Centier FINANCIAL PARTNERS

INVESTMENTS & FIDUCIARY SERVICES

QUARTERLY MARKET INSIGHTS

4TH QUARTER 2023

SPOTLIGHT

PRIVATE CREDIT BOOM

– Private credit's assets under management (AUM) have skyrocketed to $1.6 trillion as of March 2023, a doubling in size since 2018.

– Investors have been attracted to private credit because it offers higher yields due to an illiquidity premium.

– Borrowers are attracted to private credit's superior deal customization, speed, execution, and confidentiality.

A boom in private credit has led medium-sized companies to shift away from bank lending and leveraged loans. Private lending has rapidly grown from a niche market into a formidable rival to traditional sources of financing as money pours into private credit funds from asset managers, insurance companies, endowments, and pension funds. According to alternative asset data provider Preqin, private credit's assets under management (AUM) have skyrocketed to $1.6 trillion as of March 2023, double its size in 2018. Excluding $440 billion in uninvested capital, private credit's $1.2 trillion in debt outstanding is almost the size of the U.S. high yield bond and leveraged loan markets. It is nearing half the size of overall U.S. banks' business lending of around $2.8 trillion. Asset manager BlackRock projects private credit will grow to $3.5 trillion AUM by 2028.

Private credit refers to debt financed by non-bank lenders, such as alternative asset managers like Blackstone, and which is not publicly traded. It covers a range of strategies, including direct lending, distressed, mezzanine, real estate, venture, and special situations. According to Goldman Sachs Asset Management, direct lending is the largest strategy and accounts for around half of private credit's assets. Direct lending loans are usually somewhat similar to leveraged loans with floating interest rates and non-investment grade credit risk profiles. The main difference is that leveraged loans are typically sold to investors after being pooled into tradable securities such as collateralized loan obligations (CLO), whereas direct lending loans are held by the lenders until maturity.

Prior to recent years, private credit tended to serve smaller and less profitable borrowers that could be too small for the public debt market and might have challenges with attaining conventional bank financing that skewed toward less risky borrowers. The market opportunity for private credit has expanded in recent years into a more diverse group of borrowers as the growth in public debt markets caused a structural shift toward serving larger borrowers with bigger deal sizes. The average deal size for issuing high yield bonds and leveraged loans has steadily risen over the last decade to $700 million and $470 million last year, respectively. Bigger average deal sizes are unrealistic for an increasing number of medium-sized firms looking to issue relatively smaller amounts of debt. Issuing public debt with small deal sizes can be unattractive for borrowers because it risks being undersubscribed among investors due to less liquidity. According to Pitchbook, leveraged loan issuance among middle market companies has stagnated near multi-decade lows in recent years as financing shifts to private lenders. The National Center for the Middle Market estimates there are nearly 200,000 U.S. middle market businesses with revenue between $10 million and $1 billion. medium-sized businesses account for around one-third of U.S. private sector Gross Domestic Product (GDP).

Private credit's growth has been supported by borrowers seeking private financing because it can provide more customization with deal terms, quicker speed and certainty of execution, and increased confidentiality. Private loans often have one lender which fosters closer relationships with borrowers compared to working with a group of lenders for leveraged loans. Closer relationships between borrowers and lenders can enable more customized financing terms and a wider range of options in the event of default. Fewer parties in a deal may also create quicker and more certain deal execution, especially during times of market stress.

Investors have been attracted to private credit because it offers higher yields due to an illiquidity premium. This yield premium is driven by private loans' non-publicly traded status and their historically higher credit risk. The Cliffwater Direct Lending Index, an asset-weighted index of 13,000 loans using SEC required filings for business development companies, had an average yield around 11% over the last decade compared to mid-single digit average yields for high yield bonds and leveraged loans. The yield spread between private loans and leveraged loans has recently narrowed to less than 3% as the Federal Reserve's interest rate hikes caused a jump in leveraged loan yields. Some long-term investors who engage in asset liability matching, such as pension funds and life insurance companies, also appreciate that private debt is not held in mark-to-market investment vehicles. This means private loans' accounting value tends to be less volatile during periods of market stress and can thus reduce unrealized losses.

> "PRIVATE CREDIT'S $1.2 TRILLION IN DEBT OUTSTANDING IS ALMOST THE SIZE OF THE U.S. HIGH YIELD BOND AND LEVERAGED LOAN MARKETS."

The swift rise in private credit has raised concerns among some investors and regulators. Private lenders have less stringent public disclosure requirements compared to banks and lack the visibility of leveraged loans. The lack of transparency creates uncertainty about the level of distress in private credit as the newly popular asset class endures its first higher interest rate environment and potential recession. A material shock in this less regulated area of the economy might reveal surprising vulnerabilities in the financial system, however, private credit is likely not a large enough market to cause a broader systemic issue.

