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1Q 2024 Commentary

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THE BIG THING: Stocks Rallied; Large Cap & Growth Did Best Despite Higher Interest Rates

- Large cap stocks had another strong quarter, followed by mid cap, then small cap.
- Growth outperformed value across market caps.
- Bonds sold off and yields rose as economic growth and inflation surprised to the upside.

EQUITIES

The fourth quarter rally continued into the first, with all major US indices posting positive returns.

Quarterly Returns: Leadership Still Growth Oriented

- Best: Large Growth +11.4%, Large Core +10.6%, Mid Growth +9.5%[1]
- Worst: Small Value +2.9%, Small Core +5.2%, Small Growth +7.6%
- All indices were up.
- The S&P 500 returned +10.6%, NASDAQ +9.2%.
    - NVIDIA +82%; Apple (-11%); Tesla (-29%).
- International: developed markets +5.7% and emerging markets +1.5%.
- Gold +8% and hit another all-time high; the dollar rose vs Euro, Yen and Pound.
- Bitcoin returned +68%.
- Hedge fund and other alternative asset returns were mostly positive.

FIXED INCOME

Quarterly Returns: Bond Prices Fell on Stickier Inflation

- Municipal and corporate bond prices ended the quarter down slightly as interest rates rose. (***Table 1*** below).
    - Corporate bond interest rates rose less than Treasuries (spreads narrowed).
- Inflation began to rise again, reversing the trend of the prior 18 months.
- Economic growth continued to come in better than expected.
- Net issuance of US Treasury bonds was $576 billion in 1Q, a slightly slower annualized pace than the $2.4 trillion net issuance in calendar year 2023.[2]
- The Fed continued to shrink its balance sheet:[3]
    - -$143 billion in 1Q.

[1] Large cap growth = Russell 1000 Growth Index; Large cap core = S&P 500; Large cap value = Russell 1000 Value Index; Mid cap growth = Russell Mid Cap Growth Index; Mid Cap Core = Russell Mid Cap Index; Mid cap value = Russell Mid Cap Value Index; Small cap growth = Russell 2000 Growth Index; Small cap core = Russell 2000 Index; Small cap growth = Russell 2000 Value Index; Developed international = MSCI EAFE Index; Emerging markets = MSCI Emerging Market Index. These terms will be used throughout the commentary. Source: FactSet & PSG.
[2] Source: SIMFA, US Treasury, Bureau of Fiscal Services, and PSG.
[3] Source: Federal Reserve and PSG; the Fed owned $3.9 trillion of Treasury Notes and Bonds as of 3/26/2024.

- -$1,030 billion since the April 2022 peak.

Treasury yields rose in the quarter.

Table 1
US Treasury Yields

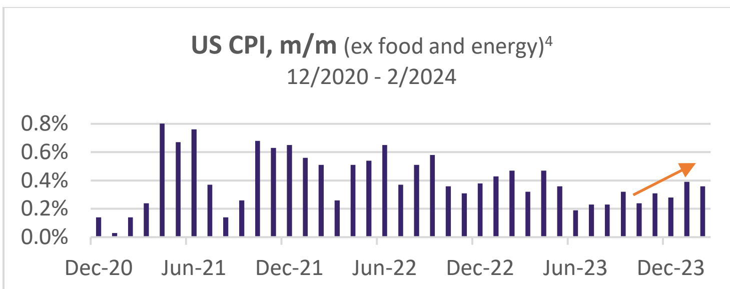
Maturity*	9/30/23	12/31/23	3/31/24	1Q24 Yield Change
3 Month	5.46%	5.35%	5.35%	0.00%
2 Year	5.04%	4.25%	4.62%	+0.37%
5 Year	4.61%	3.85%	4.22%	+0.37%
10 Year	4.57%	3.88%	4.20%	+0.32%
30 Year	4.70%	4.03%	4.34%	+0.31%

**Source: FactSet*

Inflation Moved Higher, Oil Rose

Inflation rebounded; gasoline prices jumped.

- Inflation stopped declining and began to move higher.
- It remains above the Fed's target of 2%.
- Oil prices were +16% in the quarter.
    - Wholesale gasoline prices were up 29% in the quarter, impacting inflation numbers.
    - This may have reverberations in future quarters.



ECONOMIC AND MARKET ENVIRONMENTS

Higher Interest Rates Have Not Slowed Economic Growth Thus Far

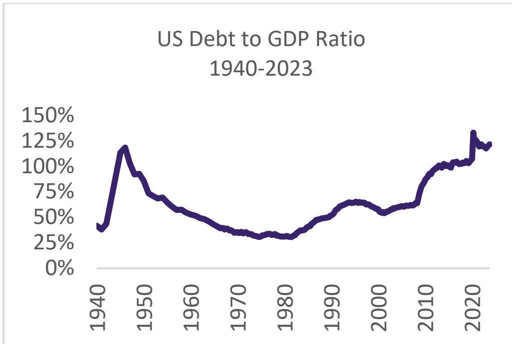
- The economy grew at a 3.4% rate in the 4th quarter.[5]
- The unemployment rate is still low at 3.8% (March).
- The US consumer continues to drive US economic growth.
- Higher interest rates do not appear to have impacted the US consumer negatively, and income from money market funds has helped wealthier households.
    - In addition, over 90% of mortgages are fixed rate, meaning the payments are not affected by changes in interest rates.[6]
- Corporate profits accelerated 4.1% higher in the 4th quarter.[7]
    - Companies which took advantage of low interest rates in 2020-21 to extend maturities are temporarily insulated from today's higher interest rates.

