MARKET UPDATE

Economic Market Update – 2023 REVIEW

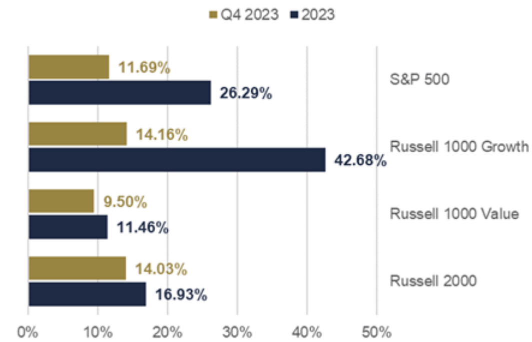
JANUARY, 2024

What a difference a year makes. After a bear market in everything in 2022, markets roared back with a vengeance in 2023 – though admittedly the ride was more than a little bumpy along the way. As 2023 began, nearly all professional forecasters were calling for a recession to hit at some point during the year. And yet, despite a continued increase in interest rates, rising geopolitical tensions, dysfunction in DC, and the worst bout of stress to the banking system since the Great Financial Crisis (GFC), the U.S. economy shrugged it all off and continued to steam ahead. As we look back on the year that was, it's worth remembering many of the events that could have derailed the economic and market train over the course of the year. The war in Ukraine raged on, marked by offensives and counteroffensives, only for the conflict to remain mired in a stalemate. Hamas' attack on Israel on October 7 reignited long-standing tensions in the Middle East with potential global implications should it turn into a broader regional conflict. Republicans required fifteen ballots before finally reaching a consensus that Kevin McCarthy should replace Nancy Pelosi as the Speaker of the House in the 115th Congress, only to see him unceremoniously removed in the fall. Donald Trump became the first president – sitting or former – to face criminal charges in federal court. Markets were roiled by the worst banking crisis since the GFC of '07-'09. Regulators were forced to step in to protect depositors after the seemingly overnight failures of Silicon Valley Bank and Signature Bank. First Republic Bank failed a few weeks later, marking the second largest bank failure in U.S. history. Credit Suisse, a storied Swiss bank with global operations, also succumbed to the stress, ultimately being absorbed by rival UBS. Artificial intelligence became all the rage, with virtually every company quickly rolling out its strategic approach to generative AI. After the fastest tightening cycle in history, the Federal Reserve felt enough progress had been made on the battle against inflation to pause rate hikes, setting up a potential pivot in 2024. Most importantly, through it all, the most anticipated recession in history that was forecasted to begin in 2023 never materialized. Markets were choppy throughout the year, but anticipation of a Fed pivot just around the corner led to a sharp Santa Claus rally, with the S&P 500 closing out the year up 26.3%[1]. The importance of the year-end rally cannot be understated. Prior to the rally that began in earnest in November, the median return for a broad spectrum of asset classes[2] was -1.1% for the year. By December 31, that median return had risen to 12%, with commodities left behind as the only major asset class to finish the year in the red. The year-end rally also saw a substantial increase in market breadth, with the number of stocks in the S&P 500 trading above their 50-day moving averages surpassing 90% for the first time since June 2020.

[1]Return figures for U.S. indices are on a total return basis; international returns are net returns in U.S. dollars unless otherwise stated

[2]Asset Classes: S&P 500 Total Return Index, Russell 2000 Total Return Index, MSCI EAFE Total Return Index (Local), MSCI Emerging Markets Total Return Index (Local), Barclays Long-Term Treasury Total Return Index, Barclays U.S. Aggregate Total Return Index, S&P GSCI Total Return Index, REIT Total Return Index

