CUMBERLAND
Private Wealth

December 31, 2023

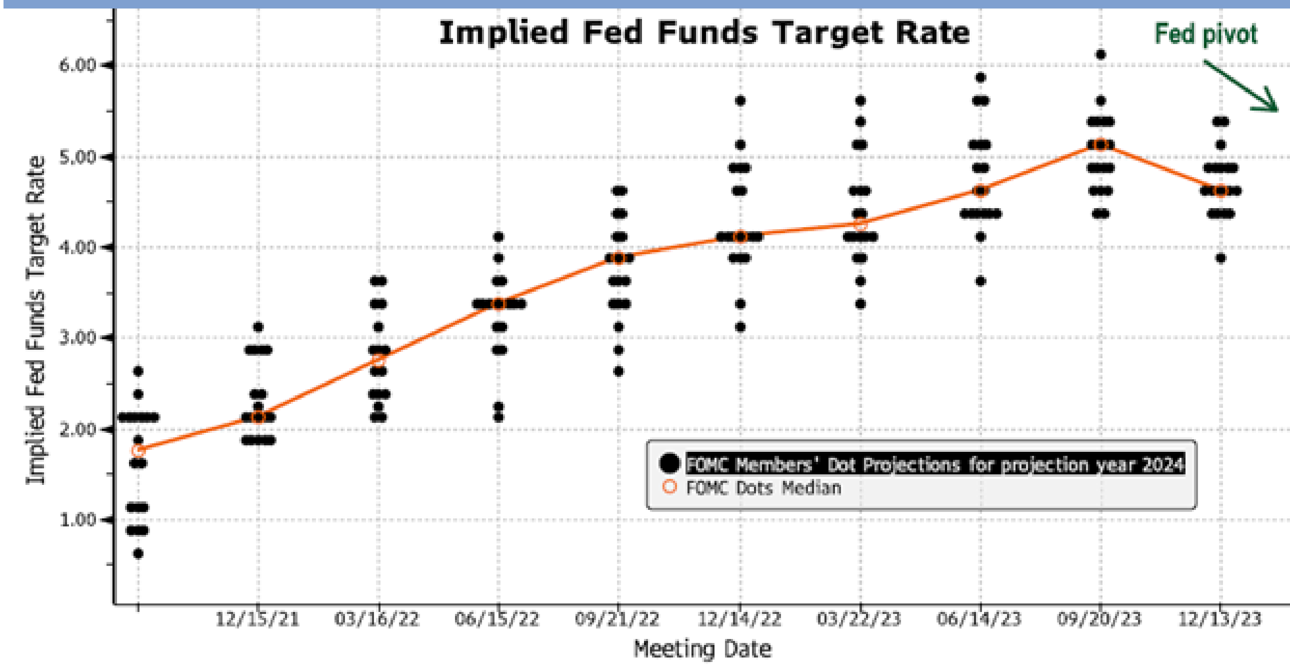
Fourth Quarter Review

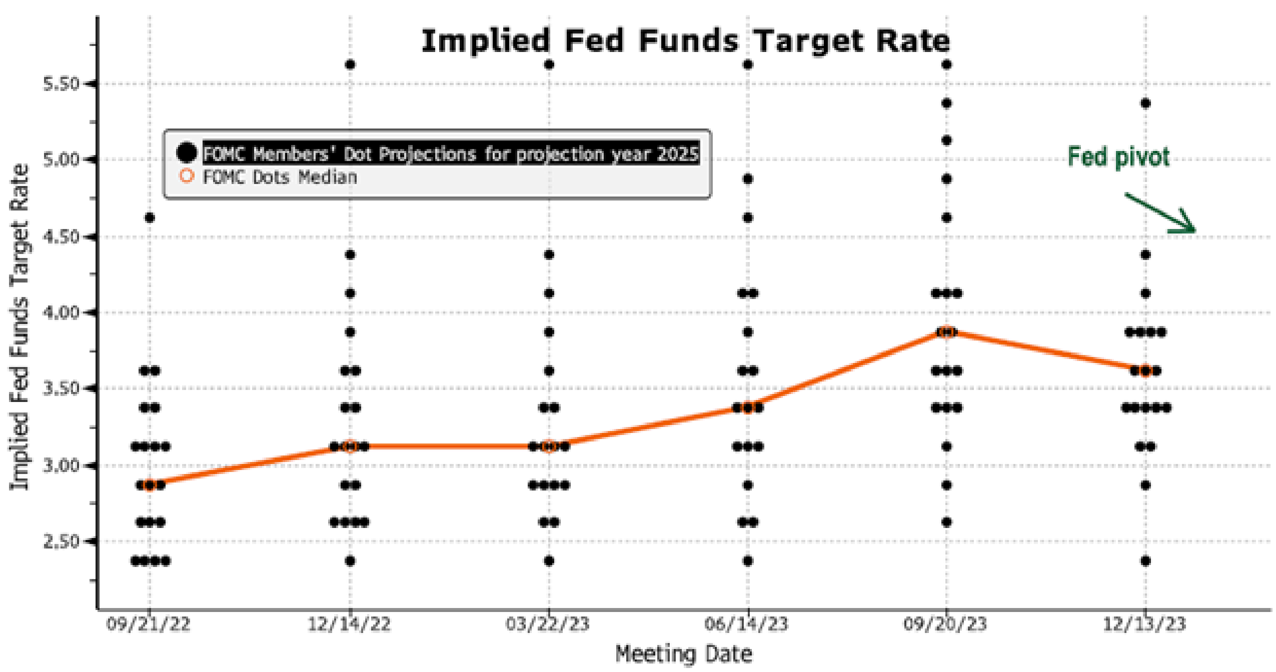
NORTH AMERICAN EQUITY STRATEGY

It seems like everyone in the investment world likes to use sports analogies to describe the current economic cycle and Federal Reserve Chairman Jerome Powell's actions, which recently happened to be a pivot, generally known in the markets as the "Fed Pivot". Team Powell has two coequal goals for monetary policy: those are maximum employment and low inflation. **Exhibit 1** shows the evolution of the Federal Funds target rate (dot plots) by Federal Reserve Board members and Bank presidents. What was indicated at the Fed's December meeting, and is confirmed in the charts below, was the "Fed Pivot". That is, they did not raise rates for a third consecutive meeting but more importantly, the median projection for the Fed Funds target rate was lowered for 2024 and 2025.

We interpret the December FOMC (Federal Open Market Committee) statement and subsequent press conference as bullish for equities and the US economy in general, primarily because there was an acknowledgement by the Fed that we are at or