Monthly CIO View

Strategy Snapshot

February 2024

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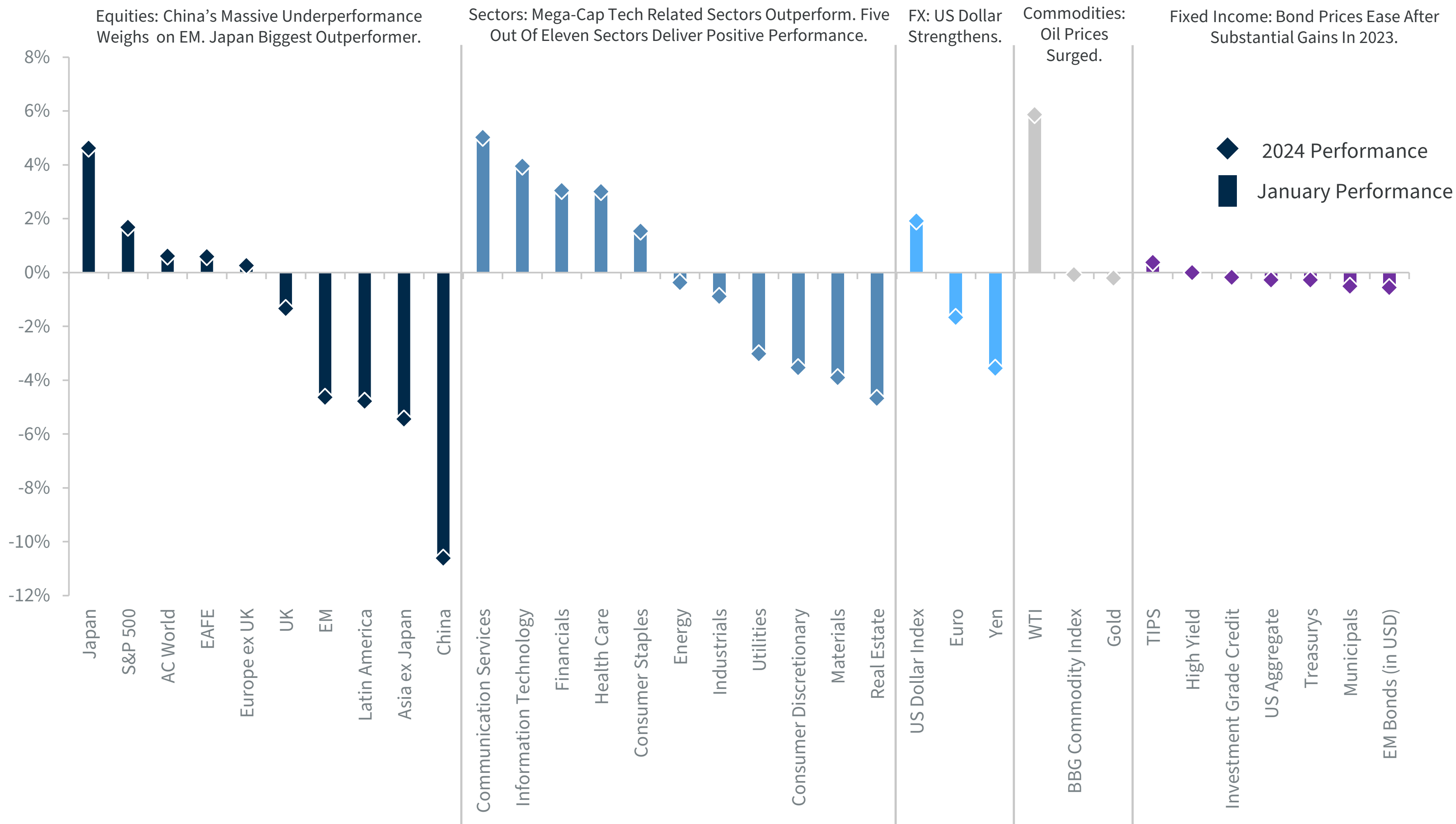
Chief Investment Officer

Returns By Asset Class | January 2024

Returns by Asset Class



Data as of 1/31/2024. All international equity indices are MSCI indices and in USD. Diamonds represent the year-to-date total returns and bars represent monthly returns.

