Pinney&Scofield

Building long-term relationships with long-term investors

January 15, 2024

Dear Client,

The investment winds swiftly changed direction in 2023. In 2022 when the Fed was raising rates to slow down the economy, nearly every asset class ended the year with a negative return. Bloomberg publishes its annual survey in which they ask prominent market forecasters for their prediction for the markets in the following year. In December 2022, the average consensus was investors should get ready for more losses in 2023. It was the first time in over 20 years that Wall Street forecasted a negative return. A recession appeared to be approaching. Bob Farrell, a former analyst at Merrill Lynch, has an investment rule that says, "When all the experts and forecasts agree, something else is going to happen." And in 2023, it did. Last year ended up being the biggest year for the stock markets in the past decade. Inflation was cut in half starting at 6.5% and getting as low as at 3.1% in November before bumping back up to 3.4% by year-end. This prompted the Fed to pause rate hikes even though inflation is still above their 2% target, and they suggested rate cuts in 2024. Lower interest rates mean lower borrowing costs for business and therefore higher profits. At this news, the markets took off. The chart below shows the year-end returns for the indexes in 2022 and 2023. The turnaround from one year to the next is remarkable.

Index	Sector	2023	2022
Bloomberg US Credit	Long-term Bonds	8.18%	-15.26%
Bloomberg US Credit 1-5 Years	Short-term Bonds	5.94%	-5.56%
Bloomberg US High Yield Composite	High Yield Bonds	13.44%	-11.19%
Bloomberg US TIPS	Treasury Inflation Protected Bonds	3.89%	-11.85%
S&P 500 Composite	US Large Growth	26.29%	-18.11%
Russell 1000 Growth	US Large Growth	42.68%	-29.13%
Russell 1000 Value	US Large Value	11.46%	-7.53%
Russell 2000	US Small	16.93%	-20.43%
NASDAQ Composite	US Large Stocks	44.64%	-32.54%
Dow Jones US Select REIT	Real Estate	13.96%	-25.96%
MSCI EAFE Growth Net	International Large	17.58%	-22.95%
MSCI EAFE Small Cap Net	International Small	13.16%	-21.39%

The tech stock concentrated NASDAQ Composite index takes the pole position in 2023. It ended the year with a return of 44.64% – one of its best years ever. We cannot discuss the 2023 performance results without mentioning the Magnificent Seven that we introduced to you in our July 2023 letter, these stocks accounted for over 50% of the S&P 500's 26.29% return! As we discussed back in July, they continue to have an historic impact as they are the current driving force of the markets. In 2023, the recession that never came (see our letter last quarter, thank you Godot) plus the emergence of artificial intelligence and the promise the technology may hold plus lowering inflation with accompanying easing of interest rate increases, all fueled these companies with Nvidia being the top performer of the seven with a return of 239% and Meta not far behind at 194%! After seeing these returns it is tempting to want to buy shares in the companies but is the performance of the Magnificent Seven sustainable? History says it is not. Data

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shows that once a company becomes one of the top largest US stocks, its performance typically tends to underperform the market on a 5-year and 10-year basis. There are exceptions to every "rule," AT&T, General Motors, and GE are just a few that were able to continue to outperform for decades. Amazon and Microsoft are entering the potential "decades" range, we shall see if they or any of the Magnificent Seven stocks will be added to this esteemed list of companies of their day.

It is interesting to note shifts in the S&P 500, an index we often reference. The top ten companies by market cap are still dominated by the Magnificent Seven, however, Tesla has fallen to nine while Eli Lilly, a pharmaceutical, has cracked the top ten just behind after completing a number of acquisitions and positive clinical trials in 2023 which led to a 61% return for the year. This return places it better than three of the Magnificent Seven and for the second half of the year, Lilly outperformed all seven while Apple and Tesla both had negative returns. We mention this only as a reference point that investing trends are persistently on the move, so tomorrow's best performers are unknown.

The returns earned in 2023 happened despite us experiencing a US banking crisis, conflicts in foreign lands and financial turbulence. This should be remembered as we look forward to 2024. In the short term we face yet another possible government shutdown. While there is anticipation the Fed will start to lower rates, the slight uptick in inflation in December may delay the cuts. Wars continue to rage on and of course the presidential election will put us all on a roller coaster. On the positive side, the chances of the economy having a soft landing and avoiding a recession has greatly increased over the last year, the emergence of artificial intelligence should continue to push the markets forward, and interest rates likely will be going down increasing corporate profits. Market gurus who focus on the obstacles forecast a down market like Gary Shilling who is predicting a 30% fall in stocks. And those who focus on the positive like Jeremy Siegal predict 10-15% return for stocks. And then there is the "what do I do with this?" category from Mohamed El-Erian who said back in October, in reference to the Treasury bond market, "the global benchmark market is charting an ambiguous path with an indeterminate outcome." Thank you, Mohamed, but not very useful. FYI, the long-term Treasury fund we use from Vanguard (ticker VUSUX) was up 12.67% in the fourth quarter. As for the rest, we shall see who will be right. Our approach is centered on the belief that ultimately market returns are driven by the difference between investor expectations and the events that actually transpire. If the real world exceeds expectations, then markets will deliver positive returns. Conversely, returns will be disappointing if developments are worse than anticipated. Historically over the long term, human ingenuity has meant actual results consistently exceed the naysayers.

With the start of a new year, it is a good time to remind everyone about the prevalence of financial fraud. Fraudsters are getting more and more creative with their techniques and technology is making it easier for them to succeed so it is important for you to stay diligent. Schwab continues to move more to online electronic workflow with new accounts and money movements and we have noticed an uptick in fake emails that appear to be coming from Schwab, Microsoft, DocuSign and even Pinney & Scofield! Whenever you receive an email, review it and check the sending address carefully before clicking on any links. If you have any doubts, do not click. We will never email you for personal information nor ask you to "click here" in an unsolicited email. If an email looks like it came from Schwab or us, call and we can confirm its legitimacy.

We wish you a happy and safe 2024 and get ready for the roller coasters!

John, Richard, Mary, and Ryan