



## To Our Clients and Friends of Parthenon LLC

A mere twelve seconds would change the course of history. However, the build up to that moment took years. In the late 1800s, two young boys received a toy helicopter powered by a rubber band. The toy didn't last long, but the inspiration did. These two mechanically gifted siblings were fascinated by flight – a passion that continued into their adult life. After building a successful bicycle business in Dayton, Ohio, Orville and Wilbur Wright used their earnings to bankroll a more ambitious mode of transportation. Their serious work on flight began in 1899, and through trial and error, they experimented on different models in Kitty Hawk, North Carolina, which was known for its sustained winds.

On December 17, 1903, the flip of a coin determined who would try to take a 32-foot wingspan prototype into the air first. Wilbur won, but his attempt failed. It was Orville who successfully navigated the next attempt, completing the first manned flight in history. The journey lasted just twelve seconds and 120 feet, but it made the feat no less remarkable.

Like the Wright Brothers, in 2023 the economy was looking for an elusive “soft landing” – in other words, the avoidance of a recession after a period of monetary tightening. Many pundits early in the year were calling for a decline in GDP at some point in 2023. Furthermore, an inverted yield curve (with short term rates higher than long term rates) and some weakening leading indicators pointed to a contraction. It never came.

With this in mind, major asset classes reversed much of 2022's damage. The S&P 500 rebounded 26.3%, enough to get it within striking distance of the all-time high (set in January of 2022). The Nasdaq took flight as well, rising 43.4%, a marked reversal from the -33.1% in the prior year. This increase was certainly top heavy. The newly coined “Magnificent Seven” mega-cap tech stocks led the way and contributed roughly 60% of returns for the S&P 500.

Although markets boasted impressive returns, the year was not without turbulence. The banking sector felt the brunt of the market's wrath. The long-dated bonds on banks' balance sheets, purchased at lower interest rates, became volatile when rates rose. This played a part in the failure of Silicon Valley Bank and Signature Bank in March, which put regional bank stocks on edge. In another bout of volatility, the market experienced a 10% correction from August to October. This seemed mainly due to the prevailing thought that the Fed would keep interest rates “higher for longer.”

It is hard to fully analyze 2023 without considering interest rates and fixed income. Bonds had a strong year, with the Bloomberg US Aggregate up 5.5%, a partial reversal of the 13% decline seen in 2022. The Federal Reserve continued hiking rates through July 2023, ending up at a Fed Funds rate target of 5.25%-5.50%. With these changes, money markets and short-dated US

Treasuries became popular investments. Inflation also tapered off from elevated numbers in 2022. Core CPI clocked in at 3.9% in December. To cap the year off, Fed Chairman Jerome Powell insinuated there could be up to three potential rate cuts in 2024, sending both stock and bond markets rallying to end the year.

Innovation was key to the Wright brothers' success. It also powered sectors of the market in 2023. Specifically, newsworthy stories included headlines from the technology and healthcare industries. Artificial intelligence took the world by storm with major technology companies scrambling to show off their capabilities. Also, new weight loss "wonder drugs" Wegovy and Ozempic were touted as having far reaching impacts in healthcare and beyond.

As we ponder the wonder of flight, we see many parallels between the economy and aeronautical engineering in 2024. Scientifically, there are four forces that impact a vessel's ability to stay in the air:

**Thrust:** the force that pushes a plane forward. This power is generated by jet engines. In 2023, the consumer was a driving force that propelled markets onward and helped to generate strong GDP numbers and provide optimism about a soft landing. The consumer was powered by a strong labor market and remaining savings from the pandemic. It will certainly be interesting to see if the consumer will continue its strength in the new year.

**Lift:** the force that pushes the airplane up. Wings are designed to move the air over the top of the wing faster than the air below it, creating higher pressure below to keep it aloft. In 2023, lift was experienced in the market by valuation expansion. At the end of the year, the S&P 500 was trading at 19.5x forward earnings, above the 30-year average of 16.6x. Although valuations are somewhat stretched, they can stay elevated for long periods of time.

**Gravity:** the force that pulls an airplane down. Since force is linked to mass, a lighter airplane will need less thrust to stay in the air. Although the geopolitical events of the year were certainly heavy, the markets somehow weren't pulled toward earth by these concerns. The Ukraine and Middle East conflicts are both still unresolved. And the potential escalation of these or a new conflict (i.e., China/Taiwan) could have repercussions for future returns. We will be observers of the global landscape in 2024 to see if the market will continue to brush off global events.

**Drag:** the force that pushes against the plane. Planes are long and skinny by design, with a pointed nose that reduces air resistance. Similarly, the headwind of inflation will have a lot to do with the upcoming year's returns. The Fed's tightrope walk is not over. Higher rates have brought inflation down – for now. However, the floor on recent inflation has been above the Fed's long-term target range of 2-3%. Any unexpected increases in inflation could cause volatility in the new year and cast doubt on a soft landing.

It is remarkable that in a few short decades after the first flight, air travel became a normal mode of transportation for the masses. And it is even more stunning that in a brief period, the foundation the Wright brothers built eventually took a man to the moon. In fact, fellow Ohioan Neil Armstrong carried pieces of fabric and wood from a wing and propeller of the Wright Flyer with him on his historic walk. It certainly seems like an appropriate nod to their contribution to one of mankind's great achievements.

Progress can move quickly, and despite all the uncertainties this year might hold, we are encouraged by the fact that, in part because of a pattern of innovation and a historically robust US economy, the S&P 500 has been nothing if not resilient over time. Over the past fifty years, the index has gained roughly 11% annually. Although we are the first to point out that this does not guarantee short-term results, it can provide us some optimism over the long run. History has also shown us that even though finding good values is difficult, it's a worthwhile pursuit. In this kind of stock market where valuations have expanded, we are all the more determined to focus on quality companies that have strong track records, management teams, and cash flow to weather potential storms. For fixed income, we will refuse to compromise quality while also looking for above average returns. Using these strategies, our hope is that the markets will continue their flight higher over the long term.



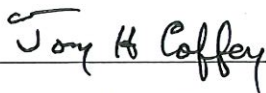
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