The Advisor

EXECUTIVE SUMMARY

- Real gross domestic product (RGDP) grew at an annual rate of 4.9% in Q3 2023, driven by strong consumer spending.
- Growth in Q4 2023 RGDP is expected to have significantly dropped from the previous quarter, with estimates forecasting growth to range between 1.5% and 2.5%.
- Consumer confidence and spending remained resilient, supported by steady employment, but the lagged effects of tighter monetary and diminishing fiscal policies appear to be working their way into the economy.
- Many economists are looking for the economy to have a "soft landing" in 2024.
- The Fed met in October and December, leaving rates unchanged and acknowledging that inflation has markedly improved.
- Geopolitical events will dominate the 2024 landscape, marked by a notable number of important elections in the U.S. and across the globe.
- Market consensus suggests that rates have peaked with financial markets rallying accordingly in the fourth quarter.
- Equity markets soared in the fourth quarter over optimism that the Fed was done raising interest rates and the economy will skirt a recession. The S&P 500 Index's 11.7% gain in the fourth quarter leaves it relatively pricey compared to its supporting fundamentals.
- Fixed income over the last two months of 2024 reversed the losses experienced through October as yields fell. The YTD total return of the Bloomberg Aggregate through October was -2.77% and by the end of year the return was +5.53%. The Index was up +8.53% for November and December.

ECONOMIC REVIEW

The U.S. economy surged in the third quarter, growing at its fastest pace since 2021, as Americans spent on travel, concerts, and movies supported by a strong labor market and savings accumulated during the COVID-19 pandemic.

The economic data around employment and inflation was relatively good throughout the fourth quarter and supports the case for a soft landing. Consumer spending was light at the start of the quarter but picked up for the holiday season to levels that exceeded initial expectations.

The Fed met at the end of October and again in mid-December, leaving its benchmark federal funds rate unchanged at 5.5% at both meetings. Chair Powell acknowledged that inflation has markedly improved over the past year but did not declare a premature victory. Financial markets interpreted the relatively dovish action and remarks as a signal that interest rates have peaked and rallied accordingly.

The European Central Bank (ECB) met in December and maintained its deposit rate at 4.0% but acknowledged that inflation was improving. The ECB does not want to let its guard down, even though inflation has dropped to about 2.4% in the European Economic Community. Europe has avoided a deep recession, but its economy has been stagnant for over a year, and unemployment is edging up in places. Like its Fed counterpart, the ECB is balancing the risks of overtightening and risking a recession with the peril of prematurely lowering rates and stalling the disinflation trend.

China's economic recovery remains elusive and appears to be losing momentum as investment and consumer spending grow at disappointing levels and a prolonged slump in properties continues. Recent data indicate that activity in imports, manufacturing, and services slowed in the fourth quarter, prompting authorities to infusion liquidity into the financial system.

Hamas' invasion of Israel in early October ignited conflict in the Middle East that added to the mounting disorder in global stability.

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MACRO SUMMARY

GDP

- RGDP expanded at a sizzling 4.9% annual rate in the third quarter, driven by strong consumer spending and supported by steady government outlays. Businesses built up inventories, but investment in plant & equipment was essentially flat over the quarter.
- Corporate profits increased 3.4% at a quarterly rate in the third quarter after increasing 0.2% in the second quarter.
- RGDP growth is expected to cool in the fourth quarter, with estimates ranging between 1.5% to 2.5%.

Employment

- The unemployment rate edged down to 3.7% in November and average weekly hours worked edged up but growth in average hourly earnings fell to a 4.0% annual rate.
- There were almost 1.4 job openings for every unemployed worker in November and the tight labor markets appear to be softening.
- Initial jobless claims continue to reflect strong labor markets, but hiring plans are weakening, while firms are finding it less difficult to find qualified labor.
- The November NFIB Survey reported that 40% of owners had job openings that they could not fill, but the number of openings was falling.

