Q4 2023

Quarterly Market & Economic Perspective

xypn invest

Keeping a Balanced Approach

SUMMARY

- All stock and bond indexes shown were positive for Q4 and for the year. A global portfolio of 60% stocks/40% bonds rose by 16.1% during 2023.
- Not surprisingly, many strategists were wrong in their predictions for how the S&P 500 would so, as well as in their predicting the US economy would have a recession in 2023.
- Fed continued to pause but not pivot, keeping rates at the 5.25-5.5% level they set in July.

POSITIVE SIGNALS

- It was a strong year for investor returns, even with all the noise, highlighting how hard it is to time the markets.
- Inflation measures continue to recede from their recent peaks; hope for a soft landing abounds.
- There is more “income” from fixed income than there has been in years.

REASONS FOR CONCERN

- US large cap stocks’ return is being driven by only a small number of stocks (the Magnificent 7).
- Many geopolitical risks lurk in the background including wars in the Ukraine and Middle East, possibilities of a US government shutdown, and 2024 is a presidential election year in the US.
- It’s still possible that inflation can increase again, causing the Fed to raise rates again.

SOURCE: MORNINGSTAR; RUSSELL, MSCI, DOW JONES, BLOOMBERG, ICE BOA ML BENCHMARKS SHOWN; PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS

COMMENTARY

2023 by the numbers...

0: The number of recessions in 2023, even though one was widely expected by most economists.
1: The number of rating agencies (out of three, Moody's) that still has US debt rated as AAA.

22.2%: The return for the MSCI ACWI, representing global stocks, clearly a strong year.

26.3%: The gain of the S&P 500. This return was driven by the Magnificent Seven, which jumped 76.3%, with the remaining stocks gaining 13.7%.

5.25%-5.5%: The Fed's policy rate reached in July as they worked to tame inflation, the highest level since 2001; the same level it was at year-end.

3.1%: The November 2023 headline CPI figure, having fallen from the 9% level it hit during the summer of 2022; still above the Fed's 2% target.

4.98%: The level the US 10 Year Treasury closed at on 10/19/2023. The last time it ended that high was 7/19/2007, when it closed at 5.04%. 10 Year Treasuries rallied at the end of the year, closing at 3.88%.

Forecasters don't have a working crystal ball

At the end of each year, it is common for economists and market strategists to make their predictions for the upcoming year.While we are confident that the people making these predictions are indeed intelligent people with good intentions, it doesn't change the fact that their predictions are often very wrong. Specifically, over the last five years the forecasts have ranged from being 26% too low to 21% too high. On average, the median annual estimate was off by about 18%, nearly double the index's long-term average annual return.

EXHIBIT 1

Firms	2023 S&P 500 Forecast	% Difference from Actual
Oppenheimer	4,400	-8%
Credit Suisse	4,.050	-18%
JP Morgan	4,200	-14%
Bank of America	4,000	-19%
Goldman Sachs	4,000	-19%
Morgan Stanley	3,900	-22%

Source:https://www.marketwatch.com/story/wall-streets-stock-market-forecasts-for-2022-were-off-by-the-widest-margin-since-2008-will-next-year-be-any-different-11671583416 , Yahoo! Finance The S&P 500 ended the year at 4769.83.

Exhibit 1 looks at the same institutions we reviewed last year at this time, so this list had no cherry-picking. We wanted to update their 2023 forecasts with what occurred.

Each of the firms shown had lower forecasts vs. what actually occurred, ranging from 8% to 22% lower. In other words, while forecasting makes for interesting debate and conversation, we wouldn't suggest basing your investment strategy off it.

An update on US inflation and the Fed

Regarding inflation, for at least the last year we have spoken about the three P's of pace, pause, and pivot. Going back to the 2nd quarter of 2023, we saw the Fed implement their last rate increase, moving rates up by 0.25% in July. Since then, the Fed has hit the pause button as the Fed Funds rate remains at the 5.25-5.5% range it set over the summer.

The Fed says they will continue to be data dependent on making any future changes as inflation is still higher than desired, and with a labor market that remains tight. They have continued to promote the idea that even though inflation has moderated from last year's highs, there is still a long way to go to hit their 2% target, and that there are no guarantees what the future will bring. In other words, it could be a while before the Fed pivots, and starts lowering the Fed Funds rate.

U.S. Equity

- ·All US stock indexes had strong gains for the quarter and the year.
- ·The majority of the S&P 500's 2023 return came from just a few stocks, known as the Magnificent Seven.

