Capital Markets Commentary and Quarterly Report: 4th Quarter 2023

Capital Markets Highlights

In Q4 2023, U.S. stock[1] and bond[2] markets rallied on improving inflation data, strong economic growth, and comments from Fed Chair Powell suggesting the Fed's interest rate hiking cycle is over and the prospects for a rare economic soft landing are improving.

The quarter started poorly with a decline in October amid fears of rising interest rates, a new war in the Middle East, and some disappointing earnings reports. Then the stock and bond markets abruptly changed course in the first week of November, jumping higher after surprisingly good labor productivity[3] and inflation data and the Fed's decision to leave interest rates unchanged for the second consecutive time[4]. From that turning point, the stock market never looked back and rose for the last nine weeks of the year, its longest winning streak since 2004[5].

In Q4, the market, as measured by the S&P 500®, was up 11.69%. It was a broad-based rally with all sectors except Energy participating. The equally weighted S&P 500 Index®[6] was up 11.81% in the quarter, a sharp contrast to the dominance of a handful of growth stocks, the Magnificent Seven, in the first half of the year.

For the full 2023 year, the market was up 26.29%, regaining all the ground lost in the 2022 bear market and closing less than 1% below its record high in January 2022.

Market returns by sector in 2023 were almost a mirror image of the returns during the 2022 bear market. The best-performing sectors in 2023 were Technology, Communication Services, and Consumer Discretionary, all sectors that were down sharply in 2022. This year's worst-performing sectors, Utilities, and Energy, both down in 2023, were the only sectors with gains in 2022's bear market.

Fixed Income returns were positive in the 4th quarter after very modest gains or losses (depending on maturity term) in the first nine months of the year, with short to intermediate-term bonds up mid-single digits for the year. The 10-year Treasury started the year yielding 3.88%, rose to 5.02% on October 23rd, and after a strong rally in November and December, finished the year where it started, at 3.88%.

U.S. economic growth surprised almost everyone by accelerating as the year progressed, from a 2+% rate in the first half of the year to 4.9% in the 3rd quarter[7] while inflation dropped from 6.5% to 3.1%[8]. The unemployment rate remained below 4% for 22 months in a row for the first time since the 1960s.

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1 All references to the stock market are the S&P 500® unless otherwise noted.
2 All references to the bond market are the Bloomberg Intermediate-Term Government Bond Index unless otherwise noted.
3 Reuters 11/2/23. U.S. worker productivity grew at its quickest pace in three years in the third quarter, depressing labor costs.
4 Fed Decision November 2, 2023
5 CNBC December 29, 2023.
6 Invesco S&P 500® Equal Weight ETF.
7 Barron's December 30, 2023.
8 December 2022 and November 2023 CPI data. Bureau of Labor Statistics. Using the Fed's preferred measure of consumer prices, the PCE (personal consumption price index) the November inflation number was even lower at +2.6%, and on a six-month basis, core PCE increased just + 1.9%, indicating that if current trends continue the Fed essentially has reached its goal. Source: CNBC December 22, 2023.

Reviewing our Predictions for 2023

Looking back on our 2023 outlook, many areas of our forecast played out as we expected. This included a strong stock market, a better bond market, declining inflation, and periods of high volatility.

We started the year optimistic about the stock market's prospects in 2023. After the 2022 bear market, we thought valuations were very attractive for many high-quality companies with good prospects for earnings and dividend growth. Our valuation work for both our Large Cap Value and Dividend Income strategies showed above-average appreciation potential.

We thought that both Growth and Value stocks would do well in 2023 and that after Growth stock's significant decline in 2022, many were in "Value" territory as the new year began. We acted on that belief and bought some of the highest quality beaten-down Growth stocks for our Value portfolio.

On the economy, we thought that GDP growth would be modestly positive, and that inflation would decline. We were concerned that after missing the early signs of inflation the Fed would overdo raising rates to a level that might cause a recession. We still worry about this. Generally, we thought the economic outlook would look brighter by the end of the year.

