Quarterly Chartbook
1Q2024

Summary Comments

2024 largely continued the equity market trends of 2023, but as interest rates started to climb with waning expectations of a series of U.S. Federal Reserve (Fed) rate cuts – equities started to retreat a bit in April. The impact of rising rates also put some pressure on many high-quality bond sectors. The YTD column of our market performance pages for March and April highlight these trends.

- The "Magnificent 7" remained at the forefront of discussion for investors and the media more broadly. However, one noticeable change in the first quarter from 2023 (when all seven stocks generated large gains) was greater differentiation of returns among the Magnificent 7. This was primarily because investors began to price individual companies based on their own merits.
- Recency bias is a cognitive bias that causes investors to place greater importance on the most recent information. This generally results in the expectation that recent strong results will continue into the future. For instance, many investors currently expect recent trends, such as outsized returns from the Magnificent 7, anything related to artificial intelligence ("AI"), and growth-oriented large-caps to continue well into the future. However, earnings growth expectations for smaller-cap companies are expected to be well in excess of the Magnificent 7 by 2025.
- One area of the market we have taken steps to emphasize for clients is an investment in "quality" companies. The term "quality" can have a variety of meanings, but for our purposes, quality businesses tend to be financially strong, have high returns on capital, and have proven, durable business models. Historically, these types of businesses have tended to do well when interest rate cuts are on hold or declining.
- Despite recent positive data, longer-term economic indicators continue to suggest slowing economic growth in the future. Following a generally strong second half of 2023 and a healthy January for U.S. payrolls and wages, recent indicators suggest softness, with a slight uptick in unemployment and slowing consumption.
- Core consumption inflation is still too high for the Fed's comfort. In fact, the Fed recently raised its year end inflation outlook to 2.6% from 2.4% and Chairman Powell reiterated the need to see "inflation moving sustainably toward 2%" before cutting interest rates.
- We continue to invest the bulk of client bond assets in actively managed mutual funds with flexible mandates. The mutual funds are balanced against low cost passively managed ETFs to manage duration and yield curve exposures. We believe this combination is the best way to navigate a potentially volatile interest rate and credit environment.

Thank you for reading. Please let us know if you would like to delve deeper into anything we have shared. We would welcome the conversation. Also, please look out for a new format next quarter. We are in the midst of responding to client feedback again and hope to deliver an even more useful document to you.

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Market Performance (As of 03/31/24)

Annualized % Returns (As of 03/31/2024)

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	29.88	11.49	15.05	12.96
Russell 1000 Index	Mid/Large Cap Stocks	29.87	10.45	14.76	12.68
Russell 1000 Growth Index	Growth Stocks	39.00	12.50	18.52	15.98
Russell 1000 Value Index	Value Stocks	20.27	8.11	10.32	9.01
Russell 2000 Index	Small Cap Stocks	19.71	-0.10	8.10	7.58
MSCI EAFE Index	Non-U.S. Developed Market Stocks	15.32	4.78	7.33	4.80
MSCI Emerging Markets Index	Emerging Markets Stocks	8.15	-5.05	2.22	2.95
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	12.80	0.38	6.24	4.74
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	11.46	0.54	3.09	4.68
Barclays Municipal Bond Index	U.S. Municipal Bonds	3.13	-0.41	1.59	2.66
Barclays Aggregate Bond Index	U.S. Bonds	1.70	-2.46	0.36	1.54
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	2.69	-1.06	1.09	1.61
BofAML U.S. Treasury Master Index	Treasury Bonds	-0.19	-2.83	-0.16	1.08
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	1.36	-2.93	-0.40	1.11
BofAML U.S. Corporate Master Index	Corporate Bonds	4.70	-1.70	1.62	2.67
BofAML U.S. High Yield Master II Index	High Yield Bonds	11.06	2.21	4.01	4.36
BofAML Euro Broad Market Index	European Bonds	4.07	-6.98	-2.32	-1.68
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	3.60	-1.54	0.86	0.42

Calendar Year % Returns (YTD as of 03/31/2024)

	YTD	2023	2022	2021	2020	2019
S&P 500 Index	10.56	26.29	-18.11	28.71	18.40	31.49
Russell 1000 Index	10.30	26.53	-19.13	26.45	20.96	31.43
Russell 1000 Growth Index	11.41	42.68	-29.14	27.60	38.49	36.39
Russell 1000 Value Index	8.99	11.46	-7.54	25.16	2.80	26.54
Russell 2000 Index	5.18	16.93	-20.44	14.82	19.96	25.52
MSCI EAFE Index	5.78	18.24	-14.45	11.26	7.82	22.01
MSCI Emerging Markets Index	2.37	9.83	-20.09	-2.54	18.31	18.44
MSCI ACWI Ex USA Small Cap Index	2.11	15.66	-19.97	12.93	14.24	22.42
BofAML Preferred Stock Fixed Rate Index	4.52	10.21	-14.60	2.24	6.95	17.71
Barclays Municipal Bond Index	-0.39	6.40	-8.53	1.52	5.21	7.54
Barclays Aggregate Bond Index	-0.78	5.53	-13.01	-1.54	7.51	8.72
Barclays Intermediate U.S. Gov/Credit Index	-0.15	5.24	-8.23	-1.44	6.43	6.80
BofAML U.S. Treasury Master Index	-0.94	3.87	-12.85	-2.38	8.22	6.99
BofAML U.S. Mortgage Backed Securities Index	-1.07	4.98	-11.88	-1.21	4.09	6.51
BofAML U.S. Corporate Master Index	-0.08	8.40	-15.44	-0.95	9.81	14.23
BofAML U.S. High Yield Master II Index	1.51	13.47	-11.21	5.35	6.07	14.41
BofAML Euro Broad Market Index	-2.58	10.57	-22.04	-9.66	13.35	4.11
BofAML Local Debt Market Plus Index	-1.78	10.00	-11.73	-6.53	4.50	16.44

Source: Morningstar Direct

Market Performance (As of 04/30/24)

Annualized % Returns (As of 04/30/2024)

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	22.66	8.06	13.19	12.41
Russell 1000 Index	Mid/Large Cap Stocks	22.82	6.98	12.87	12.14
Russell 1000 Growth Index	Growth Stocks	31.80	8.48	16.46	15.48
Russell 1000 Value Index	Value Stocks	13.42	5.17	8.60	8.43
Russell 2000 Index	Small Cap Stocks	13.32	-3.18	5.83	7.22
MSCI EAFE Index	Non-U.S. Developed Market Stocks	9.28	2.86	6.18	4.38
MSCI Emerging Markets Index	Emerging Markets Stocks	9.88	-5.69	1.89	2.96
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	9.54	-1.60	5.47	4.61
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	6.76	-0.79	2.32	4.21
Barclays Municipal Bond Index	U.S. Municipal Bonds	2.08	-1.10	1.26	2.41
Barclays Aggregate Bond Index	U.S. Bonds	-1.47	-3.54	-0.16	1.20
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	0.69	-1.67	0.78	1.42
BofAML U.S. Treasury Master Index	Treasury Bonds	-3.08	-3.87	-0.57	0.78
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	-2.15	-4.08	-0.97	0.72
BofAML U.S. Corporate Master Index	Corporate Bonds	1.40	-2.85	1.03	2.31
BofAML U.S. High Yield Master II Index	High Yield Bonds	8.89	1.50	3.52	4.18
BofAML Euro Broad Market Index	European Bonds	-0.05	-8.19	-2.75	-2.04
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	0.56	-3.03	0.40	0.08

Calendar Year % Returns (YTD as of 04/30/2024)

