



CLEARSTEAD'S INVESTMENT OFFICE

## FIRM UPDATE

In the thirty-five years since its founding, Clearstead has become a national financial advisory firm serving wealthy families and prominent institutions. We are headquartered in Cleveland OH, serve clients in 42 states, and have over 170\* employees. Importantly, almost 50 of our employees are shareholders in the firm.

Our private client team provides integrated wealth management—investments, tax planning and compliance, financial planning, family office services, and trust services—for hundreds of individuals, families, and related entities and nearly \$8 billion in assets. Clearstead institutional client services provide investment consulting to about 200 institutions and \$22 billion in assets. Our institutional clients include endowments and foundations, colleges and universities, hospitals, and retirement plans.

In our Firm Update, we provide details on our initiatives and growth over the past year. You can read the full update [here](#).

*\*Includes employees of Clearstead Trust and Avalon Trust, which are not registered by the SEC.*

## 2024 OUTLOOK

BY CLEARSTEAD'S INVESTMENT OFFICE

### ECONOMY

Recapping 2023: The consensus expectation at the beginning of 2023 was that the US economy would enter recession. Markets expected the Federal Funds rate to be lower (not higher as it ended up being) by this past December as compared to the beginning of 2023, employment was supposed to soften considerably with little to no employment growth, and the Federal Reserve's aggressive policy was set to cause an accident in financial markets. Instead, in 2023, real GDP grew (on a quarter-over-quarter basis) by +2.2% in Q1, +2.1% in Q2, and +4.9% in Q3, with Q4 expected to come in at +1.2% (though real-time data indicates GDP will register north of +2.3% for Q4).<sup>1</sup> Meanwhile, the unemployment rate rose modestly from 3.4% to 3.7%, thanks to an increase in the labor participation rate—job creation averaged nearly 240k per month during 2023.<sup>1</sup> One thing some prognosticators got right was the notion of a Fed-induced financial market accident, though it showed up in a place that very few expected (i.e., not in credit markets) through the mini banking crisis that resulted from system wide deposit flights and declining government bond values as interest rates rose.

### LOOKING TO 2024

The distortions of bringing forward a decade's worth of fiscal and monetary stimulus into a two-year period in response to the pandemic continues to haunt

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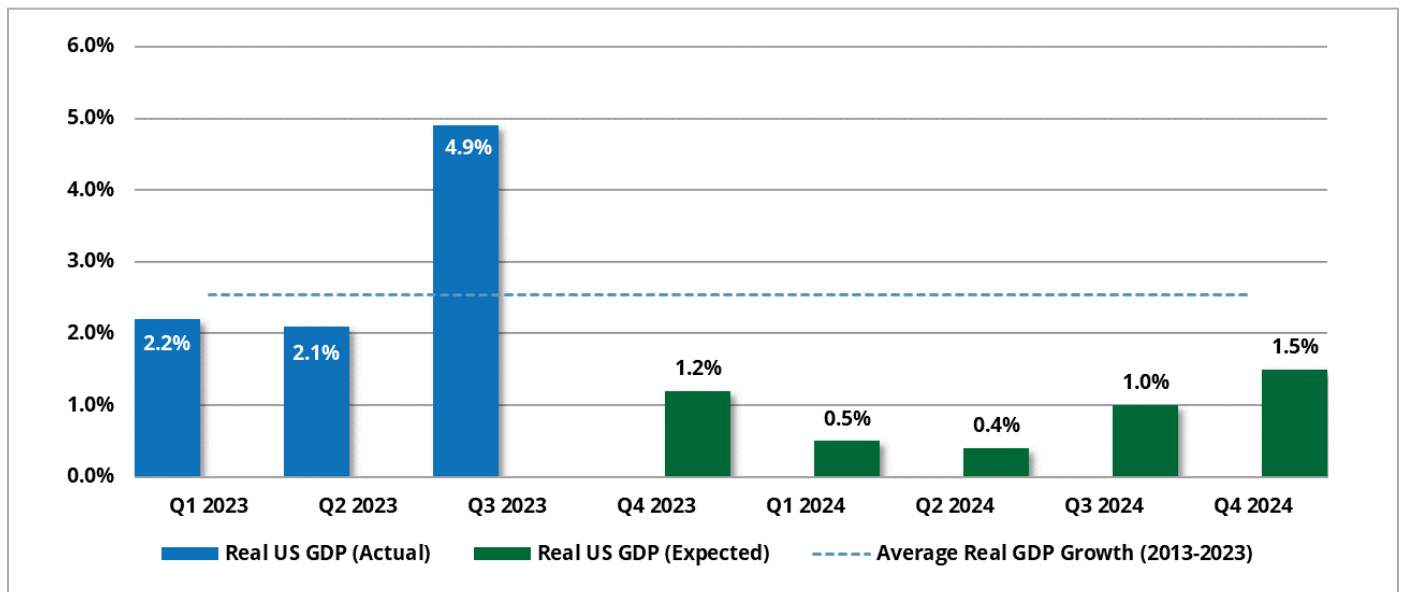
those of us charged with crafting predictions about the future. John Kenneth Galbraith once said, "There are two kinds of forecasters: those who don't know, and those who don't know they don't know" and being self-aware enough to know that we don't know, we will focus this outlook on key themes for 2024 and hope we get them right. Here goes:

