

Morningstar ETF Allocation Series

Commentary | December 31, 2023

Summary

Investors will likely be happy as they review their statements at the end of 2023. Nearly all traditional asset classes generated positive returns, boosted by performance across US large caps, US small caps, non-US stocks and bonds during the final quarter of the year.

The quarter was particularly favorable for stocks, with a rising tide lifting most boats. At a sector level, 10 of the 11 major sectors delivered positive returns for the quarter, with energy the only sector to record a modestly negative number. The Morningstar US Market Index, a barometer of US large-cap equities, posted an impressive gain of 12.1% for the quarter and a whopping 26.4% for the year, defying the earlier predictions of a difficult year due to an economic downturn. The economy has been incredibly resilient so far, with the labor market holding up and recession expectations falling.

Global markets caught the tailwind and were not too far behind, although they couldn't outshine their US counterparts. Emerging markets lagged, with China underperforming. Despite the international markets' relatively weaker performance, the overall strength in equities painted a positive picture of global investor health. The surge in small-cap stocks could be indicative of the market's renewed appetite for risk, often a harbinger of economic optimism.

On the fixed income front, bonds delivered good performance in the final quarter of 2023, also benefiting from the anticipated interest rate cuts by the Federal Reserve. The correlation between falling interest rates and increasing bond prices played out, with longer-dated bonds doing especially well.

That said, it was corporate bonds that stood tall among their peers. These bonds, which are typically more sensitive to economic conditions, outperformed government bonds, indicating a strong corporate sector. Longer-dated bonds also outperformed short-dated bonds, although all duration profiles saw gains.

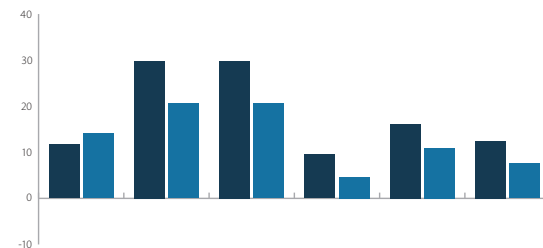
Returns of Key Indexes

	3 M	YTD	1 Y	3 Y	5 Y	10 Y
Domestic Stock						
S&P 500	11.69	26.29	26.29	10.00	15.69	12.03
Morningstar US Market TR USD	12.08	26.43	26.43	8.61	15.25	11.60
NASDAQ Composite	13.79	44.64	44.64	6.04	18.75	14.80
International Stock						
Morningstar DM xUS NR USD	10.51	17.25	17.25	3.68	8.21	4.36
Morningstar EM NR USD	7.77	11.51	11.51	-3.15	4.90	3.53
Fixed Income						
Bloomberg Aggregate	6.82	5.53	5.53	-3.31	1.10	1.81
Bloomberg High Yield Corporate	7.16	13.44	13.44	1.98	5.37	4.60
Bloomberg Credit	8.15	8.18	8.18	-3.21	2.45	2.83
Bloomberg Government Bond	5.62	4.09	4.09	-3.74	0.56	1.27
Bloomberg Long Term Treasury	12.70	3.06	3.06	-11.41	-1.24	2.28

Past performance is no guarantee of future results. Index performance is not indicative of fund performance. One may not invest directly in an index.

Morningstar Index Returns %

Large vs. Small

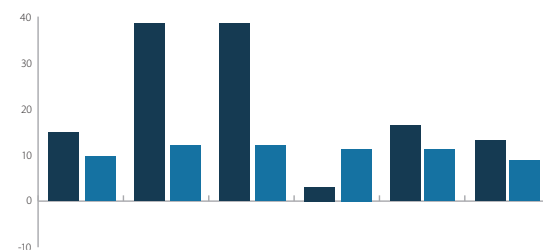


	3 M	YTD	1 Y	3 Y	5 Y	10 Y
Large Cap	11.69	29.81	29.81	9.53	16.08	12.37
Small Cap	14.07	20.59	20.59	4.56	10.88	7.56

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Both small and large stocks recorded double-digit positive returns in the final quarter, but it was small caps that took first place on the leaderboard. The Morningstar US Small Cap Index increased 14.1%, with the Morningstar US Mid Cap Index rising 12.8% and the Morningstar US Large Cap Index up 11.7%.

