

NEWSLETTER – DECEMBER 2023

MARKET TRENDS 12.31.23

Asset Class	3 Mo	1 Yr
Global Stocks		
MSCI World	11.6%	23.9%
US Stocks		
S&P 500	11.7%	26.3%
Large Cap Value	9.5%	11.3%
Large Cap Growth	14.2%	42.5%
Mid Cap	11.7%	16.4%
Small Cap	14.0%	16.8%
International Stocks		
Developed Markets	10.8%	18.1%
Emerging Markets	7.5%	8.9%
Fixed Income		
Taxable Bonds	6.7%	5.6%
Municipal Bonds	7.0%	5.9%
Alternatives		
EM Bonds	9.7%	10.6%
Floating Rate	1.6%	6.6%
Preferred	5.9%	9.7%
Gold	10.2%	13.3%
Real Estate	17.9%	11.9%

Source: Factset

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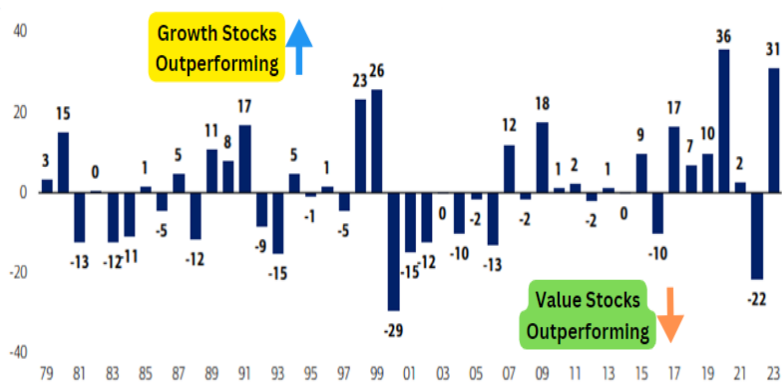
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What's the Mean We Haven't Reverted to Yet?

Despite horrible wars in the Middle East and Ukraine, U.S. equity markets charged forward with a powerful rally into year-end 2023. For much of the year, a handful of large growth stocks, aka "The Magnificent 7," have driven most of the returns in the equity market, with the NASDAQ and S&P 500 Index leading the way. Growth stocks have outperformed value (especially dividend payers) stocks by 31%, the second widest disparity of returns in the past 44 years.

Growth Stock Performance Minus Value Stock Performance



Source: BofA US Equity and Quantitative Strategy, Bloomberg

BofA GLOBAL RESEARCH

However, dividend payers and industrial stocks rallied in Q4 as measured by the Dow Jones Industrials Average (DJIA), which rose 13.1% during the fourth quarter. Despite this rally, value-oriented companies still trade at more reasonable valuations than large growth and technology stocks.

Style	Forward P/E		Div. Yield**	
	Current	Long-term avg.*	Current	Long-term avg.*
Value	14.9x	14.1x	2.4%	2.6%
Growth	26.5x	20.9x	0.8%	1.3%

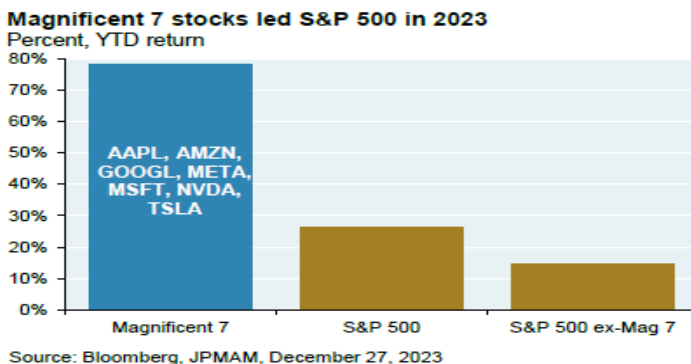
Figure 1- JPM Guide to The Markets

Bonds, which have struggled mightily due to the Fed's aggressive monetary tightening over the last couple of years, rallied violently as Fed Chair Jerome Powell announced that interest rate hikes were likely done, and that the coming year might bring as many as three interest rate cuts!

