ACROPOLIS® INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

January 2024: Volume 23, Issue 1 // David Ott, Editor

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Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

STOCKS, BONDS SURPRISE (AGAIN)

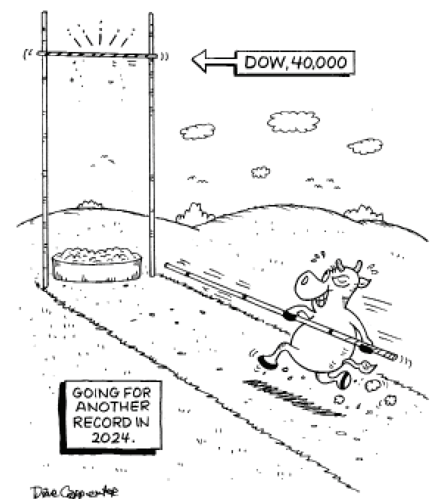
One of the central themes of Portfolio Insights over the last 23 years is that markets are full of surprises.

That goes for the economy, too. A year ago, about two-thirds of professional economists thought that the US would enter a recession in 2023. If estimates for the fourth quarter are reasonably close, it looks as though the Gross Domestic Product will grow 2.4 percent after inflation - about in line with the last 25 years.

Inflation also cooled substantially, with the core Consumer Price Index (CPI) and core Personal Consumption Expenditure (PCE) likely to come in just above four percent in 2023. That is still well above the Federal Reserve's target rate of 2.0 percent, so much work is ahead, but the trend is leaning in the right direction.

Avoiding a recession with decelerating inflation is a 'Goldilocks' scenario, so stocks and bonds rallied sharply.

Even three months ago, small-cap stocks were flat for the year, and most bond indexes were lower, but as it became clear that the Fed was primarily done hiking rates and might begin cutting soon, small caps jumped 15 percent, and bonds went from a loss to a 5.5 percent gain for the year.



While it is undoubtedly satisfying to see markets higher, it also creates some risk if too much excitement sets in. Famed investor Sir John Templeton famously said, "Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die in euphoria."

Parts of the market might be dipping into euphoria, like the Magnificent Seven, which went up 107.4 percent last year, or cryptocurrencies, which shot 139.6 percent higher.

At this point, the broad market may be growing on skepticism, but they could be maturing on optimism. Only time will tell, but we will stay invested, ready for surprises to the up and downside.

> “In charity, there is no excess.”
>
> *- Sir Francis Bacon, English Statesman*

STOCK MARKET SUMMARY

By David Ott

The S&P 500 ended the year with a bang, adding 11.7 percent in the fourth quarter to a 13.1 percent gain in the first nine months of the year.

Much of the story in the first part of the year was that the gains were concentrated within a small number of stocks related to artificial intelligence (AI) stocks that rocketed higher after ChatGPT illustrated the power of AI.

One way to measure concentrated gains is to compare the performance of the S&P 500, which weights stocks based on the market value of a company, to a simple equally-weighted index that looks at the average performance of the same 500 stocks.

In the first nine months of the year, the equally-weighted index rose just 1.8 percent, highlighting the impact of a relatively small number of stocks, often referred to as the Magnificent Seven in the financial media.

