Executive Summary

Performance in the 4th quarter was a little behind the OS's benchmark and the S&P 500. Fed Policy and AI are the two biggest narratives in the US stock market today. Even with the recent drop in long-term rates, interest rates are restrictive and economic conditions will be challenging this year. Investment in AI is rampant and likely toward the end of calendar year 2024, we will get a better picture of if there is a reasonable ROI for these investments. If AI investments benefit businesses but don't provide much consumer benefit anytime soon, one could argue the economic benefits of AI are not as great in the near-term as the dollars being invested. There was a wide variance of stock performance in the OS again this quarter. Bond holdings have increased as caution is warranted.

The Opportunistic Strategy returned 9.4% in the fourth quarter of 2023, slightly behind its benchmark and behind the S&P 500. There was a solid rebound with many OS stocks. The dramatic shift in interest rate expectations that played out through the quarter led to strong stock performance in November and December. Value stocks tend to rally significantly in these types of situations. They did but also large cap growth stocks continued their impressive run in 2023. The OS was hurt by a little higher than normal cash position and some conservatism. Also, the OS has about 5% in 4 different Chinese stocks, all of which posted double digit negative returns in 2023. While geopolitics and China's slumping economy are hurting the multiple investors are willing to pay for Chinese equities, the other issue hurting stock performance is Chinese companies are fiercely competitive. If US companies every became as competitive as Chinese companies, it would be very problematic for the stock market.

AS OF 9/30/2023	QTD	YTD	1YR	3YR	5YR	SINCE INCEPTION
OS	9.4%	17.7%	17.7%	11.7%	14.9%	15.4%
Benchmark	9.8%	12.9%	12.9%	6.8%	9.9%	8.1%
SPX	11.7%	26.3%	26.3%	10.0%	15.7%	13.3%

Inception: 9/1/2016

The US stock market is currently being driven by Fed policy and AI. It is welcome to see long-term interest rates move from very restrictive to modestly restrictive. Though just as interest rate increases did not slow down the economy nearly as quick as many expected, the drop in interest rates does not mean the economy is out of the woods. There are lags to policy shifts and even if the Fed does start cutting this year, they will be cutting from very restrictive to somewhat restrictive. It is going to be difficult for companies to meaningfully grow earnings this year. That in my opinion is leading investors to pay too high a price for companies with solid earnings growth.

It is a new year but artificial intelligence is still the biggest theme in the stock market. There are lots of neat examples of how progress in certain industries can be accelerated by AI. The business case will make sense for many companies. The consumer facing market is more of a wildcard. It seems people are getting ahead of themselves on how much AI will help the economy. While in the long run, it should create job growth, the near-term seems like it is heading in the direction of job replacement. Even that dynamic, if that is the direction AI goes, will take time to play out. The jobs market has been quite resilient recently and if it does take a turn in 2024, it won't be because AI is replacing everyone.

To be a truly massive economic paradigm shift, an industry needs to improve the standard of living for individuals, not just create efficiencies for business. Business efficiencies should trickle down to consumer benefits but that is far from certain, and the timing of such benefits seems distant. AI is being compared to the Internet revolution and the smart phone revolution, two things that truly created a communications revolution. I don't think anyone can argue that the internet hasn't changed people's lives for the better over the previous 2 to 3 decades and smartphones as well. What can AI do to improve people's lives in the near future? Things done that save time are right at the top of the list. A transportation revolution would be great for our economy. AI should help get self-driving cars on the road but progress there is very slow. It doesn't look to be changing the economy anytime soon. A healthcare revolution would be great as well. There are some interesting applications here. It will be interesting to monitor but healthcare change is slow. There is already a cost problem for healthcare in this country so AI applications that are evolutionary instead of revolutionary probably won't be compensated as much as some might think. The food industry seems ripe for a revolution, but I don't see anything on the horizon that AI is set to disrupt. It does not appear AI is about to solve the housing affordability and shortage problems in our country. Affordability in general is a challenge for many in our country and AI could improve the cost structure of many goods and services but whether that flows down to consumers is questionable and if it comes at the expense of jobs, the benefit won't be as great. AI could help make the world safer but also could make it a more dangerous place. I don't think a clear benefit will be established there. Convenience applications that come from automation already exist in some form today and will improve, though I am skeptical on the market size for such things. The entertainment industry is going to benefit and AI should help create better consumer content but it seems hard pressed to assume AI will lead the way in creating an abundance of amazing content that people just feel the need to consume.

I try not to be skeptical of change and examples of AI creating the thousands of low cost simulations needed to properly train robots is exciting. The time saved from AI writing software will create benefits. Yet, it seems to me the massive surge we are seeing from companies investing in AI comes down to two main things, neither of which has a near-term direct link to meaningful consumer benefits. One is business efficiency, perhaps at the expense of jobs. Two is fear of missing out playing out not in a stock market but in a business setting. The extraordinary growth rate of AI investment will probably face a reckoning in the later part of 2024 if the investment is way ahead of the business or consumer ROI. It seems we will get a clearer picture of the sustainability of AI investment growth later in 2024 but that isn't stopping investors from bidding up some tech stocks to really high levels. The price investors are paying for this projected growth is quite risky.

There is also the US election coming up in the later part of 2024. The election will create uncertainty and uncertainty is usually bad for the stock market. There are meaningful geopolitical issues that the world is presented with in 2024. From war to economic relocation to climate change, there are some real problems out there. Economies have historically continued to grow when faced with difficult global geopolitics but it does feel this time is more dangerous. Added risks that can lead to one questioning if the S&P 500 should be trading at an over 20x earnings multiple.