IDENTIFYING OPPORTUNITY. NAVIGATING RISK.

Bonds, as measured by the Bloomberg Aggregate Bond Index, rose 6.7% from October to year-end, pushing the index into positive territory, finishing the full year at +5.6%. The volatility in bonds has been unprecedented in our lifetime, if not in U.S. history. A reversion to the mean, a more stable, tempered credit market, would be a welcome trend in 2024 and years to come. But we will see!

However, it's important to remember that a handful of mega-cap names, such as NVIDIA, Meta, and Microsoft, drove the S&P 500 performance in 2023. And while most investors might see 20%+ returns and rejoice, the facts are that most stocks *underperformed* in 2023. 72% of S&P 500 stocks underperformed the index in 2023, the most since at least 2000. Will the stocks that have gone unloved and appear undervalued start to garner more buyers in 2024 as they did at the end of 2023? Will the tech stocks that have rallied take a breather in 2024? We never know, but valuation always matters eventually.



The Case for the 60/40 Portfolio – A Comeback or Did it Never Leave?

For the last 10-15 years, with such low yields on bonds, the financial press has often touted the "death of the 60/40 portfolio." Since so many individual investors have an asset allocation of about 60-70% in stocks with the remaining 30-40% in bonds, that headline catches attention, or eyeballs, as they say. However, these types of shock statements deal with generalities, spark more fear than they should, and are not reflective of reality as we see it here at Shorepoint, where we are managing through these types of market changes.

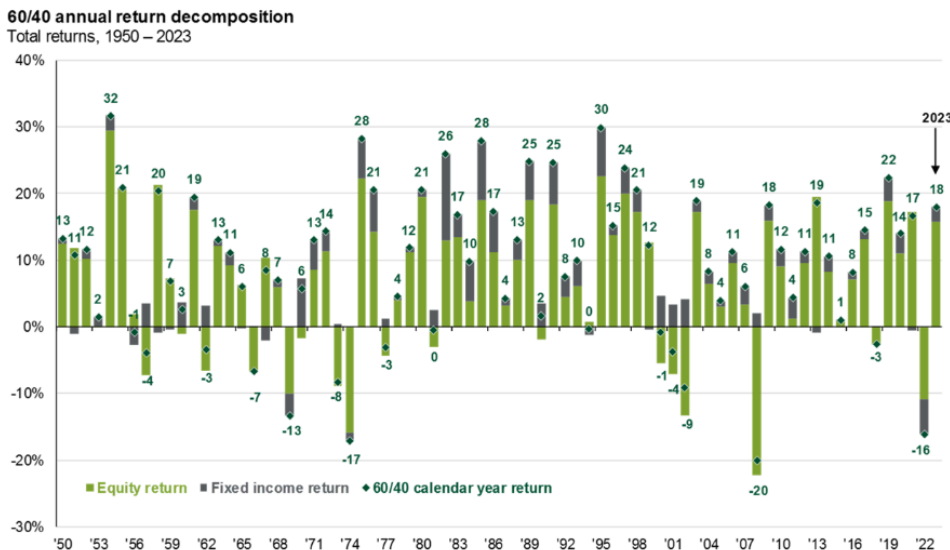
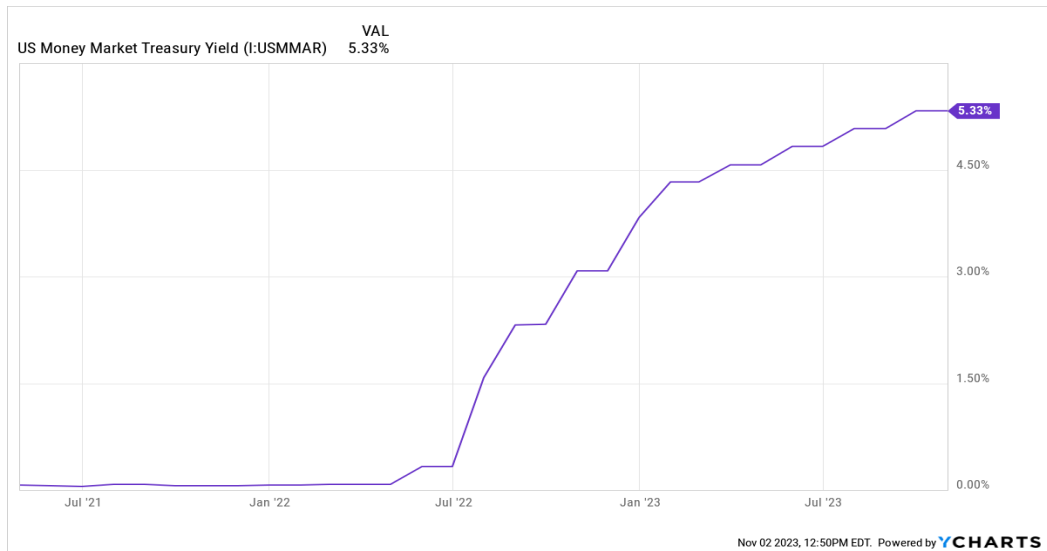


