



GUIDE TO THE GAUGES

Quarterly Economic and
Capital Market Review

Fourth Quarter 2023



Guide to the Gauges

Our Latest Assessment of Key Economic Indicators



Economy



Monetary Policy



Valuations



Investor Sentiment



Interest Rates

We believe that over the long term, stock prices are driven by two things: earnings, and what people are willing to pay for those earnings. These five gauges reflect our outlook for the factors that we believe drive stock prices.

Each gauge is comprised of a number of individual indicators, which the Investment Team evaluates on an ongoing basis to determine if the gauge is neutral, positive, or negative.

Fourth Quarter Summary

The economy has defied the naysayers and remained very strong in the face of recession calls. We expect the economy to continue to grow, but at a slower pace in 2024. Given the strength of the job market, we believe that any potential recession in the year ahead would be short and shallow.

As inflation continues to trend downward, we believe that the Federal Reserve is done hiking rates. Fed Fund Futures are currently pricing in six rate cuts beginning in March of this year, while the Fed's "Dot Plot" is signaling only three.

We held the Valuations gauge in a Neutral position this quarter and we continue to view stocks as "fairly valued" at the index level. Investor sentiment, which is a contrarian indicator, flipped from bearish to bullish in December. As a result, we moved the Investor Sentiment gauge two notches backwards to the Slow Reverse position.

The gauges represent the firm's expectations for the market, and how changes in the market will affect the strategy, but are only projections which assume certain economic conditions and industry developments and are subject to change without notice.



No Change in Position

Economy

This quarter, we held the Economy gauge in Neutral to reflect that GDP growth remains near trend, but there are some storm clouds on the horizon. December marked the 14th consecutive month of declining manufacturing activity in the U.S. The Federal Reserve appears to be achieving the elusive soft landing, although we can not rule out a recession in 2024. However, given the strength of the job market, any potential recession, in our opinion, would be short and shallow.

Key Takeaways

GDP

GDP for the first and second quarter of 2023 came in slightly above 2%. Third quarter GDP saw an acceleration to 4.9%. The Atlanta Fed's GDPNow is forecasting a slowdown to 2.5% for fourth quarter GDP.

Labor Market

The unemployment rate held steady at 3.7% in December and job openings declined to 8.8 million. The ratio of job openings to unemployed people is roughly 1:4.

Inflation

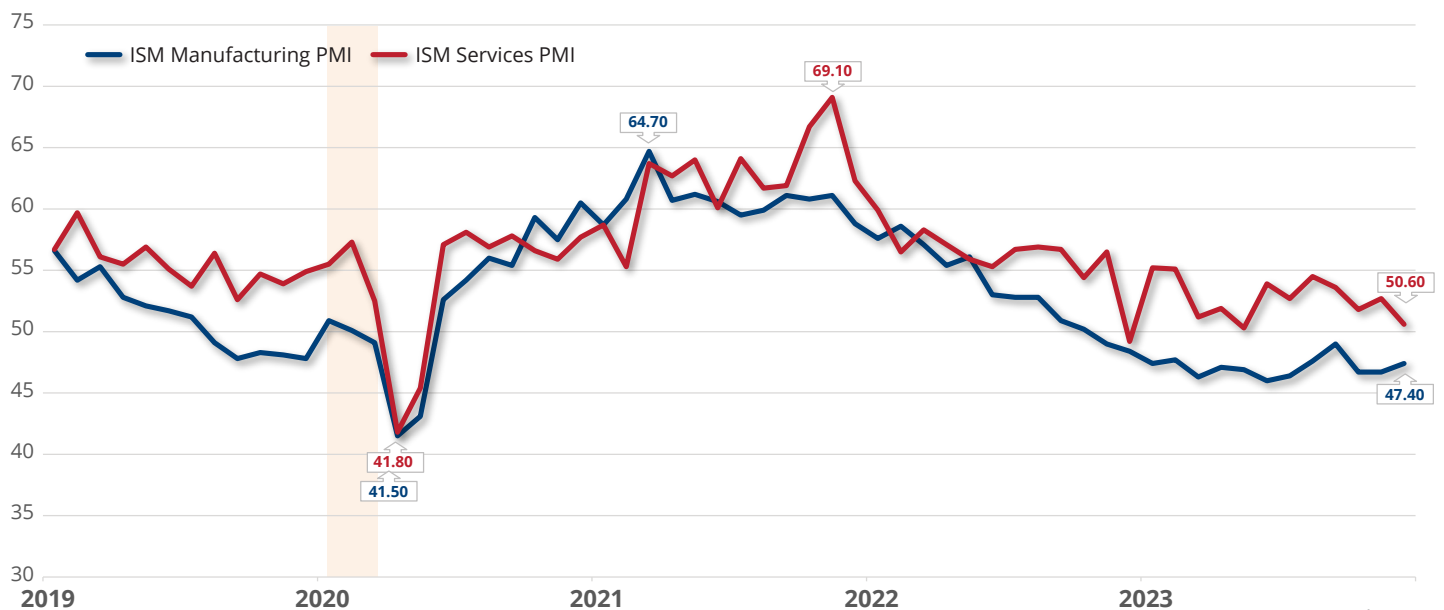
Headline Consumer Price Index (CPI) and Producer Price Index (PPI) for November came in at 3.1% and 0.9%, respectively. The Fed's preferred measure of inflation, Core Personal Consumption Expenditures (PCE) declined to 3.2%, but remains above their target of 2%.

