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WEALTH ADVISORS

Redhawk Quarterly Commentary

December 31, 2023

Each quarter, Redhawk's Investment Committee provides a Quarterly Commentary. We look at what is transpiring in the investment landscape and provide our perspective on a variety of topics. These are not predictions, and it represents our perspective on important market and economic information designed to help make decisions affecting your long-term financial strategy. Our goal is to help you understand what is going on in the markets so you can more clearly define investment goals, diagnose unintended risks, and utilize portfolios that can achieve a better financial outcome.

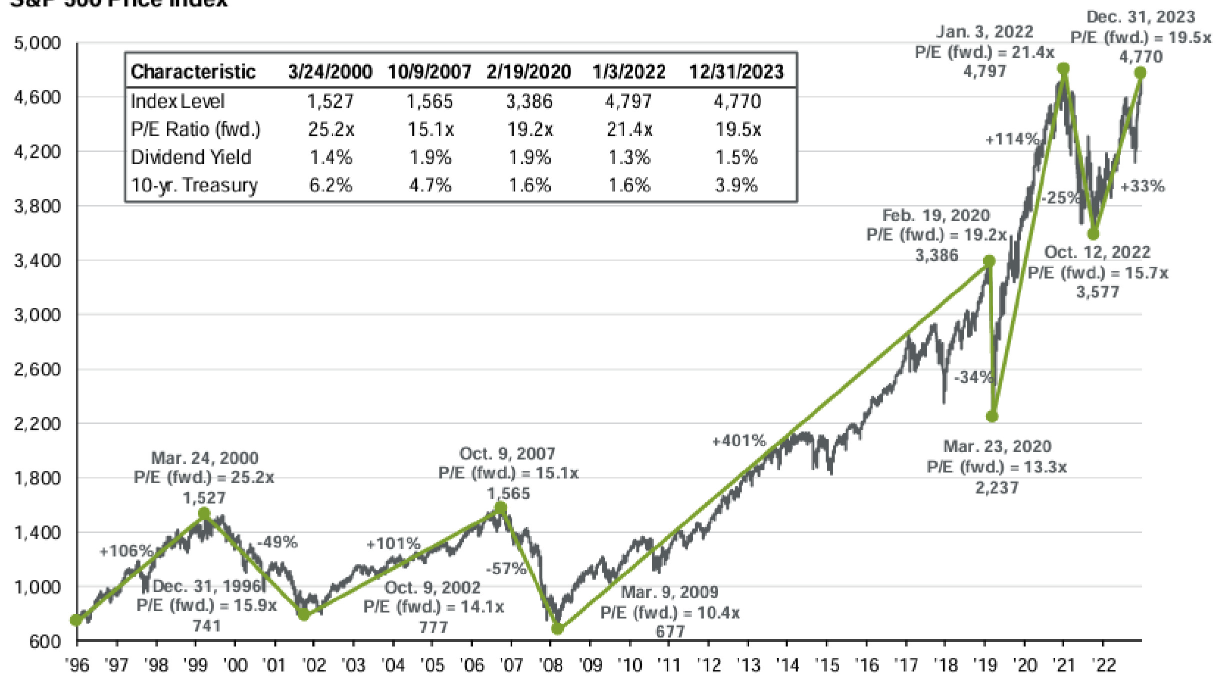
Market Commentary

The only word that comes to mind that summarizes the markets in 2023 was resilient. The year began with many reasons that investors might doubt the market. There was anxiety over high inflation, rising interest rates, and widespread "hard landing" and recession forecasts. Later in the year, the market experienced a regional banking turmoil and witnessed the onset of war in the Middle East. Yet, despite all the headwinds, the market delivered big, with the S&P 500 Index returning over 26%. The chart below, captures most of the good and not-so-good news from 2023, presented against the cumulative return of the S&P 500[1]. Market highs and lows are

Source: FactSet and Avantis Investments, data from 1/1/2023 – 12/29/2023.

highlighted to illustrate further what a tremendous year it was (blue and red dots for highs and lows and green for new all-time highs). Amazingly, a dollar tracking the index beginning with the start of the year would have reached the low mark by January 5 and experienced 47 new highs by the end of 2023.