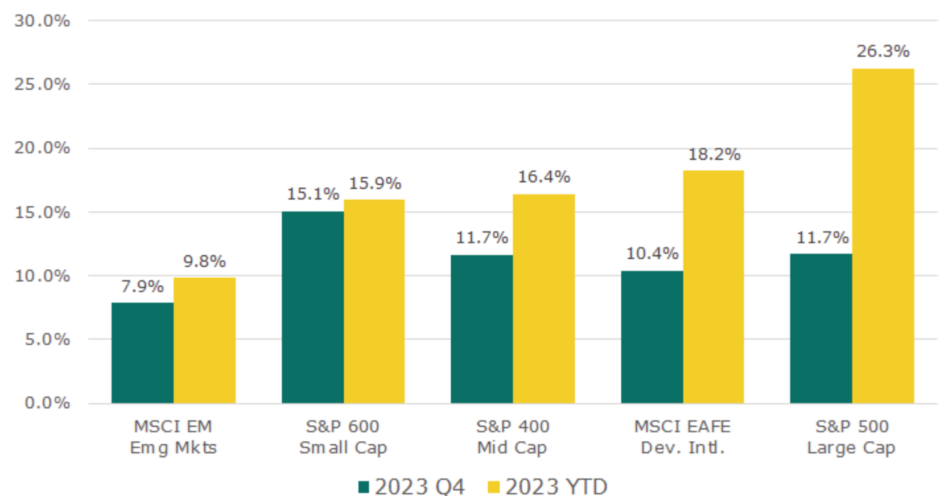
In the fourth quarter, the gap between the two measures was marginal: the S&P 500 rose 11.7 percent, and the S&P 500 equal-weight index rose 11.9 percent.

The broad rally extended beyond the equal-weighted S&P 500, as mid and small-cap stocks also rose double digits.

Developed foreign stocks did reasonably well in the fourth quarter, thanks to the relatively weak dollar. In local currency terms, the MSCI EAFE rose 6.1 percent, but thanks to the strong dollar, US-based investors made 10.4 percent, which was close to US stock returns.

The same effect occurred in emerging markets, as the MSCI EM index rose 5.7 percent in local terms in the fourth quarter, but 7.9 percent in dollar terms.

The push was just large enough to take emerging markets into double digit territory for the year. But, the index was weighed down by Chinese stocks, which lost -11.1 percent in 2023 in US dollar terms.



BOND MARKET REVIEW

By Ryan Craft, CFA

Following the terrible year of 2022, bonds regained their footing and posted solid returns in 2023. The Aggregate index grew 5.5% for the year. Within the index, Treasury bonds returned 4.0 percent, while corporate bonds had a return of more than 8.0 percent. All in all, it was a very welcome result following a historically bad year.

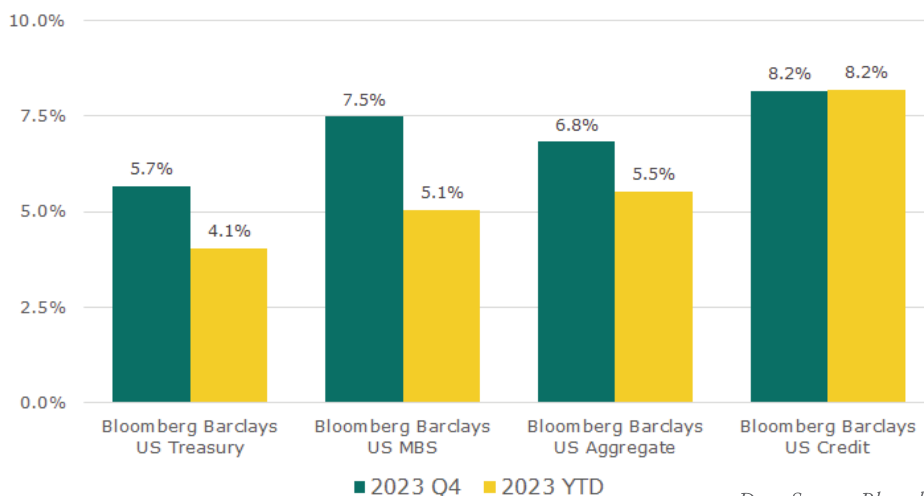
Yields on the bond market ended the year (4.5 percent) almost precisely where they began (4.7 percent), but that does not mean it was a quiet year. Instead, interest rate volatility was very elevated throughout the year. Yields traded as low as 4.2 percent and as high as 5.7 percent as investors struggled to discern the future path of inflation and Federal Reserve policy.

Inflation continued to slow throughout the year, with the headline CPI ending at 3.1 percent. Prices are still rising faster than the Fed's target of two percent, but the trend is certainly pointing in that direction.

