Broadleaf Partners, LLC

Our 2024 Playbook January 18, 2024

Each year, we look back at the prior year's Investment Playbook to assess what we got right, what we got wrong, and what we learned in the process. We then turn to the coming year, putting our dominant ideas in writing, with hopes of gaining greater clarity on the factors that might drive our investment returns going forward.

This piece isn't meant to be detailed or comprehensive along the lines of the many forecast pieces that Wall Street publishes at the beginning of each year. We also won't promote headline grabbing predictions just to get the attention of readers – we're far more comfortable being boring if that's what seems right and is more helpful to our clients.

Our Playbook is as much for us as it is for you; it is meant to serve as a compass for orienting our investment decisions during the year and helping you to understand the primary influences that may affect those decisions. How we react to new information that comes along during any given year is always subject to our discretion, a distinguishing feature of active management. Regardless of the outcome, the intent is always to drive superior returns over time, learning from our inevitable mistakes along the way.

Thank you for your continued confidence in our approach and interest in our work!

Looking Back and Looking Forward

Our annual playbook has typically focused our attention on three variables each year: the economy, the markets, and politics. This framework has served us well over the years so we will stick with it!

The Economy

At this time last year, we didn't believe a recession was as inevitable as many were expecting given the Fed's aggressive tightening campaign. We felt a soft landing or even a no landing was within the realm of reason. We also felt that inflation trends would continue to improve, enabling the Fed to halt further hikes at some point during the year. We believed strength from a broadening set of economic sectors and a healthy employment climate would offset continued weakness from pandemic beneficiaries and the more interest rate sensitive sectors of the economy like housing.

In general, our playbook for the economy was a remarkably good one, even though it didn't necessarily play out in the ways we thought it might have for the markets, which we'll get to in a moment.

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What do we think 2024 will hold for the economy?

In general, more of the same. The economy should continue to expand and the Fed may be able to cut rates a time or two by year end as inflation moderates towards their 2% goal. With the national debt level as large as it is, we don't think a recession will be required to get the Fed to reduce rates if for no other reason than that government shouldn't pay a higher rate of interest than they need to. Even in the face of economic weakness from China and elsewhere, our outlook for the domestic economy in 2024 remains positive given the strong employment outlook.

<u>The Markets</u>

We've long held to a proprietary investment approach in which three cycles work together to influence value creation in the stock market. These three cycles include the *Economic Cycle, the Innovation Cycle and the Credit Cycle.*

Last year, we believed that the factors influencing these three cycles in 2022 would largely continue into 2023. Specifically, we felt that the continued effects of supply and demand imbalances would support a broadening in stock market participation, particularly at the sector level, as China finally reopened and as difficulties on the geopolitical front remained front and center.

We felt that Innovation Cycle names and, in particular, non-profitable, pandemic-based beneficiaries, would likely remain dead money if not on an absolute basis then at least on a relative basis. On the other hand, profitable, established tech names might find some support as earnings stabilized. We wrote that earnings quality would be an important factor for investors in 2023.

With respect to the Credit Cycle, we believed the Fed would likely pause but not pivot for fear of reigniting inflation as occurred in the 1970's. We felt the markets could bounce in 2023, but given the concentration of tech in the S&P 500 and the layoffs and restructurings occurring in the sector, the markets as whole might continue to struggle and at the very least experience additional churn.

In last year's playbook, we shared our experience of living through the tech bubble over twenty years ago, suggesting that while not as dire given tech's profitability today, the case could be made for a broadening out in the market away from tech, as was the case at that time. We felt it important to stay with tech longer term, but were intrigued by the potential for a shift in market leadership in 2023.

This playbook was relatively short-lived. Artificial intelligence rescued the entire tech sector, taking many management teams by surprise. ChatGPT captured the imagination of investors and unleashed massive capital spending campaigns by the likes of Microsoft on new data center architectures and all things Nvidia. Tech companies also restructured their operations much more aggressively than anticipated. With inflation trends continuing to improve, something we got right, market based rates reversed course and started to decline.

In summary, artificial intelligence literally saved the tech sector, with falling rates fanning the flames yet further. Instead of the markets broadening away from tech, the opposite occurred, and many of the tech favorites that had been hit the hardest in 2022 bounced back the most. China's reopening was a non-event compared to the United States' own reopening, with deflationary forces and overbuilding suggesting a path dangerously similar to 1980's Japan. At halftime, we knew we needed to make changes to our Playbook and we did just that.

As we look to 2024, we'll once again put ourselves in the more of the same camp with respect to the markets. While the gains may not be as great as they were in 2023, the Innovation Cycle will in all likelihood have a greater impact on returns than the Economic Cycle. Companies will no longer be able to raise prices and may even be forced to reduce them, meaning growth will be scarcer and innovation more vital for market success.

Politics

Last year, we waxed too poetically on the topic of politics, believing that the dysfunction might moderate as the market broadened and the have's and have not's switched places in society for a period of time. Overzealous and preachy employees of the more "woke" sectors of the economy, in experiencing layoffs and tougher times, might develop some empathy for the hardened, disenfranchised Trump voter.

While some of the ESG rhetoric has toned down and tech leaders have become a tad less preachy than they were just two years ago, we were obviously a tad too idealistic in thinking we might have more empathy for one another in 2023. One need look no further than the Israeli/Palestinian conflict to realize just how divided we remain. Geopolitically speaking, We The People, may literally be our own greatest risk as a nation.

With the 2024 Presidential election looming, this year will likely be a nasty one politically. It could quite literally be dangerous to one's health if proper boundaries aren't set. For our part, we plan to avoid cable news at all costs and will seek to understand what is true by interacting with our families, neighbors and church. While some feed on digitized discontent, we'll feast on simple joys like a good book, hikes in the outdoors with our dog Lilly, and a warm, cozy fireplace. Call us selfish, but this will be our intentional reality.

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We'll close our 2024 Playbook as we have always done, by reminding investors that our business is never easy, but is always an intellectual challenge we enjoy pursuing. We appreciate your faith and trust in Broadleaf!

May God bless you abundantly in the coming year, even if it comes in ways you don't expect!

Kindest Regards,

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