Herbein
Financial Group

2023 Year in Review
& 2024 Market Outlook

Herbein Financial Group
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2023 Year in Review:

Outperforming Expectations: Above Average Returns

The underperformance of stocks and bonds in 2022 was reversed in 2023, thanks to moderating inflation that prompted the Federal Reserve to slow down interest rate hikes, all while the US economy continued to thrive. Notably, the US stock market saw exceptional returns of 26%, driven largely by the impressive performance of the "Magnificent-7" stocks, which averaged a remarkable 110% return.

However, it is unlikely that we will witness a repetition of such strong stock market returns in 2024. As our base-case scenario, we anticipate long-term average returns, but we also expect increased volatility for both stocks and bonds, with equal chances of downside risks materializing in 2024.

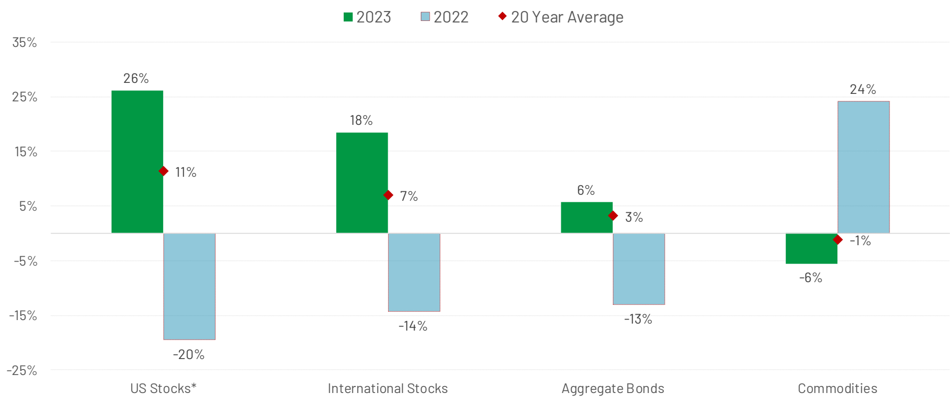

Chart 1: Reference Disclosure

The Magnificent 7:

In 2023, the performance of renowned companies like Apple, Amazon, Google, Microsoft, Meta, Tesla, and NVIDIA was exceptional. Their average return stood at an impressive 109%. This far outpaced the Total Stock Market index, which saw a modest increase of 26%. Even the average stock in the S&P 500 lagged behind with a mere 14% gain. As we entered the year, our expectations were more aligned with the average stock return of 10-15%. The extraordinary performance of these Magnificent-7 companies took us by surprise.

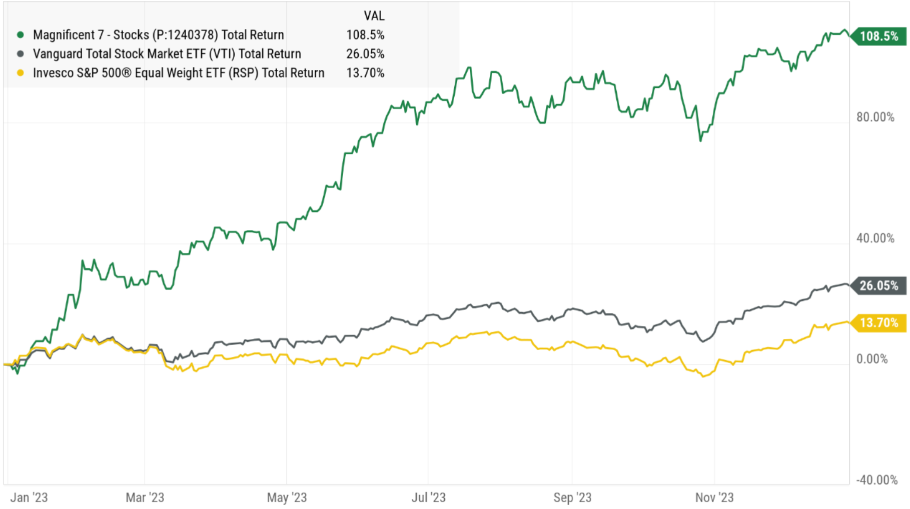

Chart 2: Reference Disclosure

Significant Reduction in Market Volatility:

Volatility in the US Stock Market, as indicated by the VIX Index, has reached its lowest point since the market crash caused by the Covid-19 pandemic in 2020. As we enter 2024, we anticipate a gradual rise in Stock Market volatility, moving closer to the long-term average of 20.