Housing

- Home sales fell in October to a fresh 13-year low, to a seasonally adjusted annual rate of 3.79 million units, as high interest rates and home prices continued to pummel the housing market.
- Housing starts climbed almost 15% in November, but the more forward-looking building permits declined modestly.
- The low 3.6-month inventory of homes at the end of October helped support home prices, as the median existing home price rose 3.4% in October from a year earlier to $391,800.
- The 30-year mortgage rate, measured by the St. Louis Federal Reserve, was quoted at 6.6% at the end of December.

Consumer

- The Conference Board's consumer confidence index strengthened to reach its highest level since April 2022 in December.
- Both the Present Situation and Expectations Indexes improved due to consumers' more favorable view regarding the economy and jobs.
- Consumers' spending patterns continue a preference for services over big-ticket items.
- Consumer holiday spending on gifts and eating out was healthy.

Business

- The ISM Manufacturing Index contracted for an eleventh consecutive month in September. The 49.0% reflected an improving manufacturing sector.
- The September ISM Services Index registered 53.6% and was its ninth consecutive month of expansion and corresponds to a 1.3% increase in annual RGDP.
- NFIB's Small Business Optimism Index remains weak, with owners noting that inflation is still an important problem. Many hold a pessimistic outlook and are concerned about waning pricing power and negative operating leverage.
- Lending standards for loans have tightened across all categories, with lenders citing a more uncertain outlook, reduced risk tolerance, deteriorating credit quality, and increased funding costs.

The Fed

- The Fed met at the end of October and again in mid-December, leaving its policy rate unchanged at 5.25% over both meetings and acknowledging that inflation has eased.
- The Fed projects a 75bp in easing for 2024 and sees the Fed funds rate dropping another 1% to 3.75% by year-end 2025.
- Expectations are for the rate to settle into 3.00% by end of 2026 and subsequently approach a 2.5% terminal rate.

Inflation

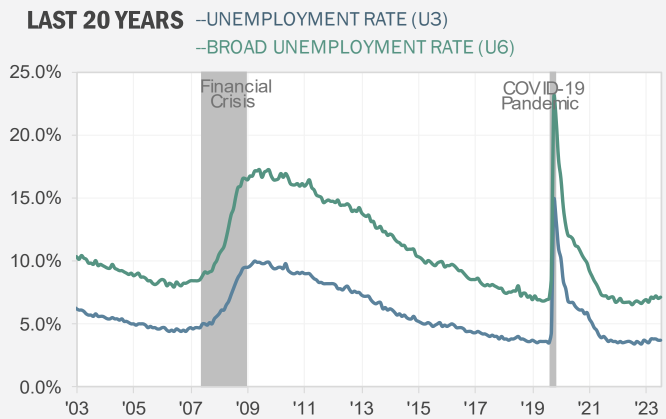
- November's 3.1% YoY increase in CPI Headline showed continued improvement over the quarter, helped by lower energy costs. Core inflation fell to a 4.0% y/y level.
- The Personal Consumption Expenditure (PCE) index increase slowed to a 2.6% rate since last November and the core measure fell to a 3.2% annual rate.
- The real M2 money stock peaked in December 2021 and continues to trend lower.

Commodities

- The U.S. dollar index fell almost 4.7% over the fourth quarter, weakened by prospects of a more dovish Fed posture. The weaker dollar should help exports to a slowing global economy for the quarter.
- Oil prices weakened significantly over the quarter, with WTI crude falling from almost $91 a barrel at the start of the quarter to $74 a barrel at the end of December. Prices fell over concerns of demand and market oversupply despite OPEC+ supply cuts and increasing conflict in the Middle East.