Global Economy | US Economy Remains A Bright Spot

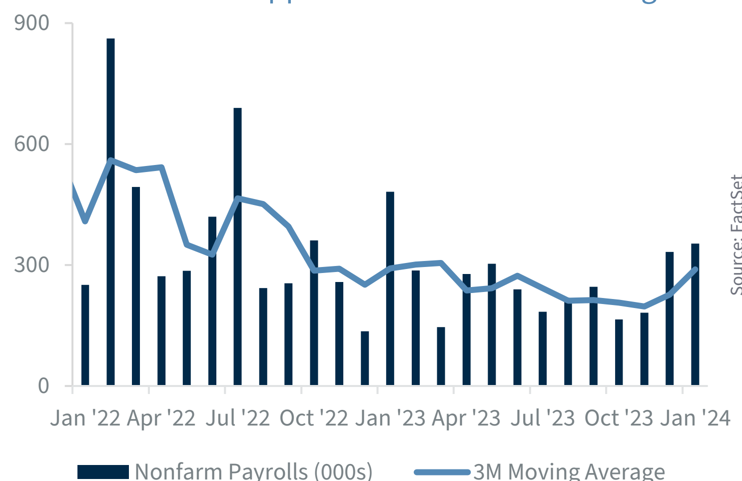
Global Economy | Recent Trends

- **The US economy continues to be a bright spot across the globe**, with growth remaining surprisingly resilient. The significant easing in financial conditions over the last few months has given way to a higher than expected first estimate of 4Q23 GDP annualized growth of 3.3%. The US economy grew at a 2.5% pace in 2023—better than other G7 nations.
- **Inflation has eased considerably since its peak of ~9% in 2022**, with the two main inflation indices, CPI and PCE Prices, down to 3.4% and 2.6%, respectively. On a three- and six-month annualized basis, core PCE is running below the Fed's 2.0% inflation target. However, the Fed wants to see more sustained disinflationary progress before cutting rates.
- **US job growth had a blockbuster month in January, adding 353k jobs.** Similarly, the number of job openings increased by 100k after reaching an ~32-month low the month prior. The strength in the labor market has been the main driver of resilient consumer spending.
- **Inflation in Europe is easing, but not as fast as markets were expecting in January** (CPI: 2.8% vs. expectations of 2.7% YoY). However, markets are still anticipating a 25 bp rate cut in April and around 100 bps of rate cuts priced into the full 2024 calendar year.
- **Deflation, geopolitical challenges, and a housing slump continue to weigh on China's economic recovery.** The government continues to roll out stimulus measures.

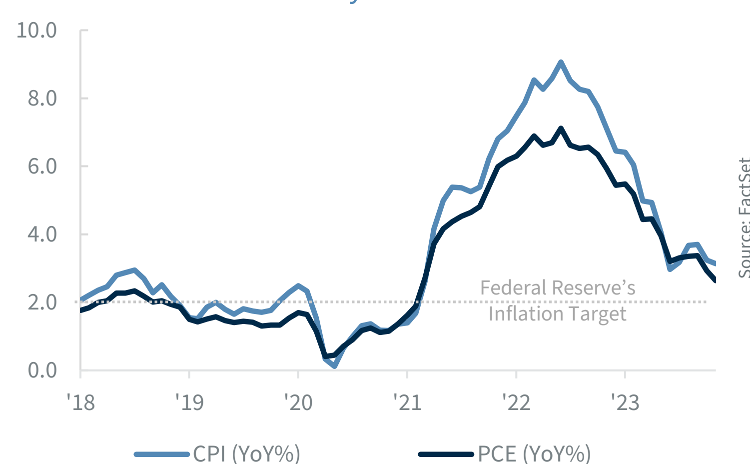
Global Economy | 12-Month Outlook

- **The ongoing strength in the labor market and consumer spending have led consensus expectations to shift away from a recession to a soft landing.** However, slowing growth and softer employment conditions should lead to a pullback in consumer spending during the year, which should tip the economy into the mildest of recessions in 2Q24.
- **Job growth is still running at a healthy clip.** We expect the pace of job growth to slow and eventually turn negative by the middle of the year. Our economist expects the economy will shed nearly 1 million jobs in the upcoming recession—far fewer than the 3.5 million average job losses in a typical recession.
- **European growth has stagnated, with the economy barely growing in 2023.** High borrowing costs, tight lending conditions and weak loan demand has weighed on economic activity. While inflation is quickly receding in Europe, policymakers are reluctant to cut rates too soon given their concerns about wage pressures and the tight labor market.
- **Structural issues (i.e., property downturn, high youth unemployment, poor demographics) continue to weigh on China's economy.** Chinese authorities are taking steps to stem the decline and stimulate demand, but more support will likely be needed to turn the economy around. China's economy remains in need of a major growth catalyst.