U.S. Equity

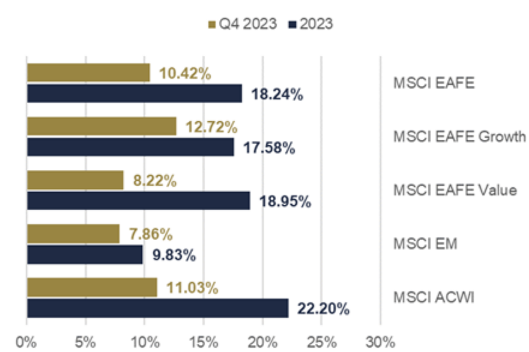


Green as far as the eye can see. Looking at a cross-section of stock market returns for 2023, 2022's sea of red was replaced by an ocean of green. Driven by the Magnificent Seven for much of the year, the S&P 500, the bellwether for US stock returns, finished 2023 up 26.3%. Small cap stocks did not participate much in the rally until the final quarter of the year, but the Russell 2000 still finished 2023 up a respectable 16.9%. Thanks to the year-end rally, all nine Russell and S&P style boxes finished the year up more than 10%. U.S. equity performance varied widely by style however, with enthusiasm around artificial intelligence leading to one of the largest annual gaps between growth and value on record. Growth stocks soared throughout the year, with the Russell 1000 Growth Index finishing the year up an eye-popping 42.7%, making double digit returns for value stocks seem pedestrian by comparison. The Russell 1000 Value Index climbed 11.5% for the year, trailing its growth counterpart by a whopping 31.2% - in the history of the indices since inception in 1987, only 2020 saw growth outperform value by a higher margin. As can be expected when the style returns diverge so significantly, performance also varied widely across sectors and industries. Information Technology and Communications stocks were the biggest winners in 2023, with the Tech sector up 56.4% on the year and the Communications sector nipping at Tech's heels, up 54.4%. Consumer Discretionary was the only other sector that outperformed the S&P 500 Index as a whole, up 41.0% for the year. Within these sectors, technology was the driving theme; the stocks contributing the most to the index's return outside of the formal Information Technology sector were Meta and Alphabet in Communications and Tesla and Amazon in Consumer Discretionary. Utilities stocks were the major laggards, with the sector down -10.2% for 2023. Energy also took a breather after experiencing the best year for the sector's performance since 1980 in 2022, closing out 2023 down -4.8%. Consumer Staples also finished the year slightly in the red, down -2.2%.

Russell Style Box
2023 Returns

	Value	Blend	Growth
Large	10.6%	29.9%	46.6%
Mid	12.7%	17.2%	25.9%
Small	14.6%	16.9%	18.7%

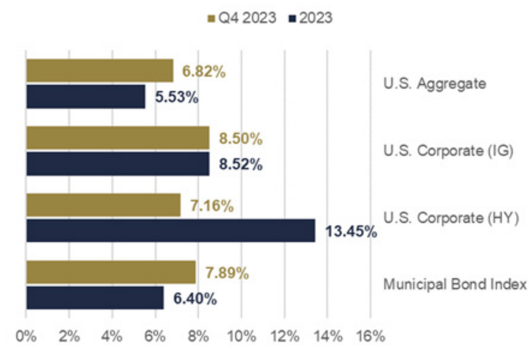
International Equity

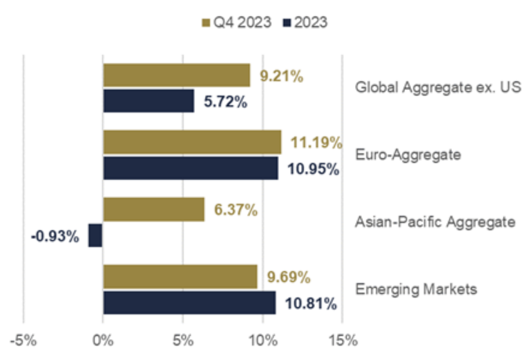


Despite lagging the U.S., international markets also produced strong returns in 2023. The MSCI EAFE Index, which tracks developed international markets, finished the year up 18.2%. The split between value and growth was significantly narrower internationally than in the U.S. Value actually outperformed internationally, with the MSCI EAFE Value Index up 19.0% for 2023 compared to the MSCI EAFE Growth's 17.6% return. The MSCI EAFE index has a value tilt relative to major U.S. indices due to the lack of any significant multinational technology firms, which are primarily based in the United States. Much of the difference in performance between U.S. and international indices in 2023 comes down to the significant differences in sector exposure. On the surface, emerging market stocks were the clear laggard on the year compared to the double digit gains in all other major stock market categories, with stocks in developing countries up just 9.8% in 2023. Digging beneath the surface, however, reveals significant return dispersion across countries. Chinese stocks were down -11.2% in 2023, and though the weight of Chinese firms in the MSCI Emerging Markets Index has fallen from a peak of around 45% to just under 23% today, the performance of the Chinese market still has a significant impact on the return of the overall index. Closer to home, stock markets in Mexico and Brazil had standout years, up 40.36% and 32.69% respectively. India, which has the second highest weight in the index after China, also posted a strong year, up 22.81%. Emerging Markets ex. China were up around 20% on the year. **Summing up the global stock market in 2023, the year-end rally was also significant globally - the MSCI All Country World Index, which tracks the global stock market, entered November up just slightly under 7% for the first ten months of 2023 – but by year's end, the index was up 22.20%.**

