MARKET INSIGHT

Fourth Quarter 2023

NEWS & VIEWS FROM LPL RESEARCH

The economic forecasts set forth in the presentation may not develop as predicted. Please note: all return figures are as of December 29, 2023 unless otherwise stated. This information is not intended as authoritative guidance or tax or legal advice. You should consult with your attorney or tax advisor for guidance on your specific situation.

LPL Research

Fourth Quarter 2023

MARKET INSIGHT QUARTERLY

Q4 2023 at a Glance

Sector	Q4 2023
Gross Domestic Product*	1.0%
S&P 500 Index	11.7%
Bloomberg U.S. Aggregate Bond Index	6.8%
Bloomberg Commodity Index	-4.6%

Source: LPL Research, Bloomberg, FactSet, 12/29/2023

* Bloomberg consensus as of 12/29/2023

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodities Index are total returns from 10/01/2023 - 12/29/2023

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Past performance is not indicative of future results.

Equities Rally as the Federal Reserve Pivot Increases Confidence in a Soft Landing

The S&P 500 gained ground in the fourth quarter, returning 11.7% including dividends to bring its 2023 return to 26.3%. The Dow Jones Industrial Average advanced 13.1%, while the growth-laden Nasdaq Composite advanced 13.8% during the quarter as growth outperformed value. The third quarter's winner, the Bloomberg Commodity Index, lost ground as oil prices receded due to uncertainty over global demand and milder-than-expected weather dragged down natural gas.

Inflation continues to improve as the headline consumer inflation rate stood at 3.1% on an annual basis as of November, compared with 7.1% a year ago. This improvement in the pricing environment is the primary reason why the Federal Reserve (Fed) signaled interest rate cuts in 2024. The narrative of "if" the Fed will cut rates has changed to "when" and "by how much" as 2024 began. Of course, the outlook for inflation will be key to those monetary policy questions and a major catalyst for equity performance over the coming year.

Corporate resilience continued to surprise Wall Street during third quarter earnings season. Pricing and related cost pressures were among analysts' key concerns going into the quarter. In addition, analysts were keen on the outlook for the economy in 2024. Actual earnings came in more than three percentage points better than expected, officially pushing the S&P 500 out of its earnings recession.

Even amid improving inflation and better-than-anticipated earnings, the global economic and geopolitical landscape remained challenging. Consumers and companies will still need to navigate elevated interest rate levels. In addition, China's economic picture remains murky as the nation continues to deal with real estate challenges.

Large Caps Led in 2023, but Valuation and a Resilient Economy Lifted Small Caps in Q4

Large and small cap stocks both traded higher in the quarter, although small caps outperformed. The valuation gap between small-cap stocks and large-cap stocks is near its highest level in the last 20 years as small caps are trading at a 20% discount to forward earnings compared to their large cap counterparts. Small-cap companies tend to perform well as economic conditions improve as investors believe in the soft-landing narrative.

During the quarter, the large cap dominated Russell 1000 Index gained 11.5%, compared to 14.0% for the small cap Russell 2000 Index. For 2023, large caps outperformed small caps, 26.5% to 16.9%, amid strength in mega-cap technology companies.

Growth Outperformed Value on Strength in the Magnificent Seven

Both growth and value gained ground during the quarter as the Russell 1000 Growth Index rose 14.2**%,** compared to the 9.5**%** advance for the Russell 1000 Value Index. Earnings growth for the Magnificent Seven (the top seven market capitalization companies—all technology related—in the S&P 500) outperformed the S&P 500 Index as operating margins for these companies reached 19.9% in aggregate compared with 13.6% for the broader market. Longer term, analysts forecast 17% earnings growth for the Magnificent Seven compared to 9% for the large cap index.

Following concentrated returns in the first quarter when ten of the largest technology names contributed to the majority of the S&P 500 Index returns, market breadth improved during the fourth quarter. Some investors believe equities are looking increasingly overbought as during the second to last week of 2023, just under half of the S&P 500 traded at a 14-day Relative Strength Index (RSI) of 70, the most in 30 years. It is important to note that in strong uptrends/bull markets, overbought conditions can persist for meaningful periods.

