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A year ago, almost no one expected 2023 to be a blockbuster year for stock returns. In fact, many strategists at Wall Street banks were calling for a recession at the start of the year, and S&P 500 price targets were generally bearish. The year started with the Federal Reserve raising interest rates at the fastest clip since the 1980s, followed by a regional banking crisis with the collapses of Silicon Valley Bank and First Republic Bank. Then came a war in the Middle East that was launched by an attack on Israel by Hamas.

Yet last year's widespread skepticism proved to be misplaced. The S&P 500 finished the year with a nine-week winning streak, its longest rally since January 2004. It closed 2023 with a 24% gain, just 0.6% from its January 2022 record. The Dow Jones Industrial Average returned 14% to top 37,000 for the first time. The Nasdaq Composite soared 43%, its best year since 2020, powered by the rise of artificial intelligence. Wall Street's fear gauge, the Cboe Volatility Index, closed the year at 12.52, its lowest level since 2020.

Excitement for generative artificial intelligence sparked by OpenAI's chatbot (ChatGPT) was the dominant theme for investors in 2023. Technology and e-commerce companies in the S&P 500 gained an average of 57%, more than double the broad index's overall performance for the year. Semiconductors and software industries recorded their best annual returns since 2009, when the market was bouncing back from the Global Financial Crisis. The "Magnificent Seven" replaced "FAANG" as the market's leaders. Nvidia, Apple, Microsoft, Alphabet, Amazon, Meta, and Tesla swelled to represent roughly one-third of the S&P 500's market value and were responsible for much of the 2023 gains.

The other key driver of such investor optimism is the anticipation that the Federal Reserve's interest rate hikes are coming to an end, powered by a downward trend in inflation data in 2023 (CPI fell from 9% at the peak in 2022 to 3.3% by year end 2023). As a result, the Fed paused its rate hiking cycle in July, and held short-term rates steady for the remainder of the year. The Fed is now projecting at least three rate cuts in 2024, while market participants have priced in as many as six rate cuts, a divergence that will need to be resolved throughout the year.

Along with the shift in interest-rate expectations came a historic move in bond yields. The 10-year US Treasury yields reached 5.19% in October 2023 for the first time in 16 years, which triggered a stretch of market volatility, but did not stymie the rally for long. The equity market regained its momentum when bond yields pulled back: the 10-year US Treasury yield ended 2023 at 3.86%, while the two-year Treasury also notched down to 4.25%, well off its recent peak set in October.

2023 culminated with a fierce "everything rally" that pushed prices higher in nearly every asset class, including stocks, bonds, gold, and cryptocurrencies. Meanwhile, a record level of cash flooded into money-market funds, making them one of the hottest investments of the year.

Fourth Quarter Market Watch

	Date	1 Quarter Ago		1 Year Ago	
	12/31/2023	9/30/2023	% chg	12/31/2022	% chg
DJIA	37,689.54	33,507.50	13.1%	33,147.25	16.2%
S&P 500	4,769.83	4,288.05	11.7%	3,839.50	26.3%
NASDAQ Composite	15,011.35	13,219.32	13.8%	10,466.48	44.6%
Russell 2000	5,037.79	4,436.43	14.0%	4,377.14	16.9%

	Date	1 Quarter Ago		1 Year Ago	
	12/31/2023	9/30/2023	% chg	12/30/2022	% chg
Japan Nikkei 225	33,464.17	31,857.62	11.2%	26,094.50	20.0%
MSCI EM (Emerging Markets)	1,023.74	952.78	7.9%	956.38	10.3%
MSCI EAFE	2,236.16	2,031.26	10.5%	1,943.93	18.9%
MSCI AC World	727.00	656.82	11.1%	605.38	22.8%
FTSE 100	8,264.89	8,078.48	6.9%	7,657.48	14.4%
SSE Composite Index	2,974.93	3,110.48	-1.5%	3,089.26	-5.6%

US Equity Sector

	Q4	1-yr ret.
Consumer Discretionary	12.4%	42.0%
Consumer Staples	5.5%	0.0%
Energy	-6.9%	-0.6%
Financials	14.0%	11.8%
Health Care	6.4%	1.7%
Industrials	13.1%	17.7%
Information Tech	17.2%	57.6%
Materials	9.7%	11.8%
Telecom	-1.4%	55.8%
Utilities	8.6%	-8.0%

US Equity Style

	Q4	1-yr ret.
Russell 1000 Value	9.5%	11.2%
Russell 1000 Growth	14.2%	42.3%
Russell 2000 Value	15.3%	14.2%
Russell 2000 Growth	12.7%	18.4%

Economic Sentiment

	12/31/2023	1 Yr. Ago
Unemployment Rate	3.70	3.50

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Perhaps energy and commodities were the exception to the "everything rally". Brent crude futures declined 10% to finish the year at $77 a barrel, despite the recent war in the Middle East, the ongoing war in Ukraine, and the repeated efforts by the OPEC to cut production and exports to support oil prices.