The S&P 500 Index ended the quarter at 4,770 with a forward P/E Ratio of 19.5x and the 10-year Treasury yield closed at 3.9% (see the chart below)[2]. It's interesting to note that the S&P 500 Index closed the year at almost the same level it was at the end of 2021.



Characteristic	3/24/2000	10/9/2007	2/19/2020	1/3/2022	12/31/2023
Index Level	1,527	1,565	3,386	4,797	4,770
P/E Ratio (fwd.)	25.2x	15.1x	19.2x	21.4x	19.5x
Dividend Yield	1.4%	1.9%	1.9%	1.3%	1.5%
10-yr. Treasury	6.2%	4.7%	1.6%	1.6%	3.9%

Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of December 31, 2023.

J.P.Morgan
ASSET MANAGEMENT

U.S. Market

The fourth quarter began with low expectations as rising long-term interest rates extended the late summer decline for stocks. On October 19, the yield on the benchmark 10-year U.S. Treasury climbed as high as 5%, the highest since 2007. Rising long-term rates are a headwind for stocks, and the S&P 500 fell over 9% from July to October. The market began to turn in late October

with the release of positive third quarter economic data and business activity reports, coupled with better than feared anticipated corporate earnings results. In addition, resilience in the job market supported better than expected consumer spending at the same time inflation softened. By December, the same 10-year Treasury fell below 4% in yield.

After an unsteady start, both stocks and bonds surged in the fourth quarter as declining inflation opened the door for potential rate cuts in 2024. Unlike earlier in the year when equity gains were narrowly led by a handful of large cap technology names, 2023's fourth quarter rally broadened with outperformance by more interest rate sensitive sectors, cyclicals, and small caps. The S&P 500 Index gained 11.7% in Q4, while small cap stocks surged 14% with 12.2% of that coming in December alone.

The real tailwind for the rally came after the Federal Reserve's (Fed) December policy meeting. The Fed kept rates steady as expected, but the market's focus turned quickly to the *Summary of Economic Projections*, which showed median policymaker projections for 75 basis points (bps) of easing in 2024 (see the red circle in the chart to the right)[3]. Additionally Fed Chairman Jerome Powell indicated in the post-meeting Q&A that the Fed is willing to cut rates even if the U.S. economy doesn't dip into a recession in 2024. "It could just be a sign that the economy is normalizing and doesn't need the tight policy," he said. The markets responded to the change in tone with a powerful rally in equities. In the bond market, after causing much pain for investors in the first 10 months of the year, the core bond index surged 6.8% for the quarter, erasing the prior three quarters of losses and bringing the 2023 return to 5.3%[3].

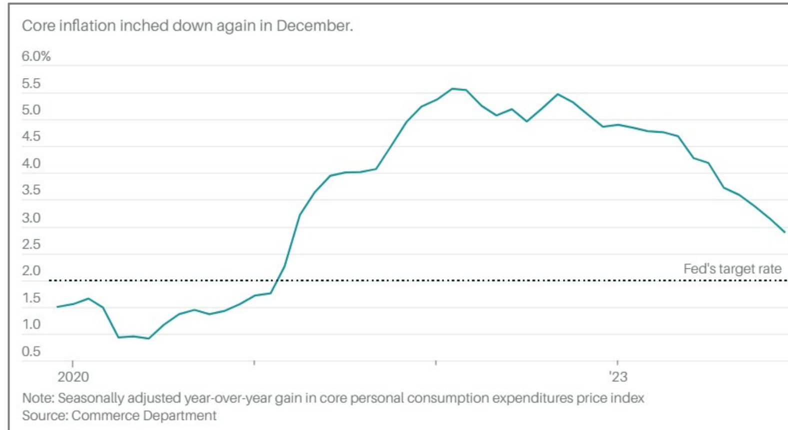
Variable	Median[1]					Central Tendency[2]					
	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run	2023
Change in real GDP	2.6	1.4	1.8	1.9	1.8	2.5–2.7	1.2–1.7	1.5–2.0	1.8–2.0	1.7–2.0	2.5–2.7
September projection	2.1	1.5	1.8	1.8	1.8	1.9–2.2	1.2–1.8	1.6–2.0	1.7–2.0	1.7–2.0	1.8–2.6
Unemployment rate	3.8	4.1	4.1	4.1	4.1	3.8	4.0–4.2	4.0–4.2	3.9–4.3	3.8–4.3	3.7–4.0
September projection	3.8	4.1	4.1	4.0	4.0	3.7–3.9	3.9–4.4	3.9–4.3	3.8–4.3	3.8–4.3	3.7–4.0
PCE inflation	2.8	2.4	2.1	2.0	2.0	2.7–2.9	2.2–2.5	2.0–2.2	2.0	2.0	2.7–3.2
September projection	3.3	2.5	2.2	2.0	2.0	3.2–3.4	2.3–2.7	2.0–2.3	2.0–2.2	2.0	3.1–3.8
Core PCE inflation[4]	3.2	2.4	2.2	2.0		3.2–3.3	2.4–2.7	2.0–2.2	2.0–2.1		3.2–3.7
September projection	3.7	2.6	2.3	2.0		3.6–3.9	2.5–2.8	2.0–2.4	2.0–2.3		3.5–4.2
Memo: Projected appropriate policy path											
Federal funds rate	5.4	4.6	3.6	2.9	2.5	5.4	4.4–4.9	3.1–3.9	2.5–3.1	2.5–3.0	5.4
September projection	5.6	5.1	3.9	2.9	2.5	5.4–5.6	4.6–5.4	3.4–4.9	2.5–4.1	2.5–3.3	5.4–5.6

