Market Update

4th Quarter 2023 Commentary and 2024 Outlook

Our Most Common Year-End Questions Answered

Rather than the usual annual review and forward outlook, we thought a direct Q&A style commentary might be more beneficial to clients and investment advisors. Feel free to send in any additional questions to clientservices@oakassociates.com for use in future commentaries.

Do you think the Federal Reserve will be investor friendly in 2024?

This is a trick question. The majority of the time, the Fed acts independent of the stock market and investors. It will monitor the stock market as yet another measure of economic confidence, but it is mostly concerned with creating slow and steady economic activity, low inflation, and a healthy job market. The volatile stock market is a leveraged barometer of these issues, but prone to being more emotional, and suffering from investment ADD.

That said, the current investment environment does look investor friendly. While interest rates are higher, the Fed has signaled that if inflation remains curtailed, it could lower interest rates throughout 2024. This would essentially remove the restrictive measures it put in place and free up bond yields to move lower over the medium term. The Fed deserves credit for successfully suppressing inflation without upending employment or producing a depression.

As far as the outlook for monetary policy is concerned, we will know more about Washington's contribution to the economy as we get closer to the November 2024 election and clarity over the parties' nominees' viability. However, it is unlikely either party will be able to enact policies that drive up the deficit given its massive increase over the past 6 years and the recent history of inflation.

Will the 2024 Presidential Election have an impact on the stock market?

The stock market is much more apolitical than most want to believe. The empirical evidence confirms that we have had good markets and bad markets under both political parties. While any one party may claim to be more pro-business, the actual results are more ambiguous and spurious. Occasionally, a bad economy produces change in Washington that simply coincides with the final stages of a bear market, making the next president seem like an economic genius. Or a robust economy overheats, prompting tighter policy from the Federal Reserve, thwarting both the stock market and a

politician's reelection prospects. At times, a divided Congress has been better for investors, while at other times, a fully functioning government has been beneficial. Given the ballooning deficits, the desire for fiscal austerity are building.

In general, the stock market is less concerned with which party is in power. Tax cuts can be stimulative, but so too is government spending, and both parties spend money and generate deficits. Overall, we believe a more important factor is what investment environment will be in effect over the next four years. The current backdrop is significantly more impacted by Fed policy and whether Washington is going to be restrictive or stimulative moving forward.

What macroeconomic data are we watching closely in 2024?

The unemployment rate is by far the most important metric for 2024 in our opinion. With the lag-time in monetary policy and cumulative effects of the Fed's tightening cycle still stalking the economy, we remain vigilant for companies looking to protect profit margins by reducing labor costs. This cycle however, employers may be more reluctant than usual to cut staff given the difficulty retaining workers during the tight labor market that followed the pandemic. Nevertheless, an uptick in unemployment can be an indicator that the economy is poised to contract.

The other important metric we are watching is the yield curve. An inverted yield curve is a generally a historic indicator of a recession, although its timing is less than helpful. More telling is when the ratio of 2yr-10yr yields un-inverts, or drops below 1. This tends to give a timelier warning that a recession is near.

If a recession is going to happen at some point, why not get defensive now?

There is always something to fear in the stock market. Being overly cautious or getting defensive too early is a great strategy to miss out on periods of strong returns. Therefore, we believe that it is better to be fully invested and participate in a rising market as much as possible, rather than lag the market and be right eventually. Trying to time the market can be very detrimental to wealth creation. The performance in 2023 is an opportune reminder of this. Despite a poor market in 2022 and the Fed aggressively raising interest rates, exiting the equity market out of fears of a deep recession would have missed out on a solid 26% gain this year, as seen by the S&P 500 Index.

Will Artificial Intelligence (AI) remain the driving force for the technology sector in 2024?

Artificial Intelligence propelled the tech sector in 2023, but tech trends often come with hype that vacillates overtime. In 2023, the public launch of ChatGPT raised awareness of AI and essentially instigated an arms race is semiconductor processing power. While we remain intrigued by the AI opportunity, we have seen many similar frenzies; from commercial scale digital printing, virtual reality / metaverse, cryptocurrency, telehealth, virtual assistants, autonomous driving, robotics, big data, quantum computing, and machine learning. AI is essentially the maturation of machine learning, big data and chatbots. Like other emerging tech opportunities, the mega-cap tech stocks

offer good optionality on AI success, while their core businesses support the deep pockets required until AI revenue develops. New companies will likely emerge as key AI players, but the path to success (and profitability) can be extremely challenging and the competitive landscape is significant.

Are the mega-cap stocks still attractive after a strong 2023?

The "Magnificent 7" mega-cap technology stocks lead the stock market in 2023 due to the combination of strong returns and large weightings in the major indexes. These are some of the largest companies in the world and their performance in 2023 was impressive, propelling US indexes higher, despite more lackluster performance elsewhere in the broader market. Supported by a growing hype over AI, perceived safety in size and their dominant market positions, these select mega-caps soared during the year. Note, this was the opposite in 2022, when they dropped sharply and hindered performance of the major indexes due to their weightings.

Whether wholesale outperformance will occur in 2024 is anyone's guess. We continue to like several of the Magnificent 7, but experience has taught us that outperformance can be followed by underperformance. It is also extremely unusual that the Top 5 or 10 names in the index outperform the rest of the 495 other stocks in the S&P 500. Knowing that size may become a limitation, we advise being selective amongst the mega-cap stocks.

