WHAT'S GOING ON WITH ASSETS IN 2024?

By Kelly Fitzpatrick

For three years now, it's been difficult to say whether the glass is half empty, half full, or just there. In early 2021, we saw inflation start to rise significantly while the Federal Reserve assured us it was "transitory," leading to a massive disconnect between the world economists were describing and the world the rest of us were living in.

As rate hikes started, real GDP shrank, signaling a possible recession (two quarters of shrinking GDP in 2022). And yet, the National Bureau for Economic Research hasn't applied that label. According to Advyzon Investment Management Chief Investment Officer Brian Huckstep, the juxtaposition between nominal GDP (which increased in 2022) and real GDP is driving that reluctance.

In 2023, investments bounced back despite ongoing rate hikes, and at the close of the year, most people—investors and experts alike—expected rate cuts in 2024.

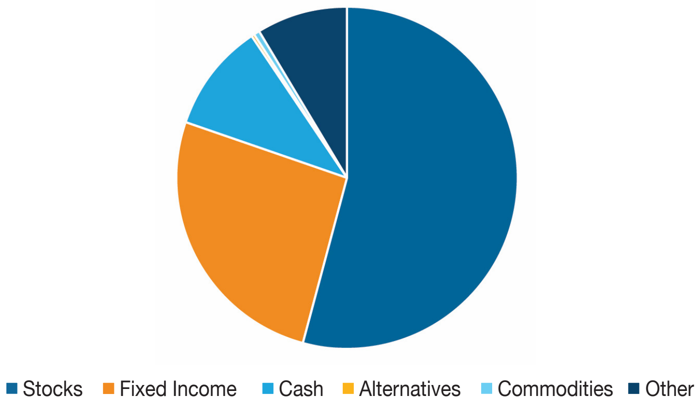
Now, halfway through 2024, surveys show the average American is discouraged about the economy despite the stock market hitting all-time highs. (The Dow crossed 40,000 in May.) The economy is growing less than expected, inflation is proving itself to be stickier than anticipated, and the jobs market—while strong—may be showing signs of weakness based on the May jobs report.

So, how are advisors allocating client assets amidst the ongoing confusion and mixed signals? According to Advyzon data, which looks at the more than 1,200 firms who use Advyzon for portfolio reporting, trends that started in 2022 extended through the end of 2023. For instance, advisors increased their allocation to alternatives, reduced their cash holdings, and shifted away from international fixed income.

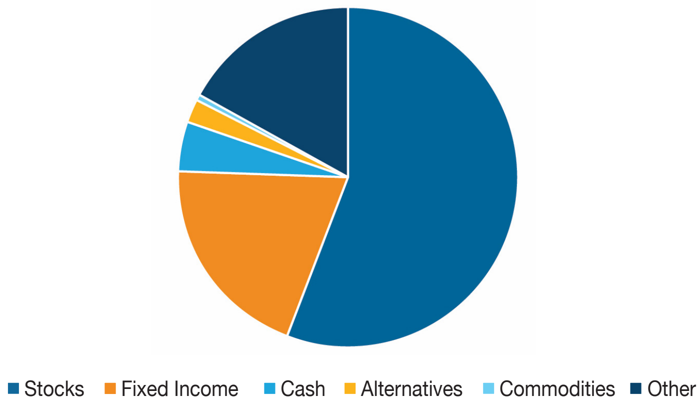
Perhaps most notable, however, is that advisors officially (according to us) shifted to an ETF mindset. While ETFs first dethroned mutual funds in 2022, by the end of 2023, ETFs significantly expanded their lead as the preferred investment vehicle.

Over the next few pages, we'll break down how advisors shifted their thinking about equities, fixed income, cash, alts and more, while sharing market analysis and economic context. But before we dive in, let's look at how overall allocations have shifted between the end of 2019 (pre-pandemic) and the end of 2023.

Allocation at the end of 2019



Allocation at the end of 2023



Note: *The term "advisors," in the context of this research, refers to the advisory firms who use Advyzon for portfolio reporting.*