near the peak of the interest rate cycle, that further interest rate hikes are no longer their base case, and that they would not want to wait until inflation got to 2% to cut rates, for fear they would overshoot on restrictive policy and weigh on economic activity. The bottom line is that it looks like the Fed is now on the side of those who own stocks!

Exhibit 1: Evolution of Implied Fed Funds Target Rate (dot plots) for 2024 and 2025

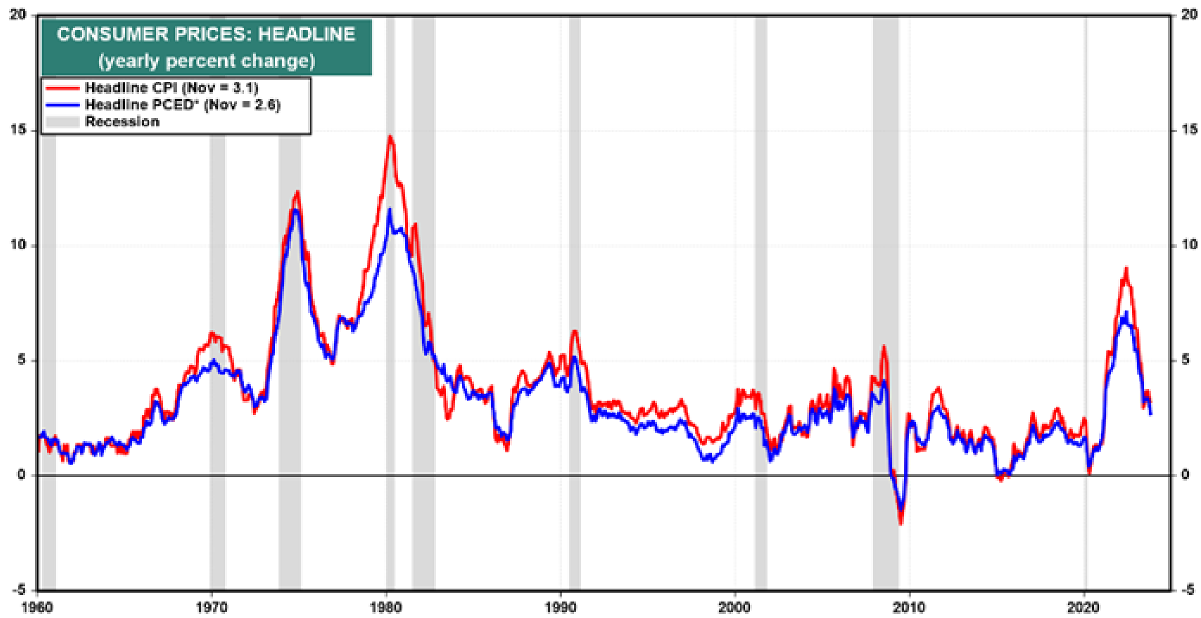




Source: Federal Open Market Committee (FOMC), Bloomberg

On December 22nd, the November PCE (Personal Consumption Expenditures) inflation data, which is the Fed's preferred measure of inflation, was released. It declined month over month for the first time in over three years. **Exhibit 2** shows both the latest PCE and CPI inflation data for November. With the PCE inflation still hovering at 2.6% year-over-year, it is not quite at the Fed's long-run target of 2% but moving in the right direction. If you combine this with the latest reading of the Atlanta Fed's GDPNow tracking model for Q4 GDP of 2.3%, inflation appears to be shifting from a headwind to a moderating tailwind without a recession.