Source: Federal Reserve, "Summary of Economic Projections."

Based on the Fed's comments and the data reinforced market expectations that the Fed had finished its rate hiking cycle and will move towards cuts in 2024. Fed chair Jerome Powell indicated that the central bank was aware of the risk of keeping rates at restrictive levels for too long.

The annual inflation rate in the U.S. (consumer price index) slowed over the period from 3.7% in September to 3.2% in October and 3.1% in November. The Fed's preferred inflation metric, the

core personal consumption expenditures price index, which excludes the more volatile costs of food and energy, slowed to 2.9% year over year in December (see the chart below)[4].



Equities rebounded sharply in the fourth quarter on the heels of what the market anticipated as a Fed pivots and interest rate cuts come in 2024. Easing inflation measures and strong labor market data helped lead these expectations. The strong performance was felt at both ends of the market-cap spectrum, where large-cap stocks returned 11.7% during the quarter and small-cap stocks increased by 14.0%. Commodities were lower courtesy of the downside reversal in crude oil prices amid growing non-OPEC oil production and global growth concerns. REITs led the pack and broke out to five-month highs as interest rates tumbled and industrial and health care REITs continued to outperform (see the chart above).

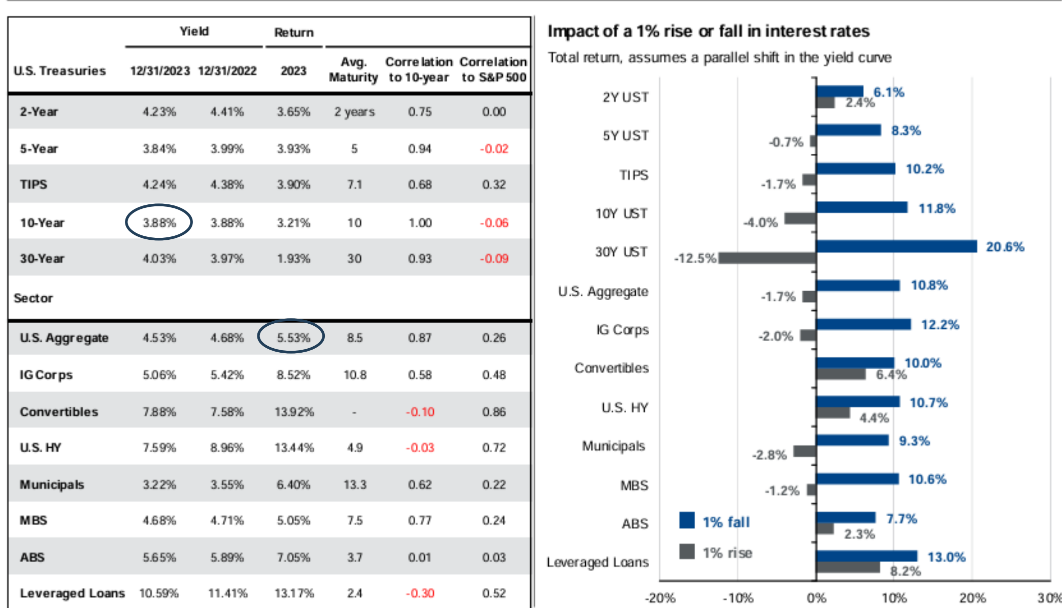
	BENCHMARK	Q4 2023	1-Year	3-Year	5-Year	10-Year
U.S. Large-Cap Stocks	S&P 500® Index	11.7%	26.3%	10.0%	15.7%	12.0%
U.S. Small-Cap Stocks	Russell 2000® Index	14.0%	16.9%	2.2%	9.9%	7.1%
International Developed Stocks	MSCI EAFE Index	10.4%	18.8%	4.5%	8.7%	4.7%
Emerging Market Stocks	MSCI Emerging Markets Index	7.8%	10.0%	-4.8%	4.0%	3.0%
U.S. Bonds	Bloomberg US Aggregate Bond Index	6.8%	5.5%	-3.3%	1.1%	1.8%
Treasury Inflation Protected Securities	Bloomberg US Treasury Inflation Protected Securities (TIPS) Index	4.7%	3.9%	-1.0%	3.2%	2.4%
High Yield Bonds	Bloomberg US Corporate High Yield Bond Index	7.2%	13.4%	2.0%	5.4%	4.6%
International Developed Bonds	Bloomberg Global Treasury ex-US Index	9.9%	6.2%	-7.9%	-1.8%	-0.8%
Commodities	S&P GSCI Index	-10.7%	-4.3%	19.2%	8.7%	-3.6%
REITS	Dow Jones U.S. Select REIT Index	16.3%	14.0%	7.2%	6.1%	7.0%

