Annual Investment Update

ECONOMIC REVIEW AND OUTLOOK

DECEMBER 31, 2023

The year 2023 began with many, if not most, economists calling for recessions in the United States and abroad. High inflation, restrictive central banks, and slowdowns in manufacturing and housing all pointed to economic struggles ahead. However, the "most anticipated recession in history" did not occur, at least it hasn't yet.

In the U.S., consumers and businesses were able to draw on excess savings, higher wages, and fiscal stimulus and, as the year went on, recession calls were pushed out. U.S. GDP growth remained unusually strong through 2023, even accelerating to a 4.9% annualized pace in the third quarter.

Power to the People A big driver of growth in the U.S. was the incredibly robust labor market. While the number of job openings declined through 2023, there remained more jobs to be filled than jobseekers to fill them. This gap provided workers the power to demand more pay and better working conditions, and they seized that power.

The Screen Actors Guild-American Federation of Television and Radio Artists and the Writers Guild of America, which represent actors and film and television writers, went on strike for months seeking improved working conditions and protections against the use of artificial intelligence (AI). Over 25 healthcare-related strikes took place in 2023, involving workers including nurses, pharmaceutical employees, and hospital staff. Most were requesting pay increases and additional staffing. Even just the threat of a strike helped Teamsters win a record contract covering 340,000 UPS employees nationwide.

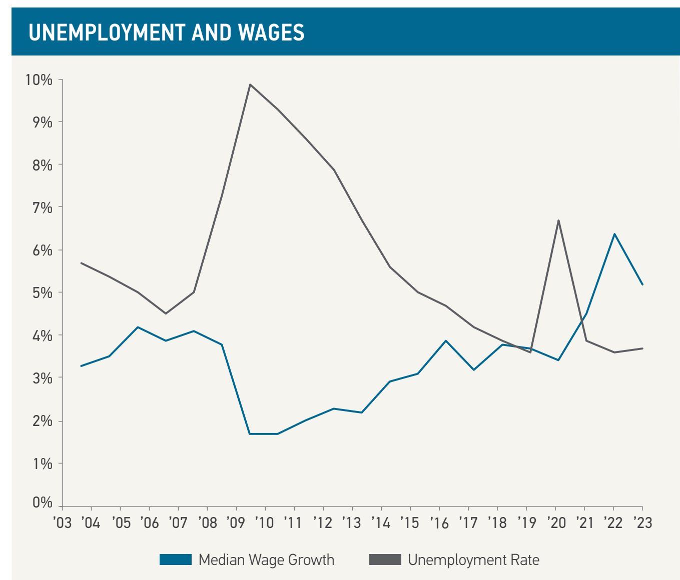
The walkout by the United Auto Workers (UAW) was likely the most consequential. In mid-September, the UAW initiated a strike against three large American automakers: General Motors, Ford, and Stellantis. Thousands of workers halted production across factories that produce about half of the vehicles manufactured annually in the U.S., accounting for an estimated 1.5% of GDP. By late October, the UAW reached deals with all three automakers, which were described by *The New York Times* as the industry's "largest wage and benefit increases in decades."

KEY ECONOMIC RELEASES

EMPLOYMENT	As of	Expected	Actual	Prior Period
Unit Labor Costs (3rd Quarter)	3Q	-0.40%	-1.20%	-0.80%
Unemployment Rate	DEC	3.80%	3.70%	3.70%
Change in Non-Farm Payrolls	DEC	170K	216K	199K
INFLATION (Year Over Year)	**As of**	**Expected**	**Actual**	**Prior Period**
Consumer Price Index	NOV	3.10%	3.10%	3.20%
CPI Ex Food & Energy	NOV	5.50%	5.50%	5.60%
Producer Price Index	NOV	N/A	-0.90%	-0.40%
HOME PRICES (Year Over Year)	**As of**	**Expected**	**Actual**	**Prior Period**
S&P/Case Shiller Top 20 Mkts.	OCT	4.84%	4.87%	3.92%
MANUFACTURING ACTIVITY	**As of**	**Expected**	**Actual**	**Prior Period**
Capacity Utilization	NOV	79.10%	78.80%	78.90%
Leading Indicators	NOV	-0.40%	-0.50%	-0.80%
GDP Annualized (3rd Quarter)	3Q	5.20%	4.90%	5.20%

Source: Bloomberg

UNEMPLOYMENT AND WAGES



Source: Bloomberg

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ECONOMIC REVIEW AND OUTLOOK (CONTINUED)

As of November, average hourly earnings were up 4% year-over-year. While the pace of wage increases slowed and higher costs bit into consumers' budgets, price inflation fell faster such that real wage growth turned positive during the year. The unemployment rate was 3.7% at the end of 2023. Low unemployment and rising wages translated into sustained spending, particularly in restaurants, entertainment, travel, and other service-sector activities.