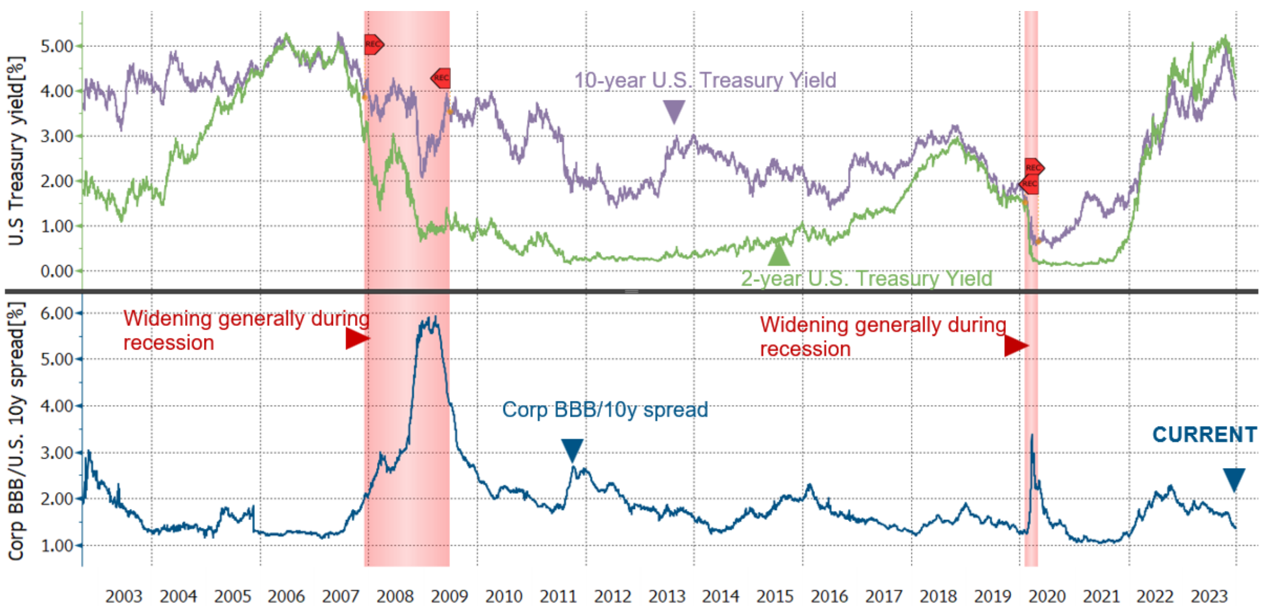
Exhibit 2: Inflation Headline CPI and PCE



Source: Yardeni Research | PCED = Personal Consumption Expenditures Deflator

The top clip in **Exhibit 3** shows the recent trend in 2 Year (green line) and 10 Year (purple line) Treasury yields, which are both are now falling. While declining long term (10 Year) Treasury yields can reflect many things including lower inflation expectations or even a potential recession, a declining 2-Year Treasury yield is likely a reflection of future Fed interest rate cuts. The bottom clip in the chart (blue line) shows investment grade or BBB bond credit spreads to Treasuries. Bond credit spreads, that is the yield required by investors for a corporate bond versus a "risk free" government bond, are often a good barometer of economic health - widening is bad and narrowing is good. The pink vertical bars represent the last two recessions. Note the credit spread widening during the previous two recessions is coincident with falling 2 Year and 10 Year treasuries yields. Today, with 2 and 10 Year Treasury yields falling, credit spreads are not widening. In fact, they narrowed this past month for both investment grade (BBB) and junk (High Yield) bonds, which is supportive of the economic soft-landing rather than a recession scenario.

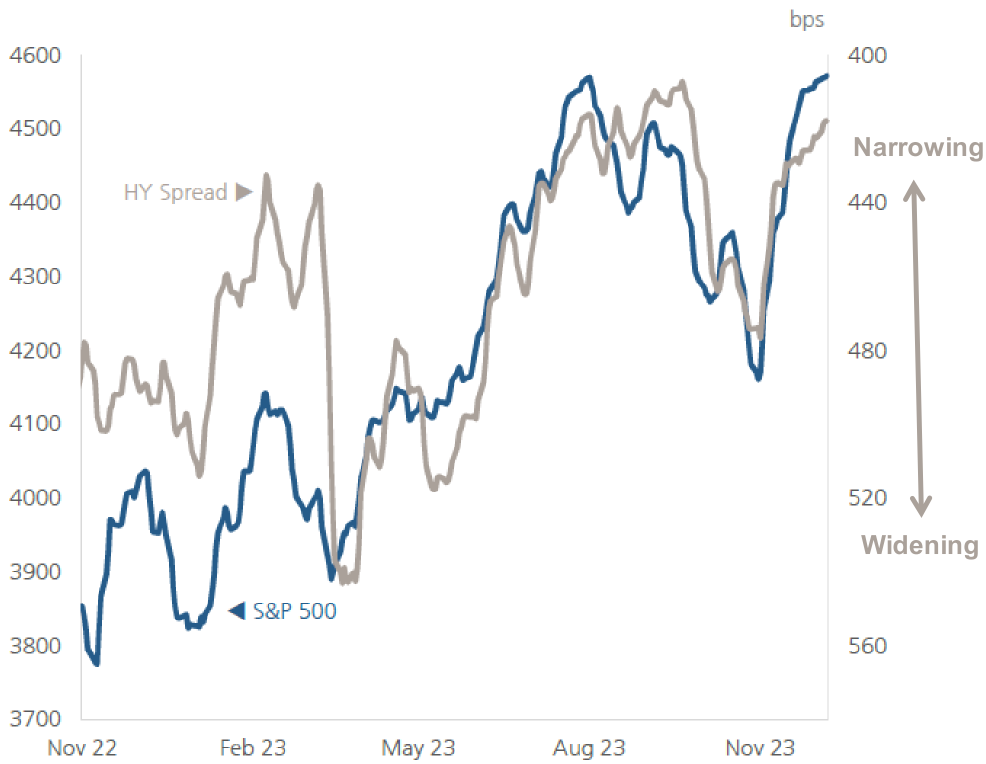
Exhibit 3: 2-year and 10-year U.S. Treasury Yield and Corporate BBB/10-year U.S. Treasury Spread



Source: Bloomberg

Exhibit 4 shows the relationship between high yield credit spreads (grey line) and stock prices using the S&P500 (blue line) as a proxy. The high yield credit spread axis is shown as inverted such that a rising line indicates spread narrowing. We discussed in **Exhibit 3** the idea that credit spread narrowing is supportive of an economic soft-landing especially when interest rates are falling, and **Exhibit 4** supports that notion, it is also positive for stocks!