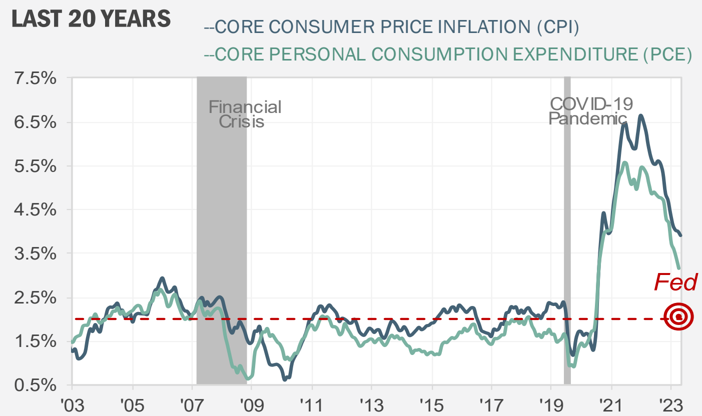
MACRO SUMMARY CHARTS

Unemployment Rate



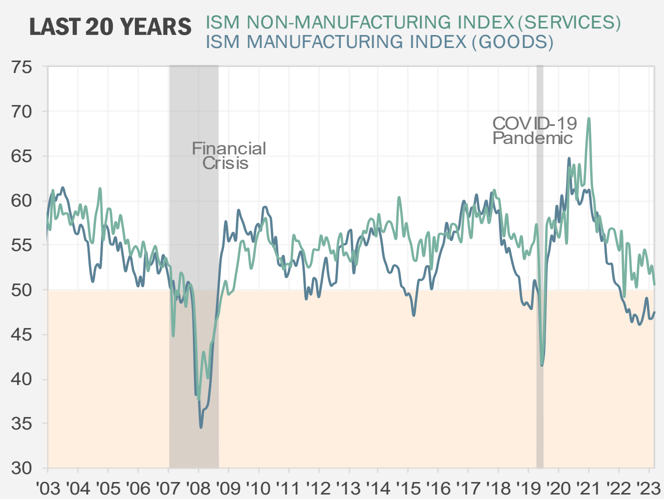
Last Observation: 12/31/2023 Source: Bloomberg, Federal Reserve, Department of Labor.

Inflation



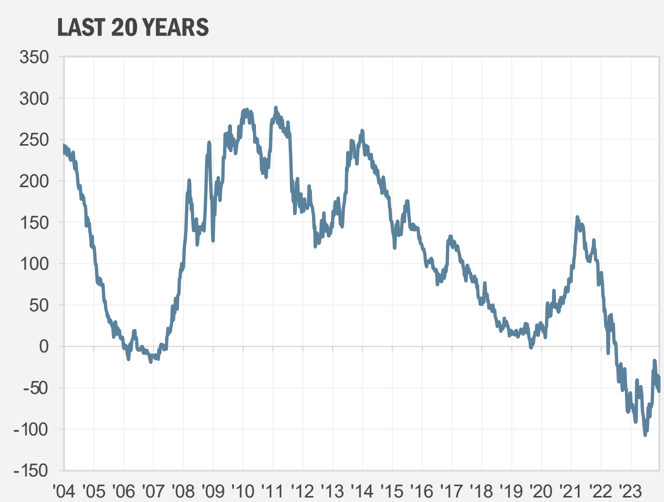
Last Observation: 12/31/2023 (Core CPI) 12/31/2023 (Core PCE)
Year-Ober-Year Change Source: FRED Federal Reserve Bank of St. Louis

Manufacturing & Services



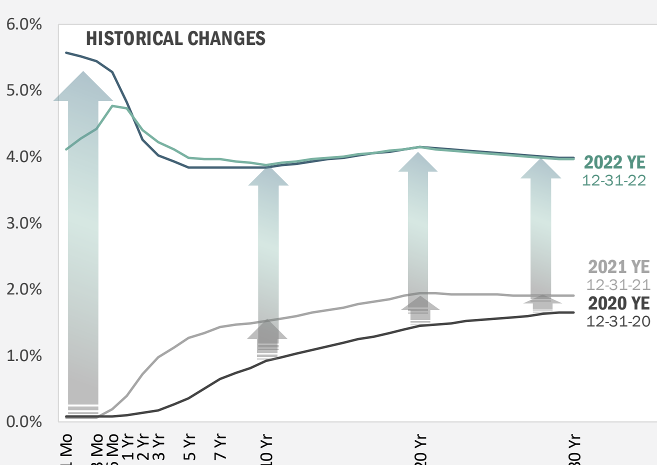
Last Observation: 12/31/2023 (Non-Manufacturing) 12/31/2023 (Manufacturing) Source: Bloomberg, Duke University, Institute for Supply Management / CFO Survey & Global Business Outlook