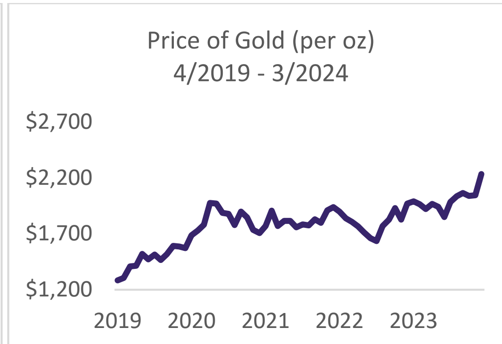
US Government Debt Continued to Rise at a Rapid Clip

[4] Data is seasonally adjusted; Source: Bureau of Labor Statistics
[5] Seasonally Adjusted Annual Rate, Source: FactSet and Bureau of Economic Analysis
[6] Source: https://www.stlouisfed.org/on-the-economy/2024/feb/which-households-prefer-arms-fixed-rate-mortgages
[7] Source: FactSet

US Federal debt rose to $34 trillion, 123% of GDP.

- US government debt rose above $34 trillion in February.[8]
  - It is up roughly $3 trillion since the debt ceiling was raised in May 2023.
- The Federal debt to GDP ratio was 123% at the end of 2023.
  - 123% is higher than the debt to GDP ratio reached in WWII (see below).
- The 2023 Federal budget deficit was 6.2% of US GDP, up from 5.2% in 2022.[9]
  - Since 1947, the only other periods when the deficit was above 6% were 2009-2012 and 2020-2021.





Bond Markets Seemingly Complacent About Debt Growth; Precious Metals Less So

- The Congressional Budget Office projects the deficit to moderate slightly before growing steadily as interest costs rise.
- Bond markets are not pricing in large inflationary risks.
- We believe there is currently little political will to bring down the deficit due to the potential pain and voter reaction to cutting government spending or raising taxes.
- Precious metals markets seem to be pricing in some monetization of the deficit/debt.
  - Gold rose 8% in the quarter to $2,238/oz, an all-time high.
  - Silver rose 3% in the quarter to $24.92/oz and since quarter-end reached a new two year high but is still roughly 50% below the 1980 and 2011 peaks.
  - Bitcoin rose 68% in the quarter to an all-time high.
    - We do not believe Bitcoin has intrinsic value, but note others view it as a hedge against debasement of the US dollar.

Gold made new all-time highs in the quarter.

Portfolio Impacts from Higher Debt and Deficits

- One logical conclusion is higher interest rates will be needed to attract buyers of US government debt.
- There is historical precedent of the Federal Reserve stepping in to buy Treasuries, capping yields available to investors.
  - This can be viewed as "printing money" to pay debt.
  - Printing money in this way is thought to be inflationary.
  - Inflation is often negative for bonds but positive for equity earnings and real assets (commodities, real estate), particularly if interest rates do not rise much.
- Higher interest rates could force politicians to muster the political will to cut spending and/or increase taxes.
  - Balancing the budget is usually positive for bonds but can be negative for equities.

[8] Source: https://www.cnbc.com/2024/03/01/the-us-national-debt-is-rising-by-1-trillion-about-every-100-days.html
[9] Referring to Federal fiscal years (ending September 30), Source: https://www.cbo.gov/publication/59711

Diversification can offer some protection in an uncertain world.

  - Not all tax increases and spending cuts have been bad for stocks.
  - The 1990s were fantastic years for both bond and equity owners, even though taxes were raised and benefits cut.
- Diversification offers safety and potential upside in either scenario.

CONCLUSIONS

Bonds:

- Our conclusion last quarter that modestly higher interest rates seemed reasonable played out.
- Bonds are attractive at these yields, which are much higher than those we could obtain over much of the prior decade.
  - While we were more measured at the start of the year, we continue to deploy cash.
- The Fed's declining ownership of Treasuries puts upward pressure on interest rates.
- Corporate bond spreads (difference in yields between quality corporate bonds and Treasuries) are currently low, but we are finding pockets of value.
- Short term municipal bonds are very expensive relative to Treasuries, but longer bonds offer relative value.

Stocks:

We continue to seek investments which we believe offer compelling risk reward and uncorrelated returns.

- Returns broadened out from just the largest companies, which we expect to continue.
- Value stocks outperformed growth stocks later in the quarter.
- Apple and Tesla both struggled in the first quarter, which tempered returns for large growth indices.
- Small Cap, Mid Cap, and Value stocks continue to trade at attractive valuations given the strong economy and consumer.

Private Investments:

- We placed numerous accredited clients in a high yield, short-term lending fund and a distressed hotel investment fund as part of our diverse alternative platform.
  - They offer potentially meaningful cash distributions to accredited investors at low minimums.
- We continue to favor distressed credit.
- We continue to search for interesting alternative investments that offer attractive risk adjusted returns which are uncorrelated with equities and bonds.

DISCLOSURE