	YTD	2023	2022	2021	2020	2019
S&P 500 Index	6.04	26.29	-18.11	28.71	18.40	31.49
Russell 1000 Index	5.60	26.53	-19.13	26.45	20.96	31.43
Russell 1000 Growth Index	6.69	42.68	-29.14	27.60	38.49	36.39
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MSCI ACWI Ex USA Small Cap Index	0.62	15.66	-19.97	12.93	14.24	22.42
BofAML Preferred Stock Fixed Rate Index	1.76	10.21	-14.60	2.24	6.95	17.71
Barclays Municipal Bond Index	-1.62	6.40	-8.53	1.52	5.21	7.54
Barclays Aggregate Bond Index	-3.28	5.53	-13.01	-1.54	7.51	8.72
Barclays Intermediate U.S. Gov/Credit Index	-1.50	5.24	-8.23	-1.44	6.43	6.80
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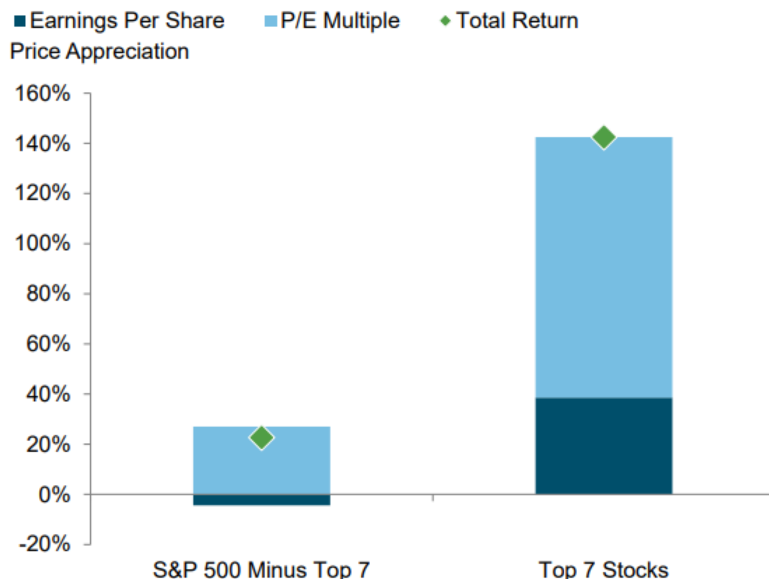
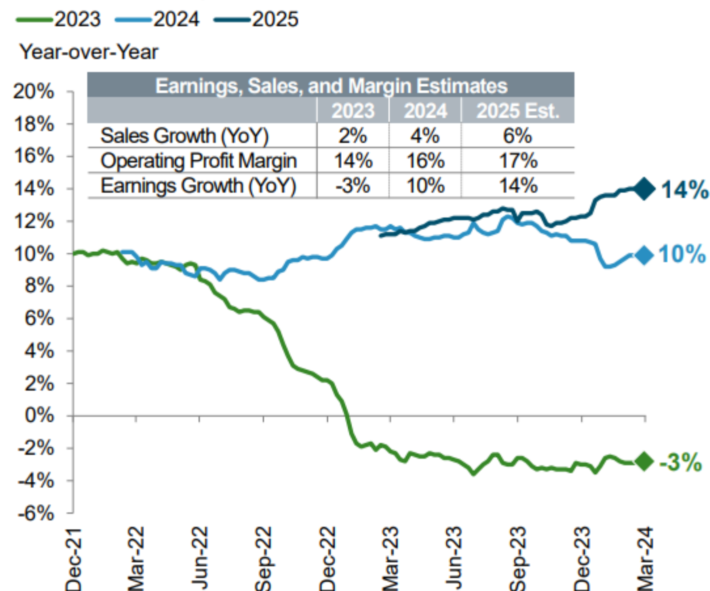
BofAML U.S. Mortgage Backed Securities Index	-3.98	4.98	-11.88	-1.21	4.09	6.51
BofAML U.S. Corporate Master Index	-2.41	8.40	-15.44	-0.95	9.81	14.23
BofAML U.S. High Yield Master II Index	0.50	13.47	-11.21	5.35	6.07	14.41
BofAML Euro Broad Market Index	-4.75	10.57	-22.04	-9.66	13.35	4.11
BofAML Local Debt Market Plus Index	-4.00	10.00	-11.73	-6.53	4.50	16.44

Source: Morningstar Direct

Equity – S&P 500® Earnings and Returns



Source: Fidelity Quarterly Market Update (Second Quarter 2024)



	2023	2024	2025 Est.
Sales Growth (YoY)	2%	4%	6%
Operating Profit Margin	14%	16%	17%
Earnings Growth (YoY)	-3%	10%	14%

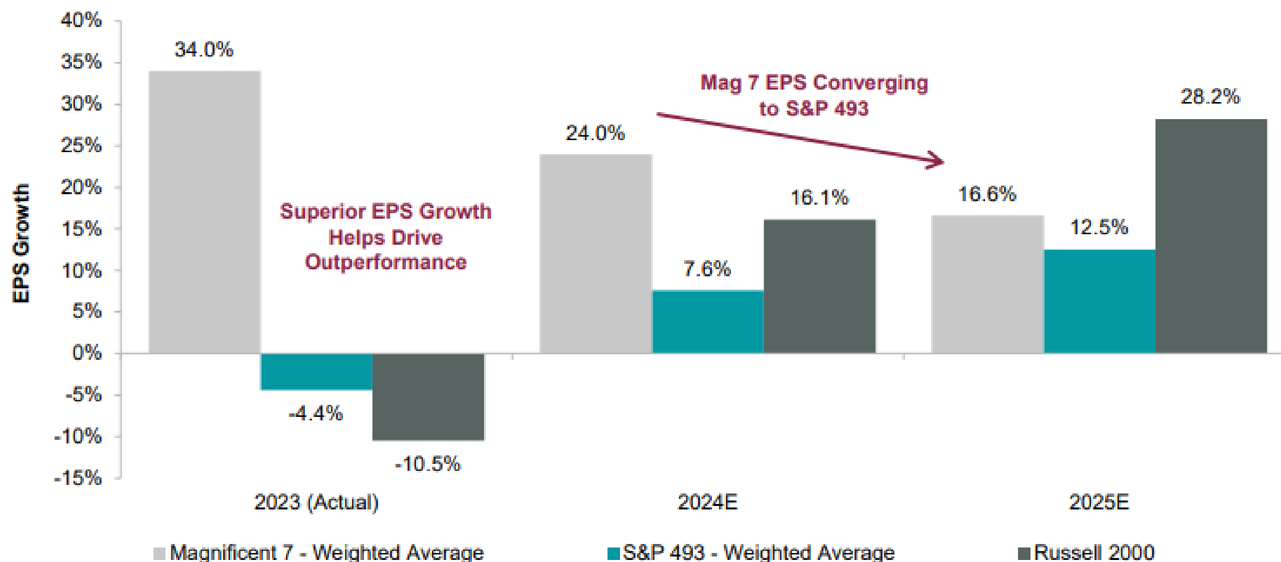
Source: Fidelity Quarterly Market Update (Second Quarter 2024)

Returns generated by the S&P 500® in the first quarter of 2024 generally followed the same path as 2023. Even though earnings have improved, P/E multiple expansion continued to be the primary driver of gains (light blue portion of bar chart – upper left).

- The "Magnificent 7" remained at the forefront of discussion for investors and the media more broadly. However, one noticeable change in the first quarter from 2023 (when all seven stocks generated large gains) was greater differentiation of returns among the Magnificent 7. This was primarily because investors began to reward (or, conversely, punish) individual companies based on their own merits.
- We believe investors will continue to scrutinize earnings reports more closely for the remainder of 2024 as focus shifts from expectations and projections to results and reality. Currently, investors expect double-digit earnings growth for the S&P 500® for 2024 and 2025. The improvement in earnings is expected to come from a combination of an increase in sales and improved profit margins (upper right).

In our view, an increase in corporate profit margins will be key to fulfilling earnings expectations for 2024 and 2025. In turn, we are paying close attention to inflation, particularly the ability of companies to pass along increased costs to customers.

Equity – U.S. Earnings & Recency Bias

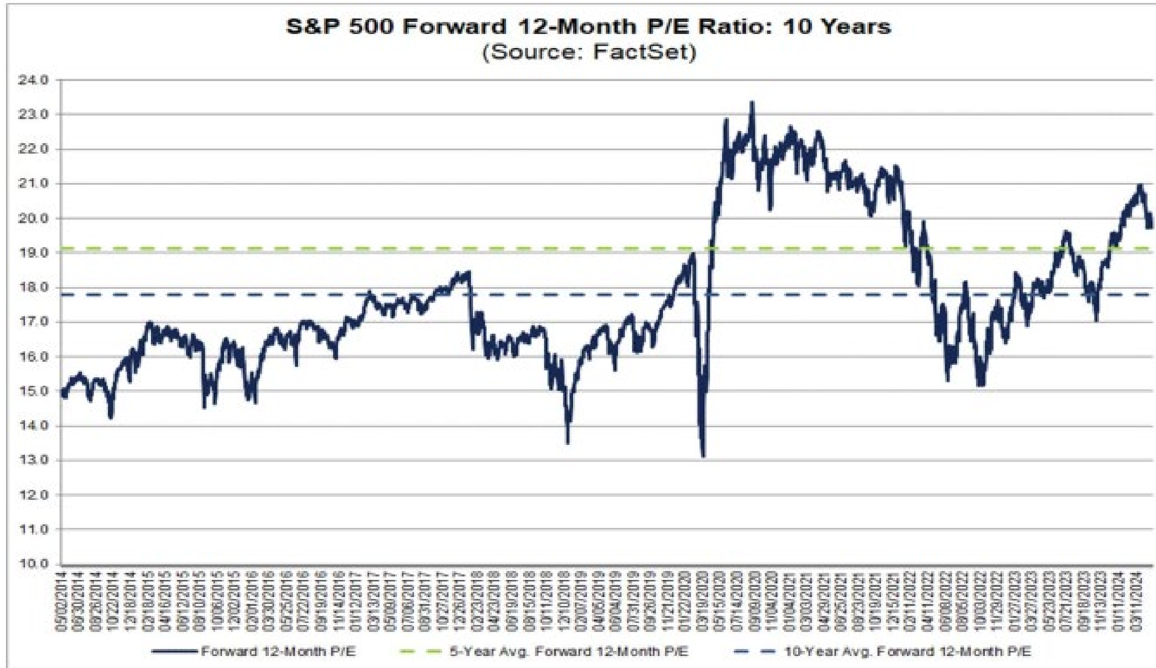


Source: ClearBridge – Anatomy of a Recession (Second Quarter 2024)

One of the strongest behavioral biases investors must routinely confront is recency bias. Recency bias is a cognitive bias that causes investors to place greater importance on the most recent information. This generally results in the expectation that recent strong results will continue into the future.