U.S. Outpaced International Equities in Q4 and 2023

U.S. equities slightly outperformed their international brethren as the MSCI EAFE Index gained 10.5% during the fourth quarter, lagging behind the S&P 500 Index's 11.7% advance. Emerging markets (EM) had a positive quarter, but underperformed their developed country counterparts, as the MSCI EM Index only gained 7.9%.

The economic landscape amid restrictive global monetary policy favored growth names, which favors the U.S. Germany is mired in a technical recession and Europe's struggles have challenged value names, which has made it challenging for developed international equity markets to outperform. Japan has been a bright spot this year as a trend toward more shareholder-friendly corporate practices and recent breakouts to multi-decade highs for some of Japan's most widely followed stock market indexes have also increased interest in this nation's equities. Moreover, company valuations remain attractive.

The Best Quarter for Bonds Since 1989 Helped Fixed Income Investors Avoid a Three-Year Losing Streak

Core bonds, as defined by the Bloomberg U.S. Aggregate Index, were up nearly 7% for the quarter as the narrative shifted to eventual rate cuts instead of further rate hikes by the Fed. The fall in yields/rise in bond prices allowed the index to avoid its first three-year losing streak ever, as the index returned 5.5% for the full year.

Inflation has shown signs of improvement during 2023, which is expected to cause global central banks to change course on monetary policy. The most credit-sensitive sectors of the bond market, including bank loans and corporate high-yield bonds, outperformed during the fourth quarter, while the most interest rate sensitive sectors lagged, most notably U.S. Treasuries.

High yield credit outperformed during the quarter despite tightening bank lending standards and increasing defaults. The fundamental backdrop for corporate borrowers is starting to deteriorate as the global economy slows. Given our expectations of a slowing economy, LPL Research doesn't think valuations in general are compelling enough to invest in the riskier fixed income markets, with the exception of preferred securities, where valuations continue to look attractive in the aftermath of the regional bank stresses in early 2023.

Energy Was a Drag on the Broad Commodities Index

The Bloomberg Commodity Index slid 4.6% last quarter, dragging down its 2023 decline to 7.9%. Uncertainty over global demand, notably in China, and record-setting U.S. production weighed on oil. Moreover, natural gas prices declined as warmer-than-expected weather and rising inventories exacerbated an already challenged supply and demand backdrop.

The paths of global energy demand and the global economy remained in question as 2024 began. Economic uncertainty in China, the world's largest importer of energy, remains elevated as the nation struggles to resolve its real estate problems and the fallout from its economic-restrictive COVID-19 policies.

Corn importers in Europe and North Africa expect a consistent stream of Ukrainian exports in 2024, which could potentially weigh on agriculture prices next year. But given persistent logistical difficulties and Russian attacks on infrastructure, some market watchers believe there is little chance of a large increase in supply. How this debate is resolved could have a meaningful impact on crop prices next year. The S&P Goldman Sachs Commodity Index (GSCI) Softs (soft commodity) Index increased 7.8% in 2023.

Gold gained ground as the metal was a bright spot in 2023's commodity space. Central bank buying, along with real interest rates pointing lower helped propel the precious metal higher. Copper and silver were essentially flat as demand for the industrial metals was marginal given hawkish global bank policies. Given the mixed performance for metals and lack of technical evidence pointing to a sustained recovery, LPL Research maintains a neutral view on both industrial and precious metals.

All commodities performance is based on Bloomberg commodity indexes

A LOOK AHEAD

Economy. The LPL Research's baseline forecast is that the U.S. economy tips into a mild and short recession in 2024 as consumer spending fades. Hawkish Federal Reserve policy is expected to shift in 2024 as the inflation landscape improves. That said, housing and food inflation could remain elevated amid strong housing demand. A cooling job market could be the impetus for a modest economic contraction if consumers face declines in disposable income. While a cooling job market over the next six months may put some downward pressure on inflation, housing inflation will likely also get some help from strong multi-family construction.