Manufacturing Down but Onshoring Expands Though services boomed in 2023, the manufacturing industry struggled. In November, the Institute for Supply Management's Purchasing Managers' Index (PMI) indicated the industry had contracted for the 13th straight month. The PMI is based on monthly surveys of more than 300 manufacturing firms and is considered a leading indicator for the economy.

Despite the contraction, a surge of manufacturing-related investment remained underway. Government stimulus, pandemic-related supply chain issues, and geopolitical tensions have increased incentives to onshore U.S. manufacturing in recent years. Tax breaks from the Inflation Reduction Act, along with programs in the Infrastructure Investment and Jobs Act and the CHIPS and Science Act, spurred sizable announcements for infrastructure improvements, new plants and factories, and expansions in electric vehicles and clean energy technologies.

Along with onshoring, "nearshoring" or "friendshoring" also gained traction. This was partially driven by the Russia-Ukraine war and high transport costs from Asia, but a strained relationship between the U.S. and China contributed as well. Mexico benefited from this trend and attracted significant foreign direct investment from large companies seeking new manufacturing capacity closer to the United States. For the first time since 2003, monthly imports into the U.S. from Mexico exceeded those from China on a trailing 12-month basis.

Still Growing, for Now Throughout 2023 there were worrisome signs in manufacturing, housing, sentiment, bank lending, and an inverted yield curve. High mortgage rates overwhelmed the impact of slightly lower home prices, and housing affordability fell to its lowest level in decades. Excess savings thinned and debt use—as well as delinquencies—increased.

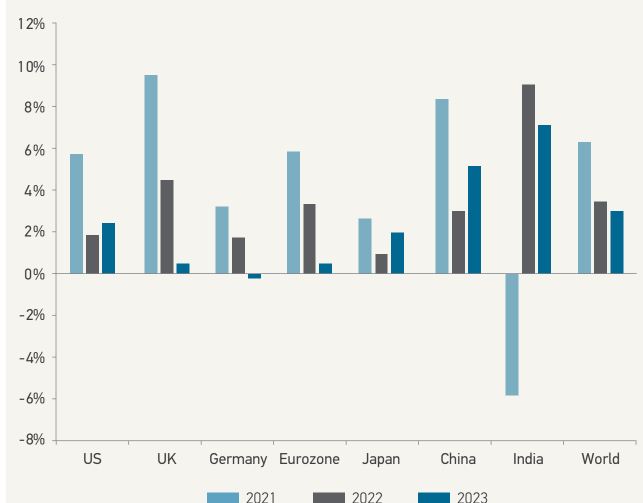
Many economies abroad saw lackluster performance. Elevated inflation, tightening financial conditions, and weak demand stunted growth across the European Union (EU). The Chinese economy struggled to meet expectations for a strong post-pandemic recovery as housing market distress, ongoing deflationary pressures, and weak consumer confidence slowed its momentum. On the positive side, India's economy showed healthy growth in 2023. Employment surpassed pre-pandemic levels and the country's financial sector remained resilient through global financial stress early in the year.

While U.S. GDP appeared to be slowing, it was still positive. As the year ended, gasoline prices were down, mortgage rates had seemingly peaked, and the stock market rallied. The University of Michigan Consumer Sentiment Survey spiked in December, with consumers feeling better about both their present situation and their expectations for the future.

A strong labor market, lower inflation, and a stable credit environment underpin much of the positivity. These factors will bear watching as important indicators of which way the economy may be headed in the coming year.

Policy Change Possible in Busiest Election Year With numerous countries scheduled to hold potentially consequential elections, 2024 is set to be a historic year. The U.S. presidential election could reshape the priorities for the world's largest economy, while the Taiwanese election may impact future relations between the U.S. and China. European Parliamentary elections could test the moxie of further EU integration. The world's most populous country, India, which relies on political stability as a key to economic growth, will vote for its prime minister. Elections in the United Kingdom, Mexico, South Korea, Iran, Russia, South Africa, and Venezuela will also be significant. Geopolitical volatility and policy shocks are risks to consider in 2024.

