Q4 23 A GAME-CHANGING 2023

MARKET REVIEW AND OUTLOOK

Kayne Anderson Rudnick
A VIRTUS INVESTMENT PARTNER

MARKET REVIEW

2023 proved to be an outstanding year for the capital markets. As the year began, investors were braced for an imminent recession, but it never really materialized. Large-cap stocks (S&P 500® Index) advanced 11.69% in the fourth quarter, bringing the year-to-date return to 26.29%. Large-cap growth stocks (Russell 1000® Growth Index) were the strongest performers, gaining 14.16% in the quarter and 42.68% for the year. Value stocks (Russell 1000® Value Index) lagged, returning 9.50% in the quarter and 11.46% for the year.

The so-called "Magnificent Seven" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) were responsible for most of the outperformance among large growth stocks during 2023. Market breadth started to improve during the fourth quarter as small-cap stocks (Russell 2000® Index) returned 14.03% for the quarter and 16.93% for the year. Developed international and emerging markets stocks continued to lag U.S. stocks. The MSCI EAFE® Index advanced 10.42% in the quarter and 18.24% for the year, while the MSCI Emerging Markets Index increased 7.86% and 9.83% for the respective periods.

Falling interest rates due to continued improvement in the inflation outlook were the principal reason that equities and fixed income performed so well during the fourth quarter. The Bloomberg U.S. Aggregate Bond Index advanced 6.82% in the quarter, bringing the year-to-date return to 5.53%. Short- and long-term Treasury yields dropped dramatically over the quarter. The yield on the 2-year note started the quarter at 5.10% and ended at 4.25%, while the 10-year followed suit, falling from 4.57% to 3.84%. High yield (ICE BofA U.S. High Yield Index) was the standout fixed income performer, advancing 7.06% in the quarter and 13.44% for the year. Municipal bonds recovered strongly in the fourth quarter, with the Bloomberg Municipal Bond Index returning 6.72% for the quarter and 1.92% for the year.

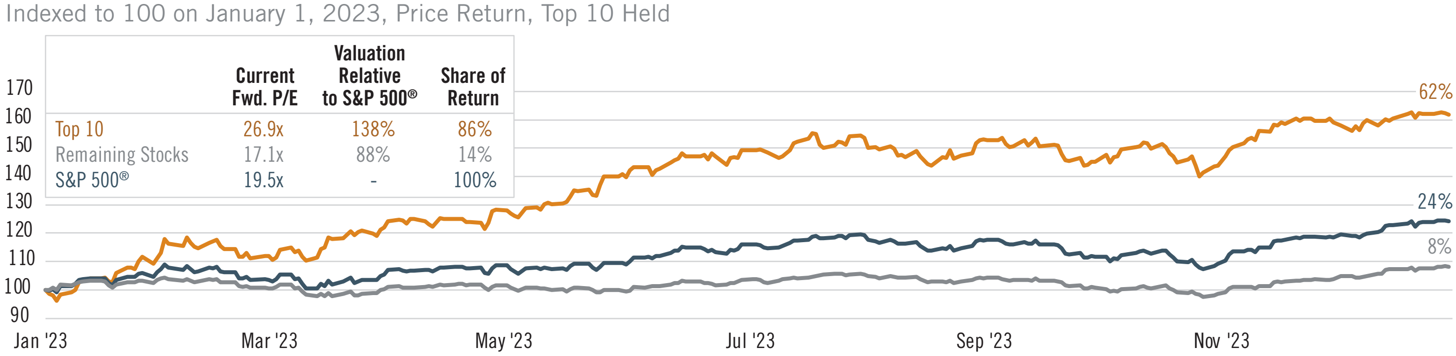
WHAT WERE THE KEY EVENTS OF 2023?

We believe three key events in 2023 were essentially wake-up calls for investors. The first was in early March when Silicon Valley Bank collapsed due to massive depositor outflows. The adage in the investment business that the "Fed tightens until something breaks" was on full display, catching the central bank and regulators by surprise. History has repeatedly demonstrated that an aggressive Fed tightening cycle of interest rate hikes usually ends when something does break. In retrospect, this seems to have been the case. Fortunately, the banking crisis this time proved not to be systemic and was isolated to only a few special situations.

The second key event of the year was NVIDIA's first quarter earnings report released in late May, which ignited the outperformance of the Magnificent Seven during 2023. NVIDIA's reported revenue outperformance led investors to recognize that artificial intelligence (AI) was not some pie-in-the-sky technology that may happen in the future. Investors saw this as tangible proof that AI was becoming significant much sooner than most investors realized. Ultimately, we believe AI will impact all types of businesses positively or negatively, but clearly large technology companies possess an early advantage, and this helped power much of their momentum in 2023.