- For instance, many investors currently expect recent trends, such as outsized returns from the Magnificent 7, anything related to artificial intelligence ("AI"), and growth-oriented large-caps to continue well into the future.
- Superior earnings growth from the Magnificent 7 was certainly true in 2023 when these companies grew earnings more rapidly than the broad market (light grey bar). However, the relative earnings growth benefit of the Magnificent 7 over the remaining 493 stocks in the S&P 500® is expected to gradually diminish in 2024 and 2025 (teal bar).
- This is particularly true when comparing the Magnificent 7 to the Russell 2000® Index, which is an index of smaller market capitalization companies. In fact, earnings growth expectations for smaller-cap companies are expected to be well in excess of the Magnificent 7 by 2025.

Equity – U.S. Valuations



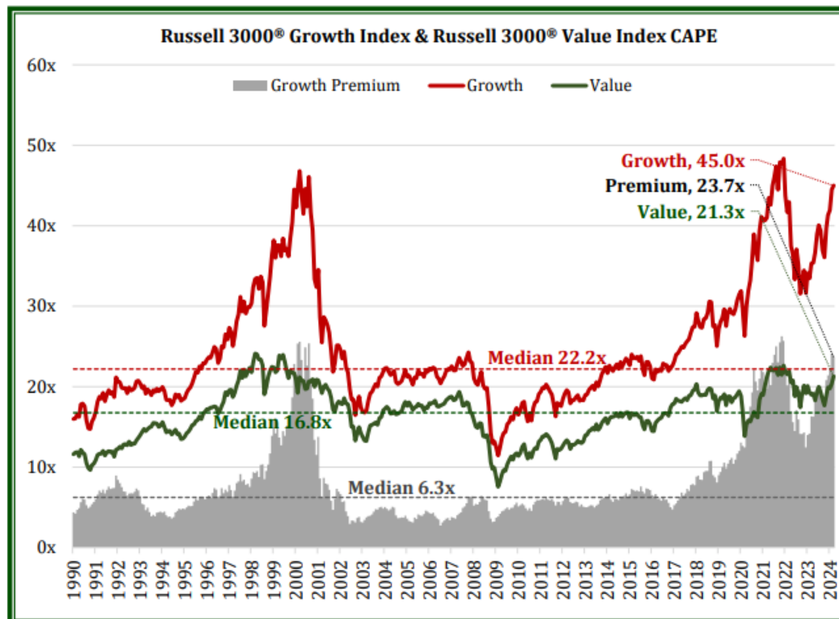
Source: FactSet – Earnings Insight (May 3, 2024)

The P/E for the S&P 500® Index increased sharply in 2023 and into the first quarter of 2024.

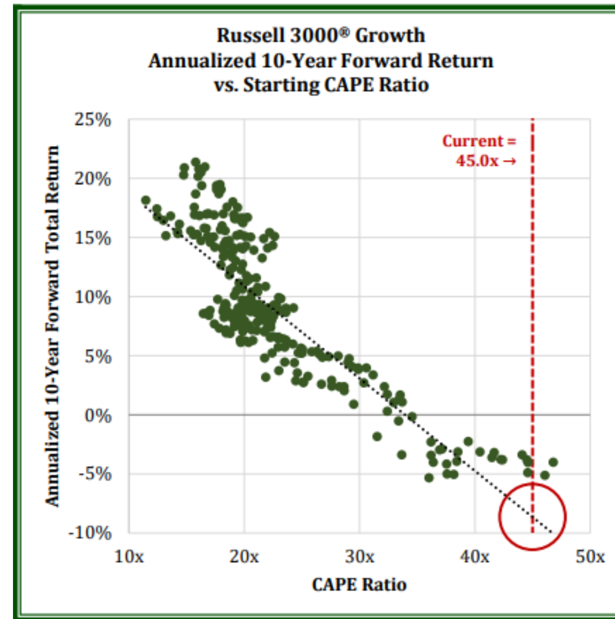
- S&P 500® valuations remain elevated compared to both five- and 10-year averages; however, the resumption of earnings growth in the first quarter, along with a brief pullback, helped to reduce levels slightly from recent highs.
- As noted on the previous "earnings" slides, the broader equity market (as represented by the S&P 500®) will be more reliant on companies outside of the Magnificent 7 to improve aggregate earnings levels for the market in the coming quarters. Whether or not companies are able to generate attractive levels of earnings growth in the face of sticky inflation and higher than expected interest rates, will be a main area of focus moving ahead.

We have noted many times in the past that valuation levels, such as measured by the P/E ratio, are not predictive of short-term market movements. However, over longer periods, they tend to be a good guidepost for future return expectations.

Equity – U.S. Growth vs. Value



Source: EIC – The Case for Value versus Growth (March 2024)

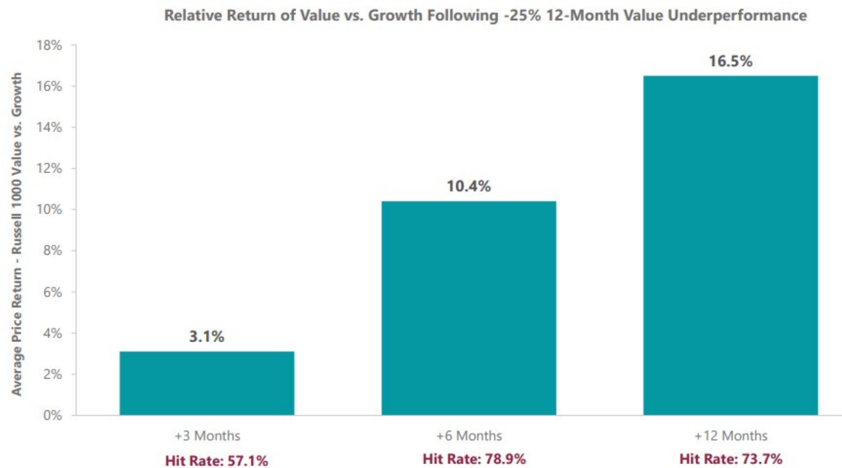


Source: EIC – The Case for Value versus Growth (March 2024)

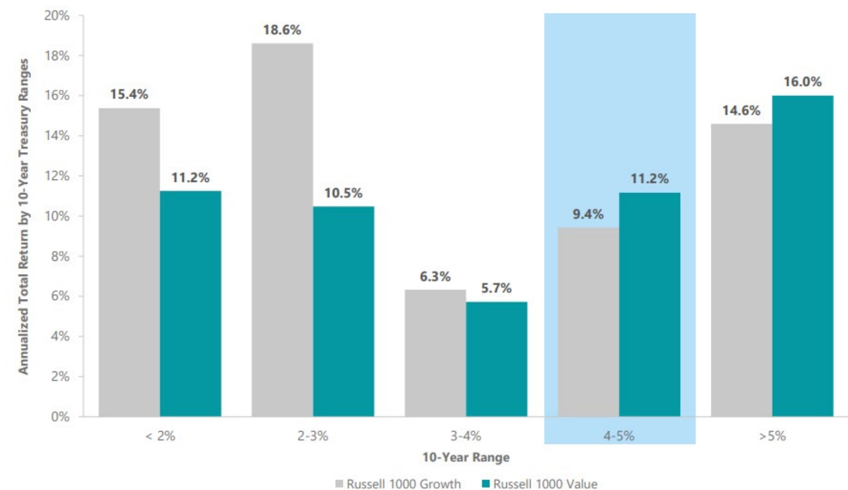
The cyclically-adjusted price-to-earnings ratio ("CAPE") incorporates longer-term earnings into the calculation of its price-to-earnings ratio. Based on this valuation metric, growth stocks (as represented by the Russell 3000® Growth Index) continue to trade near historically high levels on both an absolute basis (red line upper left) and relative to value stocks (as represented by the Russell 3000® Value Index, grey area upper left).

