Capital Markets Review
March 31, 2024

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

REVIEW

REVIEW - Summary Capital Market Commentary – 1st QTR 2024

- **Global stock markets registered strong gains in Q1 amid a resilient US economy and ongoing enthusiasm and increased productivity prospects around Artificial Intelligence. Expectations of interest rate cuts also boosted shares although the pace of cuts is likely to be slower than the market had hoped for at the turn of the year which drove bond returns negative for the quarter.**

- Equity Markets
  - US shares registered a robust advance in the quarter. Gains were supported by some well-received corporate earnings as well as ongoing expectations of rate cuts later this year. The pace of monetary policy easing is likely to be slower than had been expected at the end of last year, given resilient US economic data, but this did little to dampen appetite for equities. Data releases generally demonstrated ongoing economic resilience. Annualized GDP growth for Q4 was revised up in the third estimate to 3.4%. Nonfarm payrolls were robust although the unemployment rate rose in February. The ISM manufacturing PMI signaled expansion after 16 straight months of contraction, rising to 50.3 in March.
  - Eurozone shares posted a strong gain in Q1. The information technology sector led the charge amid ongoing optimism over demand for AI-related technologies. Over the quarter there were signs of improving business activity in the eurozone. The flash eurozone purchasing managers' index (PMI) rose to 49.9 in March compared to 49.2 in February. This signals that business activity is almost at stable levels.
  - The Japanese equity market experienced an exceptionally strong rally, with the TOPIX Total Return index recording a total return of 18.1% in Japanese yen terms. During the quarter, foreign investors played a leading role in driving the rally. This was fueled by increasing optimism over Japan's positive economic cycle, characterized by mild inflation and wage growth. This quarter marked a historic moment as the Nikkei reached its all-time high and surpassed the 40,000 yen level.
  - Asia ex-Japan equities achieved modest gains in the first quarter, with share prices bouncing back from recent lows and investors displaying cautious optimism that the gloom surrounding China may be starting to lift. Despite rallying somewhat in the middle of the quarter, Chinese stocks still ended the quarter modestly lower as foreign investors remain cautious amid ongoing fears about the outlook for the Chinese economy. Stocks in Hong Kong also experienced sharp declines in the first quarter, with many investors looking to other markets as Beijing increases its control over the former British colony and amid ongoing fears over the state of China's post-pandemic economic recovery.

