

# Freedom market commentary

2023 review // 2024 outlook

Despite the downward pressure of rising interest rates, the resilience of the U.S. economy defied expectations, producing a volatile but ultimately productive year.

At the end of the persistently dreary 2022, 2023 seemed poised to offer more of the same. The Federal Reserve (Fed) had rapidly hiked the baseline interest rate from near zero to 4.25%–4.50%, and expectations for a recession – the traditional curative for inflation – climbed alongside it. Inflation was steadily declining from its June 2022 peak of 9.1%, as measured by the Consumer Price Index, but the Federal Reserve’s actions led many commentators to ask, “At what cost?”

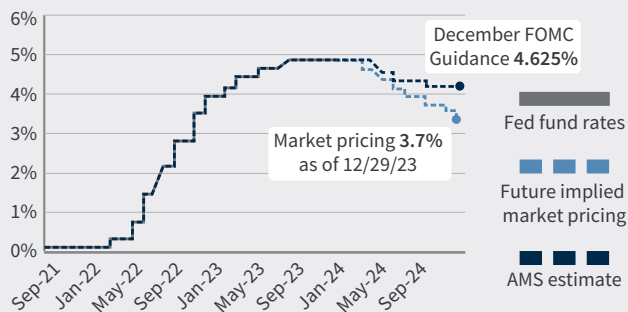
However, 2023 offered a twist. U.S. economic growth kept recession at bay as a robust labor market and confident consumer spending gave the Federal Reserve the incentive and elbow room needed to keep pushing interest rates, though at a more measured pace. At the end of 2023, the target Federal Funds rate sat at 5.25% to 5.50%. Over time, talk of a looming recession shifted into talk of a “soft landing,” a return to the 2.0% target inflation rate without a recession. Time will tell, as November’s Consumer Price Index indicated year-over-year inflation remained at an elevated level of 3.1%; it’s too early to declare victory, and a mild recession remains a likely possibility in 2024.

Meanwhile, the S&P 500 recorded one of its most productive first halves of a year, but underneath the headline numbers was severe market bifurcation. “Magnificent 7” AI-themed tech stocks with their mega size and mega performance provided a shiny veneer to headline indices. Everyone else, however,

## LOOKING AHEAD

The Asset Management Services Investment Committee expects the Federal Reserve and other central banks around the world to cut interest rates through 2024, barring significant disruption. Taken generally, this is a prevailing view on the market, though the investment committee disagrees with the consensus in degree: The market has priced in seven rate cuts through the year, starting early; the committee expects the Federal Reserve to take a more conservative approach. Rather, the committee expects the Federal Reserve will continue to rely on domestic economic resilience to keep downward pressure on inflation, then make four rate cuts beginning closer to the middle of the year.

## FEDERAL RESERVE GUIDANCE VERSUS MARKET PRICING



Market pricing at the end of 2023 pointed to expectations for steeper rate cuts than had been suggested by the Federal Reserve’s messaging. The Asset Management Services Investment Committee expects an outcome closer to the Federal Reserve’s December guidance.

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faced challenging bear conditions, weak corporate earnings and the prospect of the baseline interest rate being kept “higher for longer.” A third quarter sell-off erased much of the first two quarters’ headline gains but encouraging inflation numbers and softening language from the Federal Reserve bolstered investors’ confidence by October. Unlike the first half of the year, this fourth quarter rally was broad, especially providing relief to the

much beleaguered small- and mid-cap stocks whose perceived weakness to higher interest rates had made investors wary.

The S&P 500 capped this remarkable, volatile year by finishing its last day of trading, December 29, up 26.3% for the year and slightly off the all-time peak it had set just a day prior. The Russell 2000 index, reflecting the stock performance of small companies, finished the year up 16.9%.

## 2023 MARKET DRIVERS



### INFLATION

Inflation fell steadily through 2023 as energy prices fell and COVID-era supply chain snags were sorted out. Still, inflation and the Federal Reserve’s response to it was the major market drivers of the year, particularly as investors sought to predict the Federal Open Market Committee’s moves on interest rates based on lagged data, creating volatility.



