J.P. Morgan Model Portfolios

Year-end Review

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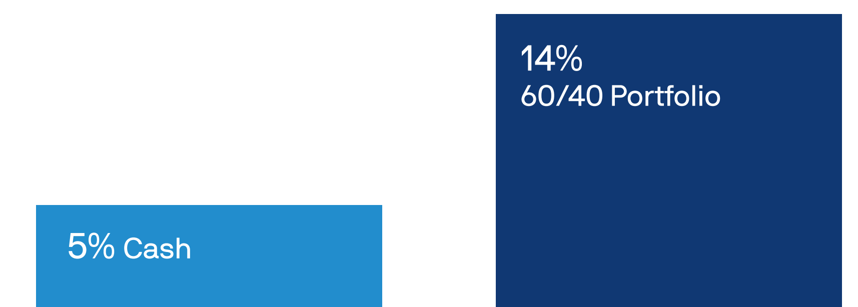
The 2023 Market Waltz: Dips, twists and lifts – oh my!

Much like a dancer approaching a dimly lit stage with uncertainty, we came into 2023 with elevated fears of a recession and low expectations for global growth. Broadly, the market expected growth headwinds from the fastest interest rate hiking cycle since the 1980s, elevated geopolitical conflict and a manufacturing recession in the eurozone given higher oil prices. Against this backdrop, investors were particularly attentive to additional headwinds posed by the regional banking crisis in March, emerging signs of consumer and credit deterioration and shrinking household excess savings. Yet the economy kept its rhythm and proved to be resilient – delivering a whopping 3.0% U.S. GDP print year-over-year in 3Q23, supported by the strength of the consumer and a healthy labor market, along with large fiscal stimulus. The delayed impact of monetary policy led to healthy equity market performance and improved market sentiment.

As the year unfolded, inflation gradually came down from 6.5% in January to 3.1% in November. Equity markets bounced to a near all-time high on the back of the largest mega-cap stocks, or the "Magnificent 7," which drove over 90% of the S&P 500's performance. The excitement around artificial intelligence and sustained healthy profit margins due to significant cost-cutting measures fueled the outperformance. Within fixed income, high yield corporate credit was one of the best-performing asset classes, as stable corporate balance sheets and supply pressures from a decline in new bond issuances kept the asset class buoyant. As near-term recession risks diminished, high yield bonds presented investors with higher coupons and less sensitivity to interest rate changes, allowing the asset class to outperform core fixed income.

Conflicting narratives on inflation kept interest rate volatility high, pushing bond yields toward a 20-year high. While cash generated a ~5% return and continued to be a tempting asset class, a traditional diversified 60% stock/40% bond portfolio (60/40 portfolio) delivered double-digit total returns last year. Events of the past year reinforce the importance of adopting a structured and diversified investment approach to navigate uncertainties in a complex investment landscape.

Cash underperformed a 60/40 portfolio in 2023



Source: Bloomberg. J.P. Morgan Asset Management.

Note: Performance shown is cumulative and based on daily returns through 12/14/23. The 60/40 Portfolio is comprised of 60% MSCI ACWI Index and 40% U.S. Aggregate Index. Cash is represented by the ICE BofA 3-Mo T-Bill Index.

Portfolio recap: Take it back now y'all

Throughout the year, elevated levels of uncertainty and two-sided risks, in the form of restrictive monetary policy and strong economic data, led us to remain active and favor diversification. Within our portfolios, we were defensive in 1H23 through a slight underweight to equities and an overweight to core fixed income as we monitored developments in monetary policy, inflation and economic growth. We repositioned our portfolios in 2H23 to get more constructive on growth, though we acknowledge that risks remain on the horizon.

1. Expressed quality bias through U.S. equities

Throughout the year, we maintained a preference for U.S. equities relative to international equities given the persistent strength of the U.S. economy. Our overweight to U.S. equities was supported by strong fundamentals, stable consumption trends and expected earnings growth. As the market rally broadened out, these factors supported the U.S. equity valuation premium relative to international equities.

- Leaning into quality companies with excess cash on hand softened the impact of elevated interest rates amid continued pressure on margins.
- At a global level, we were slightly underweight emerging markets and international developed equity allocations. We are monitoring for attractive entry points within these regions given their lower valuations.

2. Leaned into risk through credit

We maintained an overweight to core fixed income in 1H23 given yield-to-maturity levels close to 5%; then we reduced our position in 2H23 as we began to evaluate opportunities to add risk to the portfolios through extended credit, specifically corporate high yield and securitized debt. This provided our portfolios with diversified fixed income exposure at the high-quality end of the extended credit market.