ISM Manufacturing and Services PMI

The ISM Manufacturing Purchasing Manager's Index (PMI) increased slightly to 47.4 in December but remains below 50, marking the 14th straight month below 50. The ISM Services PMI unexpectedly fell to 50.6 in December, but remains in expansion territory.

ISM Manufacturing vs. Non-Manufacturing

1/31/2019 to 12/31/2023



Source: YCharts

Source: fred.stlouis.org

For illustrative purposes only. Past performance is not indicative of future results.



Moved one notch to the right

Monetary Policy

This quarter, we improved the Monetary Policy gauge to Neutral to reflect that the Federal Reserve is likely done raising rates. During the December FOMC presser, Fed Chair Powell acknowledged the risks of overtightening and made a case for potentially easing rates in 2024. However, he balanced those statements by emphasizing that the Committee is prepared to tighten further should inflation return.

Key Takeaways

Rate Hikes

December marked the third consecutive meeting where the Federal Reserve held rates steady in a range of 5.25%-5.5%.

Fed Fund Futures

Fed Fund Futures are currently pricing in six rate cuts beginning in March of this year, while the Fed's "Dot Plot" is signaling only three.

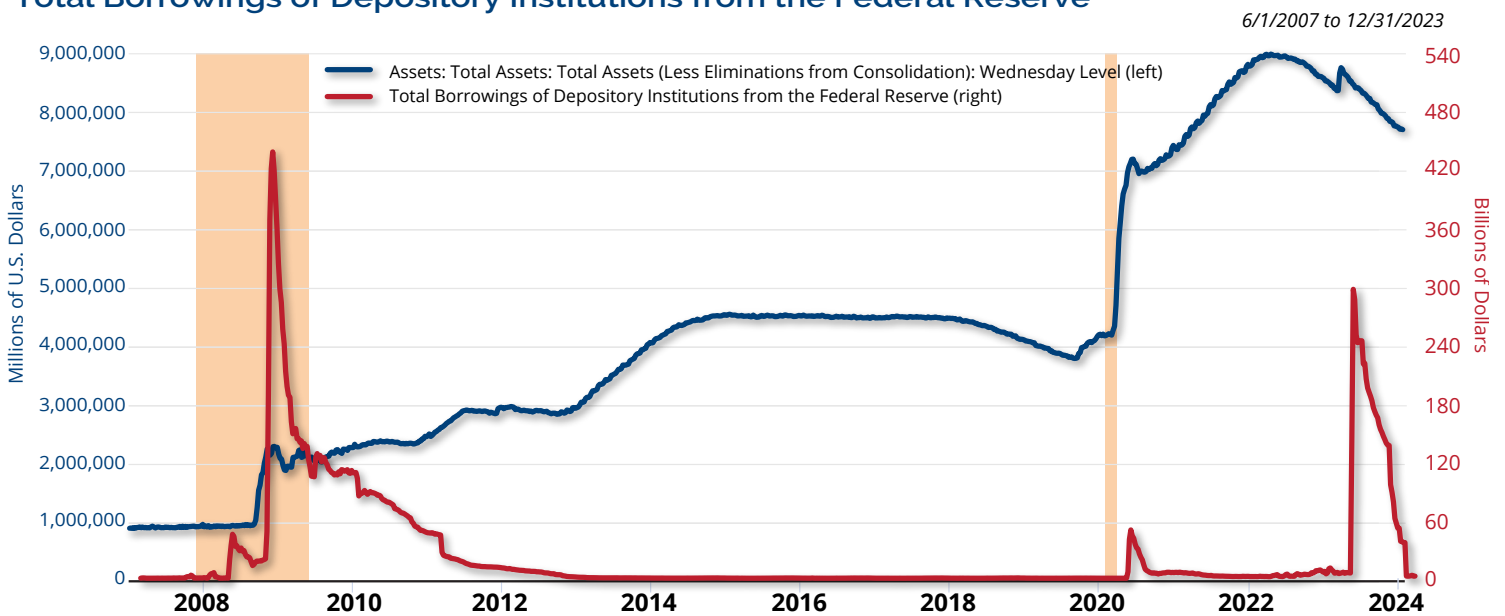
Balance Sheet

Quantitative Tightening (QT) has continued as previously outlined by the Fed with the balance sheet well below \$8T.