PIVOTS AND LANDINGS

EXECUTIVE SUMMARY

- A *soft landing* this year is now the consensus expectation.
- The Fed is likely done with rate hikes…
- …but the amount of Fed easing in 2024 might disappoint.
- S&P 500 firms will need to deliver earnings growth in 2024.

A shift in tone from Federal Reserve officials away from the hawkishness of the prior 18 months and an ensuing steep decline in U.S. Treasury yields were the prevailing market storylines of the fourth quarter. The phrases *soft landing* and *goldilocks* as descriptions of the U.S. economy's potential path in 2024 were increasingly viewed with less derision and more deference from economists, strategists, and investors. The primary catalyst for the change in Fed messaging was a continuation in the trend of cooling inflation that pushed the year-over-year increase in consumer prices closer to the central bank's 2% target. This favorable backdrop allowed the S&P 500 and Nasdaq to recover from a challenging August to October period and record impressive quarterly gains of 11.7% and 13.8%, respectively. The blue-chip Dow Jones Industrial Average closed in negative territory for the year on October 27 before powering higher over the next two months on its way to a 13.1% fourth quarter return. Meanwhile, the small cap Russell 2000 Index surged 24.2% from a three-year closing low on October 27 through year end.

A NOVEMBER TO REMEMBER

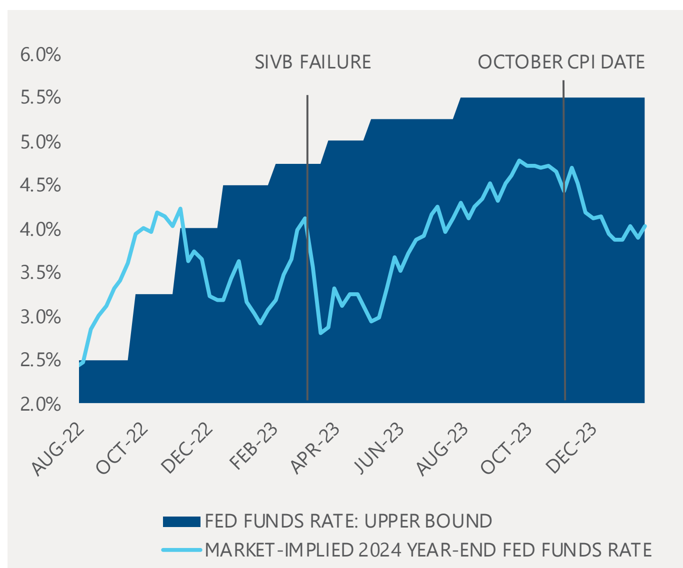
On the first day of November, the Federal Open Market Committee (FOMC) delivered what was seen by many market participants as a "dovish hold." Policymakers kept the federal funds rate in a range of 5.25%-5.50% for the second straight meeting. In his post-meeting press conference on the afternoon of November 1, Fed Chair Jerome Powell struck a slightly more balanced tone than in previous months when he noted the current tightening cycle had come far and that officials were "proceeding carefully." Throughout September and October, several Fed officials suggested the sharp increase in market interest rates (which saw the 10-year U.S. Treasury yield push above 5% for two hours on the morning of October 23) had tightened financial conditions by the equivalent of another one or two 0.25% rate hikes.

Slightly cooler-than-expected October consumer price index (CPI) data released the morning of Wednesday, November 14 seemed to provide confirmation for the growing legion of market optimists that the Fed's rate hike cycle had indeed ended in July. All the attention of investors and the financial media now turned to the timing and magnitude of Fed rate cuts. As seen in Chart 1, within several weeks, fed funds futures markets had priced in an additional 0.75% of Fed policy easing by the end of 2024. Although investors should not place too much emphasis on short-term market movements, the action on November 14 was particularly telling. On that day, the yield on the U.S. 10-year Treasury yield dropped 20 basis points within minutes of the CPI data release from 4.63% to 4.43%. The Russell 2000, S&P 500 real estate sector index, and KBW regional bank index all surged between 4.6% and 5.5% on November 14 as areas of the market hit hardest by higher interest rates enjoyed some time in the sun.

The *soft landing* camp received another shot in the arm from a November 28 speech by Federal Reserve Governor Christopher Waller titled "Something Appears to Be Giving," in which Waller said he was "increasingly confident that policy is currently well

CHART 1

MORE RATE CUTS IN 2024 WERE PRICED IN 4Q



Source: Bloomberg. Data as of 12/31/23. Past performance does not guarantee future results.