- The CAPE for growth stocks improved (declined) in 2022 when value stocks outperformed growth stocks by a large margin. However, a combination of Magnificent 7 results and AI "mania" in 2023 pushed levels back towards the highs seen just prior to 2022 and the tech boom in the late 1990's into 2000.
- Historically, when CAPE ratios for the Russell 3000® Growth Index reached similarly high levels, annualized 10-year forward returns have been poor (upper right). We are cognizant that no two periods are the same, and valuation levels may remain elevated for relatively long periods. However, if history is even somewhat similar, investor experience in growth stocks moving forward may not be as positive as recent years.

Equity – U.S. Growth vs. Value



Source: ClearBridge – Anatomy of a Recession (Second Quarter 2024)



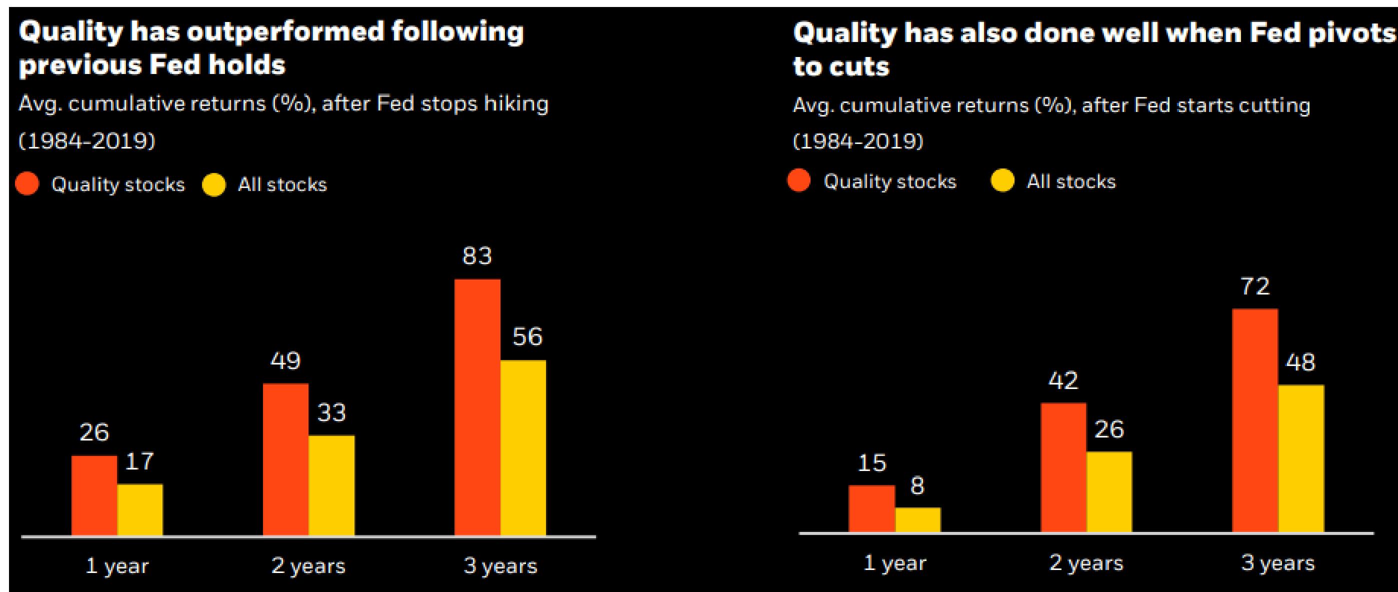
Source: ClearBridge – Anatomy of a Recession (Second Quarter 2024)

U.S. growth stocks have generated strong returns relative to value stocks. However, as could be seen in 2022 when value stocks outperformed by a large margin, that is not always the case.

- The chart in the upper left examined future return periods for value stocks relative to growth stocks after growth stocks significantly outperformed value stocks (by 25% or more). Based on this data, value stocks typically bounced back and outperformed growth stocks by an increasingly large margin as the time period increased from three months to 12 months.
- The chart in the upper right looked at the return profiles of the Russell 1000® Growth Index and the Russell 1000® Value Index under different interest rate environments (10-year Treasury yield). In general, growth stocks outperformed value stocks by the most when interest rates were low (under 3%), while value stocks tended to outperform when interest rates were higher (above 4%).

The data on this slide (and the previous slide) are intended to help investors avoid getting too caught up in the “recency bias” of expecting recent outsized gains in growth stocks to continue indefinitely. As was the case in prior periods of growth stock outperformance, all good things must come to an end. And when they do, it is important that investors remain diversified across styles, market caps and other sub-asset classes, so that long-term goals do not succumb to short-term performance chasing.

U.S. Equity – Quality



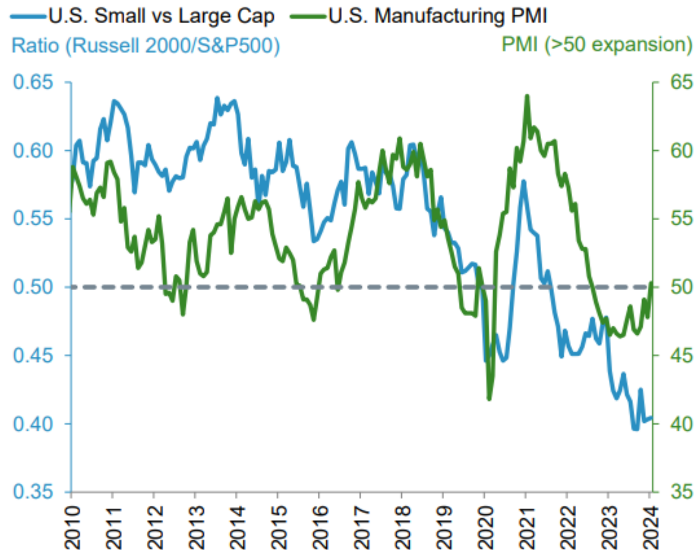
Source: BlackRock – Advisor Outlook (March 2024)

One area of the market we have taken steps to emphasize for clients is an investment in "quality" companies. We did this by adding a dedicated U.S. large cap manager to portfolios earlier this year.

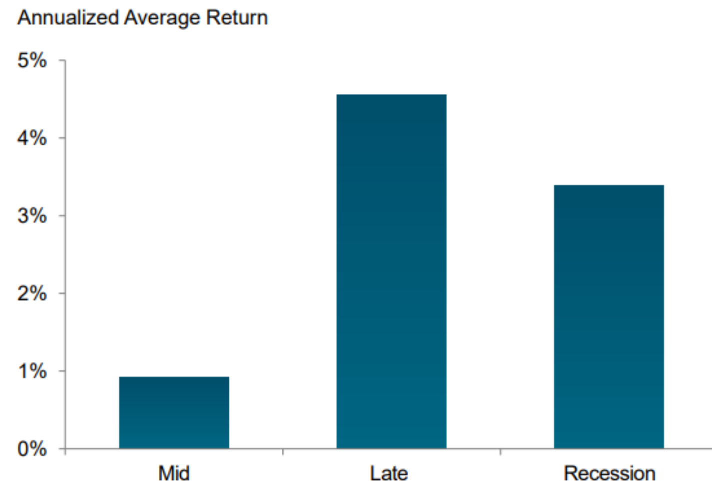
- The term "quality" can have a variety of meanings, but for our purposes, quality businesses tend to be financially strong, have high returns on capital, and have proven, durable business models.
- In addition to positive individual company characteristics, quality companies tend to perform relatively well following instances when the Fed put interest rate movements on "hold" (above left). Furthermore, quality has also generated attractive returns in periods when the Fed begins to cut rates (above right).

We believe the combination of the active manager chosen for client portfolios, financially strong companies, the current business cycle and the Fed interest rate cycle, set up well for quality companies to deliver relatively attractive returns for investors over the intermediate-term.