This persistent trend of softer inflation means that the Fed may not need to keep monetary policy at such a restrictive level. In December, the Fed acknowledged that they are open to loosening policy as inflation approaches their target. In their mind, monetary policy is currently restrictive as they attempt to cool the economy and inflation. Moving policy to a more neutral standpoint would make sense as inflation comes under control, which may require several rate cuts.

The market jumped on this narrative that the current inflation and rate hike cycle is over. Since October, long-term bond yields have fallen more than 100bps. While the FOMC estimates a potential need for 75bps of rate cuts in 2024, the market expects much more aggressive rate cuts on the horizon. The futures market currently projects six rate cuts totaling 150bps for 2024.

The significant risk for 2024 is that the market moved prematurely. If inflation changes direction or becomes stickier, it could force the Fed to maintain a tighter policy for longer. The good news for bond investors is that yields remain high (relative to recent history) and should continue to provide an excellent income level to investors.



Data Source: Bloomberg

"Risk is what's left over after you think you've thought of everything."

- Carl Richards, Financial Author

WHY WE FEAR INFLATION

By David Ott

While inflation cooled meaningfully in 2023, it is still well above the Federal Reserve's two percent target.

And the Fed doesn't target the gauge we all think of, the Consumer Price Index (CPI). Instead, they target the core Personal Consumption Expenditures (PCE) index.

Like the core CPI, core PCE strips out food and energy prices because they are volatile but don't change the numbers materially in the long run. Said another way, food and energy add a lot of noise, but don't improve the signal.

PCE differs from CPI because it measures overall inflation in the economy, not just what the consumer encounters.

They both measure the price changes of certain baskets of goods and services – the difference is the weights of the items in each basket.

The classic example is healthcare costs. PCE measures all of healthcare costs, but CPI only measures what consumers see out of their own pocket. PCE includes the cost of care covered by employers, Medicare and Medicaid.

Also, PCE tries to account for how consumers respond to higher prices. If the price of bread goes up, PCE attempts to adjust the basket to account for people buying less bread because it's more expensive, whereas CPI uses the same weight.

Some people believe that all of these adjustments amount to manipulations, and while I don't view it that way, I understand it because it introduces a lot of complexity.

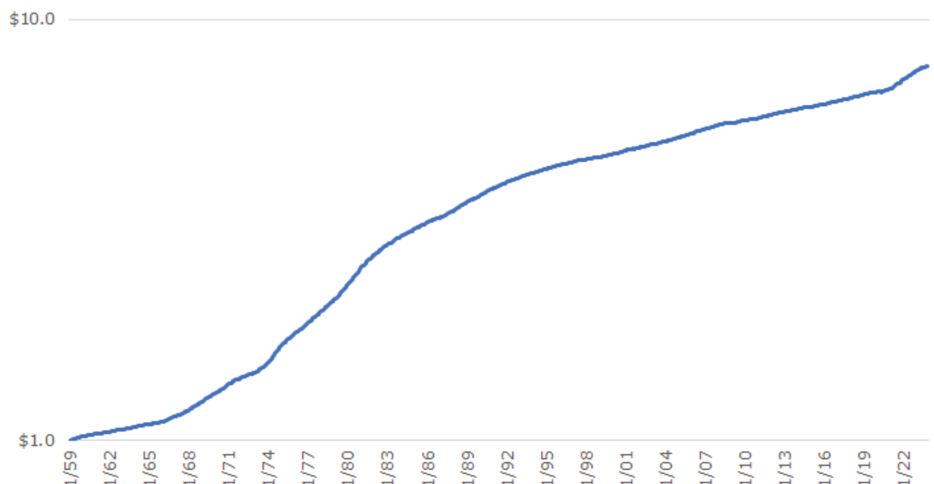
Rather than look at the recent monthly, quarterly, or even annual change, I thought it would be useful to look at the inflation growth, using the Fed's preferred measure since its inception in 1959.