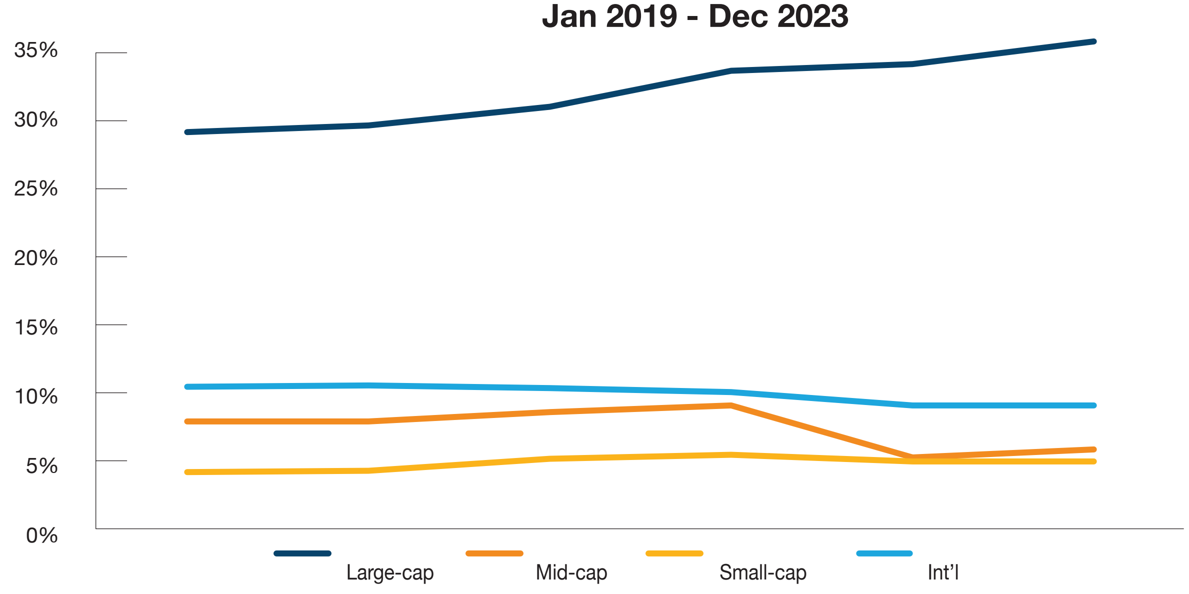
EQUITIES

Unsurprisingly, stocks continue to form the bulk of advisor allocations—though we're far from the 60% allocation we saw in 2021. Still, we saw the same factors driving equity performance in 2023 as in 2021, namely interest rates and inflation.

Following a period of volatility between January and October, stocks closed higher in 2023. As you may recall, December was marked by falling inflation, a drop in energy prices, and the Federal Reserve signaling rate cuts ahead in 2024. It's no wonder investor sentiment skewed toward optimism under those circumstances.

While the equity allocation at the end of 2023 (55.89%) was higher than at the end of 2022 (53.65%), that growth may come down to improved performance last year. Remember, the S&P lost value in 2022.

The evolution of equity: Jan 2019 - Dec 2023



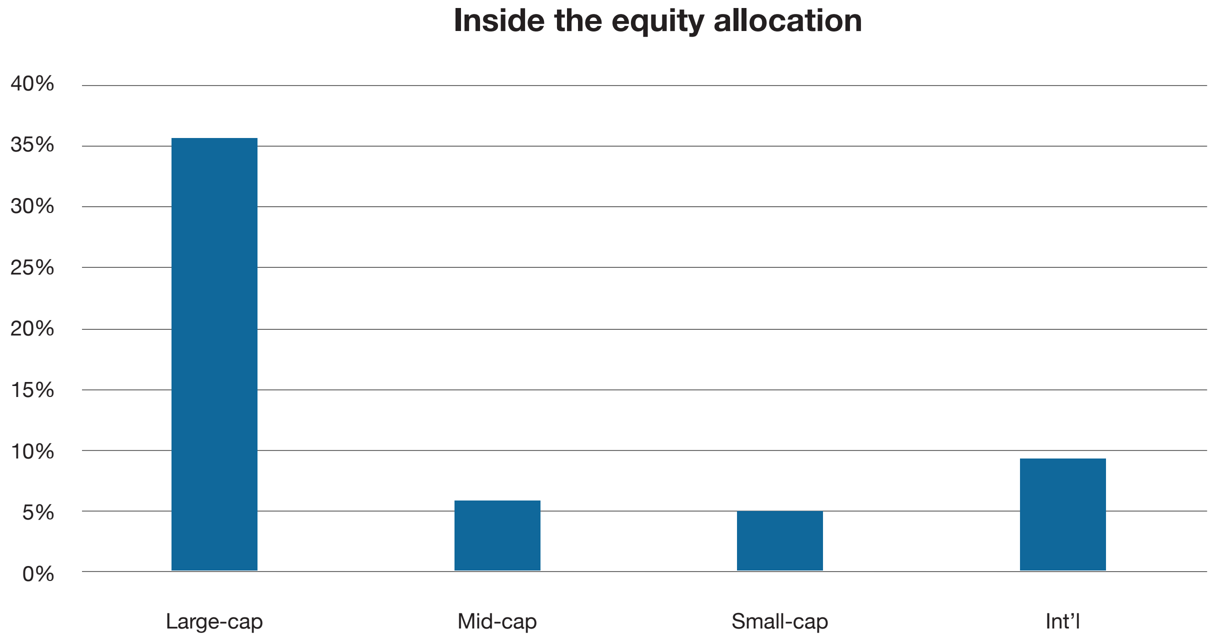
In terms of how advisors are allocating their dollars among various types of equities, large-cap stocks retained their title as most popular. The increase in allocations to large-cap (and mega-cap) stocks may be tied to performance. At the end of 2023, Advisors had just under 36% allocated to large caps, versus roughly 29% at the start of 2019.

