2023 Q4 IN REVIEW

In Q4 2023, major asset classes experienced notable gains, primarily due to market anticipation of earlier-than-expected interest rate cuts by central banks in 2024. This shift in expectations followed a trend of decreasing inflation rates in major economies with the Federal Open Market Committee indicating the possibility of three rate cuts in 2024. Global aggregate bonds returned 8.1%, marking their strongest quarterly performance in over two decades, a clear result of changing monetary policy direction. Conversely, the commodities sector saw a decline, with the S&P GSCI Index falling by 4.6%. The decrease was most pronounced in the energy sector, despite production cuts, leading to a decline in crude oil prices.

The divergent performance was observed in other sectors as well: while agriculture and industrial metals had mixed results, precious metals recorded price increases. In the equity market, growth stocks rose by 13.4%, and value stocks also showed strength with a 9.5% return. Real Estate Investment Trusts (REITs) and small caps rebounded, delivering returns of 15.6% and 12.6%, respectively. The S&P 500 index gained 11.7%, largely driven by major tech and AI stocks. The US consumer remains a key economic driver, supported by a strong job market. The prevalence of fixed-rate mortgages contributed to economic stability, insulating a significant portion of the population from interest rate fluctuations over the past year.

In the fixed-income world, anticipation of central bank rate cuts positively impacted the market, particularly benefiting government bonds. The global investment grade index outperformed high-yield bonds, achieving an 8.8% return, while high yield debt spreads narrowed. Looking ahead to 2024, the interplay of solid labor conditions, a stable housing market, and the prospect of monetary policy easing presents a conducive environment for sustained growth across various asset classes. Nevertheless, with the rally as strong and fast as it was in 2024, many hope Q1 will bring a pullback that will provide more opportunities to invest.

RECOMMENDED PORTFOLIO WEIGHTINGS

AS OF DECEMBER 31, 2023

EQUITY SECTORS

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
• Consumer Discretionary • Industrials • Materials	• Utilities • Technology • REITs • Communications • Energy	• Financials • Health Care

ASSET CLASSES

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
• Short-Term Investment Grade Bonds • Resource Commodities • U.S. Mid Cap Equities • U.S. Small Cap Equities • Cash Alternatives	• Intermediate-Term Investment Grade Bonds • Precious Metals • High Yield bonds • International Developed Fixed Income • U.S. Large Cap Equities • Emerging Market Equities	• Agricultural Commodities • International Developed Equities • Long-Term Investment Grade Bonds

FIXED INCOME

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
• Agency Securities • Bank Loans • TIPS • Mortgage-Backed Securities	• Municipal Bonds • Corporate Bonds • U.S. Treasuries	• Preferred Securities

INDEXES

DATA POINT	CURRENT	YEAR-END PROJECTION
S&P 500	4,770	5,100-5,200
NYSE	16,853	18,000-18,500
10-Year Treasury Rate	3.87%	4.50%
WTI Crude Oil	$71.89	$90-95
Gold Priced in Dollars	$2,078	$2,100-2,200
Trade Weighted Dollar Index	118.77	112-115
Effective Fed Funds Rate	5.33%	4-4.25%

2024 Q1 ECONOMIC & MARKET OUTLOOK

01. Equities

Markets Need a Refresh to Tackle New Highs.

Entering 2024, the equity market faces changing dynamics due to the end of rate hikes. Last year, with "risk-free" rates around 5%, investors leaned towards safer investments, resulting in historic levels of cash on the sidelines. This year, however, quality stocks are expected to gain strength as rate hikes cease. Additionally, a broader market is anticipated, offering more opportunities for stock-picking as market breadth widens. As we have been saying for some time, we expect the three major themes heading into the new year to be focused on innovation, reshoring, and geopolitics.

With a lens towards the past, historical data shows that quality stocks usually outperform after rate hikes. Thus, we have been and will continue to emphasize the importance of selecting stocks with strong balance sheets and consistent profitability. Market breadth, which was limited in 2023, is expected to expand in 2024, potentially enhancing returns outside of the “Magnificent 7” and AI-focused names that saw strength in 2023. Despite strong returns last year for the market-cap-weighted S&P 500, the equal-weighted S&P 500 showed more modest returns. Nevertheless, it has outperformed in the long term, suggesting potential in undervalued stocks with solid fundamentals, especially in the small-cap asset class.

Reshoring trends and geopolitical shifts also present new investment opportunities. With the market becoming less concentrated, active stock selection will be crucial, focusing on stocks with quality attributes and growth potential. Overall, the market is likely to show modest strength as it enters a rate-cutting cycle, but much will depend on economic data, inflation control, and corporate earnings stability. Investors will need to balance caution with these emerging opportunities to navigate the 2024 equity market effectively.