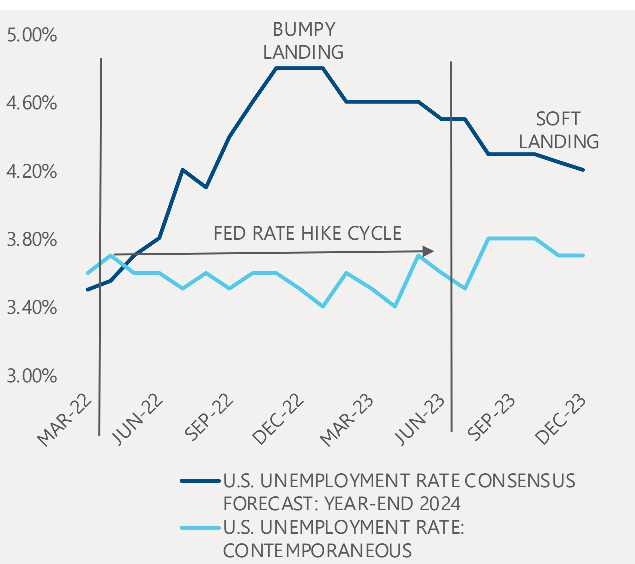
positioned to slow the economy and get inflation back to 2%." Waller's words were viewed as particularly notable considering he (along with fellow Fed Governor Michelle Bowman) is seen as one of the most traditionally hawkish Fed officials with a permanent FOMC vote.

When it was all said and done, November registered as one of the best months in modern market history with the S&P 500 Index up 9.1% and the Bloomberg U.S. Treasury Index posting a 3.5% gain. Over the last 50 years, there have only been six months (October 1975, August 1982, October 1982, February 1986, December 1991, and now November 2023) in which the S&P 500 gained at least 6% and the Bloomberg U.S. Treasury Index advanced by 3% or more.

The FOMC's quarterly summary of economic projections released on December 13 showed the median expectation of the 18 participants for the policy rate at the end of 2024 fell to 4.6% from 5.1% in September. This downward shift in the "dots plot" suggested Fed officials generally expected to reduce the fed funds rate by 0.75% in 2024. At the post-meeting press conference Chairman Powell expressed reluctance to declare victory over inflation but on several occasions suggested that annual inflation could subside to 2% without a rise in the employment rate. Although Powell did not use the phrase, this is the common definition of the historically elusive *soft landing*.

CHART 2

FEWER JOB LOSSES IN 2024 NOW EXPECTED



Source: Bloomberg. Data as of 12.31/23. Past performance does not guarantee future results.

SOFT TOUCH?

Markets didn't wait for Powell and company to spell it out for them. Mounting evidence of entrenched disinflation (the level of prices in the economy rising at a decelerating rate) and a slowing but not deteriorating labor market was enough of a signal to turn investor sentiment bullish by mid-November. Because consumer spending accounts for nearly 70% of U.S. gross domestic product (GDP), labor market trends are critical to monitor. As one would expect, U.S. consumers are more likely to pull back on their discretionary spending when they feel less secure about their job, or the prospects of quickly finding a new job.

And so, what the Fed and market optimists desired was a "goldilocks" scenario in which demand for workers cooled (helping to keep wage-based inflation in check) but stayed strong enough to soak up the roughly 80,000 monthly new entrants to the labor force. To a large extent, the jobs market delivered a "goldilocks" outcome as revised nonfarm payroll gains in the six-month period spanning July through December averaged 180,000. This struck an almost perfect balance between "not too hot" and "not too cold." It provided a measure of stabilization after job gains averaged 254,000 in the first six months of 2023 and 353,000 in the final six months of 2022. At the same time, it did not put much upward pressure on the unemployment rate.

As shown in Chart 2, the median forecast for the U.S. unemployment rate at the end of 2024 in a continuing Bloomberg survey has retreated from a high of 4.8% in December 2022 to 4.2% in December 2023. Based on the current unemployment rate of 3.7% and a labor force of 167.5 million, this 0.6% decline in the 2024 year-end estimate of the unemployment rate implies forecasters now expect approximately 1 million fewer Americans will lose their job this year. Average hourly wages grew 4.1% in December on a year-over-year basis, down from 5.9% in the 12-month period ended March 2022 but still elevated compared to an average of 2.7% from 2015 through 2019.

Continuing weekly jobless claims, a proxy for the difficulty faced by laid off workers in the U.S. to find a new job, reached a 2-year high of 1.93 million in mid-November but declined to 1.81 million over the next seven weeks. To provide a pre-pandemic frame of reference, the average continuing weekly unemployment claims in the five years spanning 2015 through 2019 was 1.96 million.