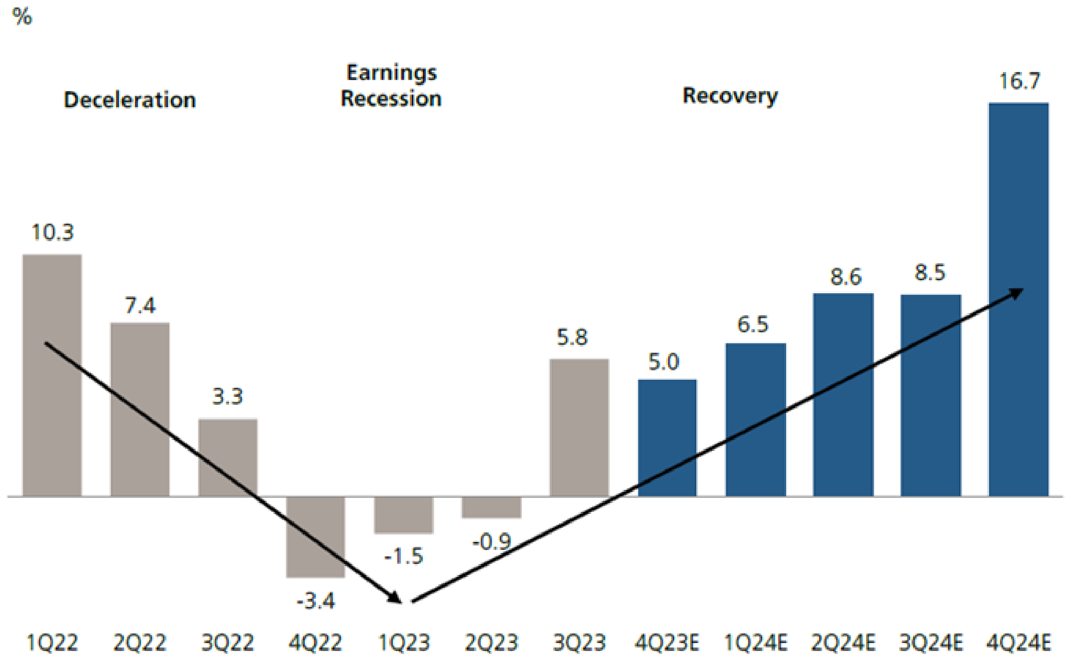
Exhibit 4: S&P 500 vs High Yield Spreads (Inverted)



Source: UBS, J. Golub, 12/12/2023

Another headwind that now appears to be shifting to a tailwind as we move into 2024 is S&P 500 US corporate earnings growth. **Exhibit 5** shows the progression of earnings growth through 2022, and into 2023 and the consensus estimated progression through 2024. As indicated in the chart, S&P 500 profit growth decelerated throughout 2022 (that is it grew but at a slower pace) and contracted (meaning earnings fell) from Q4 2022 to Q2 2023 before reversing this trend with growth of +5.8% in Q3 2023. While we await results for Q4 2023, it is also worth noting that the outlook for 2024 earnings growth is improving as well.