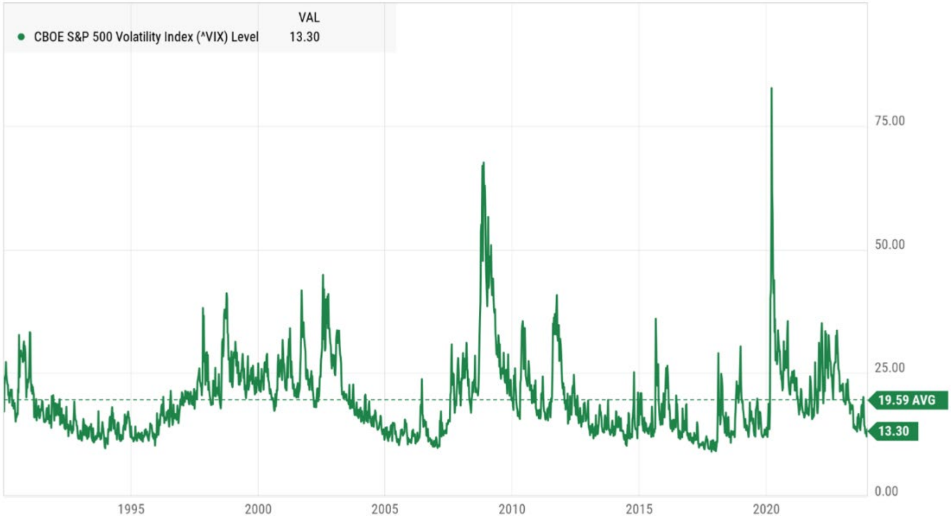

Chart 3: Reference Disclosure

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Rapid Rebound of the Stock Market:

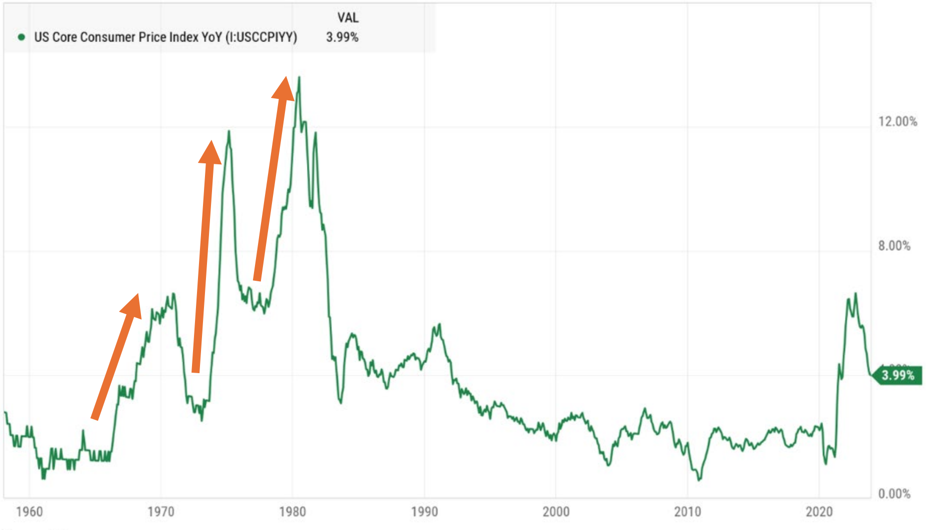
The "Bear Market" that commenced in January 2022 managed to fully recuperate those losses in just 2 years, which is less than half the time it took for the market to rebound in both 2000 and 2008. This remarkable recovery was driven by a combination of robust economic growth and increased investor confidence that the Fed will cut rates in 2024. Looking ahead, the future trajectory of the market will be influenced by various factors, including inflationary pressures, changes in interest rates, and global economic conditions.

