HAVERFORD

QUALITY INVESTING

2024

Haverford Annual Economic Outlook

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As of 1/10/24

As we stand at the threshold of a new year, one that may very well be the first "normal" year since the onset of the COVID-19 pandemic, I am reminded of a powerful insight from Morgan Housel, one of my favorite authors. In his latest book, Housel emphasizes that "it's impossible to plan for what you can't imagine."

It's a sentiment that holds true at Haverford, though we take it a step further, believing that successfully imagining what the future may hold begins with a reflection on where we are today. Entering 2024, I can unequivocally say that Haverford Trust's commitment to our Quality Investing Philosophy and our investments in our people, process, and portfolios position us better than ever to help our clients continue to build long-term financial futures.

Notably, 2023 marked a year of leadership transition for Haverford, with Keith Aleardi joining us as president. With a shared vision, Keith's addition has been seamless for our team members, clients, and partners. Speaking of team members, as I've said before, our investments in our people continue to pay dividends.

Our team now comprises

138 people

By focusing on recruiting team members who build on our strengths—as opposed to replicating them—we've created a culture where innovation, passion, and a dedication to helping others achieve their goals thrives.

Our commitment to excellence is underscored by our client and employee retention rates, both of which are considerably higher than the financial services industry average.

97%

Client retention rate

98%

Employee retention rate

We are incredibly proud of our team's charitable commitments. Through our Haverford Cares initiatives and philanthropic efforts,

We have supported

231 organizations

Donated over

$850,000

We have longstanding relationships with many of these organizations, including our mentoring and internship partnership with Cristo Rey Philadelphia High School. In 2023, we deepened this partnership, committing to hosting a former Cristo Rey student for a paid college internship each summer.

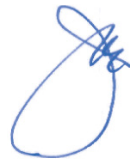
Looking ahead, we have exciting technology initiatives rolling out in 2024. We will be launching a new portfolio accounting system, the award-winning Orion platform, which will help us deliver an enhanced digital investing experience. We will also launch a new HaverfordQuality.com website, designed to keep you informed and educated about Haverford happenings and perspectives.

When it comes to the markets, the 2023 stock market gains were dominated by a very narrow group of mega-cap stocks, many of which benefited from a lot of hype around artificial intelligence (AI). While rare, we have seen these highly unusual years before. As in prior periods when so much of Wall Street was concentrated in just a handful of stocks, such as 1999, we are confident that these periods won't last forever. They often come to an end due to exogenous events. Inflections in Fed policy, such as what we are seeing now, have brought about these types of shifts in the past. Increasing clarity around Fed policy should provide greater investor confidence and could be the catalyst to broaden the stock market rally.

Over our more than 40-year history, we have found time and again that it doesn't pay to chase hype. We stay disciplined and true to our commitment to Quality Investing. We buy businesses with strong balance sheets and great management teams. They have passed our stringent quality screens and grow their earnings and dividends. These disciplines have enabled us to weather many challenging periods, including six recessions since the firm was founded in 1979. And throughout all of it, they have allowed us to stay true to our most important goal: to grow, preserve, and protect our clients' wealth. Because as history has taught us, consistency, commitment, and conviction aren't trends. They're timeless.

We are honored you have chosen us as your financial partner, and we remain ever-committed to you and your family. Entering 2024, our team stands ready to support you and guide you on your financial journey. We wish you and your loved ones a happy and healthy New Year!

Sincerely,



JOSEPH J. MCLAUGHLIN, JR.
Chairman & CEO
The Haverford Trust Company

2023 REVIEW

The primary theme of our outlook for 2023, the most predicted recession may be a benign recession, proved too pessimistic. A much-anticipated recession in 2023 never materialized as economic growth accelerated into the third quarter of the year.

In our 2023 Outlook, we were positive on consumer spending and job market strength. However, we underestimated consumers' ability to absorb higher prices and the Fed's capacity to achieve immaculate disinflation—that is, lower inflation numbers and wage growth without destroying jobs. As we anticipated, the Fed Funds rate peaked at more than 5% and was not cut during 2023. The end of quantitative easing in early 2022 resulted in more volatile bond markets.

While we anticipated that 2023 would likely bring slower growth, but better markets, we were optimistic that historical precedent would repeat:

- Markets usually post strong returns following midterm elections. This coincides with the third year of a presidential cycle.
- Markets rarely post back-to-back negative annual returns.
- Returns are often positive 12 months from the beginning of a bear market.