BONDS GET A REPRIEVE

The decline in Treasury yields in the final two months of the year and benign credit conditions helped the broad U.S. bond market avoid a third consecutive negative year of returns in 2023. After generating an average annualized return of 4.23% from 2009 through 2020, the Bloomberg U.S. Aggregate Total Return Index suffered a cumulative 14.27% decline in the two-year period spanning 2021 and 2022. The index was poised for another loss in 2023, before surging 8.92% from October 25 (when the 10-year U.S. Treasury yield was threatening to push above 5%) through December 29 to record a solid 5.53% total return in 2023.

As depicted in Chart 3, the rolling 12-month returns of broad U.S. investment-grade and high yield bond indexes reentered positive territory in June after a roughly 18-month absence. Subdued issuance, still-modest default rates, and a general trend of narrowing credit spreads after the regional bank turmoil of March and April helped boost corporate bond returns in the second half of the year. The foresight of many U.S. corporate management teams in 2020 and 2021 to accelerate the pace of refinancing into low fixed-rate debt and extend their average maturity profile reduced the need for issuance in 2023. In the high yield market, issuance could pick up in the second half of 2024 and into 2025 as below-investment grade borrowers look to refinance ahead of a looming maturity wall beginning in 2026. All other things equal, this could result in some high yield spread widening potentially as early as the summer and fall of 2024. This revival of bonds is important from a portfolio perspective considering most investors have at least some exposure to fixed income. Although the interest rate re-set of 2022 and the first half of 2023 was painful for bond investors, much higher starting yields for future total returns is a silver lining that should not be overlooked.

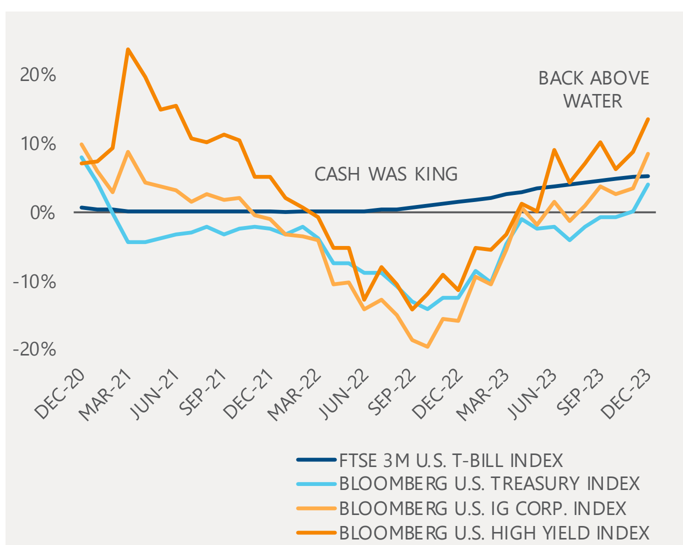
NO LANDING

Optimists contend financial conditions have tightened sufficiently to have killed off excess inflation and bring forth Fed rate cuts beginning in March. Policy easing would relieve pressure on rate-sensitive areas of the economy like commercial and residential real estate. It would provide relief to bank balance sheets weighed down by large unrealized losses that were cauterized by the Fed's emergency Bank Term Funding Program. It could also spur a wave of initial public offering and merger activity, and ultimately support higher valuations for stocks.

But yields are not predestined to move gradually lower over the course of 2024. There is a small (but probably increasing) probability that economic growth, inflation, and wage growth surprise to the upside in 2024. In this *no landing* scenario, the Fed would be hard-pressed to cut rates. Long-term bond yields would likely retest the 5% level as economic growth reaccelerates and inflation stays above trend. Although it might seem like another era, investors should remember the S&P 500 closed at a five-month low of 4,117 on October 27, one day after the initial estimate of U.S. third quarter GDP growth registered a blistering 4.9% reading. This was more than double the 2.1% growth of 2Q23 and came on the heels of much stronger-than-expected September nonfarm payrolls and retail sales on October 6 and October 17, respectively. The September jobs report was particularly unsettling for markets as U.S. employers hired a net 336,000 workers in the final month of the third quarter, nearly double the median estimate of 170,000 in a contemporaneous Bloomberg survey. The leisure and hospitality payrolls grew by an impressive 96,000 in September, driven by 61,000 new hires at restaurants as Americans fully embraced a summer of concerts, movies, and dining out. Several months later, however, the originally reported figure of 336,000 job gains in September was revised downward by 22% to 262,000. This was a trend for most of 2023 as ten of the twelve monthly payroll figures last year were revised lower in future months. All told, monthly nonfarm payrolls were downwardly revised by an aggregate 443,000 in 2023.

CHART 3

U.S. FIXED INCOME ROLLING 12-MONTH RETURNS



Source: Data as of 12/31/23. Past performance does not guarantee future results.