U.S. Equity – Opportunity



Source: Fidelity Quarterly Market Update (Second Quarter 2024)

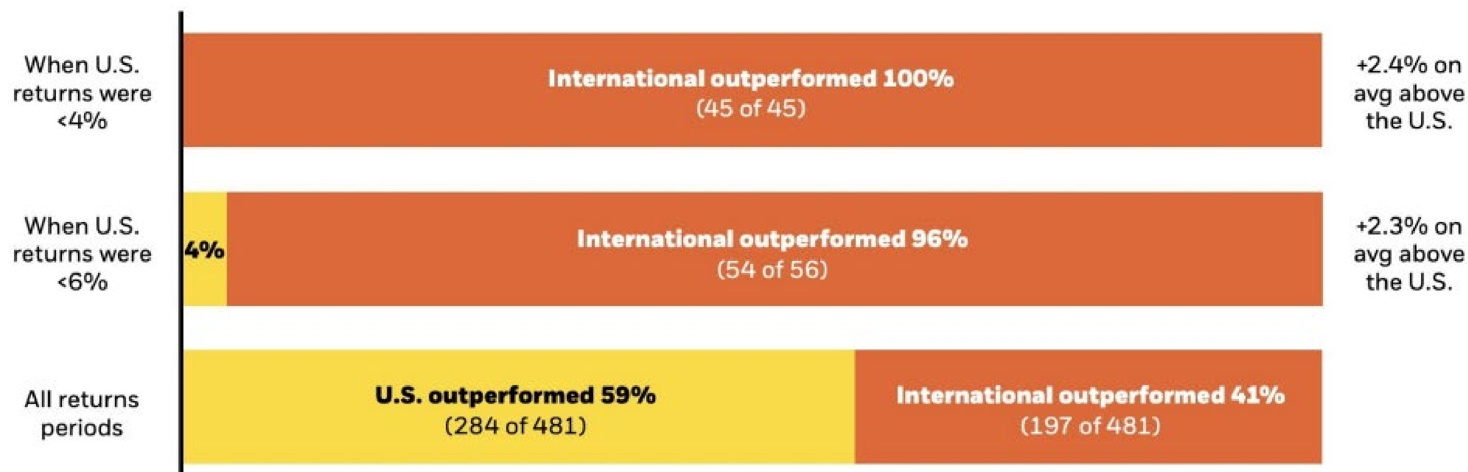


Source: Fidelity Quarterly Market Update (Second Quarter 2024)

We believe a number of positive factors, such as valuation levels, improved fundamentals, and forecasted earnings growth, among others, provide an attractive long-term backdrop for small-caps. These factors led us to add a second dedicated small-cap manager to client portfolios earlier this year.

- From a shorter-term perspective, smaller companies generally begin to outperform when manufacturing activity reaccelerates, which we have begun to see more recently (green line above left). Despite this positive development, shorter-term risks remain, which include stubbornly high inflation and interest rates. Therefore, we believe a measured approach towards increasing portfolio allocations to domestic small-cap stocks is in the best interest of clients.
- The small-cap universe of stocks is more expansive than the large-cap universe. A larger number of companies equates to more opportunities, but also more potential hazards. For instance, for a large segment of small-cap companies, profits have been elusive and interest coverage ratios remain low because of high interest rates. As a result, we have focused small-cap investments in higher quality companies, which may perform better in the latter part of economic cycles (upper right) and have diversified exposure in actively-managed strategies with different investment processes and areas of focus.

Foreign Equity – Why Own It?



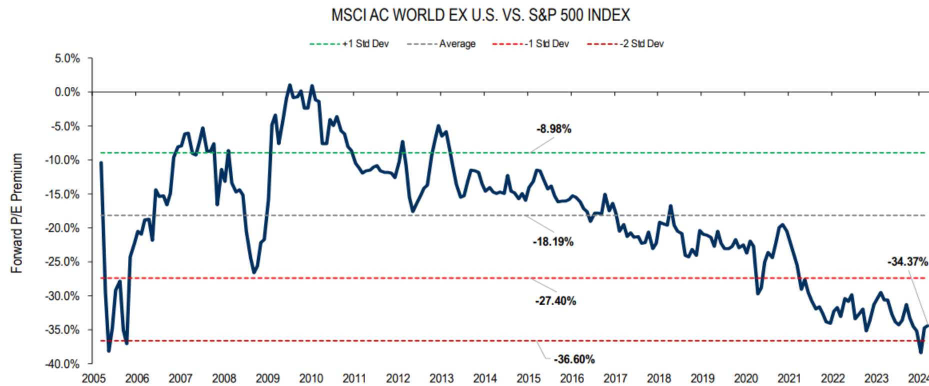
Source: Morningstar

Inevitably, whenever a particular asset class, or sub-asset class does not perform as well as another segment of the market, investors begin to question the rationale for including the relatively weaker performing investment in portfolios.

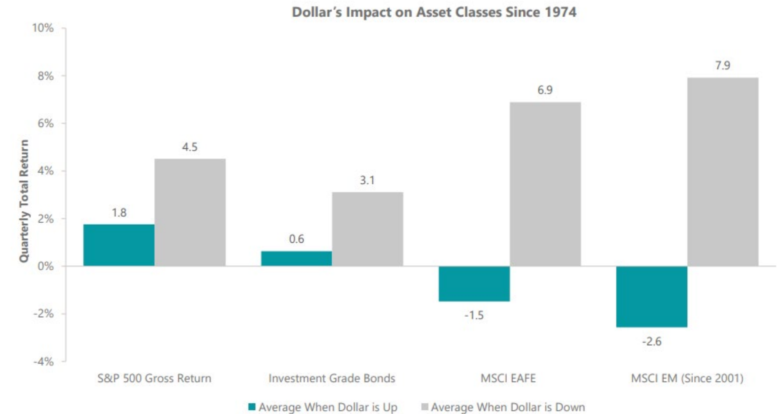
- This way of thinking becomes even more pronounced when there are large performance disparities between sub-asset classes. Taking it back to the beginning of the equity review, “recency bias” becomes increasingly strong.
- One such instance of recency bias in portfolios is the desire to own more U.S. equities at the expense of some (or, all) foreign equities. However, doing so would reduce the overall level of diversification in portfolios. This is because even though U.S. equities have performed quite well relative to foreign equities, that is not always the case.
- The bar chart above examines long-term (10-year) rolling periods from 1974-2023. What the data shows is that foreign stocks tend to do very well, and provide positive diversification benefits, when U.S. equity returns are relatively low. When U.S. returns were less than 4%, international stocks outperformed U.S. stocks 100% of the time, and when U.S. returns were less than 6%, international stocks outperformed U.S. stocks 96% of the time.

Considering the sustained strength U.S. based equity investors have experienced for over a decade (in part due to a tailwind of a strong U.S. dollar), we do not think now would be an optimal time to abandon our belief in portfolio diversification across asset classes. In our opinion, doing so may heighten volatility in portfolios and reduce long-term return potential moving forward.

Foreign Equity – Opportunity



Source: First Trust – Monthly Strategy Deck (April 2024)



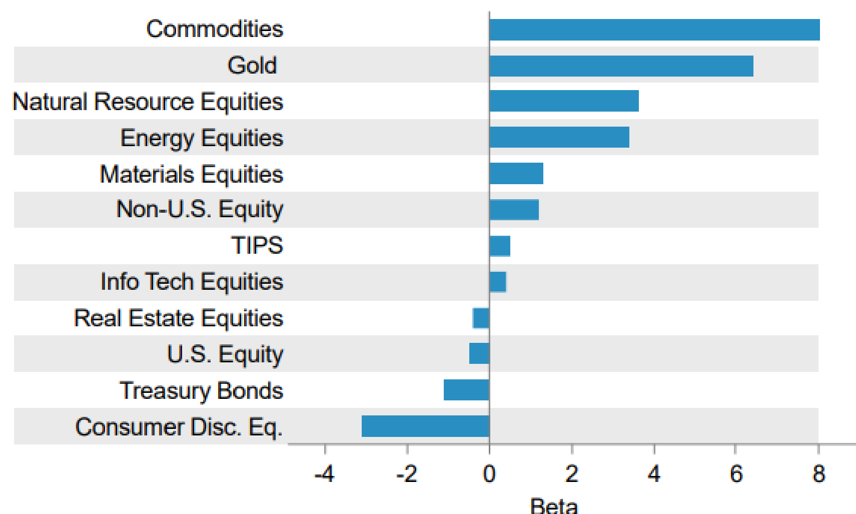
Source: ClearBridge – Anatomy of a Recession (Second Quarter 2024)

In addition to long-term diversification benefits, there are a number of factors that may be supportive for foreign equity returns moving forward. These include historically low relative valuations and currency considerations.