U.S. 2-Year/10-Year Spread



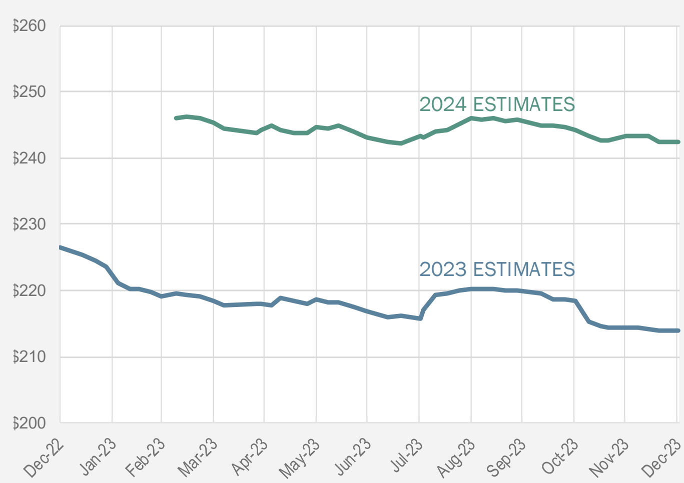
Last Observation: 12/31/2023 Source: Bloomberg

Yield Curve



As of 12/31/2023, Source: Bloomberg

Earnings Estimates



As of 12/31/2023, Source: Bloomberg

ECONOMIC OUTLOOK

The economy is expected to have slowed at a lower rate of growth in the fourth quarter and appears to be running out of steam as warning signs are starting to emerge. Americans have saved less and their incomes, adjusted for inflation, have remained flat over the past year. That could produce a slower pace of spending next year and business investment has also stalled. Higher interest rates, wars in Ukraine and the Middle East, and the looming budget debates in Washington could cause economic cracks to emerge.

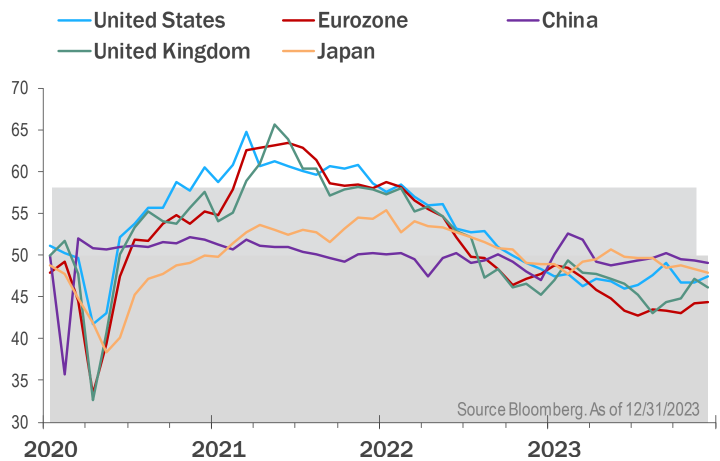
Nevertheless, consumer confidence is supported by a resilient jobs market, improving inflation, and falling interest rates. Lower energy prices and mortgage rates below 7% support a soft-landing narrative. The shift in consumer preferences from goods to services is expected to continue in 2024 and will continue to support inflationary pressures in the service sector.

The Fed's tight monetary policy appears to be working and its target policy rate is now higher than the inflation rate. The significant drop in inflation has set the stage for central bank easing in 2024. However, many traditional recessionary signals still point to potential economic uncertainty ahead. We are now experiencing the most significant decline in the money supply since the 1930s, and lending standards have tightened in response to economic uncertainty, deteriorating credit quality, and higher funding costs.

Global economic growth in 2024 is expected to slow as the lagged effects of aggressively tight monetary policy begin to take hold. However, a serious downturn can hopefully be avoided as inflation eases enough for policymakers to start cutting interest rates.

Geopolitics will dominate the 2024 landscape and substantially influence the global economy. Elections in the U.S. and many other countries will add more event risk on top of tensions in the Mideast, Ukraine, and parts of Asia.

