Quarterly Investment Report

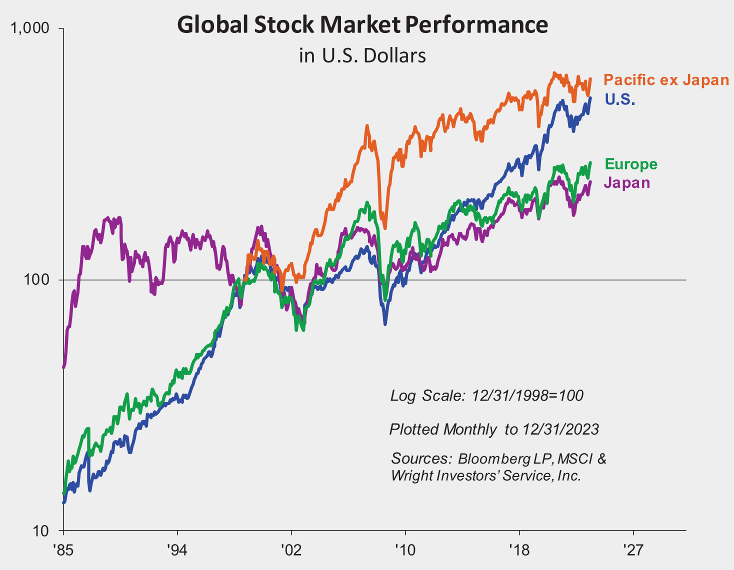
January 2024

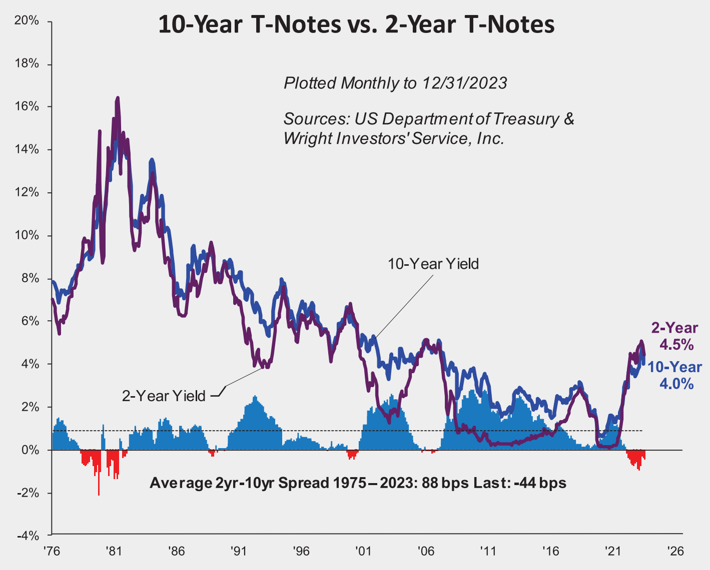
Stock markets defied most geopolitical, inflationary, and higher interest rate concerns during 2023 to close the year on a high note. The S&P 500 Index rose 26.3% for the year. A pause in the Fed's interest rate hikes, a weakening dollar, and falling oil prices supported both equities and bonds in the final quarter of 2023. Global equities, other than China, registered gains as well. The Bloomberg U.S. Aggregate Index rose 6.8% during the quarter. Despite challenges faced by the manufacturing sector, such as labor strikes and high interest rates, overall business activity improved, with the services sector recovering and driving the PMI Composite Index higher. The unemployment rate fell to 3.7% despite expectations of weaker labor conditions. The Fed's preferred inflation measure, the core PCE price index, continued to moderate. By the end of the quarter, 30-year mortgage rates were at 6.6%, having peaked at nearly 8% in October. Lower mortgage rates are expected to give some support to home demand and prices.

