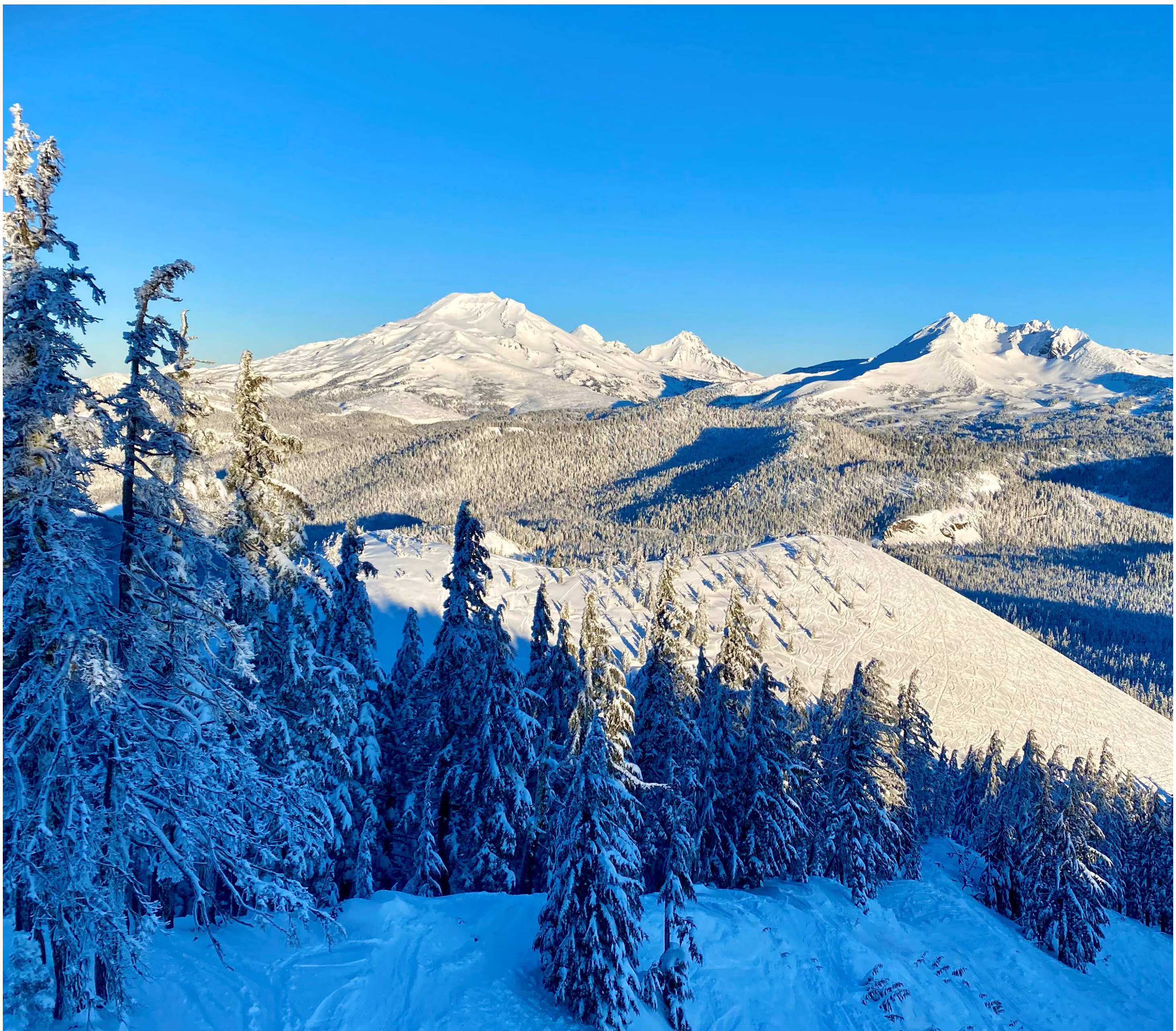
BlackDiamond Financial

INVESTMENT INSIGHTS

FOURTH QUARTER 2023



Picture by Black Diamond Analyst, Julia Ullrich
Bend, Oregon

MARKET UPDATE

Solid Economy and Falling Inflation Drive Stocks Higher

Stock Market Recovery Exceeds Expectations

The stock market made a dramatic turnaround in 2023 with the S&P 500 up 26.3%. Investor optimism was driven by strong consumer spending backed by robust and steady job growth, the rise of artificial intelligence headlines, China's reopening, and the expectation of Fed interest rate cuts in 2024.

A small number of tech stocks (the "Magnificent Seven") drove 55% of the total return of the S&P 500 index this year: Apple, Google, Netflix, Tesla, NVIDIA, Amazon and Microsoft. Investors in this group of companies overlooked headwinds from higher interest rates, as rate increases typically lower valuation multiples.

At the end of 2022, the market feared declining economic growth and the onset of a recession, primarily due to the largest interest rate increase in decades. The economy proved resilient in 2023 posting positive GDP growth, and the consensus today is for a "soft landing".

Initially considered a very unlikely outcome, a "soft landing" describes a situation where inflation declines to a sustainable level without the economy entering a recession. However, the risk of a potential downturn remains elevated. Historically, the highest risk of a recession is between 14 and 24 months following a yield curve inversion, which occurred in October 2022.