The Fed's Balance Sheet

Nearly all of the emergency lending accessed by banks through the Fed's discount window in March of 2023 has been reversed.

Total Borrowings of Depository Institutions from the Federal Reserve



Source: www.stlouisfed.com

Source: Board of Governors of the Federal Reserve System. For illustrative purposes only. Past performance is not indicative of future results.



Valuations

This quarter, we held the Valuations gauge in Neutral to reflect that P/E multiples remain in “fair value” range for S&P 500 companies.

No Change in Position

Key Takeaways

P/E Multiples

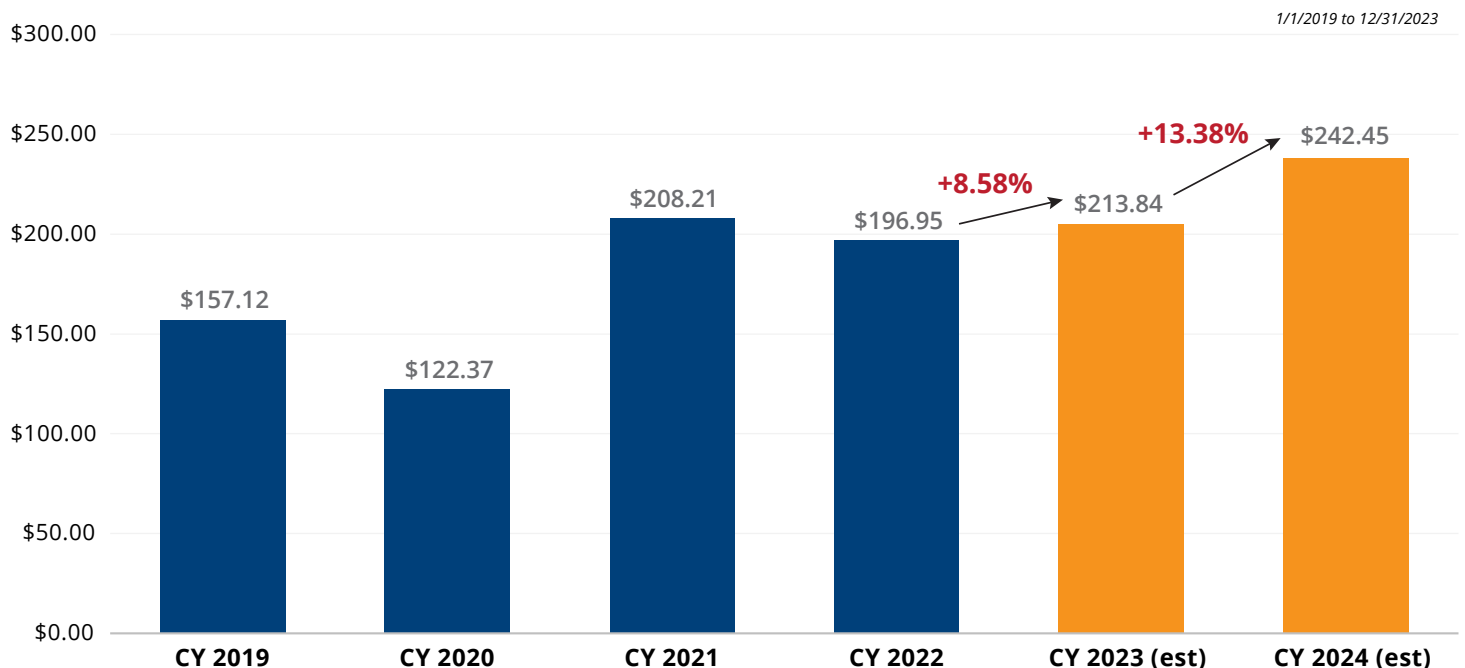
The S&P 500 staged an impressive rally in 2023 but remains in the “fair value” range as earnings growth has kept valuations near average levels over the last few decades.

Earnings

Analysts are currently forecasting ~9% operating earnings growth in 2023 and ~13% growth in 2024. Both would represent record S&P operating earnings.

S&P 500 Calendar Year Operating EPS Actuals & Estimates

The S&P 500 ended 2023 with an Operating P/E ratio of just over 21. Since 2000, the S&P 500 has had an average Operating P/E ratio of 19.55.



Source: S&P Global 1/1/1996 to 9/30/2023. For illustrative purposes only. Past performance is not indicative of future results. Neither past actual, projections, nor other forward looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially



Moved two notches to the left

Investor Sentiment

This quarter, we moved the Investor Sentiment gauge from Slow Forward to Slow Reverse to reflect that investor sentiment flipped from bearish in October to bullish in December. We also observed that stock volatility, as measured by the VIX Index, decreased as the quarter ended. This is a contrarian indicator. The more fear and pessimism among investors, the more positive for stocks, and vice versa. This is a sensitive gauge and can change quickly.

