MONTHLY MARKET UPDATE

November 2023

Highlights:

- Intermediate and long-term rates increased, with the 30-year Treasury yield breaking through 5% for the first time in almost twenty years.
- The stock market experienced a strong first half of the year but has since seen a decline, with the S&P 500 dropping 2.1% in October, bringing the year-to-date return to 10.7%.
- October's market decline was broad, driven by expectations of prolonged high interest rates, resulting in a downturn across all S&P 500 sectors except Utilities.

The first half of the year was an unexpected bounty for the stock market as the S&P 500 Index gained more than 20% through the end of July. Almost half of that gain has since been whittled away, with a -2.1% additional decline in October, bringing the year-to-date return to 10.7%. Smaller companies have struggled even more, with the Russell 2000 Index declining 7.7% during October and now down 4.5% for the year. As we have been emphasizing, the average company within the publicly traded markets this year has fared worse than the S&P 500 Index, whose return has been dominated by the double-digit returns of a handful of mega-cap companies. An equal-weighted index of the S&P 500 companies is down 3.9% this year.

Short-term interest rates remained steady during October, and the Federal Reserve announced it is keeping the federal funds rate steady at 5.5%. Intermediate and long-term interest rates continued advancing higher during October, with the 30-year Treasury yield breaking through 5% for the first time in almost twenty years. The spread between corporate bond yields and Treasury yields continues to be narrower than historical averages, indicating the market is not yet concerned about credit risk in this higher interest rate environment.

The October decline was broad, with every S&P 500 sector down, with the exception of Utilities. An overriding weight on the market was the broadening expectation of high interest rates for some time. Concerns about how the U.S. consumer will withstand this persistence were reflected in the worst performing S&P sector, Consumer Discretionary. Another negative for many large-cap global companies was the combination of a strong U.S. dollar with struggling overseas economies. The impact of high rates for longer was also evident in the modest downward revisions of forward earnings expectations for 2024 and 2025.

All of this might seem at odds with the surprisingly robust third quarter GDP advance estimate of 4.9%. However, a deeper look at the number produces temperance. For instance, 1.3% of that growth was inventory expansion, a temporary effect, while other elements were more reflective of cost increases exceeding the overall inflation rate. An increase in consumer spending was a major driver of the GDP growth. Cost-sensitive consumers will recognize the inflationary forces behind some of the leading contributors: housing, utilities, health care, food, and insurance. Expectations for the fourth quarter are in the 2% range, which is still higher than expectations from early in 2023 when many were anticipating a late-year recession.

As we look forward through the end of 2023 and into 2024, one positive of the market dip has been an improvement in overall stock market valuation. By month end, the forward one-year P/E ratio for the S&P 500 was 17.1x, which is lower than the 5-year average of 18.7x and the 10-year average of 17.5x. Another measure of corporate health is the year-over-year earnings growth rate. So far, third quarter year-over-year earnings growth has been 2.7%, after little to no earnings growth in Q1 and Q2.

PORTFOLIO MANAGER Q&A - TOM TIBBLES

International markets started the year strong out of the gate but have since lagged U.S. domestic markets. What's been the cause of that weakness as we've progressed into 2023?

For international investing, it's not at all surprising for liquidity to dry up in the summertime, and it coincided with a couple of macro and geopolitical events that really caused flows to subside. Central banks surprised the markets by suggesting their work was not finished and expectations, particularly in equity markets, had gotten ahead of themselves. So, there was a bit of a step back over the summer. More recently, geopolitical turbulence has been a dark cloud over not only international but global markets. The other thing to take note of is what's happening with currencies. Given that the expectations for interest rate cuts have had to circle back, that has supported the U.S. dollar. All other currencies, across the board, have lagged, which also shows up in the returns. It is a significant headwind, but it is also an opportunity going forward.

Tom Tibbles, CFA
Head of International Equity Team, Portfolio Manager

How are you taking the geopolitical risks into account with respect to your portfolio?

