The fourth quarter of 2023 capped a remarkable run-up in financial markets, culminating in a 26+% return for the S&P 500 and a 5.5+% return for the Bloomberg Barclays Aggregate Bond Index. Coming on the heels of double-digit negative returns for both indices in 2022 and despite the looming calls for a recession and seemingly unending Fed rate hikes, the year-end result was both welcomed and impressive.

Perhaps the biggest story in equities for 2023 was the extremely narrow breadth of the market, as the so-called Magnificent Seven stocks accounted for more than 70% of the S&P 500's total return for the year; excluding companies from the information technology and communications services sectors would have resulted in a 2023 S&P return of just 7.6%. Indeed, those companies were some of the few that exhibited durably positive earnings growth for the year (30+%), while the aggregate index's earnings grew a measly 1.05%. However, the last two months served to support a healthier picture, as the equal-weighted index returned 11.87% for the quarter, above the market-cap weighted index and reflective of a broadening of positive investor sentiment, a generally supportive signal for the market. We would expect the earnings growth picture to further normalize going forward and given that the other 493 stocks trade at much more reasonable P/E ratios (17x forward earnings), this should be a constructive catalyst.

In the fixed income markets, a round trip of sorts was made. The yield on the 10-year US Treasury Bond began the year at 3.84% and ended the year at 3.848%. Similarly, the yield curve went from being inverted roughly 50 basis points in January, to a 43 basis point inversion in December. Without context it would seem that 2023 was an uneventful year for bonds, however that couldn't be farther from the truth; what those numbers mask was extreme volatility throughout 2023, as the 10-year traded above 5% and routinely saw 10-20bps daily swings (unheard of for the usually sleepy bond market), while the 2-year peaked at 5.25%, before settling back down to 4.25% in December, reflecting the market's expectations for aggressive Fed rate cuts in 2024. Investment grade corporate bonds, high yield bonds and leveraged loans all saw extremely favorable returns in Q4 as rates rallied, consumer and economic data remained robust and a general risk-on attitude prevailed.

Going forward, much of the market action is likely to be dictated by both the trajectory of the economy and the prospect and/or speed of Fed rate cuts. Currently, the market is pricing in a very rapid pace of cutting, expecting the first 25bps cut to come in March and a better than 80% chance that the Fed Funds rate will end the year at least 1% below current levels. Whether or not this comes to fruition is certainly debatable, as any whiff of increasing inflationary pressure will serve to bolster the Fed's resolve. The US consumer (and therefore the economy) persists in their surprising resiliency and while the labor market is showing signs of slowing, any contraction will

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come from a baseline level of historical tightness, lowering the prospect of a meaningful or severe recessionary environment.

In the fourth quarter we took advantage of the selloff in rates to add duration to the fixed income portfolio and lock in yields of 6.5-7% for 10-year corporate bonds. With rates having rallied substantially, those positions (and the portfolio as a whole) have increased in value, while decreasing current yields in the market. As a result, we are now looking to other sectors of the fixed income universe, most specifically securitized/structured credit (Agency MBS, CLOs) to provide excess and non-correlated returns. Equity-wise, we continue to believe that companies with positive and growing free cash flow yields and strong balance sheets will outperform. We remain constructive on technology companies, as they enjoy a myriad of structural tailwinds, though we expect that a broadening of the market may occur going forward, favoring those sectors that have underperformed, as well as small-cap stocks overall. Going into 2024, we're neither overly optimistic nor negative, though we do believe that the setup for a moderately positive return year is certainly in the cards, a scenario for which we are well-positioned.

We hope you had a wonderful holiday season and look forward to meeting and/or speaking again in the New Year! As always, please do not hesitate to contact us if you have any questions or concerns, or to schedule a portfolio review.

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