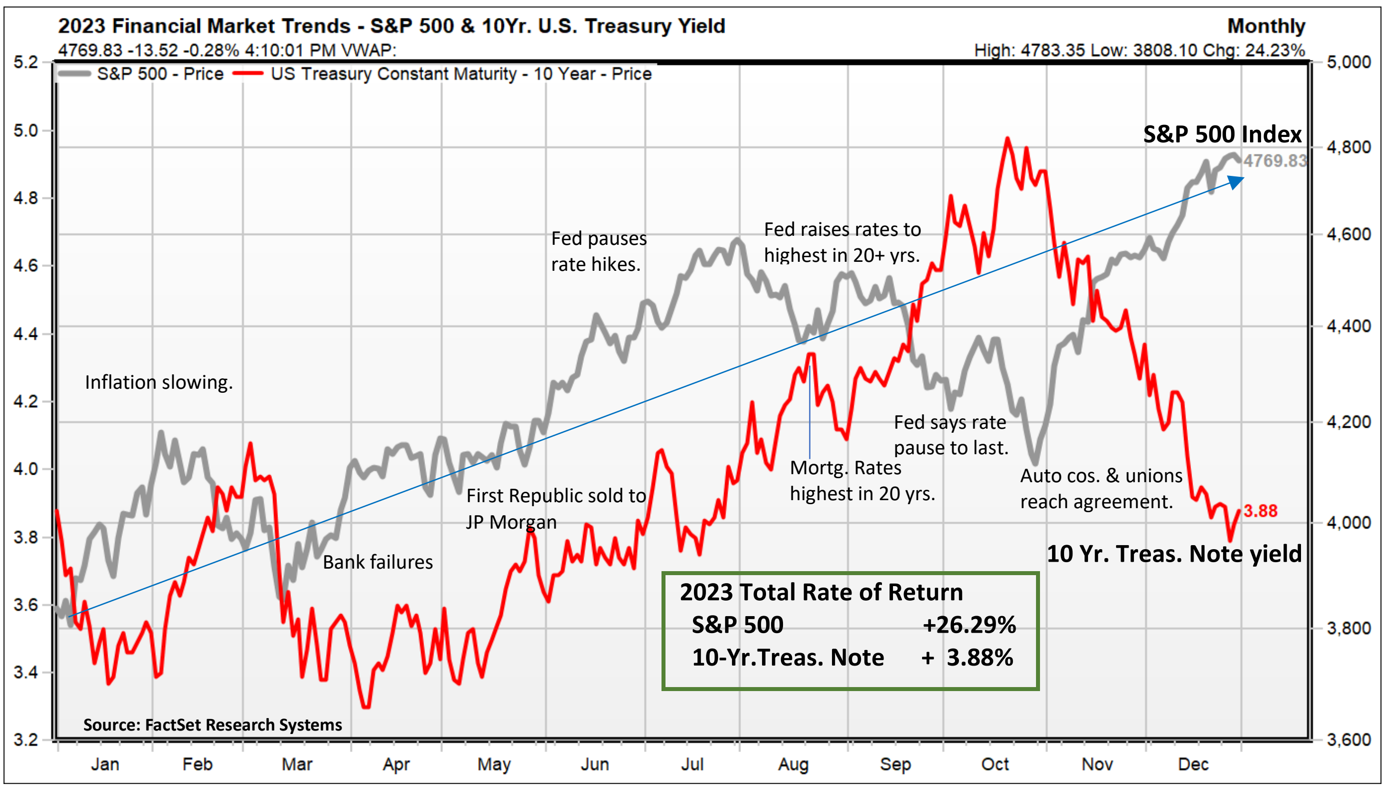
2023, MEMORABLE, SURPRISING & REWARDING – 2024 EXPECTATIONS

Inflation, The Fed, Recession, Ozempic, ChatGPT

Year end 2022 consensus was that 2023 would be a challenging period for financial markets due to:

- Inflation
- An inverted yield curve (recession indicator)
- Declining U.S. Leading Economic Indicators
- Restrictive monetary policy
- High interest rates
- High oil prices
- Likelihood of a recession
- Decline in consumer spending (about 70% of U.S. GDP)
- Rising Unemployment
- Geopolitical uncertainties/conflict

Despite the concerns above, 2023 financial market returns remained strong. [i]



Stock Returns YTD* [i]	
NASDAQ	+44.64%
S&P 500	+26.29%
Dow Jones	+16.18%
Mid-Cap Stocks (IJH)	+16.42%
Small-Cap Stocks (IJR)	+16.07%

Bond Returns YTD* [ii]	
1-3 yr Treasury notes	+4.16%
7-10 yr Treasury notes	+3.64%
20+ yr Treasury bonds	+2.77%
Barclays Aggregate Index	+5.65%
T.I.P.S	+2.43%

Intl. Stock Returns YTD* [i]		
EAFE	+16.77%	Europe, Australia, Far East (developed areas outside U.S.)
EEM	+8.99%	Emerging markets (lesser developed areas outside U.S.)

