Q4 2023

Quarterly Perspectives

MEEDER

MARKET PERFORMANCE UPDATE

Stocks rallied in the fourth quarter and boosted 2023 total returns, as illustrated in **Exhibit 1**. Market breadth improved near the end of October when PCE Inflation results were less than market expectations. Investor confidence increased that the Fed would no longer tighten monetary policy, and interest rates fell at a historic rate. The 10-year Treasury yield declined from roughly 5% to 3.8% in just two months! For perspective, this move in yields was more substantial than 98% of all 2-month moves going back to 1962.

EXHIBIT 1

MARKET PERFORMANCE AS OF 12/31/2023

INDEX	Q4	2023
S&P 500 Index TR	11.7%	26.3%
S&P 500 Equally Weighted Index TR	11.9%	13.8%
S&P Mid Cap Index TR	11.7%	16.4%
Russell 2000 Index TR	14.0%	16.9%
MSCI EAFE Index TR	10.4%	18.2%
MSCI EM Index TR	7.9%	9.8%
Bloomberg Aggregate Bond Index TR	6.8%	5.5%

SOURCE: BLOOMBERG

Demand for small- and mid-cap stocks spiked after a positive inflation data surprise because higher interest rates impact smaller companies disproportionately more than their large-cap peers. Small-cap stock performance gained 14% in the fourth quarter, pushing their annual returns into positive territory. Those gains in the final quarter were impressive but nothing compared to the 2023 performance of the Magnificent Seven stocks. The group includes Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia, and Tesla, which combined to produce a return of +107% in 2023. This performance was primarily because these companies are leading their respective peers in innovation by heavily incorporating artificial intelligence into their products and business models. This adoption drove the difference between the market-cap-weighted S&P 500 Index and the Equally Weighted S&P 500 Index returns of 26.3% and 13.8%, respectively.

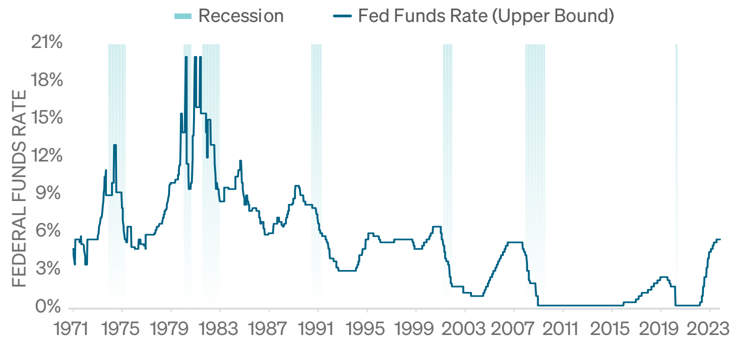
THE FEDERAL RESERVE

The Fed remained at the center of investment discussions throughout the year as the committee continued its quest to contain the highest inflation the U.S. has experienced since the early 1980s. The Fed raised interest rates four times throughout 2023 and increased the federal funds rate to a range of 5.25%-5.50%, its highest level in 22 years. The Fed raised the cost of capital to reduce inflation, "gently tapping the brakes" to dampen the extended robust economic growth. The Fed's goal is to avoid pushing the economy into a recession by reducing rates before economic growth stops, creating a soft landing.

One significant problem is that the Fed has only accomplished a soft landing twice in nine rising-rate cycles since 1970. At the December FOMC meeting, Powell admitted that the committee does not have a good track record in orchestrating soft economic landings. **Exhibit 2** plots the upper bound of the Fed Funds rate since 1970 and shows both the expansionary and recessionary periods. The illustration shows that historically, the Fed typically begins cutting interest rates but fails to lower them quickly and substantially enough before the economy enters a recession.

EXHIBIT 2

TOO LITTLE...TOO LATE



SOURCE: NBER & BLOOMBERG

Investors are concerned that this could occur again and continue to watch the U.S. employment situation closely as a leading indicator. Thankfully, the December jobs report showed that the Fed is one step closer to achieving its soft landing as unemployment remained relatively stagnant at 3.7%, and job openings continue to decline. As economic activity continues to slow, employers in the U.S. are choosing not to fill open positions rather than eliminating existing ones and is a trend the Fed wants to continue.

