U.S. and global stocks and bonds rallied to close out 2023. A drop in bond yields, slowing inflation, and a more dovish central bank policy contributed to the late-year surge.

- U.S. stocks soared for the quarter, boosting year-to-date returns. Most broad size and style indices delivered double-digit returns for both periods. Small-cap stocks led the way with 14% returns during the quarter.
- The interest rate-sensitive real estate sector was the top-performing S&P 500 sector for the month and quarter. The sector was up roughly 18% in the quarter.
- Foreign developed and emerging market stocks rose sharply for the quarter, although they lagged U.S. stocks by a little.
- In its attempt to engineer a soft landing, the Fed held rates steady and forecasted three rate cuts in 2024. Other major central banks stayed on hold for the quarter.
- After climbing to 3.7% in August, the annual rate of U.S. headline inflation slowed to 3.1% by November. Inflation moderated in most developed countries.
- US Treasury yields declined for the month and quarter, and the broad bond market delivered solid gains. U.S. core bonds were up 6.8% in the quarter.

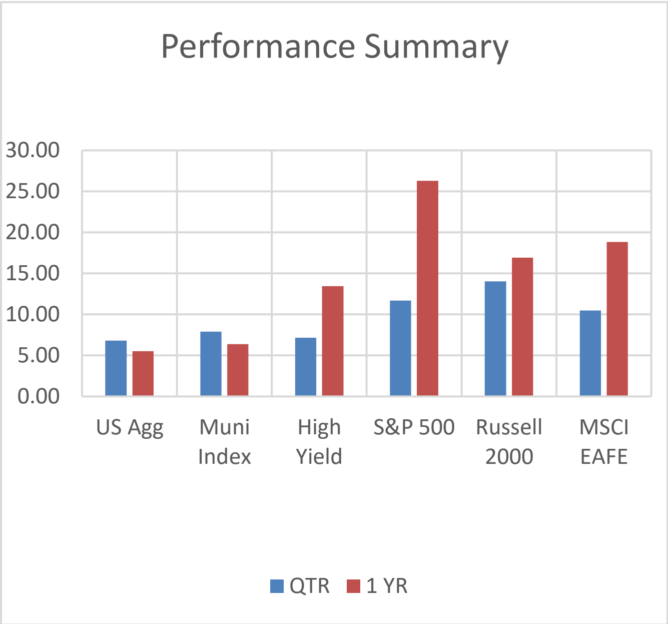
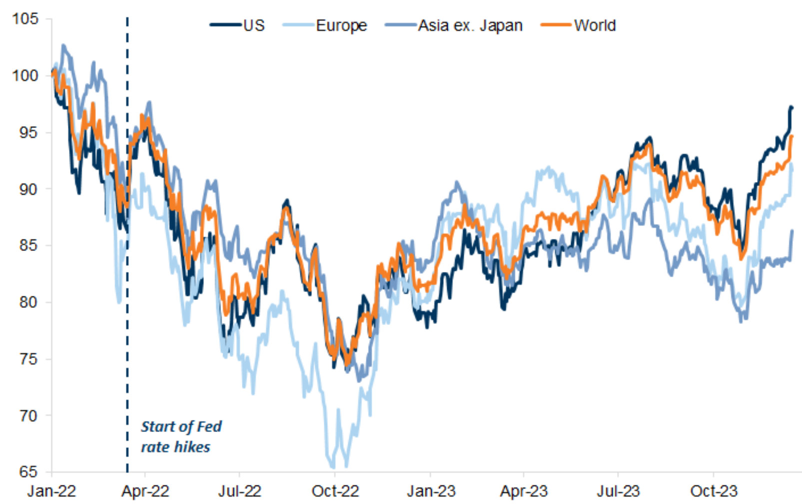


Exhibit 1: The swings in equity markets have been wide but little aggregate progress has been made
Price performance (indexed to 100 in Jan-2022, in USD)



Source: FactSet, Goldman Sachs Global Investment Research

A Wild and Volatile 2-Year Round Trip

Had you closed your eyes on January 1st of 2022 and opened them on January 1st of 2024 you would not have missed much. Most global stock indices have 'round-tripped' in performance, dropping sharply from early 2022 to October of 2022, and then rallying to recover most of those losses back and finishing the past two years basically flat, see the chart to the left.

