CARDEROCK
CAPITAL® MANAGEMENT, INC.

January 10, 2024

Over the past two months, diversified portfolios finally came back into favor after experiencing an extremely narrow market where only the largest companies made progress. The market pivot that started in November allowed us to aggressively lower our cash reserve target to buy stocks with favorable pricing and good prospects. And while this turn did not make up for the relative underperformance experienced in most of 2023, we strongly believe this will be short-lived and expect the market to gravitate towards Growth, rewarding our holdings as the New Year unfolds.

On many fronts, we believe pandemic era trends are firmly behind us as inflation continues to fall and supply chain disruptions are no longer hampering production. An economy marked by high investment, high productivity and strong labor will undoubtedly boost profits, and we see a more normal cycle ahead than the volatile one we are just now exiting. In our opinion, we have reached a turning point in markets that should reward a broader range of companies versus a select few.

Our View for 2024

The Economy

Interest Rates decline slowly but steadily, providing a positive impulse to the large portion of the economy dependent on credit.

Labor markets remain robust while wage growth and job openings come down from their lofty pandemic heights.

Investment in infrastructure, energy and advanced chip technology will boost productivity and help contain inflation.

Growth will decelerate but not fall off a cliff in 2024, with a recession increasingly unlikely.

Stocks

Earnings Growth will be positive after more than a year of declines.

Profit Margins steadily move up as supply chain disruptions diminish and inflation comes down to tolerable levels.

Quality Growth stocks will perform well as narrow leadership in Tech stocks gives way to broader participation among previously downtrodden issues.

Fixed Income

Interest Rates have peaked, however further gains from bonds in 2024 are unlikely as rate cuts have been firmly priced in.

Treasury Bills will remain a key supplement to our cash management in 2024 and beyond, as we are unlikely to return to a zero-interest rate environment any time soon.

Final Thoughts:

While we expect the momentum from the end of 2023 to continue, there will be bumps along the way in 2024. The overhangs of the Ukraine/Russian war, the Israeli conflict and the Presidential election will increase volatility. This will most likely lead our activity to be slightly higher in 2024 versus last year as we take gains and reallocate to more attractive opportunities. Bonds and short-term U.S. Treasury Bills will continue to offer an attractive alternative with longer term maturities becoming more appealing. Our current Cash Reserves for Equities stands at 8%, and while this is low on an historical basis, we are confident this level is appropriate as we focus more on rotation among issues rather than pulling back exposure. We are optimistic about the markets over the next twelve months and believe Quality Growth companies will shine.

As always, feel free to call us to review your investment progress or with any questions you may have.

Warmest Regards,

Daniel A. Kane, CFA
President

Stephen F. Knapp, CFA
Director of Research

In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

Random Gleanings

"Seven firms including Microsoft Corp. and Nvidia Corp. drove about three-quarters of the index's gain in 2023, in a rally stoked by an investor obsession with AI's potential to disrupt vast parts of the economy. Pressure is mounting on companies to deliver on some of the earnings hope embedded in their ever-rising stock prices. 'We're getting closer to the moment when the companies that are claiming AI-related profits will have to start showing them,' said Mark Lehmann, chief executive at Citizens JMP Securities. 'I am not calling for an expansion of multiples next year; the returns will have to come from companies actually turning in better profits.' At nearly 30% of the S&P 500, they have more sway over the benchmark than ever before." Jeran Wittenstein and Ryan Vlastelica, "*Big Tech's Ability to Deliver on AI Profits Looms Over S&P 500*"**, Bloomberg,** December 10, 2023.

"If financial markets are correct in suggesting the desirability of an early rate reduction, they have gone too far in suggesting interest rates will decline almost as quickly as they rose, pricing in 1.5 percentage points of reductions in both the US and Eurozone this year. There is a danger that inflation will reignite if economies are run too hot. Central banks would therefore be wise to start easing quickly but not move too fast unless economies appear to be heading for a deep recession. They need to find a gentle path towards relatively neutral interest rates to neither stimulate nor restrict economic growth and inflation. This level is unknown but is not necessarily much lower than the official rates that prevail today and certainly not near zero." Chris Giles, "*Buckle up – the Inflation Battle is Entering a New Phase*"**, Financial Times,** December 3rd, 2023.

"The past 10 years' performance, which saw the S&P 500 outperform cash by a real 11.9%, was, of course, extraordinary. What would it take to duplicate that feat over the next 10? Assuming real earnings growth of 2.5%, roughly the postwar average, the cyclically adjusted p/e ratio would need to more than double from its current value of 30 to 61, which happens to be nearly 40% higher than the Tech Bubble peak of 44. Yes, real earnings expanded at the remarkable real rate of 4.5% over the past decade, but such superior growth over the long-term trend was entirely due to declining interest expenses and corporate tax rates." Evan Lorenz, *"Essay in Inference"*, **Grant's Interest Rate Observer**, December 22nd, 2023.

"The biggest restraint of all for China is politics. Abroad, China needs to navigate around the rising hostility of the US and its allies. At home, it needs to manage the shift to a more balanced economy and sustain the relationship between the communist state and the capitalist economy. These challenges are the most difficult the rising giant faces. If it fails to manage them, it could, at worst, end up in conflict with the high-income democracies and, at best, be another country caught in the 'middle-income trap'." Martin Wolf, *"Politics Poses the Biggest Threat To Economic Growth in China"*, **Financial Times,** October 24th, 2023.

"The key economic question for 2024 is how to think about the interest rate cuts we're likely to get from the Federal Reserve. Are they good news for the economy as borrowers catch a break, or a sign of impending recession as they were in 2001 and 2007? Policy easing this year would come after rate-sensitive and cyclical parts of the economy have been in a slump for roughly two years. Those areas were already set to rebound somewhat in 2024 — the added boost from rate cuts could turn that recovery into something closer to a boom. The extent to which we get a pickup in credit- and investment-driven growth in 2024 will determine whether we get something like a soft landing or an environment much hotter than that." Conor Sen, "*Coming Rate Cuts Portend a 1980s-Style Economic Resurgence*"**, Bloomberg,** January 4th, 2024.