Job Growth Appears To Be Re-accelerating



Disinflationary Process Continues



Equities | US Equities Climb To Record Highs

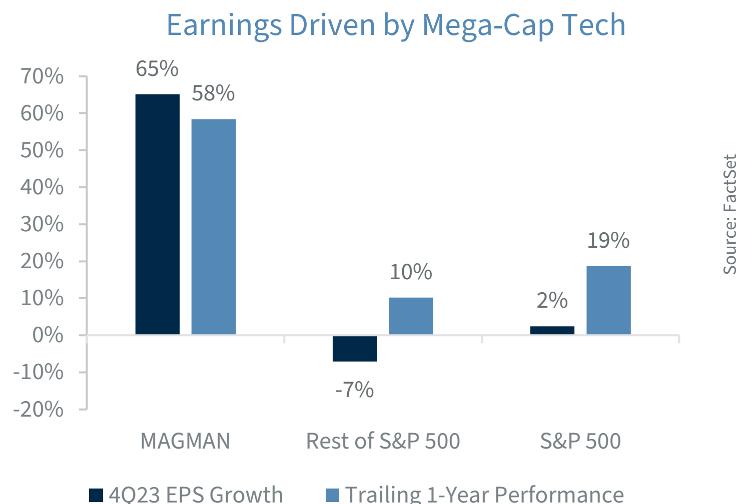
Global Equities | Recent Trends

- **US equity markets are off to a strong start to the year,** with the S&P 500 Index climbing to a record high (its first in two years) ending the month at 4,928. The strong gains were fueled by growing optimism for a soft landing (which has been supported by solid economic releases and cooling inflation) and investor euphoria surrounding AI.
- **Market breadth (i.e., more stocks rising) improved significantly in the final months of 2023; however, that did not carryover into the new year.** Instead, the S&P 500's gains year-to-date were primarily driven by a narrow group of leaders (i.e., MAGMAN—Microsoft, Apple, Google, Meta, Amazon and NVIDIA). Small-cap stocks also lagged (-3.9% MTD).
- **4Q23 earnings season has been lackluster, but strong earnings from the Tech-related sectors is starting to turn things around.** With over 60% of S&P 500 companies reporting, only 74% have beat on earnings and 65% have beat on revenue—well below their previous five-year averages. S&P 500 earnings are on pace to rise ~2% YoY in 4Q23; however, excluding MAGMAN, earnings are expected to decline ~7% YoY.
- **Emerging market equities underperformed** (-3.4% MTD), weighed down by weakness in Chinese equities, reduced expectations for future Fed cuts, and a stronger dollar. Within EM, Asia (-4.0%) is modestly outperforming Latin America (-4.8%).

