MONTHLY MARKET UPDATE

February 2024

Highlights:

— The S&P 500 returned 1.7% in January, driven by mega-cap stocks, while the equal-weighted index returned negative (-0.8%), with midcap and small cap stocks suffering more.

— Economic indicators reflected surprising strength in the U.S. economy, with robust GDP growth and job gains, alongside continued consumer confidence and decreasing inflation.

— Federal Reserve Chairman Powell's late-month address eliminated prospects for a much-anticipated March rate cut and tempered expectations for future cuts.

Following extremely strong months for stock and bonds in late 2023, January proved a more moderate month. While the S&P 500 Index's return of 1.7% suggests a solid month for stock investors, the equal-weighted return of the index was negative (-0.8%), while midcap and small cap stocks suffered even more. It was the familiar story of index returns driven by a handful of mega-cap stocks. A sense of the disparities was evident in fourth quarter corporate earnings reports (with about half reporting as of this writing), which have been highly bifurcated by sector. Technology, Consumer Discretionary, Communication Services, and Utilities Sector stocks reported double-digit gains, while Financials, Health Care, Materials, and Energy produced double-digit declines. Mega-cap tech stocks have dominated the aggregate earnings growth. While interest rates showed some volatility during the month, the yield on the bellwether 10-year Treasury ended about where it started, and bond returns were basically flat.

Behind these returns were an array of economic reports and indicators, the bulk of which showed surprising strength in the U.S. economy via GDP growth and job gains. Consumer confidence remained strong behind trailing stock gains and lower gas prices. Meanwhile, inflation measures continued the downward trend, which had produced wide expectations of Federal Reserve easing in 2024, a primary driver of the late 2023 stock rally. The hopes for a series of five or more interest rate cuts gradually faded with each report of economic strength. This was capped by a late-month address by Federal Reserve Chairman Powell that virtually eliminated the prospects for a much-anticipated March cut. He also dampened expectations regarding the number of cuts we could expect this year.

Despite the Fed disappointments, spirits remained high following the strong stock and bond returns in 2023. However, we believe a clear-eyed look at the economy, stock valuations, and yields gives cause for caution. For instance, the GDP growth is concentrated in the service side of the economy, while manufacturing has been in decline for more than a year. The Materials and Energy Sectors are also lagging. The peak Federal Funds rate hit in July of last year, and history shows the effects often take over a year to be fully expressed. Every week, a large number of loans are resetting at much higher rates, a particular strain on small businesses that face higher costs or even financing woes as banks deal with liquidity issues by tightening issuing standards. Recent troubles with a New York regional bank, New York Community Bancorp, sent shivers through the banking sector and reinforced how we may still have to deal with problems imposed by high rates.

PORTFOLIO MANAGER Q&A - ANDY ROMANOWICH

Andy Romanowich, CFA
Portfolio Manager, Analyst

With the stock market up double digits in 2023, mostly on price-to-earnings multiple expansion, how do you view current valuations across the market caps?

In general, we're seeing more attractive valuations the lower you go down the market cap spectrum. It shouldn't be a real surprise, coming out of last year, where we had really strong returns on a mega cap stocks, and even large cap stocks tended to materially outperform mid cap and small cap stocks. The S&P 500 is near its all-time high, whereas the Russell Mid Cap index is still off about 10% from its all-time high.

When we think about valuation at the stock level, we tend to approach it the same way a business owner would approach valuing their business. We're focused on the business's future cash flow producing ability and discounting that to today. So, ultimately, we think in terms of intrinsic value. We do not try to predict short-term movements in stock prices; in fact, we try to take advantage of short-term changes in stock prices by anchoring on intrinsic value. Where we see a divergence of stock price versus our intrinsic value estimate is where we see the opportunities to invest.

How does the team factor in the cost of debt, especially with many years of cheap financing starting to roll off balance sheets?

Financial strength is a very important part of our process, and we don't purchase too many stocks with elevated levels of debt or aggressive capital structures. When evaluating debt, we tend to look at the normalized cost of debt or normalized interest expense. We recognize that the low interest rate environment of the last five to ten years was not normal. So, by modeling future cash flows based on a normal environment, our portfolio can be better prepared for higher rates.

We think long-term. In our Mid Cap portfolio, the average stock has been held for eight or nine years. We come into these investments thinking like long-term business owners, which means we need to be prepared for any interest rate environment. For this reason, rising interest rates tend to hurt competitors more than our businesses, and we're seeing that start to play out in the market. Some competitors are going out of business or pulling back on spending to save costs to meet their interest payments. Meanwhile, our businesses are investing; they continue to invest in the company, widen their competitive advantages, and become stronger over time.

Where are you finding opportunities in the mid cap space?

In general, we tend to find opportunities in areas where there's fear. Fear drives aggressive selling, and when you combine that with the market's tendency to be very short-sighted, that's what excites us. That's where you see wonderful business trading at cheap valuations – or using the framework I discussed earlier, where you see a big gap between our estimate of intrinsic value and where the stock is trading. Right now, one area that's catching our attention is consumer staples. This sector was one of the weakest performers in the Russell Mid Cap last year. You can point to a lot of investor concerns that have driven stock prices lower – whether it be the impact on demand from GLP-1 weight loss drugs or pricing in a more disinflationary, potentially deflationary environment. These question marks have driven fear, creating a fertile ground for us to search for quality companies that are being overlooked.