Stock Market

In the fourth quarter of 2023, the U.S. stock market rebounded with significant gains across sectors. The S&P 500 Index rose 11.7% for the quarter and 4.5% in December. The Dow Jones Industrial Average and Nasdaq Composite outperformed, with monthly increases of 4.9% and 5.6%, respectively. The three indices were up 26.3%, 16.2%, and 44.6%, respectively, for the year. During the quarter, Mid-cap stocks rose in tandem with Large-caps, advancing 11.7%, and Small-caps outperformed with a total return of 15.1%. Additionally, across all market capitalizations, value stocks outperformed growth stocks. Equities across most sectors increased significantly. Notably, Real Estate, which had faced headwinds in the previous quarter, performed exceedingly well, rising 18.8% for the quarter. Conversely, Energy, which had fared exceptionally well in the previous quarter, fell -6.9% in the fourth quarter and was the only sector with negative returns. Information Technology, Financials, and Industrials were the other top performers with total returns of 17.2%, 14.0%, and 13.1%, respectively.

Internationally, U.S. equities outperformed most major developed and emerging markets, except Europe. European stocks, as represented by the MSCI Europe ex UK, witnessed a 12.3% increase in U.S. dollar terms for the quarter. While all major developed markets and emerging markets exhibited positive returns, the Chinese markets continued to struggle, declining -4.2% for the quarter. Furthermore, the U.S. Dollar depreciated -8.1% against the Swiss Franc, -5.6% against the Yen, and -4.2% against the Euro, and was broadly lower against other major currencies.





Bond Market

The Bloomberg U.S. Aggregate, a comprehensive index of investment-grade, dollar-denominated bonds, increased 6.8% during the quarter and 5.5% in 2023. It underperformed the Bloomberg U.S. High Yield Bond index, which rose 7.2% for the quarter and 13.4% for the year. Non-U.S. Dollar bonds, as represented by the Bloomberg Global Aggregate ex-U.S. Index, witnessed a significant rise of 9.2% in the quarter. A rally in the fourth quarter prevented bonds from suffering an historically unmatched third consecutive annual loss. The Fed held rates steady during the quarter. Treasury yields, across various maturities (except for 1-month), declined, causing the yield curve to shift downward, although it remains inverted. Treasury Inflation Protected Securities' yields fell more than Treasury yields and expectations for breakeven inflation moderated. During the quarter, the 30-year yield in the U.S. dipped below 4%, marking its lowest level since July. This decline may be attributed to bond investors factoring in the implications of the Federal Reserve's recent shift in policy stance. On December 13, Federal Reserve officials unveiled updated quarterly projections for the Federal Funds benchmark interest rate. These forecasts signal the Fed's intention to implement a more substantial reduction in the Fed Funds rate in 2024 compared to their earlier expectations outlined in September.

Alternatives

Commodities exhibited a weaker performance than equities and bonds during the quarter. The S&P GSCI, a widely recognized benchmark for gauging commodity performance, closed the quarter -12.1% lower. Energy prices saw declines, with crude oil, natural gas, and heating oil prices dropping by -21.1%, -14.2%, and -24.1%, respectively. Conversely, metal prices, including gold and copper, recorded gains of 12.1% and 4.1%, respectively, during the quarter. Moreover, wheat prices in U.S. Dollar terms rose by 16.0%, while corn prices fell -1.2%. The S&P United States REIT Index surged by almost 14.8%, reflecting the impact of dropping interest rates during the same period.

