CANNELL & SPEARS

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"The strength of the team is each individual member. The strength of each member is the team."

– Phil Jackson

In past letters and market commentaries we have discussed the pointlessness of the myriad stock market prognostications upon which the news media seems to focus. The new year brings a fresh set of predictions, which are likely to prove as uninformed as the previous year's.

Stock market performance of 2023 seems to have caught many investors by surprise. A year ago, market participants were licking their wounds after the 2022 sell-off. The coordinated monetary tightening by global central banks had left many of the market's most beloved stocks battered at the start of the year. The consensus expectation was that rising interest rates would make a recession an inevitability and, in turn, prove a challenge to equities.

This pessimism proved to be entirely misplaced. Stocks rose in the face of regional bank collapses, war breaking out in the Middle East and continuing in Ukraine, and the Federal Reserve remaining hawkish. By year's end, what started as a narrow rally in stocks with exposure to artificial intelligence (the so called Magnificent Seven), broadened somewhat to include other S&P sectors.

While a greater number of stocks participated in the fourth quarter market runup, with many delivering what should be considered terrific annual returns, their performance paled in comparison to the small number of companies that dominated the investing headlines. The concentration of the 2023 market is best exemplified by the performance of the three widely followed indexes: the NASDAQ Composite rising 43%; the S&P 500 gaining 24%; and the Dow Jones Industrial Average (DJIA) advancing 14%.

The exceptional returns that the NASDAQ Composite delivered may leave an investor with a more traditionally diversified portfolio disappointed. However, focusing on a single year often obscures the reality that volatility works both ways! As an illustration, it may prove helpful to look at those same three indexes over the 2022 sell-off and the 2023 recovery:

Cumulative Price Return

Index	2022	2023	2-Year
NASDAQ Composite	-33%	43%	-4%
S&P 500 Index	-19%	24%	0%
DJIA	-9%	14%	4%

Source: *FactSet*

As one can see from the above chart, an investor in the riskier part of the market – as represented by the NASDAQ Composite – might have been able to boast at a New Years celebration; however, their performance over the 2-year period would have proved better had they invested in the humdrum DJIA.

In investment parlance, this is known as "risk drag". Risk drag captures the mathematical reality that there is an asymmetrical relationship between loss and gain. The larger the percentage loss you incur, the greater the percentage gain that you require to be made whole. For example, consider losing 10%, 25% and 50% in three different companies during the year.

To recover your initial investment, each of these stocks would have to rally 11.1%, 33.3% and 100% respectively. Simply put, big losses require enormous gains to recover.

We continue our cautious optimism as we concern ourselves with individual companies, as opposed to the market, and see opportunities. We believe that there are excesses within the market – the Magnificent Seven make up a larger share of the MSCI All Country World Index than all the stocks from the U.K., China, France, and Japan combined – and are always striving for diversification without overpaying for it. With inflation cooling significantly and the economy slowing reasonably, we expect our companies will continue to deliver solid earnings.

2024 has far more certainty from a financial planning perspective. We have seen an increase in several Federal transfer tax exclusions, a bump in the retirement contribution limits, and changes in the federal interest rates used in certain estate planning techniques. We have provided a high-level summary below:

- Federal estate and gift tax exclusion amount and the Generation-Skipping Transfer (GST) tax exemption will increase from $12,920,000 to $13,610,000 per person. Note, this amount is scheduled to revert to $6,460,000 in 2026.
- Federal annual gift exclusion increases from $17,000 to $18,000 per person ($36,000 for married couples).
- 401K contributions limits rise to $23,000, though “catch up” contributions remain $7,500 for employees over 50 years old.
- IRA contribution limits are $7,000 ($8,000 for those 50 or older).
- Higher Applicable Federal Rates (AFR) may make a Qualified Personal Residence Trust (QPRT) an attractive estate planning option for some clients.
- Charitable Remainder Trusts should also prove an effective estate planning tool for those charitably inclined.

As with all financial planning considerations, clients should not only speak with us, but also include their trust & estate attorney and their tax advisor to ensure your plans meet your specific circumstances.

Everyone at Cannell & Spears is looking forward to 2024. We thank you for your continued confidence and trust.

Sincerely,

Cannell & Spears