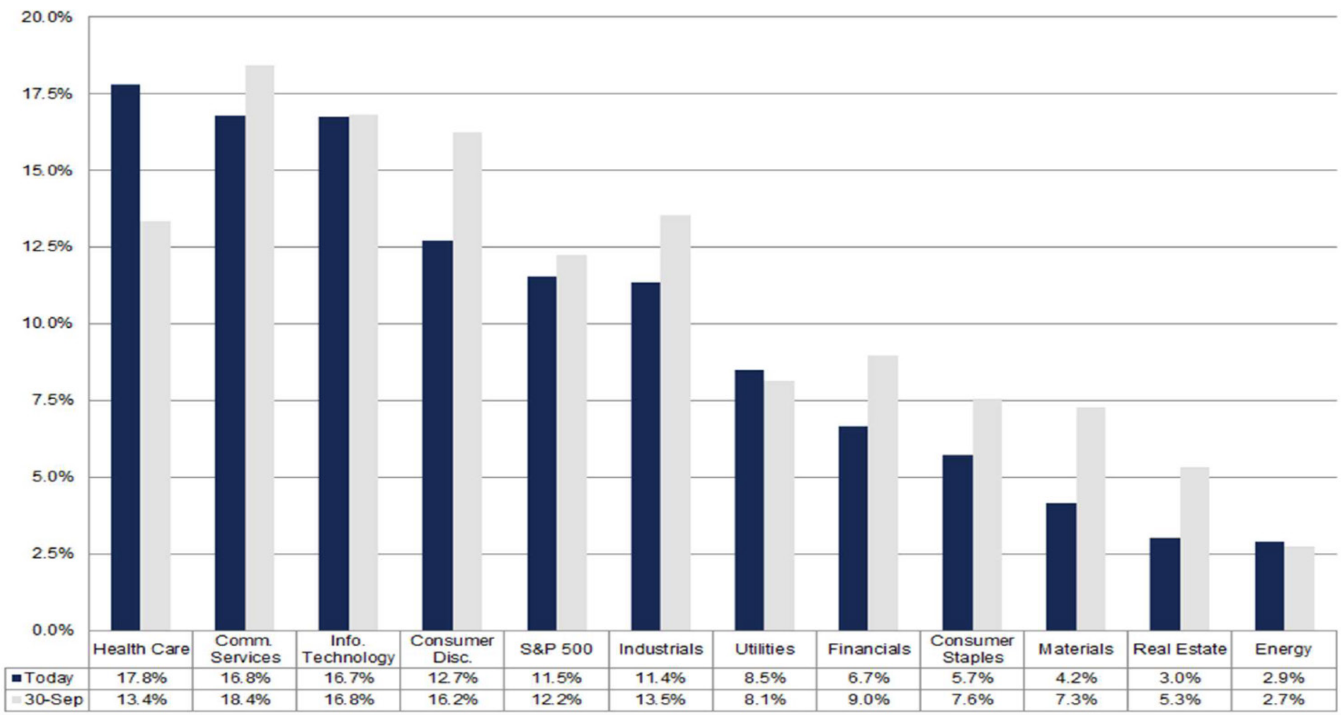
Exhibit 5: S&P 500 EPS Growth



Source: UBS, J. Golub, 12/18/2023

Exhibit 6 shows a breakdown of the consensus earnings growth by sector for 2024. While the Health Care, Communication Services and Information Technology sectors look quite dominant from an earnings growth perspective for 2024, the breadth of earnings growth is improving as all other eight sectors of the S&P500 are positive with 5 of the 8 sectors showing mid to high single- or double-digit earnings growth for 2024.

Exhibit 6: Calendar Year 2024 S&P 500 Earnings Growth

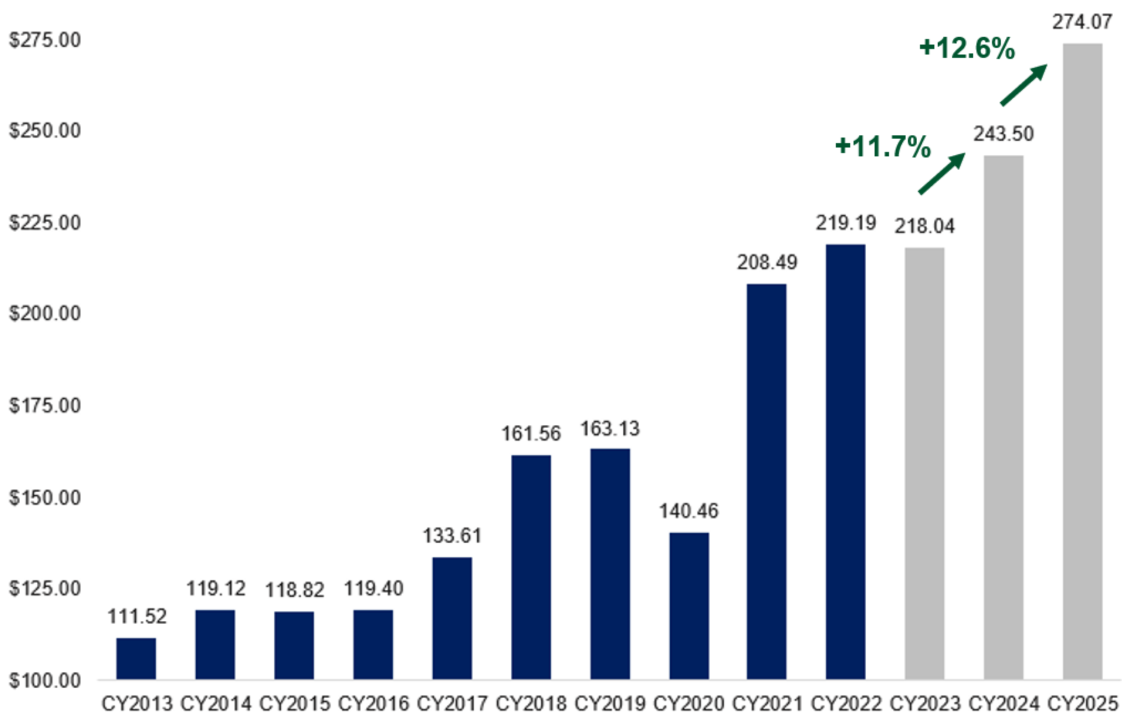


	Health Care	Comm. Services	Info. Technology	Consumer Disc.	S&P 500	Industrials	Utilities	Financials	Consumer Staples	Materials	Real Estate	Energy
Today	17.8%	16.8%	16.7%	12.7%	11.5%	11.4%	8.5%	6.7%	5.7%	4.2%	3.0%	2.9%
30-Sep	13.4%	18.4%	16.8%	16.2%	12.2%	13.5%	8.1%	9.0%	7.6%	7.3%	5.3%	2.7%

