CHARTWELL INVESTMENT PARTNERS

Chartwell Strategies Current Outlook and Investment Strategy

Summary

- *Stock prices moved higher in Q4 as investors gained confidence that the interest rate hikes, orchestrated by the Federal Reserve Board (FRB) would not induce an economic recession.*

- *The rally in stock prices was not broad but continued to be led by several popular mega-cap companies which have come to be known as the "Magnificent Seven1." Although the DJIA and S&P 500 indices recorded all-time highs in the fourth quarter and or the New Year, other indices, such as the Dow Jones Transportation Average (DJTA) and the Russell small-cap indices lagged. The NASDAQ, despite an incredible annual performance (see next bullet point) remained below its all-time high registered in November 2021.*

- *Due to the exceptional performance of the Magnificent Seven, the NASAQ advanced a stunning 11.68% in Q4 and 44.70% for the year. The performance of these seven stocks distorted the performance of the DJIA and the S&P 500, as well. Although our Chartwell portfolios recorded solid gains for the year, they were unable to match that of the leading indices.*

- *From a technical standpoint, the equity markets remain in a secular bull market. Although many positive fundamental trends are occurring, such as a lower inflation rate, problems remain. A stronger performance by the broader market and less enthusiasm for stocks selling at lofty valuations would be reassuring.*

"I walk firmer and more secure uphill than down."

-Michel de Montaigne,

Philosopher, 1533 – 1592

Background

The secular bull market that emerged from the depths of the COVID 19 pandemic in 2020 reasserted itself in the final quarter of 2023. After declining slightly in Q3, the belief that short-term interest rates were peaking filled investors with confidence that the Federal Reserve Board (FRB) has been able to tame inflation without inducing a recession. Therefore, in Q4, the Dow Jones Industrial Average (DJIA), Standard and Poor's 500 (S&P 500), NASDAQ, and Russell 2000 rose 13.09%, 11.68%, 13.84%, and 14.02%, respectively.

The equity markets did well for the twelve-month period as well. For the year, the DJIA, S&P 500, NASDAQ, and Russell 2000 rose 16.18%, 26.26%, 44.70%, and 16.88%, respectively.

Interestingly, the DJIA reached all-time highs in the fourth quarter, as did the S&P 500 in January, however the NASDAQ, despite its spectacular performance this past year, remains below its all-time high set in November 2021. In fact, although the equity markets have performed well, the advance has not been broad and homogeneous. For example, the Russell 2000 and the Russell 2000 Value Indices have also failed to make new all-time highs. The Dow Jones Transportation Average (DJTA), discussed below, has also been a laggard.

Clearly, this bull market has been dominated by the performance of seven stocks that have come to be called the "Magnificent Seven," Alphabet (Google), Amazon, Apple Computer, Meta (FaceBook), Microsoft, Nvidia and Tesla. These seven issues have had a disproportionate effect upon the performance of the S&P 500, NASDAQ, and to a lesser extent, the DJIA, due to their massive market capitalizations. In the case of the NASDAQ Index, there are 3,418 stocks listed, which have a total market capitalization of $25.56 trillion as of this writing. However, the market capitalization of the Magnificent Seven is more than half of that figure, $13.10 trillion.

In 2023 the NASDAQ appreciated approximately $7.50 trillion; however, the Magnificent Seven stocks appreciated about $5.18 trillion. If the NASDAQ were an equally weighted index, it would have appreciated about 23% as compared to the reported figure of 44.7%.

The situation is not unlike that of the late 1990's, when Alan Greenspan, then head of the FRB commented that stocks in the high technology sector were in a state of "irrational exuberance." In April 2000 the NASDAQ reached a high of 5,132 before plunging to 1,108 in November 2002, a decline of over 78%. It took thirteen years for the NASDAQ to fully recover from its fall, but it has now tripled in price from the heady period of the late 1990's!

[1] *Magnificent Seven- Alphabet (Google), Amazon, Apple Inc., Meta (FaceBook), Microsoft, Nvidia, and Tesla.*

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A bullish position has been warranted ever since the stock market began its rise after the large drop induced by pandemic fears in February and March of 2020. One of the reasons for our optimism has been the cohesive performance of the DJIA coupled with that of the DJTA. The Dow Theory, formulated a long time ago by Charles Dow, still maintains relevance in today's world. The theory maintains that the major stock market trend is determined by the direction of both the DJIA and DJTA, assuming that they are moving in the same direction. When one of the senior averages deviates from the other, failing to "confirm" the action of the other, then a change in the major trend could be occurring.

Until recently, as shown in Figure 1 below, the DJIA and the DJTA have been "in gear." However, now the DJTA has begun to lag the DJIA. The DJIA contains AAPL, IBM, Intel, and Microsoft, four popular stocks that have performed well in past months, helping to propel the average to new highs this year. However, the DJTA has not been able to make a new high, which is a cautionary signal. An examination of the DJTA shows that the airline industry, specifically, American Airlines, Delta Airlines, JetBlue, and Southwest Airlines are holding this index back. From a "technical" standpoint, it would be reassuring to have the DJTA advance to a new high, thus confirming the action of the DJIA and our belief that the markets' secular trend is "up."

Similarly, a broadening of the market to enable the Russell 2000 to attain all-time highs would add to the credentials of this bull market.
From a fundamental standpoint, perhaps the most important thing to highlight is that Q4 earnings have exceeded expectations as most corporations have adjusted to the inflationary environment by raising prices and lowering expenses, where possible.

