

Market Review and Outlook

2023: A Great Year for the Markets

At the start of last year, we were optimistic about long-term portfolio performance and expected it to be better in 2023 than it was the previous year. And indeed, 2023 turned out to be a great year for the markets. Returns were fueled by a resilient U.S. economy (largely due to the strength of consumer spending), enthusiasm for the opportunities created by artificial intelligence, and towards the end of the year the prospect of interest rate cuts in 2024.

It's important to note that not all investments benefited from these conditions. Companies leveraging the latest technological advancements did especially well – like the “Magnificent 7”: Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla. This group of tech giants reaped monster returns in 2023 and accounted for a large portion of the gains in the S&P 500 index. But let’s not forget their significant contribution to 2022’s bear market. Those companies are not immune to the business cycle and that in turn underscores our focus on diversification and avoiding concentration in any one investment. More on this follows later.

Other sectors – such as financials, utilities, and consumer staples – had a more challenging time as the Federal Reserve (the Fed) kept raising rates to cool inflation, which lead to an unexpected regional banking crisis. Energy firms saw the biggest declines in 2023, a natural reversal after a record year in 2022 supported by soaring commodity prices.

Here’s how the markets finished in 2023 in contrast to the previous year:

	2023	2022
<i>U.S. large cap stocks (S&P 500 Index)</i>	26.3%	-18.1%
<i>Tech heavy U.S. stocks (Nasdaq Composite)</i>	44.6%	-32.5%
<i>Global stocks (MSCI ACWI IN Index)</i>	21.6%	-18.4%
<i>Emerging markets stocks (MSCI EM Index)</i>	11.7%	-19.8%
<i>U.S. corporate bonds (FTSE U.S.BIG CORP. 3-7Y)</i>	7.6%	-9.2%

Source: Tamarac Inc.

2024 Outlook

We anticipate muted returns for the equity markets as the U.S. and other developed economies continue to slow down in 2024. Although concerns about inflation and a potential recession have started to ease in the U.S., we believe that we are not yet out of the woods. It takes time for the effects of the higher interest rates to work their way through the system (posing risks for the

already slowing economy). The new year also brings rising geopolitical tensions around the world and the presidential election here in the U.S. Any of these issues, or something else entirely, coupled with less attractive valuations after a strong year for equity markets, will continue to fuel near-term volatility.

We want to look beyond the headlines, identify opportunities, and be ready for what comes ahead with a strong plan based on key economic indicators.

The Economy

As the Fed hiked rates by another 1% throughout the first half of 2023, inflation started to ease (down by two-thirds from the 9% peak in mid-2022). Since their September meeting the Fed officials have decided to keep rates in the 5.25% - 5.5% range. While inflation has moderated from recent highs, it's persistent and remains above the central bank's target of 2%, posing a risk for investors that rates will be kept higher for longer.

In the U.S. the unemployment rate ended the year at 3.7%, close to pre-pandemic levels, and consumer confidence has proved resilient. Around two thirds of our economy is based on consumer spending, so we'll continue to keep a close eye on consumers.

Contrary to consensus estimates, in the first half of 2023 the GDP (Gross Domestic Product) grew faster than the 2% annual rate seen as the long-term average. After a strong third quarter the pace started to decline, and the GDP growth rate is estimated to come in at 2.4% for the year. Expectations for 2024 are that the U.S. economy will continue to slow down amidst the many uncertainties.

Election Year, Geopolitical Tensions, Etc.

As we are all aware, 2024 is an election year, and the presidential race will dominate the headlines. We anticipate the news cycle will ramp up in a very negative way, fueling even greater uncertainty. But history has shown that of all the factors that influence the markets' long-term performance, the short-term noise from presidential elections is the least important. In the long run, economic factors and asset valuations have the biggest impact on expected future returns for investments.

We also expect that some of the key issues that Congress will be navigating this year – from emergency aid for Ukraine and Israel to the looming battle over a potential government shutdown – will generate negative headlines. And the anticipated push for a more defined regulatory framework for cryptocurrency and AI (artificial intelligence) will likely also be in the news. FYI, we don't expect tax legislation to be at the forefront this year, but the 2025 expiration of most of the provisions of 2017's Tax Cuts and Jobs Act (TCJA) should bring the issue into the spotlight next year.

We'll continue to monitor substantive congressional policy proposals – and will evaluate the potential impact based on actual legislation.

