

THE INVESTOR INSIGHT

JANUARY 2024

INSIDE:

What Lies Ahead?

BACK COVER:

Q4'23 Commentary (continued)

Q4'23 Commentary and 2024 Outlook

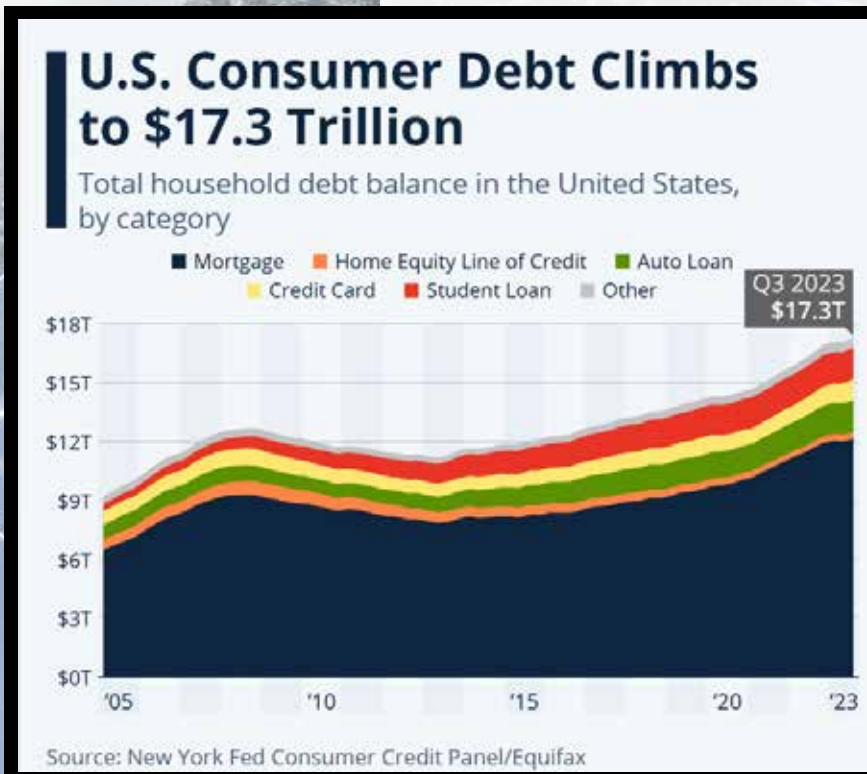
As we closed out 2023, the markets reacted to the positive news that the Fed had finally pivoted from its rate hike cycle to holding rates steady and making cuts in 2024. In fact, at his last 2023 press conference, Fed Chair Powell said there could be up to three rate cuts in 2024. In my opinion, given the weakening backdrop of consumer spending, which is 70% of US GDP, we are likely to see more than three rate cuts in 2024. But when? That is the question that has been on investors' minds as the markets sold off approximately 5% in the first few days of the new year. Will it be March, or June? I am not sure it really matters, as long as the rate hikes are behind us, and the cutting begins. While this news is positive for investors, it will likely not come without bouts of volatility. Historically, according to Bloomberg Analytics, the S&P 500 corrects on average 7% after the first rate cut, but it is also usually a bottom with equities rising thereafter. This is likely because, as I often mention in these commentaries, the Fed tends to

start raising rates late, goes too far, and starts cutting late.

Certainly, consumers with high rates on mortgages, personal loans, and credit cards are stretched, and this could lead to slower-than-expected economic growth in coming quarters given the vital importance of consumer spending to GDP growth. Another area of concern was the narrow nature of the markets in 2023. While things started to broaden late in the year, seven stocks in the S&P 500 (which are also in the NASDAQ) made up most of the gains for 2023.

One theme that drove most of the outperformance of this handful of stocks was the proliferation of artificial intelligence, or AI, which has been in the news frequently. In my view, this emerging technology will likely be the largest contributor to significant productivity gains that we have seen since the creation of the Internet. We are not suggesting investors run headfirst into buying a bunch of AI stocks; there will be winners and losers, just as there was with the Internet. I believe it will be a game changer for several companies and their customers as it will dramatically advance productivity. We'll have more on this in our podcasts and in future commentaries, but we are certainly looking for long-term opportunities in this space.

Another area that we see benefiting from rate cuts going forward are small-cap and micro-cap companies. This may surprise many, but small companies comprise more 90% of U.S. companies, and more than 40% of the publicly traded companies on the exchanges. But according to Bloomberg Analytics, over the past decade they have underperformed large-cap companies by the widest margin in history, currently selling at half the price-to-earnings multiple. Historically, this is where opportunity lies as small- and micro-cap companies



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What Lies Ahead?

