Grant Street Asset Management, Inc.
INVESTMENT ADVISORS

GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
4th QUARTER 2023
JANUARY 15th, 2024

With 2023 in the books, we look back on the last twelve months with a sense of pleasant surprise. Coming into the year, investors were cautious with an outlook of persistent inflation, rising interest rates and an expectation that corporate earnings were going to slow significantly. Many economists even forecasted a U.S. recession in 2023, but it failed to materialize, and so disciplined long-term investors were rewarded yet again with positive market performance across most sectors to close out the calendar year.

Reflecting back on the economic picture of 2023, some metrics provided mixed signals, but in aggregate, the message was similar to what investors have experienced the last few years: the U.S. consumer continued to spend, the job market remained robust, and corporate earnings enjoyed additional growth. The current unemployment rate of 3.7% is virtually unchanged from a year ago (3.6%) and has measured under 4% for twenty-four consecutive months. It remains well below the 50-year average of 6.2%. Although the number of job openings has come down throughout 2023, we view this as an expected normalization of the post-pandemic spike. The number of available jobs still outpaces the number of job seekers by 1.3 times. With a labor market this tight, the decrease in job openings has helped reduce inflation as well.

Even though headline inflation, measured by the Consumer-Price-Index (CPI), has been cut in half from a year ago and is below the 50-year average, it is still on the mind of many investors at 3.1%. Energy prices have been drastically reduced in the last twelve months, thanks to the U.S. producing record amounts of crude oil. The average price for a gallon of gas has fallen nearly 20% in the last three months alone. Food and transportation prices have moderated in the last two quarters, while shelter has remained somewhat stubborn. Demand continues for home builders to bring more supply to the market, and as supply increases, shelter inflation should further ease to more sustainable levels. To be sure, inflation will remain a focus of investors and the Federal Reserve throughout 2024.

While the calendar year returns across asset classes posted solid results for the year, investors experienced a lot of volatility throughout the year. Stock indexes rallied through July, fell more than 8% rather unexpectedly through October, and surged to finish the year. In most cases, aside from a handful of the largest stocks in the U.S., most individual stocks were only slightly positive, flat or even negative through October. This is in stark contrast to the +8.6% S&P 500 index returns being reported at the markets lowest point on October 27. From January through the end of October, the top seven largest stocks in the S&P 500 were up over 60% on average and contributed more than 100% to the total return on the index throughout the year. This means the other 493 stocks had flat or negative returns during this same time period. It is rare to see this lack of breadth across a market. Only after the Federal Reserve meeting in early November, when the Fed signaled the likely end of interest rate increases, did strong stock market performance begin to broaden out beyond the largest names. You can see evidence of this unusual market performance in the following table, when comparing the S&P 500 (market cap weighted) to the S&P 500 equal-weight index returns. These two indexes hold the same 500 stocks with different weighting methodologies.

While the equal-weight index slightly outperformed in the fourth quarter, it did not keep pace the first ten months of the year. The same can be said for mid-caps, small-caps and foreign stocks. Diversification outside of those seven largest stocks did not contribute excess returns until the fourth quarter.

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Equity Index	4Q 2023	2023	Last 3 Yrs. Thru 12/31/23 (Cum.)
S&P 500 (Large Companies)	11.7%	26.3%	33.1%
S&P 500 Equal-weight Index	11.9%	13.9%	30.7%
Nasdaq 100 (Technology-heavy)	14.6%	55.1%	33.7%
S&P 400 (Mid-sized Companies)	11.7%	16.4%	26.3%
Russell 2000 (Small-sized Companies)	14.0%	16.9%	6.8%
MSCI EAFE (Europe, Australia & Far East)	10.4%	18.2%	12.5%
MSCI Emerging Markets	7.9%	9.8%	-14.5%
MSCI ACWI (All Country World Index)	11.1%	21.5%	17.1%

Source: Morningstar Direct

Fixed Income Index	4Q 2023	2023	Last 3 Yrs. Thru 12/31/23 (Cum.)
Morningstar U.S. Core Bond	6.6%	5.3%	-9.8%
U.S. 10-year Treasury	6.6%	2.8%	-17.1%
ICE BofA 1-3 Yr. U.S. Treasury	2.5%	4.3%	-0.1%
U.S. 3-month T-Bills	1.4%	5.0%	6.6%
ICE BofA U.S. High Yield	7.1%	13.5%	6.1%
ICE BofA 7-10 Yr. Municipal Bond	7.0%	5.2%	-1.0%
Credit Suisse Leveraged Loan Index	2.9%	13.0%	17.9%

