Annual Equity Market Outlook

An Ameriprise Investment Research Group publication

Equity Research Team
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2024 Equity Outlook

The Sweet Sound of "Normal"

After a year that included a mini-banking crisis, wild swings in market-based interest rates, and the historic ascent of the *Magnificent 7** (and corresponding 'lost year' for others), we welcome the return of what we expect to be a more 'normal' market environment. However, while 'normal' may sound convincingly easy, markets will likely not take a linear path higher as there will likely be challenges (i.e., presidential election year, stubborn inflation, possible mild recession, etc.). In a declining inflationary environment with no further rate hikes and a gradual easing in long-term rates, our 2024 target for the S&P 500 is ~10% above current levels.

Furthermore, we believe focusing on some of 2023's laggard areas could provide an attractive risk/reward opportunity for investors. In particular, as inflation subsides and rates decline, bond proxy sectors could be well-positioned to outperform. These sectors also trade at below-average valuation multiples with above-average dividend yields. Similarly, dividend growth was out of favor in 2023 due to rapidly rising interest rates and the AI boom. However, dividend growth strategies often shine when market returns are more 'normal.' Finally, Quality stocks with an outsized reliance on recurring revenue or expectations for a rebound in 2024 earnings could prove attractive.

Targets for 2024

Key Measure	2023 Actual	2024 Target	Implied Change
U.S. Real GDP	+2.4%*	+1.5%	-0.9 ppt
S&P 500 Index**	4,719	5,200	+10.2%
10-year Treasury Yield**	3.91%	3.50%	-0.41%
Fed Funds Target	5.25% to 5.50%	4.50% to 4.75%	-0.75%

Source: *Ameriprise Global Asset Allocation Committee.*

** Estimated, 2023 Actual based on year-end values. ** as of 12/14/2023, Base Est.*

Key Takeaways

- The Ameriprise Global Asset Allocation Committee's 2024 year-end target for the S&P 500 reflects an increase of 10% from current levels.
- After several years of extremes, we anticipate a more normalized backdrop for stocks, including steadily declining inflation, the end of Fed rate hikes (even shifting to cuts by mid-year), and long-term interest rates edging lower.
- We anticipate the concentrated Tech-driven AI leadership theme of last year to broaden into some of the 'forgotten' areas of the market.

Recommendations

- Bond proxy sectors could offer an attractive investment opportunity amidst a more favorable interest rate backdrop.
- As interest rates subside and economic growth moderates, dividend growth should come back in favor after last year's underperformance.
- In a slower growth environment, look for Quality companies with recurring revenue and those expected to post an earnings rebound in 2024.

**Magnificent 7 includes Alphabet (GOOGL), Apple (AAPL), Amazon.com (AMZN), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA).*

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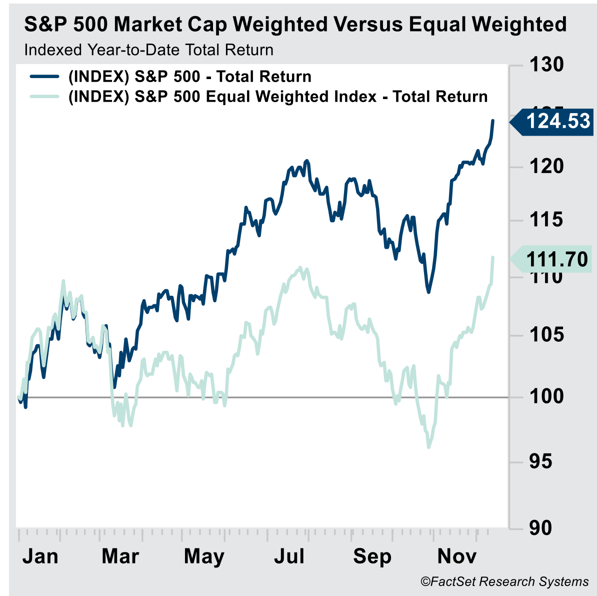
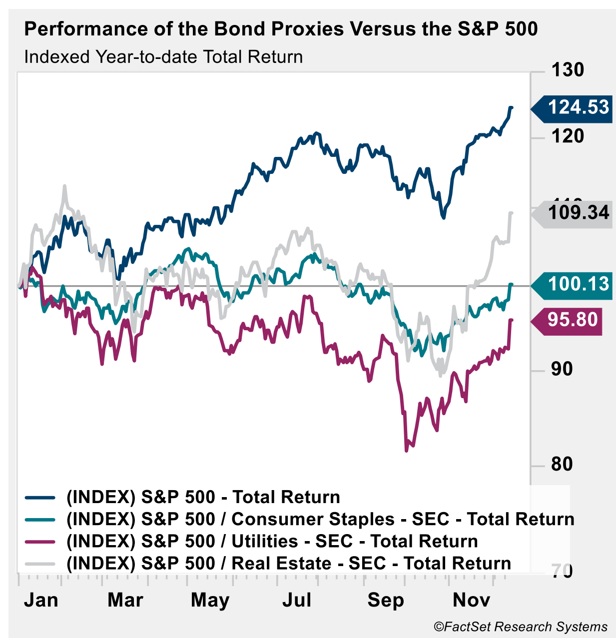
Theme: Panoramic View for 2024