As Chart 4 shows, a wave of positive U.S. economic data surprises coincided with a surge in Treasury yields during this period. The S&P 500 sold off by about 10% over this stretch and the small cap Russell 2000 suffered an 18% drawdown. This "good news is bad news" paradigm is probably confusing and frustrating for investors, who might ask: Why is the stock market down when the real economy is doing well? For better or worse, this mindset is rooted in the market's collective belief that large swathes of the economy would simply be unable to handle long-term risk-free interest rates above 5% for an extended period. In our view, the jury remains out on this assertion. After all, the U.S. 10-year Treasury yield averaged 6.17% from 1993 through 1999, a period of above-trend economic growth and strong equity returns. Setting aside comparisons of the 1990s and present, we would expect a period of volatility in equity and credit markets reminiscent of early fall 2023 should signs of a *no landing* emerge in coming months. A reflationary economic backdrop would likely support cyclical areas of the equity market more closely tied to near-term nominal GDP growth over defensive groups. Higher-quality, self-financing large caps would also likely be favored over industries and companies more dependent on external financing.

HARD LANDING

On the other side of the risk spectrum is a potential deflationary outcome in which consumer spending weakens, corporate profits contract, bank lending tightens, and defaults rise. This was the cadence of the U.S. recessions in 1990-1991, 2001 and 2007-2009. If it were to arise, this type of *hard landin*g scenario would almost certainly be the result of the "long and variable lags" in the Fed's aggressive tightening campaign which resulted in 525 basis points of rate hikes in 17 months. Of the four characteristics of a *hard landin*g mentioned above, only a pullback in bank lending has occurred. A reduction in credit supply through the traditional banking channel has been driven by increased regulatory constraints and the balance sheet stress and elevated funding costs experienced by most U.S. lenders in 2023. And yet, a look at the booming private credit industry (see this month's Spotlight section) would suggest that demand for credit from U.S. businesses is resilient. Due to the rise in prominence of private lenders (sometimes referred to as "shadow banking"), the tightening in bank lending standards we have seen in the last 18 months may not be the reliable signal of an economic contraction that it was in previous cycles.

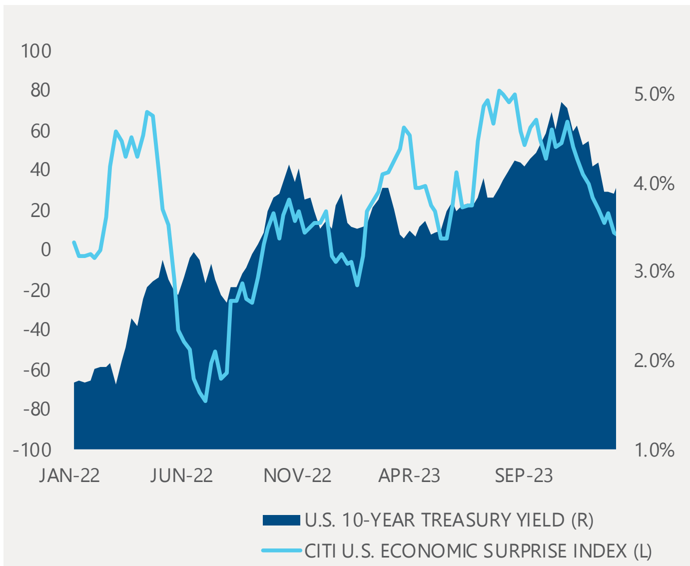
CANARY IN THE COAL MINE

We do not yet see any clear signs of an inflection in the U.S. business cycle, with the possible exceptions of elevated auto loan delinquencies and a moderate pickup in credit card delinquencies. Although these small (but potentially growing) cracks in the U.S. consumer resilience story should be monitored, in our view, they are far from imminent threats as we write in mid-January. A recent stabilization in continuing weekly jobless claims, and only slight declines in temporary hiring suggest major problems have yet to form in the broad U.S. labor market. Simply put, the recession in the U.S. that was widely forecasted for most of 2022 and 2023 has just not materialized. If anything, the domestic economy probably accelerated in the second half of last year. Although investors should not completely dismiss the potential for an economic contraction in 2024, the preponderance of data suggests increasing odds that an economic *soft landing* may indeed be in the cards.

