on cash makes that a comfortable tactical decision. In the equity allocations, we are not chasing last year's winners. We own about half of the market leaders of 2023, but we bought them years ago using our "office furniture" approach. Proud to own them, we would not add materially to those names. We are, however, finding other quality companies whose stock prices remain pressured, and many of those stocks pay a dividend. We try to be opportunistic in buying both stocks and bonds, but that means sometimes buying smaller pieces over time to build a full position and other times taking a big bite of the apple.

We may see the perfect soft landing in 2024, and if so, our clients will enjoy solid returns. We may see a harder landing, and if so, we will aggressively put cash reserves to work. Interest rates may not rise back to 5% on the long end, and if so, our moves this past quarter will look even better. Should they creep up, we will take advantage of higher rates and continue to extend bond allocation maturities. Ours is an unremarkable strategy of managing probabilities rather than one of perfect certainty.

What we can promise with perfect certainty is effort and attention. The investment team is only as good as the client service team that works with and behind it. Amy, Val, Michele, and Macy take care of the important and necessary steps that provide clients with a smoothly operating money manager experience. Knowing that everything is in order makes the work of the portfolio manager much easier, and our client service team is remarkably good at maintaining order. Soft landing or hard, boom or recession, you should be confident your accounts are in good hands.

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