One of the key market themes for 2023 was the seemingly relentless investor enthusiasm for anything related to artificial intelligence (AI) in large-cap Tech. But unlike many 'fads' in the investing world, AI-related companies experienced significant growth in revenue and earnings as customers across various end markets rushed to leverage the new technology. The result was an extremely narrow leadership for the S&P 500 in 2023, which was nothing short of eye-popping. Year-to-date through November, over 70% of the market's gain resulted from just seven companies (i.e., the 'Magnificent 7'). Another view of this disparity is to compare the S&P 500 Index with the S&P 500 Equal Weight Index (chart at right). For 2024, we anticipate the market's headwinds to recede (enter peak rates and a soft landing), thus benefiting a broader set of companies and sectors, resulting in a more panoramic market leadership theme. Does this mean the Magnificent 7 materially underperform the remaining 493 stocks in the S&P 500? Not necessarily. While the group of 7 is expected to generate strong earnings growth in 2024 (nearly 2x the S&P 500 EPS growth), we believe current valuation levels may already reflect much of this growth, thus less opportunity in the coming year to mimic the group's 2023 multiple expansion.

Bond Proxy Rebound?

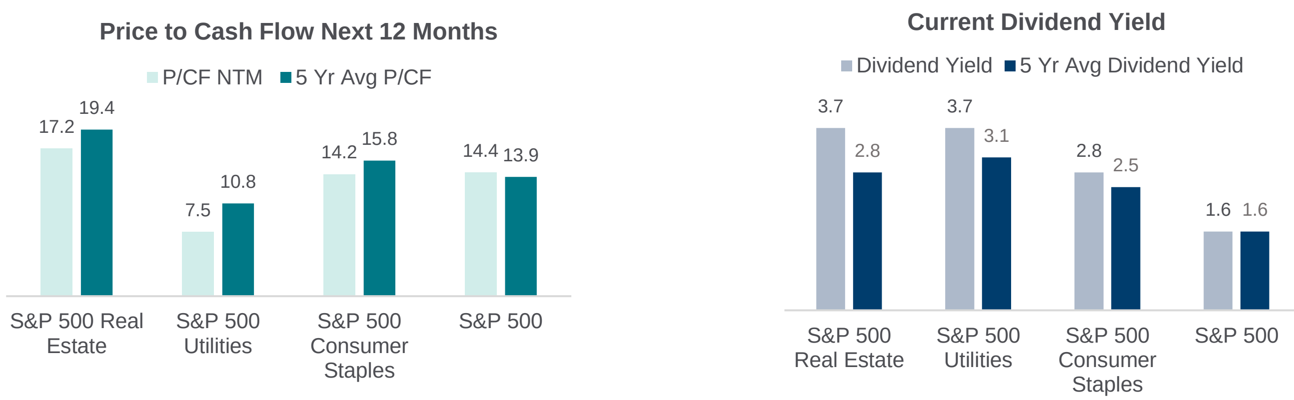


The term "bond proxy" likely conjures a perception of relative safety, predictable income streams, low volatility, and high dividends for equity investors. This is for a good reason, as bond proxy sectors (i.e., Utilities, Consumer Staples, and Real Estate) have long been considered market areas with more predictable end markets, competitive barriers to entry, and, often, regulatory support.

Although investing in bond proxy sectors may elicit expectations for safe and predictable returns, this was not the case for most of 2023. As the chart at right shows, a simple investment in the broad-based S&P 500 trounced the bond proxy sectors by anywhere from 17-30%. While hindsight is often 20/20, the delineating point for these "safe" sectors came when the 10-yr Treasury yield began its dizzying rally from 3.3% in March to 5% in mid-October, reflected in a 12% decline in bond prices. As such, so goes the price of bonds…so goes their proxies.