*12/29/23

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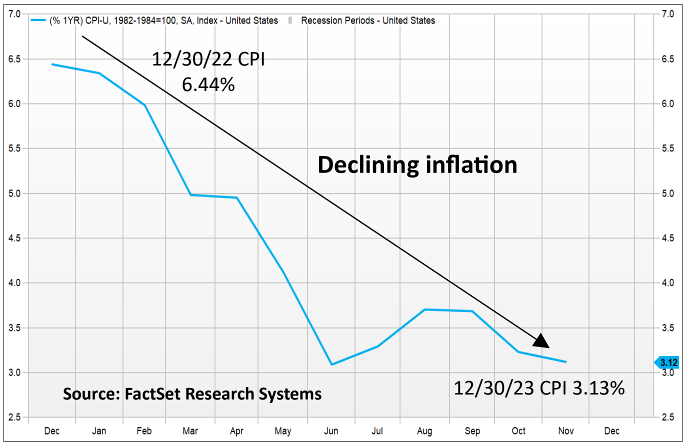
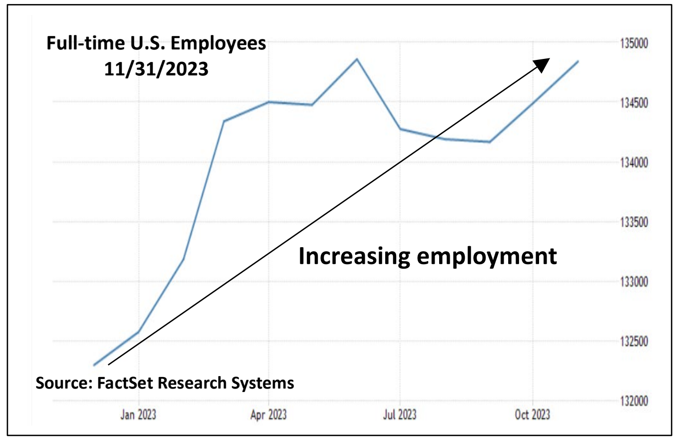
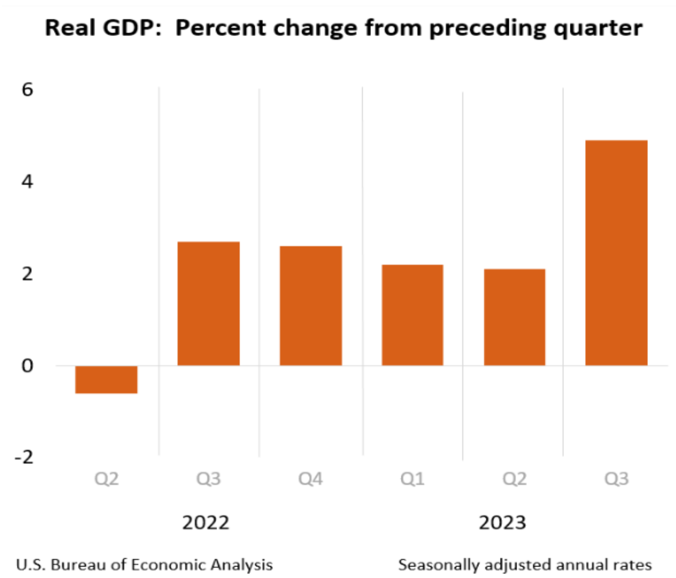
Significant reversal of trends and sentiment resulted in optimistic reinforcement and positive equity returns.