When small and medium-sized U.S. businesses lose pricing power and subsequently cut back on hiring plans, investors can be fairly certain that economic growth has already stalled or ison the verge of stalling. If we see further deterioration in these measures (see Chart 5), in combination with other metrics like consistently higher continuing weekly jobless claims, we will likely recommend portfolios reposition for increased odds of a deflationary *hard landing*. This playbook would include extending duration and

CHART 4

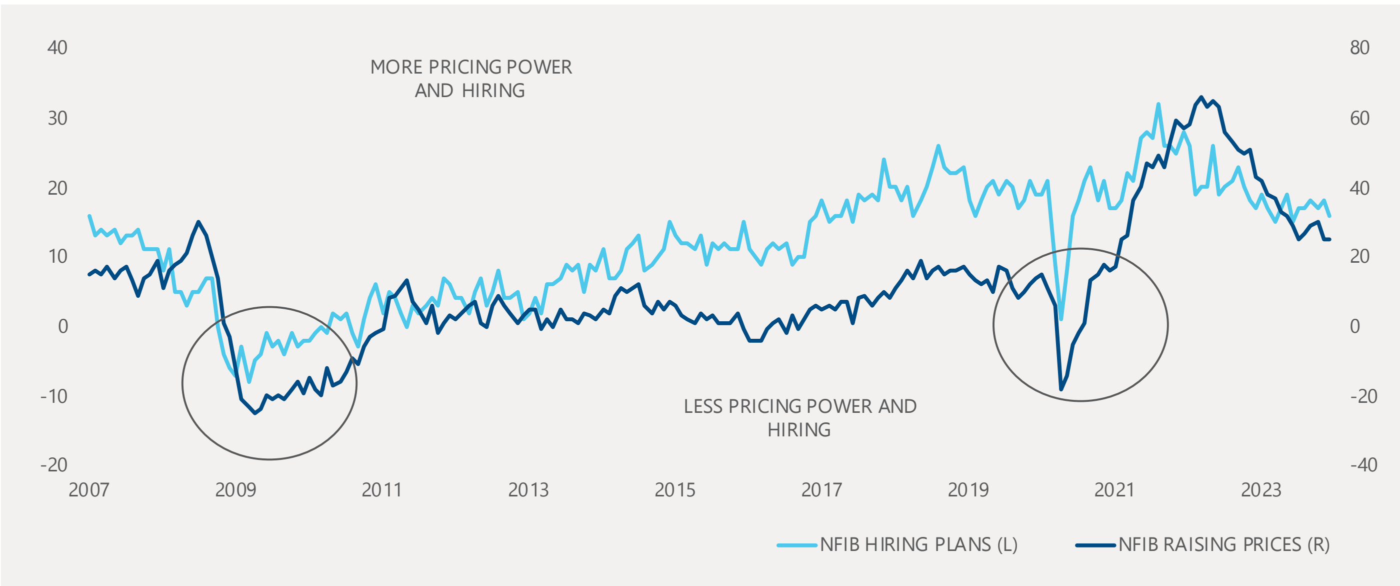
ECONOMIC DATA SURPISES AND TREASURY YIELDS



Source: Bloomberg. Data as of 12/31/23. Past performance does not guarantee future results.

CHART 5

U.S. SMALL AND MEDIUM-SIZED BUSINESSES: PRICING AND HIRING TRENDS



Source: Bloomberg. Data as of 12/31/23. Past performance does not guarantee future results. The National Federation of Independent Business (NFIB) indexes shown are diffusion indexes which measure the net percentage of respondents that plan to raise prices or expand hiring in a given month.

reducing credit in fixed income allocations, while increasing exposure to areas of the equity market with defensive and quality characteristics like industry leaders in the healthcare and consumer staples sectors.

CAN EARNINGS GROWTH DELIVER?

The S&P 500's strong returns in 2023 were entirely driven by valuation expansion, as index-level earnings are expected to have contracted by about 3% for the full year. We won't know the final rate of growth or contraction until the conclusion of 4Q23 earnings season in mid-February. The earnings story of 2023 was one of eclipsing low expectations. The index experienced a shallow earnings recession, with three consecutive quarters (4Q22, 1Q23, 2Q23) of negative year-over-year EPS growth. But this was a much better (or less bad) outcome than widespread expectations at the beginning of the year for a 10%-20% decline in profits.

As of mid-January, bottom-up analyst estimates aggregated by Bloomberg indicated the S&P 500 would generate 10% adjusted EPS growth in 2024 after recording cumulative growth of just 5% over the prior two years. To meet these expectations, large U.S. companies will need to achieve some combination of decent sales growth and incremental margin expansion. An increase in share buybacks could also help boost index-level profit growth in 2024. Accelerated stock repurchases might be particularly relevant for the large cohort of S&P 500 firms with share prices that did not keep up with the broad market last year and remain 10%-20% below their all-time highs from 2021 and early 2022.

As seen in Chart 6, the healthcare, communication services, technology and consumer discretionary sectors are expected to drive the majority of S&P 500 index-level profit growth in 2024. Those four sectors, which accounted for 60% of the benchmark's market capitalization as of December 31, are home to many of the most high-profile mega cap growth winners of 2023. The ten most prominent members of this vaunted group, Microsoft (MSFT), Apple (AAPL), Alphabet (GOOGL), Amazon.com (AMZN), NVIDIA (NVDA), Meta Platforms (META), Tesla (TSLA), Eli Lilly (LLY), Broadcom (AVGO), and Advanced Micro Devices (AMD), represented nearly 30% of the S&P 500's market capitalization at year end. Given their combination of size and the lofty profit growth expectations ascribed to them by analysts, this group of 10 stocks will likely be a major determinant of whether current expectations for healthy S&P 500 profit growth in 2024 prove too optimistic.