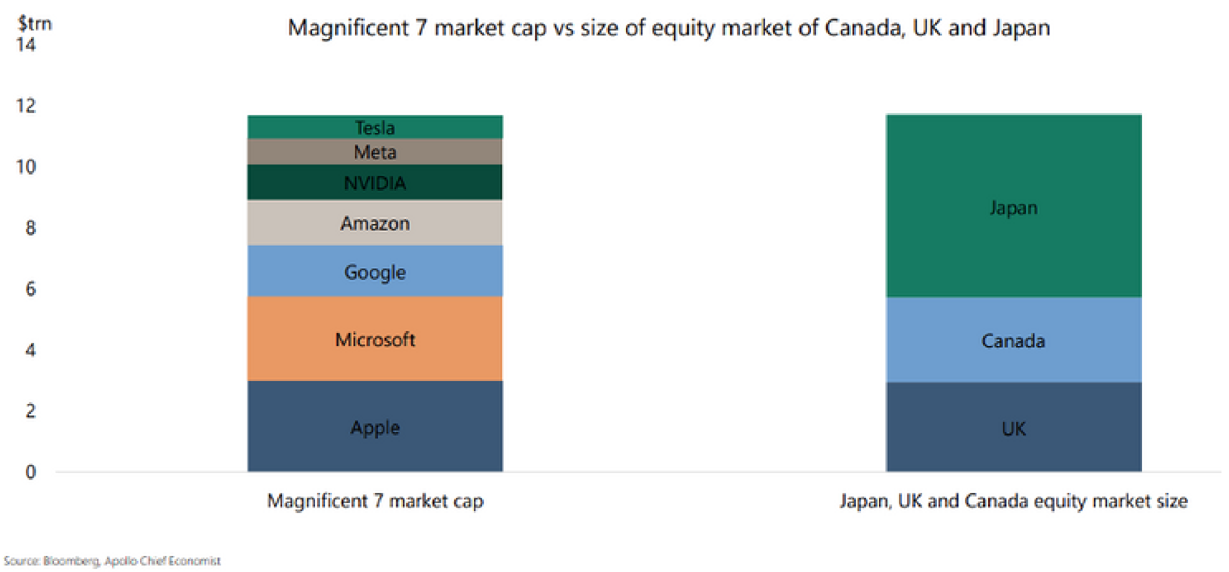
EXHIBIT 2

Company	2023 Return
Apple	48.9%
Microsoft	58.0%
Alphabet (Google)	58.3%
Amazon	80.9%
Nvidia	239.0%
Meta	194.1%
Tesla	101.7%
S&P 500	26.3%

SOURCE: MORNINGSTAR

The seven stocks shown in Exhibit 2, known as the Magnificent Seven, were the key drivers behind the overall success of the S&P 500 in 2023. These seven stocks had a combined 2023 return of 76.3%, compared to the 13.7% return for the remaining stocks of the S&P 500. This is important because when investors see the return of the S&P 500, they should know it is being driven by just a few names and not the broad market in general.

EXHIBIT 3



SOURCE: BLOOMBERG, APOLLO CHIEF ECONOMIST

Plus, when a stock rally is broad, the overall health of the market is considered to be better.

Just how big are the Magnificent Seven today? They are so large that their combined market cap is roughly the same size as the equity markets of Japan, Canada, and the UK combined (Exhibit 3). It is also important to think about the valuation of these seven US large cap stocks.Per JP Morgan, at year end these 7 stocks had a forward P/E ratio of 26.9x, vs. 19.5x for the S&P 500 overall and 17.1x for the remaining stocks in the S&P 500, suggesting these seven stocks are overvalued vs. their peers. It doesn't mean they still can't go up; it just means they appear to be overvalued.

Non-U.S. Equity

- Like US stocks, non-US stock returns were quite strong in Q4 and for the year.
- Unlike US stocks, the rally in international stock markets was broader.
- Non-US developed large cap stocks underperformed their US counterparts over the quarter, but non-US developed small cap stocks outperformed US small caps.

Unlike the S&P 500, whose return is dominated by just a few stocks, international indexes are currently more balanced and diversified. The top ten stocks in the MSCI World ex-US IMI returned 18.3% during 2023, while the remaining stocks generated a very similar return of 18.0%.

A common question we receive is "why should we own non-US stocks when US stocks have outperformed non-US stocks for most of the last decade or so?" One reason why we like international stocks is for diversification.

While US stocks have outperformed more recently, that hasn't always been the case. In fact, you only need to go back to the 2000's to find the last period when international stocks outperformed. Remember the "lost decade" when the S&P 500 earned almost no return?Plus, we also know the US Dollar is relatively strong vs. a basket of other major world currencies. If the USD were to weaken, it would be a tailwind for non-US stocks denominated in those currencies.