Source: Charles Schwab.

Fixed Income Markets

U.S. Treasury yields fell sharply at the end of the fourth quarter as the Fed pivoted towards an easing bias in 2024. After raising rates by more than 5 percentage points since early 2022, the Fed held rates steady at both of its fourth quarter meetings, and the median projection from Fed officials suggested that they could lower rates by 75 basis points in 2024.

U.S. bonds rebounded sharply in the fourth quarter amid declining Treasury yields and cooling inflation. The fourth-quarter rally left the broad bond market index with a solid year-to-date gain. The Bloomberg U.S. Aggregate Bond Index returned 3.83% in December and 6.82% for the fourth quarter. This late-year rebound, amid slowing inflation and a more-dovish Fed, pushed the index's one-year return to 5.53% (see the chart below). Treasury yields sharply declined in the quarter, with the 10-year note ending December at 3.88%, which was the same as 12/31/2022.



U.S. Treasuries	Yield 12/31/2023	Yield 12/31/2022	Return 2023	Avg. Maturity	Correlation to 10-year	Correlation to S&P 500
2-Year	4.23%	4.41%	3.65%	2 years	0.75	0.00
5-Year	3.84%	3.99%	3.93%	5	0.94	-0.02
TIPS	4.24%	4.38%	3.90%	7.1	0.68	0.32
10-Year	3.88%	3.88%	3.21%	10	1.00	-0.06
30-Year	4.03%	3.97%	1.93%	30	0.93	-0.09
Sector						
U.S. Aggregate	4.53%	4.68%	5.53%	8.5	0.87	0.26
IG Corps	5.06%	5.42%	8.52%	10.8	0.58	0.48
Convertibles	7.88%	7.58%	13.92%	-	-0.10	0.86
U.S. HY	7.59%	8.96%	13.44%	4.9	-0.03	0.72
Municipals	3.22%	3.55%	6.40%	13.3	0.62	0.22
MBS	4.68%	4.71%	5.05%	7.5	0.77	0.24
ABS	5.65%	5.89%	7.05%	3.7	0.01	0.03
Leveraged Loans	10.59%	11.41%	13.17%	2.4	-0.30	0.52

Source: Bloomberg, FactSet, Standard & Poor's, U.S. Treasury, J.P. Morgan Asset Management. Sectors shown above are provided by Bloomberg unless otherwise noted and are represented by – U.S. Aggregate; MBS: U.S. Aggregate Securitized - MBS; ABS: J.P. Morgan ABS Index; IG Corporates: U.S. Corporates; Municipals: Muni Bond; High Yield: Corporate High Yield; Leveraged Loans: J.P. Morgan Leveraged Loan Index; TIPS: Treasury Inflation-Protected Securities; Convertibles: U.S. Convertibles Composite. Convertibles yield is as of most recent month-end and is based on U.S. portion of Bloomberg Global Convertibles Index. Yield and return information based on bellwethers for Treasury securities. Sector yields reflect yield-to-worst. Correlations are based on 15-years of monthly returns for all sectors. Past performance is not indicative of future results.
Guide to the Markets – U.S. Data are as of December 31, 2023.