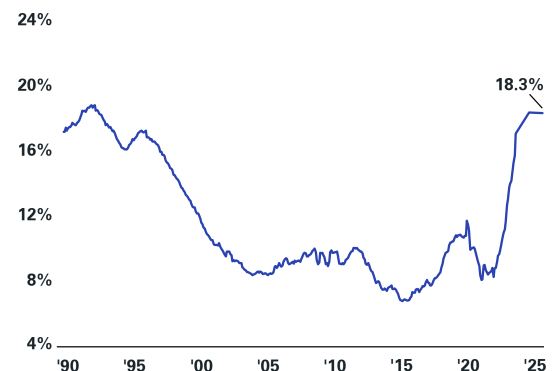
Unfortunately, our expectation that diversification would finally work fell short. While the S&P 500 advanced 26% including dividends in 2023, beneath the surface returns were not as rosy. The equal weighted S&P 500 advanced only 14% and 2023 ranks among the narrowest bull markets in history with the top 10 stocks accounting for 63% of the index's return.

As we look to 2024, we expect to see the following themes develop.

Markets' and investors' focus will shift from the monetary to fiscal policy.

Investors' fixation on every utterance from an Federal Open Market Committee (FOMC) member has been well warranted. Rising interest rates and quantitative tightening have resulted in significant asset price volatility during the past two years. Future shifts in central bank policy will continue to have critical implications for markets, but we believe a shift in focus toward fiscal policy could come in 2024.

US Government Net Interest Expenses, as % of Tax Revenue
(1990-2022 actual, 2023-2025 projected)



Source: Strategas, Congressional Budget Office projections, Sept 2023

The federal government is currently operating at a $2 trillion fiscal deficit, which is more than 6% of the GDP and most likely unsustainable in the long term. Historically, budget deficits of this magnitude are incurred in response to severe economic weakness or a major war footing. In addition, higher interest rates have brought increased financing costs. Interest expense has grown to over 15% of tax revenue and is forecasted to continue to rise to over 18% in 2025. Additionally, inflationary pressures stemming from fiscal policy could provide further complications for the Fed.

The country's budget is different from a household budget. Running deficits for decades is possible, and so far, there have been no consequences to increased government spending. However, that doesn't mean that at some point there won't be a call for accountability and an increase in fiscal discipline. An election year could bring increased scrutiny on government spending, but it will more likely come from bond market participants who will have to absorb the increasing supply of Treasury debt. As a result, longer-term interest rates may not decline as much as expected once the FOMC begins to lower rates.

The Fed was late to the inflation-fighting party and will likely stay past last call.

By all indications, inflation data is moving in the right direction. The November 2023 Consumer Price Index (CPI) report showed prices have increased 3.1% year over year while month over month, core inflation is running at a 3.3% annualized rate. We believe the rate of change in the CPI may continue to fall next year; the housing component of prices, which is a backward-looking measure, is set to put downward pressure on the index

during the first half of 2024. Inflation readings at or below current levels will continue to support the Fed's current decision to keep rates where they are, with a bias toward several rate cuts in 2024.

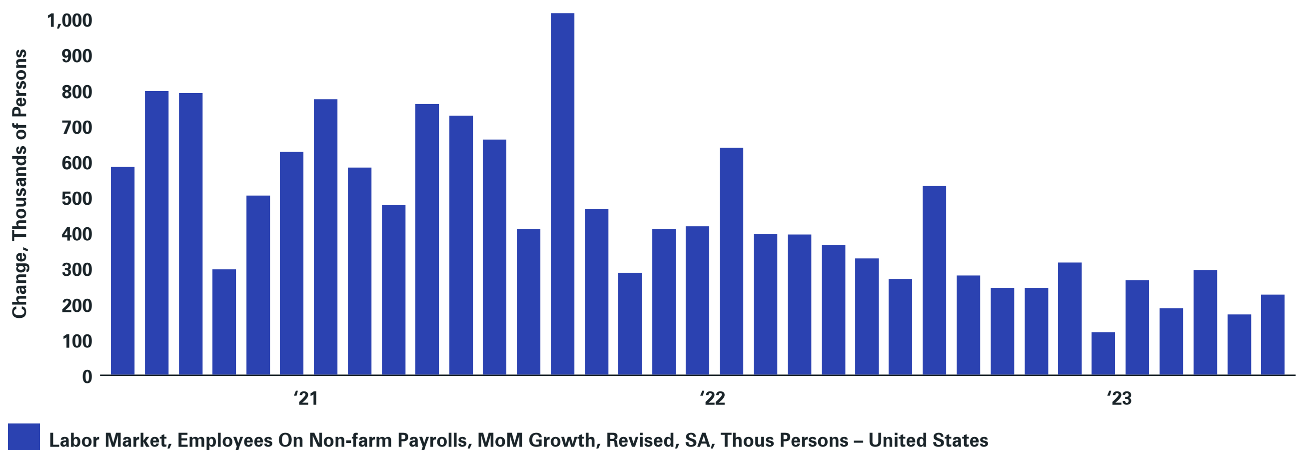
However, with an unemployment rate below 4%, the FOMC feels very little pressure to move too quickly to lower rates. If signs of a weakening labor market begin to appear in 2024 and inflation continues its current course, we believe the Fed will enact two or three 25-basis-point cuts as it seeks to balance the risks of economic growth and price stability.

