SMITH CAPITAL INVESTORS

Keeping the Show on the Road

Bottom-up company fundamental analysis and individual security selection are at the core of generating risk-adjusted returns at Smith Capital Investors, but our active management process would not be complete without overlaying our blended top-down macroeconomic views to drive portfolio management decisions. In our view, the combination of these two processes is what allows us to challenge market narratives and generate alpha. As the fourth quarter 2023 earnings season comes to an end, our investment team took a step back from evaluating individual company performance to identify trends on a sector-wide basis and determine overall macroeconomic themes using company data and guidance from earnings reports. We use the following real-time anecdotes to support our blended top-down macroeconomic views and supplement our active portfolio management process.

Overall trends and fundamentals diverge across industries, but looking holistically across sectors, companies exited 2023 from a position of strength and are approaching 2024 with a tone of cautious optimism as they continue to adapt to a higher interest rate environment. As inflation moderates and cost pressures ease, the margin expansion that most companies across sectors experienced in the back half of 2023 is expected to continue, though at a more subdued pace. We believe this, paired with a heightened focus on increased productivity and rationalization of expenses will lead to modest improvements in profitability, though somewhat offset by continued pressure in labor costs (low to mid-single digit increases broadly) to drive moderate earnings expansion in 2024. Some companies have announced labor force reduction plans, but overall layoffs have not been a common theme and have been generally concentrated in sectors such as technology, where a hiring spree in 2020 and 2021 is undergoing further rationalization. That being said, hiring plans going forward are broadly muted, indicating the labor market is still strong but slowly softening.

We believe these trends support the view that the U.S. economy is healthy and can continue to grow this year.

The consumer was a large driver of better-than-expected growth in 2023, so this became a key topic of focus when looking for forward commentary from individual companies**. In general, consumer spending continues to be robust, but as prices rise and interest costs remain elevated, consumers are becoming more intentional with where discretionary dollars are spent rather than exhibiting broad-based strength.** Consumption resilience, however, is becoming increasingly negatively correlated with income cohort and age group – younger and lower earners are starting to show potential cracks emerging. Services continue to be favored over goods categories as post-pandemic consumption trends normalize. Consumers are choosing to trade down in essential categories such as food and groceries to continue spending in areas like travel and entertainment.

Barring any material degradation of labor market conditions, overall spending should continue to drive the economy though will not exhibit equal strength across end markets.

This presents an opportunity for proper sector rotation to deliver outsized performance in 2024.

Inflation has been a major focus for markets at the start of the year as expectations surrounding the Fed response continue to reset with fewer cuts as pricing pressure remains sticky. **Extrapolating commentary across sectors, pricing power is expected to moderate in 2024 but outright deflation is not likely, indicating potential stickiness in inflation.** Low single digit increases will likely be taken where demand dynamics allow for greater price inelasticity. **If demand allows this trend to become broad-based across multiple sectors, upward pressure would be placed on inflation and likely warrant a more restrictive Fed response.**

Extracting real-time data from companies provides essential information that allows for a constant refresh of the overall macroeconomic picture and is a fundamental part of our top-down portfolio management process.

The most recent round of earnings data supports our view that excluding any major shocks, the Fed can remain patient and proceed carefully, growth can continue at a moderate pace, and markets will likely be characterized by sideways movement with small bouts of volatility.

In this vein, proper yield curve and duration management will be a core driver of risk-adjusted returns in 2024.

Let’s keep talking!

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Please consider the charges, risks, expenses, and investment objectives carefully before investing. Please see a prospectus, or, if available, a summary prospectus containing this and other information. Read it carefully before you invest or send money. Investing involves risk, including the possible loss of principal and fluctuation of value.

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