THE FED PIVOTS FROM HIKING RATES TO POTENTIAL CUTS

At the December FOMC meeting, Jerome Powell stated, "We believe that our policy rate is likely at or near its peak for this tightening cycle..." Powell's statement indicated that the committee shifted its focus from potentially raising interest rates to anticipating future cuts. So, how will markets perform UNTIL the Fed starts cutting interest rates? **Exhibit 3** examines the historical performance of the S&P 500 over the last nine monetary tightening cycles when the Fed has paused and illustrates the return of the S&P 500 Index calculated from the day after the last Fed rate hike until the day of the First Fed cut. Some cycles produced positive returns while others were negative, but the S&P 500 Index was up +5.2% on average during the pause. **Exhibit 4** shows that from the day after the last rate hike on January 27, 2023, through the end of the year, the price of the S&P was 4,770, representing a gain of 5.14%! The Fed has not made its first interest rate cut, but it will be interesting to see how prices move as we get closer to that first cut.

EXHIBIT 3

WHAT HAPPENS WHEN THE FED PAUSES?

DAY AFTER LAST FED HIKE	DAY OF FIRST FED CUT	NUMBER OF DAYS	RETURN FROM DAY AFTER LAST FED HIKE TO CUT
5/2/1974	7/1/1974	60	-6.6%
3/4/1980	4/1/1980	28	-9.4%
5/11/1981	6/1/1981	21	2.1%
8/22/1984	10/2/1984	41	-2.1%
2/27/1989	6/5/1989	98	11.9%
2/2/1995	7/6/1995	154	17.2%
5/17/2000	1/3/2001	231	-6.9%
6/30/2006	9/18/2007	445	19.6%
12/20/2018	7/31/2019	223	20.8%
AVERAGE		145	5.2%

SOURCE: BLOOMBERG

EXHIBIT 4

IF HISTORY REPEATS ITSELF

DAY AFTER LAST HIKE: 7/27/23

S&P 500 PRICE	+	AVERAGE INCREASE	=	NEW S&P 500 PRICE
4,537 7/27/23		**5.2%**		**4,773**

12/31/23
S&P 500 = 4,770

SOURCE: BLOOMBERG

WHEN WILL THE FED START CUTTING RATES?

The Fed's stated objective is to reduce PCE inflation to 2%, but does that mean the Fed will wait until then before cutting? Powell addressed this concern directly at the last Fed meeting and stated, "You wouldn't wait to get to 2% [inflation] to cut rates. It would be too late. You'd want to be reducing the amount of "restriction on the economy well before you get to 2%."

It will be interesting to see how the equity markets will react to the first interest rate cut. One common perception among investors is that the stock market performs well as soon as the Fed starts cutting interest rates. History tells us this is not necessarily the case.

In fact, **Exhibit 5** shows over the past nine initial interest rate cuts, more than half of the Fed's first cuts were followed by declines in the S&P 500 Index that ranged from -22.6% to -55.5%. The Technology bubble in the early 2000s and the Great Financial Crisis proved to be the worst scenarios, with the Fed cutting interest rates at two different times during the secular bear market of 2000–2009.

EXHIBIT 5

WHAT TO EXPECT AFTER THE FIRST FED RATE CUT?

FIRST CUT DATE	S&P 500 DECLINE TO LOW	NUMBER OF DAYS TO LOW
07/01/1974	-27.6%	94
04/01/1980	-2.3%	20
06/01/1981	-22.6%	437
10/02/1984	-1.2%	7
06/05/1989	-8.3%	493
07/06/1995	-0.5%	13
01/03/2001	-42.4%	644
09/18/2007	-55.5%	538
08/1/2019	-24.2%	235
AVERAGE	**-20.5%**	**276**

SOURCE: STRATEGAS, BLOOMBERG

On the other hand, four of the nine occurrences were followed by minimal weakness and achieved strong 6-month returns. On balance, over the past nine initial interest rate cuts, the S&P 500 Index had an average decline of -20.5% and an average 6-month return of 3.4%.

While the market has experienced both bull and bear markets following the first Fed rate cut, history does not indicate that the Fed's accommodative policy will carry the market higher. Valuations matter, too. **Exhibit 6** illustrates that when the market experienced a decline of at least -20 % after the Fed's first cut, the average S&P 500 trailing PE ratio was 18. On the other hand, when the S&P 500 had a decline of less than -10 %, the average PE ratio was 11.4. The current P/E ratio of 23 could be another reason to be more cautious once the Fed makes its first cut.

EXHIBIT 6

VALUATIONS MATTER

S&P 500 INDEX DECLINES AFTER FIRST FED RATE CUT SINCE 1974

DECLINES AFTER FIRST FED RATE CUT	S&P 500 P/E RATIO* ON FIRST FED RATE CUT
Greater than **-20%**	18
Less than **-10%**	11

23
CURRENT P/E

*Trailing 12-month price to earnings ratio

SOURCE: BLOOMBERG

HOW IS THIS IMPACTING PORTFOLIOS?