Global Equities | 12-Month Outlook

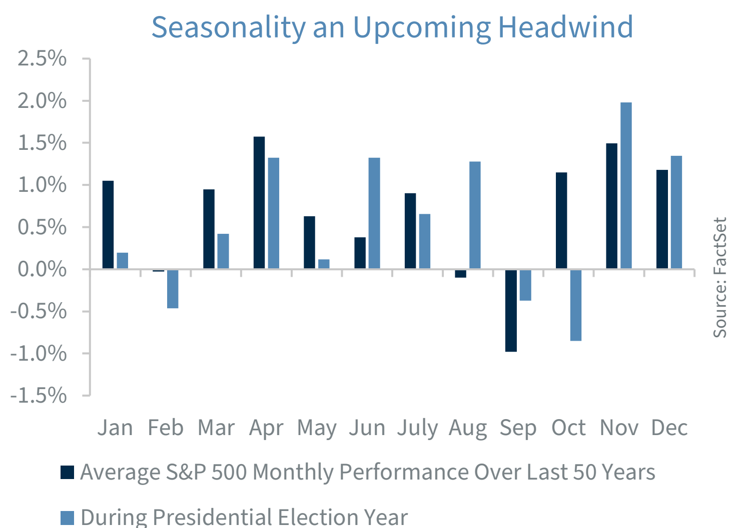
- **The equity market's strong gains at the end of 2023 and early 2024 has tempered our near-term expectations for the market.** An expected slowdown in economic activity, combined with falling earnings expectations should lead to increased volatility as a lot of the good news has been priced into valuations (P/E multiples are elevated relative to average). Our year-end target for the S&P 500 is 4,850 ($225 EPS forecast and a 21.5x multiple).
- **While we remain cautious on the market near term, we continue to expect gains over the longer-term horizon.** The current bull market is in its early stages from a magnitude and duration perspective relative to averages, and secular trends such as AI should continue to boost the market longer term. We would use periods of weakness to build positions.
- **European equity valuations remain historically undervalued relative to US stocks.** However, fundamentals still favor US stocks over international developed equities. Stronger economic growth, more dynamic consumers, and higher weights to the sectors we favor (Tech, Health Care and Industrials) suggest US equities should continue to outperform.
- **We remain constructive on emerging market equities. However, selectivity remains crucial.** While China will continue to face headwinds, EM Asia (i.e., India) and LATAM (i.e., Mexico/Brazil) should benefit from attractive valuations and recent friendshoring trends.