Figure 2- JPM Guide to The Markets

IDENTIFYING OPPORTUNITY. NAVIGATING RISK.

Let's look at an example, a case study from the recent past. If a moderately aggressive client in their 50s were retiring in 10-15 years, we might have their retirement assets at a target 65% equity allocation, with the remainder primarily in bonds.

From 2009 through 2021, money markets or "cash" were paying less than 1%, so we had very little of our client portfolios allocated there-maybe, 1-2%. On the bond side of the portfolio, our choices were either 1-2% yields on high-quality fixed income securities or accepting more risk on lower-quality bonds and/or longer-term income securities to earn better results in the 3-6% range.



We did a bit of both; we took on that risk and potentially higher volatility on the bond side of the portfolio, but we reduced it from 35% to 25-30%, which worked fine despite the narrative of pundits.

And that same client saw their equity allocation rise from 65% to 70-75%. We would have expected increased volatility with these moves we made in stocks and bonds. Still, with the Fed printing money and keeping interest rates extraordinarily low, volatility wasn't particularly bad, especially after the great financial crisis of 2007-2009, which set an agonizing bar for volatility.

Our point is that the 60/40 portfolio was not dead then and it is not dead now. It was still a sound, core framework for protecting and growing clients' assets. We modified our approach to find the lower-risk parts of the markets that could still earn competitive returns. However, the allocation framework that has worked for over a century was not repudiated.

So, What's the Latest on the 60/40 Portfolio? How's the 65% Client Allocated Now?

