

February 2024 Investment Newsletter

Key Takeaways

- Modest economic growth expectations continue to be surpassed in the U.S., leading to a broadening ‘soft-landing’ consensus. On the contrary, more optimistic expectations leave markets more susceptible to disappointment.
- The anticipated timing of the Fed’s first rate cut keeps extending. While market participants entered the year expecting six cuts, three or fewer cuts now appear more likely as the Fed has emphasized its decisions will be data dependent.
- Inflation prints will continue to make headlines but the data has been trending lower with the Fed’s favored inflation indicator, PCE, getting closer to the 2% target. CPI is also falling but is running slightly hotter due to a larger constituent weight in housing.
- Supportive economic data and better than expected earnings from U.S. companies powered another strong month for risk assets. Roughly three-quarters of U.S. companies exceeded Q4 earnings expectations with ~90% reported.
- Newly found complacency with a soft-landing scenario has contributed to expanding investor risk appetite evidenced by a variety of factors stemming from historically tight credit spreads to the recent surge in crypto assets.
- February was supportive for international stocks, although they continue to lag U.S. counterparts. Chinese equities rose more than 8% supporting emerging market equities. Japan has been a standout performer within developed, ex. U.S. indices.
- Rates rose in the belly of the curve over the month, reflecting stronger economic data and growth expectations. With the rise in rates, duration-sensitive assets generally suffered.
- Alternative assets continue to gain in popularity within diversified portfolios. Within the private equity sector, exit activity is set to increase as M&A and IPO conditions loosen and funds look to return capital to investors.
- As investor optimism continues to impact markets and raise valuations, it’s a time to remain disciplined and express a modest preference toward quality and liquidity across asset classes and within portfolios.



Economy

Following a strong start to 2024, the U.S. economy remained resilient in February and continued its growth trajectory, driven by falling inflation, a resilient labor market, real wage growth, and positive consumer sentiment.

Inflation Continues to Trend Lower Despite Sticky Housing Prices

- Core PCE, the Fed's preferred measure of inflation, has continued its downward trend to start 2024 with the most recent reading coming in at 2.8%.
- Core goods inflation has seemingly been eliminated with prices declining 0.6% YoY, while services ex. housing ticked up slightly.
- Housing prices remain sticky, increasing ~6.1% YoY, and continue to pull up the overall measure.
- With the Fed stressing that any decision to cut rates will be data dependent, trends in sticky sectors will likely be a key topic at future FOMC meetings as it seems the final stretch in the battle against inflation will be the most difficult.

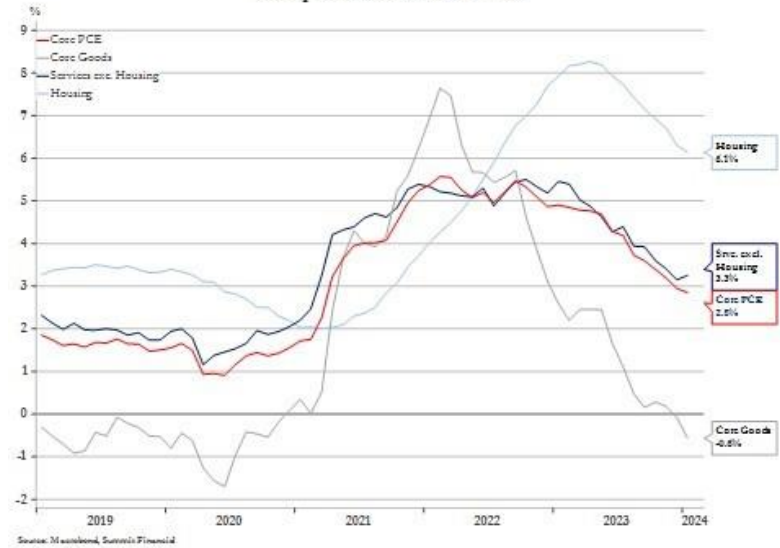
Favorable Consumer Trends Continue to Support U.S. Economic Growth

- Real wage growth turned back positive in the second half of 2023 and remained above zero through February.
- Naturally, this continues to support overall sentiment as consumers maintain purchasing power.
- The labor market has also remained strong, with unemployment staying below the Fed's preferred 4.0% level.
- While it remains unclear whether a soft-landing will be achieved and if GDP growth can continue to outpace expectations, for now, favorable trends in pricing and labor continue to support the consumer-driven U.S. economy.

