

COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

MARKET RECAP

The US Equity market had a strong fourth quarter of '23 as concerns about inflation were replaced with hopes of lower interest rates in '24. The equity rally in the quarter was broad-based across the market capitalization spectrum and geography. The S&P 500 finished the quarter up 11.7% and the year with 26.3% total return. The Dow Jones Industrial Average had an even better Q4, up 13.1%, finishing the year up 16.2%. The MSCI EAFE Index of international developed market equities was up 10.1% in the quarter. The MSCI Emerging Markets index was up 7.5%. Value stocks had their best quarter of the year, up 13.6%, and the only one in the year in which they outperformed growth stocks, as measured by S&P 500 Growth and Value indices. Growth stocks still had a solid 10.1% return in the quarter. Small Cap stocks, represented by the Russell 2000 index, were up 13.6% in the quarter, which constituted the bulk of its 15.1% return for the year. Real Estate sector was the best performer in the quarter, up 18.8%, closely followed by Technology, which was up 17.2%. Energy was the worst performing sector, down 6.9%, followed by Consumer Staples, which was up 5.5%. Commodities (as measured by the GSCI Commodity Index) lost 10.7% during the quarter. Fixed income assets recovered nicely in the quarter as well, with the Bloomberg Intermediate Govt/Credit Index up 4.6% while the Bloomberg 5-year Muni Index was up 5.2%. Global fixed income, as represented by Bloomberg Global Aggregate Bond Index, was up 8.1%, finishing the year with 5.7% total return.

MARKET RECAP AND OUTLOOK FOURTH QUARTER 2023

KEY POINTS

MARKET SCORECARD as of 12/31/2023	TOTAL RETURN IN USD	
	Q4	2023 TR YTD
DOW JONES IND AVG	13.08%	16.17%
S&P 500	11.69%	26.29%
NASDAQ	13.56%	43.42%
MSCI EAFE EQUITY (GROSS)	10.09%	15.03%
RUSSELL 2000 INDEX	13.56%	15.09%
MSCI EMERGING MARKET EQUITY (GROSS)	7.45%	7.04%
BLOOMBERG INTERM. TREASURY	3.99%	4.28%
BLOOMBERG INTERM. GOVT/CREDIT	4.56%	5.24%
BLOOMBERG 5 YEAR MUNI INDEX	5.22%	4.31%
BLOOMBERG HIGH YIELD CORP INDEX	7.16%	13.44%
ishares S&P GSCI COMMODITY TR INDEX	-10.73%	-4.27%

Note: All returns include invested cash flows expressed in U.S. dollar terms

- Inflation has decelerated, offering room for the Fed to potentially reduce its Fed Funds interest rate target in the coming year.
- Leading Economic Indicators and the yield curve continue to point to a slowdown in the economy.
- Employment has been one bright spot, staying firm throughout last year, but consumer finances are beginning to show signs of stress.
- This is an election year, which usually brings with it loosening fiscal policy, however government spending levels are already stretched, leaving less room for spending increases going forward.
- US equity market valuations are expensive and sentiment remains stretched. We continue to find good value in the defensive parts of the market as well as international equities and have kept our fixed income duration relatively short.