Key Takeaways

AAll Survey

After reaching 50% bearish readings at the end of October, the AAll Survey retreated to 25% bearish by the end of December as stocks staged a year end rally. Bullish sentiment ended December at 46% after being above 50% in the prior two weeks.

VIX Index

The VIX moved above 20 in October, its highest level since March, as stocks sold off. The VIX ended December at 12.45, a sign of complacency among investors.

What Does the AAll Survey Indicate About Bullish and Bearish Sentiment?

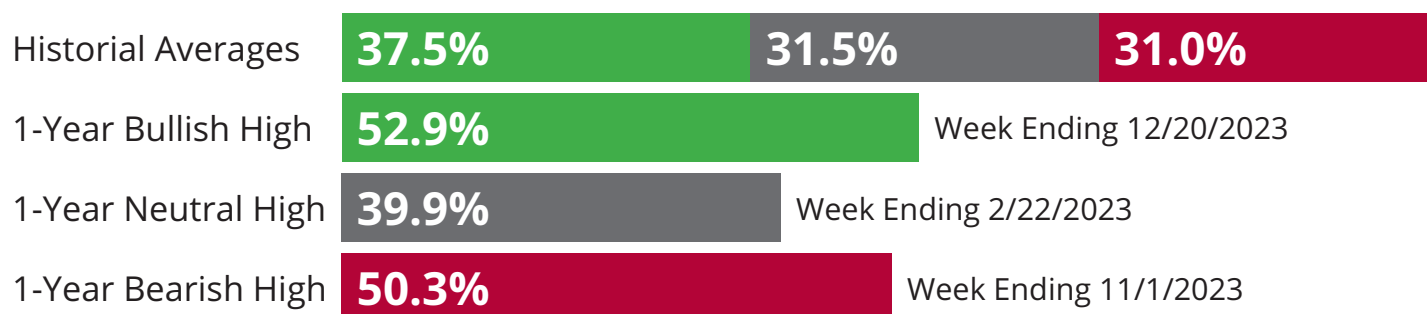
Since its inception in 1987, the AAll Survey has been a useful contrarian indicator. In the past when the survey reaches extreme levels of bullishness or bearishness, a change in direction for the market often follows.

Week Ending

■ Bullish ■ Neutral ■ Bearish



Historial View



Source: American Association of Individual Investors

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Moved one notch to the right

Interest Rates

This quarter, we improved the Interest Rates gauge to the Neutral position to reflect the likely end to the Fed's current interest rate hiking cycle and the dramatic drop in long-term interest rates since October.

Key Takeaways

Change in Yields

The curve reached new highs in Oct, but fell by the end of Dec. The planned bond issuance was not as large as feared and the idea that the Fed is done raising rates seemed to be validated.

Yield Curve

The spread between 3-month and 10-year Treasuries remains inverted. This signal has preceded prior recessions, although it does not indicate the depth or duration of a potential recession.

Interest Rate Volatility

Interest rate volatility, as measured by the BofA MOVE Index, dropped below 100 in the middle of September, but ended December at 114.62.

U.S. Treasuries Yield Curve

Since hitting a high water mark on October 19th, the long end of the Treasury yield curve ended 2023 dramatically lower.

Date Range: October 19, 2023 to December 29, 2023



Source: www.ustreasuryyieldcurve.com

	1 Mo	3 Mo	6 Mo	1 Yr	2 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
10/19/2023	5.58	5.60	5.56	5.44	5.14	4.95	5.00	4.98	5.30	5.11
12/29/2023	5.60	5.40	5.26	4.79	4.23	3.84	3.88	3.88	4.20	4.03

Source: Federal Reserve Bank of St. Louis

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The Standard and Poor's 500, or simply the S&P 500, is a stock market index tracking the stock performance of 500 large companies listed on stock exchanges in the United States.

The 3 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 3 months.

The 10 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 10 months.

The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.

The ISM Services PMI provides significant information about factors affecting total output, growth, and inflation.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

The price-to-earnings (P/E) ratio relates a company's share price to its earnings per share.

VIX of VIX (or VVIX) is a measure of the volatility of the Chicago Board Options Exchange (CBOE) Volatility Index (VIX). The CBOE's VIX measures the short-term volatility of the S&P 500 indexes, and the VVIX measures the volatility of the price of the VIX. In other words, VVIX is a measure of the volatility of the S&P 500 index and alludes to how quickly market sentiment changes.

Gross domestic product (GDP) is a monetary measure of the market value of all the final goods and services produced and sold in a specific time period by countries.

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