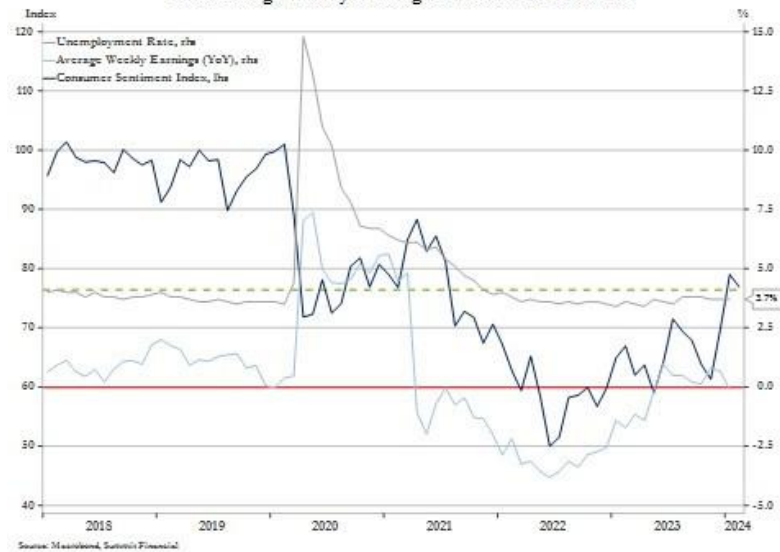
USD Strength Continues into 2024

- Higher relative yields, coupled with a resilient economy, have led to continued strength for the USD, despite many economists calling for it to start showing cracks in 2024.
- Higher-for-longer benchmark rates should continue to bolster the USD, and the case for future declines will continue to weaken if U.S. economic growth remains strong.
- Capital continues to flow into the U.S., further reinforcing the USD's role as the world's reserve currency despite any short-term bumps in the road.

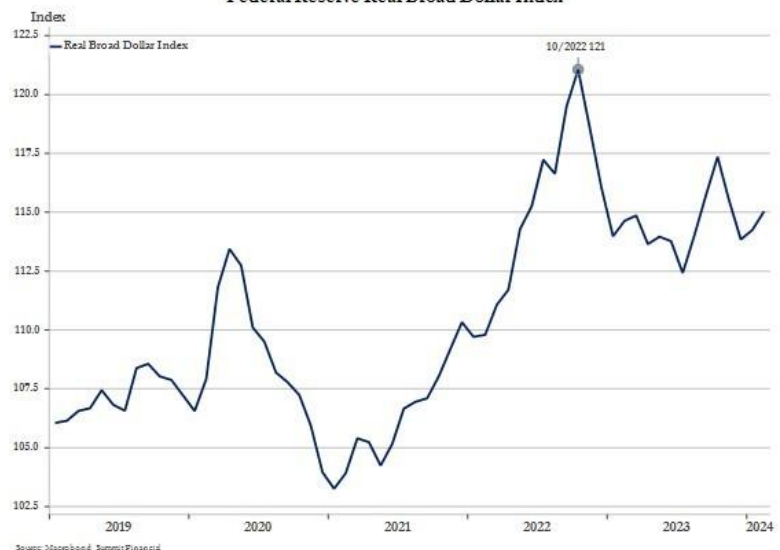
Components of Core PCE - YoY



Real Average Weekly Earnings & Consumer Sentiment



Federal Reserve Real Broad Dollar Index



Markets

Is the Market in an AI Bubble?