- Economic growth is likely to be below trend throughout the year but remain positive.
- Inflation should continue to decline, though it will remain higher than the Fed's 2% target.
- The 10-Year US Treasury yield is likely to remain between 3.5% to 4.5% for 2024, leading to low single-digit type returns from traditional fixed income. Fed funds should decline, the magnitude of which depends on the path of inflation.
- A deluge of issuance from the US Treasury to fund the budget deficit could add more than usual volatility to bond markets.
- For equities, lofty earnings expectations mean fundamentals must deliver or markets may suffer.
- The 'magnificent seven' may shift to the rear-view mirror and 2024 could be a year where diversification pays off—2023's laggards could become leaders.
- Other key macro themes to watch: Artificial Intelligence exuberance continues, election season across the globe, near shoring trends remain, and wars may impact supply chains.

## ECONOMY, INFLATION, AND THE FED

After a stronger than expected 2023, expectations are for real GDP growth to slow on a quarter-over-quarter (QoQ) basis in the first half of the year before picking up in the second half of 2024. Overall, US economic growth in 2024 is likely to be below both the long-term trend and the most recent ten-year average growth rate of +2.5% (QoQ).

**US ECONOMIC PROJECTIONS: REAL GDP  
(QOQ SEASONALLY ADJUSTED ANNUAL RATE)**



Source: Clearstead, U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPC1>, Bloomberg Consensus Estimates, as of December 31, 2023, Quarter-over-quarter Seasonally Adjusted Annual Rate, Bloomberg consensus estimates for GDP growth.

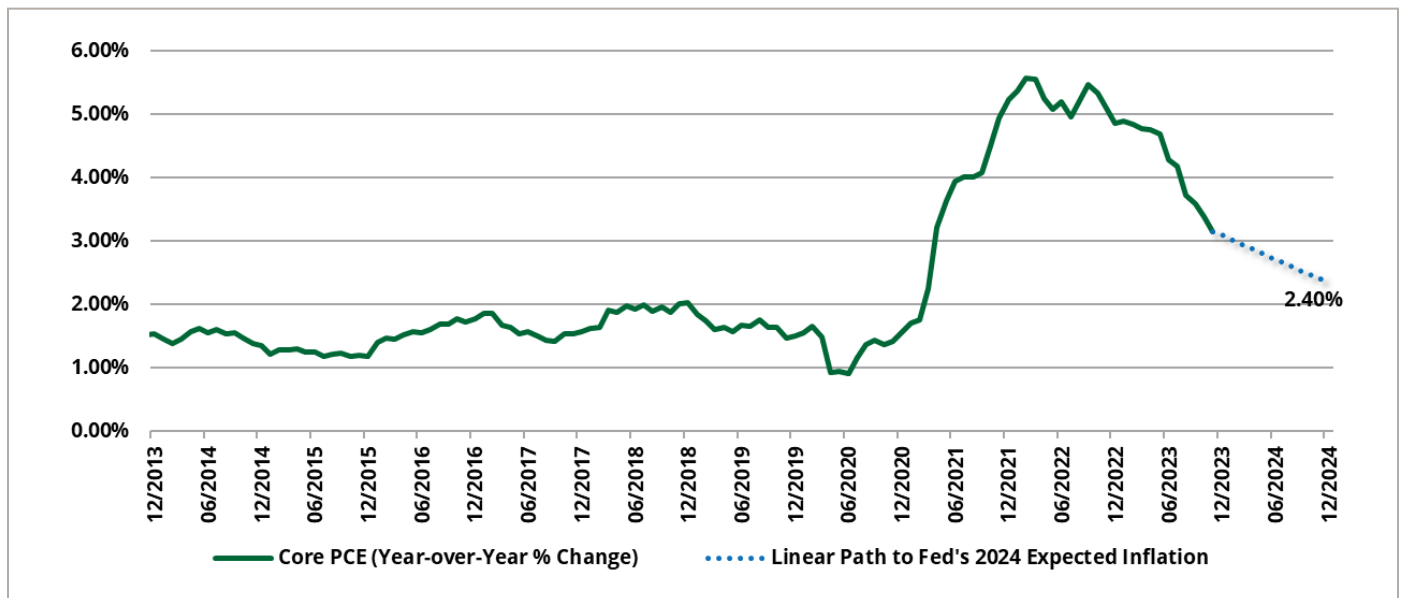
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One of the big surprises in 2023 was the resilience and tightness of the labor economy and the US economy enters 2024 on better footing than most expected would be the case. Post-Covid normalization between the manufacturing and services sectors of the economy continued over the course of 2023, as the manufacturing sector spent the entirety of 2023 in contraction—with the ISM's (Institute for Supply Management) Manufacturing index averaging 47.0 during the year.<sup>2</sup> In the services sector, spending supported the overall economy, and, while slower than 2022, the ISM Services index averaged 53.0 during 2023 and grew in every month of the year.<sup>3</sup> *Readings above and below 50.0 are associated with economic expansion and economic contraction, respectively.* We expect more of the same for 2024 out of these segments of the economy but note the potential for upside surprise in the manufacturing sector.