Fixed Income

After an absolutely brutal few years for fixed income markets, bond investors could start to see the light at the end of the tunnel as 2023 came to a close. After a prolonged period of globally coordinated monetary policy tightening in the face of widespread inflationary pressure that pushed down bond prices, central bankers around the world appear to be on the verge of a pivot. The Bloomberg U.S. Aggregate Bond Index, a broad measure of the performance of investment-grade fixed income markets in the U.S., gained 5.53% on the year. Bonds spent much of the year in the red, but like stocks also saw a sharp rally in Q4, largely triggered by pauses from the Fed and expectations for a pivot to rate cuts in 2024. Floating-rate securities continued to outperform, posting a double-digit gain of 13.04% in 2023, but were bested by high yield corporate bonds, which were up 13.45%. Investment-grade credit also had a strong year, with the Bloomberg Investment Grade Corporate Index notching an 8.52% gain. International fixed income returns were solid as well, with the Bloomberg Global Aggregate Bond Index finishing the year up 5.72%. International fixed income returns varied by region however. Asian (mainly Japanese) bonds struggled, ultimately finishing slightly in the red, while European bonds were up 10.95%. Cash continued to post competitive returns in 2023, with short U.S. Treasury Bills finishing the year up 5.14%, but after a round trip in rates over the course of the year, the Bloomberg U.S. Aggregate Bond Index did ultimately outperform cash in 2023 despite spending much of the year in the red. With a Fed pivot in the offing, longer dated bonds are likely to outperform in 2024 as well. After one of the worst years on record for the proverbial 60/40 portfolio in 2022, disciplined, diversified investors were rewarded with strong returns in 2023.





The year-end rally led to strong cross-asset returns for 2023 – but the question on the mind of every investor is where do we go from here? For equity investors, the starting point suggests that U.S. stocks are unlikely to repeat last year's stellar performance and returns will likely be closer to the long-term averages in 2024. The rally in 2023 was driven mainly by multiple expansion, but with current multiples towards the higher end of the historical range, significant multiple expansion is unlikely to continue from here. Margins have stabilized but are also unlikely to expand from here given the

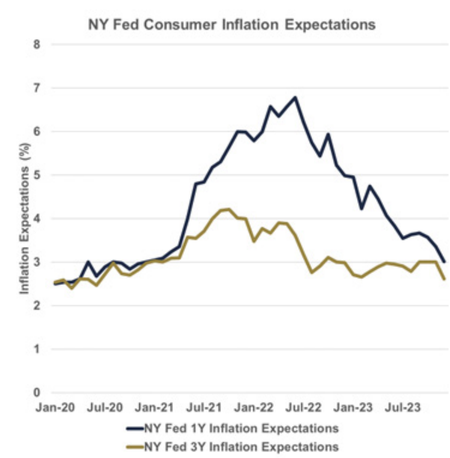
S&P 500 Performance After First New High In At Least One Year