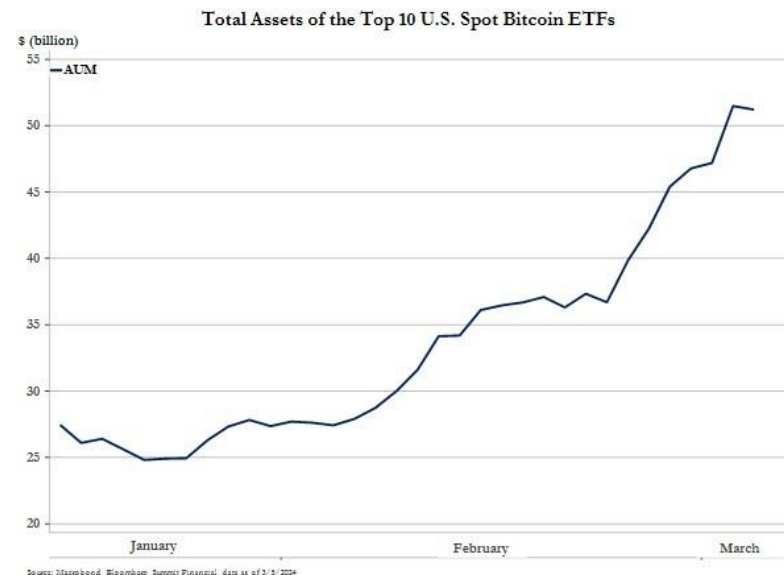
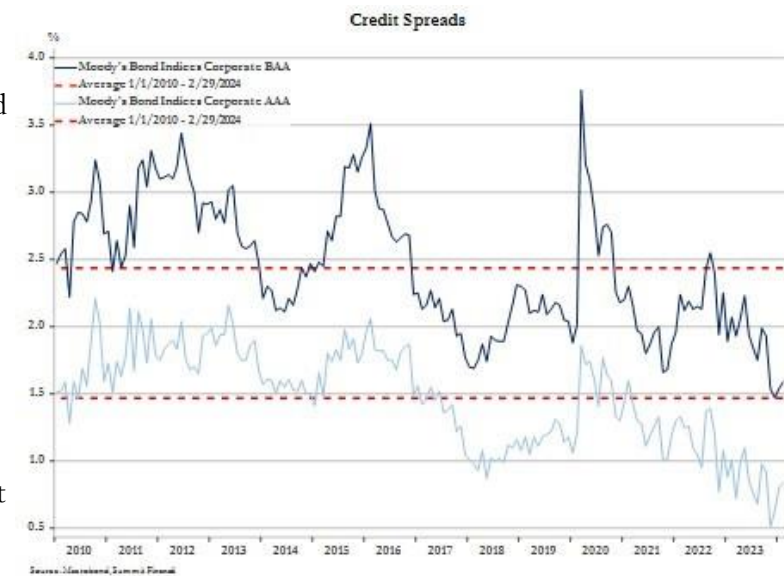
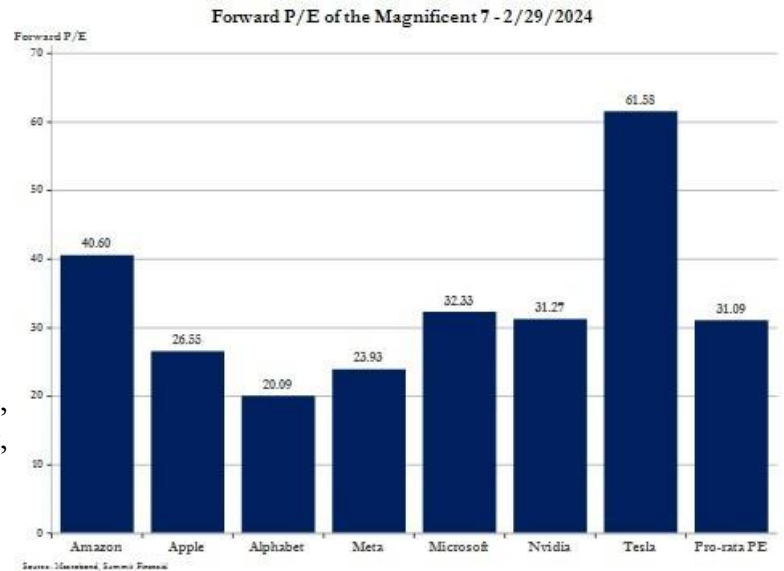
- AI enthusiasm, led by current posterchild Nvidia, caused some to question whether a speculative bubble is brewing.
- Despite the rally, it's uncertain that bubble territory can be declared. Nvidia currently trades at ~28x forward P/E, although valuations are rising.
- The Magnificent 7's pro-rata forward P/E of 31 is elevated, but can be partially justified by a higher level of quality relative to the broader market.
- Margins for these companies currently average near 23%, approximately 2.5x the ~9% margin of the broad market, and all have strong balance sheets.
- To further put the situation into perspective, forward P/E's were over 100x during the 2000 Dotcom Bubble.