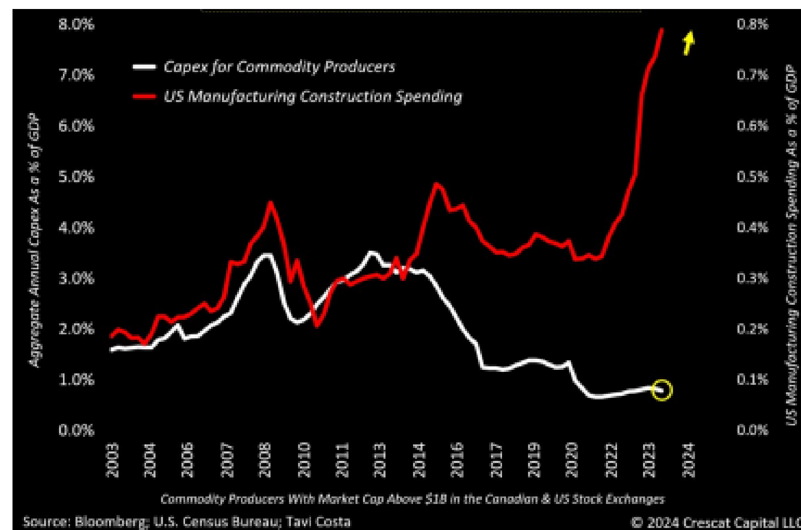
- The chart above left examines the relative forward P/E premium of foreign stocks (as measured by the MSCI All Country World ex U.S. Index) compared to U.S. stocks (as measured by the S&P 500® Index). Based on this data, foreign equities are now trading at a valuation "discount" relative to U.S. equities that has not been seen in nearly 20 years. While this does not mean U.S. stocks are destined to underperform meaningfully in the short-term, we believe it does provide a relatively attractive starting point for foreign equities to perform relatively well over the intermediate- to long-term.
- The U.S. dollar has also experienced a relatively long period of sustained strength against many foreign currencies. As is the case with equity markets, foreign currencies also tend to move in cycles. In turn, if the U.S. dollar experiences any type of gradual, or sustained weakening, this could provide a significant tailwind to results for U.S. based investors in foreign equities (chart above right – MSCI EAFE® represents developed foreign markets while MSCI EM represents emerging markets).

Given the current global economic backdrop, starting valuations, and improved fundamentals in many developed foreign and emerging markets, we continue to believe foreign equities have the potential to deliver attractive, differentiated returns for investors.

Commodities – Opportunity



Source: Fidelity Quarterly Market Update (Second Quarter 2024)



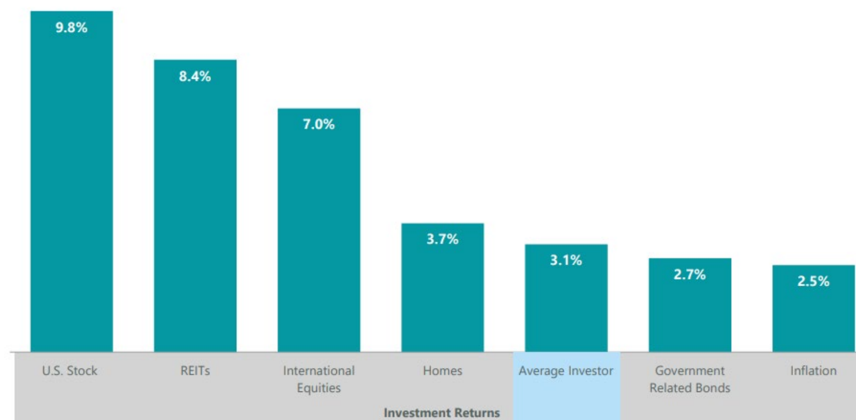
Source: Towle – Investor Letter (1Q24)

Inflation has been stubbornly "sticky" in the U.S., which has caused the Fed to put their plans to cut interest rates on hold. This has resulted in an increase in volatility across asset classes.

- Inflation is one of the primary risks we have highlighted internally in our investment meetings. This is primarily because much of the equity gains from the fourth quarter of last year into this year have been predicated on the belief that interest rate cuts would provide a boost to the economy, reduce potential stress in the financial sector, and improve the outlook for the consumer, among other considerations. If inflation were to become more entrenched, and interest rates were to remain high, it could potentially change the direction of the market and sector participation.
- One asset class that has performed well during periods of unexpectedly high inflation is commodities. As can be seen in the chart (above left), commodities have a positive sensitivity (beta) to inflation surprises. This is also the case for gold, and natural resource, energy and materials equities. The backdrop for commodity producers is also quite positive (above right) as capital expenditures have been declining for the past decade.

We will continue to monitor inflationary measures closely and may add a diversified commodity-oriented investment if we believe the diversification benefits are positive for portfolios.

Why is Volatility Important?



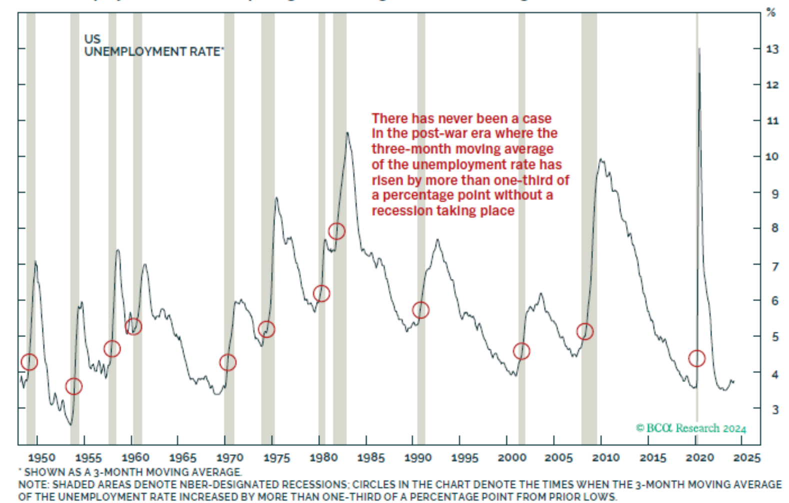
Source: ClearBridge – Anatomy of a Recession (Second Quarter 2024)

We often discuss volatility, risk-adjusted returns and diversification extensively in investor communications and in face-to-face meetings with clients and prospects. The natural question is, "Why?"

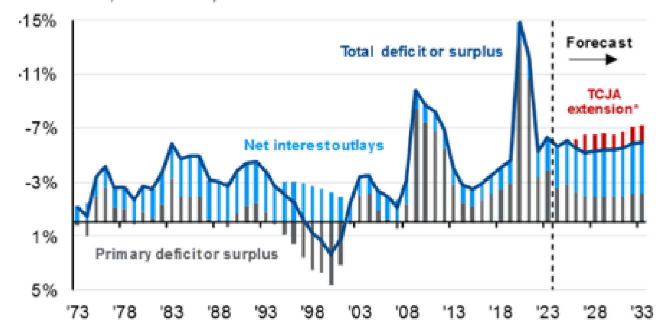
- In most circumstances, a client's long-term goal is built around a return on invested capital, and the return of capital. Two dangers that may prevent investors from achieving their long-term goals are: 1) significant drawdowns (losses over the short-term), which make consistent compounding of capital more difficult; and 2) turning temporary losses into permanent losses (i.e. panic selling after a large loss).
- The study above looked at average investor returns over a 20-year annualized period relative to major asset classes, assets, and inflation. What the study found is that the average investor returned significantly less compared to the best performing asset classes. This wasn't because investors completely avoided the asset classes, but rather because investors generally buy high and sell low (add to assets that have performed well and sell assets that have performed poorly).
- In turn, we look to provide diversified portfolios to clients that tend to decline less than the market when it goes down at the expense of outperforming the market when it goes up significantly. We have found this results in lower volatility portfolios for clients, which are then held in both relatively good and relatively weak periods. This then reduces the potential for panic selling at inopportune times, which can be damaging to long-term goals.

Fixed Income – U.S. GDP Growth, Will it Last?

- Despite recent positive data, longer-term economic indicators continue to suggest slowing growth in the future. Following a generally strong second half of 2023 and a healthy January for U.S. payrolls and wages, recent indicators suggest softness, with a slight uptick in unemployment (chart right) and slowing consumption. Certain sectors, such as technology, finance, and real estate, are witnessing layoffs, while education, health care, and hospitality sectors remain healthy.
- In addition to unemployment, other labor market indicators such as job openings, quits rate, average hours worked, and job finding probabilities have all declined significantly from peak levels.
- While we believe that U.S. growth may have peaked and is likely to decelerate towards levels in the rest of the developed markets this year, several factors may sustain the U.S. economy. These factors include:
    1. Large fiscal stimulus and ongoing federal deficits, which have bolstered U.S. demand relative to other regions (chart right). However, U.S. savings have diminished, which represents a risk.
    2. Many U.S. households have low fixed-rate mortgages that have insulated them from rising rates.
    3. Despite weakness in U.S. regional banks, most holders of high-quality, low interest rate bonds have weathered market losses well, mitigating systemic risks.
    4. While certain sectors like commercial real estate and bank loans remain vulnerable to rate increases, overall risks to the broader U.S. economy appear manageable as non-rate sensitive sectors continue to take a larger share of economic output.