Growth vs. Value



	3 M	YTD	1 Y	3 Y	5 Y	10 Y
Growth	14.87	38.48	38.48	3.04	16.38	13.08
Value	9.71	11.98	11.98	11.29	11.22	8.83

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Contrastingly, inflation-linked bonds, which are designed to help protect investors from inflation, failed to keep up with their counterparts. Given lower-than-expected inflation prints, these securities didn't see the same level of demand, leading to underperformance for the period.

Growth stocks had a strong finish to the year, with the Morningstar US Growth Index gaining 14.9% in the final quarter. This resulted in outperformance relative to value stocks, which also saw healthy gains but failed to keep pace. The Morningstar US Value Index increased 9.7% in Q4, held back in part due to losses among energy stocks.

Index Definitions

Bloomberg Credit Index: The US Credit Index comprises the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities. The US Credit Index was called the US Corporate Investment Grade Index until July 2000, when it was renamed to reflect its inclusion of both corporate and non-corporate issuers. Index history is available back to 1973. The US Credit Index is a subset of the US Government/Credit Index and the US Aggregate Index.

Bloomberg Government Bond Index: Securities issued by the US Government (i.e., securities in the Treasury and Agency Indices). Inclusions: Public obligations of the US Treasury with a remaining maturity of one year or more. Publicly issued debt of US Government agencies, quasi-federal corporations and corporate or foreign debt guaranteed by the US Government.

Bloomberg Long Term Treasury Index: Securities in the long maturity range of the US Treasury Index. The US Treasury Index represents the public obligations of the US Treasury with a remaining maturity of one year or more.

Bloomberg US Aggregate Bond Index: The US Aggregate Bond Index is the market-value-weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed and mortgage-backed securities, with maturities of at least one year.

Bloomberg US Corporate High Yield Index: The US Corporate High-Yield Index measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB/BB or below, excluding emerging market debt. The US Corporate High-Yield Index was created in 1986, with history backfilled to July 1, 1983, and rolls up into the Bloomberg US Universal and Global High-Yield Indices.

Morningstar DM ex-US Index: The index tracks developed markets ex-US targeting the top 97% of stocks by market capitalization.

Morningstar Emerging Markets Index: The index tracks emerging markets targeting the top 97% of stocks by market capitalization.

Morningstar Large Cap Index: The Morningstar Large Cap Index tracks the performance of US large-cap stocks. These stocks represent the largest 70 percent capitalization of the investable universe.

Morningstar Mid Cap Index: The Morningstar Mid Cap Index measures the performance of mid-cap stocks in the US. It targets securities that fall between the 70% and 90% market cap thresholds of the investable universe.

Morningstar Small Cap Index: The Morningstar Small Cap Index tracks the performance of US small-cap stocks. These stocks fall between the 90th and 97th percentile in market capitalization of the investable universe. In aggregate, the Small Cap Index represents seven percent of the investable universe.

Morningstar US Growth Index: The Morningstar US Growth Index tracks the performance of stocks that are expected to grow at a faster pace than the rest of the market as measured by forward earnings, historical earnings, book value, cash flow and sales.

Morningstar US Market Index: The index measures the performance of US securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index.

Morningstar US Value Index: The Morningstar US Value Index tracks the performance of stocks with relatively low prices given anticipated per-share earnings, book value, cash flow, sales and dividends.

NASDAQ Composite Index: Measures the performance of all issues listed in the NASDAQ Stock Market, except for rights, warrants, units and convertible debentures. Morningstar reports the NASDAQ Composite as a price return.

Standard & Poor's 500 Index: Market-capitalization-weighted index of 500 widely held stocks. Member companies are chosen based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies.

One may not invest directly in an index.

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