We're also seeing opportunities in technology within the semiconductor value chain. This area has endured headwinds lately, whether it be because of end market demand or just supply in the channel, and revenues haven't come through as investors had initially expected. What we see from a long-term perspective within some of these companies is tremendous competitive positioning with great earnings power in the long-term. Short-term, their stocks are down because investors are focused on trying to predict when this cycle inflects and when sales growth will inflect higher. We are more patient. We see long-term earnings power and account for it in our valuation of the business.

U.S. EQUITIES (%)

	January	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	1.3	1.3	14.4	10.6	11.2	11.8
S&P 500	1.7	1.7	20.8	11.0	14.3	12.6
Russell 1000	1.4	1.4	20.2	9.8	14.0	12.3
Russell 1000 Value	0.1	0.1	6.1	9.2	9.3	8.8
Russell 1000 Growth	2.5	2.5	35.0	10.0	18.0	15.5
Russell Midcap	-1.4	-1.4	6.7	5.5	10.1	9.5
Russell 2000	-3.9	-3.9	2.4	-0.8	6.8	7.0

U.S. EQUITY CHARACTERISTICS - S&P 500

	January	2023
Price/Earnings Ratio (NTM)	19.9	19.7
Weighted Avg. Market Cap ($B)	744.7	721.7
Dividend Yield (%)	1.4	1.5

U.S. EQUITY SECTORS - S&P 500 (%)

	January	2023	Weight
Communication Services	5.0	55.8	8.9
Consumer Discretionary	-3.5	42.4	10.3
Consumer Staples	1.5	0.5	6.1
Energy	-0.4	-1.3	3.8
Financials	3.0	12.1	13.1
Health Care	3.0	2.1	12.8
Industrials	-0.9	18.1	8.6
Information Technology	3.9	57.8	29.5
Materials	-3.9	12.5	2.3
Real Estate	-4.7	12.4	2.4
Utilities	-3.0	-7.1	2.2

INTERNATIONAL EQUITIES (%)

	January	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	0.6	0.6	14.7	6.1	10.2	8.4
ACWI ex USA	-1.0	-1.0	5.9	1.1	5.3	4.2
MSCI EAFE	0.6	0.6	10.0	4.6	6.9	4.8
Emerging Markets	-4.6	-4.6	-2.9	-7.5	1.0	2.9
China	-10.6	-10.6	-29.0	-23.3	-6.9	0.4
Japan	4.6	4.6	18.5	2.5	6.6	5.9
Germany	-1.0	-1.0	8.4	0.5	4.7	2.4
United Kingdom	-1.3	-1.3	5.7	8.4	5.1	2.8
India	2.4	2.4	27.5	13.7	12.7	10.6

KEY ASSET PRICES

	January	2023
EUR/USD	1.09	1.11
USD/CAD	1.35	1.32
USD/JPY	147.94	140.92
GBP/USD	1.27	1.27
Bitcoin ($)	42,582.6	42,265.2
Gold ($/oz)	2,050.0	2,066.0
Crude Oil (WTI) ($/bbl)	77.3	75.8

FIXED INCOME (%)

	January	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	-0.3	-0.3	1.3	-3.5	0.4	1.1
Municipal	-0.5	-0.5	2.9	-0.8	2.0	2.8
U.S. Aggregate Bond	-0.3	-0.3	2.1	-3.2	0.8	1.6
Investment Grade Corporate	-0.2	-0.2	4.0	-2.9	2.0	2.6
High Yield	0.0	0.0	9.3	1.9	4.4	4.5

U.S. TREASURY YIELDS (%)

	January	2023
3-Month	5.4	5.4
6-Month	5.2	5.3
2-Year	4.3	4.2
5-Year	3.9	3.8
10-Year	4.0	3.9
30-Year	4.2	4.0

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The Dow Jones Industrial Average® (The Dow®), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The S&P 500® Index is an unmanaged index of large companies and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 89% of the total market capitalization of the Russell 3000 Index.

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The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

Emerging Markets - MSCI Emerging Market Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

China - MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

Japan - MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

Germany - MSCI Germany Index is designed to measure the performance of the large and mid cap segments of the German market.

United Kingdom - MSCI United Kingdom Index is designed to measure the performance of the large and mid cap segments of the UK market.

India - MSCI India Index is designed to measure the performance of the large and mid cap segments of the Indian market.

Government Bond - Bloomberg US Government Index measures the performance of the U.S. Treasury and U.S. Agency Indices, including Treasuries and U.S. agency debentures. It is a component of the U.S. Government/Credit Index and the U.S. Aggregate Index.

Municipal - Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

U.S. Aggregate Bond - Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Investment Grade Corporate - Bloomberg U.S. Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

High Yield - Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Weighted Avg. Market Cap: measures the size of the companies in which the portfolio invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share.

Price-to-Earnings (P/E) Ratio: measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's earnings per share of stock in a portfolio.

Dividend Yield: the portfolio's weighted average of the underlying portfolio holdings and not the yield of the portfolio.

A basis point is one hundredth of a percent.