Chart 4: Reference Disclosure

Inflation Continues to Remain High:

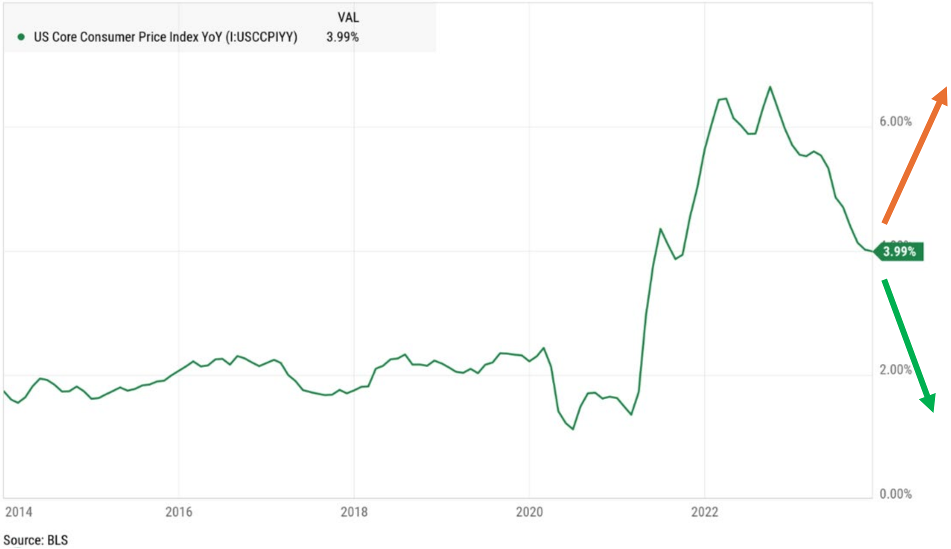
The US Core Inflation rate, currently standing at 4%, is twice the average of the past decade, exceeding the FED's target of 2%. In their statement on December 13th, the FED expressed confidence in the normalization of inflation towards the 2% mark, signaling a sense of accomplishment and highlighting the effectiveness of their monetary policies in maintaining price stability.

Controlling inflation can be challenging. It often follows a cycle: *Inflation Spike* leads to *Higher Wages*, which results in *More Spending*, leading to *Higher Prices*, and ultimately causing *More Inflation*. The last major period of inflation in the United States took two decades to finally bring under control, spanning from 1965 to 1985.



Source: BLS
Chart 5: Reference Disclosure

What lies ahead for inflation? Core inflation has reached a plateau in its downward trend, stubbornly hovering at 4%. We foresee that the path towards achieving a 2% target will prove more arduous than anticipated by the market.