GDP GROWTH BY REGION



Source: Bloomberg

BOND MARKET REVIEW AND OUTLOOK

DECEMBER 31, 2023

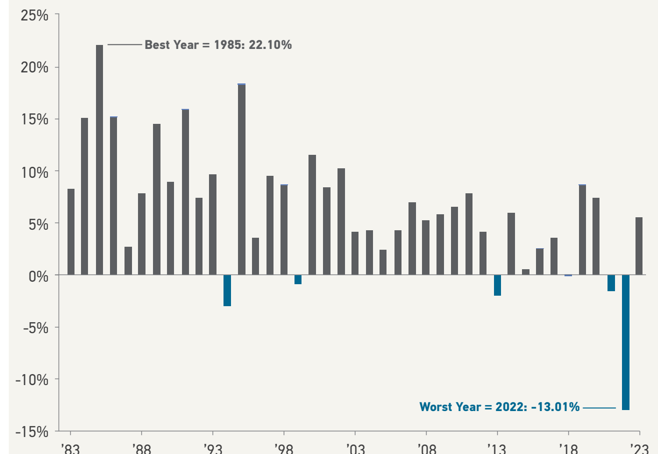
The bond market, after an unprecedented two consecutive years of losses, appeared poised for a historic third year of negative returns during most of 2023. Market participants braced for a recession while the Federal Reserve (the Fed) continued its fight against inflation. Nearly all sectors of the debt market were affected by additional unique challenges: municipal bonds faced declining tax receipts, the mortgage debt market experienced slowing repayments, and corporate debt's rising refinancing costs impacted their margins. Despite these hurdles, the Bloomberg Aggregate Index ended the year up 5.5% after a pivot in the Fed's interest rate policy drove a significant fourth-quarter rally across bond markets.

Higher Rates, Lower Bonds Inflation started 2023 at 6.5%, down from its peak of over 9% but substantially higher than the Fed's 2% target. The Fed's federal funds rate began the year at 4.5% after seven rapid and steep rate hikes in 2022, with four additional hikes taking place during 2023. Market consensus early in the year was that the higher interest rates would slow the economy, if not plunge it into a recession, helping to tame inflation but at a steep cost.

As interest rates rise, older bonds generally lose value since investors can receive higher interest payments from newer issued bonds. Mounting losses were most acutely felt by small regional banks, which hold substantial bond portfolios for regulatory purposes. By March 2023, the book losses were so considerable that depositors panicked about banks' ongoing viability, and sharp withdrawals quickly became a modern-day bank run. The sudden withdrawal of deposits forced banks to sell bonds at a steep loss, exacerbating their problems by turning "book" losses into actual losses and causing a banking crisis. Efforts by the Fed and the Treasury quickly resolved the crisis, but at the expense of briefly reigniting inflation over the summer.

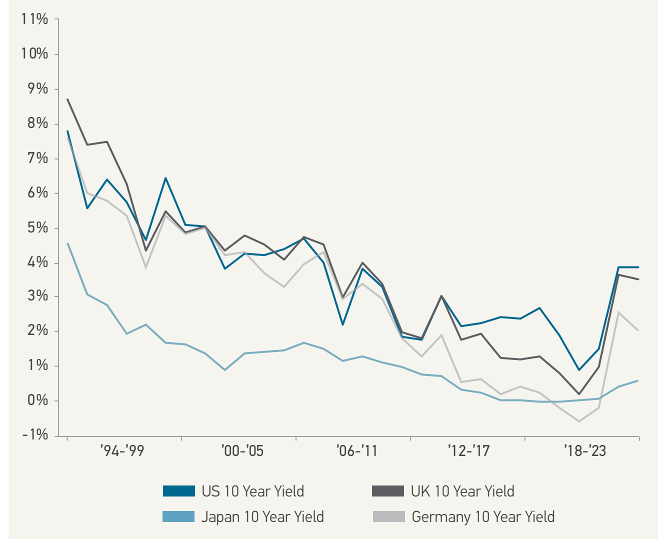
The Pivot Rate hikes, while detrimental to bond values, have been wildly successful at bringing inflation down over the past 18 months. The Fed, satisfied with its progress, signaled a pivot to its policy stance early in the fourth quarter, indicating that the end of rate hikes was near and rate cuts would likely be introduced in 2024. The bond market rallied substantially on the pivot and eliminated the possibility of a third down year for bonds.