According to Huckstep, many investors may have sought out mega-cap stocks, in particular, after fleeing the bond market. “Some investors are becoming disenchanted with poor bond performance and are electing to move into equities,” he notes. He adds: “When that happens, they may replace those bonds with equities they perceive as safe. Mega-cap U.S. stocks fit the bill as they typically have diversified business models, large cash reserves to cushion challenging periods, and easy access to capital markets.”

For small-cap stocks, we saw allocations fall at the end of 2022, a trend that continued through the end of 2023. Advisors had 4.95% allocated to small caps at the close of last year, up from 4.9% at the close of 2022. Advyzon data shows firms tend to allocate 4-6% to small-cap stocks historically.

While small caps were in line with historical averages, mid caps saw more of a swing over the past few years. At the end of 2021, advisors had 9% allocated to mid-cap stocks. In 2022, that allocation shrank to 5.2%. That number increased slightly by the end of 2023—5.8%. It’s likely these shifts in allocations were driven by performance.

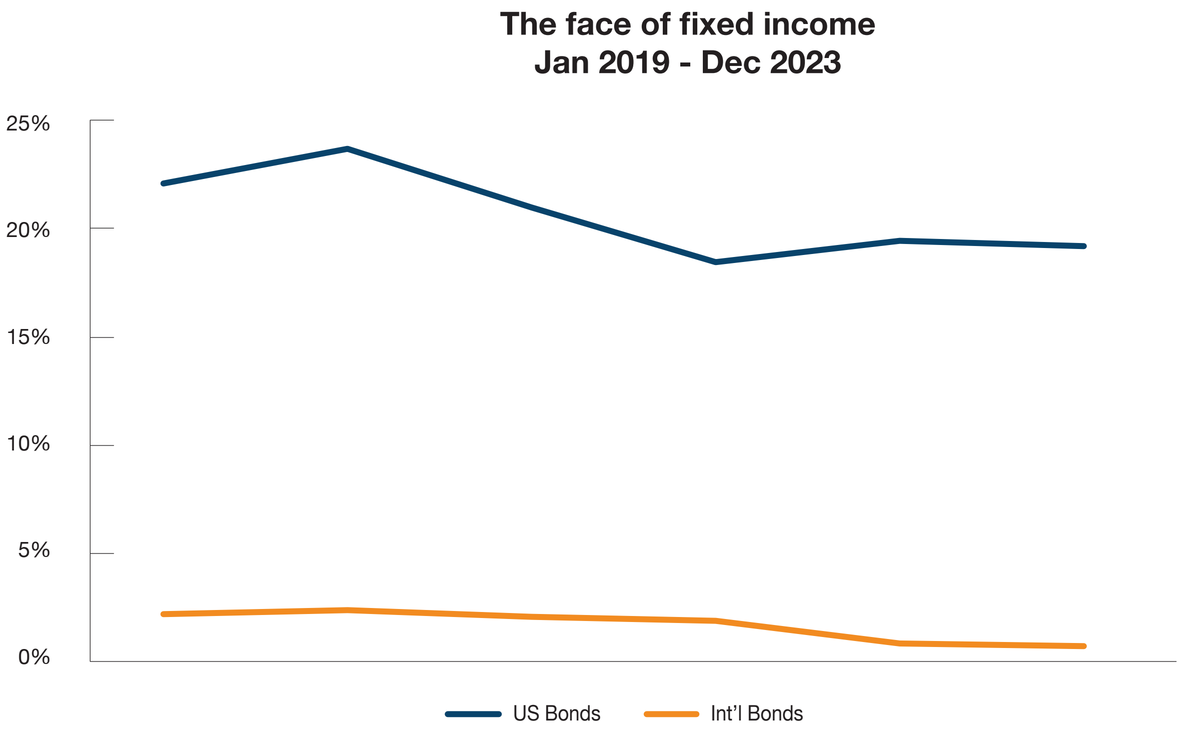
The allocation to international stocks stayed consistent through the end of last year; advisors have historically held around 9% of their equities outside of the U.S.



FIXED INCOME

For years, advisors have kept their fixed income allocation constant between 20-25% of client assets. Between 2021 and 2022, we saw a drop of just 0.04% in bond allocations. In 2023, however, the bond market experienced a truly turbulent year of ups and downs, though it did end on a high note after a November and December rally. With such drastic swings from month to month, it's no shock that fixed income allocation dropped slightly below average to 19.9%.

