Quarterly Market Update – 4Q, 2023

Market Summary & Outlook

Recap

Global Markets Rally to Closeout 2023

Nearly all major global markets notched a gain in Q4 and 2023, culminating with a nearly 42% gain for U.S. growth stocks to close out the year. Decelerating global inflation was the prominent tailwind driving risk assets higher and fostering a renewed growth business cycle for the Information Technology sector. International equity returns weren't hard to come by either, with Latin America posting a 32.7% gain and Japan rising from a decade's long growth slump, tallying 20%+ returns. Most fixed income maturities posted single digit returns, with High-Yield being the notable winner, returning 13.5% on the year.

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Equity Valuations Rose, non-U.S. Still Attractive

Domestic stock valuations rose off the back of flattish earnings and rising share prices in 2023. However, valuations are nowhere near their 20-year highs set early in 2021. Developed and Emerging market valuations are running at or below their long-term averages but are not considered overly "cheap" by historical measures.

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Fixed Income Yields Drop and Credit Spreads Tighten

Treasury yields fell sharply in Q4, dropping near or at their historical long-run averages. The Fed has signaled possible rate cuts later in 2024, however, with a persistently tight labor market and strength in consumer spending, the Fed will be redescent to cut and renew fears of higher-for-longer inflation.

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Unprecedent Debt Levels Represents Growing Risk to Economic Growth

Major global economies are facing greater fiscal pressures from aging demographics and rapidly growing number of retirees. As a percent of GDP, global public debt represents nearly a 1-to-1 ratio of debt to GDP. While the ratio of U.S. workers to retirees has steadily declined since 2010, posing a secular growth risk for the economy and financial markets.

ABOUT THE FIRM

Virtus Capital is an independent investment advisory firm serving high net-worth individuals, families, and business owners.

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Performance

Equity Benchmarks	Returns as of 12/31/23 3 Month	Returns as of 12/31/23 YTD
S&P 500 PR	11.24%	24.23%
DJ Industrial Average PR	12.48%	13.70%
Nasdaq Composite PR	13.56%	43.42%
Vanguard Balanced Composite	9.99%	17.69%
MSCI AC World Index ex USA Net	9.75%	15.62%
Spliced Emerging Market Index	6.77%	9.55%

Bond/Commodity Benchmarks	Returns as of 12/31/23 3 Month	Returns as of 12/31/23 YTD
Bloomberg US 1-5 Year Treasury	3.21%	4.37%
Bloomberg US 5-10 Yr Treasury	5.98%	4.11%
Bloomberg US Long Treasury	12.70%	3.06%
Bloomberg US 5-10 Yr Corp	8.44%	8.84%
Bloomberg Municipal Bond	7.89%	6.40%
Bloomberg Commodity Index TR	-4.63%	-7.91%

*Data Source: Morningstar and Vanguard Funds

Stock Talk

Our high-conviction thoughts for the upcoming market-cycle and where we see potential areas of competitive advantage or business challenges.

Virtus Capital's tactical approach to portfolio design begins with a high-level qualitative analysis of market trends to uncover misunderstood areas of opportunity and underrecognized value. After identifying broad segments of interest, a sector specific, multi-factor fundamental analysis drives the portfolio's selections and strategic asset allocation. Our disciplined and thoughtful investing style produces a repeatable, rules-based process that helps better identify and capture medium to long-term underappreciated market trends.

+ Additions	– Subtractions
ACN	KHC
IPXHY	TSN
META	

Accenture (ACN) – *Consulting* – A diversified business management and technology consulting firm based in Dublin, Ireland. Accenture has generated a leading market position to deliver AI consulting services in this fast-growing customer segment. ACN's market capitalization and 3-year revenue growth rate ranks in the top-quartile among industry competitors, with their earnings-per-share consistently out-performing in the past 7 of 8 quarters [(1)].

