January 16, 2024

Quarter Ending December 31, 2023

Quarterly Performance	Q3 Index	YTD	Close
Dow Jones Industrial Average	17.9%	13.70%	$37,689.54
NASDAQ Composite Price	13.8%	43.42%	$15,011.35
Standard & Poor's Averages	11.69%	24.23%	$4,769.83

After a volatile third quarter, the fourth quarter of 2023 marked a positive turn for investors, characterized by strong returns across most major asset classes. The S&P 500 rallied 11.69% for the quarter, finishing up 24.23% for the year. One of the biggest gainers of the quarter and year was the NASDAQ. The index rallied 13.8% in the fourth quarter, finishing a staggering 43.42% higher for the year.

The fourth quarter market momentum was positive for most asset classes; however, the 2023 annualized returns were driven by a small group of companies. As we've covered throughout the year, most of the performance gains in the S&P 500 were driven by a handful of names, dubbed FANG or the "Magnificent Seven". Together, these companies delivered nearly 75% of the index's total return during the year. For perspective, the S&P 500 equal weight index was up 13.87% for the year versus 24.23% for the market weight index. According to Dow Jones Market Data, that outperformance is the largest percentage-point difference since 1998.

Despite the positive momentum, it's crucial to acknowledge the narrative shifts and uncertainties that defined 2023. From initial concerns of a recession to the anticipation of rate cuts in early 2024, the market demonstrated its resilience amid evolving economic challenges.

On paper, and emotionally, investors will leave 2023 on a high note. Investor sentiment and enthusiasm have driven broad-based indices near all-time highs. That said, we would also like to point out one thing: investors tend to have very short memories. As an example, here are two quotes from our recent quarterly letters:

- "The year was drama-free for equity investors…as the major indices finished the year very close to their all-time highs."
- "The year will be remembered not only for the severity of losses, but also for their breadth…it is the first year since the 1870s that both US stocks and long-term bonds fell more than 10%."

The first quote is from our 2021 Q4 letter. The second quote is taken from our 2022 Q4 letter. At this time last year, the S&P 500 had just logged its worst annual performance since the financial crisis and concerns about an imminent recession were pervasive across Wall Street. Short-term performance numbers are a snapshot in time and don't provide a good representation of what's going on in the economy. Many would be shocked to know this, but despite the wonderful performance numbers of 2023, most broad-based indices are up marginally over the last two years.

Since the beginning of November, the markets have risen sharply in anticipation of the Fed cutting interest rates as soon as the first quarter of 2024. More interestingly, the worse the economic data is, the more bullish investors have become. In reality, weaker economic growth and lower inflation, which would coincide with a rate-cutting cycle, do not support currently optimistic earnings estimates or valuations that remain well above long-term trends. To support this viewpoint, since 1970, there have been nine instances in which the Fed significantly cut the Fed Funds rate. The average maximum **drawdown** from the start of each rate reduction period to the market trough was 27.25%.

According to CNBC, from 1926-2023, the average annual return of the S&P 500 has been 10.4%. More specifically, of that 10.4%, 62% of the performance has come from price appreciation and 38% has come through dividend payments. Remember, when it comes to investing, market volatility cannot be completely avoided, but it can be mitigated.

Moving forward, the U.S. markets and economy are poised for a year of change and transition. Moderating economic data and possible rate reductions give us cause for concern moving forward. In short, more volatility.

At QAM, we will continue to focus on our long-term value-based investment approach. Focusing on valuations and fundamentals has always been the key to being a successful investor.

Wishing you the best in the New Year!

Regards,

Jeffrey L. Farni, Sr.

John C. Farni