2024 Economic and Investment Outlook – A Long and Winding Road

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The Year in Review: 2023

In 2023, the narrative primarily revolved around the U.S. economy's response to the extensive monetary tightening implemented by the Federal Reserve Open Market Committee (FOMC or Fed) over the last two years. Notably, challenges emerged with the failure of several banks – Silicon Valley Bank, Signature Bank, and First Republic Bank – to name a few. Lending standards tightened for both consumers and businesses, leading to an uptick in credit card and auto loan delinquencies and an overall slowdown in business investment. Despite the turmoil in the banking system and increased headwinds to consumers and businesses, the U.S. economy proved to be incredibly resilient. Consumers continued to spend at record levels, unemployment remained low (under 4%), and inflation began to moderate. Did the Fed achieve the seemingly impossible feat of orchestrating a soft landing, or have the full effects of higher interest rates yet to unfold?

In a year characterized by surprising economic strength, multi-decade high interest rates, robust consumers, and persistent geopolitical risks, 2023 could be described as a year of competing forces. Good news was bad news, bad news was good news, and there was plenty to digest in between. We even saw the Fed shift to a more dovish stance at the December meeting, indicating three potential rate cuts in 2024. With everything that happened, let's see how the major asset classes fared:

- **Equities** – Markets across the world rallied with most major markets posting positive returns. In the U.S., the "Magnificent Seven" dominated large-cap returns, driving nearly two-thirds of the S&P 500 Index's 2023 returns. International equities, both developed and emerging, generally exhibited strong performance and benefited from more diversification compared to U.S. equities.
- **Fixed Income** – Yields exhibited significant volatility in 2023 as bond markets sought stability following a historically challenging year in 2022. The 10-year treasury rate surged to nearly 5% in October, before rallying on the news of a Fed "pivot" and ultimately closed the year just under 3.9%. Below investment grade credit outperformed investment grade credit due to lower duration (interest rate sensitivity), and a stronger than expected economy.
- **Diversifiers** – Hedging strategies generally met expectations, performing in-line with high quality fixed income and exhibiting low volatility. The asset class continues to serve a role in diversified portfolios, but a reduced allocation could be considered with higher yields on investment grade fixed income.
- **Inflation Sensitive Strategies** – Performance of real assets diverged significantly in 2023. Midstream energy and other real assets (timberland, farmland, and traditional infrastructure) generally yielded positive returns. In contrast, commercial real estate faced substantial headwinds driven by higher interest rates and reduced transaction volume. Within the commercial real estate market, the office sector remains the most challenged due to several factors, including the continued trend of work-from-home.

CHART 1: CALENDAR YEAR 2023 RETURNS

Equities			Fixed Income		
US Large Cap	S&P 500	26.30%	Core Fixed Income	Barclays US Agg	5.50%
US Small Cap	Russell 2000	16.90%	Defensive Fixed Income	Barclays 1-3 Yr US Treas	4.30%
International Equity	MSCI EAFE	18.20%	Municipal Fixed Income	Barclays Muni 5 Year	4.30%
Emerging Markets	MSCI Emerging Markets	9.80%	High Yield	ICE BofA US High Yield	13.50%
Diversifiers					
Hedge Funds	HFRI Fund of Funds	6.40%			
Midstream Energy	Alerian Midstream Energy	14.00%			
Direct Real Estate	NCREIF ODCE	-12.01%			

Sources: Morningstar and Abacanto Holding Portfolio Solutions. As of 12/31/2023.

2024 Capital Markets Outlook

Looking ahead to 2024, the risks of a recession are still very real. The lagged effects of tighter monetary policy, mounting pressure on consumers and businesses, and increased geopolitical risks all pose challenges to continued economic growth and corporate earnings. While we certainly can't predict what will happen next, we do know that the Fed has effectively declared the war on inflation over and pivoted to a more dovish stance.

1. Broad inflation continues to moderate in 2023 as energy and automobile prices fell throughout the year. Meanwhile, core CPI (which excludes food and energy) remains stubbornly above the Fed's 2% target, as shelter and services have continued to drive year-over-year price increases.
2. Employment pressures continue to soften with job growth slowing as 2023 comes to an end. The unemployment rate remains low, but wage gains are trending downward, which could prove to be a continued tailwind for lower future inflation.
3. U.S. consumers remained strong in 2023 and acted as a driving factor of a strong economy. However, they are likely to face significant challenges in 2024 with elevated housing and rental costs, higher interest rates, the return of student loan payments, and the spend down of excess savings.
4. U.S. equity valuations appear a bit rich, particularly when compared to 10-year treasury yields. With a majority of 2023 returns being driven by multiple expansion, continued near-term upside will likely result from corporate earnings growth. Outside of the U.S., valuations are more attractive and could offer strong risk adjusted returns going forward.
5. Higher starting yields point to better income generation and returns for bond investors going forward. With a Fed pivot on the table, there is a strong possibility of additional tailwinds to returns from rates moving lower.