Date	# Days Since Previous High	1 Month Later	3 Months Later	6 Months Later	One Year Later
09/22/1954	7261	0.4%	10.4%	14.5%	41.8%
09/24/1958	539	2.4%	8.7%	11.4%	14.1%
01/27/1961	374	3.6%	6.7%	9.0%	11.3%
09/03/1963	433	-0.5%	1.6%	7.4%	13.3%
05/04/1967	309	-6.2%	1.4%	-1.7%	4.9%
03/06/1972	819	0.2%	0.1%	2.5%	5.0%
07/17/1980	1897	3.5%	10.1%	11.0%	7.7%
11/03/1982	487	-2.9%	0.3%	14.3%	14.5%
01/21/1985	323	3.4%	3.1%	10.9%	17.4%
07/26/1989	484	4.0%	1.7%	-2.3%	5.6%
02/14/1995	259	2.7%	9.5%	15.8%	36.9%
05/30/2007	1802	-1.6%	-6.4%	-6.7%	-8.6%
03/28/2013	1375	1.6%	2.8%	8.3%	18.4%
07/11/2016	285	2.1%	0.8%	6.2%	13.5%
Mean		0.9%	3.6%	7.2%	14.0%
Median		1.8%	2.2%	8.6%	13.4%
% Positive		71.4%	92.9%	78.6%	92.9%
All Periods Mean		0.6%	1.8%	3.6%	7.5%

Source: Ned Davis Research

expected impact of rising interest expense, continued pressure on input costs, and higher effective tax rates. While the macroeconomic backdrop is solid, U.S. equities appear to have fully priced in a soft landing in 2024. Collectively, this suggests revenue growth will likely have to be the main driver of the market in 2024. As of this writing, the S&P 500 is flirting with the all-time high of 4796.56 hit at the close on January 3, 2022. Should investors be rooting for a new all-time high in 2024, or could hitting the mark present reasons for apprehension? A review of the historical data is instructive. The current drought without a new all-time high for the S&P 500 is the sixth longest on record dating back to 1925. Examining the periods in which the index hit a new all-time high after a drought of more than a year shows that, perhaps counterintuitively, this typically occurs in the midst of a secular bull market rather than a secular bear. Of the fourteen instances in the historical data, only those that saw a drought of 1000 days or more without a new all-time high occurred during secular bear markets, with the new record finally being hit as the market transitions from secular bear to secular bull. The evidence makes it clear that the pullback in 2022 should be viewed as a cyclical bear market during a secular bull market. So what has the S&P 500 historically done after climbing out of the hole to hit a new all-time high? Was the year-end rally too fast, too soon, leaving the market overbought and ripe for correction? Or does it represent a breakout to a new upward trend? History suggests a breakout is more likely. In the fourteen historical examples, the S&P continued to see above average returns over the next three-month, six-month, and one-year periods. On average the market was 14% higher one year after hitting a new all-time high after a substantial drought, compared to the average return of 7.5% during all one-year periods, with positive returns one year later 92.9% of the time. The one-month picture is more mixed, suggesting the market may take a breather in the near-term, but the long-term picture is much more sanguine.

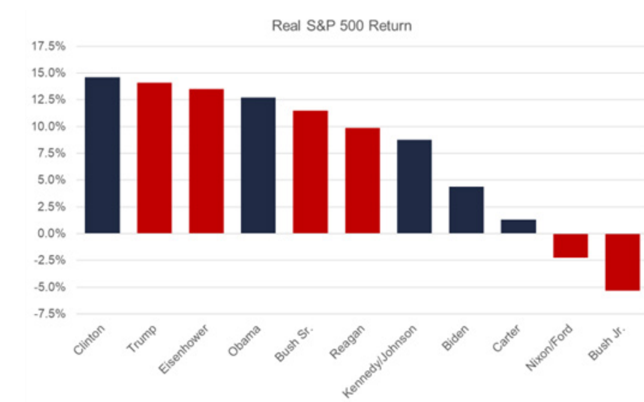
Most Forecasted Recession in History Never Showed Up