"There was a 36-year bull market for bonds between May 1984 and August 2020, as rates on the 10-year Treasury Bond slowly dropped 14.0% to 0.5%," says Huckstep. "Investors enjoyed continual price appreciation for their fixed coupon bonds on top of high coupon payments during this period." That unprecedented run ended after the Fed transitioned out of the "crisis-mode" brought on by the Great Recession and COVID and began raising rates back toward normal levels. "Since then, bond holders have suffered deleterious price declines that have caused many investors to question the role of fixed coupon bonds in their portfolios," Huckstep notes.



In terms of what types of bonds firms are investing in, 2023 resembled 2022. At the close of both, firms had less than 1% of client money invested in international bonds—0.82% and 0.70%, respectively.

This relatively small allocation to international bonds is a newer phenomenon. Prior to 2021, Advisors kept closer to 2% allocated to international debt markets. That number started to fall (to 1.88%) by the end of 2021. (Notably, this shift coincides with increasing U.S. inflation.)

While this doesn't appear to be a dramatic shift in the context of overall portfolio allocation, it does show a potential shift in the way advisors are thinking about fixed income.

CASH AND COMMODITIES

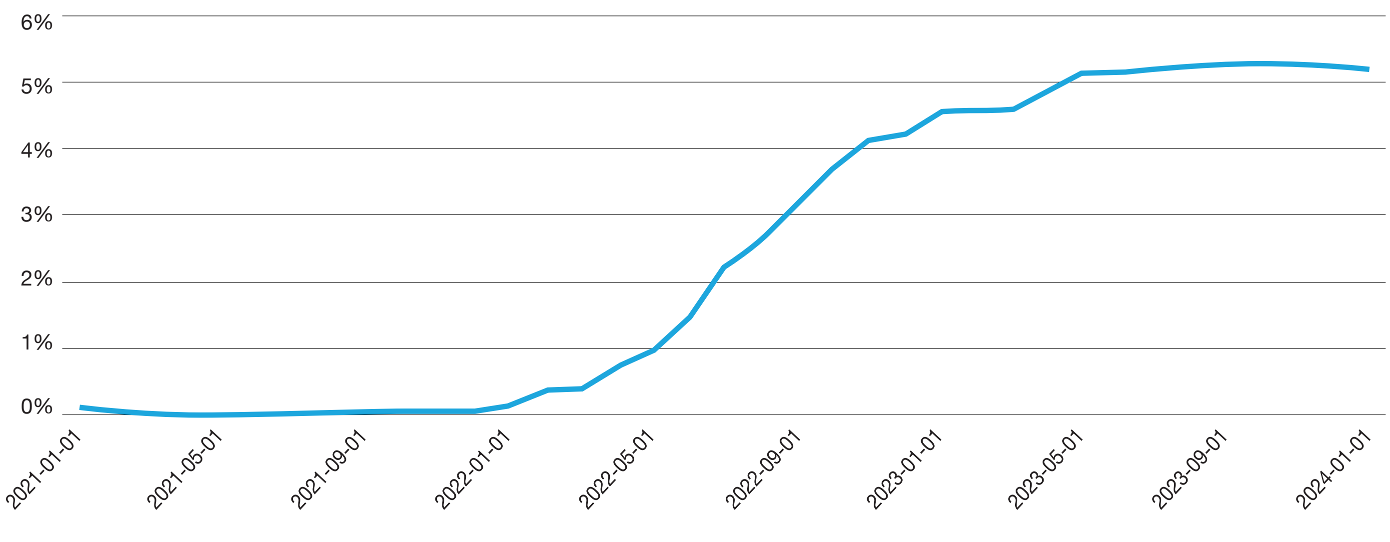
The most dramatic shift visible at the end of 2023 may have been the move away from cash. When we first started looking at the investment data of Advyzon firms, cash allocations topped 10%. In 2021, that number fell to 9.5% which makes sense, given increasing fears about inflation. In 2022, however, the number fell to 6.7% before falling again last year to 4.6% by the end of 2023.

This is, of course, notable for two reasons. First, a shift away from cash indicates concerns about inflation. However, in 2022 yields on short-term debt (often used in cash-equivalent accounts) began creeping up. By the time the Federal Reserve started hiking rates in March 2022, the yield on secondary-market Treasury bills was already starting to tick up. By the end of 2023, that yield topped 5%. In other words, advisors who reduced client cash allocations may have missed an opportunity to capture some of the short-term yield in cash equivalent accounts.

According to Huckstep, this may be down to the Fed forecast. “The end of year expectation in 2023 was that the Fed would lower rates six times in 2024,” Huckstep says. “That may have prompted some investors to preemptively exit cash and very short-term bonds to seek better returns in longer-dated bonds or other investments.”