Finally, while we expected stocks to outperform bonds in 2023, we thought fixed-income investments were more interesting than they had been in years and said we thought high-quality short-term bonds with 1–5-year maturities offered good income with minimal principal risk.

Our 2024 Outlook

We begin the new year optimistic that the economy will show another year of growth and that inflation will continue to decline towards the Fed's 2% target. We are more positive about stocks than bonds but have a favorable view of high-quality fixed-income investments with maturities inside of 5-6 years. Our outlook for stocks in 2024 is that after a better-than-average 2023, we expect stock returns to come in closer to their long-term averages of high single digits.

Our best guess is that the Fed has engineered a soft landing, though a mild, short-lived recession is still a possibility if they keep rates too high for too long. After a strong 3rd quarter, we expect the US economy to enter a slower, sustainable growth phase, around the historic trendline of 2%. Consumer balance sheets remain in good shape, holiday spending was solid, and other indicators of consumer confidence rose in December 2023[9] across all ages and household income levels. A healthy job market, infrastructure spending projects[10], and stable to lower interest rates should help stimulate the economy and prevent a slide into recession. A pickup in housing activity[11] is anticipated as mortgage rates decline in 2024 and this should have a very positive impact on the broader economy.

We believe the path to lower inflation is intact. A steady stream of data confirming slowing inflation has allowed the Fed to change its narrative from a "higher for much longer" interest rate outlook to one now projecting three

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[9] Conference Board Consumer Confidence Index December 20, 2023.
[10] Including the Infrastructure & Jobs Act and the CHIPS & Science Act.
[11] With average rates on 30-year mortgages peaking at nearly 8% in October, home sales hit their lowest level since 2010. Axios Markets December 20, 2023.

rate cuts in 2024[12] and core inflation of 2.4% at year-end 2024[13]. The spike in inflation caused by supply chain and workforce disruptions during the pandemic is largely behind us and consumer spending habits are returning to normal. Housing costs, which are now cooling but take time to show up in CPI data, make up 35% of the CPI and are the single most important factor standing in the way of lower reported CPI inflation. According to the CPI data, they rose 6.5% in the year through November. Without shelter, inflation in that period would have been just 1.4%[14].

A positive surprise on the inflation front is that the feared spike in oil prices after the October 7 attack on Israel did not materialize. Rather, oil prices declined amid rising supply and lower-than-expected demand. At year-end, the average price for a gallon of gas was $3.12, the lowest point of the year and down nearly 20% since prices peaked on September 18th[15]. This should further tamp down inflation numbers in the months ahead.

We anticipate good gains for the market in line with historic high-single-digit returns and are upbeat about both of our equity strategies. The one caveat to our upbeat outlook is that we expect market volatility throughout the year. We think the historic differential in spreads among asset classes and strategies in 2023 has set the stage for catch-up rallies and some reversals of relative sector returns in upcoming periods.

Two other factors that add to our confidence going into 2024 are M&A activity and new IPOs that have had something of a resurgence recently. These are both signs that business owners and managers are more confident in their businesses and the business environment overall.

We think that solid corporate fundamentals and supportive company outlooks will ultimately drive stocks higher in 2024. Since the pandemic, companies have learned to operate their business with more flexibility and efficiency. We anticipate that corporate earnings and dividends will be higher in 2024 versus 2023.

The companies in both our LCV and MDI portfolios have solid financial positions, businesses that are stable and growing, with strong management teams. We believe they are well-positioned to navigate the current economic uncertainty and to provide favorable stock market returns this year.

Finally, as we have noted many times, there is always uncertainty about the future. The biggest risks we see for financial markets in 2024 are the uncertainty related to a government shutdown, the Presidential election, and geopolitical risks. Presidential election years are usually positive for the stock market, as are most years, but add more uncertainty for investors to stew over[16].

We believe the formula for investment success is to look through near-term instability and stay focused on the long term. The best way to address that is to have an allocation to the stock market that is appropriate for the long term, which includes both good and bad times.

[12] Fed Minutes. WSJ 1/03/2024.