BOND MARKET CALENDAR YEAR RETURNS 1983-2023



Source: Bloomberg

10-YEAR BOND YIELDS OF MAJOR DEVELOPED ECONOMIES



Source: Bloomberg

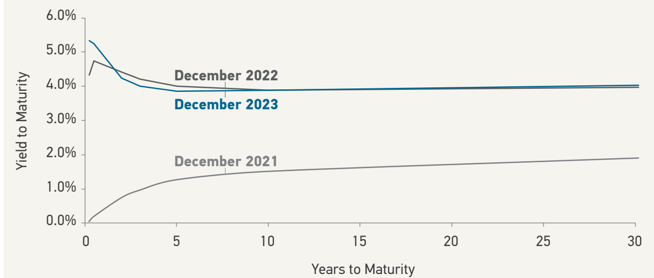
BOND MARKET REVIEW AND OUTLOOK (CONTINUED)

Munis and High Yield Municipal bonds, the tax-exempt asset class that helps finance schools, hospitals, and fire departments, came under pressure during the year as tax receipts fell across the board. Income tax, property tax, and sales tax all showed declines nationwide due to demographic changes, migration, and a slowing economy. While falling tax receipts can be bad for future issuance of municipal bonds, investors should remain confident in the ability of municipalities to repay their debts, and this asset class remains one of the safest. The market quickly realized the fall in municipal bond prices was not justified, and the Bloomberg Municipal Index rose nearly 9% from Halloween through the end of the year.

High-yield bonds, or those with a non-investment-grade credit rating (BB+ as rated by Standard and Poor's or Fitch, or Ba1 as rated by Moody's Rating Service), were a bright spot in an otherwise volatile bond market. They started the year strong, shrugged off the banking crisis, ignored the inflation concerns of the summer, and rocketed higher on the Fed's pivot. The Bloomberg High Yield Index returned an equity-like performance of 13.5% for the year. Corporate profitability remains near all-time highs, balance sheets have continued to strengthen, and the average high-yield company is in better shape today than at any time over the past few decades.

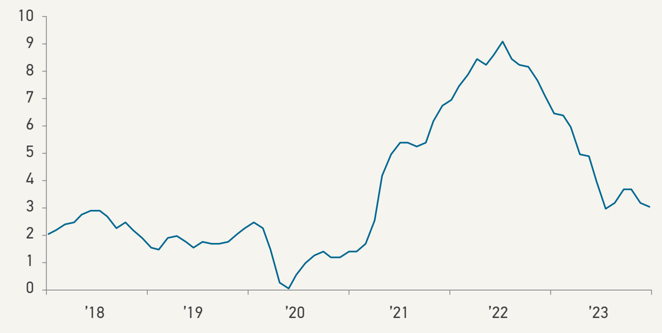
Future Looks Bright The outlook for bonds in 2024 is strong. The market anticipates rate cuts starting in the second quarter of 2024 and progressing throughout the year. Just as rising rates hurt bond values, falling rates can help their values as bonds purchased today will be more valuable in the future when rates are lower. The yield curve remains inverted between 2-year debt and 10-year debt, a historically negative indicator, but decreases to the fed funds rate should help to return the yield curve to its typical upward slope.

U.S. TREASURY YIELD CURVE COMPARISON



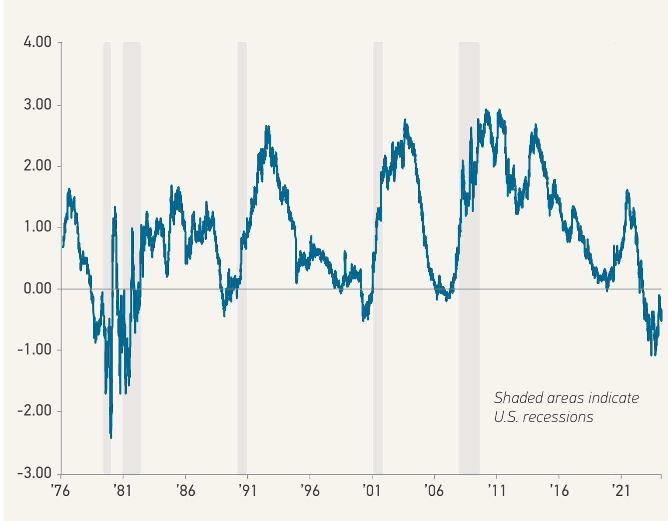
Source: Bloomberg

CONSUMER PRICE INDEX (CPI)



