Market Review Commentary

Fourth Quarter 2023

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Investment Management

2023 MARKET REVIEW

This year proved to be an outstanding year for the capital markets. As we began 2023, investors were braced for an imminent recession, which never really materialized this year. The S&P 500 Index advanced 11.69% in the fourth quarter alone bringing the year-to-date return to 26.29%. Large-capitalization growth stocks, as measured by the Russell 1000 Growth Index, were the best performers this year gaining 14.16% in the fourth quarter and 42.68% for the year. Value stocks, as measured by the Russell 1000 Value Index, lagged returning 9.50% in the fourth quarter and 11.46% for the year. The Magnificent Seven (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) were responsible for most of the outperformance by large growth stocks during 2023. Market breadth started to improve in the fourth quarter with the Russell 2000 Index of small capitalization stocks advancing 14.03% and up 16.93% for the year. International and emerging market stocks continued to lag U.S. markets. 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% for the fourth quarter and 9.83% for the full year.

Falling interest rates due to the continued improvement in the inflation outlook was the principal reason equities and fixed income performed so well during the fourth quarter. The Bloomberg U.S. Aggregate Bond Index advanced 6.82% in the fourth quarter bringing the year-to-date return to 5.53%. Short-term and long-term yields fell dramatically during the quarter with the 2-year yield falling from 5.10% down to 4.25%. The 10-year yield followed suit and fell from 4.57% to 3.84%. High yield, as measured by the 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 during the fourth quarter with the Bloomberg Municipal Bond Index returning 6.72% and 1.92% for the year.

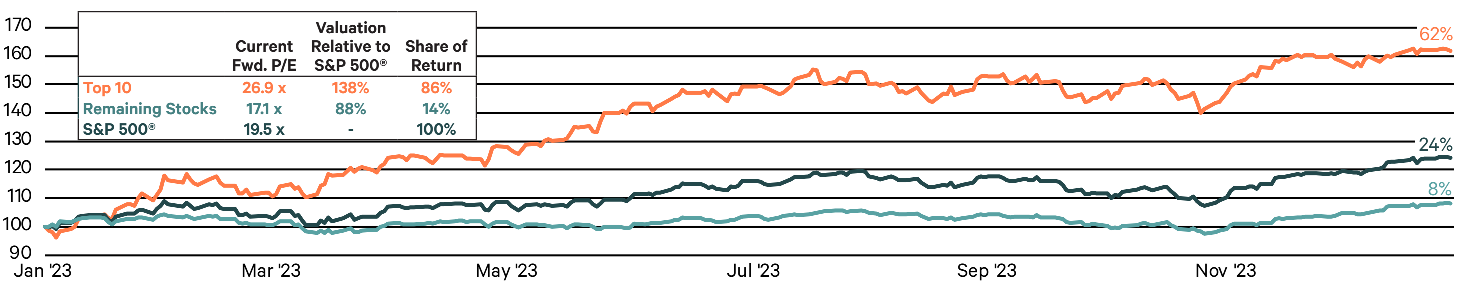
WHAT WERE THE KEY EVENTS OF 2023?

We believe there were three key events during the course of 2023 which were essentially "wake up" calls for investors. The first key event 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 and the Federal Reserve and regulators were caught by surprise. History has repeatedly demonstrated that an aggressive Fed tightening cycle usually ends when something does break. In retrospect, this seems to have been the case again. Fortunately, the banking crisis this time proved to not 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 in April that 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, and the giant technology companies hold the key early advantages that businesses need to implement AI successfully. Ultimately, we believe AI will impact all types of businesses positively or negatively, but clearly the large technology companies possess an early advantage which helped to power much of their momentum in 2023.

FIGURE 1: PERFORMANCE OF THE TOP 10 STOCKS IN THE S&P 500®

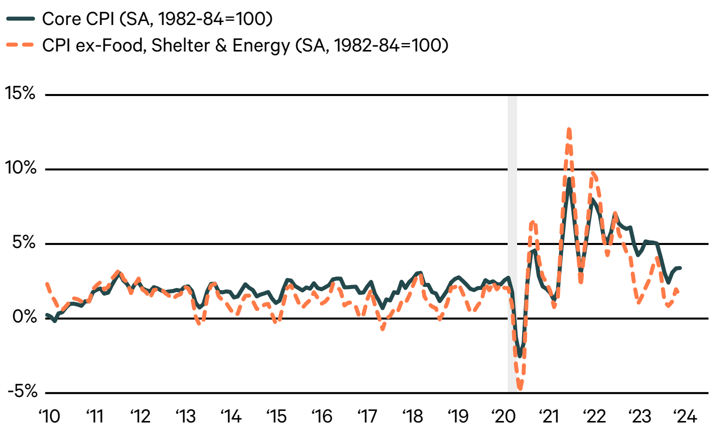
Indexed to 100 on January 1, 2023, Price Return, Top 10 Held Constant



Data presented is as of December 31, 2023, is obtained from FactSet, Standard & Poor's and J.P. Morgan Asset Management and is assumed to be reliable. This information is being provided by Kayne Anderson Rudnick Investment Management, LLC ("KAR") for illustrative purposes only. This Information is not intended by KAR to be interpreted as investment advice, a recommendation or solicitation to purchase securities, or a recommendation of a particular course of action and 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, BRK.B, GOOG, META, XOM, UNH, and TSLA. The remaining stocks represent the rest of the 494 companies in the S&P 500. ***Past performance is no guarantee of future results.***

The third event that shaped 2023 occurred in November and was arguably the most important of the year. Inflation peaked in June 2022 with a year-over-year rate of over 9%. Inflation growth rates started slowing sequentially almost every month since then but were still above the Fed's target of 2%. October's Consumer Price Index (reported in November) showed that the Fed had already reached its target (+1.5% year-over-year) if one excluded the shelter calculation which is clearly lagging real rents in many cities due to the way it is calculated. 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 caused 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 will not surprise us if we have several below 2% reports in the inflation rate over the next six-to-twelve months.

FIGURE 2: U.S. CORE CPI



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2024 MARKET OUTLOOK

With the Federal Reserve 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 coming into 2023 but there is still plenty of cash on the sidelines built up 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

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From our perspective, returns in 2024 are unlikely to be as robust as 2023 but are likely to generate returns in line with earnings growth. We expect that 2024 will experience more volatility due to the election, which is likely to be contentious.

We will continue to focus on seeking quality companies with durable competitive advantages for our clients despite the ever-shifting macroeconomic environment. We thank you for your trust and confidence in managing your assets.

Douglas S. Foreman, CFA
Co-Chief Investment Officer

Douglas S. Foreman, CFA is Co-Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has worked in investment management since 1986.

Julie Biel, CFA
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Julie Biel, CFA is Chief Market Strategist, Portfolio Manager, and Senior Research Analyst with primary research responsibilities for the small and mid-capitalization information technology and health-care sectors. Ms. Biel began her equity research career in 2004.