Meeder manages investment strategies utilizing a multi-discipline and multi-factor investment approach that guides us in allocating our portfolios. We manage investment solutions across an array of risk profiles and time horizons. Many of these solutions employ one or more of our core investment strategies: Growth, Defensive Equity, and Fixed Income.

GROWTH STRATEGY

Investment portfolios utilizing the Meeder Growth Strategy maintain a more aggressive objective and typically remain invested in the stock market.

The S&P 500 Index climbed nearly 10% in the fourth quarter, bringing the 2023 return above 26%. Growth-oriented stocks continued outperforming their value-oriented peers, with large-cap stocks posting the best performance in 2023 of the market capitalizations. After experiencing negative performance year-to-date through October 27, 2023, small-cap stocks rallied after lower-than-expected inflation data boosted confidence. This data result shifted the Fed's outlook from a potential rate hike to possible rate cuts in 2024. Investors in portfolios employing the Growth Strategy experienced more volatility in the fourth quarter than others in our suite of risk-based portfolios. However, those who remained invested earned some of the highest performance.

DEFENSIVE EQUITY STRATEGY

Portfolios that utilize the Meeder Defensive Equity Strategy follow a quantitative rules-based and data-driven approach using the Meeder Investment Positioning System (IPS) model. This investment model determines the risk relative to the reward present in the marketplace and identifies when we should increase or decrease the portfolio's target equity exposure.

We began the quarter with 90% exposure to stocks. The Israel-Hamas war caused geopolitical tensions to rise, and equity market risk increased. The long-term model score was cautious as a combination of higher interest rates and above-average inflation results challenged the equity market. By the end of October, the long-term model score turned negative, led by a combination of weak industry market breadth and worsening leading economic indicators. Equity market risk remained above its 10-year average and posed challenges for equities. The long-term model score was cautious as above-average inflation and elevated valuations remained headwinds for equity markets. These model factors guided us to reduce our equity exposure down to 77% near the end of October.

With the S&P 500 Index nearly 7% above its October low, we continued to see improvement in the short-term model score. Equity market risk fell drastically, with the VIX dropping from 21.7 in mid-October to 15 in early November. This improvement led us to increase our equity exposure to 87% shortly after mid-November. Market expectations of Fed policy turned accommodative after downward trending inflation reports and weakening job data. This data led to optimism within the intermediate-term model. The S&P 500 climbed more than 8% in November, and market breadth increased with an average of 1.5x more advancing stocks than declining stocks in November. This equity strength and improving market breadth led to all trend and momentum indicators turning positive. The short-term model score significantly increased and caused us to extend our equity exposure to 90% to begin December.

By the middle of December, an increase in expectations that the Fed will begin cutting interest rates in the first half of 2024 strengthened the intermediate-term model score to climb near one of its best readings in history. The bullish investor sentiment, which we view from a contrarian perspective, led to increased demand for U.S. small- and mid-cap stocks. The VIX fell below 12.5 for the first time in almost four years. The combination of these factor changes resulted in us keeping our equity exposure at 90% through year-end.

FIXED INCOME STRATEGY

The Meeder Fixed Income Strategy tactically shifts portfolio exposure utilizing our proprietary investment models. These models actively monitor economic and market-related factors to guide us in determining the credit quality, emerging market debt exposure, and the portfolio's U.S. Treasury duration.

It was a seesaw fourth quarter for the bond market. Interest rates rose rapidly during October, with the U.S. 10-year Treasury yield rising from 4.59% at the end of the third quarter to 5.0% by the end of the month. In November, yields declined rapidly—from near 5.0% to 3.88% at the end of the quarter—as expectations for further Fed rate hikes disappeared from the marketplace and investors began pricing in Fed rate cuts. Disinflationary economic data were the key drivers leading the bond market rally during the quarter. Investment grade fixed income rose 6.82%, and high-yield bonds rose 7.16% during the quarter.

The duration of the Tactical fixed-income strategy remained shorter than its respective benchmark, finishing the month of December with an effective duration of less than three years; however, the duration was increased during the quarter to take advantage of rising bond market yields in October and then reduced again after the rally. This positioning was a positive contributor to its relative performance during the quarter. The strategy also maintained an overweight to U.S. high yield and increased exposure to this sector during December. On a relative basis, this high-yield position positively contributed to the strategy's performance.

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