Source: BCA Research

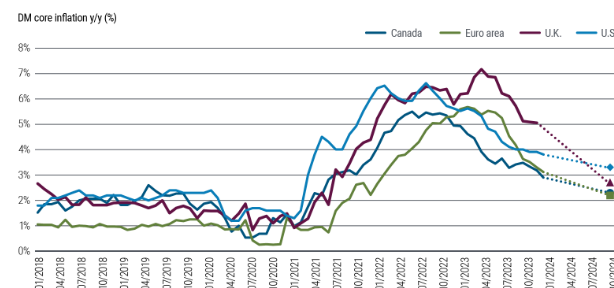


Source: JPMorgan

Fixed Income – Inflation Moderation

- The factors supporting U.S. economic growth are also likely to contribute to stickier inflation in the U.S. in 2024. The consensus forecast suggests core consumer price index (CPI) inflation in the U.S may end the year in the area of 3.0% to 3.5%. Personal consumption expenditures (PCE) inflation, the Fed's preferred gauge, could be in the 2.5% to 3.0% area at year-end
- Core PCE at those levels is still too high for the Fed's comfort. In fact, the Fed recently raised its year end inflation outlook to 2.6% from 2.4% and Chairman Powell reiterated the need to see "inflation moving sustainably toward 2%" before cutting interest rates.
- Several trends that have supported recent disinflation are also fading. Oil prices, which had fallen more than 25% from last year's high, are now up 15% from lows. Durable goods price inflation is already back to its historical normal level near zero, so further disinflation is unlikely from that component.
- Inflation cooling from the expected slowdown in rents has yet to materialize in a major way, as tight housing supply continues to be a problem. However, with rents accounting for roughly 30% of headline CPI, and almost 40% of core CPI, the eventuality of slowing rent growth could drag reported inflation lower.
- On balance, the data suggests further disinflation is likely to materialize this year, but probably less than the consensus expects. An upside inflation surprise cannot be ruled out entirely, as some forecasters are projecting inflation to reaccelerate.

Figure 3: DM inflation has cooled at varying rates

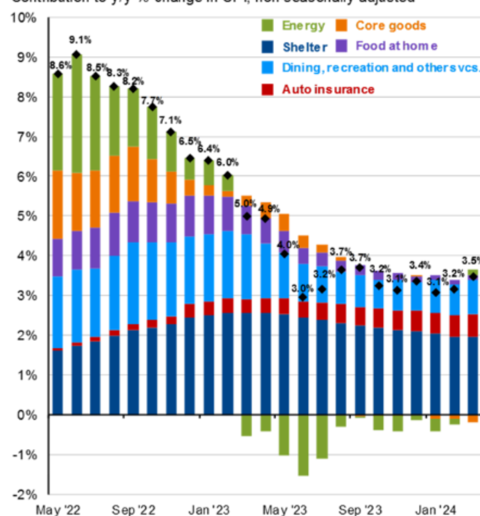


Source: Haver Analytics, PIMCO as of March 2024. Dots at right represent PIMCO forecasts for the fourth quarter of 2024.

Source: PIMCO

Contributors to headline CPI inflation

Contribution to y/y % change in CPI, non-seasonally adjusted

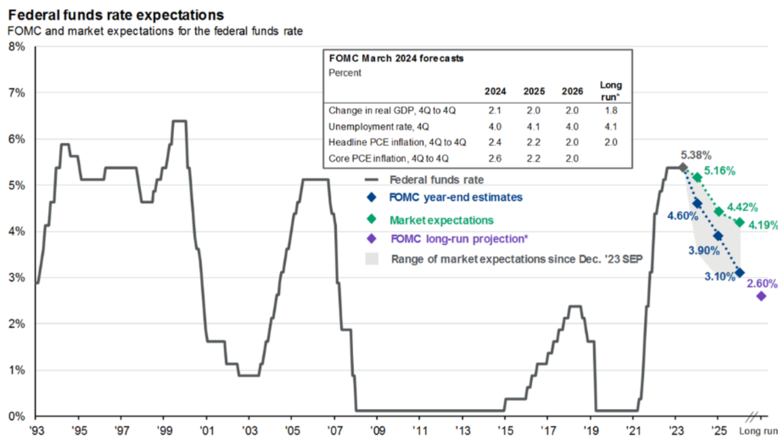


Source: JPMorgan

Fixed Income – Fed Policy

- Following 2023's solid progress on inflation, markets became convinced by the start of 2024 that the Fed was on track to cut rates in short order. However, so far this year, the U.S. economy has remained surprisingly resilient, and inflation has begun reaccelerating above target levels.

- The Fed seems to believe that restrictive monetary policy is having an effect, and after curbing costs in goods, could gradually see impacts in services, which tend to lag. It is rumored the Fed is waiting for higher unemployment and wage softening before it will be confident enough to reduce the Fed Funds rate from the current 5.25% to 5.50% range. The markets, which initially anticipated up to six interest rate cuts this year, have gradually come around to the Fed's consensus of three rate cuts. However, if inflation continues to reaccelerate, expectations may reduce further.



FOMC March 2024 forecasts
Percent

	2024	2025	2026	Long run*
Change in real GDP, 4Q to 4Q	2.1	2.0	2.0	1.8
Unemployment rate, 4Q	4.0	4.1	4.0	4.1
Headline PCE inflation, 4Q to 4Q	2.4	2.2	2.0	2.0
Core PCE inflation, 4Q to 4Q	2.6	2.2	2.0	

Source: JPMorgan

Source: Hedgeye

Fixed Income – Market Update

- The 10-year Treasury yield experienced a steady increase in the first quarter, ending 32 basis points (0.32%) higher than its starting point for the year. Concurrently, as the market adjusted its expectations and discounted the possibility of rate cuts, the 2-year yield rose by 37 basis points over the same period. This resulted in a flattening of the yield curve, which concluded with a 42 basis points spread between the 2-year and 10-year yields. Notably, this quarter marked the continuation of the 2-year-to-10-year yield curve inversion (short rates higher than long rates), persisting for a record-breaking 21 months.
- Risk assets in the fixed income markets saw strong performance throughout the quarter. Despite record issuance in Q1 (surpassing the previous record set in Q1 '20), investment grade corporate spreads tightened by 9 basis points. Notably, this tightening was led by the financial sector, which saw a reduction of 16 basis points. Additionally, U.S. high yield and emerging markets debt both tightened by 24 and 71 basis points, respectively, by the end of the quarter.
- Despite tightening spreads in the credit space, the Bloomberg Barclays Aggregate Bond Index generated a return of -0.78% for the quarter, primarily due to the significant increase in Treasury rates. Agency mortgage-backed securities emerged as the only taxable investment-grade credit subsector with negative excess returns year-to-date, recording a loss of -0.14%. Conversely, subsectors with the highest year-to-date excess returns included emerging markets debt (+5.33%), U.S. high yield (+1.59%), commercial mortgage-backed securities (+1.45%), and investment-grade corporates (+0.89%).

Maturity	12/31/22	12/31/23	2/29/24	3/31/24	1 Mo Chg	Q1 Chg
3 Mo	4.41%	5.36%	5.39%	5.38%	-0.01%	0.02%
1	4.73%	4.78%	5.01%	5.04%	0.03%	0.26%
2	4.43%	4.25%	4.62%	4.62%	0.00%	0.37%
3	4.23%	4.01%	4.42%	4.41%	-0.01%	0.40%
5	4.01%	3.85%	4.25%	4.21%	-0.04%	0.36%
7	3.97%	3.88%	4.27%	4.21%	-0.06%	0.33%
10	3.88%	3.88%	4.25%	4.20%	-0.05%	0.32%
20	4.15%	4.20%	4.52%	4.45%	-0.07%	0.25%
30	3.97%	4.03%	4.38%	4.35%	-0.03%	0.32%