Consensus Rating – Moderate Buy, Price Target - **$378.38**

Inpex (IPXHY) – *Energy* – Head quartered in Tokyo, Inpex, is the largest oil/gas production and exploration company in Japan. With excellent free-cash-flow margins and a consistent dividend growth rate over the past 3 years, Inpex, boasts a high profitability ranking in the currently under-valued Japanese financial markets. IPXHY trades as an American Depository Receipt (ADR) on the O-T-C market.

Consensus Rating – Buy, Price Target - **$15.81**

Meta (META) – *Information Technology* – The social media and networking giant out of Melo, CA rewarded investors in 2023 with triple digit returns owed to growing strength in operating fundamentals and robust earnings. Meta's management team has piloted the company to an industry leading free-cashflow-yield that ranks in the top third of their peer group. Meaning, the company possesses outsized abilities to generate discretionary cashflow and financial leverage for their capital projects. In the highly capital-intensive software and digital app space, Meta's financial position is poised to continue above trend revenue growth in 2024.

Consensus Rating – Strong Buy, Price Target - **$522.00**

Kraft Heinz Co. (KHC) – *Consumer Staples* – The third-largest food and beverage distributor in North America, Kraft Heinz, has struggled to generate shareholder value since 2017. With a decelerating 3-year revenue growth rate and consumer goods inflation decreasing to pre-pandemic levels, the food products manufacture will struggle to maintain a meaningful profit margin, as consumers in a still expanding economy preference upgraded goods and services.

Consensus Rating – Hold, Price Target - **$40.60**

Tysons Food (TSN) – *Consumer Staples* – A multi-national food company founded in 1935, specializing in frozen foods, meats, and poultry, Tyson's medium-term outlook continues to see gross margin compression as the company's steadily increasing cost of capital has become a hindrance to bottom-line profitability. In 2023, KHC ran a net-income loss of approximately ($648M) with their forward 3-year EBITDA growth rate dipping into negative territory. A significant improvement in the company's growth or profitability prospects seem unlikely in the short to intermediate term.

Consensus Rating – Hold, Price Target - **$57.50**

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Discussion

Markets

What a finish for markets in 2023. Nearly all global asset classes rose, as equities recovered from a challenging 22' and bond yields came full circle from last year's starting point. The three major U.S. stock indices – S&P 500, Dow Jones Industrials, and Nasdaq all benefited from a pause in interest rate hikes and decelerating inflation – with all three indices posting double digit returns. The primary drivers of last year's stock market rout – high inflation, tight labor market, and lowered earnings expectations faded for investors in 23', as the focus shifted to anticipated rate cuts and a recovery in corporate earnings in 24'. Year-over-year (YOY) S&P 500 earnings are forecasted to grow by 11%, while U.S. companies are expected to maintain or slightly expand their profit margins. Growth category and Information Technology stocks led the charge in 23', recording a 41.2% and 57.8% gain, respectively, while commodities, utilities, and energy were the only major asset classes with negative returns on the year. The U.S. business cycle remained in late-phase expansion throughout 2023, as the predicted recession that was the consensus among economists never materialized. The Fed may have indeed engineered the illusive "soft landing" – the jury is still out in 2024. The Fed's interest rate hiking cycle which paused this past July has come to an end (for now), as market sentiment has shifted towards anticipated rate cuts in the second half of 24'. Generally speaking, the market has priced in at least 3 to 4, .25% (or 25bps) cuts to the Fed Funds Rate – the U.S. base interest rate. The question now: has the market gotten "ahead of its skis" with the forecasted rate cuts? Federal Reserve Chairman, Jerome Powell, indicated at the Fed's most recent January meeting that the economy is not slowing, consumer spending remains strong, and the labor market remains tight – so he sees no immediate imperative to decrease interest rates. Asset markets are now put into "watchful waiting" mode to see if the anticipated cuts materialize in H2 as predicted in late 23', or if the market has misread Powell's tone and instead a cut in equity valuations is warranted to account for an unexpected higher-for-longer rate regime. All eyes will be on payrolls, jobless claims, and consumer spending data as the first half of 2024's economic reports roll in. Emerging markets saw a rebound in stock prices last quarter, with some central banks choosing to cut rates in the face of slowing economic conditions and a strong U.S. dollar. Foreign currencies in the Japanese Yen and Euro, remain undervalued relative to the purchasing power of the U.S. greenback and may provide portfolio diversification benefits, in the right context. Given the recent easing of geopolitical trade tensions between China and the U.S. as evidenced by the bilateral talks this past August, China, may regain a portion of its lost growth in 2023 and increase export production to the U.S., potentially incited by a "flattish" dollar in 24'. The Shanghai Stock Exchange Composite Index (SSE) lost just under 6% in 23', as most other major global averages experienced positive returns. China's economic growth faces structural headwinds in ageing demographics and regulatory risks, however, the worlds 2nd largest economy may benefit from the logistical and production efficiencies gained by the recent advances in regenerative AI. Combined with a strong U.S. consumer appetite, Chinese companies may see top-line revenue and earnings growth which were absent in 23' remerge in 24'. Stock valuation multiples expanded in 23' with the S&P 500's weighted Price-to-Earnings (P/E) multiple sitting just above 26 as of the end of December. This implies a slightly overvalued market when compared to the indexes long-run average of between 16-18, depending on the period's length. The top three performing sectors of 23' were Information Technology, Communication Services, and Consumer Discretionary, returning 57.8%, 55.8%, and 42.3% respectively. The bottom three performers were Consumer Staples (0.5%), Energy (-1.4%), and Utilities (-7.1%).