The typical length of an FOMC pause has been about eight months, which equates to a projected March 2024 rate cut. As of the end of December 2023, the futures market expected 80% odds of a 25-basis-point cut at the March 20 meeting, and nearly 125-basis-point cuts by year-end 2024. We are doubtful this magnitude of cuts will occur, but if they do, we believe they would likely be in response to much softer economic growth.

Consumers will continue to spend as "higher for longer" takes on a new meaning.

Higher for longer, the economic shorthand used for the past 18 months to describe the expected level of the Fed Funds rate, should be replaced by *hire for longer* as the job market continues to outperform expectations. We expect that consumer spending, which has been exceptionally strong during the past several years, will continue to grow. Initially supported by pandemic-era stimulus, the strong job market and wage growth should continue to support spending in the year ahead. While there is evidence that higher interest rates and higher prices are taking their toll on lower-income consumers, we don't see that weakness spreading across income levels. Based on comments from companies including Wal-Mart, FedEx, and Costco, we expect the prices of goods to continue to moderate and, in many cases, contract in 2024. These factors, combined with moderate energy prices and recent wage growth, will set the stage for another strong year of consumer spending.

Employee Growth Month over Month

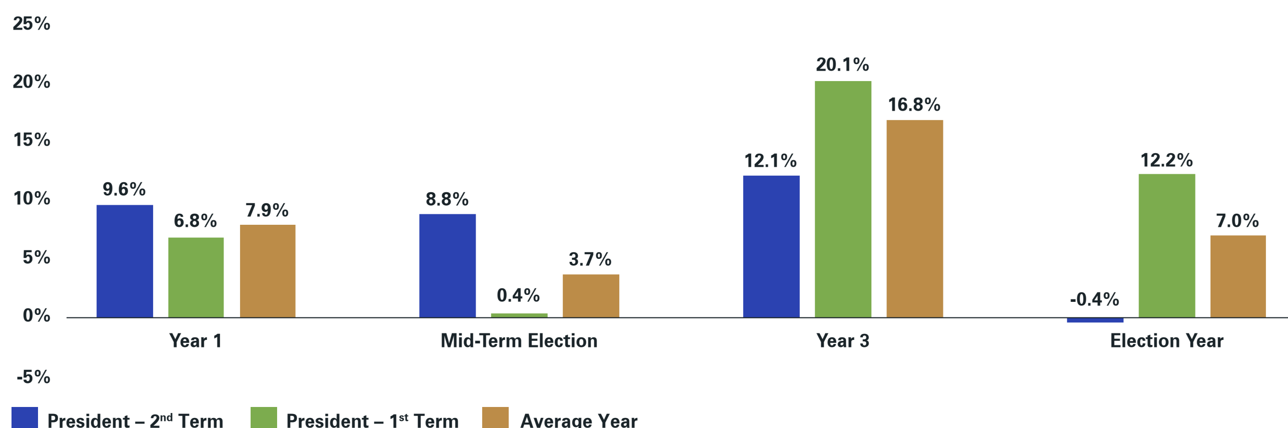


Source: FRED, Dec 29, 2023

Markets will shrug off election fervor and investors will be wise to do the same.

Markets typically provide average returns during the fourth year of the presidential cycle, with returns even higher in years an incumbent president is running for reelection. Historically in those years, market returns averaged over 12%. In fact, since 1952, the S&P 500 has not declined in any year an incumbent president has sought reelection. Presidents and their political allies have access to many levers capable of providing economic stimulus as elections approach. Historically, GDP growth has accelerated during an incumbent's fourth year in office and continued into the first year of a second term.

Economic strength has typically been a strong predictor of an incumbent's chances, with almost every president who avoided a recession going on to win reelection. Given investors' preference for certainty, the "devil you know" mentality has driven market rallies in the months before Election Day. While we expect markets to track these patterns in 2024, the leading candidates' historically low approval ratings could lead to a break in the trend. As 2024 progresses, we will continue to remind our clients not to let politics get in the way of investing.



2024 will be the first "normal" year post pandemic.

Economic models and the norms that built them were turned upside down by the pandemic. From supply chains and consumer spending to interest rates, monetary policy, and fiscal policy, 2024 is likely to bring more normalization.

The accompanying table provides over 30 years of economic and market averages split into three distinct eras: the 20 years preceding the great financial crisis (1990–2009), the decade of quantitative easing and zero-interest-rate policy (2010–2019), and the pandemic years (2020–2023). Too often, our expectations are highly influenced by recent events; therefore, a look further back can prove insightful.