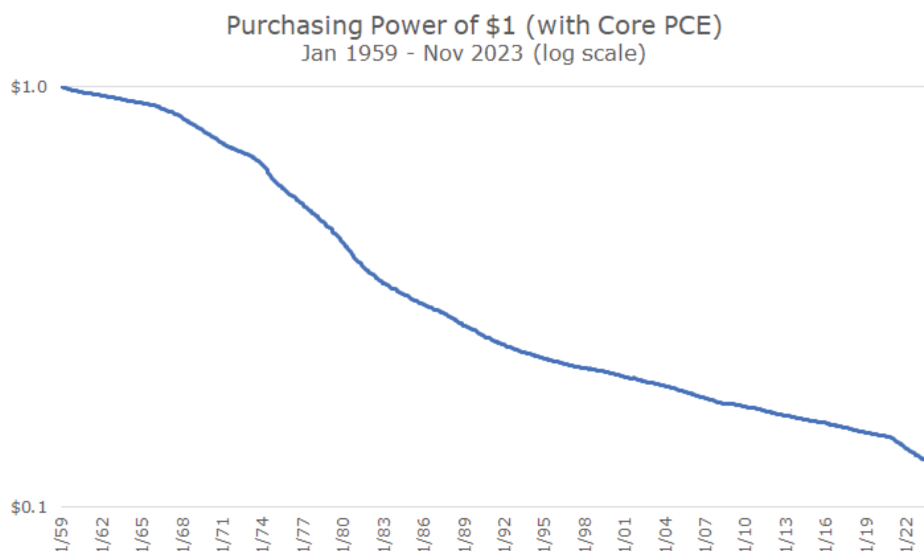
The chart below shows that, and I've used a logarithmic scale, which helps you see changes over time. When you don't do it this way, more recent data looks bigger than earlier data.

This matters with inflation because we all know that the 1970s matter a lot,

"Enjoy present pleasures in such a way as not to injure future ones."

- Seneca, Stoic Philosopher





and looking at the chart this way shows that the slope of the curve is so steep in the 70s and relatively flat after that until the Covid shock.

The chart above is nothing more than the inverse of the chart on the previous page. Instead of showing inflation rising, though, this shows the purchasing power of your dollar.

It makes more sense to me because inflation is a bad thing, and the previous chart looks like something you would want to invest in.

I also like it because it reminds me of how my dad paid a quarter to go to the movies in the 1950s: ten cents for the ticket, five cents for popcorn, and ten cents for a Coke.

Using that chart would imply that the cost is 8x higher, but we all know that you can't watch a movie with popcorn and a drink for $2 (let alone stay in the theater all day). Other costs clearly came down to offset the higher cost of the movies.

In fact, this picture reminds me of why we invest at all. If we just put $1 under our mattress or in a hole in the backyard, it won't buy as many goods and services as time passes because of inflation.

Even when inflation is gradual, like it was over the last 20 years before Covid, a dollar still loses a lot of purchasing power over time.

We buy stocks and bonds because, historically, the rates of return on those investments have exceeded inflation – not all of the time, but on average and over time.

Those investments, those risks, are what have allowed savings to maintain their purchasing power over time. A penny saved is indeed a penny earned, but it has to be invested to buy a penny's worth of goods and services over time.

This article first appeared in our weekly email newsletter, Acropolis Insights. If you'd like to subscribe, let us know, and we will add you to the distribution list.

"Save money, and money will save you."

- Jamaican Proverb

"All life is an experiment. The more experiments you make, the better."

- Ralph Waldo Emerson, American Author

INSIDE THE ECONOMY: GDP

By: David Ott

Last year, I brought back this old column and decided to cover four topics once a year, which means that we are back to gross domestic product (GDP), which measures the value of all goods and services produced by the economy.

Since last year, the economy grew by 2.9 percent through the most recent reading in the third quarter. That's slightly over the 30-year average reading of 2.5 percent.