EXHIBIT 4

	20-yr avg. P/E ratio	Current P/E ratio
S&P 500	15.6x	19.5x
ACWI ex-US	13.1x	12.9x

SOURCE: FACSTET, MSCI, S&P, JP MORGAN ASSET MANAGEMENT, DATA AS OF 12/31/2023

If the USD were to weaken, it would be a tailwind for non-US stocks denominated in those currencies. Finally, as Exhibit 4 shows, not only are most non-US stocks currently undervalued vs. their last 20-year averages, they are also well undervalued relative to US stocks, which are currently overvalued vs. their own 20 year average.

Global REITs

- Global REITs, as represented by the Dow Jones Global Select REIT, jumped 9.8% over the quarter, driving the 11.7% return for 2023.
- In the US, the sectors that performed the best over the year were data centers (30.1%), and lodging/resorts (23.9%). Source: NAREIT

Global Fixed Income

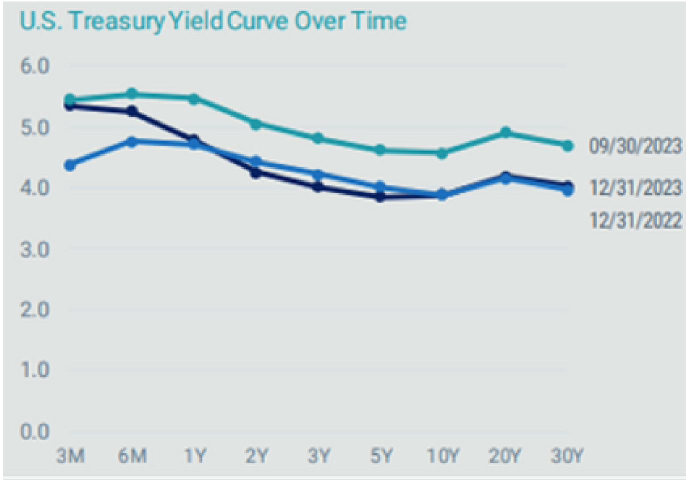
- There was a significant decline in US bond yields during the 4th quarter that drove returns. In particular, the intermediate and long parts of the curve saw their yields fall more dramatically vs. the shorter end of the curve. As a reminder, prices and yields move in opposite directions, so a drop in yields actually means positive returns.
- Global bonds ex-US (hedged USD) had a strong 2023 with gains of 8.3%.

Bond yields experienced quite a ride in the 4th quarter. For example, the 10-Year US Treasury started the quarter at 4.59%, closed as high as 4.98% in mid-October, and then steadily fell to end the year at 3.88%.

There are several possible reasons that rates began falling including the Fed keeping rates steady as inflation steadily fell, along with a belief the Fed would start cutting rates in 2024.

There are several good stories that can be told from looking at Exhibit 5. For one, you can see the rate levels we are at today vs. the very low levels of just a few short years ago (not shown, but trust us, they were much lower).This is important for investors as they can now receive actual income on their fixed income (bonds).

EXHIBIT 5



SOURCE: BLOOMBERG, DATA AS OF 12/31/2023

Also, you can see how the curve for 12/31/2023 is below that of the one for 9/30/2023, highlighting how strong the bond rally was over the last quarter, generating strong returns across Treasuries and other US bond categories. Plus, while the curve from 12/31/2023 is very similar to the curve from the previous year, it doesn't show how much change actually occurred throughout the year, meaning shorter term yields are higher vs. longer term yields. And finally, the curve is still inverted, meaning shorter term yields are higher vs. longer term yields. Nonetheless, we would caution about having too much in cash and short-term bonds, as reinvestment risk could be an issue.

Overall, we continue to view our bond allocations as a method of reducing overall portfolio risk (as measured by standard deviation), given that stocks are expected to have much higher volatility.Our portfolio's focus will continue to be on high quality bonds with an emphasis on short to intermediate duration government and corporate bonds, where default risk has historically been relatively low.

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AUTHORS

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Mario is the Chief Investment Strategist for XYPN Invest and the President & Founder of East Bay Financial Services. Mario began his investment career in 1999 with Vanguard mutual funds in Valley Forge, PA, where he consulted institutions and financial advisors on investment policy, portfolio construction, and Exchange-Traded Funds (ETFs). He also held roles as a research analyst, a municipal bond fund specialist, among others, during his tenure. In 2003 he earned the Chartered Financial Analyst designation, and he continues to mentor aspiring Charter candidates and young investment professionals.