As far as the fundamental characteristics of the mega-cap tech group, they remain extremely strong. Margins are generally best in class, their market position is enviable, and track records impressive. Valuations however, are stressed in some cases. We continue to own some of these massive wealth creators, but recognize that the margin for error is narrower after a period of outperformance and at higher valuations. As always, we will make changes to our exposure to reflect the change in risk factors as needed.

How is the consumer looking?

Higher interest rates are having the intended effect on slowing economic activity. The surge in mortgage rates is a pain point for home buyers. Despite these constraints, the consumer has weathered the tighter conditions rather well. Ultimately, a good job market and other consumer confidence building factors, such as rising home values and stock prices, still support a happy and healthy consumer. As long as the unemployment rate doesn't surge, the consumer should remain a reliable source to supports the economy. Certain data series do bear watching, such as credit card delinquencies and initial unemployment claims, but in our opinion, the majority of the consumer's impact on the economy is generated by the upper-tiers of the income spectrum that are less affected by these metrics.

In light of the 2023 regional banking crisis, is the sector investable yet?

The sharp rise in interest rates in 2022 created a crisis at some regional banks, which struggled with retaining deposits and maintaining capital requirements, depending on whether loans/assets were

carried at cost or at current market values on their balance sheet. The high-profile collapse of Silicon Valley Bank, Signature Bank and First Republic Bank prompted unprecedented actions by the FDIC to contain the crisis and reassure depositors to prevent additional ban runs. While the FDIC efforts appear to have calmed the turbulence, the Regional Bank EFT still lost 10.7% in 2023.

Similar to the process of grieving, with financials, time cures many wounds. Banks have stabilized deposits by offering better yields. Additional risk controls have been implemented and holes in balance sheets have been repaired. When your neighbor's house catches fire, all the other neighbors check to make sure their fire insurance is up to date. With sentiment now improved and balance sheet issues addressed, the regional bank stocks appear to have weathered the crisis. But with bank stocks, we have typically preferred the competitive advantages that come with size and a national presence.

Small-caps underperformed in 2023, is their outlook any brighter in 2024?

Small-cap stocks lagged their larger peers for several reasons in 2023. As mentioned, the Magnificent 7 soared and dragged the market-weighted indexes higher with them. Small-cap stocks are more levered to interest rates than their larger-cap peers due to higher interest expenses and refinancing risk. This is just one reason why we advocate a strong quality bias in small-cap stocks and warn the segment is littered with unprofitable business models.

During extended periods of near-zero interest rates over the past two decades, smaller companies benefited from cheap funding from venture capital and private equity firms, along with a tolerance towards time to profitability. As a result of the easy money era, the number of small-cap index members that fail to earn more than their cost of capital or which are unprofitable has surged. This does not mean there are not opportunities in the small-cap segment, simply that active management and a strong quality overlay are important. We believe the segment is an attractive contrarian investment, is littered with acquisition candidates, and offers a strong relative valuation argument.

You did not like Energy this year, has the outlook for Energy stocks changed?

We predicted Energy's underperformance this year based on demand issues in the global economy and falling inflation. We also concluded that after two consecutive years of 50%+ returns, the sector was likely to underperform. Additionally, with the demise in inflation and tighter monetary policy globally, the environment was not conducive to rising demand for oil. For 2024, this assessment has not changed that much. Certainly, the sector's aggressive return of capital has benefited investors, but without excess profits to distribute, this boost might also deteriorate. Turmoil in the Middle East or Russia can always shift the supply dynamic, but absent demand growth or inflation, we do not consider geopolitical events as an attractive long-term investment thesis.

Again, if any questions were missed in this update, please send in your questions and we will do our best to answer all of them.

Happy New Year and thank you for investing with Oak Associates!

Robert Stimpson,
CFA Co-Chief Investment Officer
Oak Associates, ltd.

To determine if the Oak Associates Funds are an appropriate investment for you, carefully consider each Fund's investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Fund's prospectus, which may be obtained from your investment representative or by calling 888.462.5386. Please read it carefully before you invest or send money.

IMPORTANT INFORMATION

The statements and opinions expressed are those of the author and do not represent the opinions of Oak Associates or Ultimus Fund Distributors, LLC. All information is historical and not indicative of future results and is subject to change. Readers should not assume that an investment in the securities mentioned was profitable or would be profitable in the future. This information is not a recommendation to buy or sell. This manager commentary represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice.

Past performance is no guarantee of future results. Investments are subject to market fluctuations, and a fund's share price can fall because of weakness in the broad market, a particular industry, or a specific holding. The investment return and principal value of an investment will fluctuate so that an Investor's shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. Click here for standardized performance.

The S&P 500 Index is a commonly-recognized, market capitalization-weighted index of 500 widely held equity securities, designed to measure broad U.S. equity performance. One cannot invest directly in an index.

CFA is a registered trademark of the CFA Institute.

Oak Associates Funds are distributed by Ultimus Funds Distributors, LLC (Member FINRA). Ultimus Fund Distributors, LLC and Oak Associates Funds are separate and unaffiliated.

17759008-UFD-01/08/2024