More recently, this trend of underperformance has started to reverse, with the bond proxy group posting returns more in line with the broad market and, in some cases (i.e., Real Estate), handily topping the broad market. We attribute the recent rebound to investor optimism that the Fed is done raising short-term rates and that long-term rates may have peaked. On the former, while Fed Chair Powell has not ruled out further rate hikes, recent commentary and three consecutive Fed meetings of leaving rates unchanged has helped support the "peak rate" thesis. On the retreat of long-term rates, we note the massive move this year (+170 basis points in the 10-yr yield beginning in April) has reversed since mid-October when the 10-year US Treasury topped 5%. More recently, the 10-year Treasury traded below 4%, what we would label as a steep drop (~100 basis points) in just a matter of weeks, thus benefiting bond proxy names. From a risk perspective, should our 'soft landing' scenario *not* play out in 2024, bond proxy sectors could also be a relative 'safe haven' should more growth-oriented segments of the market come under pressure. Finally, we believe attractive valuation levels and above-market dividend yields support broadening strength for the bond proxy sectors in 2024 (see charts on page 3).

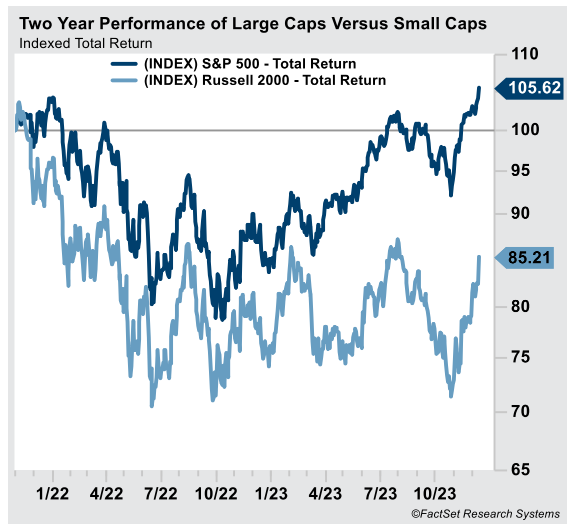
Comparison of the Bond Proxies' Valuation Metrics

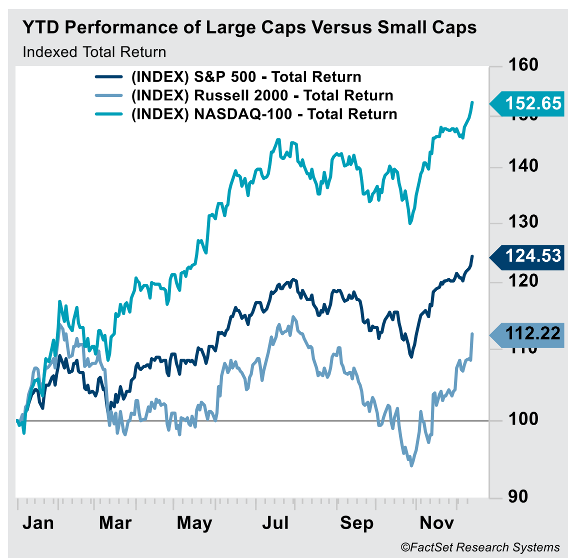


Source*: FactSet and American Enterprise Investment Services Inc. Data as of 12/12/2023, Note: Real Estate's P/CF reflects Price/FFO.*

Small Caps, Big Returns?

Another area of outsized underperformance in 2023 was the small-cap space. When compared to the S&P 500 (chart at right), the Russell 2000 Index at one point in late October was nearly 30% below its all-time high in November 2021 (fully meeting the definition of a 'bear market' and then some) versus the S&P 500 Index, down 8% over the same period (not even classified as a 'correction'). However, we note that the return differential accelerated following the regional banking crisis of early March 2023 (chart bottom right). In our view, the 2023 'mini regional banking crisis' exposed the significantly different sector allocations between various indices. In fact, while the S&P 500 has less than one-half of 1% exposure to Regional Banks (by market cap), this group makes up nearly 10% of the Russell 2000 Index. Since the banking crisis in early March through 12/12, Regional Banks have been in the proverbial 'penalty box' with the group down 19% versus the S&P 500 gains of 19%.





Attractive valuations in the small-cap space could also lend support to a broadening theme in 2024, potentially setting up an attractive entry point for long-term investors. With the downdraft in the prices of small-cap stocks, certain valuation metrics are at a significant discount versus historical levels and when compared to the S&P 500. For example, the trailing 12-month price/earnings (P/E) ratio for the Russell 2000 (excluding companies with losses) is 13x, a ~15% discount to the 5-year average of 15x. On a relative basis, the Russell 2000 P/E (ex. losses) currently trades at a 40% discount to the S&P 500 Index (13x vs 22x). Historically, a P/E spread this wide versus the S&P 500 has resulted in an attractive risk/reward opportunity in a diversified portfolio strategy.

