ACKERMAN
CAPITAL MANAGEMENT

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ACM QUARTERLY MARKET COMMENTARY – FOURTH QUARTER 2023

Capital Markets

The capital markets had their ups and downs in 2023, but finished the year on a high note with diversified portfolios earning above average returns. This positive outcome was due in large part to a surge in global stock prices in the final two months of the year that reversed a 10% correction that began in August. In the end, global stocks delivered a 22.3% total return in 2023. Large U.S. growth stocks also regained their market leadership after a very difficult 2022, but participation was broad as value stocks, small-cap stocks, and international stocks all delivered solid gains. Meanwhile, both U.S. aggregate and municipal bonds managed to finish the year with respectable returns of 5.6%, but it took a record fourth quarter to avoid a second consecutive losing year.

The Economy

Last year's volatility was a result of the changing market interpretations of shifting economic and inflation data. Coming into last year, all signs seemed to point to a 2023 recession due to aggressive Fed rate increases. Yet the economy proved resilient, particularly on the jobs front, and concerns quickly shifted back to battling stubborn inflation. This changing view was evident as the yield on the 10-year U.S. Treasury surged well above last year's peak levels to a high of 5% at the end of October. Then in November, a brief spate of softer economic data led capital markets to suddenly embrace hopes for a soft economic landing. By year end, the markets were once again discounting Fed rate cuts in the not-too-distant future.

Economic and inflation data has been difficult to interpret, much less project, due to the continued distortion from the pandemic period. It was not clear how much of the 2022 inflation spike was due to lingering supply-chain bottlenecks, and until recently, strong employment data was still just replacing the 22 million jobs lost during the pandemic. The Fed has been aggressive as they raised short-term rates from zero to 5.5% over a fifteen-month period, yet the money supply and government expenditures have both remained trillions of dollars above trend.

As we begin a new year, economic growth is slowing and inflation is falling. This is exactly what the Fed was hoping for. Furthermore, inflation should continue to recede further because the lagging, but heavily-weighted shelter component of the CPI will inevitably moderate in line with current rental data. Meanwhile, easing supply chain pressures will also help keep prices in check. With inflation numbers heading in the right direction, the Fed may indeed have the flexibility to successfully engineer a soft economic landing. However, it would be a rare historic feat. It might

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only take one unexpected economic shock to put them in a position where they cannot cut rates fast enough to stave off a recession.

Looking Forward

The Fed's delicate balancing act will likely lead to continued volatility this year. The markets will inevitably overreact to certain economic and inflation data that comes in hotter or colder than expectations. In addition, overly optimistic investor sentiment, an election year, and continued geopolitical uncertainties could also be sources of volatility. As always, it will be important for investors to maintain a patient, long-term outlook. At the same time, they should consider the possibility that the post-2008 era hallmarked by disinflation and zero-interest rate policies may have ended. Over that period the U.S. national debt as percent of GDP doubled from 60% to 120%. Meanwhile, the disinflationary effects of three decades of economic globalization also appears to be in some jeopardy due to a myriad of geopolitical dynamics. The confluence of these two realities may be the primary drivers of a new chapter in our economic history – one in which deflationary concerns are replaced by inflationary ones and baseline interest rates are more elevated.

As with any new political and economic paradigm, should a critical shift materialize, changes in certain long-term market trends are to be expected. As it relates to the equity markets, the clear dominant theme over the past fifteen years has been the superior performance of large U.S. growth stocks. Yet the mean reverting nature of the capital markets points to the possibility for change. Value stocks, small-cap stocks, international stocks, and emerging market stocks are all potentially poised for future market leadership. Expect one or more of these themes to drive relative performance in the years ahead.

Portfolio Management

Our disciplined approach to portfolio management, combining measures of relative valuation with relative price trends, is particularly well-suited for an eventual shift in market leadership. History has shown that most investors, including professionals, become complacent with their portfolios after long-periods of unchanging leadership. Not only has our approach allowed us to maintain healthy allocations to large U.S. growth stocks over the past decade despite rich valuations, but it is specifically designed to monitor and make appropriate adjustments when leadership ultimately changes. You witnessed a preview to that in 2022, when U.S. growth stocks tumbled, and we shifted toward greater value exposure and outperformed the global equity benchmark as a result. Time will tell if the 2022 resurgence of value stocks was a brief aberration or the beginning of a longer secular trend. Regardless, the mean reverting nature of the markets

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and investor sentiment almost assures that the large U.S. growth stocks will eventually cede their dominant leadership. You should take comfort that your portfolios are not on auto-pilot, and that we will course-correct in a timely manner when market trends change. This disciplined approach has been and will continue to be the key to our ability to deliver superior returns over multiple market cycles.

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