Source: Bloomberg

10-YEAR TREASURY CONSTANT MATURITY MINUS 2-YEAR TREASURY CONSTANT MATURITY



Source: Bloomberg

STOCK MARKET REVIEW AND OUTLOOK

DECEMBER 31, 2023

The stock market's performance surprised many asset managers, who began the year on the sidelines amid concerns about the trajectory of interest rates and the global economy. Yet U.S. equity markets shrugged off a series of challenges—a banking crisis, a debt-ceiling standoff, and labor strikes—to power higher. The S&P 500 climbed 26.3% for the year. International markets were up in 2023 as well. The MSCI EAFE Index, which tracks the performance of equity markets in developed countries outside of the U.S. and Canada, closed the year up 19.0%, and the MSCI Emerging Markets Index was up 10.1%.

Magnificent 7 and Narrow Market Even though the S&P 500 had a great year, the rally was led by only a few stocks. The so-called "Magnificent 7," consisting of Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla, contributed 60.1% to the return of the S&P 500 in 2023. Not surprisingly, the best-performing sectors in the U.S. were information technology (57.8%, led by Nvidia, Microsoft, and Apple), communications services (55.8%, led by Meta and Alphabet), and consumer discretionary (42.3%, led by Tesla and Amazon.com). As oil prices retreated to the $70 level, energy, the star sector of the last few years, lost 1.4% for the year. Utilities stocks tend to have high dividend payouts and thus are sensitive to rate hikes. As rates remained high, utilities suffered the most in 2023 and performed the worst of all sectors, with a -7.1% return.

Diversification didn't work well in 2023. At some points during the year, the Magnificent 7 accounted for over 100% of the S&P 500's return, meaning the other 493 companies in the index accumulated negative returns during the same period. The Magnificent 7 swelled to represent about 30% of the S&P 500's market value at the end of the year, approaching the highest-ever share for any seven stocks in history.

All Magnificent 7 stocks were related in some way to AI hype, which accelerated following the launch of ChatGPT in November 2022. Alphabet, Amazon.com, Meta Platforms, and Microsoft, the top four buyers of the latest AI chips from Nvidia, all released their own versions of large language models in 2023. Shares in Nvidia, the graphics-chip maker at the heart of the frenzy, nearly tripled for the year.

The narrow market widened toward the end of the year and other stocks began to catch up. Strong economic data, easing inflation (which powered bets that interest rates had peaked), and better-than-expected earnings gave stocks another boost.

Banking Crisis It is hard to believe we experienced a banking crisis and still had a fantastic year. When Silicon Valley Bank (SVB) faced increasing withdrawals in March 2023, the bank had to sell "safe" assets such as U.S. Treasurys and government-backed mortgage

STOCK MARKET RETURNS	LATEST QUARTER	12 MONTHS	LAST 3 YEARS
S&P 500	11.68%	26.26%	10.00%
Russell 1000 Growth	14.16%	42.67%	8.87%
Russell 1000 Value	9.47%	11.41%	8.84%
S&P 400 MidCap	11.66%	16.39%	8.07%
MSCI Developed (EAFE)	10.47%	18.95%	4.64%
MSCI Emerging Markets	7.84%	10.12%	-4.82%
Alternative Assets			
Bloomberg Commodity	-5.91%	-12.55%	8.13%
Dow Jones US Real Estate Index	17.98%	12.19%	5.25%
S&P Global Infrastructure Index	10.94%	6.82%	6.03%

Source: Bloomberg

S&P 500 RETURNS BY SECTOR

Source: Bloomberg

STOCK MARKET REVIEW AND OUTLOOK (CONTINUED)

bonds. However, as interest rates had risen significantly over the previous year, large losses were realized as the result. On March 8, SVB announced it would book a $1.8 billion loss. The next day, SVB stock crashed and shares in the financial sector slid amid fears other banks could be forced to take losses to raise cash.