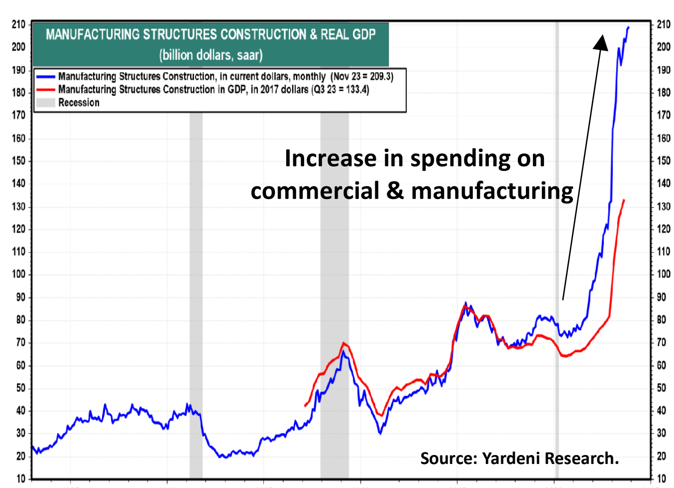


The charts on this page display trends that changed the expectations and sentiment of investors from negative to optimistic and helped lead the equity market (S&P 500) to near record highs by year-end 2023.

Despite still elevated interest rates, an inverted yield curve (short interest rates higher than longer maturity interest rates), geopolitical conflict, and negative Leading Economic Indicators, investors have embraced the idea of lower interest rates, growing corporate profits (the engine that drives stock prices), a robust labor market, and continued economic expansion.

In addition to the importance of rapidly declining inflation, another of the most significant trends influencing our positive outlook for the U.S. economy and financial markets is the increase in onshoring/reshoring, which has a major impact on capital spending. American and foreign manufacturing companies are onshoring to the U.S. to reduce/eliminate supply chain disruptions that occurred during the pandemic and the growing tensions between the U.S. and China.

The onshoring boom combined with increased government spending on infrastructure and semiconductor production capabilities has boosted both construction spending and employment to record highs. These trends are long-term in nature and enhance employment and productivity.



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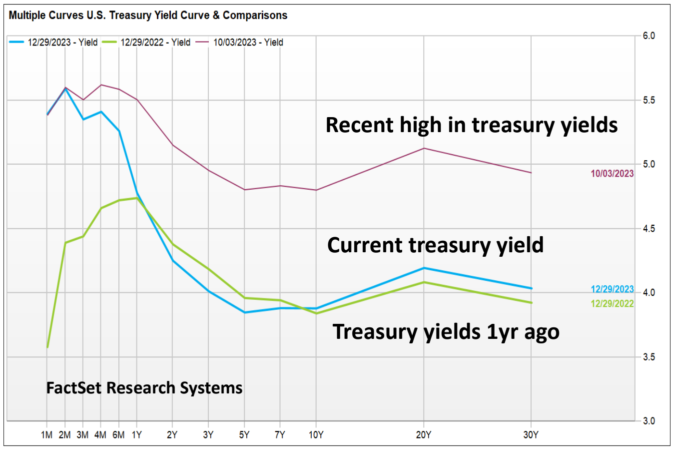
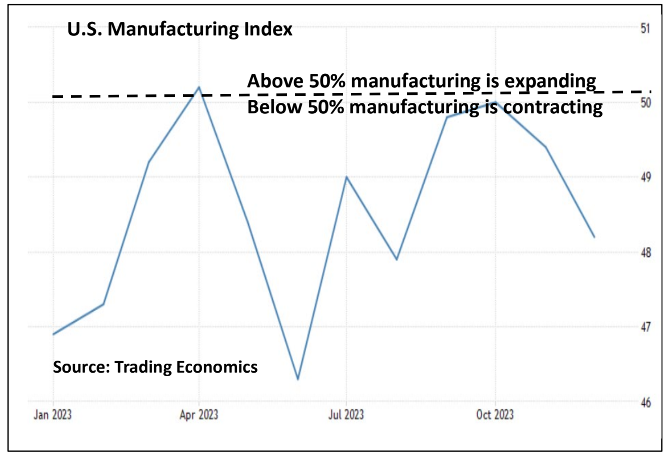
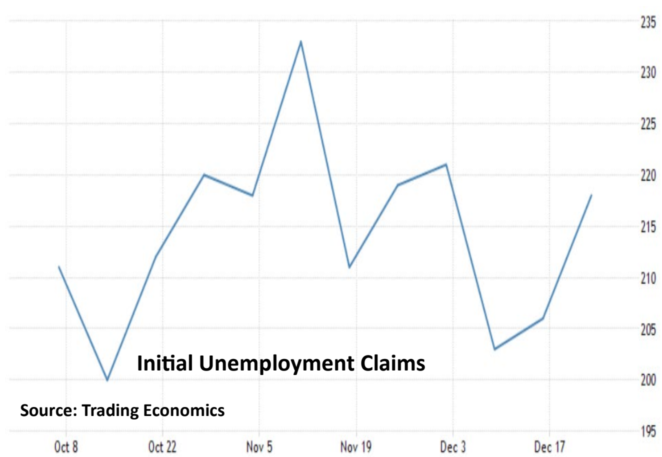
While these encouraging indicators have relieved a good deal of investor angst and led to a rapid recovery from October's market swoon, the future is not without uncertainties. As explained below, although interest rates have declined, they remain elevated, domestic manufacturing is weak, and Initial Jobless Claims have risen erratically despite the low unemployment rate.