INVESTMENT OUTLOOK

The overall investment expectations by market participants going into '24 envision a scenario of easing monetary conditions on the back of lower inflationary readings around the world and a resilient US economy. Investors are optimistic that central banks' actions will be able to reignite global GDP growth towards the second half of this year. The US, the UK, and Canada have all hinted at lower rates while China and Brazil have been lowering their rates. Europe, Japan, and Australia are yet to reverse their tightening biases for the fear of reigniting inflation. What concerns us is the sudden shift in tone by the US Federal Reserve in particular. The Fed went from not thinking about lowering rates in November to all but promising several cuts at its December meeting. This coincided with the peak in the long-term US interest rates, which pulled back from 5% to 4% in the last two months of the year. While credit spreads in the US still remain relatively tight, confirming ample liquidity and no credit quality deterioration, we have to wonder if the Fed's change in direction was not the direct result of the underlying deterioration in the health of the US banking system. U.S. banks entered Q4 of last year with more than \$1.3 trillion in non-realized balance sheet losses (treasuries, mortgages, loans), a situation that improved somewhat as rates fell in Q4. Nonetheless, balance sheet concerns have translated into a tepid loan growth environment and ultimately negative M2 money supply growth for all of '23. When combined with the stubbornly inverted yield curve, these monetary conditions do not portend well for acceleration of growth this year and are incongruent with the durability of healthy credit quality conditions. We continue to be cautious on the market and the economy, with a tactical underweight in equities and a slight preference for defensive sectors such as Consumer Staples, Healthcare, Energy, and Utilities. Our key underweights include Consumer Discretionary, Financials, and Technology. The US equity market remains vulnerable to an exogenous event given stretched sentiment and valuation. We see better value in international markets, where we have an overweight position.

GLOBAL MACROECONOMIC REVIEW & OUTLOOK

The US economy posted 4.9% GDP growth in Q3 of last year, which was an acceleration vs. 2% growth in the first half of the calendar year. That represented high-watermark for the year. Meanwhile, annual inflation rate in the US slowed to 3.1% in November, with core inflation settling at 4%. This started the talk of a soft landing scenario, by which the economy would decelerate enough to dampen inflation but still avoid a recession. Unfortunately, it always looks like it will be a soft landing at first because market participants tend to underestimate the lag effect of the Fed's actions. Any policy action usually takes on average about 22 months to manifest itself in the economy and we are at that point right now entering Q1 of '24. Leading Economic Indicators have been signaling a recession through most of last year and continue to do so. Manufacturing data in the US has been in contraction for 14 consecutive months. Services data has been approaching contraction territory as well. With the US consumers going through their last bit of savings from the post-COVID era, the US government spending has remained the key source of support for the economy. Federal deficit for fiscal '23 adjusted for the student debt forgiveness program was \$2 trillion, more than double the underlying deficit from fiscal '22. As a result, the US national debt crossed over \$34 trillion earlier this year and now constitutes close to 125% of GDP. Long-term effects of such a profligate spending policy were felt last year when long-term interest rates in the US soared from 3.25% to 5% in a span of six months. There is no doubt that similar episodes are likely in the future unless something changes meaningfully in the trajectory of government spending. Net interest expense for the US government rose 39% in the last fiscal year and was up 64% in the first two months of fiscal '24. Unsustainable government finances will be a formidable burden for the US economy to deal with and will likely dampen growth in the coming years. If we add to that simmering geopolitical risk, which is likely to continue to put pressure on the commodity complex, then the vulnerability of the US economy becomes more apparent. With China, the UK, and Europe all simultaneously growing well below potential, additional monetary stimulus will be needed to jump-start growth. That puts the Fed in a difficult position because any such action is likely to reignite inflationary expectations. We are looking for below trend real growth in the US and global economy in '24 with incrementally higher inflation and potentially another move higher in what should be a structural shift in term premiums of long-term interest rates.

INVESTMENT TEAM

www.farmerstrustco.com

DAVID A. DASTOLI, CFA, CFP® - PRESIDENT
dastolid@farmerstrustco.com - 330.740.1231

JOHN D. STEWART, CFA - SENIOR VICE PRESIDENT
AND CHIEF INVESTMENT OFFICER
stewartj@farmerstrustco.com - 330.740.1208

THOMAS S. RUMBAUGH, - VICE PRESIDENT
rumbaught@farmerstrustco.com - 330.765.0583

DALE STANDLEY - VICE PRESIDENT
standleyd@farmerstrustco.com - 330.740.1207

IGOR GOLALIC, CFA - VICE PRESIDENT
golalici@farmerstrustco.com - 724.867.2019

TODD P. FINN, CFA - ASSISTANT VICE PRESIDENT
finnt@farmerstrustco.com - 330.609.8328

DAVID R. CULP, - TRUST INVESTMENT OFFICER
culpd@farmerstrustco.com - 330.740.1213