Chart 2: Long Term Capital Market Projections

PROJECTIONS (%)

Asset Class	2024 5-10 yr Projection	2023 5-10 yr Projection	Change	Standard Deviation
Broad Domestic Equity	6.75%	7.25%	-0.50%	22.70%
Large Cap (U.S.)	6.50%	7.00%	-0.50%	21.89%
Small/Mid Cap (U.S.)	7.00%	7.50%	-0.50%	27.47%
International Equity	7.50%	7.75%	-0.25%	26.35%
Int'l Small Equity	8.00%	8.25%	-0.25%	29.82%
Global Equity	7.25%	7.50%	-0.25%	24.53%
Emerging Market Equity	8.50%	8.75%	-0.25%	32.24%
Domestic Fixed Income	5.50%	4.75%	0.75%	5.86%
Defensive Fixed Income	5.00%	4.50%	0.50%	2.17%
Below IG Fixed Income	7.75%	7.50%	0.25%	16.75%
Muni Fixed Income	4.25%	4.00%	0.25%	5.41%

PROJECTIONS (%)

Asset Class	2024 5-10 yr Projection	2023 5-10 yr Projection	Change	Standard Deviation
Commodities	5.00%	5.00%	0.00%	25.44%
Low Correlated Hedge	6.00%	6.00%	0.00%	9.16%
Private Equity	10.00%	10.00%	0.00%	13.74%
Private Debt	9.50%	9.25%	0.25%	9.77%
Real Estate	5.50%	4.50%	1.00%	11.92%
REITs	4.75%	3.75%	1.00%	36.88%
Other Real Assets	10.00%	9.00%	1.00%	24.66%
Cash Equivalents	3.00%	3.00%	0.00%	1.08%
Inflation	2.75%	2.75%	0.00%	0.00%

Portfolio Construction – A Return to Fixed Income

When we revise our forward-looking assumptions and review portfolio construction, we have a singular objective: building the best portfolios for our clients. Rather than trying to forecast interest rate movements or market fluctuations, investors should prioritize reevaluating their return objectives and understanding the downside risk inherent in their portfolios.

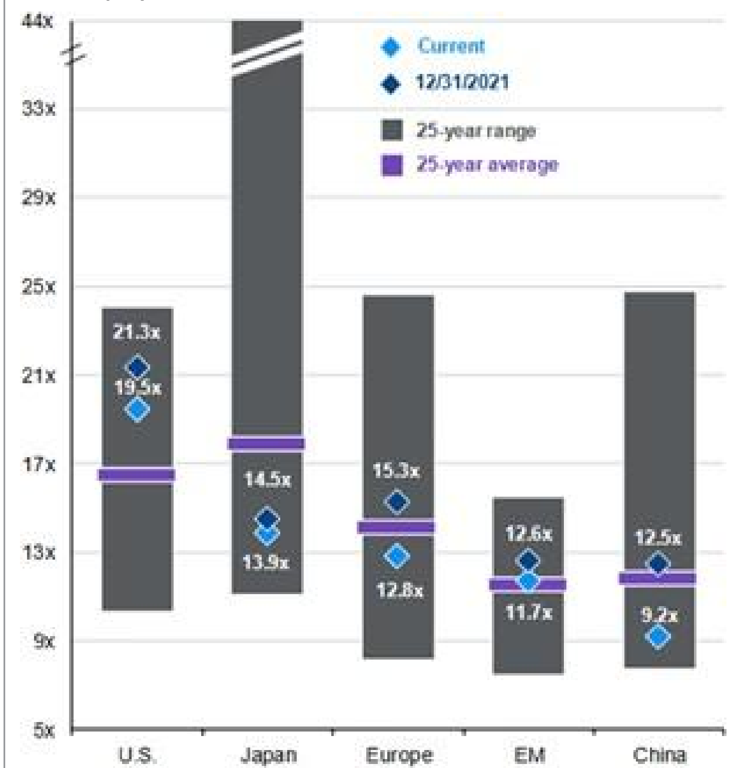
Equity markets surprised many investors in 2023, delivering robust returns around the globe despite considerable economic uncertainty at the beginning of the year. As a result, equity valuations are elevated within the U.S., potentially creating a slight headwind to future returns. Conversely, the Fed's continued interest rate hikes through the year have created higher base rates for bond investors, providing enhanced income generation and diversification benefits. This could prove beneficial for the asset class in the foreseeable future.