J.P.Morgan
ASSET MANAGEMENT

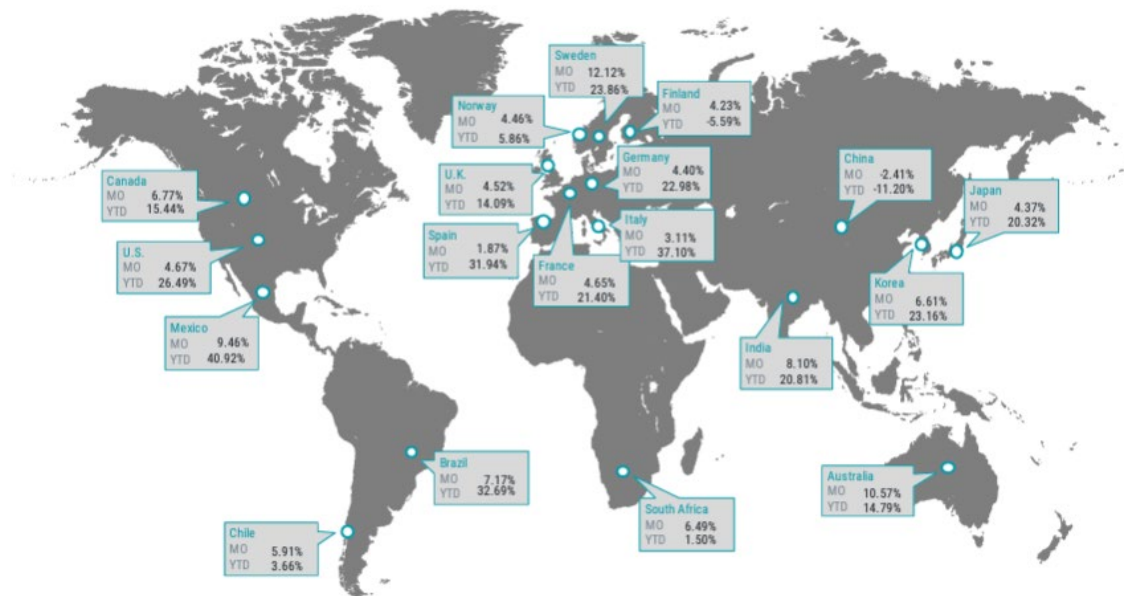
The 2-year Treasury yield dropped 80 bps to 4.23%. After widening early in the quarter, credit spreads tightened through December, and corporate bonds outperformed Treasuries in December and the fourth quarter. Mortgage-Backed Securities (MBS), which are investment products similar to bonds where each MBS consists of a bundle of home loans and other real estate debt bought from the banks that issued them, also outperformed Treasuries. High-yield

corporates advanced but lagged investment-grade corporates for both periods. The Fed held rates steady throughout the quarter. Municipal bond (muni) yields declined significantly, and munis outperformed Treasuries for the quarter. Munis advanced in December but lagged Treasuries. Inflation expectations declined in the quarter, and TIPS underperformed nominal Treasuries[1].

International Markets

It was a strong quarter for global markets. Developed markets outperformed emerging markets amid ongoing worries over China's real estate sector. Mexico was on top with an annual return of 40.92%, followed by Italy at 37.10%, Brazil at 32.69%, Spain at 31.94%, the U.S. at 26.49%, and the laggard was China coming in at -11.20% (see the chart below).

Equity Returns | Country



Source: FactSet and Avantis Investments.

International developed markets rallied in the quarter, lifting their year-to-date gains. Size and style indices delivered solid results for both periods. Large-cap and small-cap stocks performed similarly in the quarter, gaining nearly 11%. For the year, large-cap growth stocks gained 17.65% and outperformed small-cap growth stocks, which returned 10.57%. Large-cap and small-cap growth stocks outperformed their value peers for the quarter. Year to date, value stocks maintained a performance advantage over their growth counterparts (see the chart to the right).

