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Minot DeBlois Advisors LLC – Year in Review and Investment Outlook
January 2024

Despite significant market volatility throughout the year, returns for 2023 were positive for almost all asset classes. Financial assets benefited from investors' relief that numerous negative outcomes did not occur – primarily that the U.S. economy avoided recession and inflation began to recede. Market leadership remained quite narrow, however, and domestic equity returns were dominated by just seven technology stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla[i]. Dubbed the *Magnificent Seven* by financial journalists, these stocks' combined market cap now represents 30% of the total market cap of the S&P 500 and they accounted for the majority of the index's return in 2023.

Most of the gains for these stocks came via the expansion of their P/E ratios, rather than profit growth, driven by understandable excitement surrounding new Artificial Intelligence technologies. While much remains to be determined, in broad economic terms there is potential for AI to increase productivity, help with labor shortages, and contain inflation. It is not yet clear, however, which companies will see material and long-lasting profit growth via sales of AI-enhanced products, and for which companies AI will prove to be a source of competition or an added cost.

The strong performance of these technology stocks resulted in one of the largest return disparities between the market-weight index and the equal-weight index in 25 years, though this effect abated somewhat in the final two months of the year; solid economic growth and declining inflation enabled the Federal Reserve to signal that interest rates had peaked for this cycle, resulting in an almost 15% broad-based advance in the S&P 500 in November and December. Returns for a typical diversified portfolio were the inverse of those experienced in 2022. JP Morgan noted that the traditional 60/40 balanced portfolio returned -17% and +17% in 2022 and 2023, respectively. The 10-year U.S. Treasury Note, despite fluctuations, began and ended the year with a 4% yield, and U.S. bonds returned over 5% in aggregate, rebounding from one of the worst annual returns on record in 2022.

Outside of the U.S., many risk asset classes also delivered double-digit returns, albeit below those of U.S. large cap stocks. By several traditional measures – P/E ratios, expected earnings and economic growth, and market cap to GDP – domestic equities appear significantly over-valued relative to foreign developed and emerging market stocks. They may remain so, to some degree, given the United States' economic stability and growth profile.

Benchmark	Total Return One Year	Annualized Return Five Years	Annualized Return Ten Years
S&P 500 (US Large Cap Stocks)	26.2%	15.7%	12.0%
MSCI EAFE (Foreign Developed Large Cap Stocks)	18.2%	8.2%	4.3%
Barclays Aggregate Bond Index (US Investment Grade Bonds)	5.5%	1.1%	1.8%
US Short-Term Treasury Bills (US Government Money Market Fund)	5.1%	1.9%	1.3%

The S&P 500 Index is a broad measure of US large capitalization stocks; the MSCI EAFE Index is a broad measure of mid-large capitalization stocks in developed international markets; the Barclays Aggregate is a broad index of US investment grade fixed income securities; the 90-Day US Treasury Bill represents short-term government money market funds. Returns are provided by sources deemed to be reliable but are subject to change or revision.

Investors enter 2024 with expectations and concerns much like those of a year ago, focused on (1) inflation, (2) interest rates, and (3) the success of large technology companies. The U.S. economy is now expected to make a "soft landing", meaning that the economy will successfully cool from Covid-era stimulus and inflation will fall to more normalized levels without generating a recession. Twelve months ago, the Wall Street consensus was that a recession was likely imminent.

There have been five decades since the early 1900s during which real returns for stocks were negative, and all were preceded by periods of relatively high valuations and/or inflation. In 2023, we had both, although inflation has moderated. While overall economic data is fairly positive and consumers remain resilient, some indicators – the yield curve, industrial production, and the health of lower-end consumers – augur caution. Structural forces that may have kept inflation quite low are no longer as dominant, government debt continues to climb across major economies, and underinvestment in traditional and alternative sources of energy implies higher capital investment for years to come. Looking at historical precedent, many commentators have expected the impact of higher rates to be a significant headwind to the economy and labor market, but thus far this has not been the case. Concerns persist, however, regarding the possibility for future negative impacts[ii] of Federal Reserve interest rate hikes that occurred over the past year.

The market has shifted quickly in recent months to forecast at least five interest rate cuts in 2024, which appears optimistic given a strong labor market and inflation that is receding but remains above the Federal Reserve's long-run target. Interest rates may remain higher than those of the past decade and closer to long-term averages. Some market commentators have noted that interest rate stabilization would be beneficial to dividend paying stocks, which are traditionally favored by long-term fiduciary investors. Ultimately, consumers will be the key to economic growth, and for current conditions to hold, wages need to grow sufficiently to preserve real incomes, but not so fast as to reignite inflation.

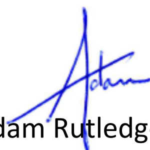
While we believe that risks are relatively balanced economically (although geopolitical risks in this election year abound), above-average recent market performance and high valuation levels leave us more cautious regarding prospective investment returns. Late this summer, with the U.S. stock market close to its all-time high, we lowered our strategic target weightings for stocks and introduced a small allocation to high yield bonds across all investment objectives where we have the discretion to do so. We realize that, with stocks having performed so well, selling securities can be an expensive proposition for taxable accounts, but we believe that disciplined rebalancing of portfolios lays the groundwork for superior risk-adjusted returns. Over long periods of time, and particularly during economic declines and market downturns[iii], this balanced approach has provided strong risk-adjusted returns.

In uncertain times, we remain focused on protecting capital by investing in stocks of durable companies with reasonable valuations and mitigating risk by diversifying investments across sectors and geographies while limiting concentrated exposures. The risk control portion of our portfolios is invested in high quality bonds where we favor intermediate-term investments with minimal credit risk. The portfolios we manage are therefore *balanced*, and headlines blaring historic declines (and increases) in the stock market rarely translate directly into the experience of an individual investor.

As we embark upon a new year, we appreciate your continued confidence in us, and most importantly, we wish all of our clients, friends, and colleagues a **healthy and happy new year**.

Zachary Bourque CFA

Gregory Gullickson CFA


Adam Rutledge CFA

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[i] Many of the technology stocks that performed exceptionally well in 2023 do not pay a dividend or only pay a very small one, were among the worst performers in 2022, and have high valuation multiples.

[ii] This is what the Federal Reserve describes as the "long and variable lags" in seeing the effects of changes in monetary policy.

[iii] Ultimately, we believe this is most compatible with our goal of providing our clients a "smoother ride" in portfolios' investment returns so that the timing of a client's need for funds will not have a pernicious impact.