### U.S. ECONOMIC RESILIENCE

Strong consumer spending bolstered by elevated COVID-era savings levels buoyed growth of the U.S. economy, despite rising interest rates and recessionary expectations. A “soft landing” without recession is possible, but “soft-ish” may be a more prudent descriptor as a mild recession remains the most likely outcome, based on leading indicators pointing to weakness ahead.



### INTEREST RATES

Rising interest rates caused difficulties for investors of longer maturity bonds through 2023 while simultaneously creating long-term yield opportunities for buyers of new issues. As yields fell in the fourth quarter, fixed income bounced back, ending the year positive.

Small- and mid-cap stocks, punished for their presumed weakness against rising interest rates, also benefited from the fourth quarter’s shrinking yields, ending the year positive and roughly on par with large-cap international equities.



### ARTIFICIAL INTELLIGENCE

The performance of AI-themed stocks helped growth stocks achieve their best year in more than a decade and created the greatest disparity with value stocks since 2020. This put headline index numbers at odds with the vast majority of the market, though a fourth quarter rally helped close the gap to create a productive year across most sectors and asset classes.

## 2023 MARKET THEMES



The Fed, interest rates and inflation



Consumer spending vs. recession



Fixed income and small-to-mid-cap equity growth



Expectations for higher corporate earnings

## EQUITY

After declining performance during the third quarter of 2023, corporate earnings among large companies appear to be stabilizing. While it is expected that both profit and margins will recover during 2024, the market consensus of 12% growth may be too optimistic.

Looking down market, as interest rates and yields decline, we believe small-to-mid-size companies are primed for growth, having suffered under perceptions of weakness against “higher for longer” interest rates – perhaps more than warranted. Under loosening monetary conditions, these stocks could experience a rapid rebound as their major headwind eases. Freedom continues to hold an overweight position in small-to-mid-cap stocks relative to policy guidelines, which is a good position for this potential opportunity.

Among sectors, industrials, energy and communication services are likely poised for outperformance based on improving fundamentals and reasonable prices. As the economy slows and

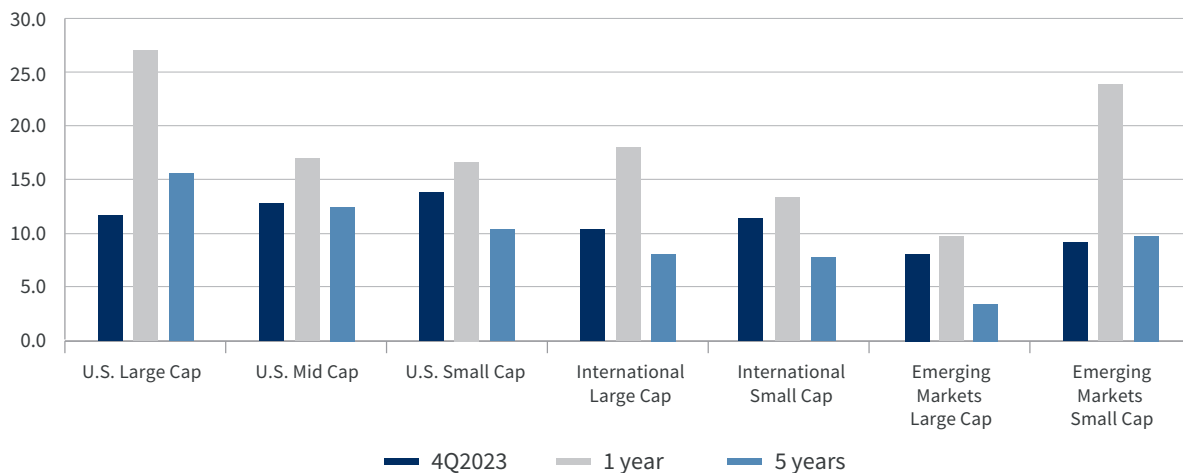
still-high inflation persists, consumer discretionary, consumer staples and technology sectors may experience some headwinds through 2024.