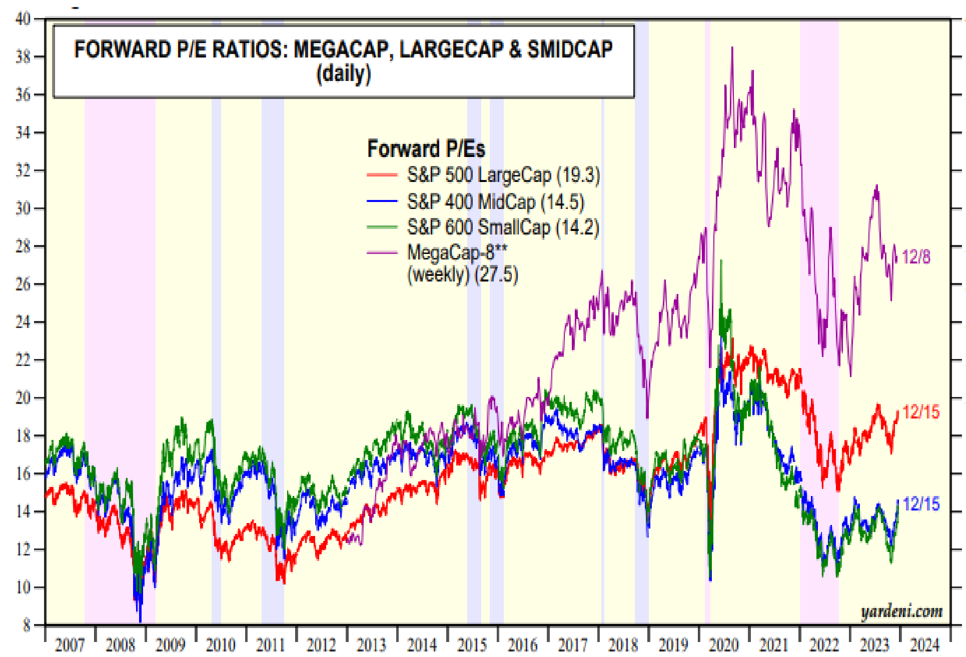
The sharp declines in stocks in 2022 were driven by simultaneous fears of recession and rising inflation that led to a global sell-off. Growth stocks in the U.S. were down sharply in 2022 at (29.14%), while value stocks performed much better, down only (7.54%). The sharp rebound in stocks from October 2022 to the end of 2023 was driven by a drop in inflation and a belief the economy would avoid recession. In this environment, growth stocks led the way, up 42.68% in 2023 while value stocks lagged, up only 11.46%. it may surprise investors but over the combined two-year period value stocks actually outperformed with a return of 1.52% (Russell 1000 Value), while growth stocks were up only 0.55% (Russell 1000 Growth). Growth stocks have taken investors on a wild and volatile ride over the past two years but have lagged their value counterparts on both an absolute and risk-adjusted basis. Value stocks have taken investors on a 'smoother' ride the past two years but either way, had you closed your eyes for the past two years you wouldn't have missed much!

Opportunities Ahead

The S&P 500 stock index is currently trading at a high price-to-earnings multiple of roughly 20 times. However, much of the higher valuation is being driven by the 'MegaCap-8' which trades at a multiple of close to 28 times forward earnings. Excluding those 8 stocks would reduce the market's multiple to a little below 17, a more reasonable level. The chart below shows the high valuation on the Mega-Cap 8 and how valuations on small and midcap stocks have gotten relatively inexpensive in comparison at below 14 times forward earnings.