The volatility of OS stocks was on display again as shown below in the advancers and detractors table. Macy's proved to have more earnings resilience than investors expected and also received a takeover offer at $21 per share. $21 is too low for Macy's to accept but it does provide somewhat of a backstop for the share price and Macy's is one of the largest holdings. Impinj rebounded meaningfully after a very large sell-off in 3Q. Impinj is extremely volatile. It has a great long-term secular tailwind that should provide solid growth for at least a decade but the stock does sometimes hit extremes on the high and low side. Intel is proving it will be a player in the AI chip space and also a player in the foundry space. One can argue Intel is investing too much in the foundry space but they do have some impressive chip tech coming to the market soon. Its manufacturing is improving but also its chip design. I see no reason why Intel can't be a very relevant important part of the semiconductor market for years to come and while the stock valuation is a little high, it looks reasonable compared to Nvidia and AMD.

Kyndryl is proving it can transition its large talented IT workforce to generate business in growth areas while profitably managing the decline in IT outsourcing. The stock has rerated because of that. The OS recently trimmed Kyndryl. Harmonic rallied in 4Q after a meaningful sell-off in 3Q. It has an activist investor calling for a sale of its smaller segment. Cable company investment in next-gen access equipment is going through a pause so Harmonic will likely be volatile in the near-future. Hooker Furniture is a very small market cap furniture company. Its business is stabilizing after very difficult furniture trends in the past year. It has a very clean balance sheet and good leverage to any improvement in furniture demand.

Embraer had strong stock performance in 4Q. Brazilian stocks had strong 4Q performance. In addition, Embraer is garnering more optimism from investors that it can achieve margin targets. Ally Financial rose over 30% as well. An interest rate turn would be good for Ally. Its deposit base is sticky but also demanding. Depositors at Ally expect to earn high interest and the deposit beta to Fed funds rates is strong. Rising interest paid to depositors has harmed Ally's Net Interest Margin but that can stabilize or even improve if the Fed starts lowering rates. Almost everyone of the over 30% plus advancers was trimmed during the 4th quarter but none were eliminated.

ADVANCER/DETRACTORS	2023 3Q RETURN
Macy's Inc.	74.7%
Impinj Inc.	63.6%
Intel Corp.	41.8%
Kyndryl Holdings, Inc.	37.7%
Harmonic Inc.	35.4%
Hooker Furniture Corp.	35.3%
Embraer SA	34.5%
Ally Financial Inc.	32.5%
Bayer AG	<23.1%>
Criteo	<13.3%>
Daqo New Energy Corp.	<12.0%>
Baidu, Inc.	<11.4%>

It was a good quarter for stocks but still there were some ones that corrected. Bayer had a major drug trial failure for a next-gen anticoagulant. It was a big setback for growth in its pharma division. Also, more legal trouble from Roundup and PCB's surfaced in 4Q. Criteo sold off meaningfully after its 3rd quarter earnings update. The ad markets are soft but more relevant is there seems to be some pressure coming for margins in its retail media growth segment. Large retailers are using their muscle to get a larger share of ad dollars for themselves and Criteo will have to accept that or risk losing some large retail clients. This is obviously a troubling dynamic that bears watching but Criteo can grow earnings through a better optimization of its cost base and I expect that to occur. Daqo New Energy is a Chinese polysilicon supplier. Chinese polysilicon suppliers continue to expand into an already oversupplied market. The environment is difficult, and investors are selling. Daqo currently trades at a price quite a bit lower than its net cash position, so investors expect Daqo to squander cash on useless expansion. The discount to net cash is extreme. This company in July will have an ability to close its discount to its China listing. I expect some type of capital markets move if the stock price stays this low. Baidu is another Chinese company with poor stock performance. Baidu is now trading at a price that is not a whole lot more than its net cash and investments value. The company is an extremely talented company with a solid core search business and other growing businesses including a leading AI position in China. Investor pessimism over anything China is extreme.

The OS currently has a relatively high allocation to bonds. There were even some purchases of a few municipal bonds in the 4th quarter. One is up 20% in just a couple months since purchase. Investor fear over long-duration assets created some unique buying opportunities in bonds. It was not viewed as prudent to buy a lot of municipal bonds for a strategy whose accounts are overwhelmingly tax-free so municipal bonds purchases were smaller than they should have been. Aside from those opportunistic purchases, the higher-than-normal allocation to bonds is a reflection of the risks that lie ahead in the equity market. Stock prices seem too high when one considers the risks that lie ahead in 2024. whose accounts are overwhelmingly tax-free so municipal bonds purchases were smaller than they should have been. Aside from those opportunistic purchases, the higher-than-normal allocation to bonds is a reflection of the risks that lie ahead in the equity market. Stock prices seem too high when one considers the risks that lie ahead in 2024.

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PORTFOLIO MANAGER

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Net of fee performance is calculated using the highest tier on the firm's standard fee schedule for that strategy. A model fee is deducted on a quarterly basis by dividing the highest fee by 1/4th and applying this to the composite gross return for the first month of each calendar quarter. Actual fees are generally deducted in the first month of each calendar quarter and are treated as withdrawals. Net of fee performances does not reflect Advisor fees (which may range from 0.35% to 1.50% depending on account size). If Investment Advisor fees are deducted from the account, it will lead to reductions in return.

Waterfront Balanced performance reflects the performance of the Institutional share class of the Ivy Balanced Fund from 8/4/2014 to 11/15/2021. From 11/16/2021 onward, it reflects the performance of the WAM composite strategy called Waterfront Balanced. Matt Hekman, the Waterfront Balanced portfolio manager, was the lead manager on the Ivy Balanced Fund from 8/4/2014 to 11/15/2021 and transitioned immediately to managing the Balanced strategy with the same investment process for Waterfront Asset Management.

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