3-month Treasury bills

Secondary market rate, discount basis

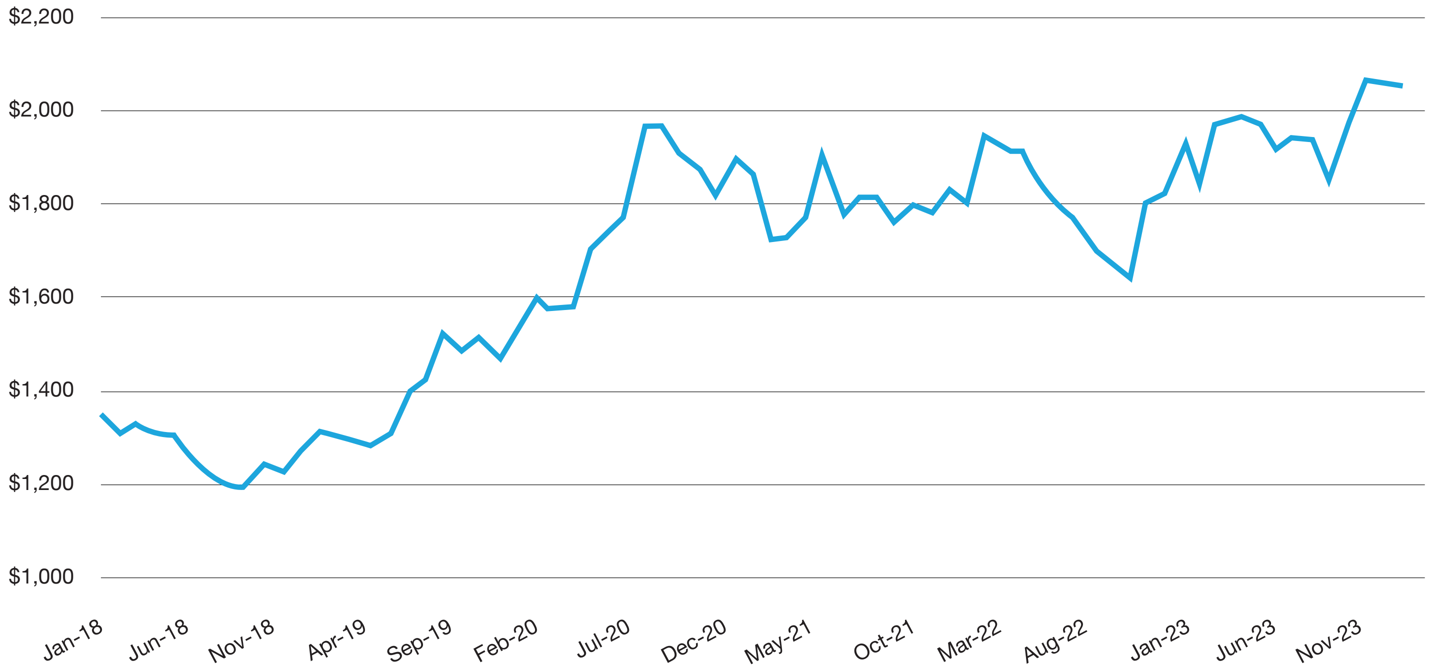


Source: St. Louis Federal Reserve

(We should note, however, that cash equivalent accounts and short-term fixed income products can be categorized several ways within Advyzon, depending on user preference. It's possible that firms did seize the day on higher short-term yields but documented the allocation as something other than cash.)

Interestingly, commodity allocations haven't shifted much during the past few years of higher inflation. At the end of 2023, advisors had 0.45% allocated to commodities, slightly less than the 0.57% they had allocated at the end of 2023. As far as performance went, commodities were a mixed bag. Grain prices fell significantly in 2023, for example, while gold prices hit record highs.

Gold prices:
January 2018-December 2023



Source: COMEX via Yahoo Finance

ALTERNATIVES AND OTHER INVESTMENTS

In 2022, we saw a distinct jump in advisor allocations to alternatives and “other” investments. This, along with a shift away from mutual funds and toward ETFs, was one of the most notable shifts going into 2023. By the end of 2023, however, not much had changed.