OUTLOOK

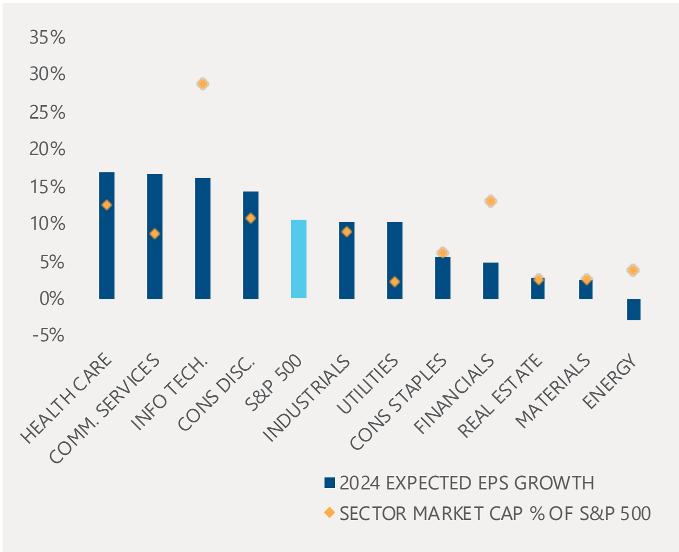
Although the odds of a historically rare *soft landing* have risen, our base case is the U.S. economy is probably in a late-cycle environment following more than 500 basis points of Fed rate hikes from March 2022 through July 2023 and a likely slowdown in fiscal deficit spending in 2024 and 2025. Investors will need to determine to what extent further stock market gains depend on the fulfillment of the market's expectations for 125 bps of Fed rate cuts and 10% index-level profit growth. If it becomes clear that one or both look less likely to materialize, a period of recalibration and digestion across the U.S. equity market in the first half of 2024 seems likely. Our sense is current valuations in U.S. large cap stock indexes have probably priced in both these outcomes. At between 20 and 21-times expected EPS over the next 12 months, the S&P 500 is about 20% more expensive than its average valuation over the last 30 years. This does not mean investors should reduce equity positions and raise cash. But it does reinforce our recommendation that client portfolios maintain a neutral equity and credit stance. The upward reset in yields across the fixed income universe over the last two years has made high-quality bonds an increasingly attractive component for diversified portfolios with long-term investment horizons. Unlike during most of the zero-to-low interest rate period from 2009 through 2021, high quality bonds now offer a solid income cushion in addition to the stability and the potential for price return they have historically provided.

We can't emphasize enough that disinflation and a cooling, but not deteriorating, jobs environment is the stock market's overwhelming preference. If we see a substantial acceleration in payrolls or wage gains, investors should expect higher Treasury yields and lower stock prices in a reflationary *no landing* scenario. If we start to see negative payroll prints, falling Treasury yields and lower stock prices would be in order as the market begins to price a deflationary *hard landing* scenario. For now, the data suggests the market consensus for a *soft landing* is appropriate. It is not always wrong to embrace a consensus view (although perhaps it is boring). But when that view is overwhelmingly consensus, investors should be watching very closely for signs of a shift in the environment. Just one year ago consensus expectations called for a recession and an equity market drawdown in the first half of 2023. At the time, bearish investor positioning fully reflected this consensus view. The risk to investors one year ago was not appreciating the upside potential in markets that a combination of widespread defensive positioning and better-than-feared outcomes for job growth, consumer spending, and corporate profits might produce.

Finally, we would be remiss to not mention that the presidential election cycle could amplify market volatility in 2024, especially during the historically weak period of August through October leading up to election day on November 5. Elevated policy uncertainty notwithstanding, presidential election years tend to produce above-average stock returns. Since the end of World War II, there have been five instances of a Democratic incumbent running for re-election: Harry S. Truman in 1948, Lyndon Johnson in 1964, Jimmy Carter in 1980, Bill Clinton in 1996 and Barack Obama in 2012. The S&P 500's average total return in those presidential election years was 18.4%, compared to its average of 12.3% for all years from 1948 through 2023. The index's total average return in the five years immediately following those election years (1949, 1965, 1981, 1997, and 2013) was 19.1%. While it goes without saying that the past is not prologue, history suggests the U.S. stock market can withstand (and perhaps even thrive) during a presidential election year and the first year of a new administration. Investors should probably expect higher odds of a decent backdrop for stocks if it becomes clear we are headed toward a divided government in which major legislation with substantial economic impacts is less likely to be passed.