Global Purchasing Managers' Index (PMI)



FIXED INCOME COMMENTARY

MARKET REVIEW

2023 was an incredibly volatile and eventful year with plenty of forces for investors to navigate. We started the year with concerns about recession, but growth came in stronger than expected, stoking fears of more persistent inflation. Revisions to late 2022 releases of Core CPI moved December's 3m annualized rate to 4.25%, shifting the narrative to a "no landing" scenario of inflation staying higher and growth remaining strong. This swiftly changed in March with the collapse of Silicon Valley Bank, raising concerns of broader financial contagion culminating at the beginning of May with the closing of First Republic Bank and JPMorgan's acquisition of most of its assets. Positive economic news continued, necessitating central banks to remain focused on persistent inflation. As the regional bank crisis simmered, speculation mounted of a possible pause, but the Fed hiked again in May and then in June with Statement of Economic Projections (SEP) dot plot signaling two more hikes in 2023.

As we entered the third quarter, the prospect of higher-for-longer began to push rates higher. At the September FOMC, the Fed's SEP dot plot showed the 2024 median dot of 5.1%, the highest since 2007. Inflation pressures persisted as oil moved up by over $20/bbl. Investors became increasingly focused on budget deficits and the potential of increased treasury supply. This was capped with Fitch downgrading the U.S. credit rating from AAA to AA+ and the 10-year yield surpassing 5% intraday by late October. In early November the narrative shifted again as inflation surprised to the downside and central banks began to sound more dovish. This led the market to begin to price the potential for a "soft landing" where inflation would move to the Fed's target while avoiding a recession. The year ended with a surprise pivot by the Fed at the December FOMC as the SEP dot plot signaled the potential of 75bps of rate cuts in 2024.

The last two months of the year completely reversed the losses experienced through October. The YTD total return of the Bloomberg Aggregate Index through October was -2.77%, and by year-end the return was +5.53%. The Index was up +8.53% for November and December. The change in sentiment was dramatic, with yields through October on the 2-year, 10-year and 30-year Treasury up 66bps, 106bps, and 113bps respectively, and by year-end the 2-year was down 18bps, the 10-year was unchanged, and the 30-year was higher by only 7bps. During November the Treasury Index had its best month in more than a decade, returning +3.47%, followed by +3.36% in December. For Q4 the Index returned +5.66% with a YTD of +4.05%.

The corporate market remained resilient as spreads moved tighter in the last two months of the year, reaching +99 as investors reacted to more dovish Fed comments. Spreads initially moved wider in October reaching a spread of +130, but as the economic narrative shifted in November and rates fell, spreads steadily marched tighter. Investors took advantage of higher all-in yields to add exposure as the strong technicals persisted. The Corporate Index had an excess return of +203bps for Q4, with +455bps YTD. The best performing sectors for the quarter were Wirelines, Media/Ent, and Chemicals, while Construction, Pharmaceuticals, and Integrated Energy lagged.

For the mortgage sector, 2023 looked to be another challenging year. The MBS Fixed Rate Index excess return YTD through October was -120bps. November and December, though, posted strong returns of +133bps and +64bps, taking Q4 to +133 and the YTD to +68bps, breaking a three-year string of annual negative returns for the sector. 30-year Conventionals slightly outperformed 30-year GNMA issues, while 30-year 3.0%, 3.5%, and 4.0% coupons outperformed the rest of the coupon stack. 15-year issues slightly underperformed the sector.

The ABS market had a good quarter with the ABS Index posting +37bps of excess return taking the YTD to +120bps. The new issue supply did taper after a heavy Q3, and spreads did leak wider in October but December, like other spread sectors, was strong producing an excess return of +35bps, the strongest month of the year. Credit cards underperformed autos with an excess return of +28bps versus +38bps respectively. Non-AAA underperformed AAA tranches with excess returns of +20bps versus +39bps respectively.