Mario is Past President of CFA Society South Carolina and Former Chairman of the College of Charleston Finance Department Advisory Board. His approach to investments and the industry has been featured in Investment News, NAPFA Advisor Magazine, South Carolina Public Radio, and other publications and media outlets.

Eric Stein, CFA

Prior to joining East Bay, Eric worked for a variety of firms, both large and small. This includes 7+ years with Goldman Sachs Asset Management where he held roles in areas such as performance measurement, client service, risk analysis, and portfolio construction. During his tenure there, Eric had the opportunity to cover many different types of asset classes, vehicles, and client types. Eric also worked at RSM U.S. Wealth Management for 10+ years, serving as the Chief Investment Officer while providing strategic leadership and solutions for their national investment platform.

As a Partner at East Bay, Eric serves a select group of financial advisory firms as their outsourced Chief Investment Strategist. Responsibilities of this role include continuous oversight of advisor clients' investments, bespoke strategies for unique situations, client communications, and more.

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Investors cannot invest directly in an index. Indexes are unmanaged and reflect reinvested dividends and/or distributions, but do not reflect sales charges, commissions, expenses or taxes.

An investor should consider a portfolio's investment objectives, risks, charges and expenses carefully before investing. The underlying funds' prospectus contain this and other important information. Please read any applicable prospectus carefully before investing.

DISCLOSURES

Benchmark descriptions: MSCI ACWI Index, MSCI's flagship global equity index, is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets, covering approximately 85% of the free float- adjusted market capitalization in each market. Russell 3000 Index is a market-capitalization-weighted equity index that tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities. Standard & Poors 500 is an index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices. Russell 1000 Index is an index of approximately 1,000 of the largest companies and is a subset of the Russell 3000, comprising approximately 90% of total market capitalization of all listed US stocks. 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MSCI EAFE Small Cap Index captures small cap representation across Developed Markets countries around the world, excluding the US and Canada. MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries and covers approximately 85% of the free float-adjusted market capitalization in each country. MSCI Frontier Markets Index captures large and mid cap representation across 29 Frontier Markets countries and covers about 85% of the free float-adjusted market capitalization in each country. Dow Jones Global Select REIT Index is designed to measure the performance of publicly traded REITs and REIT-like securities and is a sub-index of the Dow Jones Global Select Real Estate Securities Index (RESI), which seeks to measure equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded globally. The index is designed to serve as a proxy for direct real estate investment. Dow Jones U.S. Select REIT Index tracks the performance of publicly traded REITs and REIT-like securities and is designed to serve as a proxy for direct real estate investment, in part by excluding companies whose performance may be driven by factors other than the value of real estate. The index is a subset of the Dow Jones U.S. Select Real Estate Securities Index. Dow Jones Global ex-US Select REIT Index is designed to measure the performance of publicly traded REITs and REIT-like securities traded globally ex-US. ICE BofAML 3-Month T-Bill Index is an unmanaged index that measures returns of three-month Treasury Bills. ICE BofAML 1-5 Year US Treasury, Corporate and Municipal Indexes are subsets respectively of ICE BofAML US Treasury, Corporate and Municipal Indexes including all securities with a remaining term to final maturity greater than or equal to 1 year and less than 5 years. ICE BofAML 5-10 Year US Treasury, Corporate and Municipal Indexes are subsets respectively of ICE BofAML US Treasury, Corporate and Municipal Indexes including all securities with a remaining term to final maturity greater than or equal to 5 years and less than 10 years. ICE BofAML 10+ Year Treasury, Corporate and Municipal Securities Index are subsets respectively of ICE BofAML US Treasury, Corporate and Municipal Securities Indexes including all securities with a remaining term to final maturity greater than or equal to 10 years. Bloomberg Barclays Global Aggregate Bond Index provides a broad-based measure of the global investment-grade fixed income markets (one version shown with its currency hedged back to the USD and is noted as such). Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed- rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and nonagency). J.P. Morgan Global (ex-US) Government Bond Index: Is the standard unmanaged foreign securities index representing major government bond markets outside the US markets (one version shown with its currency hedged back to the USD and is noted as such). ICE BofAML US Inflation-Linked Treasury Index tracks the performance of U.S. dollar denominated inflation linked sovereign debt publicly issued by the U.S. government in its domestic market. Qualifying securities must have at least one year remaining term to final maturity and no more than 5 years to maturity. Bloomberg Barclays U.S. Corporate High Yield Bond Index is a total return performance benchmark for fixed income securities having a maximum quality rating of Ba1.