The weakness in the oil markets was driven by a number of events, including a more relaxed US enforcement of sanctions that let Iran increase exports, and increased production among US oil producers. US oil production, which reached a record in 2023, may not be able to offset ongoing global disruptions, as consolidation among US oil companies could ultimately cap production volume.

Still, recent geopolitical instabilities have triggered supply disruption and pushed energy prices higher. Oil prices jumped in early December after an attack on vessels in the Red Sea, a signal of widening geopolitical conflict in the Middle East. Such disturbances could trap vast quantities of crude in the Persian Gulf and spur prices higher.

Much of the optimism that propelled the stock market's rally in 2023 rested on data suggesting the economy has slowed enough for inflation to ease, but not enough to fall into a recession. This "soft landing" scenario would allow the Federal Reserve to shift to cutting interest rates. While the outlook for 2024 is more positive than 2023's predictions, some strategists warn that such optimism among investors is a cause for concern. The "everything rally" pushed S&P 500 valuations to the higher end of the long-term range, driven in large part by the "Magnificent Seven" group of big technology companies.

The outlook for 2024 will rest in large part on the path of earnings, given stretched valuations for the index's largest companies. For 2024, Wall Street is expecting an acceleration of corporate profit gains, with S&P 500 earnings projected to grow 11.6%. Strategists at JPMorgan are among the bears, with an S&P 500 price target of 4,200. Goldman Sachs strategists, who correctly predicted that the economy would avoid a recession in 2023, said they expect the S&P 500 to end 2024 at 5,100, a 7% gain from the starting level of 4,770. But if we have learned anything from 2023, it is the difficulty of predicting the short-term moves in markets.

Bond Markets

	12/31/2023	1 Qtr Ago	1 Yr. Ago
Treasury Bill, 90 Day	5.35	5.46	4.41
Treasury Note, 2 Year	4.25	5.04	4.42
Treasury Note, 5 Year	3.85	4.61	4.00
Treasury Bond, 10 Year	3.88	4.57	3.88
Treasury Bond, 30 Year	4.03	4.70	3.97

Commodities

	12/31/23	1 Qtr Ago	1 Yr. Ago
Gold	2,071.80	1,672.00	1,826.20
Crude Oil	71.65	79.49	80.26
UD Dollar Index	101.03	112.08	103.27
Bloomberg Commodity Index	98.65	111.49	112.81

Exchange Rates (Rate per US dollar)

	12/31/23	1 Qtr Ago	1 Year Ago
Euro	0.905	0.945	0.937
British Pound	0.784	0.819	0.831
Swiss Franc	7.092	7.304	6.952
Chinese Yuan	83.214	83.041	82.730
Indian Rupee	140.980	149.225	131.945
Japanese Yen	0.905	0.945	0.937

Interest Rates

	12/31/2023	1 Qtr Ago	1 Yr. Ago
PRIME RATE	8.50	8.50	7.50
FEDERAL FUNDS RATE	5.33	5.33	4.34
LIBOR RATE 30 DAY	4.25	5.04	4.42
LIBOR RATE 3 MONTHS	3.88	4.57	3.88
30YR FIXED MORTGAGE	6.61	7.31	6.42

As an homage to the recently departed Charlie Munger, we underscore his influence over generations of investors, and in particular, his partner at Berkshire Hathaway, Warren Buffett. Munger pushed Buffett to pay up for quality businesses, steering him away from an early focus on the cheapest stocks. Buffett credited Munger with shifting his investment strategy: "Forget what you know about buying fair businesses at wonderful prices; instead, buy wonderful businesses at fair prices."

Our investment professionals have long been proponents of investing in quality companies at reasonable prices, thus Munger's investment playbook will continue to resonate with us long after his passing. The era of ultra-low interest rates turbocharging returns in unprofitable growth stocks has passed. Meanwhile, traditional value investors have to compete for a diminished set of opportunities. As such, our quality playbook is increasingly relevant. We remain vigilant in seeking out and owning "wonderful businesses" at fair prices for your portfolios.

Kevin Kavanaugh
Chief Investment Officer

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