Source: Morningstar Direct

On the defensive side of the portfolio, bonds contributed positively to performance for the fourth quarter and for 2023 overall. However, similarly to equities, fixed income had a rough start to the year as interest rate and inflation concerns drove yields higher. During the third quarter, the Fed raised rates to the highest level in twenty-two years. The yield on the 10-year U.S. Treasury hovered well above 4% for the majority of the third quarter and peaked at 5% in Mid-October, its highest yield since 2007. In the same August through October period when stocks lost more than 8%, bonds did not provide much protection. The Morningstar U.S. Core Bond Index fell 4.6% over that same period. Needless to say, it was a brutal stretch for both stocks and bonds. Fortunately, the Fed's early November meeting and corresponding comments virtually confirmed the end of rate increases and served as a catalyst for equity and bond markets. Investors shifted focus to 2024, anticipating the Fed's first interest rate-cut and falling rates throughout 2024. As a result, the yield on the 10-year U.S. treasury bond fell more than 0.50% in November and continued lower in December. Investors who had shifted bond holdings away from short-term and into intermediate and long-term maturity bonds were finally rewarded by this drop in yield. As a reminder, when bond yields fall, the prices of bonds paying current market interest rates will increase. After producing a total return of 6.6% in the final quarter of the year, the Morningstar U.S. Core Bond index finished 2023 with a positive return of 5.3%.

For conservative investors holding cash, we believe bonds are an attractive opportunity for deploying excess cash today. Historically, after reaching peak interest rates, the subsequent 12-month return of core bonds has been positive in each of the last six rate-hiking cycles dating back to 1984. There is no doubt that interest rates on money market funds and certificates of deposit (CDs) have been appealing for the last eighteen months. However, as the Fed reduces interest rate targets at some point in 2024, returns on cash and CDs will likely lag broader fixed income due to a lack of appreciation that is unavailable in cash-like investments. We believe bonds have an opportunity to post double-digit returns over the next twelve to twenty-four months as the Fed reduces rates. For equity investors, there is no shortage of opportunities. Asset classes and sectors left behind during the narrow market of 2023 have attractive historical valuations and are poised for recovery moving forward.

The economic outlook for 2024 has a very similar feel to early 2023: interest rates are at multi-decade highs, unemployment is low with a historically strong labor market, and the U.S. consumer continues to appear resilient, which should help to preserve corporate earnings and buoy stock prices. Different from last year, we are tracking elevated consumer credit and accompanying higher delinquency rates. We anticipate the labor market to remain supportive of consumer income overall, so we view the elevated credit as a natural slowing mechanism for the economy overall. Fortunately, inflation has slowed in a meaningful way, and consumers are enduring through the elevated interest rate environment.

Much of the volatility felt across markets over the past year was driven by economic data releases and interest rate decisions by the Fed. For example, about half of the most volatile performance days in equities (as measured by days where the S&P 500 index was up or down 1%+) occurred on days the Fed met to vote on an interest rate decision. Furthermore, the ten best performing days contributed 75% of the total return throughout the year. Our experience has taught us that it is impossible to adequately time the market for these days of magnitude. Therefore, it is prudent for long-term investors to remain invested even through the most volatile moments. History has repeatedly shown us the reward in that approach. As long-term investors, we remain committed to our investment philosophy, influenced by the continual research and experience of our advisors. We thank you for your trust in our team.

GRANT STREET TEAM UPDATE

We wish to announce that Matt Collins joined the Grant Street team in October as a Client Service Associate on our operations team. Prior to joining Grant Street, Matt had over four years of industry experience working as an insurance and investment advisor in Rochester, NY. He was also a senior sales representative for a global steel pipe manufacturer. Although Matt has experience advising clients on insurance and investments, he has found his true passion in operations and client service. Grant Street's focus on team-based client service and coordination coupled with Matt's relationship management, industry knowledge and organization skills has us very excited to join our team. Matt and his spouse relocated to Pittsburgh from Rochester and currently reside in Brookline with their dog.