Notice on the chart below that I'm showing the quarterly reading (in annual terms), which is why you don't see anything that says 2.9 percent. If you take the last four readings in green and combine them, that's how you get to 2.9 percent.

The quarterly numbers show a little more granularity, but since it takes a little mental effort to multiply, they are shown in annual terms.

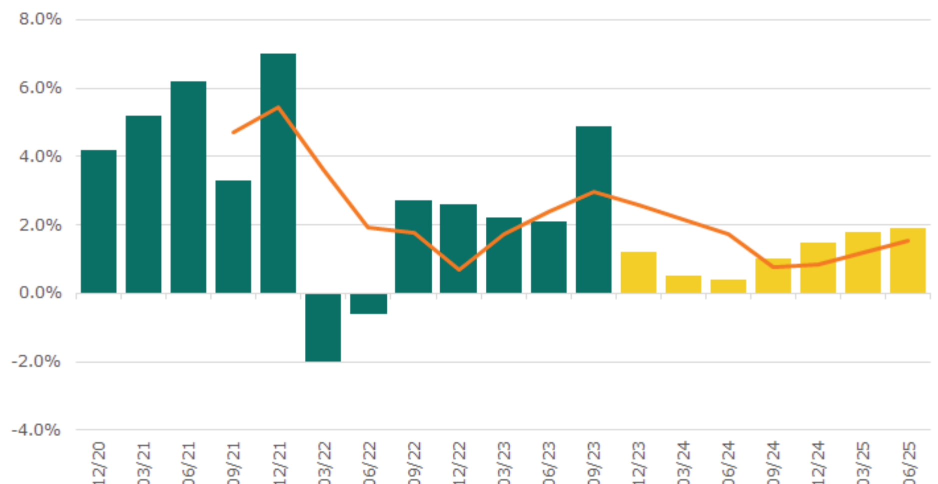
The ridiculously high and low readings related to the pandemic have fallen off the chart since I show three years of realized data and almost two years worth of forecasts. In the realized data, in green, I think there are three phases in this period. The first is the relatively strong readings that coincide with the economy reopening.

Then, there are two quarters of decline, which economists used to call a recession, but don't anymore. Then growth rose again, but to relatively low levels, hovering around two percent.

There is one big 4.9 percent reading most recently, but that is generally viewed as a one-time event related to warehouse construction and new machinery purchases.

The yellow forecasts show what looks like a continuation of a slowing trend from before the big bump, although they never quite get to negative, which signals that economists are upping their forecasts to exclude a recession.

The consensus had been for a recession in 2023 or early 2024, but most economists see slow but accelerating growth in the short run.



Data Source: Bloomberg

PROTECT YOURSELF AGAINST FRAUD

By: Marie Tustin, CFP®

Editors Note: This is the first of a two part article from Marie about how to protect yourself from fraud. Check back next quarter for more valuable information.

Your financial security is our top priority, and with no end in sight to fraud scams that continue to develop as rapidly as technology itself, this topic has never been more critical.

Acropolis takes many measures above and beyond our regulatory requirements to maintain your financial security, but we are only half of the equation.

Most of the financial scams at bay are aimed directly at you, hoping that you are either unaware of the risks or to catch you off guard in a moment of distraction.

So, in addition to continuing to take top security measures from the institutional side, one of our goals this year is to help you stay aware and personally protected as best as possible.

As we go into 2024, the top scam concern is the rise of artificial intelligence (AI) enhanced technologies used to empower imposter scammers.

Imposter scams are nothing new to the fraud business, as they are the original con artist on the streets acting to be a magician, all while stealing the watch off your wrist. The imposter-con has only grown more advanced along with the technology itself.

I remember getting my first fraud call almost fifteen years ago, not long after graduating from college. It was a voicemail from the "IRS" informing me I would be severely fined or imprisoned if I did not immediately call back to pay for a tax lien I supposedly owed.