Source: Baird Advisors

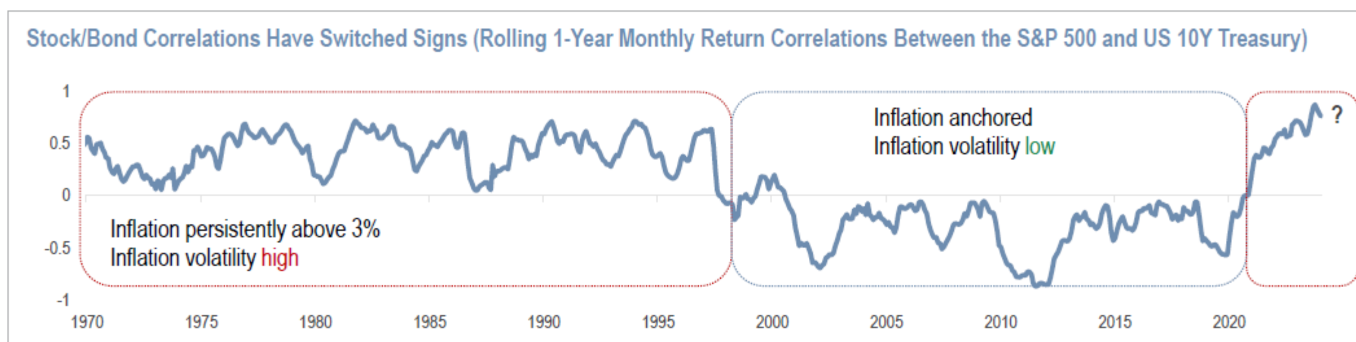
Total Returns of Selected Bloomberg Indices and Subsectors

	Mar Total Return	Mar Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.92%	0.24%	-0.78%	0.23%	6.21
U.S. Gov't/Credit Index	0.88%	0.21%	-0.72%	0.34%	6.33
U.S. Intermediate Gov't/Credit Index	0.64%	0.14%	-0.15%	0.22%	3.77
U.S. 1-3 Yr. Gov't/Credit Index	0.40%	0.04%	0.42%	0.09%	1.84
U.S. Treasury	0.64%	0.00%	-0.96%	0.00%	6.04
U.S. Agency (Non-Mortgage)	0.46%	-0.01%	0.08%	0.14%	3.18
U.S. Agency RMBS (Pass-Throughs)	1.06%	0.34%	-1.04%	-0.14%	6.08
CMBS (Commercial Mortgage Backed Securities)	0.91%	0.37%	0.85%	1.45%	4.32
ABS (Asset-Backed Securities)	0.49%	0.06%	0.68%	0.54%	2.63
U.S. Corporate Investment Grade	1.29%	0.56%	-0.40%	0.89%	7.01
U.S. High Yield Corporates	1.18%	0.71%	1.47%	1.59%	3.15
Emerging Market Debt	2.78%	2.17%	4.71%	5.33%	4.92
Municipal Bond Index	0.00%	N/A	-0.39%	N/A	6.07
Taxable Municipal Bond: Agg Eligible	1.20%	0.27%	-0.44%	1.53%	9.34
TIPS (Treasury Inflation Protected Securities)	0.82%	0.00%	-0.08%	0.00%	6.73

Source: Baird Advisors

Fixed Income – Relative Positioning

- Despite continued interest rate volatility, we believe client portfolios are well-positioned to produce attractive returns over the intermediate- to long-term. The portfolios continue to yield over 5.00%, which is attractive from a historical perspective. Starting yields in this range offer a favorable risk/reward profile when stress testing against a 1% change in interest rates.
- We continue to invest the bulk of client assets in actively-managed mutual funds with flexible mandates. We prefer the flexibility and diversification across credit sectors versus over- or under-allocating to any one area. The mutual funds are balanced against low cost passively-managed ETFs to manage duration and yield curve exposures. We believe this combination is the best way to navigate a volatile interest rate and credit environment.
- With the Fed still expected to reduce rates in 2024, yields in the two-to-five-year range remain compelling, and client portfolios are positioned to take advantage of the expected rate changes. However, we will be cautious not to extend duration significantly, as the inflation trajectory remains uncertain over the short-term. In periods of persistent inflation, long duration assets tend not to work as an attractive hedge against risk assets.
- On the credit side, we continue to maintain a neutral policy on investment grade and high yield corporate bonds. Our longer-term bias is to be overweight these sectors. Corporate credit spreads remain tight, which may be warranted given improved fundamentals and the lack of refinancing needs. An increase in mergers and acquisitions could provide openings for research-driven managers. Across loans and securitized products like mortgage-backed securities and collateralized loan obligations, income-generation potential continues to be attractive. Given continued interest rate volatility, we believe non-traditional sources of diversification like insurance-linked securities have the potential to add value.



Source: Neuberger Berman

Our Team

We are an investment firm, founded by investors.

Bob Batchelor, CFA®, CFP® is Co-Founder and Chief Executive Officer of Entasis Asset Management. Bob has 25 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee. Bob has also earned the right to use the Certified Financial Planner™ certification and SE-AWMA™ professional designation.

Charles (C.J.) Batchelor, CFA® is Co-Founder and Chief Investment Officer of Entasis Asset Management. C.J. has 20 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a voting member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee.

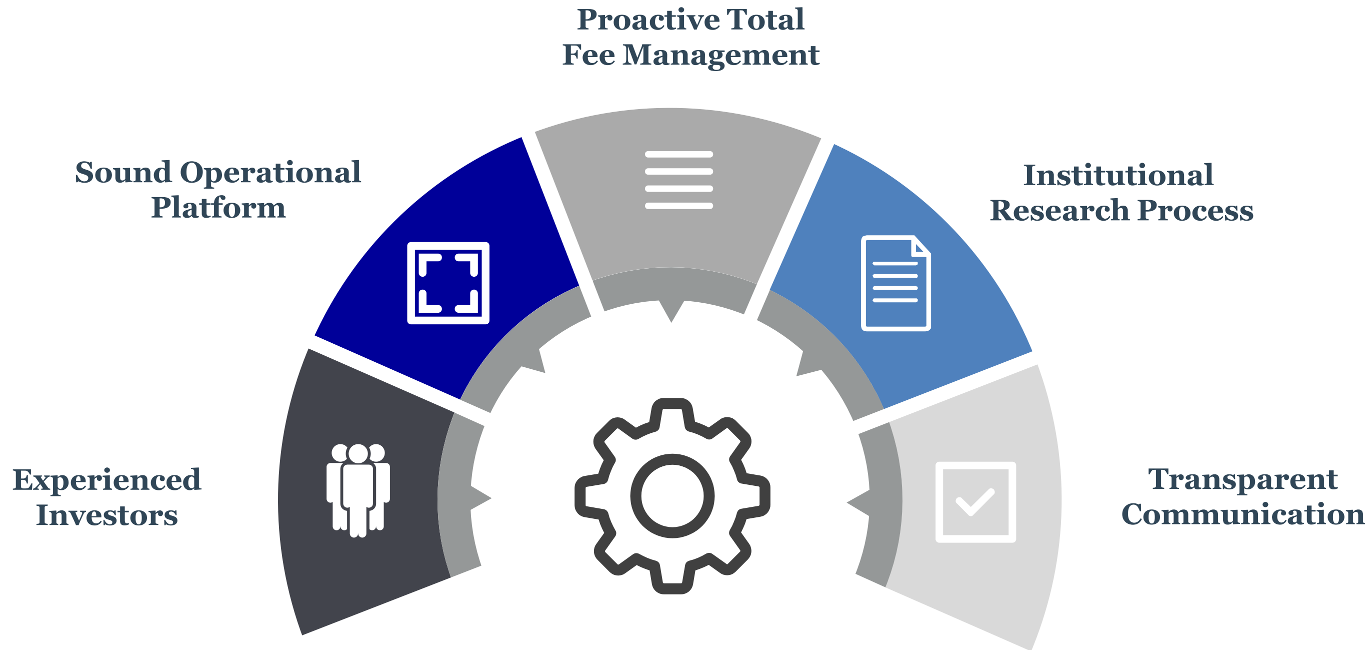
Mike Peters, CFA® is Co-Founder and Senior Wealth Advisor at Entasis Asset Management. Mike has 20 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as a voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

David LaCroix is a Senior Wealth Advisor at Entasis Asset Management. David has more than 50 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.

The Entasis Difference



Disclosure

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Investment Terms

Valuation levels are typically shown by calculating the price level of an index or a company relative to any number of characteristics of an index or company. For instance, the price-to-earnings valuation metric looks at the price of an index (or stock) divided by the total earnings of an index (or stock). Based on the multiple (in this instance, the multiple is how much investors are willing to pay – the price – for a given amount of earnings), it provides investors with a general sense of how expensive, or cheap, the overall market is at the present time. While there are a significant number of valuation metrics that are used in practice, and many ways to vary/modify the calculation of the price-to-earnings ratio, in this summary we are focused on the price investors are willing to pay (the level of the S&P 500® Index) divided by earnings expectations for the equity market (S&P 500 Index) over the next 12 months. This valuation metric is referred to as the forward P/E. A **yield curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% (0.0001). **Interest coverage** is a measure of a company's ability to meet its interest payments on its debt. **Federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. It is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions, which in turn have a bearing on key aspects of the broad economy including employment, growth and inflation.

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