Valuations and Opportunities

- U.S. Equity Markets - The S&P 500 Index (representing the U.S. large cap market) is trading above its historical valuation average, but the recent returns have been skewed by the mega cap companies. We see opportunities in stocks outside the technology sector that were left behind in 2023. Another area of opportunity within the U.S. that we're keeping a close eye on is mid and small cap equities. Overall, our focus heading into 2024 remains on profitable companies with strong fundamentals and positive upside potential.
- Foreign Equity Markets - International stocks didn't do as well as U.S. stocks in 2023, but they still notched a solid performance for the year. On a rolling 12-month comparison since October 2022, international stocks have performed in line with U.S. stocks. And International Value actually outperformed U.S. Value over that same period. There's no denying that the lower valuations and higher dividend yield of international equity make it attractive.
- U.S. Fixed Income - Higher yields have resulted in a more favorable outlook for bonds, offering the most compelling expected returns we've seen in over a decade. In addition, bonds are positioned to do relatively well as the Fed is expected to pivot to a more accommodating monetary policy in the coming year – especially longer-term bonds, which are more sensitive to changes in interest rates (bonds move in the opposite direction of rates).
- Cash and cash equivalents – Cash-equivalent investments, like money market funds, have benefited from higher interest rates. While we expect short-term rates to decline this year, returns on cash will likely outpace inflation, suggesting positive real returns (i.e., inflation-adjusted returns). This potential for a source of income marks a welcome shift from the trends of the last decade.

As always, we will continue to systematically rebalance your portfolio, taking some profits from highly appreciated assets and adding to asset classes that have greater potential. We believe staying disciplined and avoiding concentration in individual investments is critical. Of course, accomplishing that in a tax-efficient manner continues to be a priority. In fixed income, we'll maintain investments in high quality bonds that provide stability through income and help reduce risk.

The Bottom Line

As previously mentioned, we expect the economy to continue to slow down in 2024. The question becomes how slow it will get, and whether we manage to avoid a recession. In addition, there is no denying that U.S. equities are on the high side of their historical valuations, and we believe that U.S. stock prices don't have much room to appreciate as we head into 2024.

Geopolitical tensions and the noise from an election year will continue to fuel volatility, but with short-term volatility come opportunities for the long-term investor.

In this environment, we believe investing in a diversified global portfolio of stocks and bonds is as important as ever. Our investment philosophy has not changed and is built on a long-term systematic approach to grow and protect your portfolio.

We remain committed to these time-tested principles, ensuring that your portfolio continues to take advantage of the inevitable ups and downs of the market:

- Maintain a well-diversified investment portfolio.
- Stay invested through the ups and downs - especially the downs.
- DO NOT try to time the market!
- Tune out the noise and remain focused on your long-term financial plan and investment strategy.

In taking a systematic and disciplined approach to managing your money, our goal is to provide you with peace of mind, so you can live your best life! We fully understand our responsibility to you and appreciate the trust you have placed in the NCM Team. We look forward to continuing to support you and your family for years to come.

If you have any questions or would like to discuss your portfolio in more detail, we're always available for a call or meeting.

Thank you for your continued partnership.

The NCM Team

Extra Credit – Diversification Works!

One of the ways we manage the risk in your portfolio is through diversification and we thought it would be helpful to reiterate why it's important and illustrate how it works.

The “quilt chart” below shows the returns for various asset classes since 2008. It's been a wild ride as investments have come in and out of favor, driven by three major market downturns (2008, 2020, and 2022), various macroeconomic environments, and several geopolitical conflicts.

In any given year it would be impossible to predict which asset class would perform the best and that's why trying to chase returns doesn't work as a long-term investment strategy. For example, energy and commodities (dark green square) did very well in 2022, only to finish at the bottom the following year. Meanwhile, U.S. large cap companies enjoyed a strong year in 2023 after the bear market of 2022 – a return that's not likely to repeat this year.