Our primary emphasis remains on constructing custom portfolios for our clients and employing regular rebalancing to help maximize the probability of meeting their long-term goals. We continue to advise our clients to maintain diversification and have exposure to asset classes that do well in a variety of economic scenarios.

Equities – Future Returns Likely Driven by Corporate Earnings

Nearly two-thirds of the S&P 500's returns in 2023 were made up the "Magnificent Seven" – Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla – primarily fueled by multiple expansion. Given the elevated valuations in the U.S., the trajectory of corporate earnings in 2024 and beyond becomes increasingly important and will likely be a large driving factor of continued strong returns. Beyond the U.S. borders, developed international and emerging market equities appear more attractively priced with the valuation discrepancy between the S&P 500 and MSCI ACWI ex-U.S. nearing 25-year lows. Amid continued economic uncertainty and higher global interest rates, companies with lower starting valuations and strong cash flows could begin to outperform their pricier, higher-growth counterparts.

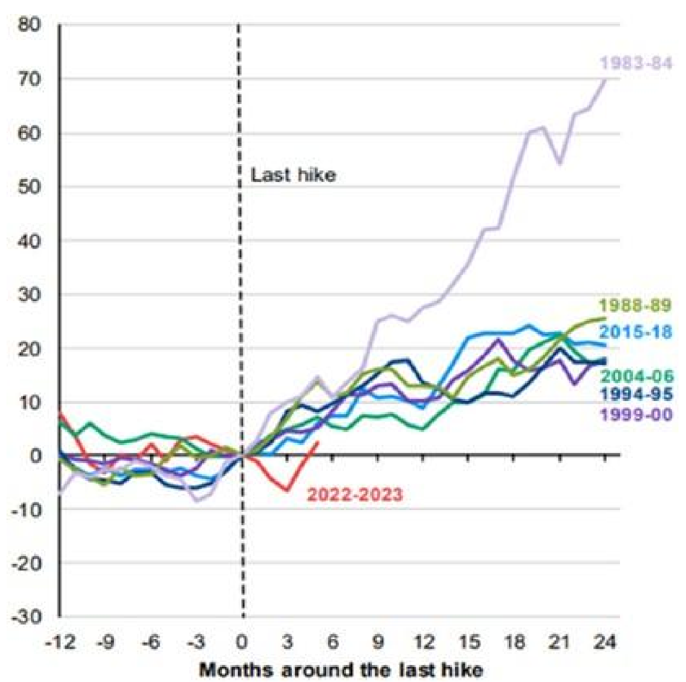
Global Equity Valuations



Sources: FactSet, MSCI, Standard & Poor's, and J.P. Morgan Asset Management. As of 12/21/2023.

Punchline: Despite higher valuations, increased geopolitical risks, and continued economic headwinds, equities continue to play a critical role in portfolios, providing long-term capital appreciation and protection in a higher inflationary environment. Diversification across company size, investment style (value or growth), and geographical location is essential for long-term investors.

10-Year U.S. Treasury Returns around end of Fed Hiking Cycle



Sources: J.P. Morgan Guide to the Markets, FactSet, Federal Reserve, S&P Global, LSEG Datastream, J.P. Morgan Asset Management. Assumes last hike of 2022-2023 cycle was in July 2023. Data as of December 31, 2023.

Fixed Income – Higher Base Rates and Potential Tailwinds of a Fed Pivot

Bond investors were rewarded for their patience in 2023 as we saw strong returns across the bond landscape. As a result of continued Fed hiking and elevated base interest rates, we have raised our return expectations and anticipate that bonds will provide attractive risk-adjusted returns over the coming years. The possibility of rate cuts in 2024 introduces the possibility of further tailwinds for bond returns if interest rates decline across the yield curve.

Punchline: The current backdrop for fixed income looks attractive going forward. We are generally increasing client exposure to fixed income and urging investors to put excess cash to work and consider extending duration to lock in higher fixed rate yields.

Hedging Strategies – Consider a Reduced Allocation

Hedging strategies continue to play an important role within a diversified portfolio and can enhance the overall risk-return characteristics across market cycles. Our expectations for this asset class have been to out perform bonds with similar volatility. While this has certainly played out over the last several years, this hurdle is becoming increasingly difficult to beat with higher base rates.