[13]WSJ: Fed Begins Pivot Towards Lowering Rates as Inflation Declines, December 13, 2023.

[14] WSJ: December 16, 2023.

[15] CNBC December 29, 2023, quoting data from motorist group AAA.

[16] Historical data shows markets have tended to rise in Presidential election years, with the S&P 500® recording positive returns in 20 of the 24 election years since 1928, or 83.3% of the time. The average return for those election years was 11.58%, according to figures from First Trust. That's well above the S&P 500 average return of 9.81% for all years since 1928. Source: Investopedia December 31, 2023. Economic and inflation trends have demonstrated a stronger relationship with market returns than election results.

Large Cap Value Strategy

Matrix's Large Cap Value Portfolio (LCV) showed strong performance results in 2023[17]. In the 4th quarter, the portfolio outperformed both the S&P 500® and the Russell 1000 Value® Index. For the full year, the portfolio modestly underperformed the S&P 500® and was nicely ahead of the Russell 1000® Value Index.

Performance results in 2023 benefited from investments made in high-quality Technology and Communication Services companies when their share prices were much lower. In the 4th quarter, more stocks in a variety of sectors outside of Technology contributed to the portfolio's strong results. Our holdings in Financials were up double digits across the board in Q4, responding to the solid results they have been reporting and getting a lift from improving investor sentiment as interest rates declined. It's worth noting that in the aftermath of the mini-banking crisis in March and April, our financial holdings have quietly been the portfolio's top sector since May 31st and are up around 28.5% in the back half of the year.

In 2024, we expect good but less spectacular results from last year's biggest winners and continued contributions from Financials in a less restrictive interest rate environment. We also expect greater gains from other areas of the portfolio that lagged in 2023 like Healthcare, Industrials, and Materials.

In the 4th quarter, we opportunistically added to positions in Air Products & Chemicals, L3 Harris Technologies, Morgan Stanley, and Zimmer Biomet.

The largest sector weightings in the Large-Cap Value portfolio as of December 31 were in Technology, Financials, Healthcare, and Communication Services, all areas we expect to do well in 2024.

Looking ahead, even after the LCV portfolio's robust gains in 2023, we are optimistic about the portfolio's positioning and prospects in 2024. The portfolio's companies have strong and growing franchises and are positioned to prosper as the economy settles into historic trend line economic growth of around 2% with stable to lower interest rates. If we are right in our market outlook for the upcoming year, we expect the LCV portfolio to build on 2023's strong results with another year of solid gains.

Dividend Income Strategy

The Matrix Dividend Income (MDI) portfolio had a solid year of high single-digit performance. This follows very strong relative performance in the 2022 bear market when the portfolio defended extremely well, down just modestly in a very tumultuous year.

2023's results were well behind the S&P 500® and modestly lower than the Russell 1000 Value® Index. The weak comparisons to the S&P 500 resulted from very few of the stocks responsible for the market's strong results in 2023 (the Magnificent Seven) being dividend payers and thus were not candidates for inclusion in the Dividend Income portfolio. Because the portfolio defended so well in 2022, even with the performance lag this year, the Dividend portfolio's results were better than the S&P 500 and the Russell 1000 Value Index's returns over the past two years, with a lot less volatility since the start of the bear market in 2022.

In the 4th quarter, the portfolio was up low double digits, outperforming both benchmarks. Portfolio performance in the quarter was led by strong gains in Financials, Industrials, and Technology. As noted above, after a very poor start to the year, Financials were the strongest contributors to the portfolio's gains since the end of May.

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[17] This and subsequent references to Matrix performance (LCV and MDI) are net of fees and YTD as of December 31, 2023.

In the 4th quarter, we started a new position in Duke Energy, building our exposure in the utility sector, and opportunistically added to positions in Air Products & Chemicals, M&T Bank, Medtronic, Morgan Stanley, NextEra Energy, Pfizer, and Texas Instruments.