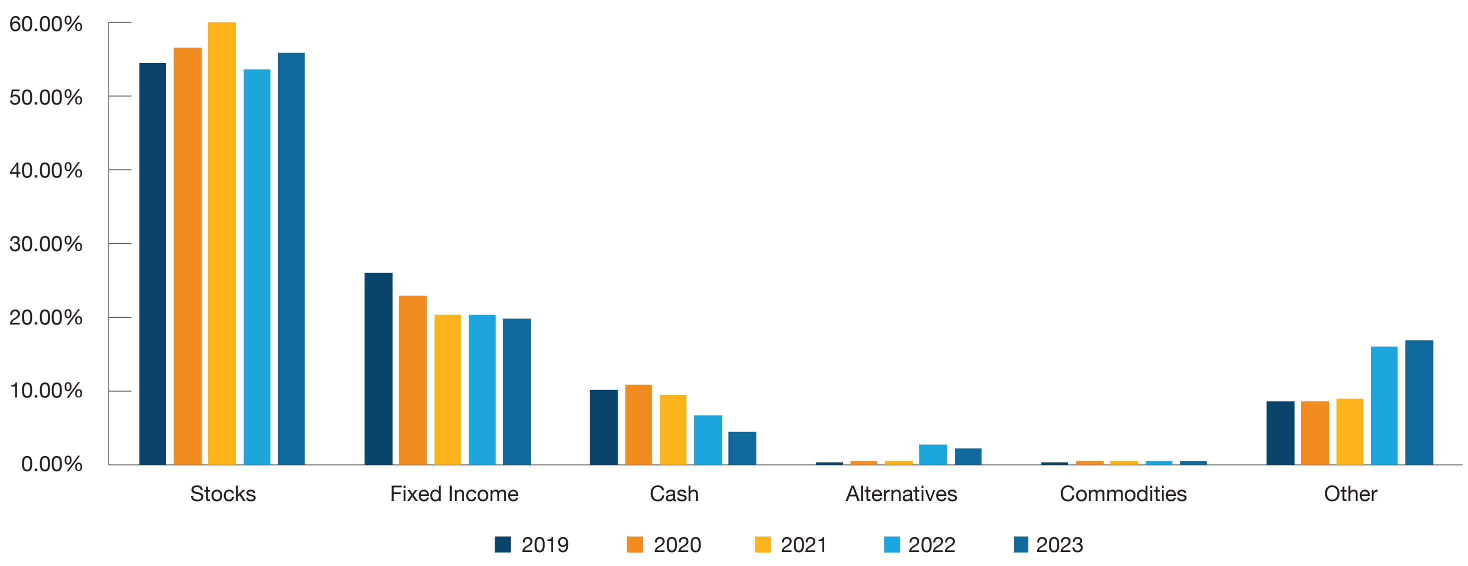
Advisors had 2.3% allocated to alternative investments at the close of 2023, down from 2.7% at the end of 2022. This is still significantly higher than the less than 1% advisors allocated to alts prior to 2022.

Alternatives, like cash, can be classified in myriad ways beyond a simple “alternative” label. It’s one reason we like to look at alt allocations alongside what advisors mark as “other” (which includes unclassified investments).

(For this study, the definition of “alternatives” aligns with Morningstar classifications and tends to refer to liquid alts—think managed futures, long-short equities, and option-driven funds.)

With a wide number of factors at play, it’s hard to draw any single conclusion from the growing allocation to alts and “other” investments. However, it does seem like advisors focused on diversification in 2023, a trend likely to continue as mixed economic conditions persist in 2024.

Advisor Allocations at Year End



ETFS REIGN SUPREME

We're calling it, officially: ETFs are the reining favorite for advisors when it comes to investment vehicles. After (finally) topping mutual funds at the end of 2022, ETFs extended their lead through 2023. By the end of the year, advisors had nearly 30% allocated via ETFs. At the same time, allocation to mutual funds dropped to just under 22%.

Huckstep flagged a few popular trends that likely spurred more advisors to pivot to ETFs.

"The SEC's approval of the first cryptocurrency ETFs prompted a handful of the advisors we work with to add crypto allocations to their Model Portfolios," Huckstep says, before noting that not all custodians allow cryptocurrency ETFs on their platforms. "Check with your custodian first if you want to add these products to your portfolios."

"We also saw a handful of clients add 'buffer ETFs' to their Model Portfolios," he adds. If you aren't sure what a buffer ETF is, Huckstep describes them as an ETF "designed to truncate downside risk, often by giving up return." These buffer ETFs are replacing the structured notes that used to fill this role in client portfolios, since they're simpler to use and accessible to smaller accounts.

