4th Quarter Market Review and Comment
February 2024

Updated Market Performance

Returns	4th Quarter 2023	One Year	Annualized 3 Year	Annualized 5 Year	Annualized 10 Year
S&P 500	**11.57%**	**26.29%**	**10.00%**	**15.69%**	**12.03%**
DJIA	**13.09%**	**16.18%**	**9.38%**	**12.47%**	**11.08%**

Performance: October continued the downtrend set in August and September falling -2.10%. November began an upward trend after September's losses and ended up getting the wishbone posting a return of 9.13%. December's returns followed November's lead, rising by 4.54%. This left us with a 4th quarter 2023 total return of 11.57%.

After the 3rd quarter 2023 gave us a loss of -3.15%, the 4th quarter 2023 started off negatively but had a strong finish. We ended the quarter positive leaving us with a return of 11.57%. The Dow Jones Industrial Average (DJIA) outperformed the SP500, posting a 13.09% gain over the same period. For the previous twelve months the SP500 returned 26.29%, outperforming the DJIA which returned 16.18% over the same period. The annualized three-year returns for the SP500 were 10.00%, the DJIA three-year returns trailed the average increasing 9.38%. Over the last five years the annualized returns are well above historical norms (around 10.26%), with the SP500 returning 15.69% and the DJIA posting 12.47%. The ten-year annualized numbers are running above long-term averages (around 10.26%), with the SP500 returning 12.03% versus the DJIA which turned in 11.08%.

Breaking down the returns for Q4 2023, we note that there were five outperforming sectors and six underperformers. **The best sectors were Real Estate (18.83%), Information Technology (17.17%), and Financials (14.03%). The underperformers during the quarter were Utilities (-7.57%), Energy (-6.94%), and Consumer Staples (5.54).** The best sectors over the last year were Information Technology (57.84%), Communication Services (55.80%), and Consumer Discretionary (42.41%). Following behind were Utilities (-7.08%), Energy (-1.33%), and Consumer Staples (0.52%).

Economy: Growth in the economy increased in 2022 by 1.90% compared to an increase of 5.90% in 2021. 2022 began the deceleration in growth leaving us with growth below historical trends (Historical growth is ~3.15%). Growth in 2023 was modestly accelerated but was below historical averages coming in at 2.5%. We anticipate growth to modestly contract this year. The Fed has pivoted and is now in a holding pattern. They have also telegraphed rate cuts for this year if needed. Recession risks are currently moderate. We had a technical recession in the first half of 2022 which is defined as two negative quarters of GDP. We think a more meaningful recession will occur sometime in 2024 or early 2025. At the current moment, the recession looks to be shallow and short.

The advanced estimate of 4th quarter 2023 Gross Domestic Product (GDP) is 3.30%; according to the report released at the end of January by the Bureau of Economic Analysis (BEA). The latest estimate suggests that overall economic growth in the 4th quarter 2023 decreased to 3.3% from the 3rd quarter 2023 third estimate of 4.90%. GDP for 2023 came in at 2.5%. While GDP for 2022 came in at 1.90% compared to 5.80% in 2021, -2.20% in 2020, 2.50% in 2019, 3.00% in 2018, and 2.50% in 2017. Currently, the Atlanta Fed (Forecast of U.S. GDP Growth) has forecasted 2024 Q1 GDP growth at 4.2%. Blue Chip consensus has forecasted 2024 Q1 GDP growth at 1.40%. By comparison, China says their GDP increased 5.20% in the 4th quarter of 2023. Increasing from 3rd quarter 2023 reading of 4.9%. China's 2023 GDP was 5.20%, 3.00% in 2022, 8.10% in 2021, 2.20% in 2020, 6.70% in 2019, 6.70% in 2018, and 6.90% in 2017. Growth rates for the European Union (EU) and the Euro Area were 0.20% and 0.10% respectively in the 4th quarter 2023. For 2023, GDP grew 0.50% for the EU and 0.50% for the Euro Area. For 2022, GDP grew 3.40% for the EU and 3.40% for the Euro Area. For 2021, GDP grew 6.00% for the EU and 5.90% for the Euro Area. For 2020, GDP fell -5.60% for the EU and -6.10% for the Euro Area. For 2019, GDP rose 1.80% for the EU and 1.60% for the Euro Area. This is down from the 2.10% growth achieved by the EU and the 1.80% achieved by the Euro Area in 2018. GDP Growth forecasts for the end of the 1st QTR 2024 are 0.60% for the EU and 0.50% for the Euro Area.

Unemployment is continuing to trend below historical norms (~5.705%). According to the Bureau of Labor Statistics, January unemployment remained unchanged at 3.70%. Unemployment for 2023 came in at 3.63%, nearly unchanged from 2022. Unemployment for 2022 came in at 3.65% which is 1.71% below 2021's rate of 5.36%. Unemployment was 8.11% and 3.67% in 2020 and 2019, respectively. The number of unemployed was essentially unchanged at 6.1 million for January. The labor force participation rate held at 62.5% in January. In January, job gains occurred in professional and business services, health care, retail trade, and social assistance. Employment declined in the mining, quarrying, and oil and gas extraction industry.

Inflation increased 3.40% in December slightly, running above the average trend. After averaging 3.53% in the 3rd quarter 2023, inflation as measured by the Consumer Price Index (CPI) decreased to an average of 3.23% for the 4th Quarter 2023. The average rate of inflation for 2023 decreased by 3.88% to 4.13% from 2022's 8.01% and was above average by historical standards (~2.63% over last 30 years and 3.28% from 1914-2023). The energy index decreased 2.0% for the 12 months ending December, while the food index increased 2.7% over the last year.