Duke Energy is a well-run electric and gas utility company with customers in the South, Mid-Atlantic, and Midwest. We have owned Duke in the Dividend portfolio before and sold it at a healthy profit. The opportunity to repurchase Duke came about because the share price fell when Utilities fell out of favor in 2023 as interest rates rose. The company has historically shown consistent earnings and dividend growth. On December 31, 2023, the current dividend yield is 4.2%.

We sold our holding in Tyson Foods because we were concerned about the company's dividend coverage during the current cyclical downturn in its business profitability.

On 12/31/23, the Dividend Income portfolio's largest sector concentrations were Financials, Healthcare, and Information Technology. We believe these sectors should do very well in 2024, especially Healthcare which lagged badly in 2023, and Financials which we believe will continue to add to its second-half 2023 gains on good business momentum combined with attractive valuations. We expect our Technology holdings to build on last year's gains. We have been building our Utility exposure in the portfolio now around 8% from 4% on 12/31/22, expecting a good recovery in this group as the economy slows and interest rates stabilize or trend lower.

We are pleased that the MDI strategy delivered on its goal of being more protective than the market during difficult years like 2022, while also generating a strong and growing income stream, and showing solid returns in better market years like 2023.

In Q4, six of our portfolio holdings raised their dividends by an average of 5.1%. For the year, 24 of 25 holdings raised their dividends by an average of 6.2%. At year-end, the portfolio had a 3.1% dividend yield, which compares favorably with the 1.49% yield on the S&P 500, and the 2.30% yield on the Russell 1000 Value.

Bonds

After one of the worst years in fixed-income performance in the last 50 years in 2022, bonds showed a positive return in 2023, but with significant intra-year volatility. The yield on the 10-year Treasury climbed by nearly 170 basis points from early April to late October[18] before falling by 114 basis points to end the year unchanged at 3.88%.

The 2-year Treasury yield ended 2023 at 4.25% vs. 4.43% at the end of 2022, the 5-year was 3.85% vs. 4.00%, the 10-year rate ended 2023 at 3.88%, exactly where it started the year, and the 30-year was 4.03% vs. 3.96% at the beginning of the year.

Short and intermediate bond returns were up in the mid-single digits for the year.

We think the Fed is done raising interest rates this cycle but will be slow to lower them in 2024. Our expectation for fixed income returns in 2024 is positive, with the bulk of the return coming from the healthy current yield. After the recent rally in intermediate and longer-term bonds, we have less conviction in their outlook for the upcoming year but are very comfortable in our favorable outlook for shorter-term fixed-income investments.

Matrix's fixed income positioning has been very cautious in recent years, focusing on high-quality corporates, U.S. Treasuries, agencies, and municipals (where appropriate) with nearer-term maturities. In 2023 we extended

[18] J.P. Morgan Economic and Market Update, David Kelly, December 31, 2023

maturities, first to 2-4 years, and then out as far as 7 years. After the recent decline in rates, we are now mostly investing in bonds with maturities in the 12-month to 5-year area.

With our conservative positioning, our taxable and municipal bond portfolio performance in 2023 was in line to modestly better than their benchmarks.

Looking ahead, with high-quality shorter-term bonds now offering yields between 4% and 5%+, we are more interested in fixed income than we have been in years. However, we are still cautious about long-term bonds where we think there is more interest rate risk.

Balanced Accounts

Balanced accounts were up in the 4th quarter, benefiting from the rally in stock prices and gains in the bond market, and were further aided by our overweight to stocks.

With stocks and bonds both up for the year, balanced accounts had a nice recovery year in 2023. Looking forward, we expect stocks and bonds to return to their long-term relationship, where stocks are the driver of long-term growth and bonds provide income and stability during difficult stock market environments.

At current interest rates and stock appreciation potential, we believe that stocks are more attractive than bonds, but that high-quality short to intermediate-term bonds, are also attractive investments and should provide stability, modest growth, and a healthy income stream for balanced portfolios in the upcoming year.

As we start 2024, we expect to use the sharp rally in stocks in the last two months of 2023 as an opportunity to reduce our equity overweight for those accounts where equity appreciation brought their stock exposure to above the upper limit of our 10-percentage point band. Overall, we expect to maintain our overweight to stocks but have a less pronounced overweight than we had in 2023.