Source: FactSet Earnings Insights, 12/15/2023

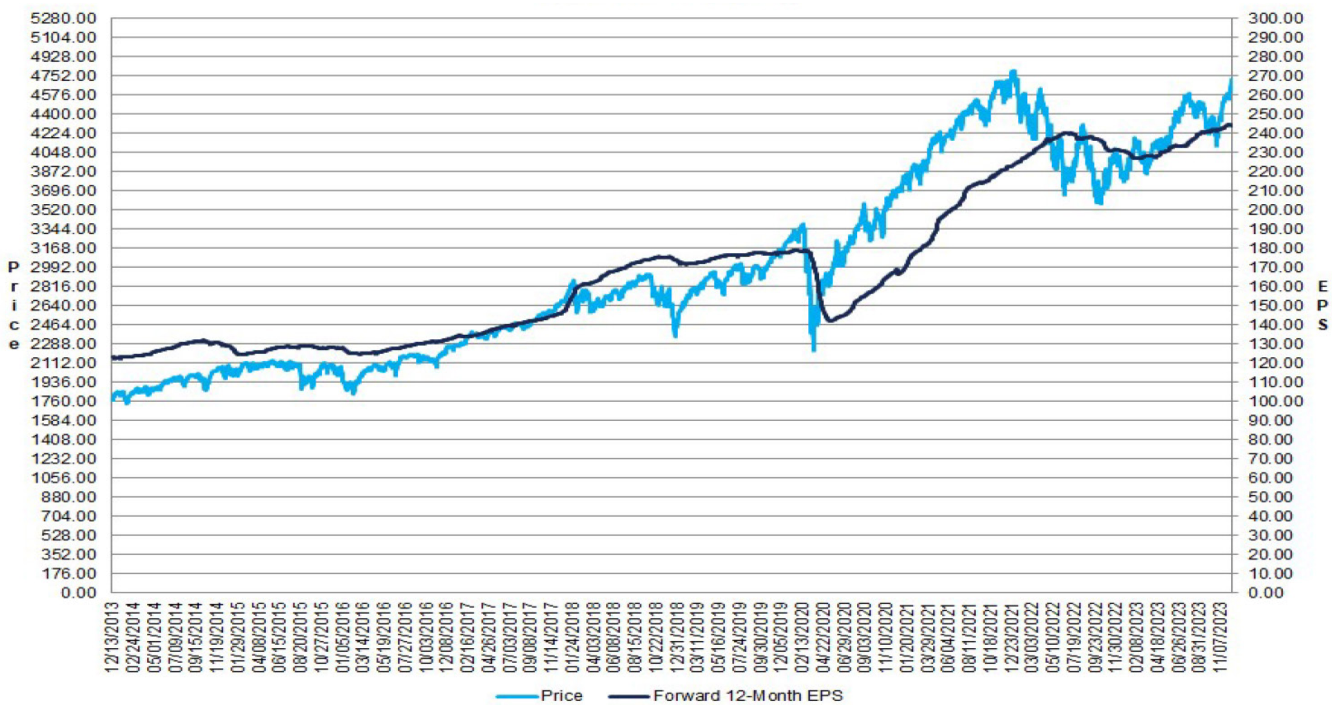
Exhibit 7 shows the market consensus earnings growth outlook for 2024 and 2025, which again look quite healthy. Consensus earnings growth for the S&P500 is up +11.7% for 2024 and +12.6% for 2025. **Exhibit 8** shows the long term relationship between the change in earnings and the change in stock prices using the S&P500 as a proxy. If earnings for the S&P500 do indeed continue to rise, then this too should provide positive momentum for stocks in 2024.

Exhibit 7: S&P 500 Calendar Year Bottom-Up EPS Actuals & Estimates



Source: FactSet

Exhibit 8: S&P 500 Change in Forward 12-Month EPS vs Change in Price



Source: FactSet Earnings Insights, 12/15/2023

Asset Allocation for our North American Equity Strategy As of December 31, 2023	
Equities	95%
Fixed Income	0%
Cash	5%

During the fourth quarter, the S&P500 total return was +11.7% in US dollars. Adjusting for currency, the S&P500 returned +8.9% in Canadian dollars, as the Canadian dollar appreciated about +1.6 cents, closing the quarter at US$0.7551. The TSX total return was +8.1% in the fourth quarter.

Our overall equity exposure increased marginally from 94% to 95% with cash declining from 6% to 5% and we remain essentially fully invested. Our US equity exposure increased from 42% to 47% while our Canadian exposure decreased from 52% to 48%. In the case of portfolios invested in our North American plus International Equity strategy, the actual weights of US and Canada within their equity holdings will be proportionately lower than this given the 20% allocation to international companies at this time.

During the quarter, we shifted our allocation in favour of US equities (+5%) over Canadian equities (-4%) with cash making up the difference. Canadian real GDP growth declined -1.1% annualized during the third quarter of 2023 and the latest report for October pointed to little rebound so far for the fourth quarter (+0.03% month over month versus consensus of +0.2%). The shorter duration of mortgages in Canada (5 Year being predominant) versus the US (30 Year being dominant) means that about 60% of all outstanding mortgages in Canada will come due over the next three years creating a further drag on the Canadian consumer as they refinance their mortgages at potentially much higher interest rates. While Canadian banks have most likely sufficiently reserved for any fallout from this, it will no doubt be a relative headwind here in Canada. It is also important to note that most of our Canadian holdings have international revenue, meaning our exposure to the economic environment in Canada is lower than indicated by where the companies are based.

During the quarter we added new positions in **Walmart Inc, Amazon.com Inc** and **Vertex Pharmaceuticals Inc**. In our view, **Walmart** wins in almost any economic environment. Consumers turn to Walmart during inflationary times to stretch their purchasing power. As inflation subsides, Walmart will likely lead in lowering prices, which should drive increased traffic and unit growth.