Non-U.S. Developed Markets

	QTD (%)		YTD (%)	
	Value	Growth	Value	Growth
Large	8.49	12.80	19.01	17.65
Small	10.04	11.18	14.70	10.57

Source: FactSet and Avantis Investments.

Emerging Markets

	QTD (%)		YTD (%)	
	Value	Growth	Value	Growth
Large	7.58	7.67	13.72	4.53
Small	10.18	7.74	24.10	23.79

Source: FactSet and Avantis Investments.

The broad emerging markets advanced for the quarter and year-to-date period but underperformed its developed markets peers. Small-cap stocks outperformed large-caps in the quarter. For the year, small-cap growth stocks returned 23.79% versus 4.53% for large-cap growth stocks. Large-cap growth and value stocks performed similarly in the quarter, while small-cap value stocks outperformed their growth peers. Year to date, the value style outperformed across the board (see the chart to the left).

Economic Outlook

As we enter 2024, the U.S. economy avoided the feared recession. The Fed has pivoted and seems inclined to cut interest rates in 2024. The labor market is strong and the consumer resilient, providing a good backdrop to start the year. Should productivity gains continue to improve, we may see a broader-based rise in corporate earnings expectations during 2024, despite slower overall economic growth.

While it is impossible to predict what will happen to markets in the short term, markets have historically done well following a peak in inflation, the conclusion of a Fed tightening cycle, and a trough in consumer confidence. We are constructive on both stocks and bonds as the economy normalizes and deflationary tailwinds continue.

With a mix of macroeconomics and earnings, fundamental tailwinds and headwinds, high quality companies with strong pricing power, stable earnings, and healthy balance sheets are more likely to withstand margin pressure and high financing costs to meet growth expectations. U.S. high quality companies are expected to grow their earnings by 15.9% and revenue by 7.3% in 2024, exceeding the broad market by 4.3% and 1.8%, respectively. Their operating margins are expected to continue expanding at a faster pace than the broad market. This is consistent with historical trends observed in 2019, when the U.S. economy slowed from the previous year and the Fed held interest rates at the cycle's peak. During that period, quality companies outpaced the broad market in earnings growth and managed to expand their operating margins when the broad market experienced a margin decline[6].

As a factor, Quality has historically outperformed the broader market in seven out of eight economic slowdowns, and by an average of 6.5% on a cumulative basis since 1988. Quality's track record of consistently outperforming the broad market in every recession since 1988 highlights its resiliency in challenging economic environments. Quality struggled to outperform in 2022 as markets re-priced its expensive valuations to their lowest level since 2018, amid the Fed's aggressive rate hikes. But with the Fed closer to its terminal rate, Quality's reasonable valuations and the regional bank crisis rekindled investors' interest in 2023 (see the chart below)[6].

Source: FactSet, as of November 11, 2023. **Past performance is not reliable indicator of future performance.** Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

Summary

There are a several factors that we are watching closely in 2024. First, the rally has caused valuations to increase at a time when top line growth is weakening. Whether companies can support margins and earnings growth in the face of weaker pricing power will be a key focus in the coming months. There is also the question of how new AI technologies will proliferate and impact productivity across the economy. The technology is undoubtedly transformational, but a key question is how quickly we will see the impact. Lastly, geopolitics will remain in focus as wars in Europe and the Middle East coincide with a presidential election at home and slowing economy in China. While markets largely shrugged off such concerns in 2023, they require constant monitoring.

So, while markets are starting the year on optimism, we will be closely monitoring these developments domestically and globally. We also have confidence that many of the shifts we made in the last year have positioned portfolios well to perform through whatever challenges arise.

We continue to focus on managing both risks and return potential. We understand the risks facing both the markets and the economy and are committed to helping you effectively navigate this challenging investment environment.

Acknowledgements

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It is not enough to own a portfolio personalized for your situation, based on your comfort with risk and long-term financial goals. You must be patient and disciplined, too. With Risk-Guard™, our risk management process, our investment committee is reviewing the market conditions and underlying investments on a weekly basis. Please contact your Redhawk financial advisor to learn more.

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