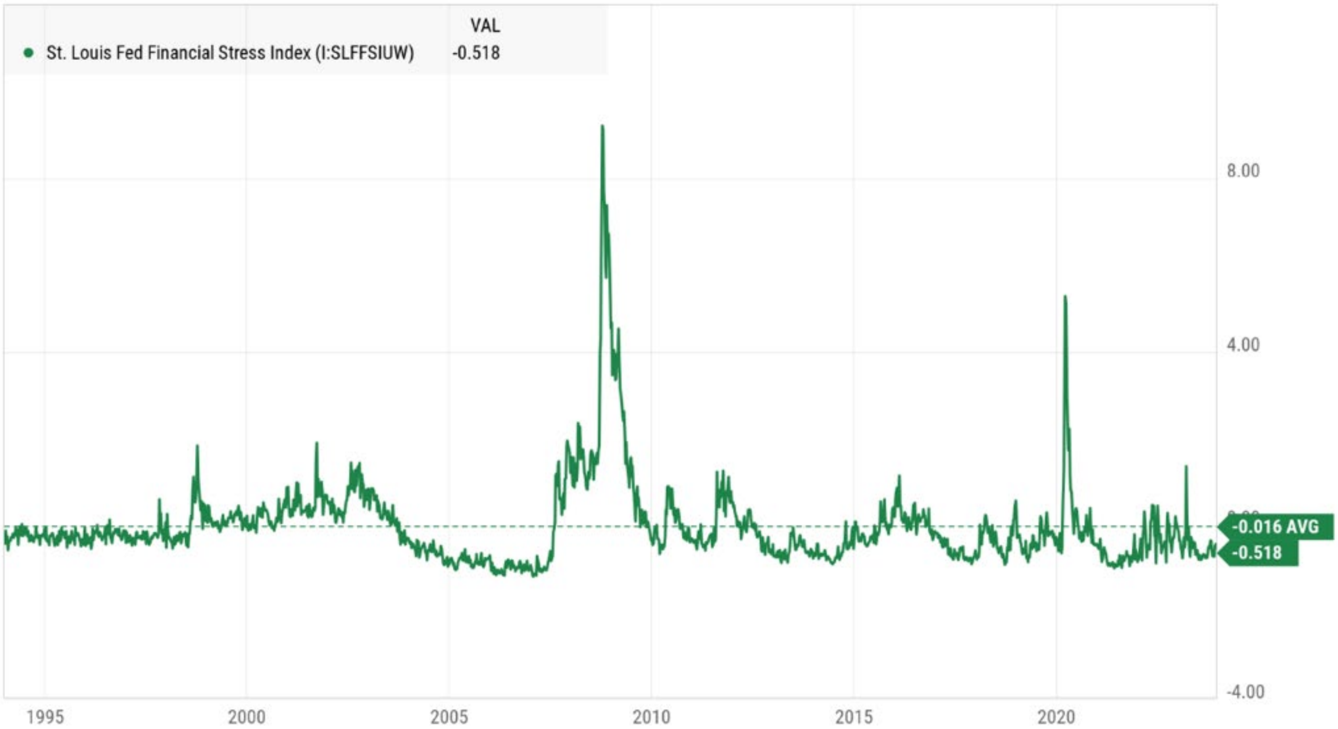


Source: BLS
Chart 6: Reference Disclosure

Easing Financial Conditions:

The current market is factoring in a scenario where interest rates continue to decline, unemployment remains low, and volatility stays minimal. This combination creates an environment where asset prices are expected to rise. However, it is important to note that asset prices are already high and above their usual trend, while core inflation persists at 4%.

The below chart of the Federal Reserve St. Louis Financial Stress Index is a measure of the degree of financial stress in the markets. A positive value of the index typically indicates that financial market conditions are more stressful than average while a negative value suggests less stress than average.



Source: Federal Reserve Bank of St. Louis

Chart 7: Reference Disclosure

US Housing Market Above Trend:

Before the Covid pandemic, the Average Annual Growth Rate of US Housing stood at +5.5%. Since 2020, that growth rate has surged to an average of +8.5%. According to the Long-Term Trend analysis, the Median US Home Price was projected to be $315,000. However, the current market conditions have surpassed this projection by an impressive +35%, with the median price reaching a staggering $431,000. This unexpected surge in home prices reflects the robust demand and limited supply in the housing market, thereby presenting both opportunities and challenges for buyers and sellers alike.

Average Annual Growth Rate	
1963 - 2019	5.5%
2020 - 2023	8.5%

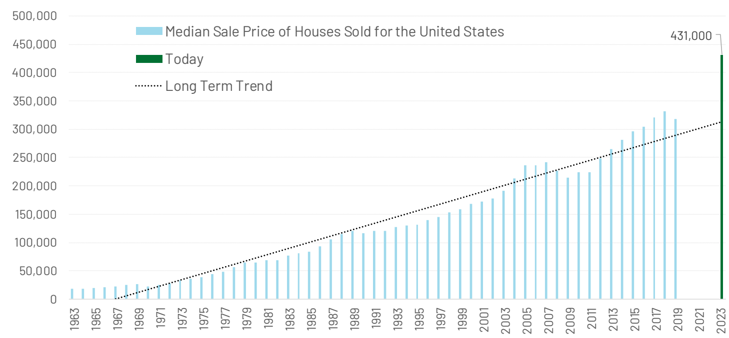


Chart 8: Reference Disclosure

Falling Interest Rates in Q4 2023:

Interest rates in the US have experienced a consistent decline this quarter, with the 10-Year Treasury Rate decreasing by 1%. As a result, the US Stock Market has responded positively, gaining an impressive 12% during this period.