Overseas, markets in developed economies are showing early signs of stabilization as earnings trough and companies increase stock buybacks. Expectations point to easing market environments, which combined with their low valuations could create opportunity for growth. However, the traditional volatility of the sector warrants patience. Freedom portfolios remain underweight in international developed equity relative to domestic equity, seeing a better risk-return profile in the U.S. at this moment.

Among emerging economies, 2023 saw markets in India returned 21% and Mexico posted 40%+ return in USD terms while MSCI China index lost 11%, a severe divergence of trends. This gap could narrow in 2024 as Chinese policies continue to ease, consumer confidence climbs and earnings growth recovers.

## EQUITY RETURNS

Source: Morningstar as of 12/31/2023



## FIXED INCOME

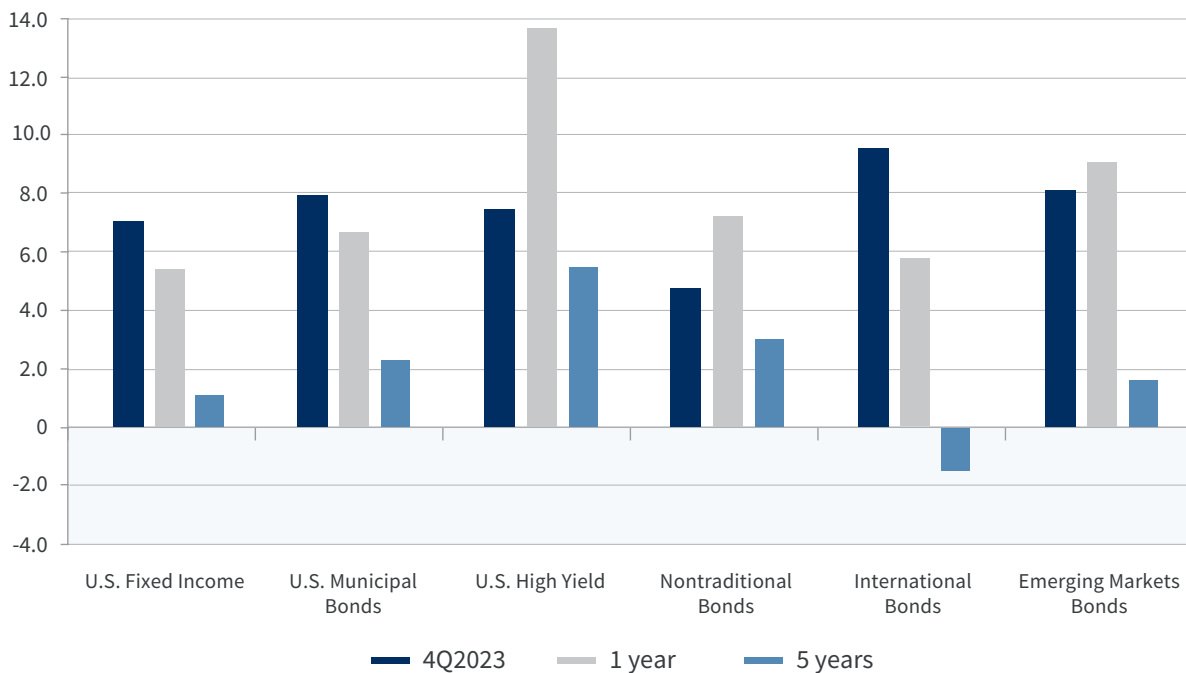
The Federal Reserve’s aggressive action on interest rates pushed yields to their highest point in 16 years in 2023, a stiff headwind for bond prices. As the Federal Reserve’s stance has softened, yields have declined, and bond prices have risen in response. Lower interest rates should provide an additional benefit to prices, but despite the 10-year U.S. Treasury yields dropping 120 basis points in the fourth quarter of 2023, policy uncertainty and bond volatility may keep yields high and volatile than where they may settle beyond 2024.