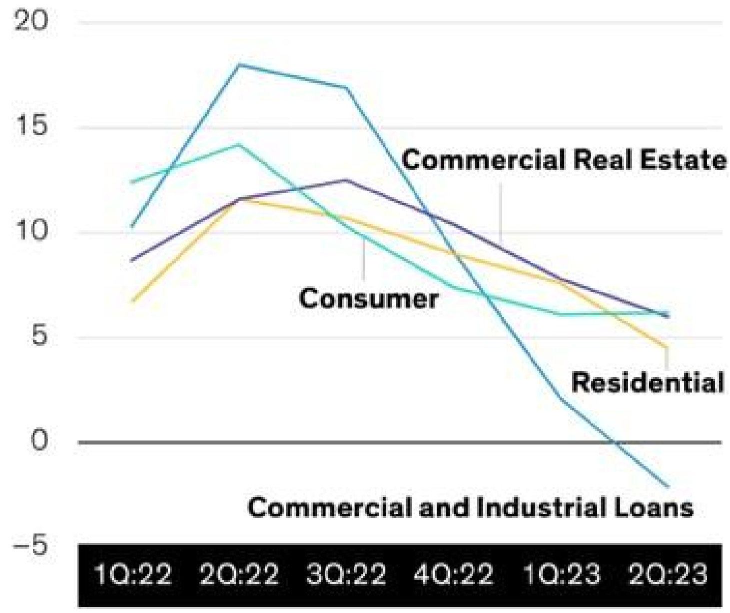
Punchline: We continue to recommend an allocation to hedging strategies within a diversified portfolio; however, we suggest investors consider a reduction to this exposure in favor of high-quality fixed income. This should result in higher income generation, lower costs, and improved portfolio liquidity.

Private Credit – Attractive Yields and Growing Opportunity Set

Private credit continued to grow as an asset class in 2023 as higher interest rates forced many banks to curtail lending in the face of increased liquidity constraints. This created a void in the lending markets with demand for capital outpacing supply, allowing private capital to step in and provide a longer-term source of funding. Even if the pace of economic growth slows, the asset class should remain quite resilient, as yields are likely to stay comfortably above pre-pandemic lows and deal terms are likely to remain favorable.

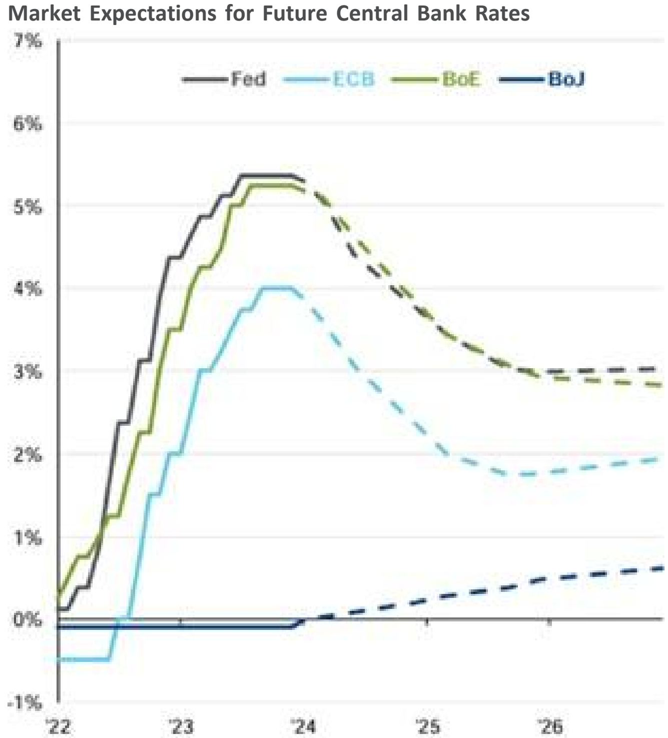
Punchline: With an expanded opportunity set, private credit offers investors the potential for strong risk-adjusted returns, while providing enhanced income generation and diversification benefits outside of public bond markets.

10-Year U.S. Treasury Returns around end of Fed Hiking Cycle



Sources: Alliance Bernstein, US Federal Reserve. Data as of June 30, 2023.

Market Expectations for Future Central Bank Rates



Sources: J.P. Morgan Asset Management, BIS, Bloomber, FactSet. Data as of 12/31/2023.

Central Bank Policy

After continued rate hikes into the middle of last year, the Fed pivoted to a more dovish stance in their December meeting by maintaining current rates and signaling the possibility of three rate cuts in 2024. This came as a surprise to the market as inflation remains well above the Fed's long term target of 2%, despite extensive monetary tightening over the last couple of years. Despite anticipated rate cuts, we expect that rates will remain higher than the prior cycle.