CHART 6

S&P 500 EXPECTED EPS GROWTH IN 2024 BY SECTOR



Source: Bloomberg. Data as of 12/31/23. Past performance does not guarantee future results.

ECONOMIC OUTLOOK AND INVESTMENT POLICY

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	The real growth rate of the U.S. economy is likely to decelerate from about 2.5% in 2023 to between 1.5% and 2.0% in 1H24.
Federal Funds Rate	The Fed seems poised to cut its policy rate by as much as 100 basis points in 2024 beginning in either early May or mid-June.
Inflation	Year-over-year U.S. consumer inflation might remain above the Fed's stated 2% target for longer than markets expect in 2024.
Employment	Although job growth will likely continue to cool in coming months, there are no convincing signs of major cracks in the labor market.
Consumer Confidence	If gas prices remain contained, food inflation slows, and real wages stay positive, U.S. consumer confidence should continue improving.
Oil	Increased U.S. production and demand weakness in Europe and China should keep WTI crude oil in a $70-$80 per barrel range in 1H24.
Housing	Overall housing market activity will probably remain suppressed until and unless 30-year fixed mortgage rates approach 6%.
International Economies	Above-trend GDP growth in India, Mexico, and Japan in 2024 to be offset by weakness in China, the euro zone, and the UK.

	MINIMUM		NEUTRAL		MAXIMUM
FIXED INCOME			●		
Core Bonds				●	
TIPS	●				
Non-Investment Grade			●		
International	●				

CURRENT OUTLOOK

In late September, we increased the recommended target weights for fixed income allocations by 1%-3% and shifted the recommended composition of the underlying mix of securities to reduce risk and expected interest rate volatility. We believe the upward reset in yields across the fixed income universe over the last two years has made high-quality bonds an increasingly attractive component for diversified portfolios with long-term investment horizons. Unlike during most of the zero-to-low interest rate period from 2009 through 2021, high quality bonds now offer a solid income cushion in addition to the stability and the potential for price return they have historically provided.

U.S. high yield corporate bond spreads narrowed by nearly 100 basis points in the second half of 2023, supported by resilient economic data. If signs of a weakening labor market and consumer spending backdrop begin to emerge, we will likely recommend reducing exposure to below-investment grade credit and increasing duration in the core bond allocation.

	MINIMUM		NEUTRAL		MAXIMUM
EQUITIES			●		
Large Cap			●		
Mid Cap				●	
Small Cap		●			
Developed International			●		
Emerging Markets		●			

CURRENT OUTLOOK

We think a neutral equity allocation remains appropriate for client portfolios given the current economic and market conditions. The U.S. economy is probably in a late-cycle environment following more than 500 basis points of Fed rate hikes from March 2022 through July 2023 and a likely slowdown in fiscal deficit spending in 2024 and 2025. Although not our base case scenario, odds have increased in recent months that the Fed will be able to engineer a historically rare soft landing, whereby inflation normalizes near 2% without much, if any, rise in unemployment.

We do not see any convincing signs of an inflection in the U.S. business cycle, with the possible exceptions of elevated auto loan delinquencies and a moderate pickup in credit card delinquencies. Although these small (but potentially growing) cracks in the U.S. consumer resilience story should be monitored, they are not imminent threats at the present time. Given the balance of risks and opportunities, we think it makes sense to keep equity allocations near benchmark weights across market cap and geographical categories with an overarching focus on quality in terms of leverage, earnings volatility, and return on capital.

	MINIMUM		NEUTRAL		MAXIMUM
ALTERNATIVES*			●		
	CAP PRES	IWSG	BAL	GWSI	GROWTH
Gold		●	●	●	
Hedged Equity					
Arbitrage					

CURRENT OUTLOOK

We recommend most portfolios maintain a moderate allocation to gold given our assessment that the economic, policy, and geopolitical backdrops appear well suited for the precious metal. We think the combination of the likely conclusion of the Fed's rate hike cycle, potentially volatile inflation, and an increase in armed conflicts in 2023 should allow gold to dampen overall portfolio volatility in 2024. Our alternatives allocations, as seen in the table to the left, are designed to decrease the overall risk profile of our five investment objective-based portfolios (CAP PRES, IWSG, BAL, GWSI, and GROWTH.)

The above minimum/neutral/maximum recommendations represent MainStreet Advisors' current positions relative to our Strategic Asset Allocation ranges. Views expressed have a 6-12 month horizon and are those of the MSA Investment Committee.

*Cap Pres: Capital Preservation, IWSG: Income with some growth, Bal: Balanced, GWSI: Growth with some income

IMPORTANT DISCLOSURE INFORMATION

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