In our view, higher quality corporate bonds currently appear to offer the best risk-reward characteristics as investment-grade-rated companies enjoy better balance sheets and less need to refinance debt in the near term. About one quarter of constituents in the high-yield index have debt maturities coming due in the next four years, with 2024–2025 being the heaviest years for issuances, adding risk in the near term.

Freedom remains slightly overweight to high-quality bonds and slightly underweight to equity, positioned for declining economic growth and the potential for a mild recession in the U.S.

## FIXED INCOME RETURNS

Source: Morningstar as of 12/31/2023



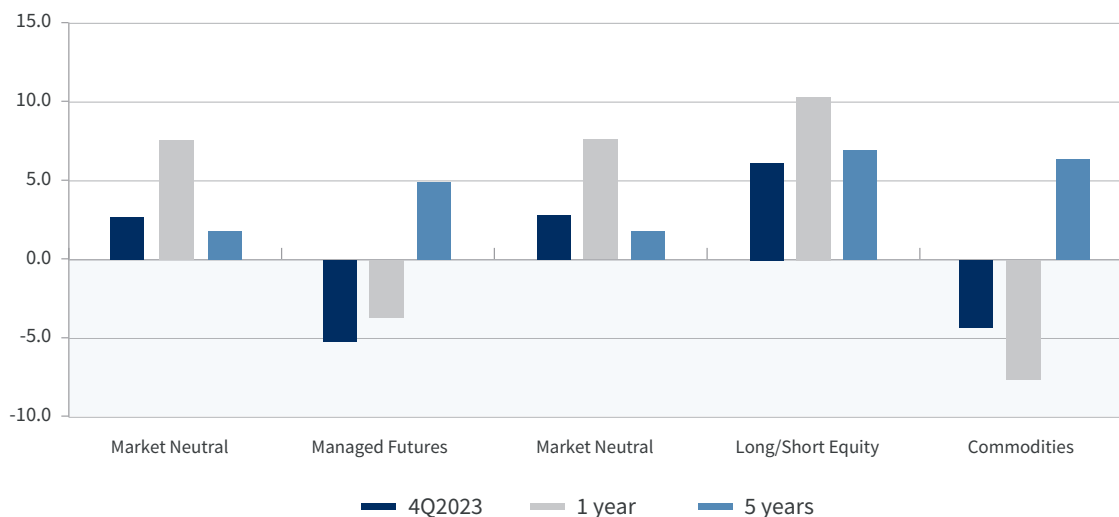
## ALTERNATIVES

The AMS Investment Committee uses alternative investments for either diversification or return enhancement. In the last decade, easy monetary policy and ultra-low inflation rendered alternative assets less attractive relative to equity

and bonds. However, we believe the persistent inflation and tighter monetary policy going forward increases the utility of alternative assets in diversified portfolios. Freedom portfolios are slightly underweight the liquid alternatives sector.

## ALTERNATIVE INVESTMENTS RETURNS

Source: Morningstar as of 12/31/2023



## FINAL THOUGHTS

Despite its severe unevenness, by the end, 2023 provided a rebound from a difficult 2022, and we enter 2024 amid a broader rally than we've seen in two years. While elevated inflation is likely to remain so for some time to come – and indicators suggest a mild recession in our immediate path – the

outlook in 2024 is far more optimistic than a year ago. Freedom portfolios' diversified positioning in both growth sensitive sectors as well as more defensive market segments will smooth the sail in a likely still volatile market, where a few weeks can constitute the majority of an asset's performance for the year.

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***Further information on the funds selected for the Freedom portfolios is available by prospectus, which can be obtained through your financial advisor. Investors should carefully consider the investment objectives, risks, charges and expenses of mutual funds and exchange traded funds before investing. The prospectus contains this and other information about the funds and should be read carefully before investing. All investments are subject to risk, including loss.***

You should understand that the annual advisory fee charged in these programs is in addition to the management fees and operating expenses charged by mutual funds and exchange traded funds if applicable. These additional considerations, as well as the fee schedule, are listed more fully in the Client Agreement and the Raymond James & Associate's Form ADV Part 2A.