Key Takeaway

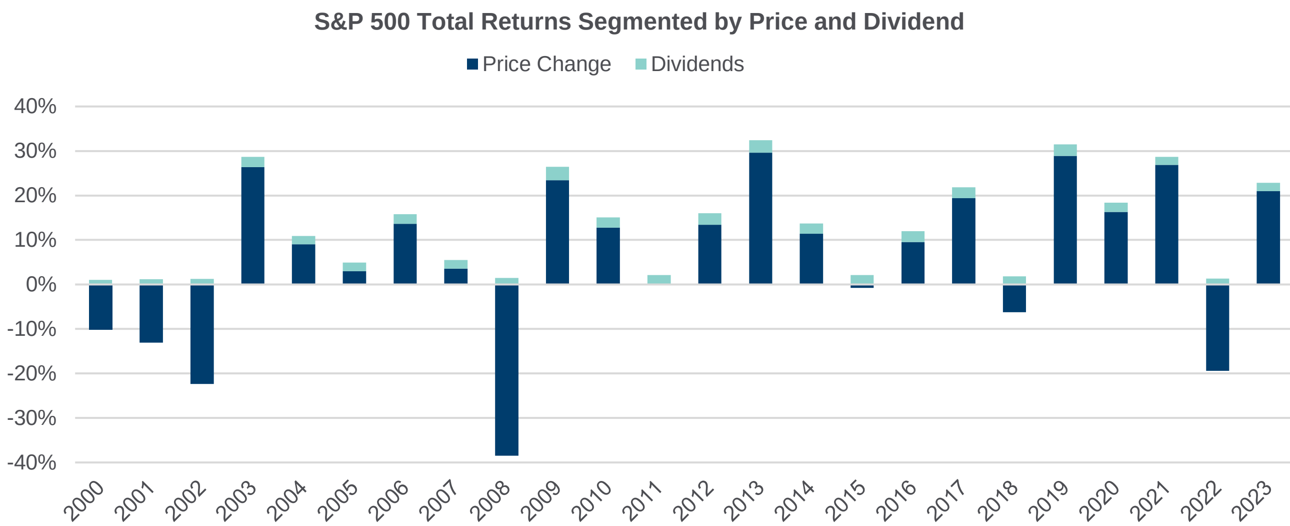
In a more 'normal' economic environment (i.e., no additional rate hikes, declining inflation, soft landing), we believe the narrow market leadership in 2023 can broaden to other market areas. Consider some of last year's laggards, such as bond proxy sectors with solid valuations and attractive dividend yields, as well as the small-cap space for potential outperformance in 2024.

Theme: Dividend Growth Means More in ‘24

In 2023, the Federal Reserve raised interest rates at an unprecedented pace, resulting in a 22-year high in the fed funds rate. Although we believe interest rates have peaked, we anticipate the aftershocks of the Fed’s tightening cycle to reverberate across the economy and equity markets in 2024. We expect elevated interest rates to create potential headwinds for companies and consumers. Increased debt servicing costs could reduce corporations’ capital expenditure (capex) plans and spur more disciplined consumer spending. With potentially slower spending as our base case scenario, we believe a “post-peak rate” environment could reinvigorate dividend growth as a solid defensive theme for 2024.

Dividend indices and strategies struggled in 2023 as cash investments offered an attractive risk-free opportunity. However, we believe the prospects of a Fed rate cut and lingering inflationary pressures could reinforce the benefits of dividend-paying stocks in 2024. Historically, when equity market returns are modest, dividends were a more meaningful contributor to full-year total returns. The chart below illustrates the S&P 500’s total return since 2000, segmenting the contribution of price appreciation and dividends.

Dividends Are Historically a Meaningful Contributor to Annual Total Returns

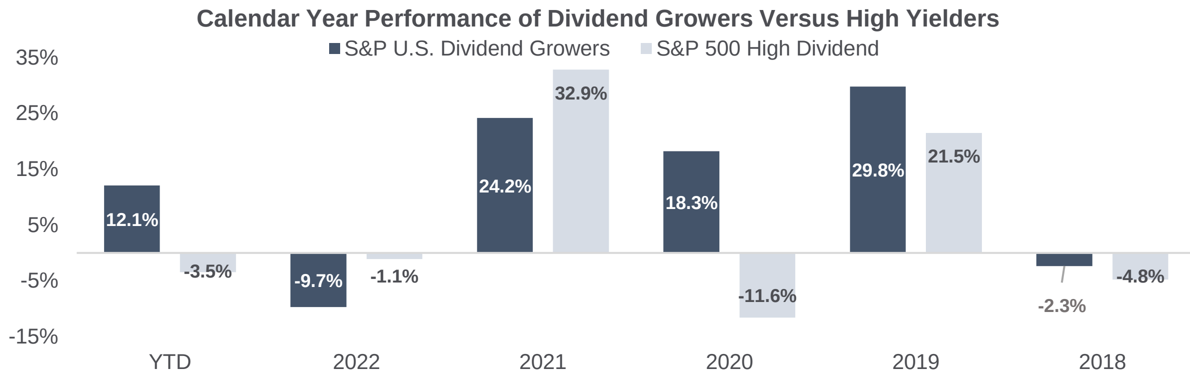


Source*: S&P Dow Jones Indices and American Enterprise Investment Services Inc. 2023 return is year-to-date as of 12/12/2023.*

Dividend Playbook: As the economy heads toward a “soft landing” and the equity market is potentially poised for a modest return, falling rates and rising dividend income streams could bode well for 2024 total returns.