Earnings Driven by Mega-Cap Tech



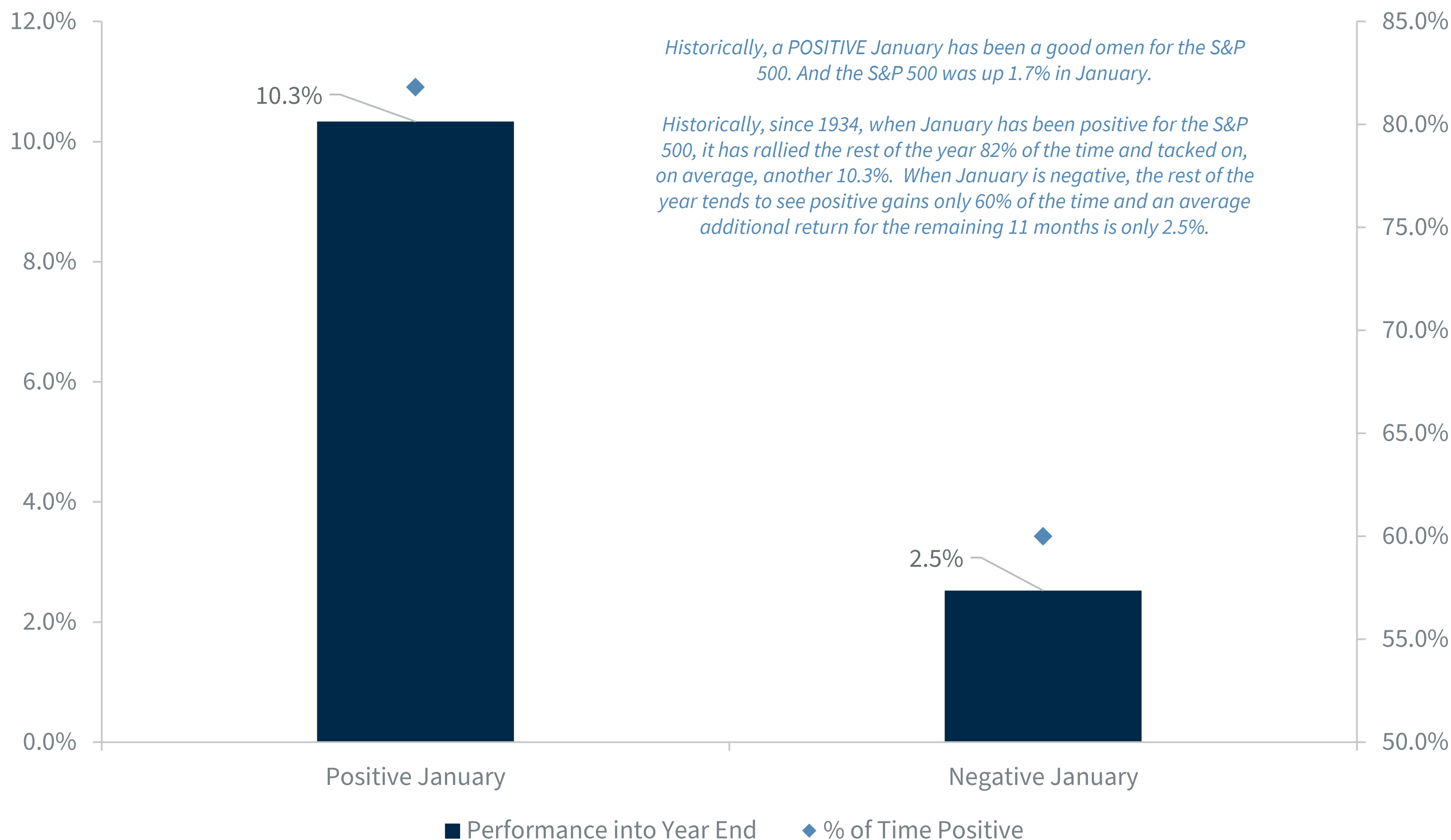
Source: FactSet

Seasonality an Upcoming Headwind



Source: FactSet

AS GOES JANUARY, SO GOES THE YEAR

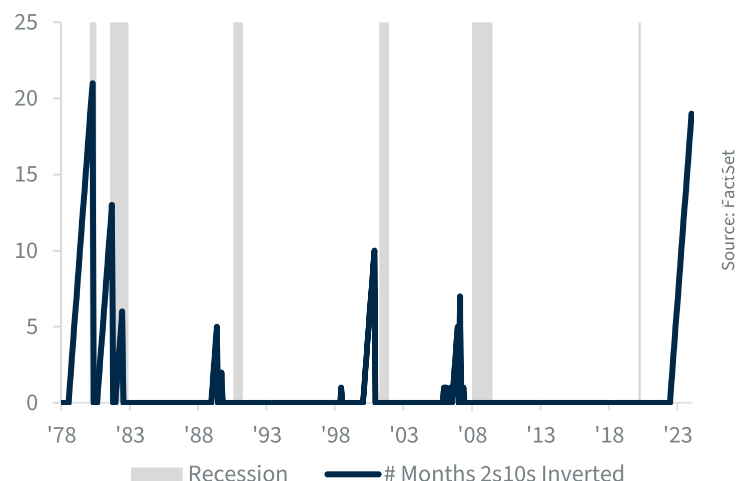


Source: FactSet, Data as of 1/31/2024. Returns are price return.