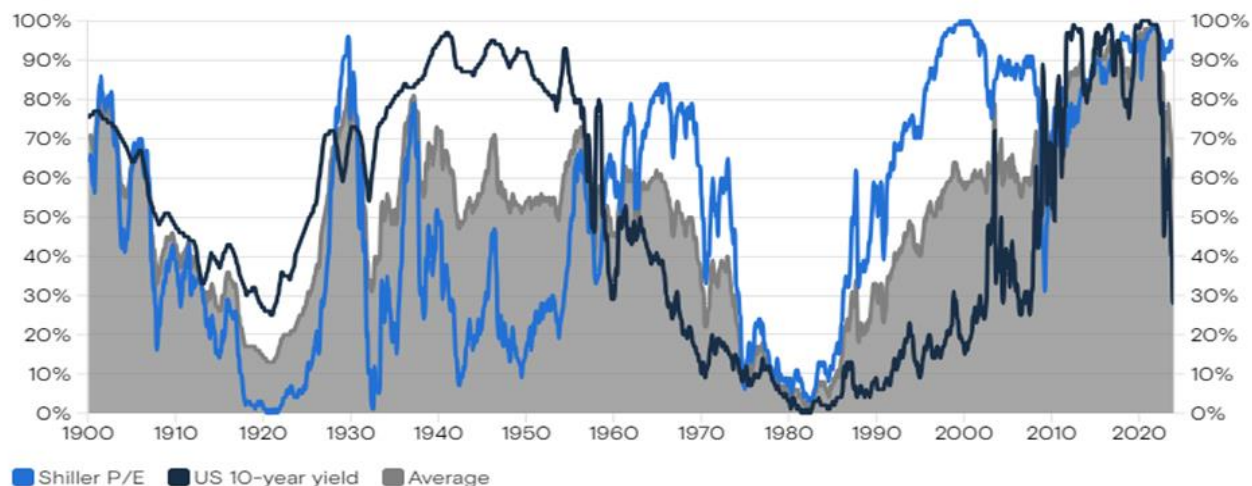
Let's fast forward with that same moderately aggressive client to 2021/2022. Shorepoint began decreasing our allocation to stocks. That same client equity exposure was reduced to an estimated 50% -60 % allocation to stocks. As interest rate hikes occurred, we could allocate more of the 40% to 50% side of the bond portfolio to cash. Most clients now have a 6% to 12% weighting in money markets, earning solid yields (3% - 5.2%) for the first time in over a decade.

IDENTIFYING OPPORTUNITY. NAVIGATING RISK.

At this time, bond yields were rising. They were selling off. Shorepoint was able to unwind and reduce the credit quality and duration risks we had taken over several years. We sold down some of those exposures and bought higher-quality and shorter-term bonds without sacrificing the yield our clients needed. We call that upgrading the portfolio.

While equities remain relatively expensive, bond yields are near their long-term average

Valuation percentile (since 1871); a higher percentile means valuations are more expensive



Source: Robert Shiller, Haver Analytics, Goldman Sachs Research

**Goldman
Sachs**

With bond yields reverting to historical norms, we are confident about the long-term future of our client portfolios. As the Fed begins to pause or even cut rates, we will look to trade out of cash and buy bonds over the next part of the Fed cycle.

While relatively high equity valuations may lead to below average equity returns, the bond side of portfolios offers better yields and potential capital appreciation when the Fed starts cutting rates. So, we are hopeful that portfolios will provide solid, lower volatility returns to our clients over the next few years.

Looking Ahead

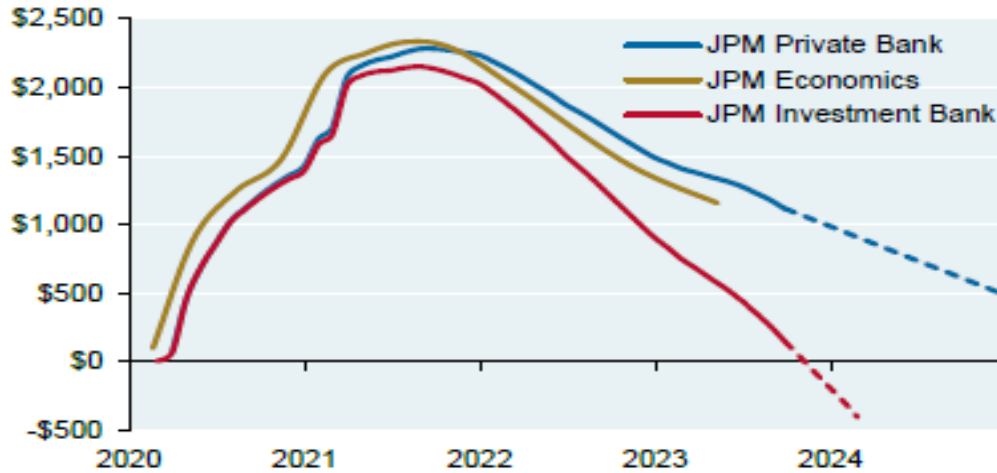
Throughout all of 2023, the market bucked a myriad of economic concerns, defying all expectations and putting thoughts of any probable recession in the rear-view mirror (for now). The key to the significant uptrend in stocks have revolved around the expectations that the Fed has finished hiking rates and that 2024 will represent a 'Goldilocks' scenario, in which rates come down significantly, inflation remains under control and earnings growth accelerates.