1) **Dividend Growth versus Dividend Yield**: In our opinion, not all dividend-paying equities are the same. We recommend investors focus on dividend growth stocks, rather than searching for higher yields. The total return potential of higher-yielding stocks is often lower due to more limited price appreciation. Our Quality theme emphasizes resilient business models supported by recurring revenues, significant economies of scale, and solid free cash flow generation. In our view, companies with long track records of dividend growth often exhibit similar attributes. We advise avoiding higher-yielding stocks in 2024 as weaker balance sheets and negative free cash flow generation could result in potential “value traps” during more volatile periods.

In Recent Years Dividend Growers Have Outperformed High Yielders



Source: *S&P Dow Jones Indices and American Enterprise Investment Services Inc. 2023 return is year-to-date as of 12/12/2023.*

2) **Stay Diversified Across Sectors**: Slowing corporate profits, election year uncertainty, geopolitical tensions, and somewhat elevated valuations sit high atop investors' wall of worry heading into 2024. We believe the outsized YTD gains in The Magnificent 7 and the strength of the year-end rally could increase the risk of near-term profit-taking in early 2024. According to data from *S&P Dow Jones Indices* (S&P DJI), The Magnificent 7 accounted for nearly 72% of the S&P 500 Index's year-to-date total return through November. We believe investors could view potential pullbacks as opportunities to increase their exposure to dividend-growth sectors. Unlike bond proxies, dividend growers can be found in nearly every sector. Per S&P DJI, 408 issues, or almost 80% of the S&P 500 Index, paid a dividend at the end of November, and the year-to-date median increase was 7.1%. Although dividend growth is prevalent across the Index, we recommend that investors stay diversified to help mitigate risk. We also recommend investors use projected EPS growth rates as a starting point for assessing a sector's prospects for dividend raises in 2024. The table below highlights the current consensus estimates for S&P 500 sector y/y growth rates for earnings per share and dividends per share.

Dividend Growth Offers a Wide Moat for 2024

S&P 500 Sector	2023 Estimated One Year EPS Growth	2023 Estimated One Year Dividend Growth	2024 Estimated One Year EPS Growth	2024 Estimated One Year Dividend Growth
Communication Services	23.1%	0.9%	15.9%	7.3%
Consumer Discretionary	36.3%	1.2%	11.4%	7.0%
Consumer Staples	3.6%	1.5%	5.8%	5.6%
Energy	-26.5%	7.1%	3.0%	-4.8%
Financials	-0.6%	-8.2%	6.2%	9.0%
Health Care	-20.7%	6.4%	19.7%	5.4%
Industrials	11.1%	8.5%	11.5%	5.5%
Information Technology	5.0%	5.1%	16.7%	6.3%
Materials	-26.5%	7.1%	3.0%	-2.9%
Real Estate	-2.8%	-3.2%	3.1%	2.2%
Utilities	6.1%	5.2%	8.4%	6.0%
S&P 500	0.8%	5.0%	11.5%	5.1%

Source: *FactSet and American Enterprise Investment Services Inc. Data as of 12/12/2023.*

Although not every sector is projected to increase dividends in 2024, a majority (at least eight of the 11 S&P sectors) are projected to grow their dividends above the S&P 500's forecasted growth rate of 5%. We screened the Equity Recommended List for selections projected to grow their dividends faster than the S&P 500. The table on page 7 lists the current dividend yields and the forecasted one-year dividend growth rate.