This trend of easing financial conditions is expected to continue in the near future, as the Federal Reserve has committed to maintaining its accommodative monetary policy until employment and inflation targets are met. However, this raises concerns about potential asset bubbles and the implications of a sudden market correction.

Source: Federal Reserve
Chart 9: Reference Disclosure

A Strong US Economy?

The economy is experiencing rapid growth, with the GDP increasing by 4.9% last quarter and projected to reach 2.3% in Q4 2023. However, this robust economic expansion, coupled with low unemployment rates, poses challenges for reducing inflation. We believe that the current exceptionally low level of unemployment is unsustainable in effectively bringing inflation back to its target rate of 2%. Moreover, the labor market is exerting its influence by demanding higher wages and greater flexibility, showing little concern for job security or switching occupations.

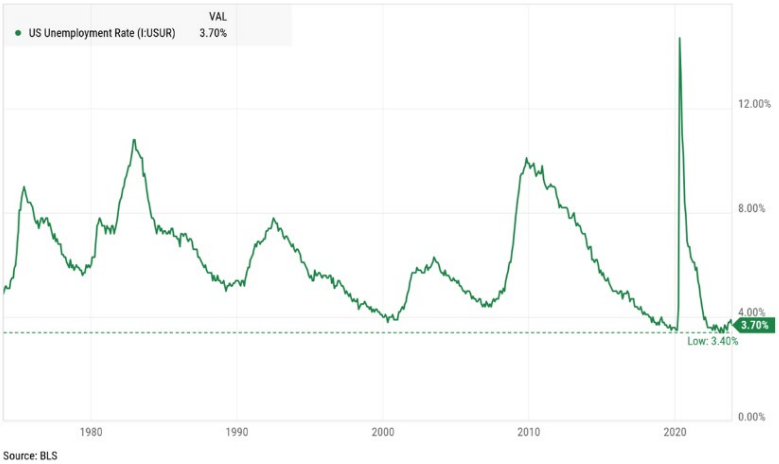


Chart 10: Reference Disclosure

The Million Dollar Question:

What lies ahead for interest rates? Let's examine the disparity between long-term interest rates and Core Inflation, comparing it to historical averages. To truly restore normalcy to the financial system following the "0% Interest Rate Experiment" that ensued after the 2008 Financial Crisis, we must either witness a decrease in inflation from 4% to 2% or a rise in long-term interest rates to approximately 6%. However, it is important to note that the latter contrasts with what we observed in Q4 2023.

The Federal Reserve's interest rate decisions will likely have a significant impact on the stock market and overall financial stability and uncertainty.

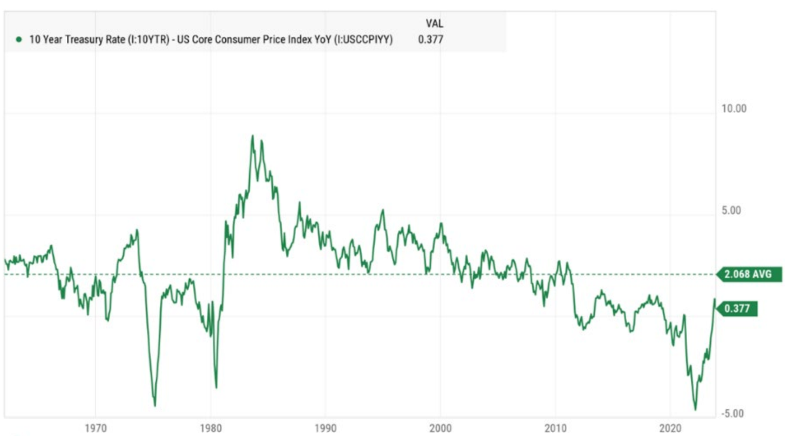


Chart 11: Reference Disclosure

Our Outlook for 2024:

As we look ahead to 2024, we anticipate that there will be increased uncertainty surrounding inflation and interest rates. This, in turn, is expected to result in heightened market volatility, potentially impacting various sectors and asset classes. Given these circumstances, it becomes imperative for us to closely monitor economic indicators and adapt our strategies accordingly to navigate the changing landscape effectively.