Arguably one of the most important factors to watch in 2024 is inflation. The stock and bond market rallies that began in late October/early November last year have generally been predicated on the notion of a soft-landing/no recession scenario alongside declining inflation rates. Thereby, leading to a Federal Reserve that is assumed to be less restrictive or more dovish from a monetary policy point of view. After registering 3.2% in November, core PCE (Personal Consumption Expenditures) is now at its lowest level since mid-2021, clearly a welcome sign.<sup>3</sup> Furthermore, expectations for lower inflation continues to embed not only in financial markets but have now become the median expectation for the Fed. Following the Fed's final meeting of 2023 in December, the central bank's Summary of Economic Projections (SEP) noted the median expectation for core PCE for the year end of 2024 was 2.4%—an expected decline of -0.8% from the most recent reading of 3.2%.<sup>4</sup>

INFLATION EXPECTED TO DECLINE IN 2024



Source: Clearstead, Bloomberg LP, as of 12/31/2023.

The SEP cemented investor sentiment and added to the bullish tone that closed out 2023—a set-up that could pose problems for markets in 2024 if inflation data does not play nice. As of now, markets are expecting six 25 bps rate cuts during 2024, three more than the median expectation from the Fed's December 2023 SEP.<sup>4</sup>

## FEDERAL RESERVE SUMMARY OF ECONOMIC PROJECTIONS (SEP)

December 2023 Median Projections	2024	2025	2026
Unemployment Rate	4.1%	4.1%	4.1%
Core PCE Inflation	2.4%	2.2%	2.0%
Federal Funds Rate	4.6%	3.6%	2.9%

Source: Clearstead, <https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20231213.pdf>, as of 12/13/2023.

# 2024 OUTLOOK

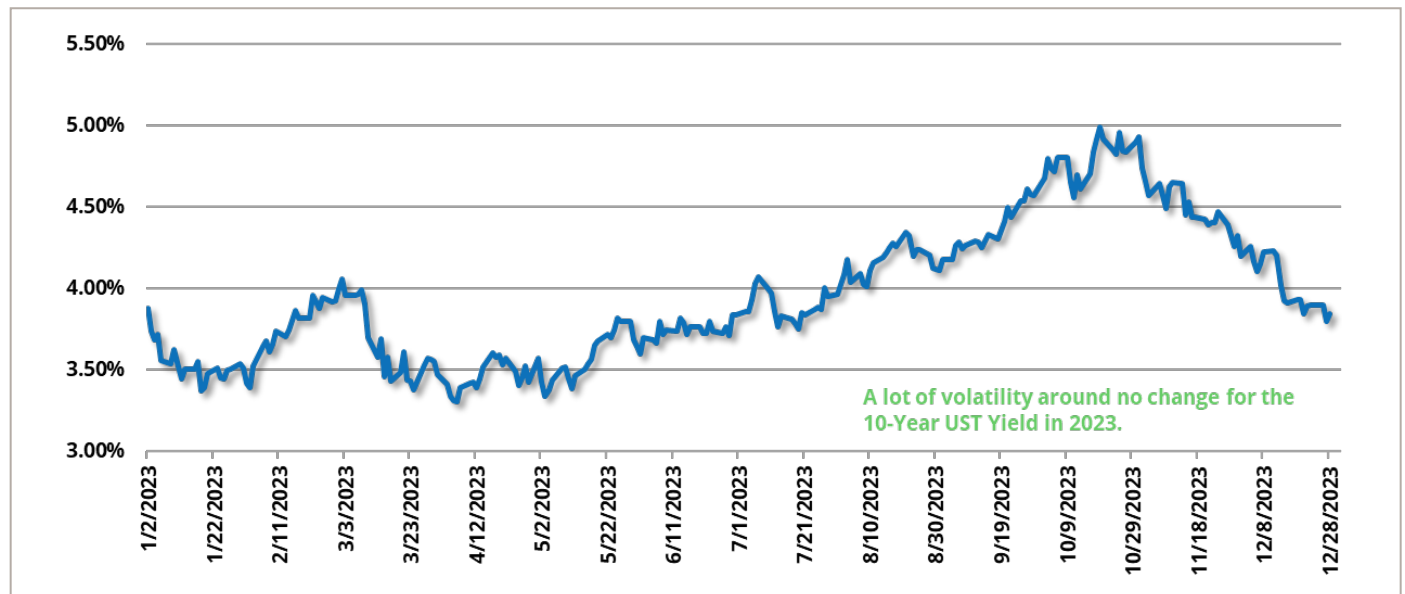
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We find ourselves at odds with markets and, in our view, the market seems to have got ahead of itself in assuming six 25bps rate cuts as the path for core inflation to be significantly lower by year end 2024 likely requires weakness in labor markets that we don't see as clearly evident at this point in time. As of today, we would be more aligned with the Fed's SEP which suggests three 25bps rate cuts. The risks for investors heading into 2024 now stem from the exuberance that lifted markets throughout the final months of 2023 that were driven by falling long-term interest rates, declining inflation, and no recession—so expectations are high. More below.