Over the decades, geopolitical risks are something we have always had to adjust to. It circles back to one of the fundamental premises in our approach. We focus and invest in solid, high quality franchise companies that can handle turbulence in the macro economy, whether from a political or economic source. That provides us with tremendous confidence in our companies. On top of that, when it comes to managing our portfolio construction, we have a method that we refer to as our Portfolio MATRIX framework. The simple idea is that we don't want to put all our eggs in one basket. We've seen too many times how things can turn on a dime, especially in the international environment. Our Portfolio MATRIX framework gives us a picture of all of our portfolio holdings at a point in time against the backdrop of the sources of volatility, be it regional, by sectors, and so on. The combination of great companies and our risk control framework is what we've utilized for over two decades to handle events as they regularly come up.

With respect to a strong U.S. dollar and rising interest rates, there has been concern in the past about some emerging market economies being able to pay dollar-denominated debt. How are you feeling today about the opportunities and risks in emerging markets?

There has always been elevated risk in emerging markets. But there are ways to incorporate that in your analysis. When we talk about investing in strong companies, part of our focus is that our candidate firms have strong balance sheets. We explicitly focus on companies that will not have any difficulty with debt, no matter what happens to the interest rate cycle. This applies right across the portfolio, but most specifically for emerging markets.

When we think about emerging markets, a distinct cycle is brought about by developed country monetary policy, such as tightening interest rate regimes in the Fed and other developed countries. We have been through this cycle numerous times before. If the country or the company has outstanding dollar-denominated debt, that can be a toxic situation. So, we try to avoid that at all costs. However, the other thing we know about this cycle is that once interest rates plateau and the central banks have done what they've needed to do in the developed economies to squeeze out inflation, we come into what I refer to as the sweet spot for emerging markets. Economies in developed jurisdictions have constricted growth to the point where they're satisfied that inflation will come down. However, it takes many, many quarters for mature, developed economies to be able to turn around and start to grow again. As a result, we see this phase of the monetary policy cycle where excess liquidity builds up in developed economies. And in looking for the best current investment opportunities, it is hard to ignore the combination of secular growth, such as that found in many emerging economies and their companies, with low valuations because they've gone through either a slowdown or recession. That's where we think we will be in the next couple of quarters.

Are there any particular regions or industries around the world where you're finding the most opportunities?

As we just mentioned with emerging top tier countries, take a country like India, where we project that there will be continual growth opportunities. India is just getting going, and there are some really world beating companies there. Now, you have to be selective in your timing. We have some great investments there and candidates we've been tracking for years.

In developed countries, there has been a substantial rotation by sectors, and opportunities are starting to unfold in some of the more defensive areas like health care, food ingredients, and luxury goods. Industries that Europe, in particular, excels at. So, we are monitoring for declines in stocks. In many cases, we are very familiar with the companies that are growing the most; it's just a matter of their region or sector coming out of favor.

I think Japan has a lot of challenges in its future. Within the global auto sector, they have poorly managed the transition to electrification, and as a consequence, that area is somewhat risky. In other areas, however, such as electronics and semiconductor capital equipment, there are some amazing companies that have world class franchises. As you see this theme of friend-shoring and diversifying global supply chains play out, the high technology area could give Japan a renaissance of competitiveness, and it could really benefit from global multinationals wishing to diversify away from being so dependent on China.