With so much bullishness in the current environment, stocks, especially technology and growth, seem priced for perfection. Consumers appear exhausted from the impacts of inflation and excess savings are now reaching a point which could eventually lead to slowing consumer spending in 2024.

IDENTIFYING OPPORTUNITY. NAVIGATING RISK.

Estimates of US household excess savings

US\$, billions

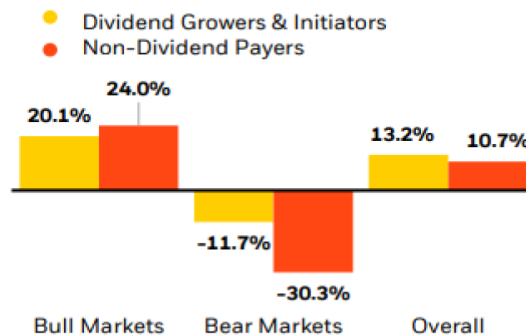


Source: J.P. Morgan, September 2023

We must be careful here and go where the puck isn't to butcher a Wayne Gretzky saying. That means being contrarian - focusing on opportunities in value and dividend-paying stocks and other stocks that have underperformed as well as stocks that are well-positioned to grow earnings and cashflow.

4. Dividend Payers have Weathered Diverse Market Conditions

Average returns from 12/31/78 – 12/31/22³

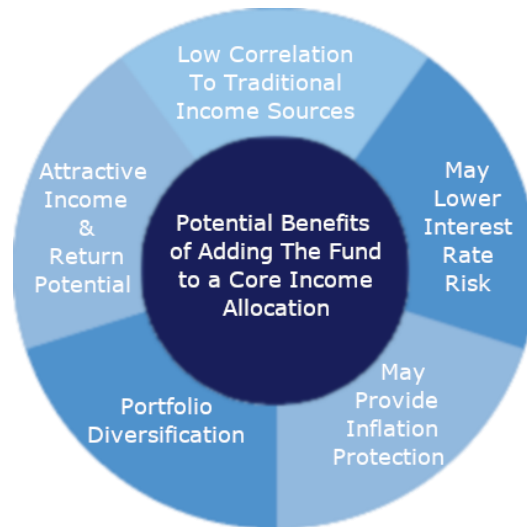


Source - Blackrock (Link)

There is clearly a path for continued appreciation in equities if the so called economic 'Soft Landing' holds true and inflation continues to decelerate to more normalized levels. However, after coming off such a growth driven outperformance in stocks, we are more comfortable primarily sticking to finding undervalued companies with durable cash flows, solid balance sheets, strong competitive positions, and consistent dividend growth that trade at attractive valuations.

Alternatives – Shorepoint Income Fund II, LP

We are launching our second private fund, Shorepoint Income Fund II, L.P., following the successful launch of our first private investment fund, Shorepoint Income Fund I LP, in 2019. While a 60/40 portfolio of stocks and bonds is a traditional means of diversifying your investments, adding an additional sleeve of alternative assets has been a good way to help further diversify a portfolio, reducing volatility, while adding to returns and providing an additional stream of income.



The Shorepoint Income II Fund is only appropriate for some investors, given the limited liquidity and income/net worth requirements; however, it is an attractive alternative for some investors. The Fund will have an allocation to private real estate, debt, and equity investments. We are available to discuss in detail the Fund and if this is appropriate for your situation.