## FIXED INCOME MARKETS

Bond markets enter 2024 after a roller coaster of a ride in 2023. As seen in the chart below, the 10-Year US Treasury (UST) Yield began 2023 at 3.88% and ended 2023 at 3.88%, and Rip Van Winkle might have remarked "what's the big deal?" For those of us that had to wake up every day and confront markets, we witnessed the 10-Year UST Yield reach as low as 3.25% in the aftermath of the mini banking crisis while testing 5.00% in mid-October—talk about an interesting way of going nowhere. We would expect much of the same out of the 10-Year UST in the sense that rangebound is a reasonable expectation, though within a tighter range of 3.5% to 4.5%. As we enter 2024, the median strategist forecast for the 10-Year UST for the year-end is 3.98%, the mid-point of our expected range. While that might imply a snoozefest for bond markets, considering the 10-Year UST is currently at 3.88%, we expect anything but that.

10-YEAR US TREASURY YIELD



Source: Clearstead, Bloomberg LP, as of 12/31/2023.

Risks in bond markets remain, as UST issuance needed to fund the US government's increasing deficits is expected to increase by nearly 25% from 2023 to 2024.<sup>5</sup> The expected surge in US Treasury issuance may unfold into one of two potential scenarios: (1) yields push higher as supply-demand dynamics adapt, or (2) government bonds may crowd out capital from other sectors of the bond market. It is not clear how this plays out in 2024, though one thing seems certain to be a fixture in bond markets again, and that is volatility.

Credit markets should otherwise behave OK. High yield and leveraged loan markets are poised to see an uptick in defaults over the course of the year but are better characterized as normal business cycle-related stresses and not any sort of extraordinary negative credit event. In sum, it looks to be another year of volatility but, given the benefit of higher beginning yields, we would expect that much like 2023 investors in 2024 should expect to earn their coupon.

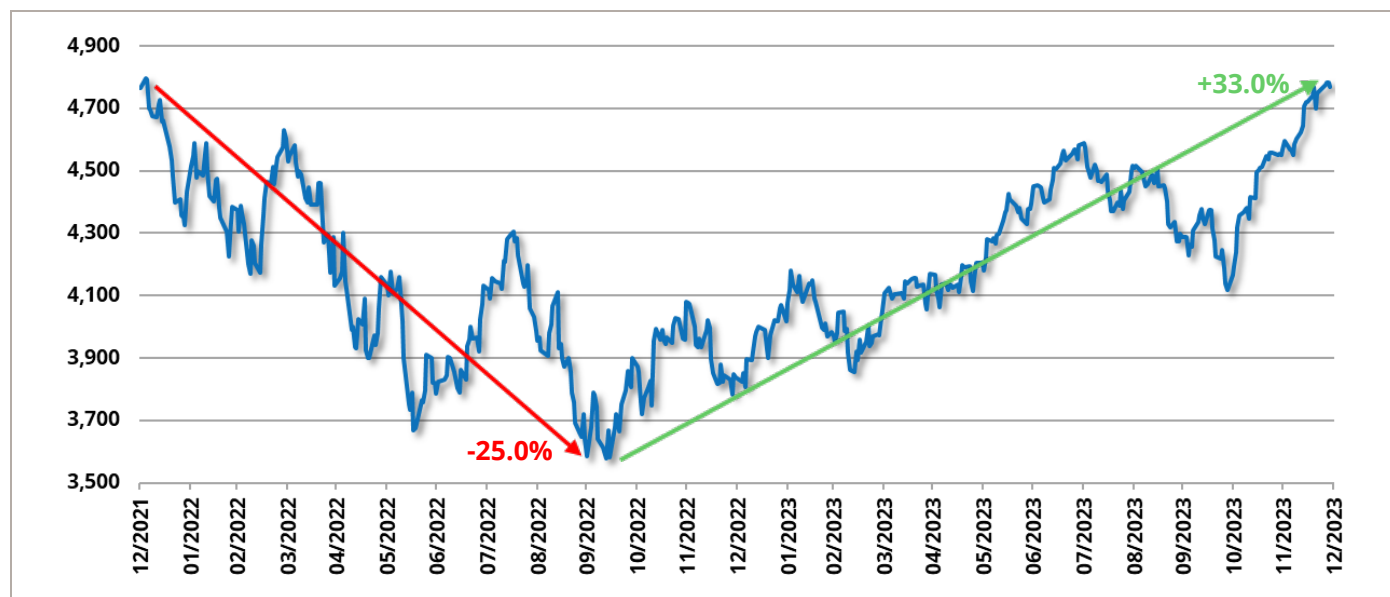
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## EQUITY MARKETS