Given where we are in the market cycle and the lack of breadth in the recent rally, we see now as an excellent time to allocate to names in sectors that have not run as much in the past two quarters, including consumer materials, industrials, and energy. We expect, should the U.S. successfully navigate recession and earnings fall in line with the end-of-year consensus, that the theme of 2024 will be market breadth (a widening of the 2023 rally beyond AI-influenced tech names). As we are long-term investors, discounts to fundamental value provide excellent opportunities to invest.

02. Fixed Income

A Fed Pivot is More Than Priced In..

2023 closed with a Federal Reserve pivot. The bond market sniffed this change out and yields peaked early in Q4. The 10-year closed below 4% and markets have priced in nearly six rate cuts by year end. The Fed is prognosticating three cuts, and our view is that the Fed is more right than the market.

While inflation will continue to moderate through the first half, the economy should hold relatively strong due to solid consumer balance sheets, low unemployment, and high fiscal spending. This should give the Fed reason to hold off on initiating their rate cuts until the back half of the year, or until they see a credit event that would trigger a more worrisome economic outlook. The election and potential for resurgent inflation in the back half of the year could throw the Fed's plan for an easing cycle for a loop, however.

While credit spreads have tightened, there are still parts of the corporate bond market that remain attractive. We are more apt to continue to take credit risk, but less inclined to take duration risk, especially as we see more upside risk to rates than downside risk after this move. We like residential mortgage debt but would be wary of taking on a ton of commercial mortgage-backed securities. TIPS remain attractive, as the upside of inflation is likely to materialize in the medium term due to the Fiscal dominance that is beginning to take hold amongst the G7 economies.

Overall, we expect rates to surprise to the upside modestly, and credit markets to hold together with spots of flareups likely. This means investors still must be diligent to avoid too much duration risk, but also take advantage of credit opportunities.

03. Commodities

Recent Weakness Likely Brings Long-Term Opportunity.

Oil prices pulled back for most of the quarter as US supply continued to surprise to the upside. This is driven by improved shale drilling techniques that are allowing producers to get more out of the ground faster. This does not, however, improve the overall production levels they can get out of each well, which means that depletion rates are likely to increase. This does improve well economics due to a faster payback period, which should drive better investment from the sector. Long term this does not bode well for sustained production levels as the better wells will run dry quicker. We expect these factors, along with geopolitical uncertainty, to drive prices of oil and gas higher throughout the year.

Gold prices have begun an uptrend that we see as durable, but a true chase has not begun yet which leaves us neutral in the near term, but a full Fed cutting cycle by year-end should catalyze a breakout in precious metals.

Agriculture commodities remain weak, but we are seeing some renewed strength in certain pockets. We are also seeing weakness in base metals, but copper remains our favorite within that subsector.

We expect the dollar to weaken throughout the year, which should help buoy prices for commodities more broadly. Overall, we still see us in a secular bull market for commodities due to structural underinvestment, but near-term economic weakness has brought a calm to prices. This reset will likely help fuel buying in the next leg since investors are once again underweight in their commodity exposure.

CONCLUSION

As we embark on an election year, we must remind ourselves that those in power tend to want asset prices rising into the election season. This dynamic is likely even more pronounced in such a charged political environment. Mix that backdrop with a Fed that is becoming more accommodative, and you get a picture that bodes well for asset prices.

The Fiscal situation in the US continues to spiral, but that is a problem for the Fed and Treasury to manage since Congress is unlikely to reform the drivers of the deficit, which are entitlements and the rapid retirement of the Baby Boomers. This is bringing off-balance sheet liabilities on the balance sheet and pushing more dollars into the system, which is inflationary. Down the line, this will be a problem, but the Fed and Treasury have been shown to be adept at muddling through a challenging situation.

Ultimately a weak dollar is needed to maintain the debt trajectory, which we know tends to be good for asset prices, especially harder assets and value equities. We see this as a theme going forward that we plan to continue to take advantage of. While near-term markets are overbought, a mild pullback could easily refresh sentiment so asset prices have the power to reach new highs, which are likely later in the year.

DISCLAIMER

There is no assurance that any of the target prices or other forward-looking statements will be attained. Any market prices are only indications of market values and are subject to change. Past Performance is a no guarantee of future results.

The prices of small and mid-company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.
Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment. Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility.

All fixed income investments may be worth less than original cost upon redemption or maturity.

Although Treasury Inflation-Protected Securities (TIPS) are considered free from credit risk, they are subject to other types of risk. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income in the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

The yield, average life and the expected maturity of mortgage-backed securities are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Investments in the energy sector are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments in this sector.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real Estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Additional information available upon request.

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