The CMBS market continued to recover, with the CMBS Index posting +67bps of excess return, bringing YTD to +114bps. Non-agency slightly outperformed agency issues with an excess return of +73bps versus +61bps respectively. Performance though was very rating specific. Triple-A and double-A tranches outperformed with excess returns of +63bps and +81bps, while triple-B issues were -175bps. Deal performance depended on property type concentration and vintage as higher office exposure and older issues lagged.

FIXED INCOME COMMENTARY (CONTINUED)

MARKET OUTLOOK

- We leave 2023 with an economy that appears to be slowing after a very strong growth of 4.9% in Q3, and a central bank acknowledging the shift. Surprisingly, the Fed "pivoted" at its December meeting by leaving rates unchanged and suggesting it will begin to cut rates in 2024. Bond and stock markets received this message with great enthusiasm. Apparently, the Fed determined the normalization of supply chains will reduce inflation, and they can afford to be patient. By maintaining Fed Funds at higher-for-longer they hope to create a glide path where employment equilibrium is restored, wage growth tapers, and inflation gradually moves towards their 2% target without the economy falling into recession.

- The Fed's key market moving adjustment came from the Summary of Economic Projections. Members of the FOMC lowered their median forecast for year-end 2024 Fed Funds by 50bps to 4.625%. This lowering implies a total of 75bps of cuts for 2024. Chair Powell made little effort to push back against these expectations. The Fed's embrace of interest rate cuts next year is understandable considering the latest economic data shows the potential for PCE Core inflation to reach close to 2% by the middle of 2024. Fed Funds futures are showing approximately a 75% probability of a 25bp cut at the March meeting with about 150bps in cuts for the whole year. In reaction to the pivot, interest rates moved sharply lower. Members of the Fed appear to have been surprised by the aggressive interpretation of their message. After all, in the press conference, Powell noted "we will need to see further evidence" of declining inflation "to build confidence." Still, he acknowledged that the timing of rate cuts was "a discussion for us at our meeting."

- We expect rate cuts next year and forecast 25bps at the June meeting and another 75bps by the end of 2024. We see the 2-year potentially reaching 3.5% and the 10-year close to 3.7% by the end of the year with a slightly positive-shaped yield curve between 2s and 10s. This outlook hinges on continued disinflation as supply chains normalize, employment equilibrium is restored, and wage growth is lowered. If inflation continues to fall, the Fed will have room to begin cutting rates and avoid being too restrictive.

POSITIONING

- The strategy sits at 102% of the benchmark duration with a slight overweight to the belly of the yield curve. We anticipate that if we get close to our year-end target for the 10-year, we will move the strategy back to neutral and look for an opportunity to reset the long position. We expect the yield curve to eventually steepen led by shorter maturities, but this hinges on inflation continuing to trend lower.

- We are slightly underweight Agency MBS but are looking for opportunities to add weight as we expect high quality carry to be important next year. We continue to be overweight 30-year Conventionals versus 30-year GNMAs and underweight 15-year issues. We continue to overweight seasoned 30-year Conventional issues as we expect them to outperform in a lowering rate environment. In the lower coupons (discount dollar), we are focused on issues that are likely to pay down faster.

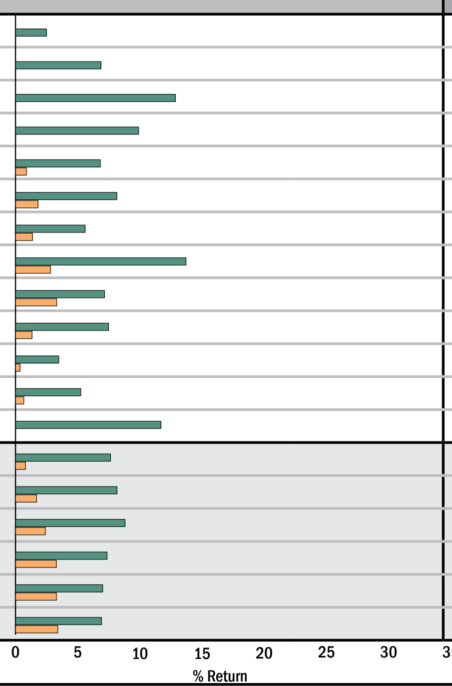
- During Q4 we moved the strategy to neutral versus the Corporate Index as the probability of recession fell and a soft-landing looked like the most probable scenario. With the index at a spread of +99bps we see little value but don't expect much to move the market substantially wider in the near term. The sector remains well supported by strong technicals as buyers remain attracted by the higher all-in yields and supply has been manageable. We see little deterioration in the fundamental picture, but a more dramatic slowdown or a mild recession could impact the sector.