The S&P 500 now approaches all-time highs set in early 2022, and we can officially say the index has done nothing for two years—though in spectacular fashion (much like the bond market's journey in 2023). Over those two years (2022 and 2023), the S&P 500's trek to near zero return included a peak-to-trough drawdown of -25.0%, followed by a recovery of +33.0% to get back to near even.

S&P 500 (PRICE INDEX)



Source: Clearstead, Bloomberg LP, as of 12/31/2023.

Throughout much of 2023 we remarked about the concentration of the so-called magnificent seven (Microsoft, Amazon, Tesla, Nvidia, Alphabet, Tesla, Meta) and the fact that those companies were distorting the market's returns and, by extension, it meant that growth stocks were outperforming value stocks by a wide margin. *Further highlighting the extreme concentration of the S&P 500, nearly 72% of the index's constituents underperformed the index in 2023—a record share dating back to at least 1980.*<sup>6</sup> However, as seen in the chart below, growth and value stocks share an odyssey of nothingness from 2022 much like that which was experienced by the S&P 500. In fact, despite growth trouncing value in 2023, value has performed better since the beginning of 2022. Needless to say, the volatility between growth and value has been significant and not picking sides has been a good strategy over that stretch.

	2022	2023	2022-2023
Russell 1000 Growth	-29.1%	+42.7%	+0.6%
Russell 1000 Value	-7.6%	+11.4%	+1.5%
Russell 2000 Growth	-26.4%	+18.6%	-6.6%
Russell 2000 Value	-14.5%	+14.6%	-1.0%

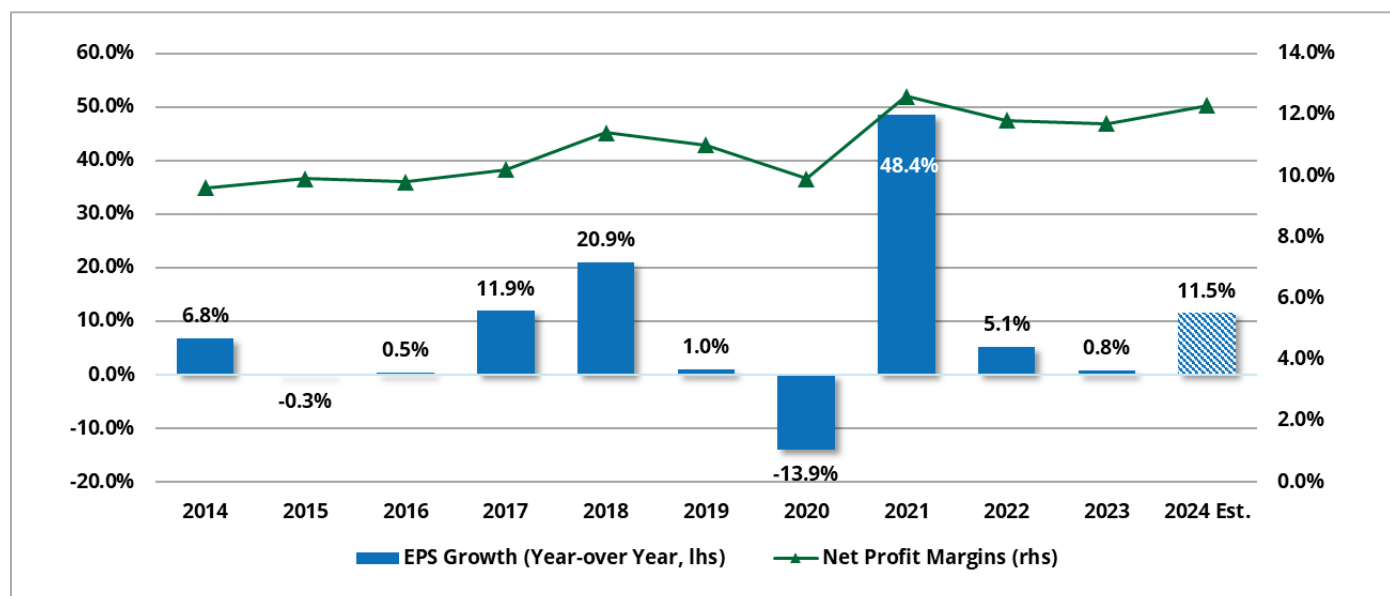
Source: Clearstead, Bloomberg, Total Returns as of 12/31/2023, periods longer than one year are annualized returns.