THE PERFORMANCE OF THE DJIA AND THE DJTA OVER THE PAST FOUR YEARS

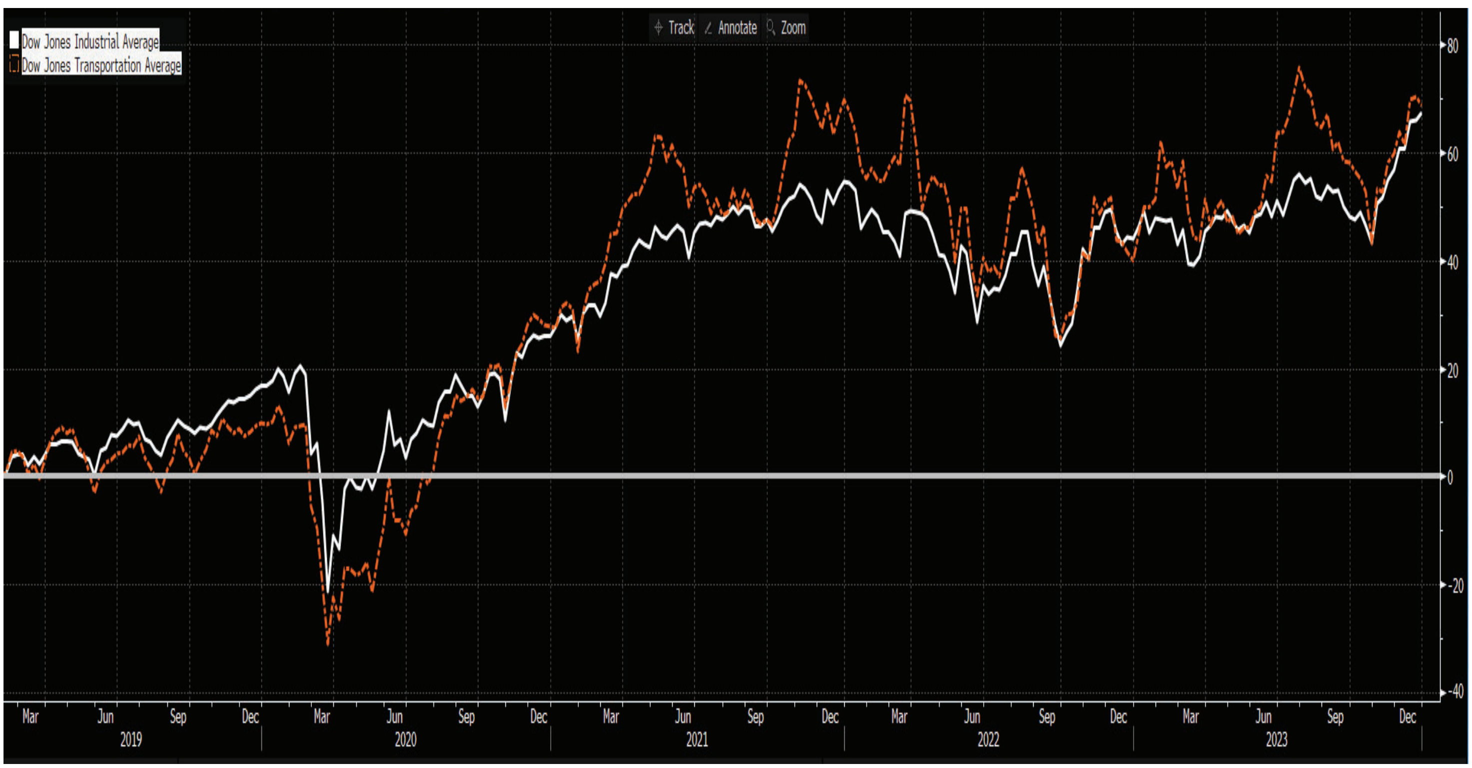

Figure 1. In Recent Months, the DJTA has Failed to Confirm the Primary Bullish Trend.
Source: Bloomberg

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Chartwell News

We hope everyone had a healthy and happy holiday! As we start 2024, we wish everyone the best for the coming year. A letter was sent out in November announcing Mike Magee's departure from Chartwell, Pete Schofield's pending retirement at the end of 2024, and Mark Tindall's assumption of the management of the portfolios in 2024. We have reached out to many of you (as we work through the list) to invite you to participate in calls with us, so that we can provide more detail on the transition from Pete to Mark, along with Mark's plans for the positioning of your portfolios. If we have missed you, please let us know so that we can set up a call (or visit). Melissa Haupt (610.407.4859) or Rebecca Johnson (610.786.4945) would be happy to schedule a time.

Additionally, we wanted to make you aware that Bob Killen has decided to retire from Chartwell (effective as of this writing). We are grateful to him for all his guidance and wisdom during the years that he was part of the firm. We wish him all the best in retirement.

For our retirement clients that must take a Required Minimum Distribution ("RMD"), please be sure to update your RMD distribution amounts with the new calendar year. We thank you for the continued confidence you've placed in Chartwell Investments. As always, please do not hesitate to call your Chartwell Investment Team; Pete Schofield (610.407.4858) or Mark Tindall (610.407.4835).

Dow Jones Industrial Average: The DJIA or "The Dow" is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The Nasdaq Composite Index is the market capitalization-weighted index of more than 2,500 common equities listed on the Nasdaq stock exchange.

S&P 500® Index: (registered trademark of The McGraw-Hill Companies, Inc.) is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.

Indicies are unmanaged and have no expenses. Investors cannot invest directly in an Index.

Past performance is no guarantee of future performance. Investment involves a risk of loss.

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