Equities: We recommend maintaining an underweight position until valuations align appropriately. Our preference is to opportunistically add risk in small to mid-cap stocks rather than large-cap stocks.

Bonds: High-grade corporate balance sheets are robust, and we expect spreads to tighten or remain tight. We recommend opportunistic additions to high-grade and high-yield credit positions when spreads widen.

Cash: With "risk-free" yields exceeding 5%, we will continue to deploy our cash reserves and add risk at more favorable entry points throughout 2024.

Liquid Real Assets: After profit-taking throughout 2023, we advise maintaining a core position in Gold.

Liquid Allocation: Balanced

Allocation	Target	Current
Equity	50%	44%
Bonds	45%	39%
Liquid Alternatives	5%	2%
Cash	0%	15%
	100%	100%

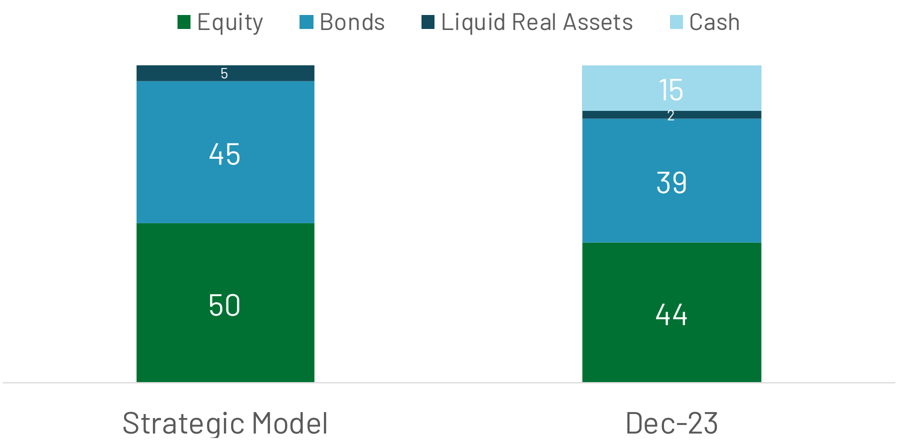


Chart 12: NEFG Balanced Portfolio vs Strategic Model

Disclosures

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Chart_1: *Ycharts.com*
US Stocks: [VTI], Vanguard Total Stock Market ETF
International Equity: EFA, iShares MSCI EAFE ETF
Aggregate Bond: AGG, iShares Core US Aggregate Bond ETF
Commodities: GSG, iShares S&P GSCI Commodity-Indexed Trust
NOTE: Stock Market and Commodities benchmarks were changed from 2022 commentary, from [{SPY ETF] and ^GNX Index] to a broader and more investible instruments [VTI ETF, GSG ETF]

Chart_2: *Ycharts.com*
Magnificent 7 Total Return
Vanguard Total Stock Market ETF (VTI) Total Return
Invesco S&P 500 Equal Weight (RSP) Total Return

Chart_3: *Ycharts.com*
CBOE S&P 500 Volatility Index (VIX)

Chart_4: *Ycharts.com*
S&P 500: ^SPX, S&P 500 Index

Chart_5,6: *Ycharts.com*
US Core Consumer Price Index YoY (I:USCCPIYY)

Chart_7,8:[*https://fred.stlouisfed.org/series/MSPUS*](https://fred.stlouisfed.org/series/MSPUS)
St. Louis Fed Financial Stress Index (I:SLFFSIUW)
Median Sales Price of Houses Sold for the United States (MSPUS)

Chart_9: *Ycharts.com*
Vanguard Total Stock Market (VTI)
10 Year Treasury Rate (I:10YTR)

Chart_10: *Ycharts.com*
US Unemployment Rate (I:USUR)

Chart_11: *Ycharts.com*
10 Year Treasury Rate (I:10YTR)
US Core Consumer Price Index YoY (I:USCCPIYY