So now what? First, being that we are believers that over the long-term stock prices generally follow earnings, we begin with expectations for earnings for 2024. After an earnings recession in 2023 which yielded less than 1% YoY growth in earnings for the S&P 500, a significant recovery is expected in 2024, somewhat predicated on an expectation for improvement in net profit margins.<sup>7</sup> Current expectations are for nearly 12% YoY earnings growth for the S&P 500 index in 2024. Those lofty expectations have been met by a rally in equity markets—built on the idea of declining interest rates and falling inflation—that now mean earnings have little room for error. Fundamentals must meet or beat expectations or markets will suffer.

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## EXPECTATIONS ARE HIGH FOR 2024



Source: Clearstead, Factset Earnings Insight, as of 12/8/2023 & 12/15/2023.

Guessing where stock markets will end the year is more art than science and invariably there is a herd mentality with forecasters. That said, we can use our long-term equity return drivers (earnings growth, change in price-to-earnings multiple, and dividends) to build a set of expectations for the year. With little room for broad expansion in valuations, coupled with nearly 12% earnings growth and after accounting for dividends, we arrive at a 7%-10% type expectation for the S&P 500 (currently trading near 4,700 as of 12/31/2023)—understanding that even a hint of earnings' misses is likely to pull markets lower so the downside risk to this baseline is higher than usual when going through this exercise. Top-down strategists seem similarly disposed and the Q4 2023 rally seemed to wreck a lot of 2024 forecasts. That said, the median strategist year-end target for the S&P 500 as of now is 5,100.<sup>8</sup> From a bottoms up point of view (an aggregation of analyst target prices) the year end estimate is 5,068, and so the central tendency for year-end 2024 squares around 5,100 for the S&P 500.<sup>9</sup>

It is possible that, at the beginning of the year, markets may experience much of the same with the magnificent seven driving markets. Although, we do think that, by the end of year, we might be looking back at 2024 as a year where everything else did better—meaning that the areas that were left behind in 2023 play catch up and small cap stocks, value stocks, dividend stocks, and developed international could fare better. The verdict is still out on emerging markets which have structurally changed, so this remains a coin toss.

## GEPOLITICS

**Elections Galore in 2024:** Get ready to vote next year, because major elections are going to take place across the globe, particularly in the world's largest democracies.

Country & Type	Time	Implications
Taiwan – Presidential	Jan-2024	China will be watching closely to see if any of Taiwan's mainstream political parties—particularly DPP—push an aggressive line towards Taiwan declaring formal independence; this election has the potential to strain already poor US-China relations.

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Country & Type	Time	Implications
Indonesia – General	Feb-2024	The world's third largest democracy heads to the polls in which tensions between old and new guard are on display and there is always a backdrop of how to guide its economy between US and Chinese spheres of influence.
South Africa – General	Feb-2024	As Africa's largest economy, many EM market watchers will be eager to see if the country can turn the corner on corruption and improve the business climate.
Russia – Presidential	Mar-2024	It's a forgone conclusion who will win this election—Putin—but any election being held amid a war-time economy/society can be volatile and we expect a lot of anti-US/NATO rhetoric in the run-up to the vote that could see a new low set in Russia's relations with the West.
India – General	Apr-May-2024	The world's largest democracy will see if current PM Narendra Modi will win a new mandate to further reform the Indian economy and continue his Hindu-nationalistic foreign and domestic policies.
Mexico – General	Jun-2024	Mexico could see its first female President elected and the opportunity to take advantage of near/friend-shoring trends as well as make progress quelling violence and corruption.
US – Presidential	Nov-2024	The US looks set to see a re-match of Presidents Joe Biden and Donald Trump—not since Teddy Roosevelt has a former President run for an election against an incumbent. Only Grover Cleveland won two separate (non-consecutive) Presidential elections.