Source: Schroders, Baird & SAA

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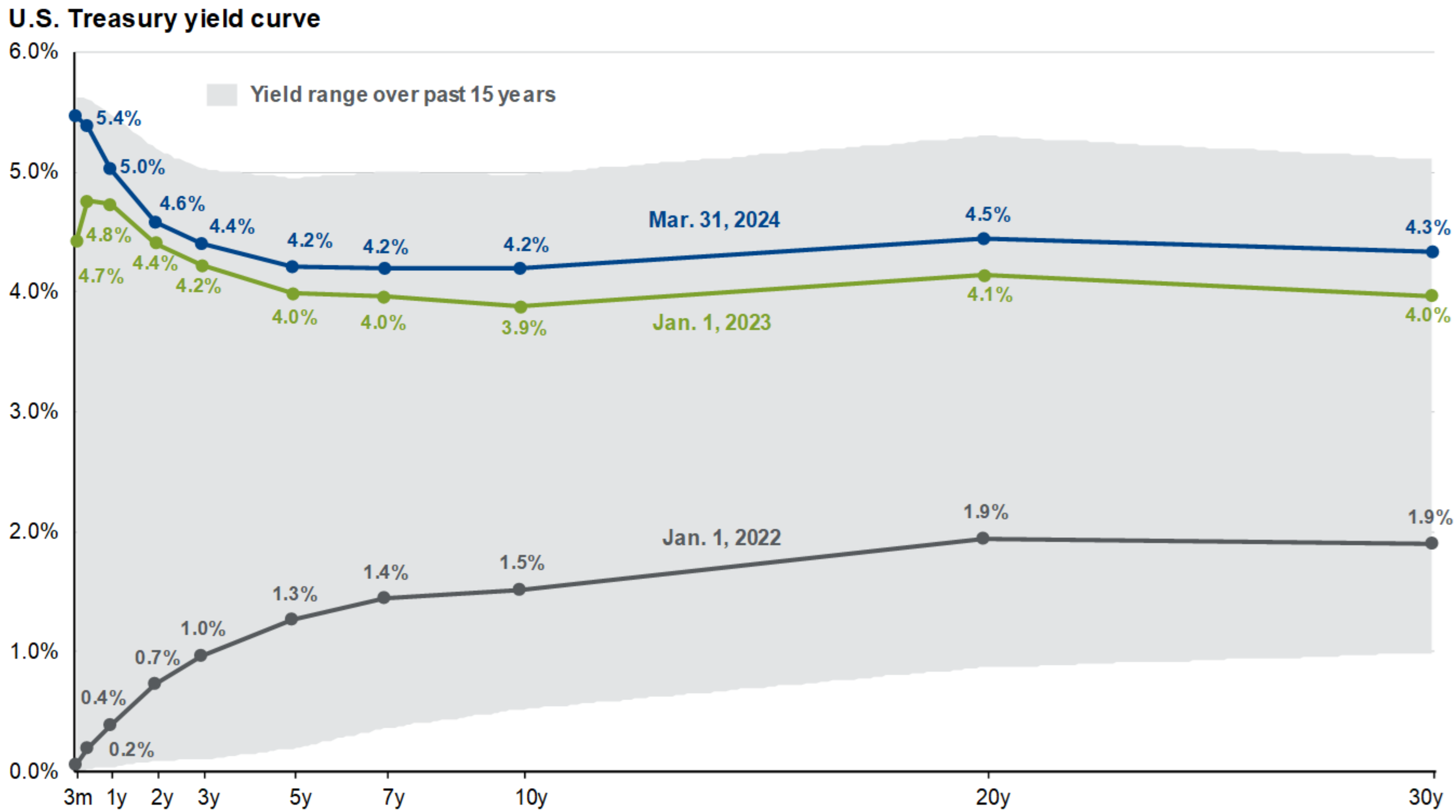
- Bond Markets
  - Inflation remained a central concern for markets. Despite indications of diminishing inflationary pressures, unexpected high inflation readings tempered enthusiasm for imminent rate cuts. Both the US and eurozone reported inflation rates exceeding forecasts, raising alarms about the enduring nature of service sector inflation.
  - In the US, the 10yr Treasury yield fell 5 bps in March but ended 32 bps higher for the quarter. The 2s10s yield curve inversion persisted throughout the quarter, stretching to what is now a record 21 months, and ended with -42 bps of inversion. Economic data remained strong, with February payrolls gaining +275k, above the 200k consensus (although the prior two months were revised lower), and inflation, as measured by the Core PCE, easing only slightly, to 2.8% YoY down 0.1% from year end. While Core PCE of 2.8% is down sharply from the 4.8% rate a year ago, it’s 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. Because of the strong data, market expectations for rate cuts fell during the quarter, down from six at the start of the year to now in line with the Fed’s own projection for three cuts in 2024; the first cut is currently expected in June (60% probability), well ahead of the November election.
  - Eurozone inflation continued to cool in the quarter. The annual inflation rate (consumer price index) was 2.6% in February, down from 2.8% in January. In February, European Central Bank President Christine Lagarde sought to downplay the chances of an imminent interest rate cut. She told the European Parliament that the central bank does not want to run the risk of reversing any cuts.
  - The Bank of Japan ended its historic negative rate policy, raising the target on their policy rate by 20 bps to a 0-0.1% range. Importantly, this also ends the era of negative yielding debt, which in late-2020 exceeded $18 trillion.

The information contained herein has been obtained from sources believed to be reliable, but the accuracy of the information cannot be guaranteed.