Economy

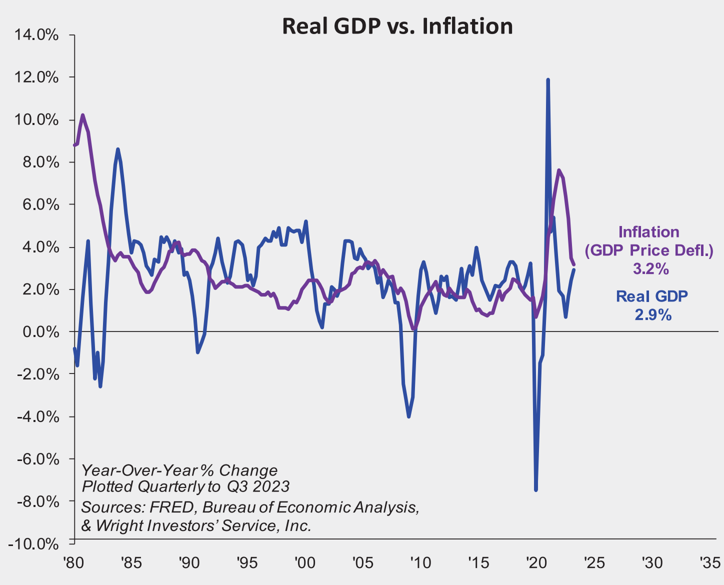
The PMI Composite Index was driven higher by the strength of the U.S. services sector, while the manufacturing sector continued to exhibit weakness. The U.S. PMI Composite Index increased a revised 50.9 in December 2023, suggesting that the U.S. economy gained further traction in the month and ended the year with the highest level of optimism among purchasing managers since July. The services sector experienced increased demand, improved business operations, and stronger employment supported by easing financial conditions, leading to a revised PMI of 51.4. The index value for December marked the 11th consecutive period of expansion with the growth in the quarter attributed to increased expenditure on advertising, promotion of additional services to existing clients, and relaxation of financial conditions, resulting from a significant drop in Treasury yields. In contrast, the manufacturing sector continued to decline with the index contracting (sub-50 value) for two out of the three months in the quarter. The decline in output was moderate but marked the quickest pace in six months. Manufacturing continues to be a burden on the economy and faces continual challenges, with accelerated declines in order books leading factories to decrease production, reduce staff, and cut back on input purchases. The current trend in order books paints a picture of supply surpassing demand for many goods, suggesting potential risks to production, employment, and prices as we enter 2024.

In November, unemployment fell to 3.7% from 3.9% a month earlier, while the number of unemployed people showed little deviation at 6.3 million. On a positive note, non-farm payrolls expanded by 199,000 for the month, compared to 150,000 for the previous month.

Global Investment Returns In U.S. Dollars

	Q4 2023		YEAR 2023	
	Stocks	Bonds	Stocks	Bonds
U.S.	**11.8%**	**6.8%**	**26.5%**	**5.5%**
Canada	11.2%	10.1%	15.4%	7.9%
Mexico	18.6%	9.8%	40.9%	9.8%
Japan	**8.2%**	**6.8%**	**20.3%**	**-5.9%**
Pacific ex Japan	11.4%	6.0%	6.4%	3.7%
Australia	15.2%	10.2%	14.8%	5.1%
China	-4.2%	4.7%	-11.2%	3.0%
Hong Kong	3.4%	5.1%	-14.8%	7.3%
Europe	**11.1%**	**11.2%**	**19.9%**	**10.9%**
France	10.3%	9.5%	21.4%	8.3%
Germany	13.0%	11.0%	23.0%	9.3%
Italy	12.7%	11.5%	37.1%	13.5%
Netherlands	19.9%	12.3%	25.8%	10.0%
Spain	12.4%	11.1%	31.9%	10.9%
Switzerland	10.1%	12.7%	15.7%	18.3%
U.K.	6.9%	13.1%	14.1%	11.2%
World	**11.4%**	**8.1%**	**23.8%**	**5.7%**
World ex U.S.	10.5%	9.2%	17.9%	5.7%

Sources: MSCI Stock & Bloomberg Barclays Bond Indexes as of 12/31/2023



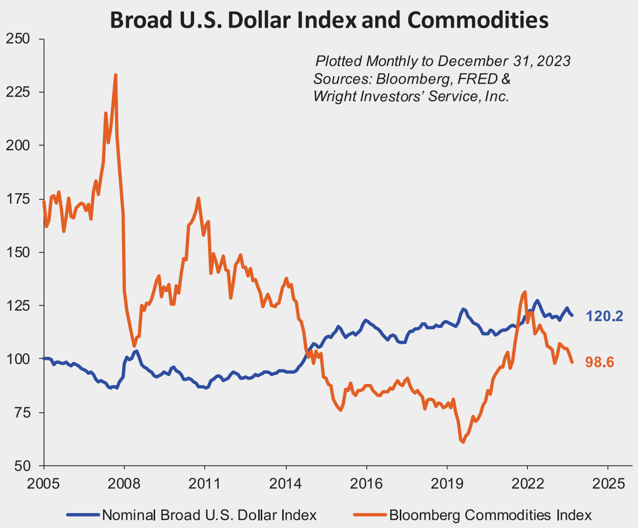
Key sectors that experienced job growth included health care, government, and manufacturing, marking the return of workers from several labor strikes. Among these, the health care sector saw the most significant increase, adding 77,000 jobs. Conversely, the retail trade sector continued to decline, experiencing 38,000 job losses. Job gains in the information sector, totaling 10,000, were primarily driven by the motion picture and sound recording industries where employment increased largely due to the resolution of labor disputes. The labor force participation rate remained nearly unchanged at 62.8%, showing no significant changes since August.