**Russia-Ukraine War:** The conflict is likely to grind-on through all of 2024 as neither side looks ready for serious peace-talks unless battlefield gains/losses fundamentally change the dynamic. The silver lining for markets is that Ukrainian grain is likely to keep flowing next year and Europe has largely shifted away from Russian energy and diversified its supply base.

**Israel-Gaza War:** While the conflict in Gaza may wind down over the course of H1-2024, the aftermath has left the world on edge. The region remains volatile and renewed fighting between Israel and Hamas, or Hezbollah in Lebanon, or other Iranian proxies in Syria are an ever-present possibility. Iranian-back Houthi fighters in Yemen have been attacking tankers and freighters in the Red Sea in solidarity with Hamas which have raised the cost of shipping through the Suez Canal and could snarl European supply chains and spurred a cross-nation naval task force to help police this key shipping route.

**China-Taiwan Tensions:** The future of political status of Taiwan is a constant source of tension in East Asia. China views nearly all foreign policy matters through the lens of its One China policy which involves the eventual incorporation of Taiwan under formal rule by Beijing. China will continue to pressure neighbors (economically, diplomatically, and militarily), both near and far, to support its position that Taiwan must inevitably recognize Beijing's ultimate authority over the island territory.

**Near-Shoring/Friend-Shoring:** More and more companies are shifting from a philosophy of “just in time” to “just in case” in terms of their inventory management and national security concerns are front-and-center for production of many technology components which is causing global supply chains to be substantially re-oriented. This is providing opportunities for key US trade partners from Mexico to India to benefit from concerns about an over reliance of global supply chains on Chinese suppliers.

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**US Debt Levels:** Last year, the US spent more on monthly interest payments than it did on its monthly defense budget. As interest rates rose last year and net public debt outstanding hovers around 100% of GDP, interest expenses rose to approximately \$659 billion dollars—about double that amount that was spent on interest payments just a year ago. Expect difficult budget negotiations going forward and interest payments to increasingly crowd out other government spending priorities in the coming years.

## PRIVATE MARKETS

Private investments, while lagging public markets, generally trended higher in 2023, with private credit and private equity leading the category, while venture capital detracted as venture-backed company valuations start to normalize with down rounds trickling into the marketplace. We will have to wait a couple of quarters for finalized numbers, but as of 6/30/2023, the PitchBook Global Private Capital Index was up 5.5% YTD. Private market transaction volumes have slowed substantially, resulting in fewer exits and, subsequently, less distributions back to limited partners (“LPs”). Overall fundraising activity is down and has forced open strategies to remain in the market for longer with less lofty fundraising targets. While these factors have broadly weighed on managers in all private market asset classes, there are silver linings for investors who stay the course by committing to private strategies on an annual basis.

As public equities have sharply rebounded mainly due to multiple expansion, private equity-backed companies have seen gains primarily driven by operational improvements and strategic acquisitions after battenning down the hatches last year. Relying on multiple expansion to generate outsized private market returns seems ill-advised as private company valuations have remained stagnant, partially explained by sparse deal activity largely due to buyer-seller disconnect on pricing. The median PE buyout EV/EBITDA multiple sits at 11.5x as of Q3 2023, slightly lower than the 11.8x valuation from 2022.<sup>10</sup> Frothy private company valuations can be attributed to several factors including the lack of leveraged buyout (“LBO”) financing from traditional lenders, expensive cost of debt when available, asset owners expecting Q4 2021 valuations, and potential buyers sitting on elevated amounts of dry powder waiting for an opportunistic time to deploy into lower valuations. Private companies who levered up with floating rate debt before the current interest rate regime are having trouble covering their interest burden, which is eating into profits and causing firms to negotiate with lenders and inject additional capital. With liquidity in mind, fund managers may want to wash their hands of existing portfolio companies by utilizing secondary markets to generate realizations and fund distributions for limited partners. These dynamics, coupled with the fact that active PE funds are effectively ‘on the clock’ to deploy capital, may result in valuations trading lower and more deal activity going forward.

Private credit has generated strong equity-like returns as elevated base rates and the pullback in supply from traditional lenders has allowed private credit managers to finance higher quality deals with more downside protection via tighter covenants. While other private asset classes have struggled hitting fundraising targets, private credit commitments have grown exponentially as yields trended higher and retail-oriented offerings were launched to enable easier access to non-traditional investors in the space. While there may be some merit to classifying today’s environment as the “Golden Age of Private Credit,” there are a few key risks investors should monitor going forward. Waning borrower fundamentals and a higher interest expense could affect a borrower’s ability to service its debt obligations. Additionally, the sheer volume of supply added to the market has fueled competition to finance the best-in-class deals. That said, we expect private credit to generate 2023-like returns in 2024. For new private credit strategies coming to market in 2024, we favor opportunistic managers with a track record of generating strong returns and low loss ratios in multiple business cycles.