Tax Mitigation

We started early and remained active in the last few months of the year in our tax mitigation activities to offset gains with losses when it made economic and investment sense. These actions allowed us to significantly reduce the ultimate capital gains realized in most portfolios. While we may not have been able to eliminate all your realized gains, our actions significantly lowered them while maintaining the integrity of the portfolio, allowing it to fully participate in a market rebound. We did not take every loss available when we judged the trade-off would be detrimental to portfolio returns.

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We thank you for the trust you have placed in us and send our best wishes for a happy, healthy, peaceful, and prosperous 2024.

Disclosure:

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All data is through (or as of) 12/31/2023 unless otherwise noted.

For more information about Matrix Asset Advisors, please visit our website at www.MatrixAssetAdvisors.com. Our website includes our firm's Client Relationship Summary document.

Definitions:

The S&P500® Index *is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. You cannot invest directly in an index.*
The Russell 1000 Value® Index *measures the performance of those Russell 1000 Index® companies with lower price-to-book ratios and lower forecasted growth values.*
Fixed Income *type of investment security that pays investors fixed interest or dividend payments until their maturity date.*
Inflation *is a sustained increase in the general level of prices for goods and services.*
Financials *a section of the economy made up of firms and institutions that provide financial services to commercial and retail customers.*
Health Care *all businesses involved in the provision and coordination of medical and related goods and services.*
Information Technology *businesses that sell goods and services in electronics, software, computers, artificial intelligence, and other industries related to information technology (IT).*
Consumer Discretionary *an economic sector classification of non-essential consumer goods and services.*
Communication Services *includes companies that sell phone and internet services via traditional landline, broadband, or wireless. The communications sector also includes companies that create and produce movies, television shows, and other content.*
Growth Strategy *a collection of business initiatives that seek the maximization of a company's value within a period.*
Federal Reserve *is the central banking system of the United States. It was created on December 23, 1913, with the enactment of the Federal Reserve Act, after a series of financial panics led to the desire for central control of the monetary system in order to alleviate financial crises.*
Economic Growth *an increase in the production of economic goods and services, compared from one period of time to another*
Dividend Income Large Cap Core *- the largest U.S. companies, or those with market capitalizations of $10 billion or more, where neither growth nor value characteristics predominate.*
Value Strategy *investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.*
Balanced Accounts *combines asset classes in a portfolio in an attempt to balance risk and return. Portfolios are divided between stocks and bonds, either equally or with a slight tilt, such as 60% in stocks and 40% in bonds. Balanced portfolios may also maintain a small cash or money market component for liquidity purposes.*
Energy Sector *is the totality of all the industries involved in the production and sale of energy, including fuel extraction, manufacturing, refining and distribution.*
Utility Sector *companies that provide electricity, natural gas, water, sewage, and other services to homes and businesses.*
Manufacturing *the making of goods by hand or by machine that upon completion the business sells to a customer.*
Corporate Profitability *is a measure of an organization's profit relative to its expenses.*
Mergers & Acquisitions (M&A) transactions *in which the ownership of companies or their operating units — including all associated assets and liabilities — is transferred to another entity.*
IPO *a company's ownership is transitioning from private ownership to public ownership. For that reason, the IPO process is sometimes referred to as "going public."*
Volatility *is the degree of variation of a trading price series over time, usually measured by the standard deviation of logarithmic returns.*

US Governments *(Treasuries) are debt obligations issued by the United States Government and secured by the full faith and credit (the power to tax and borrow) of the United States.*

Agencies *a low-risk debt obligation that is issued by a U.S. government-sponsored enterprise (GSE) or other federally related entity.*

Municipal Bond *is a bond issued by state or local governments or entities they create such as authorities and special districts. In the United States, interest income received by holders of municipal bonds is often, but not always, exempt from federal and state income taxation.*

10-year Treasury Yield *the yield that the government pays investors that purchase the specific security.*