The third event that shaped 2023 occurred in November and was arguably the most important of the year. After inflation peaked in June 2022 with a year-over-year rate of more than 9%, inflation growth rates had started to slow sequentially

FIGURE 1: PERFORMANCE OF THE TOP 10 STOCKS IN THE S&P 500®
Indexed to 100 on January 1, 2023, Price Return, Top 10 Held

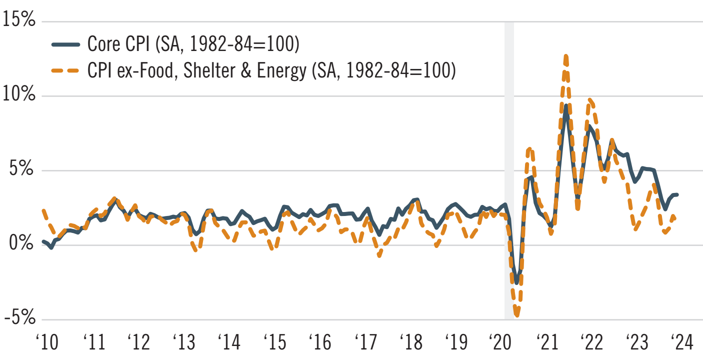


Past performance is no guarantee of future results. Data is as of December 31, 2023, obtained from FactSet, Standard & Poor's, and J.P. Morgan Asset Management, and assumed to be reliable. This information is being provided by Kayne Anderson Rudnick Investment Management, LLC ("KAR") for illustrative purposes only. KAR does not intend for this information to be interpreted as investment advice, a recommendation or solicitation to purchase securities, or a recommendation of a particular course of action. It has not been updated since the date listed, and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein. The top 10 companies used for this analysis are held constant and represent the S&P 500's 10 largest index constituents at the start of 2023. The top 10 stocks are: AAPL, MSFT, AMZN, NVDA, GOOGL/GOOG, BRK.B, META, XOM, UNH, and TSLA. The remaining stocks represent the rest of the 494 companies in the S&P 500.

almost every month since then but were still above the Fed's 2% target. The October Consumer Price Index (reported in November) showed that the Fed had reached its target (+1.5% year over year) if one excluded the shelter calculation, which lags real rents in many cities due to the way it is calculated. In response, markets immediately started to discount a "Fed pivot" in 2024.

Significant recession fears present throughout 2023 have started to give way to a "soft (or no) landing" outlook for 2024. Our thinking has been (and continues to be) that most of the inflation over the last couple of years has been driven by the boom/bust cycles caused by COVID, resulting in supply chain disruptions to many industries. Absent another global health pandemic, we believe these effects should now be behind us. In fact, it would not surprise us if we have several inflation rate reports below 2% over the next six to twelve months.

FIGURE 2: U.S. CORE CPI



Data is as of December 31, 2023, obtained from Strategas, and assumed to be reliable.

2024 MARKET OUTLOOK

With the Federal Reserve's hiking cycle behind us and corporate earnings growth likely to resume, we believe 2024 should be a favorable year for equity returns. Coming into 2024, investor sentiment is nowhere near as negative as it was a year ago, but plenty of cash has built up on the sidelines over the last year. As short-term interest rates decline and the yield curve moves to flat, or even positively sloped, we believe this capital will make its way into fixed income and equity markets.

FIGURE 3: MONEY MARKET FUND ASSETS

Data is as of December 31, 2023, obtained from Strategas, and assumed to be reliable.

From our perspective, returns in 2024 are unlikely to be as robust as they were in 2023 but are likely to be in line with earnings growth. We expect that 2024 will experience more volatility due to the U.S. presidential election, which is likely to be contentious. As always, we will continue to focus on seeking quality companies with durable competitive advantages for our clients despite the ever-shifting macroeconomic environment.

continued

Authored by:

Douglas S. Foreman, CFA
Co-Chief Investment Officer, Portfolio Manager

Julie Biel, CFA
Chief Market Strategist, Portfolio Manager and Senior Research Analyst

Kayne Anderson Rudnick (KAR) believes that superior risk-adjusted returns may be achieved through investment in high-quality companies with market dominance, excellent management, financial strength, and consistent growth, purchased at reasonable prices.

Index definitions: The S&P 500® Index is a market capitalization-weighted index that includes 500 of the largest U.S. companies. The **Russell 1000® Growth Index** is a market capitalization-weighted index of growth-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The **Russell 1000® Value Index** is a market capitalization-weighted index of value-oriented stocks of the 1,000 largest companies in the Russell Universe. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell universe, which comprises the 3,000 largest U.S. companies. The **MSCI EAFE® Index** measures developed foreign market equity performance, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index tracking the equity performance of global emerging markets. The **Bloomberg U.S. Aggregate Bond Index** is a market value-weighted index that tracks the daily price, coupon, pay downs, and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. The **ICE BofA U.S. High Yield Index** tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. The **Bloomberg Municipal Bond Index** is a market capitalization-weighted index that measures the USD-denominated long-term tax-exempt bond market. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

The commentary is the opinion of Kayne Anderson Rudnick. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Past performance is no guarantee of future results.

All investments carry a certain degree of risk, including possible loss of principal.