- We remain overweight ABS and we continue to be constructive on the sector. We remain active in the new issue market, and while spreads have tightened the sector still looks compelling relative to other spread sectors. We continue to allow our sub-prime holdings to pay down. Any additional investment will continue to be in AAA tranches from high quality shelves.

- We are overweight CMBS with a bias to the non-agency deals. Our exposure remains in the highest quality tranches with exposure to trophy properties or superior markets. While risks remain, we have a favorable view on recently issued deals as these securities look relatively attractive to other spread sectors. We remain cautious on commercial real estate segments but are comfortable holding our current positions and selectively increasing its weight.

Fixed Income Market Performance Overview

	Fourth Quarter 2023		2023 Year-to-Date	
	Total Return	Excess Return	Total Return	Excess Return
U.S. Treasury 2-Year	2.49	-	3.65	-
U.S. Treasury 10-Year	6.87	-	3.21	-
U.S. Treasury 30-Year	12.85	-	1.93	-
U.S. TIPS 10-Year	9.90	-	1.16	-
Bloomberg U.S. Aggregate	6.82	0.88	5.53	1.40
U.S. Credit	8.15	1.81	8.18	4.20
Bloomberg U.S. Intermediate Credit	5.60	1.37	6.94	2.67
U.S. Long Credit	13.71	2.82	10.73	7.41
U.S. High Yield Corporate	7.16	3.31	13.44	8.86
MBS	7.48	1.33	5.05	0.68
ABS	3.48	0.37	5.54	1.24
CMBS	5.25	0.67	5.42	1.14
S&P 500	11.69	-	26.29	-
AA	7.64	0.80	6.86	3.01
A	8.16	1.70	7.70	3.74
BBB	8.81	2.40	9.41	5.43
BB	7.36	3.29	11.6	7.07
B	7.01	3.29	13.78	9.12
CCC	6.91	3.40	19.84	15.29



Source: Bloomberg. As of 12/31/2023.

EQUITY MARKET COMMENTARY

MARKET COMMENTARY

Equity markets began the quarter with a downward trajectory, but reversed sharply at the end of October, buoyed by improving economic data that suggested the Fed had finished raising interest rates. Enthusiasm over equities was also fueled by excitement over the prospects of Artificial Intelligence (AI) and its potential to increase productivity and profitability across the economy.

The S&P 500 Index gained 11.7% in the fourth quarter, led higher by investors' infatuation with AI stocks in the Information Technology sector and also helped by the Finance and Real Estate sectors that are expected to benefit from lower interest rates and a steady economy. Energy was the only sector to decline over the quarter, dragged down by lower oil prices. Small cap stocks rebounded convincingly, pulling the mid-cap indices higher with them. The growth style worked well in the large-cap areas of equity markets, while value outperformed in both the mid and small cap indices.

Factor performance in the fourth quarter reflects investors' move towards a "risk-on" posture in anticipation of lower interest rates and a soft landing for the economy. Shares of smaller capitalized, value-oriented companies displaying more trading activity outperformed shares of larger, value-oriented companies exhibiting higher profitability. After penalizing these factors for much of the year, investors rewarded companies showing higher momentum and paying dividends in the fourth quarter.