Fixed Income | Yields Consolidate After Strong Rally

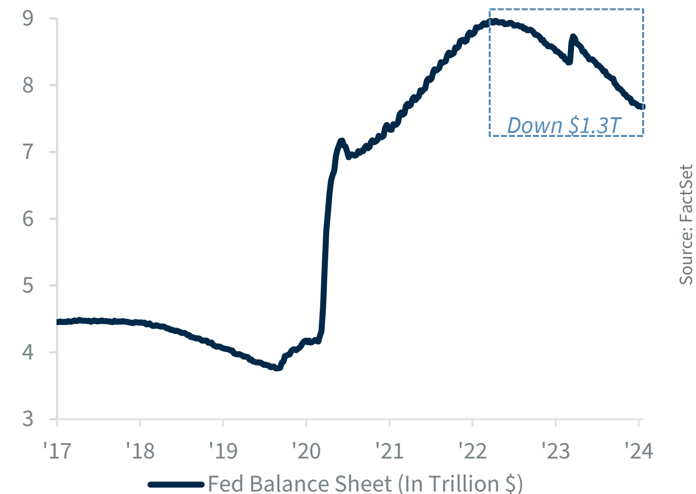
Global Bonds | Recent Trends

- **The Federal Reserve left interest rates unchanged at 5.25-5.50% for the fourth consecutive meeting.** Policymakers lifted their tightening bias and stated the next move in rates is likely lower. However, Powell expressed caution about cutting rates too soon. This pushed the odds of a March rate cut down to ~20% after reaching nearly 80% mid-month.
- **The tug-of-war between the markets and the Fed continues, with Fed's first rate cut now expected in May.** The reassessment pushed Treasury yields slightly higher, with the 10-year climbing 11 bps to ~4.0%. The 10-year Treasury yield has remained below the 2-year yield for 19 consecutive months—its longest inversion since the 1980s.
- **The Fed's balance sheet reduction plans are starting to come into focus** as policymakers are planning to discuss their plans to slow or halt their balance sheet reduction plans when they meet again in March. Since the start of quantitative tightening, the Fed's balance sheet has declined by $1.3 trillion to $7.6 trillion.
- **Bond issuance stepped up dramatically since the start of the year** as companies take advantage of the lower borrowing costs after the sharp decline in rates in the final months of 2023. Strong investor demand for corporate bonds pushed US investment grade spreads (92 bps) to their narrowest level in two years.



Global Bonds | 12-Month Outlook

- **The Fed has removed its tightening bias and signaled that rate cuts are now on the horizon**. While the timing of the Fed's initial rate cut remains uncertain, we expect the Fed to begin cutting interest rates in June amid slowing growth and cooling inflation. We expect the Fed to lower the fed funds rate three to four times by year-end 2024.
- **Slowing growth, cooling inflation and the end of the Fed's tightening cycle should drive the 10-year Treasury yield to 3.5% by year end 2024.** However, bouts of volatility are likely as the market continues to price in a more aggressive easing cycle than the three rate cuts that the Fed has penciled in this year.
- **Bond yields remain below their recent peak but are substantially higher than their COVID lows.** The current elevated level of yields (across all sectors) provides generous income (the highest in over a decade) and can cushion against any unexpected rise in interest rates, while offering diversification benefits from equity risk.
- **Spread valuations are historically tight, but yields remain attractive in investment grade and high yield credits.** We favor investment grade over high yield as lower quality credits are likely more vulnerable given expectations for a more challenging economic environment. Higher yields can provide a cushion for potential spread widening.



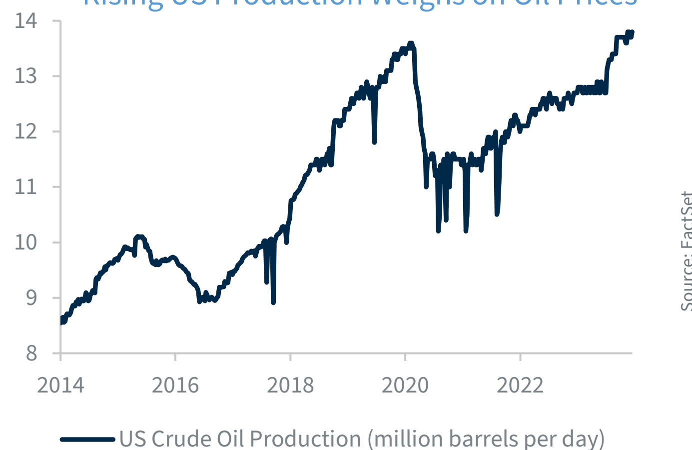
Commodities & Currencies | Commodity Weakness Continues

Commodities & Currencies | Recent Trends

- **The Bloomberg Commodity Index started off the year on a weak note (January: -0.1%),** declining for the sixth consecutive month, tying the longest streak since 2016. Despite strength in energy prices and the resilience of US economic data, broad commodities declined on strength in the dollar and growth concerns emanating from China.
- **On the back of elevated geopolitical risk (particularly in the Red Seas as Houthi attacks hampered key supply chain lines) and elevated US demand,** crude oil prices rallied for the first time in four months in January**.** However, the upside was limited as record US oil production and a stronger dollar weighed on prices.
- **The US Dollar Index (+2.0%) reversed its recent weakness and rallied for the first time in three months.** The US dollar strengthened on falling expectations for future Fed cuts (particularly as Chair Powell talked down a March rate cut), relative strength of the US economy (as the consumer has remained resilient) and widening interest rate differentials between the US and its DM counterparts.
- **After rising to an all time high in 4Q23, gold prices took a reprieve to begin the year.** The decline in the precious metal was driven by reduced expectations for future interest rate cuts, rising interest rates and a stronger US dollar.