The U.S. economy has proven to be strong and resilient. This past year (2023) is an example of just how flexible and responsive it can be in reacting to changes in domestic and global dynamics.

Potent fiscal expenditures (The Chips Act, Inflation Reduction Act, etc.) have led to strong capital spending, a positive labor market, rising real income, and the opportunity to be less dependent on foreign sources with uncertain supply chains. These factors should be long-term positives. However, the rising U.S. government deficit and related interest payments will keep pressure on the current and future administrations to address this important issue and help reduce a good deal of future uncertainty.

Moving Forward

Concerns:

- Market sentiment is very bullish (complacent).
- The interest rate yield curve remains inverted.
- Interest rates remain elevated & restrictive.
- Some data trends, particularly manufacturing, are weak.
- Slowing global growth.
- Weak domestic housing market.

Positives:

- Economic data (ex. mfg.) remains solid.
- Employment situation positive (3.7% unemployment [ii]).
- Inflation continues to decline.
- Credit spreads narrowing (recession less likely).
- Semiconductor index (economic proxy) leading market advance.
- U.S. $ less volatile and less expensive (U.S. goods less expensive overseas).
- S&P 500 Index valuation high but impacted by small group of stocks. S&P "490" more reasonably valued.

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2023 began with low expectations and morphed into a year of significant disconnects between the economy and equity markets. Trends reversed and equity market returns were positive. 2024 is beginning with the economy and the markets more coordinated. Current interest rates are far less competition for long-term equity returns, corporate profits are rising rather than falling, spending on construction for commercial facilities (reshoring, onshoring, semiconductors, etc.) has exploded (more job growth), inflation is declining, and the Federal Reserve is likely to begin reducing rates during the first half of 2024.

When combined, these factors lead us to a constructive outlook for positive stock and bond returns for the coming year. However, prognosticating short-term financial market returns with any degree of accuracy is almost impossible particularly with the geopolitical environment in such disarray, the outlook for China's economy (2nd largest in the world) questionable, and uncertainty regarding the effect of the shock of recent high interest rates and inflation on global economies and businesses.

Some things never change!

As mentioned in previous communications, we believe successful investing can be pursued by having patience, a longer-term investment horizon, maintaining a balanced, disciplined, and diversified portfolio, and focusing on quality. The past five years have been a good example of the rewards of patience and diversification. They have been a period of significant challenge for investors due to COVID-19, the subsequent recession (2020), election uncertainties, significant and extended supply-chain issues, a period of rapidly rising interest rates and inflation, and armed conflicts in Europe and the Middle East. Despite those challenges, the equity market (S&P 500) provided a total rate of return (price + dividends) of +15.7%[iv] compound annually.

During the past year, we took action to shorten the maturity (less volatility) and maximize the quality of the bond portion of client portfolios. Additionally, as equity markets declined in the spring and fall we added to existing stock positions or initiated positions in the stocks of companies we have strong confidence in. We will continue to be disciplined and take advantage of opportunities to enhance the quality and potential capital appreciation of portfolios. At times, those actions may be the opposite of those recently taken and include extending the maturity of bond portfolios to "lock in" attractive yields and/or to modestly reduce portfolio equity exposure to maintain the unique asset allocation stated in each client ***Investment Policy Statement.***

Thank you for your confidence. Our attention is constantly on maintaining a long-term investment perspective (taking actions today that can benefit one "tomorrow"), adhering to the philosophy and disciplines we have discussed with you, avoid reacting to extremes, and to maintaining high quality, well diversified portfolios.

We highly value our relationship and friendship. We look forward to any comments, questions, or critique you have, and we look forward to seeing again soon. Best Wishes for another safe and pleasant New Year!

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i FactSet Research Systems   ii Barron's Magazine, 1/2/2024   iii Dept. of Labor Statistics, 12/2/2023   iv Lipper, 12/30/2023