The short-term Treasury bond market continues to deliver yields of 5%, presenting an attractive safe haven for risk-averse investors.

This year once again exemplified the folly of acting on Wall Street predictions. The stock market's strong performance was well beyond the range of all predictions made at the beginning of 2023. Successful investing requires a disciplined, long-term approach that focuses on asset allocation, diversification, staying invested, and risk management rather than trying to time the market.

Comparative Returns

		Annualized Performance			
	Q4 2023	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	11.7%	26.3%	10.0%	15.7%	12.0%
Small Cap U.S. Stocks[2]	14.0%	16.9%	2.2%	10.0%	7.2%
International Stocks[3]	9.8%	15.6%	1.6%	7.1%	3.8%
Real Estate[4]	15.6%	12.3%	5.9%	6.2%	6.3%
U.S. Bonds[5]	6.8%	5.5%	(3.3%)	1.1%	1.8%

1 S&P 500 index. 2 Russell 2000. 3 MSCI ACWI ex-U.S. index. 4 MSCI U.S. REIT index. 5 Bloomberg Barclays Aggregate Bond index.

Reinvestment Risk Rises in a Declining Interest Rate Environment

Short-term Treasuries have been among the best investments over the last two years. Investors in short-term Treasuries avoided losses experienced by stocks and longer-term bonds in 2022 and gained 5% in 2023 with essentially zero risk.

However, investors who hold short-term bonds face a new challenge going forward – reinvestment risk. When interest rates decline, interest income and the proceeds from maturing bonds will likely be reinvested at lower rates, thereby reducing future income potential.

The Federal Reserve predicts a gradual decline in the Fed Funds rate from 5.5% to 2.9% by the end of 2026. Cuts to the Fed Funds rate reduce the yield investors expect to receive on short-term bonds.

Investors can diminish this risk by diversifying and laddering their bonds (holding bonds with different maturities).

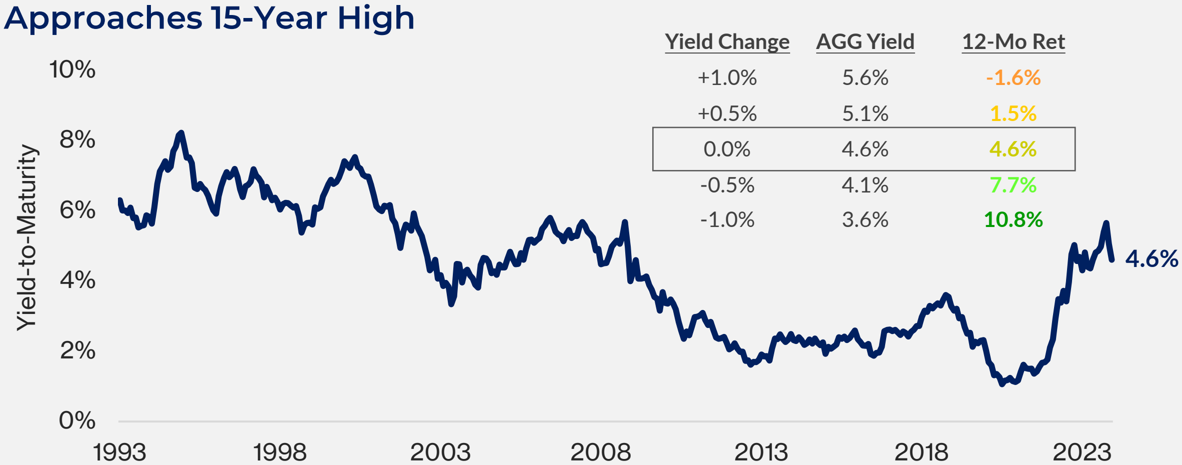
Intermediate-term Bonds Look Attractive

In a normalized market, bond portfolios typically include a mix of short, intermediate, and long-term bonds to help mitigate the impact of interest rate fluctuations. These portfolios are often diversified to include U.S. Treasury, investment grade corporate, high yield, and municipal bonds for investors in high tax brackets.

High-quality intermediate-term bonds, as represented by the Bloomberg Aggregate Bond Index, have approached their highest yield since 2008. With a current yield of 4.6%, these bonds have become an increasingly attractive asset class to consider. This yield is lower than current short-term Treasury yields of 5.4%, but 1.7% higher than expected short-term Treasury yields in 2026. This means if rates decline as the market anticipates, it is advantageous to extend the maturity of bond portfolios now.

There is moderate risk in extending bond maturities as bond prices move inversely with interest rates. As the chart below depicts, a 1% increase in the interest rate for the Aggregate Bond Index implies a negative 1.6% total return over the next year. However, if interest rates decline (as the Fed predicts) by the same amount, the bond portfolio is expected to gain 10.8%.

Bloomberg Aggregate Bond Index Yield Approaches 15-Year High



Source: Bloomberg, Black Diamond Financial

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ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment adviser with a unique and holistic focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals through the use of low cost, tax-efficient investment strategies. We create individualized investment portfolios for each client that are risk-appropriate, return optimized, and tax-efficient. Where appropriate, we incorporate institutional quality private investments to capture illiquidity premiums or yield opportunities. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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