Commodities & Currencies | 12-Month Outlook

- **Commodity prices are likely to stabilize or move slightly higher in 2024 after steep declines in 2023.** However, geopolitical flare-ups, particularly with ongoing wars in Russia and the Middle East, rising tensions in the Red Sea and weather-related disruptions (i.e., due to el Nino or other extreme conditions) could lead to interim bouts of elevated volatility.
- **Supply dynamics are likely to remain a key driver of oil prices in 2024.** Ramped up US and non-OPEC+ production has more than offset the voluntary production cuts from OPEC+ members. The US government's need to refill its Strategic Petroleum Reserve and recovering demand later in 2024 should push oil prices up to our $85/barrel forecast.
- **The US dollar has likely peaked in this cycle.** However, a sustained move lower relative to other developed market currencies will require a rebound in risk appetite and a global economic recovery. The US dollar should gradually weaken as the Fed easing cycle gets underway in 2024 and the market begins to anticipate a global economic rebound.
- **The euro should remain stable relative to the US dollar, remaining in a 1 to 1.10 range in 2024.** While the ECB maintains a hawkish bias, weak growth and rapidly declining inflation should push policymakers to cut rates in 2024. **However, the deeply depressed Japanese yen could strengthen as the Bank of Japan** does not cut rates in 2024.



Summary | Key Year-End Forecasts and Views

1 ECONOMY

US GDP: +1.3%

The US economy has remained remarkably resilient. However, we expect the lagged impact of the Fed's restrictive monetary policy, high borrowing costs and a cooling labor market to dampen consumption in the months ahead. This will lead to a mild recession starting in 2Q, with full-year growth forecasted to moderate to a +1.0% pace. Inflation will continue to slow toward the Fed's 2.0% target over the course of the year, and the unemployment rate will peak at 4.9%.

2 BOND MARKET

10-Year Treasury: 3.5%

Slowing growth and cooling inflation will allow the Fed to dial back some of its policy restraint 2024. We expect the Fed to cut rates three to four times by year end. Historically, the end of the Fed's tightening cycle has been a catalyst for yields to move lower, therefore we expect the 10-year Treasury yield to fall to 3.5% by year end. However, supply concerns and overly optimistic rate cut expectations may cause some interim volatility along the way. We favor high-quality bonds over lower-rated credits.

3 EQUITIES

S&P 500: 4,850

The equity market's strong gains has tempered our near-term optimism for the market. Consensus earning expectations are too optimistic and we expect a challenging macro backdrop should push earnings lower and lead to more volatility. Our year-end target for the S&P 500 is 4,850 ($225 EPS, 21.5x P/E multiple). We prefer US over international equities, remain constructive on emerging markets (India in particular) and expect small caps to outperform.

4 DOLLAR DIRECTION

EUR/USD: 1.05

The US dollar has peaked. However, weak global growth and a more resilient US economy should limit the dollar's downside. Once the easing cycle begins and a global recovery gets underway, the US dollar should gradually weaken. Stagnant growth in Europe and the prospect of ECB rate cuts should limit the euro's upside, with the currency remaining broadly stable. The Japanese yen should continue to strengthen as the BOJ exits negative interest rate policy in 2024.

5 OIL

Oil: $85/barrel

Supply dynamics are likely to be a key driver of oil prices in 2024. While OPEC+ nations have attempted to stabilize prices with voluntary production cuts, ramped up production from the US and non-OPEC+ nations has provided an offset. The US government's need to refill the Strategic Petroleum Reserve is likely to put a floor under falling oil prices. This, plus the prospect of better demand once a global recovery is in sight should drive oil prices to our $85/barrel target later this year.

6

Volatility:

Supply chain normalization, disinflation and the end of the Fed's tightening cycle has driven equity market volatility toward its pre-pandemic levels. However, volatility is likely to pick up in a market that's already priced in the good news due to elevated geopolitical risk, optimistic earnings, the US presidential election and seasonality. Interest rate volatility is likely to remain elevated as fiscal dynamics remain in focus and as the market is overly optimistic on Fed rate cuts.

