

Dear Clients,

It is both delightfully simple and genuinely compelling to be able to summarize the behavior of the equity markets, not only in the calendar year that just ended, but over the last two years.

In 2022, the Dow, the S&P 500, and the Nasdaq 100 experienced peak-to-trough declines of 21%, 25%, and 35%, respectively. A week before Christmas 2023, all three were in new high ground on a total return basis (including dividends).

Why stocks did this is irrelevant to the wonderful lessons to be drawn from this experience. There are almost as many theories and explanations of why as there are market commentators. We would point out, however, that the number of said commentators who successfully forecasted both the market action of 2022 and of 2023 is, to our knowledge, plus or minus zero.

What should matter most to us long-term, goal-focused, plan-driven equity investors is not *why* this happens, but *that* it happened. Specifically, that there could be a pervasive and very significant bear market over most of one year and that those declines could be entirely erased in the following year. Although it's not nearly as quick or perfectly symmetrical as the 2022-23 experience, *that's how it works*.

As always, then, we break our year-end letter into two parts: the timeless and enduring principles reinforced by these two years, and a consideration of current conditions.

General Principles

- The economy cannot be consistently forecast, nor the market consistently timed. We believe that the highest probability method of capturing equities' long-term return is to remain invested all the time.
- We are long-term owners of businesses as opposed to speculators on the near-term trend of stock prices.
- Declines in the mainstream equity market have always been surmounted, as America's most consistently successful companies ceaselessly innovate.
- Long-term investment success most reliably depends on planning and acting continuously on that plan.
- An investment policy based on anticipating (or reacting to) current economic, financial, or political events/trends most often fails in the long run.

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Current Commentary

- The long-term disruptions and distortions resulting from the COVID-19 pandemic are still working themselves out in the economy, the markets, and society itself in ways that can't be predicted, much less rendered into coherent investment policy.
- The central financial event in response to COVID-19 was a 40% explosion in the M2 money supply by the Federal Reserve. It predictably ignited a firestorm of inflation.
- To stamp out that inflation, the Fed then implemented the sharpest, fastest interest rate spike in its 110-year history. Both debt and equity markets cratered in response.
- Despite this, economic activity just about everywhere except in the housing sector has remained relatively robust; employment activity has been largely unaffected.
- Inflation has come down significantly, though not yet close to the Fed's 2% target. Prices for most goods and nearly all services remain elevated, straining middle-class budgets.
- Capital markets have recovered significantly as speculation now centers on when and how much the Fed may lower interest rates in 2024, and whether a recession may yet begin. These outcomes are unknowable—probably even to the Fed itself—and don't lend themselves to forming a rational long-term investment policy.
- Trends in the US federal deficit and the national debt continue to appear unsustainable. Social Security and Medicare appear to be on the path to eventual insolvency unless reformed. The serial debt ceiling crisis continues, and a bitterly partisan presidential election loom. The markets will face significant challenges in this new year, just as they do every year.

Our recommendations are essentially what they were two years ago and what they've always been. Let's revisit your most important long-term financial goals soon. If we find that those goals haven't changed, I'll recommend staying with our current plan. If our goals and plan aren't changing, there'll most probably be no compelling reason to materially alter your portfolio.

As always, we welcome your questions and comments, and look forward to talking with you soon. Thank you again for the opportunity to serve you and your family. It is an absolute privilege to do so.

Sincerely,

The Team at Black Balsam Wealth Advisors

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