Gross Rate of Return *is the total rate of return on an investment before the deduction of any fees, commissions, or expenses. Often quoted as the rate of return on an investment in strategy marketing materials. Returns for more than a year are often annualized, which provides the geometric average return of an investment for each year over a given time period.*

Net Rate of Return *is the total rate of return on an investment after the deduction of any fees, commissions, or expenses. Often quoted as the rate of return on an investment in strategy marketing materials. Returns for more than a year are often annualized, which provides the geometric average return of an investment for each year over a given time period.*

Interest rates *are the amount a lender charges a borrower and is a percentage of the principal—the amount loaned.*

Soft Landing *in the business cycle is the process of an economy shifting from growth to slow-growth to potentially flat, as it approaches but avoids a recession. It is usually caused by government attempts to slow down inflation.*

The Magnificent Seven *Large tech-oriented companies. The group includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta.*

Bear Market *is defined as sustained periods of downward trending stock prices, often triggered by a 20% decline from near-term highs.*

Operating Results *show what the company has earned in connection with its business activities before deduction of interest and taxes.*

Dividend Yield a financial ratio that tells you the percentage of a company's share price that it pays out in dividends each year.

Industrials *Companies that manufacture machinery, handheld tools, and industrial products. This sector also includes aerospace and defense firms as well as companies engaged in transportation and logistics services.*

GDP (Gross domestic product) *is a monetary measure of the market value of all the final goods and services produced and sold in a specific time period by countries. Due to its complex and subjective nature this measure is often revised before being considered a reliable indicator.*

High Grade Corporate Bonds *that are believed to have a lower risk of default and receive higher ratings by the credit rating agencies, namely bonds rated Baa (by Moody's) or BBB (by S&P and Fitch) or above. These bonds tend to be issued at lower yields than less creditworthy bonds.*

Maturities *are the agreed-upon dates on which the investment ends, often triggering the repayment of a loan or bond, the payment of a commodity or cash payment, or some other payment or settlement term.*

Recession *a significant, widespread, and prolonged downturn in economic activity.*

Housing Data *is a comprehensive source for historical statistics on households, housing, and housing finance.*

Basic Materials *is an industry category made up of businesses engaged in the discovery, development, and processing of raw materials.*

CPI *The Consumer Price Index (CPI) consists of a family of indexes that measure price change experienced by urban consumers. Specifically, the CPI measures the average change in price over time of a market basket of consumer goods and services. The market basket includes everything from food items to automobiles to rent.*

Consumer Spending *the value of the goods and services purchased by, or on the behalf of, U.S. residents.*

Supply Chain *is a complex logistics system that consists of facilities that convert raw materials into finished products and distribute them to end consumers or end customers.*

2 Year Treasury Yield *is the yield received for investing in a US government issued treasury security that has a maturity of 2 years.*

5 Year Treasury Yield *is the yield received for investing in a US government issued treasury security that has a maturity of 5 years.*

30 Year Treasury Yield *is the yield received for investing in a US government issued treasury security that has a maturity of 30 years.*

Short Term Bonds *are bonds that will pay back your principal, or mature, quickly, typically within four years.*

Intermediate Term Bonds *issued with maturity dates that are between two and 10 years.*

Long Term Bonds *maturities of between 10 years and 30 years.*

Taxable accounts *are accounts where the normal IRS tax rules apply. In a taxable account, you pay taxes on interest, dividends, and capital gains, in the year in which you earn them.*

The Bloomberg Intermediate US Government/Credit Bond Index *is a broad-based flagship benchmark that measures the non-securitized component of the US Aggregate Index with less than 10 years to maturity.*

Core inflation *the change in prices of goods and services, except for those from the food and energy sectors.*

Invesco S&P 500® Equal Weight ETF *is based on the S&P 500® Equal Weight Index (Index). The Fund will invest at least 90% of its total assets in securities that comprise the Index. The Index equally weights the stocks in the S&P 500® Index. The Fund and the Index are rebalanced quarterly.*