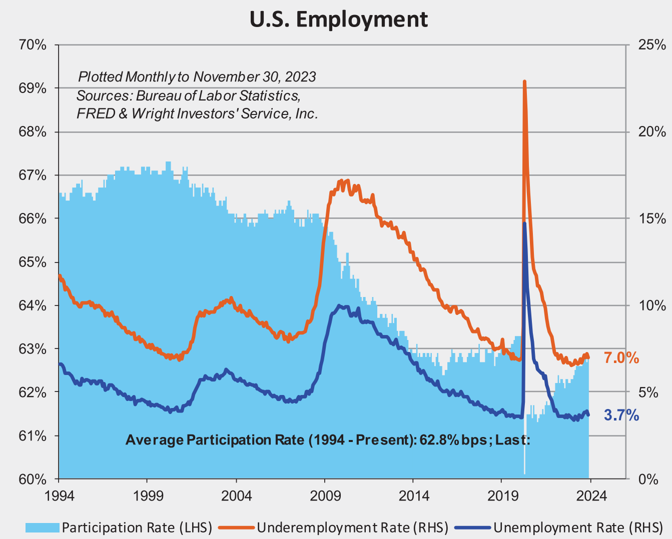
Further signs of inflation coming under control were evident as the headline PCE index moderated to 2.6% on a year-over-year basis. This followed a 2.9% rise in October, reinforcing hopes of continued improvement and slowing inflation. Energy prices decreased during November, falling 2.7%. Excluding the volatile food and energy components, the core PCE price index showed a modest monthly gain of 0.1%, mirroring the increase in the prior month. The year-over-year core PCE price index increased 3.2% in November, slightly below the economists' forecast of 3.3%, and lower than the 3.4% increase in October. This seems to confirm that inflation is moving towards the Fed's targeted level. U.S. consumer spending increased 0.2%, both in October and November, following a more substantial 0.7% increase in September. The reduction in spending is, in part, attributed to the impact of elevated borrowing costs and concerns about a potential economic slowdown.

As of December 28, the average rate for a 30-year fixed mortgage stood at 6.6%, marking its lowest point since May and continuing a nine-week downward trend. This decrease mirrors the ongoing reduction in the long-term Treasury yields seen since October. Despite the potential positive impact of declining mortgage rates on the housing market, the persistent lack of existing homes for sale continues to be a limiting factor. This could potentially drive house prices up in the coming year, particularly if demand stays relatively strong. According to a recent report from the National Association of Realtors, the sales of existing homes increased by 0.8%, reaching an annual rate of 3.82 million units in November after adjusting for seasonality. This marks the end of a five-month streak of declines. Housing starts in November were at a seasonally adjusted annual rate of 1,560K, 14.8% above the revised October estimate of 1,359K and 9.3% above the November 2022 rate. Building permits in November were at a seasonally adjusted annual rate of 1,460K, 2.5% below the revised October rate of 1,498K, but 4.1% above the November 2022 rate.

Investment Outlook

While several indicators suggest the possibility of a so-called soft landing, there are reasons to remain cautious. Investors responded positively in December to the Federal Open Market Committee's decision to keep rates within the range of 5.25% to 5.50%, coupled with indications of potential rate reductions in 2024. The December dot plot from the Federal Reserve projects a median federal funds rate of 4.6% in 2024, indicating additional decreases by the Fed in the subsequent years. To their likely relief, the impact of the Fed's actions is evident as inflation comes under control without showing significant signs of economic growth weakening. It seems clear that the central bank is transitioning to more accommodative policies, potentially fostering growth in 2024. However, a recent survey taken by Bloomberg L.P. suggests most economists expect U.S. GDP to drop to 1.3% in 2024 from an expected annual growth rate of 2.4% in 2023. Stocks and bonds, which performed well in the final weeks of 2023, may see further increases, although the gains could be modest. While it is expected that U.S. corporate profits will rise due to subdued inflation levels and reduced interest rates in the future, the increase may not be sufficient to sustain elevated stock valuations.