Amazon's two primary businesses are e-commerce and cloud computing. Prior to the pandemic, Amazon was only starting to become profitable. During the pandemic, Amazon had to invest heavily to overhaul its distribution network from a national to regional fulfillment model to keep up with the increased e-commerce demand as well as to move to same day Prime shopping. While this investment previously weighed on Amazon's profitability, we believe the bulk of the investment is over and the company will now benefit from higher profitability in this segment. This is potentially an inflection point for Amazon's earnings while the stock's valuation (price relative to earnings) has come down as earnings grow.

Vertex Pharmaceuticals has a global monopoly in cystic fibrosis treatments, which has led to industry leading sales and profitability, along with an exciting pipeline of other potential therapies, including a non-addictive pain treatment with potential to compete with opioids. A complete review of the business and fundamental outlook for new companies purchased during the quarter can be found in **Appendix 1.**

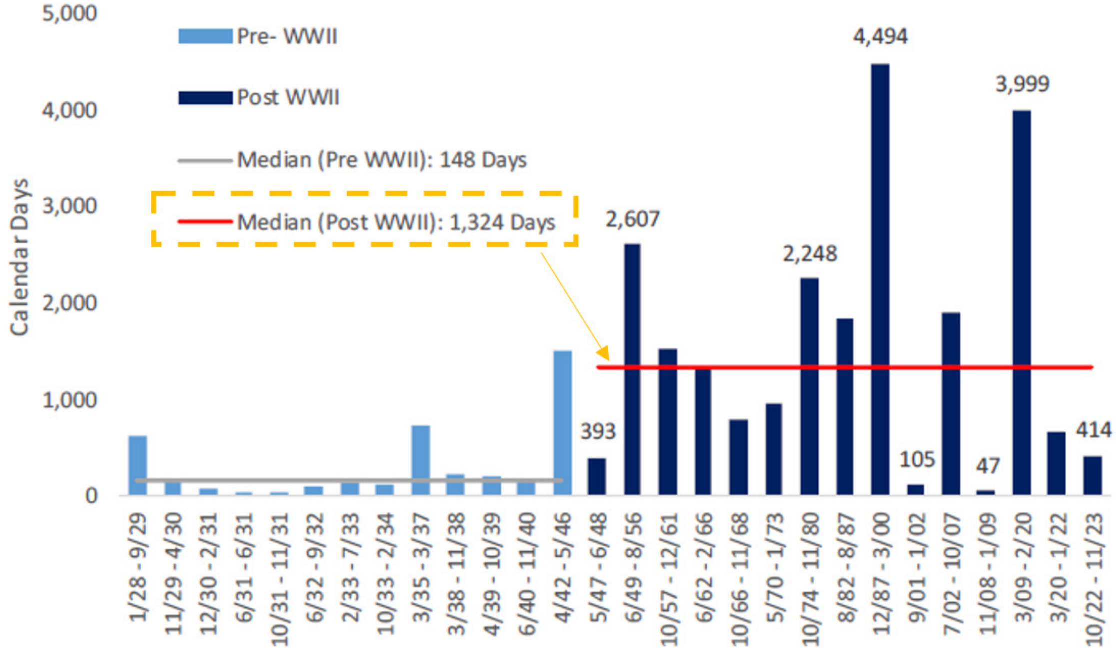
Closing Comments and Outlook

After the technical correction of -10.3% from the July 31st 2023 High, to the October 27th Low, the S&P500 has since increased by +15.9% as of December 31st and may be overbought in the near term. However, the shift made by the Fed earlier this month (the Fed Pivot) and the resultant decline in both short- and long-term interest rates, combined with the evolution from decelerating/contracting earnings growth to positive earnings growth looking forward, create positive tailwinds for the market looking out into 2024.

Exhibits 9 and 10 compare the length and strength of both pre-WWII and post WWII bull markets. Looking more specifically at the post WWII bull markets, historically the median length is 1324 days with a median gain of 86.4%. This compares to the current bull market length of 414 days and counting, running from the October 12th 2022 low to November 30th 2023, in which the S&P 500 was up 27.7%.

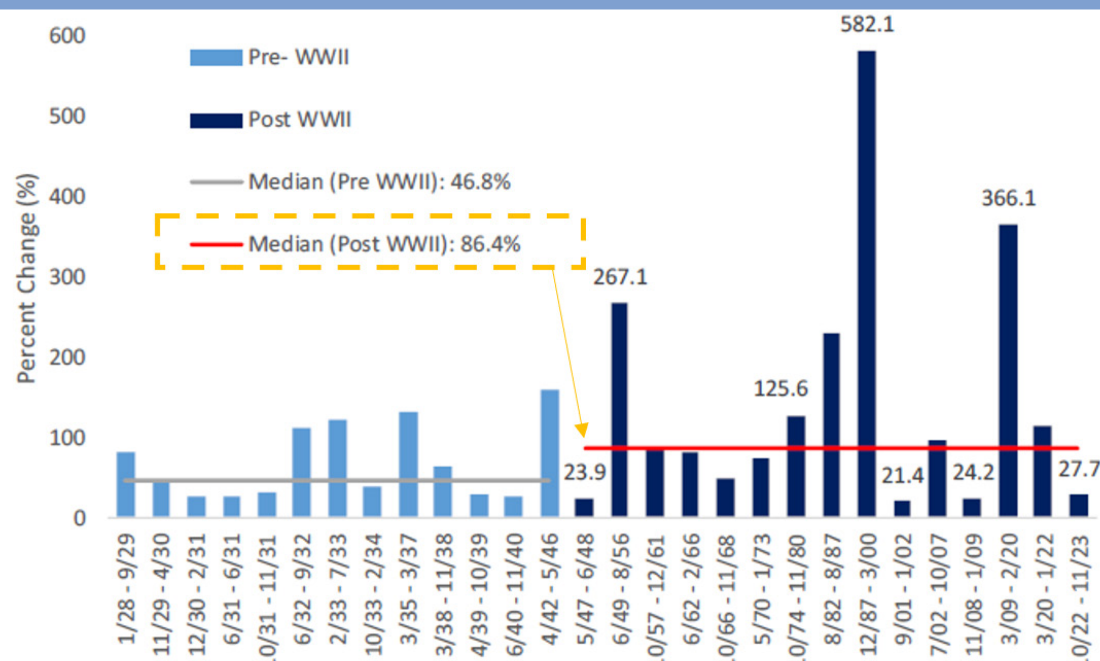
Comparing this bull market to previous post-WWII bull markets, according to Bespoke Investment Group (the author of the charts below), this one isn't even old enough for a mid-life crisis! Applying these median days and performance level of historical bull markets to the current period would translate into a target price on the S&P 500 of over 6,600 in May 2026 compared to the December 31st close of 4769, or a 38% return over the next couple years!