Outlook

Virtus Capital's base-case for U.S. capital markets in 2024 favor a continuation of late-cycle business expansion, historically normal treasury yields with a flattening of the yield curve, as the short and long dated maturities move towards a positive slope. Even if the Fed rate cuts come later and lighter than anticipated any cuts would allow for duration-premium to build back and investors be compensated for holding longer dated treasuries. If Inflation takes longer to moderate towards the Fed's target of 2%, than the biggest risk to equity markets remains the Fed keeping rates higher for longer. This being the case, investors would need to more carefully weigh the risk-reward premium of bond yields over equities, as the risk-tradeoff is less clear. A major tailwind for economic growth appears to be the emergence of AI products and the synergistic services supporting their development and distribution. The AI market is expected to grow by a compounded annual growth rate (CAGR) of 15.83% from 2024-2030, resulting in a $738B market size according to Statista. If AI delivers on future promises, the growth rate is likely underdone as the cloud services market alone is expected to grow at a CAGR of 16.40% between 2024-2029, according to Mordor Intelligence's market research. Arguably speaking, AI has the potential to be equal to, if not more transformational in market terms than cloud computing and has the opportunity to be far reaching in its use applications across the breadth of global industry. Alternatively, like the internet craze of the late 90's/early 2000's, AI over-investment bears some semblance to the meteoric rise and fall in valuations of start-up tech companies during the Dot Com bubble. The consensus U.S. equity market outlook for 2024 calls for an increase in earnings and sales, with margins remaining flat or slightly growing, YoY. Virtus Capital's investment management strategies continue to highlight portfolio diversification and strategic asset allocations to quality companies that possess long-term competitive advantages. Our investment philosophy focuses on a long-term approach to portfolio diversification and security selection. So far in 2024, many of our investors have taken the opportunity to reallocate capital from money market instruments to equities. We help investors take advantage of near-term opportunities in our actively managed portfolios. Virtus Capital's Q1, 24' market outlook calls for another strong start to the year for growth stocks. Our approach to portfolio construction aims to deliver greater long-term value through our risk-adjusted and fully customizable investment management strategies.

Q4, 2023 Quote:

"If you're not thinking of owning a stock for 10 years, don't even think about owning it for 10 minutes"

-Warren Buffett

Iconic Investor and Author

About the Author

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Managing Executive of Virtus Capital, Jon is a Certified Plan Fiduciary Advisor and is passionate about helping individuals and organizations reach their vision of success. Jon leads a team of experienced financial professionals, delivering premier investment advisory and retirement plan consulting services across the nation. Virtus Capital is an independent fiduciary firm that provides decision makers and investors expert, objective advice to meet their individual and organizational objectives.

Sources

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