INVESTMENT COMMENTARY

December 2023

2023 – Fourth-Quarter Rally Lifts Stocks & Bonds

"The biggest risk and the most important news story of the next 10 years will be something nobody is talking about today."– Morgan Housel

Asset Class Snapshot	12/31/23
Asset Class	2023 Return
U.S. Large Cap (Russell 1000)	26.53%
U.S. Small Cap (Russell 2000)	16.93%
International Developed (MSCI EAFE)	18.85%
Emerging Markets (MSCI EM)	10.27%
Taxable Bonds (Bloomberg Aggregate)	5.53%
Municipal Bonds (Bloomberg Muni Aggregate)	6.40%

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The past year rewarded both stock and bond investors alike as the global economy continued to expand in the wake of higher interest rates. At this time last year, most economists were predicting a recession at some point in 2023 as central banks around the world confronted inflation head on – using interest rates as their weapon of choice. In addition to elevated inflation and higher interest rates, the past year saw a tremendous amount of stress on the banking system, a near-miss with the U.S. debt ceiling, along with plenty of geopolitical turmoil. Against the odds, both the economy and markets remained resilient. Meanwhile, inflationary pressures subsided, and corporate earnings held strong. Today, all measures of inflation are substantially lower than they were a year ago, and instead of further rate hikes, central banks now are contemplating rate cuts in the year ahead.

All told, a globally diversified 60% equity (MSCI ACWI Index) / 40% bond (Bloomberg Global Aggregate) portfolio returned more than 15% for investors in 2023.

Stocks – S&P 500 Approaches All-Time High

Equity investors were handsomely rewarded over the past year after suffering through a difficult 2022. The S&P 500 posted a total return of 26.29% for 2023, as large cap growth stocks in the U.S. staged an impressive rally. Growth outperformed value across the board domestically, with the most pronounced dispersion in large caps where the Russell 1000 Growth returned more than 42% compared to the Russell 1000 Value, which gained about 11.5%. Small cap stocks experienced a tremendous amount of volatility over the past year, but still managed to gain nearly 17% over the past 12 months. Stocks in the technology and communications sectors were amongst the bests performers, while utilities, consumer staples, and energy stocks finished the year slightly lower. International developed stocks had a strong year as well with the MSCI EAFE index gaining 18.85% in total return. Emerging market stocks struggled to keep pace with the broader market, but still gained more than 10% despite stocks in China falling nearly 11%.

U.S. Equity Style Snapshot			12/31/23
YTD	Value	Blend	Growth
Large	11.46%	26.53%	42.68%
Mid	12.71%	17.23%	25.87%
Small	14.65%	16.93%	18.66%

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U.S. Earnings – Outlook

In the U.S., the 2024 outlook for corporate earnings is quite optimistic with profits expected to grow by approximately 11% in the coming year – double the long-term average. Margins are expected to remain strong as pressures on wages and input costs continue to slow. Still, revenue growth is likely to remain rather modest as the economy continues to slow and consumers exhaust their excess savings. With that said, analysts still expect each of the 11 sectors of the U.S. market to experience positive earnings growth in the coming year.

Bonds – A Strong Year in Fixed Income

It was another volatile year for bond investors following a tumultuous 2022 where bonds fell more than 13% in total return. After starting the year at 3.84%, the yield on the 10-year Treasury note traded as high as 5% in mid-October before finishing the year mostly unchanged at 3.86%. This allowed investors to take advantage of significantly higher interest rates over the course of the past year, which translated into positive returns across the board. After dropping briefly into negative territory in October, both taxable and municipal bonds finished the year markedly higher as the Bloomberg taxable bond index finished the year higher by 5.53% in total return, while the Bloomberg municipal bond index was higher by 6.40%.

Federal Reserve: Declaring Victory?

Inflation and the future path of interest rates will remain top of mind for investors in the year ahead. Core inflation currently stands in the 3-4% range, well off the peak but still above Fed's target of around 2%. Today, the federal funds rate currently sits at a target range of 5.25%-5.50%. The markets believe the Federal Reserve is finished with rate hikes for this cycle, and we agree. However, the markets also are pricing in a total of six 25 basis point rate cuts in 2024, which would leave the federal funds rate around

3.75%-4.00% by year-end. Without a significant drop in inflation, we think the Fed may be a bit more cautious than that, and the markets may be overly optimistic regarding the speed and magnitude of rate cuts in the coming year.

Looking Forward: 2024

From a valuation standpoint, the S&P 500 looks far from cheap, currently trading at around 19.5 times next year's expected earnings. However, this premium may be justified given many of the largest corporations have been insulated from higher interest rates, with approximately half of the debt for companies in the S&P 500 maturing beyond 2030. In addition, many of these companies are sitting on excess cash that is now earning meaningful interest. Approximately 86% of the S&P 500 2023 return came from the top 10 stocks, and looking forward, we believe this trend will reverse and investors will benefit from a well-diversified portfolio. In bonds, we continue to view most areas of fixed income as relatively attractive for investors looking to their portfolio for stable cash flow.

Looking ahead to the new year, the 2024 presidential elections are sure to steal their fair share of headlines. Elections can have major consequences regarding policy and other issues, but when it comes to the markets, the only conclusion that can be drawn is that investors are generally better off ignoring them altogether. Numerous variables influence the political climate in a presidential election year, making it difficult to base market strategy on a single factor. Research by Vanguard dating to 1860 finds no statistical relationship between the performance of a 60/40 portfolio in presidential election and non-election years. It's understandable to have concerns about an election, but as far as your portfolio and the markets are concerned, history suggests they are nothing to worry about as there has been no distinguishable correlation between the political party in the White House and stock market returns. Regardless of which party takes control of Washington, companies generally find a way to make profits and generate positive returns for investors.

Please let me know if you would like to set up a meeting to discuss any questions about your portfolio.