MARKET VALUATION

- Earnings estimates for 2023 fell through mid-July before recovering into the end of the third quarter, only to drift lower and end the year near its lows.
- Earnings estimates for 2024 fell from their introduction in early March until late July. They peaked in late August and finished the year near the July lows.
- The market capitalization of the 10 largest companies in the S&P 500 Index account for 32% of its weight and contributed 23% of its earnings. This represents a concentration risk for investors of the index.
- Earnings are estimated to grow by 13.4% in 2024 and reflect no economic slowing.
- The S&P 500 Index (SPX) of large-cap stocks traded at 22.4 times its trailing 1-year earnings at year-end and 19.7 times its 1-year forward earnings.
- The S&P 400 Index of mid-cap stocks traded at 18.0 times its estimated 2023 earnings and 15.2 times its 2024 earnings at the end of December.
- The S&P 600 Index of small-cap stocks was priced at quarter-end to reflect 18.6 times its estimated 2023 earnings and 14.9 times its projected 2024 earnings.
- The valuation gap between Growth and Value styles remains tilted towards a relatively cheap Value vs. expensive Growth.
- Small cap indices reflect much more reasonable valuation, especially within the Value and Core "style boxes".
- Third quarter earnings results revealed that 41% of the companies in the Russell 2000 Index reported being unprofitable, suggesting that investors in the asset class pay close attention to fundaments.

MARKET OUTLOOK

- After the Fed's December meeting, financial markets relinquished hopes of a Fed "pivot" on rates in the third quarter but moved back to expectations of a fed funds rate cut in early 2024.
- Low earnings yield relative to bonds implies that the market is fairly valued from an asset allocation perspective.
- Equity markets are not pricing in a recession. However, there is a risk of further pricing weakness and more volatility as equity investors adjust their expectation to inflation and interest rates that remain above the post-global financial crisis averages.
- The 4Q earnings season will likely see decelerating earnings growth that reflects a slowing economy.
- Slowing inflation could reduce revenue growth and pressure margins, which may undermine earnings growth compared to earlier quarters.
- Equities indices can continue to advance as participation beyond the "magnificent seven" broadens and, if inflation doesn't accelerate, to impede the Fed's easing.
- Equities advanced in 2023 primarily upon multiple expansion, but higher real rates and cost of capital have become more constrictive and pose a risk for equity multiples.
- Equity risk premiums are well below the averages of recent years and represent a source of significant risk if investors become more risk-averse and require lower multiples on equities.
- Analysts expect the Health Care, Energy, Materials and Real Estate sectors of the S&P 500 Index to experience earnings contraction in 2023, while the Consumer Discretionary, Financials, Utilities and Communications Services sectors are expected to realize well above average growth in earnings.
- Earnings for the S&P 500 Index are expected to increase across all sectors in 2024. The Information Technology and Health care sectors are expected to experience 2024 earnings growth that is more than 20% over 2023 levels.

Performance Overview (%)	Historic Annual Periods					Recent Quarters				2023	Trailing Periods		
	2018	2019	2020	2021	2022	Q1'23	Q2'23	Q3'23	Q4'23	YTD	1-Year	3-Year	5-Year
LARGE CAP CORE (S&P 500 Index)	-4.38	31.49	18.40	28.71	-18.11	7.50	8.74	-3.27	11.69	26.29	26.29	10.00	15.69
LARGE CAP GROWTH (Russell 1000 Growth Index)	-1.52	36.39	38.49	27.59	-29.14	14.37	12.81	-3.13	14.16	42.68	42.68	8.86	19.50
LARGE CAP VALUE (Russell 1000 Value Index)	-8.27	26.54	2.80	25.16	-7.54	1.01	4.07	-3.16	9.50	11.46	11.46	8.86	10.91
SMALL CAP CORE (Russell 2000 Index)	-11.02	25.52	19.96	14.81	-20.44	2.74	5.21	-5.13	14.03	16.93	16.93	2.22	9.97
SMALL CAP GROWTH (Russell 2000 Growth Index)	-9.31	28.48	34.63	2.83	-26.36	6.07	7.05	-7.32	12.75	18.66	18.66	-3.50	9.22
SMALL CAP VALUE (Russell 2000 Value Index)	-12.86	22.39	4.63	28.27	-14.48	-0.66	3.18	-2.96	15.26	14.65	14.65	7.94	10.00

Source: eVestment. As of 12/31/2023. Periods greater than 1 year are annualized.

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