2009-2023		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Ann.	Vol.	Fixed Income	EM Equity	REITs	REITs	REITs	Small Cap	REITs	REITs	Small Cap	EM Equity	Cash	Large Cap	Small Cap	REITs	Com dty.	Large Cap
Large Cap	21.9%	5.2%	79.0%	27.9%	8.3%	19.7%	38.8%	28.0%	2.8%	21.3%	37.8%	1.8%	31.5%	20.0%	41.3%	16.1%	26.3%
Small Cap	REITs	Cash	High Yield	Small Cap	Fixed Income	High Yield	Large Cap	Large Cap	Large Cap	High Yield	DM Equity	Fixed Income	REITs	EM Equity	Large Cap	Cash	DM Equity
11.3%	21.2%	1.8%	59.4%	26.9%	7.8%	19.6%	32.4%	13.7%	1.4%	14.3%	25.6%	0.0%	28.7%	18.7%	28.7%	1.5%	18.9%
REITs	EM Equity	Asset Alloc.	DM Equity	EM Equity	High Yield	EM Equity	DM Equity	Fixed Income	Fixed Income	Large Cap	Large Cap	REITs	Small Cap	Large Cap	Com dty.	High Yield	Small Cap
10.9%	20.3%	-25.4%	32.5%	19.2%	3.1%	18.6%	23.3%	6.0%	0.5%	12.0%	21.8%	-4.0%	25.5%	18.4%	27.1%	-12.7%	16.9%
High Yield	DM Equity	High Yield	REITs	Com dty.	Large Cap	DM Equity	Asset Alloc.	Asset Alloc.	Cash	Com dty.	Small Cap	High Yield	DM Equity	Asset Alloc.	Small Cap	Fixed Income	Asset Alloc.
8.6%	18.4%	-28.9%	28.0%	16.8%	2.1%	17.9%	15.9%	5.2%	0.0%	11.8%	14.6%	-4.1%	22.7%	10.6%	14.8%	-13.0%	14.1%
Asset Alloc.	Com dty.	Small Cap	Small Cap	Large Cap	Cash	Small Cap	High Yield	Small Cap	DM Equity	EM Equity	Asset Alloc.	Large Cap	Asset Alloc.	DM Equity	Asset Alloc.	Asset Alloc.	High Yield
8.1%	16.6%	-33.8%	27.2%	15.1%	0.1%	16.3%	7.3%	4.9%	-0.4%	11.6%	14.6%	-4.4%	19.5%	8.3%	13.5%	-13.9%	14.0%
DM Equity	Large Cap	Com dty.	Large Cap	High Yield	Asset Alloc.	Large Cap	REITs	Cash	Asset Alloc.	REITs	High Yield	Asset Alloc.	EM Equity	Fixed Income	DM Equity	DM Equity	REITs
7.4%	16.1%	-35.6%	26.5%	14.8%	-0.7%	16.0%	2.9%	0.0%	-2.0%	8.6%	10.4%	-5.8%	18.9%	7.5%	11.8%	-14.0%	11.4%
EM Equity	High Yield	Large Cap	Asset Alloc.	Asset Alloc.	Small Cap	Asset Alloc.	Cash	High Yield	High Yield	Asset Alloc.	REITs	Small Cap	High Yield	High Yield	High Yield	Large Cap	EM Equity
6.9%	11.5%	-37.0%	25.0%	13.3%	-4.2%	12.2%	0.0%	0.0%	-2.7%	8.3%	8.7%	-11.0%	12.6%	7.0%	1.0%	-18.1%	10.3%
Fixed Income	Asset Alloc.	REITs	Com dty.	DM Equity	DM Equity	Fixed Income	Fixed Income	EM Equity	Small Cap	Fixed Income	Fixed Income	Com dty.	Fixed Income	Cash	Cash	EM Equity	Fixed Income
2.7%	11.5%	-37.7%	18.9%	8.2%	-11.7%	4.2%	-2.0%	-1.8%	-4.4%	2.6%	3.5%	-11.2%	8.7%	0.5%	0.0%	-19.7%	5.5%
Cash	Fixed Income	DM Equity	Fixed Income	Fixed Income	Com dty.	Cash	EM Equity	DM Equity	EM Equity	DM Equity	Com dty.	DM Equity	Com dty.	Com dty.	Fixed Income	Small Cap	Cash
0.8%	4.5%	-43.1%	5.9%	6.5%	-13.3%	0.1%	-2.3%	-4.5%	-14.6%	1.5%	1.7%	-13.4%	7.7%	-3.1%	-1.5%	-20.4%	5.1%
Com dty.	Cash	EM Equity	Cash	Cash	EM Equity	Com dty.	Com dty.	Com dty.	Com dty.	Cash	Cash	EM Equity	Cash	REITs	EM Equity	REITs	Com dty.
-0.2%	0.7%	-53.2%	0.1%	0.1%	-18.2%	-1.1%	-9.5%	-17.0%	-24.7%	0.3%	0.8%	-14.2%	2.2%	-5.1%	-2.2%	-24.9%	-7.9%

Source: J.P. Morgan Asset Management

Now look at the white square, which represents a well-diversified portfolio. While never at the top, and never at the bottom, it was doing its job – providing competitive, more predictable, positive returns in the long term without the wild swings.

Diversification works because it spreads the risk across various assets and ensures that the poor performance of any single investment has a reduced impact on the overall portfolio. In essence, maintaining a diversified portfolio positions you for long-term success!