DISCLOSURES

Diversification does not ensure a profit or guarantee against a loss. Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

INTERNATIONAL INVESTING | International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

OIL | Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

CURRENCIES | Investing in currencies is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

GOLD | Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

FIXED INCOME | Fixed-income securities (or “bonds”) are exposed to various risks including but not limited to credit (risk of default of principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise.

Investments in municipal securities may not be appropriate for all investors, particularly those who do not stand to benefit from the tax status of the investment. Municipal bond interest is not subject to federal income tax but may be subject to AMT, state or local taxes.

US TREASURYS | US Treasury securities are guaranteed by the US government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value.

US DOLLAR | The US Dollar Index is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies,[1] often referred to as a basket of U.S. trade partners' currencies.[2] The Index goes up when the US dollar gains "strength" (value) when compared to other currencies.

DEFINITIONS

AGGREGATE BOND | **Bloomberg US Agg Bond Total Return Index:** The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

HIGH YIELD | **Bloomberg US Corporate High Yield Total Return Index:** The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below.

CREDIT | **Bloomberg US Credit Total Return Index:** The index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

MUNICIPAL | **Bloomberg Municipal Total Return Index:** The index is a measure of the long-term tax-exempt bond market with securities of investment grade (rated at least Baa by Moody’s Investors Service and BBB by Standard and Poor’s). This index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

PCE INDEX | **Personal Consumption Expenditures (PCE) Index:** The PCE price index looks at U.S. inflation by measuring changes in the cost of living for households. It tracks the prices of a basket of goods and services, each with different weightings, to reflect how much a typical household spends every month.

BG COMMODITY INDEX **| Bloomberg Commodity Index** is calculated on an excess return basis and reflects commodity futures price movements.

BLOOMBERG INDUSTRIAL METALS INDEX | **Bloomberg Industrial Metals Index** reflects the returns that are potentially available through an unleveraged investment in the futures contracts on industrial metal commodities.

BLOOMBERG ENERGY INDEX | **Bloomberg Energy Index** is composed of futures contracts on crude oil, heating oil, unleaded gasoline and natural gas. It reflects the return of underlying commodity futures price movements only and is quoted in USD

MSCI EM ASIA INDEX | The **MSCI Emerging Markets (EM) Asia Index** captures large and mid cap representation across 8 Emerging Markets countries*. With 1,160 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

NASDAQ | The **Nasdaq Composite Index** is a market capitalization-weighted index of more than 3,700 stocks listed on the Nasdaq stock exchange. As a broad index heavily weighted toward the important technology sector, the Nasdaq Composite Index has become a staple of financial markets reports.

S&P 500 | The **S&P 500 Total Return Index:** The index is widely regarded as the best single gauge of large-cap U.S. equities.

EMERGING MARKETS EASTERN EUROPE | **MSCI EM Eastern Europe Net Return Index:** The index captures large- and mid-cap representation across four Emerging Markets (EM) countries in Eastern Europe. With 50 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

ASIA EX JAPAN INDEX | **The MSCI AC Asia ex Japan** Index captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries* (excluding Japan) and 9 Emerging Markets (EM) countries in Asia. With 983 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country.

AC WORLD INDEX | **The MSCI AC World** Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI) and is comprised of stocks from 23 developed countries and 24 emerging markets.

EMERGING MARKETS LATIN AMERICA | **MSCI EM Latin America Net Return Index:** The index captures large- and mid-cap representation across five Emerging Markets (EM) countries in Latin America. With 116 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

EMERGING MARKETS | **MSCI Emerging Markets Net Return Index:** This index consists of 23 countries representing 10% of world market capitalization. The index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 23 countries.

JAPAN | **MSCI Japan Net Return Index:** The index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 319 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

EUROPE | The **MSCI Europe Index** captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe*. With 428 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

MSCI EAFE | The **MSCI EAFE** (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

MSCI EM | The **MSCI Emerging Markets Index** captures large and mid cap representation across 25 Emerging Markets (EM) countries*. With 1,420 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

CITIGROUP ECONOMIC SURPRISE INDEX | **Citigroup Economic Surprise Index** represents the sum of the difference between official economic results and forecasts. With a sum over 0, its economic performance generally beats market expectations. With a sum below 0, its economic conditions are generally worse than expected.

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DATA SOURCES

FactSet as of 2/4/24.

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