The economy surprised everyone in 2023, bucking off recession fears and making substantial progress on the path to a soft landing. The biggest surprise was that while the labor market continued to rebalance in a healthy manner and inflation continued to trend in the right direction, GDP growth remained exceptionally strong. Most professional forecasters believed that the Fed could not tame an overheated labor market and bring down inflation rates not seen since the 1980s without causing some collateral damage to the economy. The experience of 2023, however, proved the prognosticators wrong; as we enter 2024, the stage is now set for inflation to approach the Fed's 2% target and the labor market appears back in balance based on pre-Covid levels, all without the economic pain experts thought was needed to do so. Wage growth has fallen to levels consistent with target inflation and the ongoing rebalancing of the auto and housing markets provides tailwinds for continued disinflationary pressure over the course of the year. Importantly, consumer expectations of future inflation have materially declined from the highs hit in 2022. The decline in inflation has also led to a rise in real rates, which serve to further tighten financial conditions without any additional action from the Fed. This increase in real rates gives reason to believe that the Fed will pivot at some point during 2024, though the market may be a tad overzealous at the moment, pricing in six 25 basis point rate cuts over the course of the year. Our base case expects fewer cuts during the year, but due to the level of real rates, the bar for the Fed to cut should a macroeconomic shock or growth scare arise during 2024 will be low. We are also more cautious than the market on the timing of the first rate cut. The market is currently pricing in a cut at the March Fed meeting, but our current base case sees the first cut coming at the May or June meeting as more likely. Absent any shocks, the Fed will likely begin to cut rates once core PCE inflation falls to 2.5%. In 2023, the key economic data releases to watch were the monthly inflation reports. Given the progress the Fed has made, the key economic data we will be monitoring in 2024 is contained in the monthly jobs report. Weakness in the labor market will be the catalyst most likely to accelerate the Fed's timeline on a monetary policy pivot. Overall, we expect inflation to approach target in the back half of the year, with the inflation rate finally reaching 2% sometime in 2025. Given the Fed's dual mandate of price stability and full employment, with the disinflationary path firmly set in, the labor market is likely to dictate the course of Fed action going forward from here. With that backdrop, we expect that the robust economic growth seen in 2023 will slow meaningfully over the next twelve months. Growth should return to or fall slightly below trend in 2024, which corresponds to GDP growth somewhere in the range of 2% for the year. A key reason growth exceeded expectations in 2023 was a surge in business investment due to the subsidies in the CHIPS Act and Inflation Reduction Act, which will begin to tail off going forward. Consumer consumption will be the main economic engine going forward, and with the excess savings cushion that built up during the COVID era largely depleted and the fall off of the surprise effects of fiscal policy that boosted investment in 2023, economic growth will likely closely track with real income growth going forward. **While there will almost certainly be a little turbulence as we approach the runway, the Fed looks poised to pull off the rare feat of engineering a soft landing for the economy in 2024.**

Robust Year-End Rally Provides Opportunity To Rebalance

Given the historical market action in the lead-up to a Federal Reserve pivot, investors should take the opportunity to review their financial picture and rebalance portfolios in alignment with their goals and risk tolerance at the start of 2024. The S&P 500 has never rallied more than 11% in the three months leading up to the first rate cut in a new easing cycle. Given the uncertainty around the timing of a first rate cut, we expect markets will likely be choppy in the first half of the year. Markets have typically rallied strongly in the six months after the first cut, however, with the S&P 500 up around 12% on average historically after a pivot from the Fed, suggesting a stronger back half of the year in 2024. Given this expected volatility in the beginning of the year and the strong market rally in recent months, investors should take the opportunity to review financial plans, rebalance portfolios to long-term targets, and look to put any cash that remains on the sidelines to work. Driven by a significant increase in the forward expected returns for fixed income, the future prospects for the 60/40 portfolio have improved materially. The significant outperformance of equity markets in 2023 suggests that portfolio allocations may have drifted in recent months. The start of the year provides an excellent opportunity to align portfolios with your goals and risk tolerance, locking in gains where equity exposure has drifted upward and



taking advantage of the best opportunities in the bond market in over a decade. Given that 2024 is an election year, coverage of the U.S. Presidential contest will dominate news coverage throughout the year and may contribute to short-term market volatility. While the election will certainly be consequential, it bears mentioning that historically which party controls the White House hasn't been correlated with market performance or economic growth. As always, investors who remain disciplined and focused on their long-term plan despite the cacophony of noise during the 2024 election cycle will ultimately be rewarded.

We remain committed to focusing on your long-term financial goals and priorities and constructing portfolios designed to reach those goals while minimizing risk. The volatility environment experienced over the last several years demonstrates the value of disciplined professional management. Our clients' interests always come first, and our goal for 2024 is to continue to separate the signal from the noise and focus on what truly matters to the economy and markets to help you achieve your investment goals. As we begin the new year, we wish you and your family a healthy and prosperous 2024.

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