Consumption is an important driver of the economy as it represented 67.7% of the 3rd quarter 2023 nominal GDP. The U.S. Census Bureau announced in January that retail sales for December 2023 were 0.60% from November and were up 5.6% above December 2022. Non-store retailers were up 9.70% from last year, while the food and beverage industry were up 11.10% from December 2022.

The manufacturing economy contracted in January. Economic activity in the manufacturing sector contracted for the month of January, with the overall economy contracting for the 15th consecutive month. This follows a 28-month period of expansion. The Purchasing Managers Index (PMI®) registered 49.1; an increase of 2.0 from December's reading of 47.1. The four manufacturing industries reporting growth in January were apparel, leather & allied products, textile mills, transportation equipment, and chemical products. The 13 industries reporting contraction in January were wood products, machinery, plastics & rubber products, nonmetallic mineral products, furniture & related products, computer & electronic products, fabricated metal products, petroleum & coal products, food, beverage & tobacco products, electrical equipment, appliances & components, paper products, miscellaneous manufacturing, and primary metals. A reading above 50 indicates that the manufacturing sector is generally expanding while below 50 indicates that it is generally contracting. Based on historical relationships between PMI and

GDP, a PMI of 49.1 corresponds to a 1.90% increase in real gross domestic profit (GDP) on an annualized basis.

Home prices continued to increase in November. According to the S&P Case-Shiller Home Price Indices home prices in November increased 5.10% over the last 12 months, which is up 0.40% from the previous month's 4.7%. Detroit and San Diego had the largest year-over-year increases with 8.2% for Detroit and 8.00% for San Diego. According to the National Association of Realtors, the year-over-year change in existing home sales was -17.40% in September for Single family homes between $250,000-$500,000. Housing supply continued to remain tight in September with 3.3 months of supply.

Markets: The S&P 500 hit an all-time high on January 19th, 2024, at 4839.81 surpassing its previous record set two years earlier. It then set another high on February 2, 2024, at 4,958.61. At this time, the market will continue to be driven by dovish monetary policy, inflation, slowing economic growth, and geopolitical risks.

What will move the markets moving forward:

- **Earnings: Earnings growth for the SP500 is expected to increase 1.60% for the 4th quarter of 2023. For Q4 2023, the estimated earnings increase for the S&P 500 is 1.60%. If 1.60% is the actual increase for the quarter, it will mark the 2nd straight quarter that the index has reported earnings growth.** Looking at future quarters, analysts project earnings growth for the 1st QTR 2024 to be 4.5%. Earnings growth for 2024 is projected to be 11.2%.
- **Valuations: Valuations rose meaningfully last year.** The Price to Earnings at the beginning of 2023 was 16.7. It has increased to 19.51 through the 4th quarter 2023. The 20 Year average P/E is 15.6, which is 3.91 below our current levels. There is not a lot of room for P/E expansion currently without meaningful earnings growth.
- **Interest Rates/Monetary Policy: Short Term Interest Rates have been stable since September and are right above historical averages. The average effective Fed Funds rate since July 1954 is 4.60%. The average over the last 10 years is 1.31%.** The Federal Reserve left rates unchanged at a range between 5.25%-5.50% in its latest meeting in January and is expected to lower rates 3 to 5 times for the remainder of this year. The Fed will continue reducing its holdings of Treasury securities, agency debt, and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet. The Committee is strongly committed to returning inflation to its 2 percent objective. The spread between the 2-year and 10-year Treasury yields is -0.33% as short-term rates have risen faster than long-term rates. The yield curve is currently inverted (2-year yield is higher than the 10-year yield) and financial conditions are currently tightening. **Eight of the last Nine recessions since 1955 have occurred during a rising interest rate environment when short term rates were higher than long term rates (Inverted Yield Curve), which leads to our ongoing concern of the Fed raising rates too far. It is not if, but when.**
- **Inflation: Inflation meaningfully decreased in 2023.** Currently the Fed has paused interest rate increases. Currently, we do not see the Fed needing to raise rates to continue to fight inflation. Slower economic growth should allow inflation to continue to slowly decrease.
- **Russia-Ukraine Conflict and other Geopolitical risks: The current conflict is continuing to weaken the European economy more than the US economy, with some speculation of a recession in some countries (especially Germany) as soon as the 1st quarter 2024.** At this time, it is hard to determine the total impact this conflict will have on the US. US-China relations

remain tense. The conflict Israel and Gaza is continuing to drag on with no cease fire in sight. US-Iran relations remain tense.

- **Election Year:** Since 1952, the S&P 500 has averaged a 7% gain during U.S. presidential election years. While a 7% gain is far from disastrous, it is also well short of the 17% average S&P 500 gain in the year prior to an election year. It's also below the roughly 10% average annual total return for the S&P 500 in a typical year. Of course, it's important to remember that past performance does not guarantee future returns, and there have only been 17 presidential elections since 1952. The good news for investors heading into 2024 is that the S&P 500 has not declined during a presidential re-election year since 1952 and has averaged a 12.2% annual gain in re-election years.

Forecast:

We think the biggest threats to the stock market are interest rates continuing to increase, economic contraction and geopolitical risks. We think the SP500 will end Q1 2024 between 4800 and 4900. At this juncture, we venture a guess that stocks will end the year somewhere between 6% and 8% for the year.

For the next six to twelve months, the Federal Funds rate will most likely decrease from its current range of 5.25%-5.50% to 4.50-4.75%. **The 10-year Treasury, which is currently priced at ~4.16% should remain in a range between 4.25%-4.50% through the end of the 1st quarter.**

As always, we appreciate your continuing confidence in our firm. Please let us know if you have questions.

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