Stocks. LPL Research maintains its year-end 2024 S&P 500 fair value target of 4,850 to 4,950 based on a price-to-earnings ratio (P/E) of 19.5 and a 2025 EPS estimate of $250, implying mid-to-high single digit returns this year. If stronger earnings come through and/or interest rates decline, it may justify a higher fair value S&P 500 target range. And while rates may be the most impactful driver of stock valuations, corporate profits are moving into a sweet spot. Risks include a potential widening conflict in the Middle East or Europe, an increase in U.S.-China tensions, and reacceleration in inflation that pushes interest rates higher.

Bonds. After one of the most significant rate hiking campaigns from the Fed in history, short term interest rates are at their highest levels in two decades. The risk is these yields won't last, forcing investors to reinvest proceeds at lower rates. So, unless investors have short-term income needs, it may make sense to extend the maturity profile of fixed income holdings to lock in higher yields for longer. Historically, core bonds, as proxied by the Bloomberg Aggregate Bond Index, have performed well after the Fed has paused prior interest rate hiking cycles. LPL Research expects 10-year Treasury yields may end the year between 3.75% and 4.25%, recently revised down 4.25% to 4.75%.

Please note: All return figures are as of December 29, 2023, unless otherwise stated.

Past performance is not indicative of future results.

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U.S. Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

FOURTH QUARTER DATA

Real Estate Tops Sector Rankings as Energy Lags Given Energy Price Weakness

S&P 500 sector performance, ranked by fourth quarter returns*

Sector	Q4 2023
Real Estate	**18.8%**
Information Technology	**17.2%**
Financials	**14.0%**
Industrials	**13.1%**
Consumer Discretionary	**12.4%**
S&P 500 Index	**11.7%**
Communication Services	**11.0%**
Materials	**9.7%**
Utilities	**8.6%**
Healthcare	**6.4%**
Consumer Staples	**5.5%**
Energy	**(6.9) %**

Small Value Led Amid Positive Performance Across the Board

Domestic and international asset class performance, ranked by fourth quarter returns*

Asset Class	Q4 2023
Small Value	**15.3%**
Mid Growth	**14.6%**
Large Growth	**14.2%**
Small Growth	**12.8%**
Mid Value	**12.1%**
Russell 3000	**12.1%**
S&P 500 Index	**11.7%**
Large Foreign	**10.5%**
Large Value	**9.5%**
Emerging Markets	**7.9%**

Unhedged Foreign Bonds Lead Amid Dollar Strength

Bond market performance, ranked by fourth quarter returns*

Sector	Q4 2023
Foreign Bonds (Unhedged)	**9.9%**
High-Yield Munis	**9.2%**
Investment-Grade Corporates	**8.2%**
Preferred Stock	**8.1%**
Munis	**7.9%**
MBS	**7.5%**
High-Yield Corporate	**7.2%**
Bloomberg U.S. Agg	**6.8%**
U.S. Treasuries	**6.6%**
Foreign Bonds (Hedged)	**6.0%**
TIPS	**4.7%**
Bank Loans	**3.2%**

**Sources: LPL Research, FactSet, as of 12/29/2023

All data as of 12/29/2023

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The sectors are represented by the 11 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg U.S. MBS Index; Investment-Grade Corporate – Bloomberg U.S. Corporate Bond Index; Municipal – Bloomberg Municipal Bond Index; Municipal High-Yield – Bloomberg Municipal High Yield Index; TIPS – Bloomberg Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg U.S. High Yield Loan Index; High-Yield – Bloomberg U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and are usually expressed annually as a percentage based on the investment's cost its current market value or its face value.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

Small cap is a term used to classify companies with a relatively small market capitalization. The definition of small cap can vary, but it is generally a company with a market capitalization of between $300 million and $2 billion. The prices of small cap stocks are generally more volatile than large cap stocks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

The Bloomberg Global Aggregate Index measures the performance of global investment grade debt. The index includes treasury, corporate, and securitized fixed-rate bonds. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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