Theme: Recurring Revenue & Earnings Rebound Under the Quality Umbrella

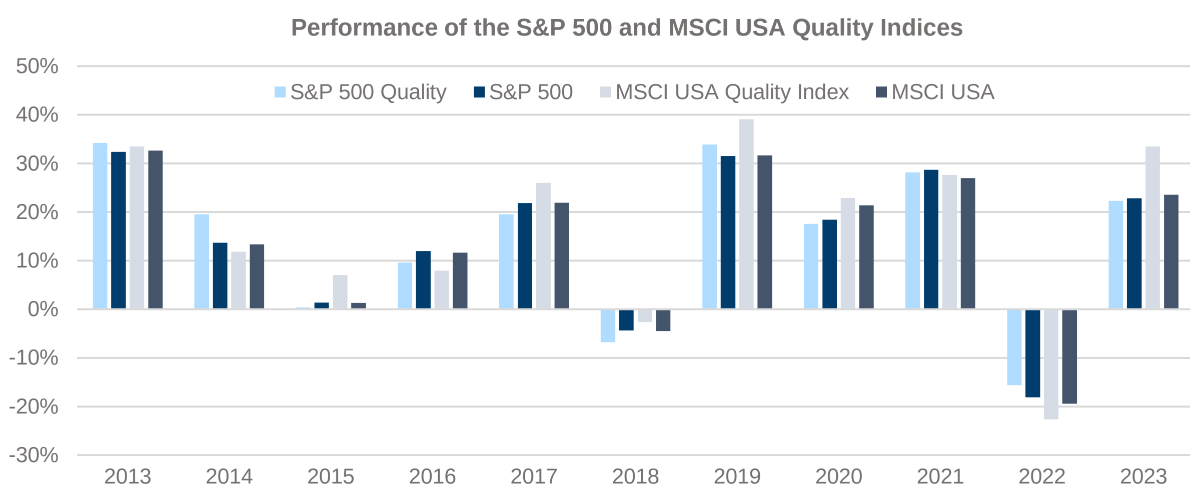
Following a bifurcated 2023 equity market dominated by mega-cap technology, we believe an improved backdrop for US corporations in 2024 could drive more broad-based earnings growth. Specifically, despite ongoing recession concerns, FactSet projections point to nearly 12% S&P 500 earnings growth next year, powered by an 18.2% spike in growth in 4Q'24. This fourth-quarter breakout aligns with our view that as temporary headwinds from inflation and supply chain distortions fully normalize, many Quality companies could be poised to exhibit renewed margin consistency and earnings growth. In our view, the anticipated earnings trajectory highlights a steady build toward a more ubiquitous recovery next year. With inflation receding from 40-year highs and the Fed likely ending its rate hike cycle, we believe investors should focus on high-quality companies with resilient business models that can thrive in the transitioning economic landscape.

The Umbrella of Quality: A solid body of academic research and our internal analysis suggest that high quality stocks outperform their lower quality peers and the broad market over time. We define Quality stocks as those with high profitability, stable earnings, and low balance sheet debt. Quality was a solid performer in 2023, with the iShares MSCI USA Quality Index up 33.5% versus the S&P 500 Index +22.9% (year-to-date through 12/12/2023). While this outperformance was aided by the 44% exposure to the Technology sector (the best-performing sector in 2023), we believe Quality can be a solid performer in 2024.

In a slower growth environment, Quality stocks could hold up well due to their strong profitability and stable earnings. In addition, while we expect a moderation in interest rates in 2024 as inflation subsides, this could play out slower than expected, creating a choppy environment for economic growth and the equity market. Finally, heightened geopolitical risk raises the uncertainty factor in 2024. Potential sources of instability include the U.S. presidential election, the Israel-Hamas war, the Russia-Ukraine war, and ongoing US tensions with China and multiple countries. These issues can create economic uncertainty and heightened stock market volatility, and we believe Quality stocks can help provide at least a partial hedge against these events should they develop.

Under the Quality umbrella, two key themes could provide solid stock opportunities in 2024: **Recurring Revenue** and an **Earnings Rebound**.

Quality is a Long-Term All-Weather Factor

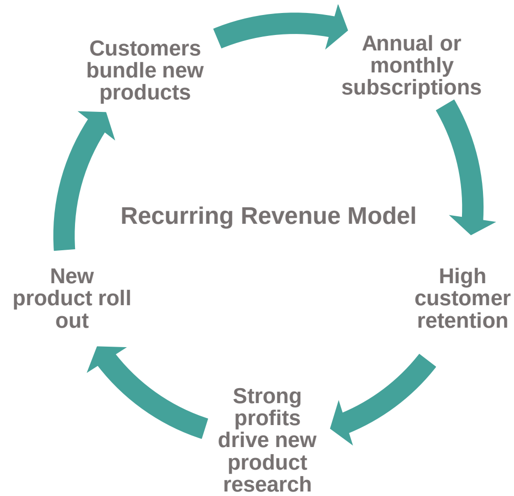


Source*: S&P Dow Jones Indices, MSCI, Bloomberg, and American Enterprise Investment Services Inc. 2023 is YTD as of 12/12/2023.*

Recurring Revenue: Companies with subscription-based or recurring revenue business models can generate relatively predictable growth and financial stability even during a slower economic expansion. Attributes like strong profitability, high barriers to competitive entry, scalability, and modest capital requirements provide recurring revenue providers an edge across market environments.