Economic Strength Continues to Drive Tightening Spreads


- Investment-grade bonds were negative for the month and year-to-date but higher yields offer support and will help to erode those losses as time goes on.
- Credit-sensitive portions of the market (ex. high yield) outperformed due to tightening spreads and higher starting yields.
- Munis fared better than taxable investment-grade bonds due to more favorable market technicals.
- Credit spreads continuing to grind lower is indicative of general complacency with the soft-landing scenario. Tight pricing leaves little room for error should key factors surprise to the downside.

Bitcoin ETF Assets Growing at Record Pace

- Since their January 11th launch, investors have piled into Bitcoin ETFs at a historic pace with total assets of the top 10 funds currently topping \$50B.
- BlackRock's iShares Bitcoin Trust eclipsed \$10B in assets on 2/29, the fastest a new ETF has ever reached that milestone, making it the second largest.
- The Grayscale Bitcoin Trust ETF remains the largest, while Fidelity's Wise Origin Bitcoin Fund is third on the list and has over \$6B, making it their third-largest ETF.
- Despite their popularity and recent price spikes, Bitcoin and other similar cryptocurrencies have struggled to find true use cases that could lead to some determination of economic or fundamental value. They are also



notoriously volatile, and any potential allocation should
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be viewed with caution.



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It is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership; The Russell 1000 Index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000 Index representing approximately 90% of the total market capitalization of that index. It includes approximately 1,000 of the largest securities based on a combination of their market-cap and current index membership; The Russell Midcap Index measures the performance of the mid-cap segment of the US equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap Index represents approximately 31% of the total market capitalization of the Russell 1000 companies; the S&P 500 Index is a market capitalization-weighted Index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of eleven different sectors; the MSCI EAFE Index (Europe, Australasia, Far East) captures large- and mid-cap representation across developed markets countries around the world excluding the US and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the MSCI Emerging Markets Index captures large- and mid-cap representation across emerging markets countries around the world. The index covers approximately 85% of the free float-adjusted market capitalization in each country; The MSCI World Index captures large- and mid-cap representation across developed markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the Bloomberg Commodity Index (BB Comm Index, Commodities) reflects commodity futures price movements and is calculated on an excess return basis. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. Roll period typically occurs from the 6th-10th business day based on the roll schedule; the Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency); the Bloomberg Barclays Global Aggregate Ex US Index is a measure of investment-grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Bonds issued in US dollars are excluded; the Bloomberg Barclays Municipal Bond Index covers the US dollar-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds; the Dow Jones US Real Estate Index measures the performance of real estate investment trusts (REITs) and other companies that invest directly or indirectly in US real estate through development, management, or ownership, including property agencies; The Bloomberg Barclays US Corporate High-Yield Index measures the US dollar-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. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded; The HFRX Global Hedge Fund Index is comprised of funds representing the overall hedge fund universe. Constituent funds include but are not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, even driven, macro, merger arbitrage, and relative value arbitrage. The underlying strategies are asset weighted based on the distribution of assets in the hedge fund industry; MLPs, or Master Limited Partnerships, are represented by the Alerian MLP Index, which is the leading gauge of energy infrastructure Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index constituents earn the majority of their cash flow from midstream activities involving energy commodities; The S&P 500[®] Real Estate comprises those companies included in the S&P 500 that are classified as members of the GICS[®] Real Estate sector; The S&P Case-Shiller Home Price Index measures the value of single-family housing within the US. The index is a composite of single-family home price indices for the nine US Census divisions. Leading economic indicators (LEI) are statistics that precede economic events. They predict the next phase of the business cycle. The OECD Composite leading indicators (CLIs), designed to anticipate turning points in economic activity relative to trend, continue to strengthen in most major economies. The MOVE Index measures US interest rate volatility. The index tracks the movement in US treasury yield volatility implied by current prices of 1-month OTC options. The Cboe Volatility Index (VIX) is a real-time index that represents the market's expectations for the relative strength of near-term price changes of the S&P 500 Index. