

The Fairlead Quarterly

Fourth Quarter of 2023



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Quarterly Overview

On December 29th, the last trading day of the of 2023, the Wall Street Journal ran an article headlined, “The Blockbuster Year No One Saw Coming” – which kind of says it all. After a dismal 2022, and with fears of persistent, elevated inflation, high interest rates, a stretched consumer and a potential recession, there was cause for caution, if not outright pessimism, and no one was forecasting the year we had. Of course, there is a lesson there – no matter how many data points you have or how sophisticated your algorithms are, seeing the future is still a tricky business.

In 2023 the market was strong right out of the gate. Using the S&P 500 ETF (SPY) as a proxy for the broader market: after losing – 18.17% in 2022, it gained 7.2% in the first quarter (not an unexpected regression toward the mean) and then another 8.69% in the second quarter putting it up 16.79% for the year. To recover the –18.17% in 2022 the market would have to be up 22.20% but recovering 16.79% by the end of June was remarkable. The third quarter saw the market take a bit of a breather, adhering to the adage “Sell in May and Go Away”, with a small decline of –3.22%. The fourth quarter witnessed a classic “Santa Claus” rally with the market jumping 11.64% putting it up 26.19% for the year. Turns out the guy in the red suit was Jerome Powell (Chairman of the Fed) and the present he

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brought was a significantly more dovish outlook on the Fed’s posture towards inflation, the economy, and expectations for future Fed rate increases (or lack thereof) fueling hopes for a declining interest rate environment in 2024.

The Russell 1000 ETF (Large Cap Stocks) was up 12.07% during the quarter, with the Russell 1000 Growth ETF up 14.21% in Q4 and up 42.60% for the year! The Russell 1000 Value was up 9.49% turning a flat year into a respectable 11.36% return. As previously cited, the value-growth differential is a rotational recovery from 2022 when growth was down –29.31% and value was only down –7.74%.

Midcap and Small-Cap indexes, which had significantly underperformed the large caps saw strong gains in the fourth quarter. The Russell Midcap Index ETF was up 12.74% (17.06% for the year), with growth up 14.52% and value up 12.03%. The Russell 2000 Small Cap ETF was up 13.99%, with growth up 12.79% and value up 15.27%. The vast majority of the gains for the Russell 2000 indexes came in the fourth quarter with the 2000 Value going from a negative –0.60% to a positive 14.57% for 2023.

Foreign markets also experience a nice bounce. The MSCI EAFE ETF (Developed Overseas Markets) was up 10.71%, 18.40% for the year. The Foreign Emerging Markets ETF (MSCI Emerging Markets) was up 8% for the quarter and was up 8.99% for 2023.

The bond markets were up on the Fed's revised posture. Treasury yields decreased driving bond prices up. The Vanguard Total Bond Market ETF (BND) was up 6.61% in the third quarter and was up 5.66% in 2023. Goldman Sachs U.S. High Yield Corporate Bond ETF (Junk- lower quality bonds) was up 7.05%, up 12.12% for 2023.

The Vanguard Real Estate Investment Trust (REIT) ETF rebounded 18.21% turning a 5.44% YTD return into a 11.79% 2023 gain. The Utilities Select Sector SPDR gained 8.48% but still lost -7.17% for the year. The Alerian MLP ETF (Energy - Master Limited Partnership) rose 2.91% for the quarter, up 21.43% in 2023.

The Backdrop

Oil & Commodities: Average crude oil prices (WTI Crude) which are extremely volatile were somewhat range bound during 2023. They started the year at \$76.87, had a closing low of \$66.61 in March and a high of \$93.67 in September and ended the year at \$71.89.

Commodities came under pressure in the fourth quarter with the Invesco Deutsche Bank Commodity ETF down -7.79%, and down -6.22% in 2023. Precious metals salvaged a lackluster year in the fourth quarter. Gold (SPDR Gold ETF). was up 11.50%, up 12.69% for 2023. Silver (iShares Silver ETF) was up 7.08%, but was still down -1.09% for the year.