Historically, when market volatility spikes, quality companies with recurring revenue have outperformed as their reliable cash flows offer stability amid turbulence. Examples of industries with recurring revenue include software, retail membership services, cloud computing, digital media, and consumer internet platforms. By continually monetizing existing customers, these companies create durable and recession-resistant revenue streams. Additionally, the scalability of these models leads to margin expansion over time, enabling reinvestment in innovation and customer retention – a virtuous cycle of growth. For 2024, we believe a more normal and, thus, less bifurcated stock market (versus 2023) bodes well for Quality companies leveraged to a recurring revenue business model.

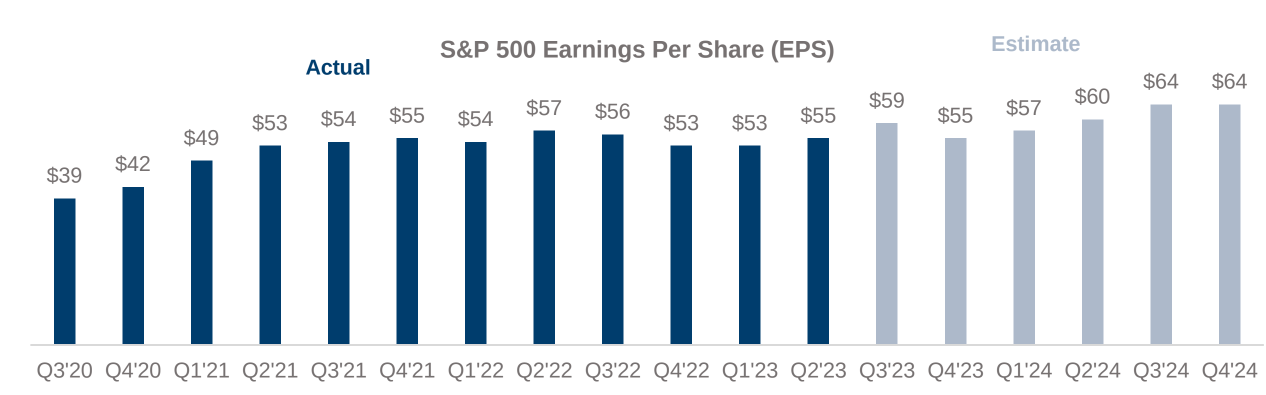
Recurring Revenue Flywheel



Earnings Rebound: The unprecedented economic and market shocks of the past few years caused significant, albeit temporary, earnings instability across the entire economy, even among many high-quality companies. With consistency a cornerstone of quality, some companies fell out of favor despite maintaining leadership in other areas like competitive positioning and profitability. However, as the economic backdrop is expected to normalize after multiple years of significant distortion, we believe many of these firms are primed to display a resurgence in earnings power. As a result, we believe certain stocks are well-positioned to reestablish their quality designation as multi-year earnings consistency trends resume.

Specifically, we believe significant EPS upside exists in 2024 from firms across sectors that faced acute situational headwinds but retained fundamentally rigorous business models. As stability returns, the market could re-rate these stocks in line with premium quality valuations, given their requalified status. This compounds the earnings-driven appreciation potential. The unwinding of temporary economic challenges combined with the enduring competitive strength of these businesses could drive a quality reversion. Identifying stocks poised to reexhibit earnings stability could present an attractive risk/return scenario as they potentially rejoin the quality ranks.

S&P 500 EPS Growth Expected to Rebound in 2024



Source*: FactSet and American Enterprise Investment Services Inc. Data of 12/07/2023.*

Key Takeaway

We believe Quality stocks could outperform again in 2024. Within Quality, we see two themes that could drive outperformance: Recurring Revenue and Rebounding Earnings. In an uncertain economic outlook, stocks with high recurring revenue provide greater earnings predictability and potentially premium valuation, in our view. In addition, we believe companies delivering above-market EPS growth (in an environment where growth is scarce) could also deliver solid returns.

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Investments in a narrowly focused sector may exhibit higher volatility than investments with broader objectives and is subject to market risk and economic risk.

Product risk disclosures

American Depository Receipts (ADR) are securities issued by a U.S. bank that typically represent a foreign company's equity and that trade similarly to domestic equities, and are either listed on an exchange or over-the-counter. As with any equity investment, ADRs are subject to market and company specific risks. ADRs will also be subjected to foreign market risks. These risks include possible losses due to foreign currency translation, geopolitical instability, and deviations in the market value of an ADR compared to that of the underlying common shares in its primary market. ADRs may suffer from a lack of investor protection and recourse. In the event of a liquidation of the underlying company, the holders of its ADRs are not guaranteed of being able to enforce their right of claim and therefore they may lose their entire investment. Investors of ADRs may also take on risks associated with the parties involved with the sponsoring Bank.