Similarly, while bonds are expected to perform well in the coming year due to expected interest rate cuts in 2024, the Fed meeting minutes did not offer direct insights into when these cuts might commence. With the war between Russia and Ukraine showing no signs of abating, geopolitical concerns are mounting further after the October 7th attack by Hamas forces on Israeli civilians. Joining the action are Houthi rebels based in Yemen, who have been targeting tankers and container ships with drone attacks in the Red Sea. Ships are now avoiding the Red Sea and Suez Canal, opting instead to travel around the much longer and more costly Cape of Good Hope route, at a risk of putting upward pressure on the prices of those transported goods and negatively impacting the supply chain. It is widely accepted that Iran is providing support to both Hamas and the Houthis. This volatile and unstable situation could easily deteriorate into a broader conflict and draw the U.S. closer to direct involvement in the region. Elsewhere, Taiwan will hold a general election on January 13th, and the outcome could affect Chinese military behavior in that area. If tensions mount there, the U.S. could be drawn into the conflict to a yet unknown degree, adding to an already elevated level of geopolitical risk and uncertainty.

While inflation abates, employment remains strong, earnings growth expectations are sanguine, the outlook for the U.S. economy is positive. Furthermore, election years have a reputation for producing supportive economic conditions and hence good financial markets. However, the widely anticipated recession of 2023 has yet to materialize, and many participants have retired that call and instead envision some form of soft landing. We remain skeptical that this is the most probable outcome. The full impact of the increases to the Fed Funds rate likely has not yet been felt in earnest, counter to expectations, and it is widely acknowledged that these changes take effect with "long and variable" lags. Furthermore, on average, U.S. equities are not currently undervalued, and for another upward move, economic and financial conditions will need to be supportive. Globally, growth is facing challenges in many regions. However, it doesn't imply that all markets will experience negative trends in 2024, and there are opportunities for gains. Taking a broader view, whether in favorable or challenging times, it is important for investors to invest in portfolios of well-diversified, high-quality securities and maintain a long-term perspective to navigate through uncertain markets.

The U.S. Economy 2022–2025

			% Change In		End of Period Rates	
		Real GDP*	PCE Core Deflator*	Profits from Operations#	90-Day T-Bills	10-Year T-Notes
2022	Q1	**-2.0%**	**6.0%**	**46.9%**	**0.5%**	**2.3%**
	Q2	-0.6%	4.7%	36.0%	1.6%	3.0%
	Q3	2.7%	5.0%	19.9%	3.2%	3.8%
	Q4	2.6%	4.7%	11.8%	4.3%	3.9%
2023	Q1	**2.2%**	**5.0%**	**5.1%**	**4.7%**	**3.5%**
	Q2	2.1%	3.7%	2.3%	5.3%	3.8%
	Q3	4.9%	2.0%	-0.8%	5.4%	4.6%
	Q4 e	1.2%	3.4%	-2.1%	5.3%	3.9%
2024	Q1 e	**0.5%**	**2.8%**	**-1.7%**	**5.3%**	**4.1%**
	Q2 e	0.4%	2.5%	-0.1%	5.0%	4.0%
	Q3 e	1.0%	2.5%	3.4%	4.6%	3.8%
	Q4 e	1.5%	2.4%	7.9%	4.3%	3.8%
2025	Q1 e	**1.8%**	**2.3%**	**11.9%**	**4.0%**	**3.7%**
	Q2 e	1.9%	2.2%	13.4%	3.7%	3.7%
	Q3 e	N/A	N/A	13.7%	3.5%	3.6%
	Q4 e	N/A	N/A	12.3%	3.3%	3.6%

e: Bloomberg Consensus Estimates; *: Quarter-Over-Quarter Annual Rates; #: Year-Over-Year Change in S&P500 EPS Sources: Bloomberg LP, Wright Investors' Service, Inc.

U.S. Stock Market