The Fed, The Treasury and Global Central Bankers: There were two Fed meetings in the fourth quarter of 2023, and in each a decision

was made to hold rates steady at 5.25%-5.50% - a level first achieved last July and its highest level since 2001. But nuance matters and the tone of the speech after the second meeting had pundits accelerating their expectations for the first of a series of rate cuts starting in March.

On December 14th the Wall Street Journal said, "The ECB and the Bank of England held interest rates steady as central banks around the world move from monetary tightening to talk of rate cuts."

Trade, Tax & Fiscal Policy: Budget talks are front and center as a budget crisis looms. Once again, the specter of a government shutdown is upon us. Curiously, the impasse pits support for the Ukraine against support for addressing the immigration crisis at the southern border. A certain faction within the Republican party wants greater assurances on funding and policy response on immigration and certain budget cuts before voting in favor of a bill that provides significant aid to Ukraine.

U.S. and Overseas Economic Activity:

Europe: In the third quarter of 2023 (most current data) the Euro Area GDP contracted by -0.1%, its first decline since the final quarter of 2022. The decline was primarily attributed to changes in inventory, while household consumption rose, ending three periods of stagnation or contraction.

U.S.: The third quarter 2023 GDP (third estimate) increased by 4.9% - a significant increase over the previous quarter's 2.1%. The real GDP reflected increases across the board in consumer spending, private inventory investment, exports, non-residential fixed investments and state and local government spending that were partially offset by a decrease in exports.

China: The third quarter GDP grew at 4.9% over the same quarter of the previous year and represents a deceleration from the second quarter GDP which grew at 6.3%. After years of government sponsored economic growth, China, is now challenged by a real estate bubble that produced some massive developer defaults including more than half of its largest 50 developers. China is also grappling with deflation, and a high youth unemployment rate.

Inflation: The Consumer Price Index for All Urban Consumers (CPI-U) rose 0.3%, seasonally adjusted in December; up 3.4% over the last 12 months. This is a slight uptick from 3.1% in November and fluctuating monthly results may prevent the Fed from easing as early as the market currently predicts.

Unemployment: The employment statistics have been mixed. In October hiring slowed to 150,000 and the unemployment rate rose to 3.9%. In November 199,000 jobs were added but unemployment dropped to 3.7%. In December 216,000 jobs were added, higher than the 170,000 expected, but the unemployment rate remained at 3.7%.

Housing: S&P CoreLogic Case/Shiller data (published with a two-month lag – October 2023) continued to show a strong housing market. The National Home Price NSA Index Year over Year reported a 4.7% annual increase in October. The 10-city composite showed an increase of 5.7% up from 4.8% the previous month. The 20-city composite posted a 4.9% year-over-year increase.

“U.S. home prices accelerated at their fastest annual rate of the year in October... Detroit kept pace as the fastest growing market for the second month in a row, registering an 8.1% annual gain. San Diego maintained the

second spot with 7.2% annual gains, following by New York with a 7.1% gain. We are experiencing broad based home price appreciation across the country, with steady gains seen in nineteen of twenty cities...Each of our 10-city, 20-city and National Index remain at all-time highs, with 8 of 20 cities registering all-time highs (Miami, Atlanta, Chicago, Boston Detroit, Charlotte, New York and Cleveland).” (S&P Dow Jones Press Release)

Going Forward

In the first half of 2023 market performance was fueled largely by a mega-cap growth stock recovery, bouncing off a terrible 2022 and driven by the hope of Artificial Intelligence (AI). While the 2023 rally was broad-based (though heavily favoring large growth stocks) it was based on Price/Earnings (P/E) expansion. In other words, the market wasn't rising because companies were earning more money, it was rising because people were willing to pay a higher price for the same earnings. As such the market is “richly” valued. What could go wrong in 2024? 1) Persistent inflation might prevent the Fed from delivering expected decreases, 2) the consumer, who has been surprisingly resilient might start to moderate behavior, 3) the economy might stall or go into recession, and 4) High Global Geopolitical Risk may weigh in.