It was a very alarming message to receive as a young adult, and I remember the immediate feeling of fear that I incorrectly filed my tax return, which is the reaction scammers are banking on.

The message was so alarming that it also made me suspicious. So, instead of calling the scammer back as they were hoping, I called my dad – who, of course, confirmed my suspicion and told me, "The IRS won't ever call you to initiate a payment request over the phone, nor initiate a call to you to verify any personal information." This statement continues to remain true today.

At this point, we've all encountered an imposter scammer in one form or another: spam calls, texts, emails, social media posts/messages, credit card theft, etc.

It's overwhelmingly unavoidable. In fact, imposter scams remain the number one reported scam to the FTC, with over 750,000 reports resulting in more than $2.7 billion in monetary losses for 2022.

If you're anything like me and think those statistics are surprisingly small… they are. The vast number of fraud cases across all genres go largely unreported due to the shame many can feel after "falling" for a scam and a general sense of hopelessness that leads to thinking, "What's the point?" given the lack of justice for those committing the crimes.

In part two of this article, I'll share specific recommendations from the Federal Trade Commission on how to avoid imposter scams.

In the meantime, be careful out there!

"The market is a device for transferring money from the impatient to the patient."

- Louis Rukeyser
Host, Wall $treet Week

Major Indexes	2023
Dow Jones	16.2%
S&P 500	26.3%
S&P 400 Mid-Cap	16.4%
S&P 600 Small-Cap	15.9%
MSCI EAFE (Intl)	18.2%
MSCI Emerging Mkt	9.8%

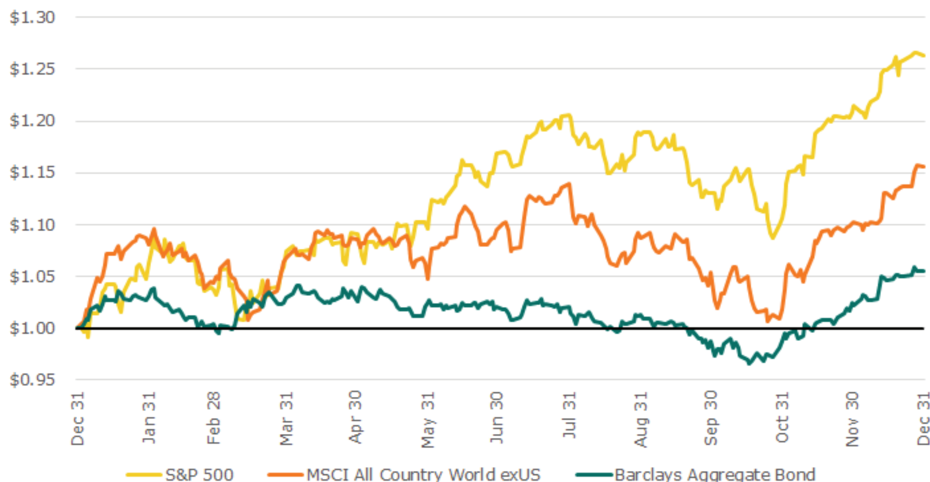
Equity Styles	2023
S&P 500 Growth	30.0%
S&P 500 Value	22.2%
S&P 500 Quality	25.0%
S&P 500 Momentum	17.7%

S&P Sectors	2023
Basic Materials	12.6%
Communications	20.5%
Consumer Discretion.	42.3%
Consumer Staples	0.5%
Energy	-1.4%
Financials	12.1%
Healthcare	2.1%
Industrials	18.1%
REITs	12.3%
Technology	57.8%
Utilities	12.1%

Interest Rates	2023 Q4
Fed Funds	5.5%
Prime Rate	8.5%
3-mo. Treasuries	5.3%
2-yr. Treasuries	4.3%
5-yr. Treasuries	3.9%
10-yr. Treasuries	3.9%

All Data as of 12/31/23

THE BIG PICTURE



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