Growth securities, at times, may not perform as well as value securities or the stock market in general and may be out of favor with investors.

International investing involves increased risk and volatility due to political and economic instability, currency fluctuations, and differences in financial reporting and accounting standards and oversight. Risks are particularly significant in emerging markets.

Master Limited Partnerships (MLPs) concentrate investments in the natural resource sector and are subject to the risks of energy prices and demand and the volatility of commodity investments. Damage to facilities and infrastructure of MLPs may significantly affect the value of an investment and may incur environmental costs and liabilities due to the nature of their business. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment.

In addition to risks which generally pertain to equity investments, including market volatility and the potential loss of principal, investors in **MLPs** should be aware of additional risks including commodity (energy) price and demand volatility; regulatory changes; taxation changes at the company level or the investor level; and accidents and associated environmental impacts. **MLPs** are concentrated in energy-related investments, and thus, would be expected to react to macro risks impacting the sector. Additionally, please be sure to consult with a tax expert to help assess your unique situation and constraints when it comes to taxation.

In addition to risks which generally pertain to equity investments, including market volatility and the potential loss of principal, investors in REITs should be aware that risks include real estate specific uncertainties such as interest rate/refinancing risk, property value changes, and management skill. Overall economic conditions can impact property values and cash flows, which in turn may negatively impact share prices.

Investors should consider the investment objectives, risks, charges, and expenses of a real estate investment trust **(REIT)** carefully before investing. As risk tolerance or other needs of an investor change, you may take appropriate action such as changing your reinvestments through the REIT's Distribution Reinvestment Program (DRIP) to cash, to the extent available. The prospectus contains this and other important information about the REIT and should be read carefully before investing.
Real Estate Risks - An investment in a REIT is subject to many of the same risks as a direct investment in real estate. Initially, a REIT will not own specific properties, such that an investor cannot assess the actual real estate holdings prior to investing. Some of the properties held by REITs may be subject to balloon payments, refinancing or bankruptcy. REITs also may use leverage that may accelerate the velocity of potential losses.

Limits on Distributions - Distributions are not guaranteed and may be suspended or halted. Distributions may exceed operating cash flow, resulting in return of principal.

Tax Consequences - Distributions for REITs are taxed as ordinary income, not at the capital gains rate, unless the distribution is return of capital.

High Fees - Fees for REITs may be expensive. Investors should consider the extent to which their fees are covered by distribution and share price appreciation.

Diversification Limits - While investing in a REIT may help diversify your portfolio, putting all your real estate investments in one REIT may result in under diversification. While diversification can help protect against certain investment risks, it does not assure a profit or protect against loss.

Prior performance of similar REIT investments from the sponsor or affiliates of the sponsor does not guarantee similar performance for the REIT Investment. Prior liquidity events or total return performance of prior programs, of similar REIT investments of the sponsor or affiliates of the sponsor, does not ensure that a REIT will meet the same timeframe or have similar performance.

Liquidity and Valuation risks - Lack of a public trading market creates Illiquidity and valuation complexities. Non-traded real estate investment trusts (non-traded REITs) are long- term, illiquid investments and are only suited for clients with long-term investment goals of at least 7-10 years. There can be no assurance that a secondary market for a non-traded REIT will exist. During the offering period nontraded REITs are sold at $10 a share; subsequent estimates of the non-traded REIT's value may be less.

Early Redemption Restrictions - Early redemption is often restricted or may be terminated and should not be relied on as an emergency exit strategy. Early redemption may be expensive, resulting in a lower price than the purchase price.

Like real estate, REITs are subject, but not limited to illiquidity, valuation and financing complexities, taxes, default, bankruptcy and other economic, political, or regulatory occurrences.

The products of **technology companies** may be subject to severe competition and rapid obsolescence, and their stocks may be subject to greater price fluctuations.

Generally, **large-cap** companies are more mature and have limited growth potential compared to smaller companies. In addition, large companies may not be able to adapt as easily to changing market conditions, potentially resulting in lower overall performance compared to the broader securities markets during different market cycles.

Investments in **small- and mid-capitalization companies** involve greater risks and volatility than investments in larger, more established companies.

Value securities may be unprofitable if the market fails to recognize their intrinsic worth or the portfolio manager misgauged that worth.

Index definitions

An index is a statistical composite that is not managed. It is not possible to invest directly in an index.

Definitions of individual indices mentioned in this report are available on our website at ameriprise.com/legal/disclosures/ in **the Additional Ameriprise research disclosures** section, or through your Ameriprise financial advisor.

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