	30 years pre-pandemic	20 years prior to GFC	10 years of QE	Pandemic Era	
	1990–2019	**1990–2009**	**2010–2019**	**2020-2023**	**Latest**
CPI	2.4%	2.8%	1.8%	4.6%	3.1%
Goods Inflation	(0.2%)	(0.0%)	2.4%	2.4%	0.1%
Services Inflation	2.7%	2.9%	2.3%	4.1%	4.3%
Real GDP	2.5%	2.6%	2.4%	1.9%	2.2%
Consumer Spending	4.7%	5.1%	3.9%	6.5%	5.4%
Unemployment Rate	5.8%	5.7%	6.2%	5.2%	3.7%
Labor Force Growth	1.1%	0.9%	1.6%	0.9%	1.8%
Wage Growth	2.9%	3.2%	2.4%	5.4%	1.8%
Budget Deficit	3.1%	2.2%	4.8%	9.7%	6.0%
Fed Funds	2.9%	4.1%	0.7%	1.9%	5.5%
2Yr Treasury	3.3%	4.5%	1.0%	2.0%	4.3%
10Yr Treasury	4.5%	5.5%	2.3%	2.3%	3.8%
2–10 Spread	1.2%	1.1%	1.4%	0.3%	-0.5%
S&P 500 EPS Growth	6.0%	4.0%	11.0%	8.0%	2.0%
S&P 500 PE	15.9	16.2	15.2	19.0	19.3

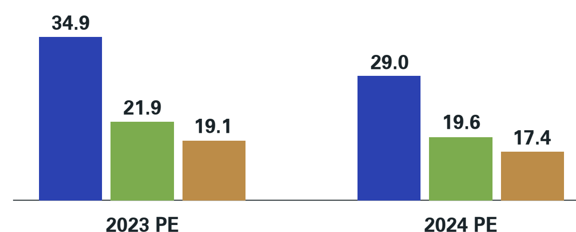
All data based on most recently available information as of 12/31/2023. Goods & Services inflation based on PCE report.
Sources: FactSet, Haverford

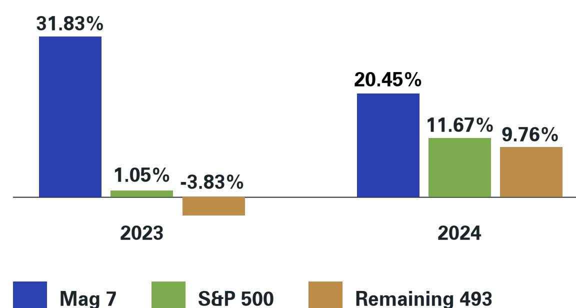
The stock market leaders in 2023 will pass the baton.

For most of 2023, performance was defined by just a handful of companies, known as the Magnificent 7, due to a combination of enthusiasm for artificial intelligence technology, rebounding earnings, and a clawback of 2022's losses. We expect 2024 to provide a more level playing field, expanding the opportunity set for stock investors. The Mag 7 are still expected to generate stronger earnings growth of 20% versus 10% for the rest

of the market. However, these stocks now trade at significantly higher multiples with lofty expectations. Comprising 28% of the market, these seven stocks heavily outweigh their earnings contribution of 20%. The remaining 493 stocks trade at a more reasonable 17x the next 12 months' earnings, in line with historical averages, and they have a number of positive-earnings tailwinds heading into 2024.

Corporations have faced unusual cost pressures over the past three years. Higher wages, soaring energy and financing costs, elevated logistics and shipping expenses, and the stronger US dollar have combined to put immense pressure on earnings, and in some sectors they have caused rolling earnings recessions. However, these costs are quickly normalizing. In addition, the anticipation of softer economic conditions prompted many companies to undertake cost-cutting initiatives that will start to flow through into better margins. The story for 2024 isn't just one of margin expansion; revenue also looks set to improve from 2023's stagnant growth. Solid consumer spending; capital investment in technology, infrastructure, and manufacturing; and a thawing of corporate and mortgage lending markets should combine to drive revenue higher.





Mag 7 S&P 500 Remaining 493

Source: FactSet, Haverford Trust

Characterizing a Normal Year

No year is ever normal, but we anticipate some move in that direction. A normal year could be characterized as having the following attributes:

- A CPI in the **upper 2% range**, composed of goods inflation of close to zero percent while services grow at **3% or more**. Structural trends such as deglobalization and demographics could make inflation stickier than in the past.
- A Fed Funds rate of approximately **75 to 125 basis points** above inflation rates.
- A **positive yield curve** in which the spread between 2- and 10-year treasury notes is about 100 basis points.
- A corporate earnings **growth of 6%** and a market multiple of **17x**.
- An unemployment rate in the **4% range** as the workforce grows by **about 1%**.
- Wage growth exceeding inflation by **about 1%**.
- A budget deficit of **less than 3%** (which cannot happen based on current policy).