Punchline: With rate hikes in the rear-view mirror and possible cuts anticipated in 2024, interest rates should stabilize, and the yield curve should gradually steepen over the course of the year.

Diversification Remains the Best Strategy

As we head into 2024, investors should temper expectations after robust performance across risk assets in 2023. While the Fed's actions appear to be working with inflation moderating and sustained levels of low unemployment, the full effects of tighter monetary policy remain unknown. The current investment landscape presents several unique challenges, and attempting to pick winners and losers within a defined period is nearly impossible. Our focus lies in recognizing the importance of what we can control, implementing a prudent process, and emphasizing the importance of constructing diversified portfolios for long-term sustainability.

Periodic Table of Returns | 2014-2023

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Annualized Return '14 -'23	Annualized Std. Dev. '14 -'23	
High	REITs 32%	REITs 4%	Midstream Energy 19%	Emerging Markets 37%	U.S. Fixed Income 0%	U.S. Equity 31%	U.S. Equity 21%	REITs 46%	Midstream Energy 31%	U.S. Equity 26%	U.S. Equity 11%	Midstream Energy 31%	High
	U.S. Equity 13%	U.S. Fixed Income 1%	U.S. Equity 13%	Int'l Equity 25%	Hedge Funds -3%	REITs 26%	Emerging Markets 18%	Midstream Energy 41%	Hedge Funds -5%	Midstream Energy 24%	REITs 8%	U.S. Equity 18%	
	Midstream Energy 8%	U.S. Equity 0%	Emerging Markets 11%	U.S. Equity 21%	REITs -5%	Int'l Equity 22%	Diversified Portfolio 10%	U.S. Equity 26%	Diversified Portfolio -12%	Int'l Equity 18%	Diversified Portfolio 7%	Emerging Markets 17%	
	Diversified Portfolio 7%	Hedge Funds 0%	Diversified Portfolio 8%	Diversified Portfolio 14%	U.S. Equity -5%	Diversified Portfolio 19%	Hedge Funds 10%	Diversified Portfolio 17%	U.S. Fixed Income -13%	Diversified Portfolio 17%	Int'l Equity 4%	REITs 16%	
	U.S. Fixed Income 6%	Int'l Equity -1%	REITs 7%	Hedge Funds 8%	Diversified Portfolio -6%	Emerging Markets 18%	Int'l Equity 8%	Int'l Equity 11%	Int'l Equity -14%	REITs 16%	Hedge Funds 3%	Int'l Equity 15%	
	Hedge Funds 3%	Diversified Portfolio -3%	U.S. Fixed Income 3%	REITs 4%	Midstream Energy -12%	U.S. Fixed Income 9%	U.S. Fixed Income 8%	Hedge Funds 7%	U.S. Equity -19%	Emerging Markets 10%	Emerging Markets 3%	Diversified Portfolio 12%	
	Emerging Markets -2%	Emerging Markets -15%	Int'l Equity 1%	U.S. Fixed Income 4%	Int'l Equity -14%	Hedge Funds 8%	REITs -8%	U.S. Fixed Income -2%	Emerging Markets -20%	Hedge Funds 6%	U.S. Fixed Income 2%	Hedge Funds 5%	
Low	Int'l Equity -5%	Midstream Energy -32%	Hedge Funds 1%	Midstream Energy -9%	Emerging Markets -15%	Midstream Energy 7%	Midstream Energy -31%	Emerging Markets -3%	REITs -27%	U.S. Fixed Income 6%	Midstream Energy 2%	U.S. Fixed Income 5%	Low

Sources: Morningstar and Abacanto Holding Portfolio Solutions. As of 12/31/2023.

While diversification may not offer immediate satisfaction – often lagging during strong equity markets like 2023 and never fully protecting against losses in downturns – it plays a crucial role in compounding returns over extended periods of time. By allocating to asset classes conducive to various economic outcomes (early cycle, growth, inflation, economic slowdown, etc.) and regularly rebalancing portfolios to policy targets, we turn time into our advantage and improve the likelihood of meeting our clients' long-term objectives. Predictions consume headlines, but the uncertainty of the future, particularly the unforeseen surprises, highlight the limits of our predictive abilities. As Morgan Housel aptly stated, "we are very good at predicting the future, except for the surprises – which tend to be all that matter." Acknowledging the inevitability of risk is crucial for better preparation. This encourages a forward-looking approach, embracing diversification, prudent risk management, and an understanding of the limits of prediction.