2023 closed with strong finishes among most of the asset classes. Unlike 2022, growth led the way and produced outsized returns for those tech investors that were able to stomach the significant drawdown the year before. A favorite performance chart of mine is the asset allocation quilt. The one below highlights the major asset classes and their respective performance.

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	10 Years
REITs 30.4%	REITs 2.4%	Small Cap 26.6%	EM 37.3%	Cash 1.7%	Large Cap 31.2%	Large Cap 18.3%	REITs 40.5%	Comdty 17.5%	Large Cap 26.2%	Large Cap 11.9%
Large Cap 13.5%	Large Cap 1.3%	Mid Cap 20.5%	Int'l Stocks 25.1%	Bonds 0.1%	REITs 28.9%	EM 17.0%	Comdty 31.1%	Cash 1.4%	Int'l Stocks 18.4%	Mid Cap 9.0%
Mid Cap 9.4%	Bonds 0.5%	Comdty 12.9%	Large Cap 21.7%	TIPS -1.4%	Mid Cap 25.8%	Mid Cap 13.5%	Large Cap 28.8%	EW -11.5%	Mid Cap 16.1%	Small Cap 8.6%
Bonds 6.0%	Cash -0.1%	Large Cap 12.0%	Mid Cap 15.9%	Large Cap -4.6%	Small Cap 22.6%	Small Cap 11.4%	Small Cap 26.8%	TIPS -12.2%	Small Cap 16.1%	REITs 7.4%
Small Cap 5.5%	Int'l Stocks -1.0%	EM 10.9%	Small Cap 13.1%	REITs -6.0%	Int'l Stocks 22.0%	TIPS 10.8%	Mid Cap 24.5%	Bonds -13.0%	REITs 11.8%	EW 5.0%
EW 4.0%	TIPS -1.8%	EW 10.0%	EW 12.6%	EW -7.2%	EM 18.2%	EW 7.8%	EW 16.3%	Mid Cap -13.3%	EW 10.2%	Int'l Stocks 4.2%
TIPS 3.6%	Small Cap -1.8%	REITs 8.6%	REITs 4.9%	Small Cap -8.6%	EW 17.5%	Int'l Stocks 7.6%	Int'l Stocks 11.5%	Int'l Stocks -14.4%	EM 9.0%	TIPS 2.3%
Cash -0.1%	Mid Cap -2.5%	TIPS 4.7%	Bonds 3.6%	Mid Cap -11.3%	Bonds 8.5%	Bonds 7.5%	TIPS 5.7%	Small Cap -16.1%	Bonds 5.7%	EM 1.8%
EM -3.9%	EW -4.7%	Bonds 2.4%	TIPS 2.9%	Comdty -13.1%	TIPS 8.4%	Cash 0.4%	Cash -0.1%	Large Cap -18.2%	Cash 4.9%	Bonds 1.8%
Int'l Stocks -6.2%	EM -16.2%	Int'l Stocks 1.4%	Comdty 0.7%	Int'l Stocks -13.8%	Comdty 7.6%	Comdty -4.1%	Bonds -1.8%	EM -20.6%	TIPS 3.8%	Cash 1.1%
Comdty -18.6%	Comdty -28.2%	Cash 0.1%	Cash 0.7%	EM -15.3%	Cash 2.0%	REITs -4.6%	EM -3.6%	REITs -26.2%	Comdty -9.9%	Comdty -1.9%

Funds: EEM, VNQ, MDY, SPSM, SPY, EFA, TIP, AGG, DJP, BIL

Some observations

Bad to good and good to bad:

- 2022 was bad for the majority of asset classes; 2023 was good
- In 2022 commodities did well; they didn't in 2023
- The Nasdaq 100 was down more than 30% in 2022; in 2023 it was up more than 50%.

Markets aren't always black and white like this, but sometimes mean reversion holds true. It pays to have patience—and a long-term investment mindset.

Large Caps vs. Small Caps:

The S&P 500 was the leader of the pack yet again. Large-cap U.S. stocks have been outperforming basically everything else since the Great Recession in 2008. As for small caps... the cheap get cheaper. Respectively, they are averaging an 8.6% return over the past ten years, but they have significantly lagged large caps.