- The additional pick-up in yield with a lower level of risk when compared to equities makes credit an attractive option, especially as recession odds are drawn out further.

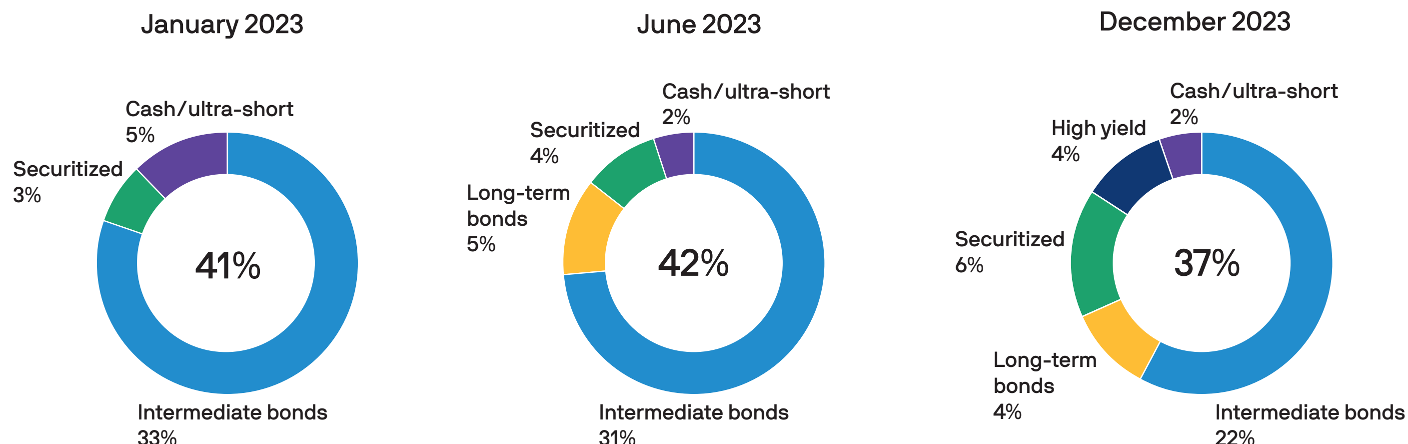
- The central bank's forecast indicates that we are at the end of the tightening cycle, leading the market to anticipate interest rate cuts. Such an environment should favor credit over core fixed income, giving way to risk assets such as equities and credit.

3. Flexible in our fixed income positioning

We initiated an overweight to duration at the beginning of 2023 as we anticipated a slowing economic growth environment. We evolved our fixed income positioning and sought to balance our long-term Treasuries allocation with credit, as mentioned above.

- Uncertainty in the face of a resilient U.S. economy increased fixed income market volatility, as U.S. 10-year Treasury yields rose from 3.88% at the beginning of 2023 to an October peak of ~4.99%.
- In response to evolving market conditions, we added to and then reduced our portfolio duration throughout the last year. As elevated interest rates continued to add pressure to the economy, we leaned into our active fixed income managers with expertise in selecting quality investments.

Active evolution of our fixed income exposure



Source: J.P. Morgan Asset Management. Allocation data ranges from 12/31/21 to 12/31/23. Allocations reflect a representative account and are shown for illustrative purposes only. Represents positions for the Moderate model. For illustrative purposes only. Should not be considered a recommendation to buy or sell a particular security or asset class. Depending on market conditions, allocation percentages and/or underlying funds are subject to change without notice.

Twirling into the new year

As we waltz into 2024, we believe the U.S. economy remains on stable footing even as bank lending growth stalls and the labor market stays afloat. Although we are more constructive on risk assets, we believe that markets are faced with many uncertainties, including upside potential from the equity multiple expansion once the Federal Reserve begins easing interest rates, while acknowledging that extended valuations pose downside risks if the economy falters. The market is pricing in good news — corporate earnings

growth for this year is priced at ~12% and the market is expecting ~+150bps of interest rate cuts. However, this story is contingent on labor market strength and disinflation; both continue to signal strength despite current restrictive monetary policy.

Attractive valuations opened pockets of opportunity across certain asset classes for investors who have remained in cash. Multi-asset portfolios offer a compelling long-term return within this environment: our 2024 Long-Term Capital Market Assumptions forecasts a 7.0% annualized return for a global 60/40 portfolio over the next 10-15 years — one of our highest forecasts in the last decade. In our outlook, every major asset class stands to outperform cash over this time period. Given this opportunity set, our portfolios remain active, diversified and nimble as global markets change the beat of the music.

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