Exhibit 9: S&P 500 Bull Markets (Length) from 1928 to 2023



Source: Bespoke Investment Group, 12/22/2023

Exhibit 10: S&P Bull Markets (Strength) from 1928 to 2023



Source: Bespoke Investment Group, 12/22/2023

Looking more specifically at the next 12 months, **Exhibit 11** below summarizes the historical one year forward performance for the same post WWII bull markets, for those that lasted at least the length of this bull market or 414 days or more. For the 11 prior bull markets that lasted at least 414 days, the S&P 500's average gain over the next year was 11.25% (median: +13.21%).

Exhibit 11: S&P 500 Bull Markets Post World War II

			S&P 500 Performance %		
Start Date	End Date	Calendar Days	Entire Bull Market	First 414 Days	Next 12 Months
5/19/47	6/15/48	393	23.89		
6/13/49	8/2/56	2,607	267.08	32.99	24.92
10/22/57	12/12/61	1,512	86.35	37.15	10.40
6/26/62	2/9/66	1,324	79.78	35.84	15.96
10/7/66	11/29/68	784	48.05	28.28	13.21
5/26/70	1/11/73	961	73.53	43.20	7.12
10/3/74	11/28/80	2,248	125.63	43.75	13.84
8/12/82	8/25/87	1,839	228.81	62.15	0.02
12/4/87	3/24/00	4,494	582.15	28.01	18.32
9/21/01	1/4/02	105	21.40		
7/23/02	10/9/07	1,904	96.21	26.73	10.63
11/20/08	1/6/09	47	24.22		
3/9/09	2/19/20	3,999	400.52	74.97	14.53
3/23/20	1/3/22	651	114.38	85.58	-5.22
10/12/22	11/30/23	414	27.70	27.70	
Average		**1,552**	**146.65**	**43.86**	**11.25**
Median		**1,324**	**86.35**	**36.49**	**13.21**

Bull Markets That Lasted Less Than 414 Days

Source: Bespoke Investment Group, 12/22/2023

If history is any guide, it suggests that there might be more upside to the length and strength of this bull market. However, what we think is most compelling is the combination of falling interest rates on the back of better inflation prospects and a continuing robust economy with higher earnings growth expectations for both 2024 and 2025. Together they are a strong combination and tailwinds, which should not be ignored.

Peter Jackson
Chief Investment Officer
December 31, 2023

APPENDIX 1

NEW EQUITY INVESTMENTS:

NORTH AMERICAN EQUITY MANDATE

UNITED STATES

Walmart Inc.

Walmart is one of the world's largest retailers selling a diverse range of products including groceries, apparel, electronics, and household goods at low prices. In our view, Walmart wins in almost any economic environment. Consumers turn to Walmart during inflationary times to stretch their purchasing power. But as inflation subsides, Walmart will lead in lowering prices, which should drive increased traffic and unit growth. Over the last five years, Walmart has invested in store automation, logistics, e-commerce, and building its advertising business. The company is now at an inflection point where those investments will start to translate into higher profitability.

Amazon.com Inc.

Amazon is primarily two businesses. First, it's the world's leading e-commerce platform. In this business, Amazon has built a significant competitive advantage in its fulfillment network. Amazon is now shipping more products on its own network than UPS and FedEx combined. During the pandemic, Amazon had to invest heavily to overhaul its network from a national to regional fulfillment model to keep up with the increased e-commerce demand as well as to move to same day Prime shipping. We believe the bulk of the investment is over and the company will now benefit from increased profitability in this segment.

The second business is Amazon Web Services (AWS), their cloud computing segment, which currently drives much of the profitability. The market has been concerned about declining sales growth as customers have been optimizing their cloud spends over the course of 2023. In the last quarter, we saw AWS's growth rate stabilize at 12% and we expect growth to reaccelerate in coming quarters.

Vertex Pharmaceuticals Inc.

Vertex Pharmaceuticals is a biopharmaceutical company with a long history of successful innovation. Vertex has a global monopoly in cystic fibrosis treatments and has recently been approved for the world's first gene editing treatment for sickle cell disease. Additionally, Vertex is developing a non-addictive pain drug that has few side effects that can be used for both acute and neuropathic pain. While there is risk in clinical trials, we are optimistic that Vertex will be able to navigate this drug to approval given the positive efficacy and safety profiles demonstrated in two different Phase 2 trials and the great need to reduce dependency on opioids.