Some might wonder why the Presidential election hasn't been mentioned, but historically election years tend to be marked by turbulence in the summer prior to the election but, more often than not, produce positive returns regardless of which party wins.

As always, I am available to discuss the markets, the economy, your portfolio, and your concerns.

JOHN VREELAND

SUMMARY OF INDEX ETF RETURNS

Global Markets Year to Date					
INDEX-INVESTABLE ETF (Price)	Fourth Quarter 2023	Year to Date 2023	Calendar Year 2022	Calendar Year 2021	INDEX DESCRIPTION
iShares Russell 1000 (IWB)	12.07%	26.41%	-19.19%	26.32%	<i>US Large-cap Stocks</i>
iShares Russell 1000 - Growth (IWF)	14.21%	42.60%	-29.31%	27.43%	
iShares Russell 1000 - Value (IWD)	9.49%	11.36%	-7.74%	24.95%	
SPDR Dow Jones Industrials - (DIA)	13.06%	16.03%	-7.01%	20.84%	
SPDR S&P 500 - (SPY)	11.64%	26.19%	-18.17%	28.75%	
Fidelity NASDAQ Composite (ONEQ)	14.19%	45.74%	-32.12%	22.11%	
Invesco NASDAQ 100 (QQQ)	14.59%	54.85%	-32.58%	27.42%	
iShares Russell Mid-Cap (IWR)	12.74%	17.06%	-17.47%	22.44%	<i>US Mid-cap Stocks</i>
iShares Russell Mid-Cap - Growth (IWP)	14.52%	25.71%	-26.90%	12.60%	
iShares Russell Mid-Cap - Value (IWS)	12.03%	12.54%	-12.28%	28.10%	
iShares Russell 2000 (IWM)	13.99%	16.84%	-20.48%	14.54%	<i>US Small-cap Stocks</i>
Russell 2000 - Growth (IWO)	12.79%	18.52%	-26.26%	2.54%	
Russell 2000 - Value (IWN)	15.27%	14.57%	-14.75%	27.96%	
iShares MSCI EAFE (EFA)	10.71%	18.40%	-14.35%	11.46%	<i>Developed Overseas (US\$)</i>
iShares MSCI ACWI World ex USA (ACWX)	10.14%	15.67%	-16.04%	7.68%	<i>World ex USA (US\$)</i>
iShares MSCI Emerging Markets (EEM)	8.00%	8.99%	-20.56%	-3.62%	<i>Emerging Mkts (US\$)</i>
Consumer Price Index - US (CPI-U)*	3.4%	N/A	6.5%	7.0%	<i>Measure of Inflation</i>
Goldman Sachs Hi Yld Corp Bond (GHYB)	7.05%	12.12%	-11.03%	3.21%	<i>High Yield (Junk) Bonds</i>
Vanguard US Bond (BND)	6.61%	5.66%	-13.11%	-1.86%	<i>General US Bond Index</i>
Vanguard Real Estate (VNQ)	18.21%	11.79%	-26.24%	40.52%	<i>Real Estate Investment Trusts</i>
Utilities Select Sector SPDR (XLU)	8.48%	-7.17%	1.42%	17.69%	<i>Utility Index</i>
Alerian MLP Index (AMLPL)	2.91%	21.43%	25.53%	39.03%	<i>Energy Master Ltd Prtnshps</i>
Invesco Deutsche Bank Commodity (DBC)	-7.39%	-6.22%	19.34%	41.36%	<i>Basket-Commodities Futures</i>
Vanguard Materials (VAW)	10.61%	13.65%	-11.79%	27.41%	<i>Materials Companies</i>
SPDR Gold Shares (GLD)	11.50%	12.69%	-0.77%	-4.15%	
iShares Silver Trust (SLV)	7.08%	-1.09%	2.37%	-12.45%	

*Inflation for the quarter is the rate of inflation reflecting the All Items (Seasonally) Unadjusted Index over the previous 12 mos. (through December 2023) and is not an investable index product. Year-to-date date is not provided.