U.S. EQUITIES (%)

	October	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	-1.3	1.4	3.2	9.8	8.0	10.3
S&P 500	-2.1	10.7	10.1	10.4	11.0	11.2
Russell 1000	-2.4	10.3	9.5	9.5	10.7	10.9
Russell 1000 Value	-3.5	-1.8	0.1	10.2	6.6	7.6
Russell 1000 Growth	-1.4	23.2	19.0	8.7	14.2	13.8
Russell Midcap	-5.0	-1.3	-1.0	6.0	7.1	8.1
Russell 2000	-6.8	-4.5	-8.6	3.9	3.3	5.6

U.S. EQUITY CHARACTERISTICS - S&P 500

	October	2022
Price/Earnings Ratio	21.1	19.1
Weighted Avg. Market Cap ($B)	649.4	417.5
Dividend Yield (%)	1.6	1.7

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

	October	YTD	Weight
Communication Services	-1.8	37.9	8.7
Consumer Discretionary	-4.5	21.0	10.6
Consumer Staples	-1.2	-5.9	6.6
Energy	-6.0	-0.3	4.5
Financials	-2.5	-4.1	12.8
Health Care	-3.2	-7.2	13.1
Industrials	-2.9	1.4	8.3
Information Technology	0.0	34.7	28.1
Materials	-3.2	-0.7	2.4
Real Estate	-2.8	-8.1	2.4
Utilities	1.3	-13.3	2.5

INTERNATIONAL EQUITIES (%)

	October	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	-3.0	6.7	10.5	6.7	7.5	6.8
ACWI ex USA	-4.1	1.0	12.1	3.0	3.5	2.5
MSCI EAFE	-4.1	2.7	14.4	5.7	4.1	3.1
Emerging Markets	-3.9	-2.1	10.8	-3.7	1.6	1.2
China	-4.3	-11.2	21.1	-16.9	-2.6	1.0
Japan	-4.5	6.2	16.8	1.8	2.9	3.9
Germany	-4.4	4.0	18.4	1.8	1.1	1.0
United Kingdom	-4.2	2.3	12.9	12.4	3.4	1.8
India	-3.0	4.8	4.2	13.4	10.8	8.3

KEY ASSET PRICES

	October	2022
EUR/USD	1.06	1.06
USD/CAD	1.39	1.36
USD/JPY	149.60	132.78
GBP/USD	1.22	1.21
Bitcoin ($)	34,667.8	16,514.0
Gold ($/oz)	1,989.0	1,827.0
Crude Oil (WTI) ($/bbl)	83.0	80.4

FIXED INCOME (%)

	October	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	-1.2	-2.6	-0.5	-5.8	-0.2	0.5
Municipal	-0.9	-2.2	2.6	-2.5	1.0	2.1
U.S. Aggregate Bond	-1.6	-2.8	0.4	-5.6	-0.1	0.9
Investment Grade Corporate	-1.8	-1.7	2.7	-5.3	0.8	1.8
High Yield	-1.2	4.6	6.2	1.2	3.1	3.9

U.S. TREASURY YIELDS (%)

	October	2022
3-Month	5.6	4.4
6-Month	5.5	4.8
2-Year	5.1	4.4
5-Year	4.8	4.0
10-Year	4.9	3.9
30-Year	5.0	4.0

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Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

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.

The Russell 1000® Growth Index is designed to track those securities within the broader Russell 1000 Index that FTSE Russell has determined exhibit growth characteristics.

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Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index.

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The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries (excluding the US) and 23 Emerging Markets countries. With 1,843 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

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.

The MATRIX portfolio construction framework distributes the weight of individual stock holdings across a two-dimensional, checker-board grid assigning geographical exposures to regional columns and industry exposures to sector rows. For example, Ferrari is a European auto company; the weight of this stock holding in the portfolio would be placed (like a piece in a game of checkers, having a size reflective of its weight) in the square that represents the intersection of the column for Europe and the row for Consumer Discretionary. By performing this distribution of all position weights twice, once for the portfolio and again for the benchmark index, it can be clearly seen how over- or under-weight the portfolio is relative to the market in the various cells of the matrix. As a risk-control practice, we limit stock weights to control the amount that the portfolio can diverge from the benchmark to within modest tilts (i.e. +/- 10%). These limits act as "guardrails" to ensure that the portfolio remains well diversified and broadly in-line with market exposures by region and sector.