It is important to review the investment objectives, risk tolerance, tax objectives and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk and no one particular investment style or manager is suitable for all types of investors.

Additional risks may include:

- Fixed-income securities (or "bonds") are exposed to various risks including but not limited to credit (risk of default or principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks.
- There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest

rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise. Short-term bonds with maturities of three years or less will generally have lower yields than long term bonds which are more susceptible to interest rate risk.

- International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility.
- Investing in emerging markets can be riskier than investing in well-established foreign markets. Emerging and developing markets may be less liquid and more volatile because they tend to reflect economic structures that are generally less diverse and mature and political systems that may be less stable than those in more developed countries.
- Investing in small-cap stocks generally involves greater risks, and, therefore, may not be appropriate for every investor. Stocks of smaller or newer or mid-sized companies may be more likely to realize more substantial growth as well as suffer more significant losses than larger or more established issuers.
- These portfolios may be subject to international, small-cap and sector-focus exposures as well. Accounts may have over weighted sector and issuer positions, and may result in greater volatility and risk.
- Alternative investments are generally considered speculative in nature and may involve a high degree of risk, particularly if concentrating investments in one or few alternative investments. These risks are potentially greater and substantially different than those associated with traditional equity or fixed income investments. The investment strategies used by certain funds may require a substantial use of leverage. The investment strategies employed and associated risks are more fully disclosed in each fund's prospectus, which is available from your financial advisor.
- Commodities trading is generally considered speculative because of the significant potential for investment loss. Among the factors that could affect the value of the fund's investments in commodities are cyclical economic conditions, sudden political events, changes in sectors affecting a particular industry or commodity, and adverse international monetary policies. Markets for precious metals and other commodities are likely to be volatile and there may

be sharp price fluctuations even during periods when prices overall are rising.

- Specific sector investing, such as real estate, can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.
- Companies in the technology industry are subject to fierce competition, and their products and services may be subject to rapid obsolescence.

## INDEX AND PEER GROUP DESCRIPTIONS

These indices and peer groups are not available for direct investment. Any product which attempts to mimic the performance will incur expenses, such as management fees and transaction costs, that reduce returns.

Bloomberg Barclays U.S. Aggregate Bond Index (U.S. Fixed Income): This index includes investment grade U.S. Government bonds, corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the index must have at least one year remaining to maturity.

MSCI EAFE Index (International Large Cap): A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S & Canada. It consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Market Index (Emerging Markets Equities): A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2009 the MSCI Emerging Markets Index consisted of the

following 22 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, the Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

Morningstar US Fund Multistrategy: Funds in this category typically have a majority of their assets exposed to alternative strategies, but at a minimum, alternatives must comprise greater than 30% of the strategy's gross exposure. The category includes funds with static allocations to alternative strategies as well as those that tactically adjust their exposure to different alternative strategies and asset classes.

Russell 2500 (U.S. Small to Mid-Cap): A broad index featuring 2,500 stocks that cover the small and mid-cap market capitalizations. The Russell 2500 is a market cap weighted index that includes the smallest 2,500 companies covered in the Russell 3000 universe of United States-based listed equities.

S&P 500 Dividend Aristocrats TR: The S&P 500 Dividend Aristocrats Index is a list of companies in the S&P 500 with a track record of increasing dividends for at least 25 consecutive years. It tracks the performance of well-known, mainly large-cap, blue-chip companies.

Bloomberg Barclays 1-3 Year U.S. Government: An inclusion of securities within Bloomberg Barclays Capital U.S. Government Index that have a maturity range from 1 up to (but not including) 3 years.

Bloomberg Barclays U.S. High Yield - 2% Issuer Cap: The index is the 2% Issuer Cap component of the U.S Corporate High Yield Index.

S&P 500 Index (U.S. Large Cap): The index consists of 500 of the largest stocks in the U.S. stock market. A market value weighted index (stock price times number of shares outstanding after float adjustment), with each stock's weight in the index proportionate to its market value.

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