As we discussed in our November commentary we believe the era of extremely low inflation and interest rates has transitioned to an environment of moderately higher inflation and interest rates. In this new environment, we believe investors will be less likely to speculate on low-quality and overvalued stocks and will shift towards more attractively priced stocks in the following areas: value, dividend-paying, small and midcap, and foreign stocks. In all of these areas, a tilt towards quality makes the most sense.

In the bond market, we favor investment-grade corporate and municipal bonds and treasury inflation protection securities (TIPs). We suggest being underweight overvalued areas of the bond market such as high-yield bonds, as we don't think investors are getting adequately compensated for the risks they are taking. Please see the last page of this commentary for more details on the best opportunities in each of the major asset classes. On the next page, we share the long-term forecast for the major asset classes from some of the firms and strategists that we follow. To no surprise, the asset classes with the highest expected returns going



* Daily stock price index divided by 52-week forward consensus expected operating earnings per share.
** MegaCap-8 stocks include Alphabet (Google), Amazon, Apple, Meta (Facebook), Microsoft, Netflix, NVIDIA, and Tesla. Both classes of Alphabet are included.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Blue shaded areas are correction declines of 10% to less than 20%. Yellow areas are bull markets. Source: I/B/E/S data by Refinitiv and Standard & Poor's.

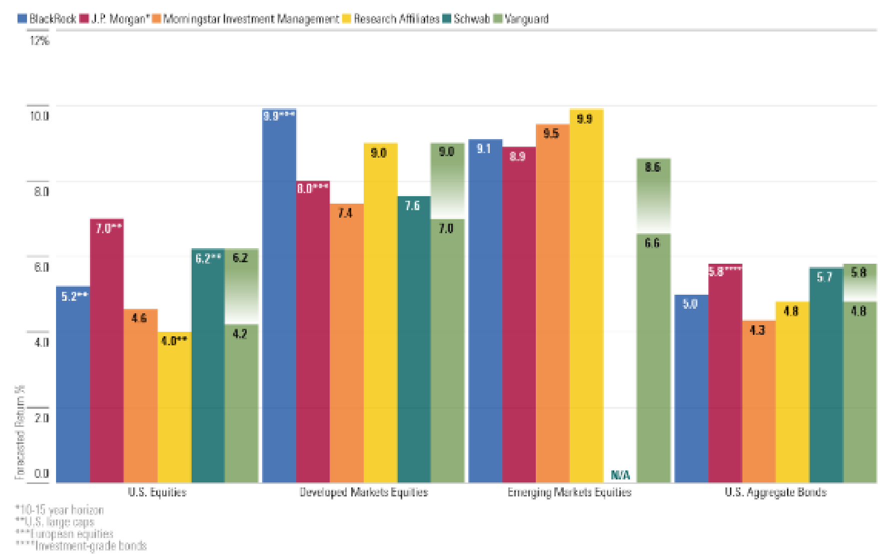
forward are ones that were left behind during the aggressive monetary policy era from 2009 to 2021 when interest rates and inflation were at extreme lows. If you look deeper at the different investment styles and market size the opportunities look even better. The takeaway is there will be good investment opportunities in the years ahead, although they will probably look different than the ones in the rearview mirror!

Risks in the Year(s) ahead

As usual, the list of potential risks in 2024 and beyond is long. Here we list a few of the ones we are watching closely:

- **An economic slowdown.** The same economic forces that allowed inflation to decline the past couple of years could lead to a recession if growth continues to slow.
- **A second wave of inflation.** Inflation has trended down sharply past year, however, a monetary policy mistake or economic shock could cause it to turn back up.
- **Geopolitical and elections risks.** These risks will be particularly high in 2024 and include: the war in Israel expanding; a negative turn in the Russian war; the U.S. presidential cycle, commodity shocks, cybersecurity risks, and more.