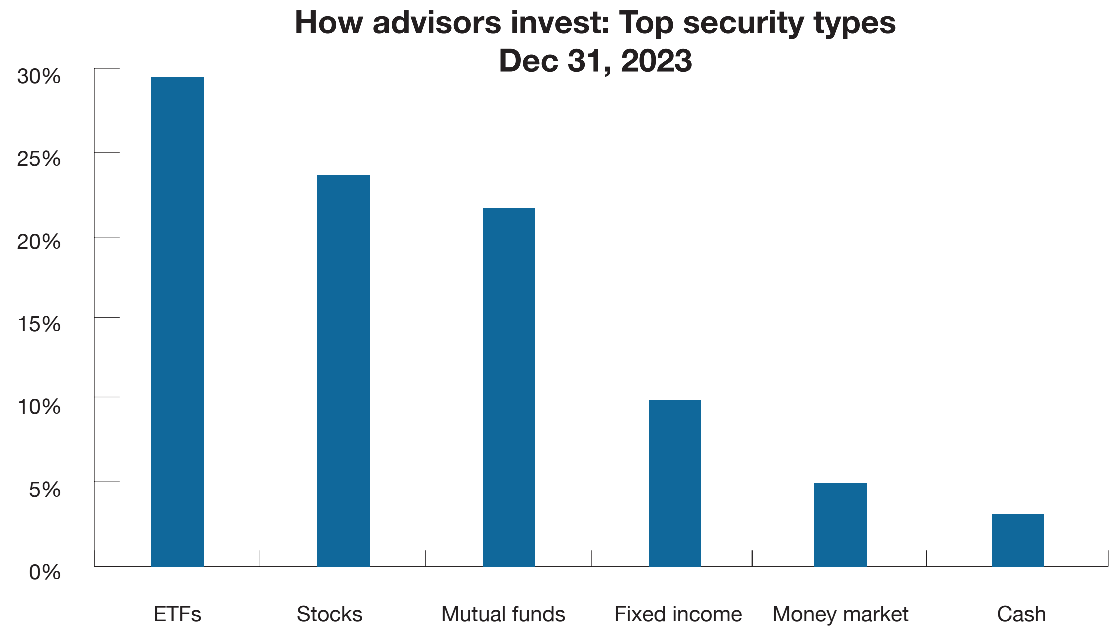
"Check with your custodian first if you want to add [cryptocurrency ETFs] to your portfolios."

While the drop is significant, it's not altogether surprising, given the lower fees and potential tax advantages that are generally associated with ETFs. However, discerning advisors may want to go a layer deeper before defaulting to passively managed ETFs.

2023 did see a rebound in the value of equity assets, though this could be down to improved performance in 2023 compared to 2022. At the end of 2021, advisors had 23.5% invested directly in equities, compared to 22.4% at the end of 2022 and 23.7% at the close of last year.

Bonds saw the opposite. At the end of 2021, advisors had just 4.9% of client money directly invested in fixed income. At the close of 2022, that number nearly doubled (possibly as a safety play in response to stock prices) to 8.9%. At the end of 2023, advisors had just over 10% of client assets directly invested in fixed income.

Here's a look at how advisor assets broke down across investment vehicles at the end of 2023.



TOP HOLDINGS

Finally, let's go one layer deeper to see top investments at the individual security level. Perhaps not surprisingly, mega-caps (and retail client favorites) Apple and Microsoft have topped the list for several years running. At the end of 2023, Advyzon advisors had roughly $3.7 billion invested across Apple and Microsoft.

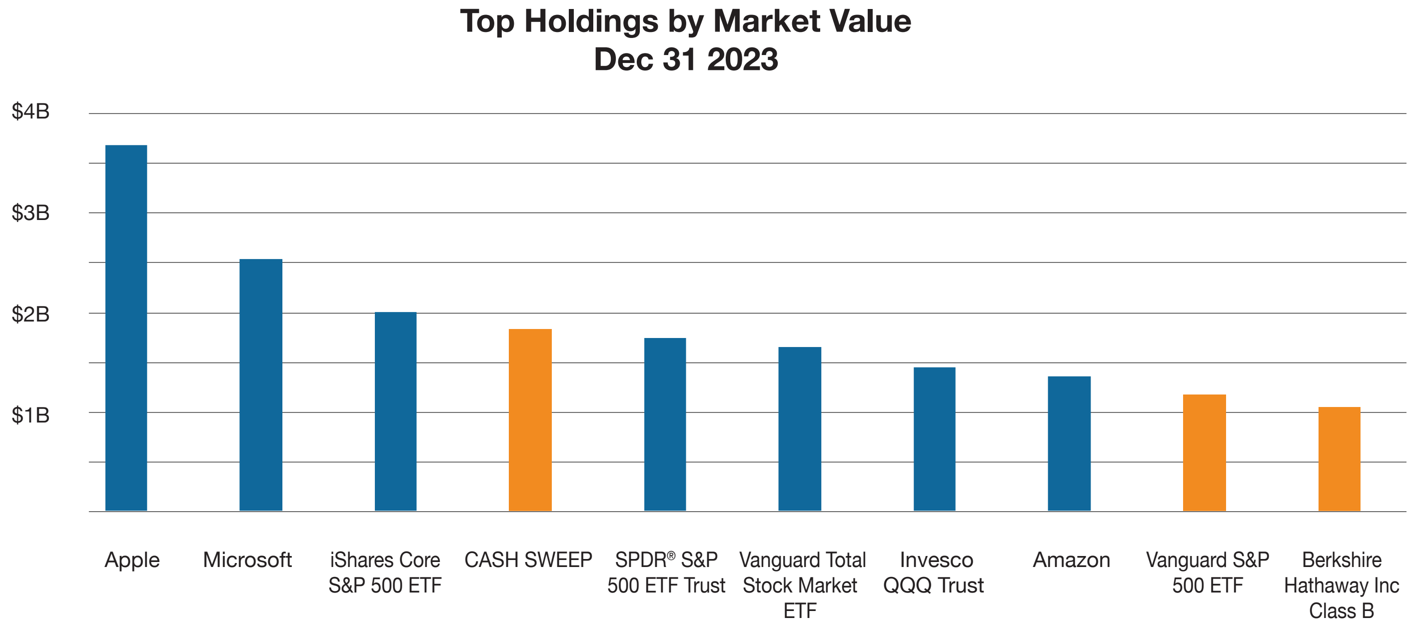
We did see a slight shift in terms of advisor preference around Index ETFs.