Valuation	S&P 500	Small Caps	Small Cap Value
Price/Earnings	21.65	13.61	10.82
Price/Book	3.87	2.05	1.58
Price/Sales	2.45	1.2	0.85
Price/Cash Flow	15.15	9.46	7.23

Source: Vanguard
Funds: SPY, VB, VBR

To be fair, small-cap stocks are cheap for good reason. Smaller corporations are far more sensitive to interest rates than are large corporations. The biggest companies were able to lock in ultra-low interest rates during the pandemic. Many small companies weren't so lucky and are now paying the price in a higher rate environment. This can't last forever, but exactly when mean reversion will make a return in the small-cap environment is anyone's guess.

I have no idea what the 2024 quilt will look like. We are off to a shaky start as of this writing, but that can be expected after the strong close to 2023. We may get mean reversion, or momentum may take charge. Investing would be a lot easier if you could predict the winners and allocate your money appropriately, but of course that's nearly impossible to do on a consistent basis. Do not let past performance dictate your 2024 investment allocation. Have a plan—and stick to it.

Brant Jones, CFP®

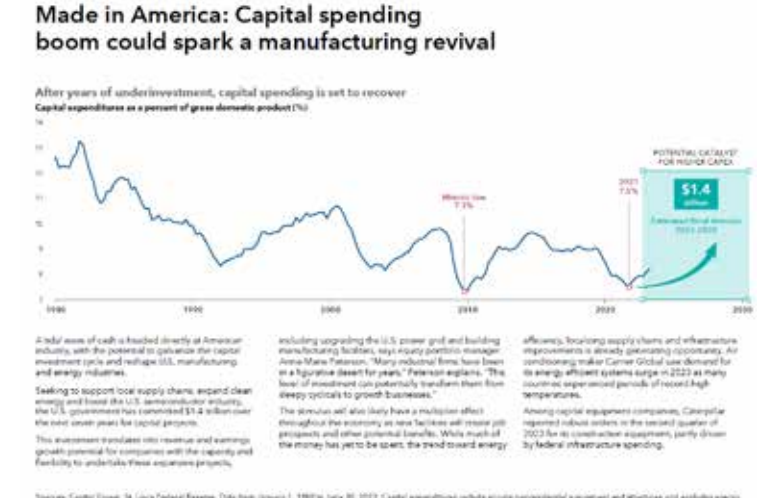
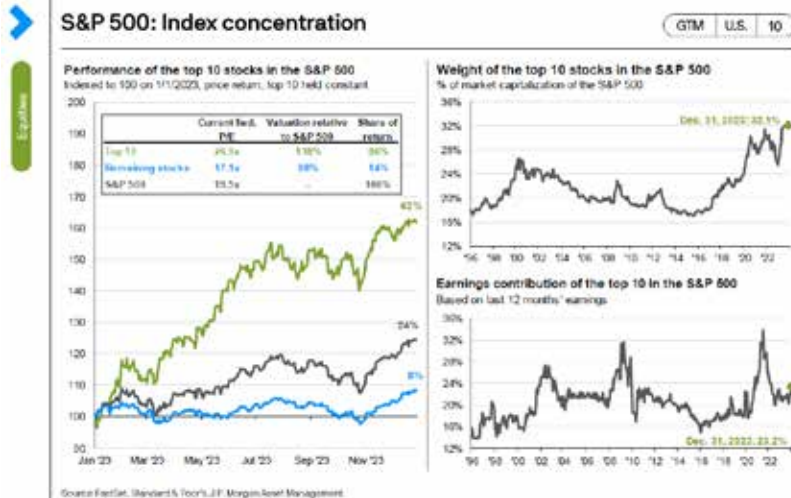
tend to do well in rate-cutting cycles such as the one we are about to enter. Also, the valuation disparity is dramatic—many small- and micro-cap companies are selling at deep discounts to their growth rates as compared to larger companies, where valuations look rich in many sectors. We are currently invested in, and are looking for good entry points on, several attractive long-term opportunities in this significantly overlooked space. Further, we expect a reversion to the mean, and we anticipate that market cap range could outperform in the years to come.

Finally, with the onshoring of manufacturing back to the US, driven by supply chain disruptions and positive legislative actions (e.g., the CHIPS Act and the very large and significant Infrastructure Investment and Jobs Act), we continue to find excellent long-term opportunities in the manufacturing sector. As you can see from the chart below, a manufacturing revival appears to be under way.

We were pleased with our performance in 2023, and we look to position the portfolio to take advantage of the potential market volatility noted above, as well as these overlooked and underappreciated market segments where we believe great values can be found. We thank all of our partners and clients for their continued confidence and trust in us, and we look forward to striving for even greater heights in 2024.

Kind regards,

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