Expert Forecasts for Long-Term Asset-Class Returns



Investors should keep in mind there will always be risk and noise in the financial markets that will challenge them to stray from their financial plan and investment strategy. There will also be times when many predict market declines with no shortage of compelling arguments for why you should heed these warnings. Doing so in 2023 would likely have done far more harm than good. Staying focused on our financial plan and investment strategy will allow you to not get whip-sawed by the ups and downs we will inevitably see in markets. In 2024 just like in 2023, the more we can tune out the noise of the markets and stay focused on our long-term objectives, the better investors we will be!

Steve Giacobbe, CFA, CFP®

Asset Class		* ↔ Neutral weight ↓ Underweight ↑ Overweight
Equities	***View****	***Comments***
U.S. Large Cap	↓	The S&P 500 is trading near a forward price-to-earnings multiple of 20. This is a relatively pricey multiple for the broader market and is largely impacted by a handful of tech and growth stocks. Looking beyond the Mega-Cap 8, there are parts of the large-cap universe that are attractively priced, including: dividend-paying and value stocks, in both areas we have a bias towards quality.
U.S. Small/Mid Cap	↔	Small-cap stocks rallied hard in the fourth quarter, up over 14%. But they remain attractively valued relative to large-cap stocks. We acknowledge the near-term risks from a potential recession, however, we are very confident they will outperform large-cap stocks over a longer time horizon. Resist the temptation to market time and stay the course.
International Developed	↔	Similar to small-cap stocks, the relative valuation of foreign stocks to US stocks is attractive. We never know when the cycle of US stock performance will change but are confident that investors with a long-term horizon will be well rewarded for staying the course. In addition, dividends are substantially higher in foreign markets, so investors are paid to wait.
Emerging Markets	↔	Valuations are attractive for the long term. Emerging markets tend to be volatile and are always susceptible to further selloffs, but over a multi-year time frame, they should outperform. Risk-tolerant investors should be overweight for the L/T.

Fixed Income		
Investment Grade	↔	Investment grade bonds rallied sharply in the fourth quarter, up over 8% globally. Although interest rates fell sharply in the quarter, bonds are still attractive at current levels. Given the lower yields, we suggest tightening up duration a little. Cash may be an attractive for investors with a short time horizon, however, we expect short term yields to fall over the next two years.
High-Yield Bonds	↓	We don’t believe they have priced in the risk of a potential recession in the next year. We would stay on the sidelines for now and look for opportunities to buy into this asset class on further selloffs. We love buying HY bonds during recessions when they get really cheap, stay patient and be ready when better opportunities arrive.
Municipal Bonds	↑	With higher yields, municipal bonds continue to be attractive, especially for high tax bracket investors.
TIPS	↔	TIPs are a hedge against higher inflation, we would hold positions in tax-deferred accounts as a long-term hedge against inflation hedge. Positive real yields make this asset class more attractive than it has been in a while.
Floating-Rate Loans	↓	Similar to HY bonds, FRLs have a significant risk in a recessionary environment. We would avoid this asset class for the remainder of this cycle.
Emerging Markets	↔	EM bonds rallied close to 10% in the fourth quarter and are still reasonably priced. We like EM bonds, but it is an asset class best left to the pros, and we typically don’t recommend buying direct positions.

Alternatives		
Absolute-Return/Alternatives	↔	We like alternative funds as a way to hedge volatility, provide real returns, and improve the risk vs reward in portfolios. We favor simple and low-cost strategies like hedged equity, real return, clean energy transition, and global macro. Over a full market cycle, they should add value to portfolios. With the increase in bond yields and positive real returns available in bonds, we have been reducing exposure to this asset class and replacing it with higher-quality bonds. Unchanged.
REITs	↔	REITs rallied close to 18% in the fourth quarter. There are diversification benefits from owning REITs and small positions may be appropriate in diversified portfolios.
Commodities/Gold	↔	We view small exposure in this area as an effective way for long-term investors to diversify their portfolios and hedge against higher inflation. These positions can be volatile in performance but may provide some relief over a full market cycle.