Beyond that, however, our top holdings look different than years past. In 2022, for example, Vanguard's Total Stock Market ETF (ticker: VTI) rose the ranks, leapfrogging over SPDR's S&P 500® ETF (ticker: SPY). Now, the number three spot goes to iShares Core S&P 500 ETF (ticker: IVV).

According to Huckstep, this comes down to price. "The ETFs that have been rising in popularity are the lower priced ones," says Huckstep. "Vanguard's VTI and iShares' IVV both have an annual expense ratio of 0.03% while SPDR's SPY is doing its best to hold on to its outdated high price tag of 0.09%."

Of course, skeptics might add that SPDR's SPY may have kept investors on board despite lower-fee alternatives due to tax considerations. Since SPY is the oldest passive-index ETF, debuting in 1993, investors who have held shares in taxable accounts for as many as 30 years may be reluctant to switch since doing so would likely incur significant capital gains taxes.

Additionally, we saw cash sweep accounts move into the number four spot, despite an overall reduction in cash allocations in 2023. This is also the first time we've seen Warren Buffett's Berkshire Hathaway make the list, in the form of baby B shares.



TRENDS WE'RE WATCHING

The S&P 500 outperformed even our optimistic predictions in 2023. Huckstep predicted returns between 5 and 15% in 2023; the S&P 500 closed more than 26% higher for the year.

In 2024, we're looking at anywhere from a 5% loss to a 5% gain for the index, with a lot riding on what happens next with the Federal Reserve. (At the end of 2023, investors predicted rate cuts throughout the year; however, stubborn inflation and a strong labor market mean we might not see multiple rate cuts after all.)

Beyond the central bank, we're also watching equity valuations. The question to ask yourself when picking investments remains: Does the current price, which may be as much as 20% higher than last year, still reflect underlying value, or is it a result of sentiment and enthusiasm?

When you dig deeper into PE and other fundamentals, some market segments look less attractive in 2024.

We're also looking at:

CORPORATE DEBT:
A significant amount of corporate debt is being rolled over with higher, fixed coupon rates. The companies making these interest payments could see margins tighten, which might affect profitability, earnings, and ultimately, share prices.

YIELD CURVE:
For the past several years, the yield curve has been either flat or inverted. Since financial firms make their money based on a traditional yield curve, this ongoing inversion has impacted bank stocks. If and when we see the Fed begin cutting rates, watch for a possible bounce in bank stocks.

POLITICS AS USUAL:
We're heading into a presidential election at the end of 2024, and while the occupant of the Oval Office doesn't seem to have too much of an impact on markets and the economy long term (from a statistical perspective), that doesn't mean we won't see short term market movement tied to politics.

"It's natural for investors to look for a connection between who wins the White House and which way stocks will go. But regardless of who wins, nearly a century of returns shows that stocks have trended upward," said Kaitlin Hendrix, Asset Allocation Research Director at Dimensional Fund Advisors.

With that in mind, advisors may want to be proactive about keeping their clients focused on the long term this year. As Hendrix put it, "Stocks have rewarded disciplined investors for decades, through both Democratic and Republican presidencies, as shareholders are investing in companies, which focus on serving their customers and growing their businesses, regardless of who is in the White House."

If, after reading this in-depth analysis, you decide you'd rather not allocate any more of your brainpower to portfolio management, Advyzon Investment Management (AIM) is available to help. AIM offers an array of support services, from trade-only management using advisor models to the Nucleus Model Marketplace and all the way up to a full-service TAMP.

If you'd like help managing your investments, set up a short (free!) demo to see how AIM can help.

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