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Core CPI excludes food and energy, while headline CPI includes all items. The Consumer Confidence Index is a measure based on a survey administered by The Conference Board that reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitude, buying intentions, vacation plans and consumer expectations for inflation, stock prices and interest rates. A treasury Bill (T-Bill) is a short-term US government debt obligation backed by the treasury Department with a maturity of one year or less. Treasury Inflation-Protected Securities, or TIPS, are inflation-protected bonds (IPBs) that are issued by the U.S. Treasury. Their face value is pegged to the CPI and adjusted in step with changes in the rate of inflation. The National Financial Conditions Index (NFCI) is a weighted average of a large number of variables (105 measures of financial activity) each expressed relative to their sample averages and scaled by their sample standard deviations. The short interest ratio is a mathematical indicator of the average number of days it takes for short sellers to repurchase borrowed securities in the open market. The ratio is calculated by dividing the total number of shorted shares of a stock by the average daily trading volume. CBD stands for central business district, which is the commercial and business center of a city. The Personal Consumption Price Index (PCE) is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. EM Debt refers to Emerging Market Debt, which is represented by the Bloomberg Emerging Markets Tradeable External Debt Index. Precious metals are represented by the Bloomberg Precious Metals Subindex. The Bloomberg Precious Metals Subindex, is a commodity group subindex of the Bloomberg Commodity Index. It is composed of futures contracts on gold and silver. It reflects the return of underlying commodity futures price movements only and is quoted in USD. Industrial metals are represented by the Bloomberg Industrial Metals Subindex, which is composed of futures contracts on aluminum, copper, nickel and zinc. It reflects the return of underlying commodity futures price movements only. It is quoted in USD. Energy is represented by the Bloomberg Energy Subindex which is a commodity group subindex of the Bloomberg CI. It 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. Infrastructure is represented by the S&P global Infrastructure Index, which is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities. Agriculture is represented by the Bloomberg Agriculture Subindex, which is a commodity group subindex of the Bloomberg CI. It is composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat. It reflects the return of underlying commodity futures price movements only and is quoted in USD. High-Yield Bonds that invest in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default. Private Credit Investments (Direct Lending) involve a high degree of risk, including the loss of the entire investment. International investments carry additional risks, which include differences in financial reporting standards, currency exchange rates, political risks unique to a specific country, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the manufacturing sector. Consumer Sentiment is represented by The University of Michigan Consumer Sentiment Index which rates the relative level of current and future economic conditions. The ISM Non-Manufacturing Index is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the services (or non-manufacturing) sector. Bank Loans are represented by Morningstar LSTA US Leveraged Loan Index as of December 31, 2022. Historical defaults, loss rates, recovery rates represent the average of 18 years of data from 2005-2022. The top 10 Bitcoin ETFs as of 3/5/2024 are Grayscale Bitcoin Trust (GBTC), iShares Bitcoin Trust (IBIT), Fidelity Wise Origin Bitcoin Fund (FBTC), ARK 21Shares Bitcoin ETF (ARKB), Bitwise Bitcoin ETF Trust (BITB), Invesco Galaxy Bitcoin ETF (BITCO), VanEck Bitcoin Trust (HODL), Valkyrie Bitcoin Fund (BRRR), Franklin Bitcoin ETF (EZBC), and Wisdom Tree Bitcoin ETF (BTCW). Data in this newsletter is obtained from sources which we, and our suppliers believe to be reliable, but we do not warrant or guarantee the timeliness or accuracy of this information. 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