Despite the various challenges facing private markets, we believe companies backed by the best private equity firms should continue to benefit from quick and decisive active ownership and additional resources that public shareholders cannot provide. We expect strategy/sector specialists with strong operational expertise and value-oriented PE managers to outperform generalist counterparts and prefer small-to-medium sized strategies relative to large “mega-funds.” Additionally, we find secondary funds to be attractive given the embedded discounted investment on top of potentially falling valuations and the liquidity challenges both LPs and fund managers have experienced as exit activity dried up.



# 2024 OUTLOOK

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## CONCLUDING THOUGHTS

After a better-than-expected year for the economy and markets we pivot to 2024 with mixed expectations for both. So long as the economy avoids recession—we currently assign a low probability for a recession—investors can expect single digit returns out of public equity and fixed income markets. The risks for equities are that earnings must meet or beat lofty earnings expectations or else returns could disappoint. For bond markets, low single digit returns seem reasonable and some of the negative tail risk of large declines in bond markets (like those of 2022) are likely off the table considering the trajectory of inflation, real GDP, and monetary policy. 2024 is likely a year where diversification pays off and we expect to be talking about more than the magnificent seven this year. For private markets, the next few years should be a great buying opportunity for private equity investors with capital left to deploy, and we encourage our clients to maintain allocations to private markets going forward.

Lastly, an increasingly ambiguous economic environment is likely to translate into greater dispersion in return outcomes across both public and private markets. To that end, we continue to focus on disciplined, repeatable, and tenured research and due diligence processes to help our clients meet their objectives. As always, we thank you for your trust and look forward to a prosperous new year.

### Source:

- (1) Bloomberg LP, <https://www.atlantafed.org/cqer/research/gdpnow>, as of 12/27/2023.
- (2) Bloomberg LP
- (3) Bloomberg LP
- (4) <https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20231213.pdf>, Bloomberg LP, Fed Funds futures, as of 12/31/2023.
- (5) <https://apolloacademy.com/23-increase-in-treasury-auction-sizes-in-2024/>
- (6) Apollo, The Daily Spark, 12/27/2023.
- (7) Source: Clearstead, Factset Earnings Insight, as of 12/8/2023 & 12/15/2023.
- (8) Bloomberg LP, Yardeni Research, Oppenheimer, Fundstrat, Goldman Sachs, Deutsche Bank, Bank of America, Societe Generale, Wells Fargo, Morgan Stanley, Barclays, JP Morgan, as of 12/7/2023.
- (9) Factset Earnings Insight, as of 12/7/2023.
- (10) PitchBook Q4 2023 Quantitative Perspectives: The Waiting Game.

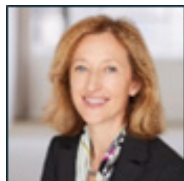
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*Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.*

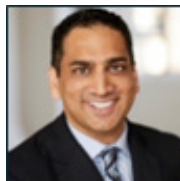
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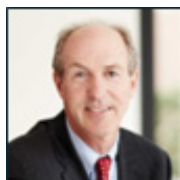
**Svetlana Loshakov, CFA**  
Head of Investments



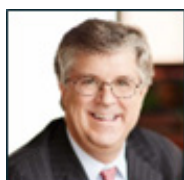
**Aneet Deshpande, CFA**  
Executive Managing Director,  
Investment Strategy



**Joe Boushelle, CFA, CAIA**  
Senior Managing Director, Alternatives



**Carl Tippit, CFA**  
Co-Chairman



**Tom Seay**  
Senior Managing Director



**Jim Awad**  
Senior Managing Director



**Dan Meges**  
Senior Managing Director



**Mike Kuebler**  
Analyst, Research



**Mike McLelland, CFA, CAIA**  
Senior Analyst, Research



**Kimberly Trnavsky**  
Alternative Investments Specialist

### MARKET BENCHMARK RETURNS

December 31, 2023		1M	3M	12M	YTD
US Large Cap	S&P 500	4.5%	11.7%	26.3%	26.3%
US Small Cap	Russell 2000	12.2%	14.0%	16.9%	16.9%
Developed Intl	MSCI EAFE	5.3%	10.4%	18.2%	18.2%
Emerging Intl	MSCI Em Mkt	3.9%	7.9%	9.8%	9.8%
Real Estate	NAREIT	8.9%	17.6%	11.5%	11.5%
Core Fixed	BarCap Agg	3.8%	6.8%	5.5%	5.5%
Short Fixed	BarCap 1-3Yr	1.2%	2.7%	4.6%	4.6%
Long Fixed	BarCap LT G/C	7.9%	13.2%	7.1%	7.1%
Corp Debt	BarCap Corp	4.2%	8.2%	8.2%	8.2%

Source: Bloomberg

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