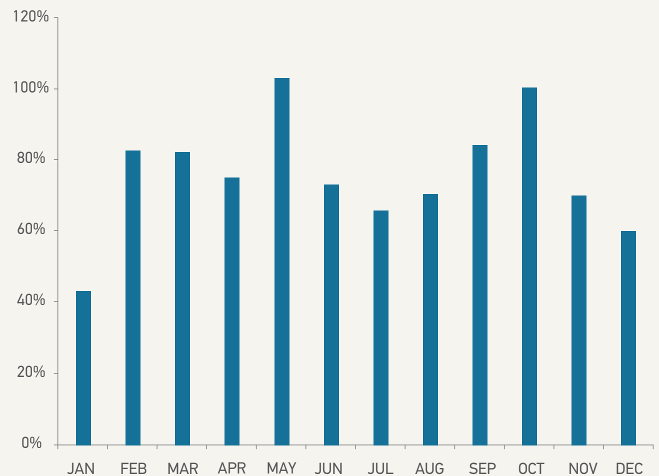
Federal regulators stepped in quickly before the situation worsened. They took control of SVB and Signature Bank, another failing bank, within two days. On March 10, the Federal Reserve also created the Bank Term Funding Program, an emergency lending program, to stabilize the banking sector. By early May, the banking crisis was seemingly under control, after a third failing bank, First Republic, was seized and sold to JPMorgan Chase. After the dust settled, JPMorgan Chase was considered a big winner of the crisis, having added $37 billion in new deposits by the end of April.

Mixed International Markets Developed countries also had a great year despite a strong U.S. dollar and high inflation. The dollar index went down slightly in 2023 but was still above its historical average. Europe avoided a broad recession and stocks there had modest growth in 2023. The Japanese stock market experienced an impressive upswing. As exports remain an important part of that country's economy, Japanese corporations benefited greatly from a negative benchmark rate and a weak yen. The Nikkei 225 Index rose around 31%, outperforming U.S. and European stocks.

China, on the other hand, struggled in 2023. Optimism about post-COVID growth got crushed in the second half of the year, with four straight months of foreign outflows, totaling a net 138 billion yuan ($19 billion) withdrawn from Chinese equities. Real estate, the sector that once accounted for a quarter of China's economy, was reeling from a series of developer failures and a crisis of confidence that investors want to see resolved before they commit capital.

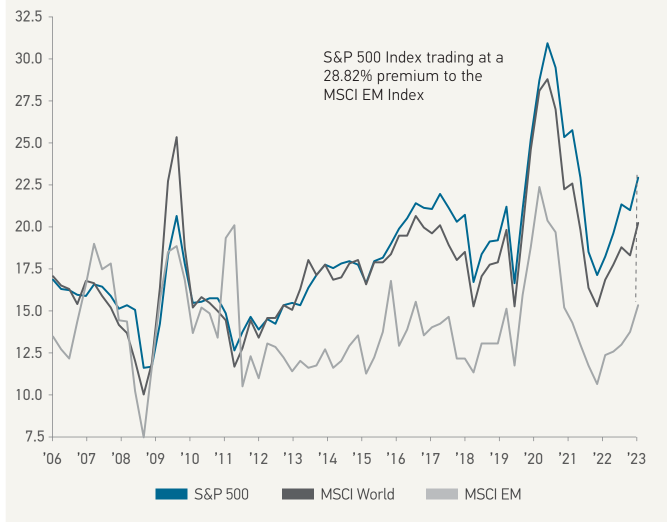
Reasons for Optimism As inflation continues to moderate, the Fed may look to cut rates in 2024. Lower interest rates would benefit corporations, thus supporting higher stock valuations. Additionally, S&P 500 profit margins, while down slightly from 2022, are still above average. Unemployment remains low, and the economy continues to grow, suggesting we might achieve a soft landing in the United States. A weakening U.S. dollar in 2024 would also boost international stock returns. While investing always carries certain risks, there are reasons to be optimistic about stock markets in 2024.

MAGNIFICENT 7 CONTRIBUTIONS TO RETURN OF S&P 500 AT THE END OF EACH MONTH



Source: Bloomberg

U.S. VS. INTERNATIONAL VS. EM VALUATIONS



Source: Bloomberg

INVESTMENT MANAGEMENT SERVICES

Perkins Coie Trust Company offers investment management services for trusts and estates, personal investment portfolios, individual retirement accounts, private foundations and endowments.

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INVESTMENT PROCESS

1. **LEARN** CLIENT GOALS & NEEDS
2. **ESTABLISH** CLIENT INVESTMENT OBJECTIVE & STRATEGY
3. **DETERMINE** ASSET ALLOCATION STRATEGY
4. **CONSTRUCT & MONITOR** INVESTMENT PORTFOLIO
5. **REVIEW & REASSESS** CLIENT NEEDS

TRUST COMPANY SERVICE

The investment process at Perkins Coie Trust Company is always client-driven.

We meet routinely with clients to ensure that we incorporate changing life-cycle needs into our investment strategies.

Annual Investment Update

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