Source: Schroders, Baird & SAA

REVIEW - UST Yield Curve & Expectations



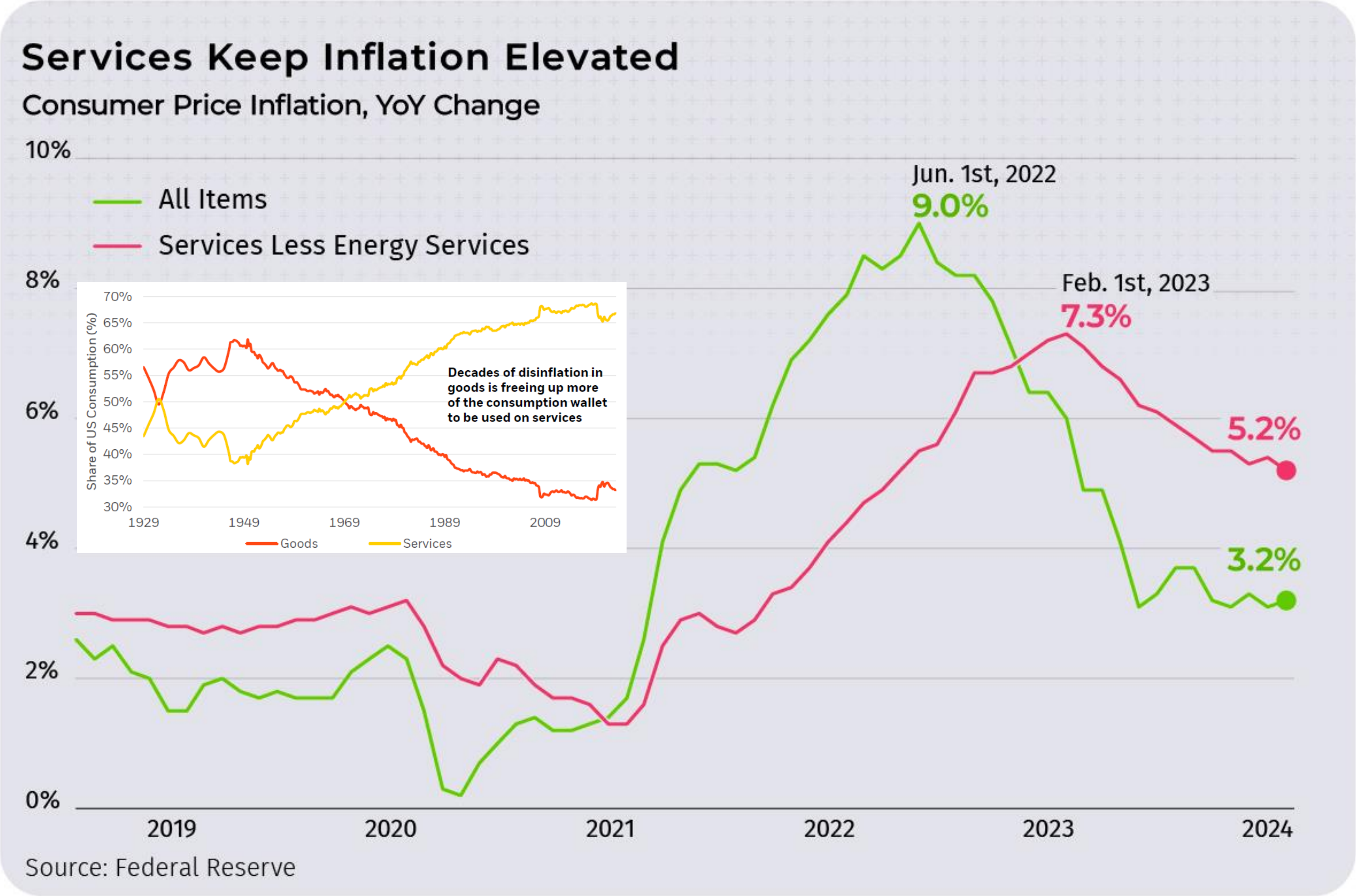
Key Take Aways:

- UST yields have risen since 12/31/2023 as investors, driven by the euphoria of aggressive rate cut projections in Nov/Dec, were reintroduced to reality with economic data continuing to show a resilient U.S. economy. With that backdrop for the moment, the Fed, barring a surprise crisis, will continue with its "data dependent" process regarding the timing and frequency of expected rates cuts for 2024/25.
- NOTE - Despite record Q1 investment-grade (IG) corporate issuance (prior record issuance Q1 '20), IG corporate spreads tightened -6 bps for the month and -9 bps for the quarter driven by strong demand to lock-in yields before the Fed's rate easing cycle begins.

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2024.

INTERMEDIATE OUTLOOK

OUTLOOK – Sticky Service Inflation

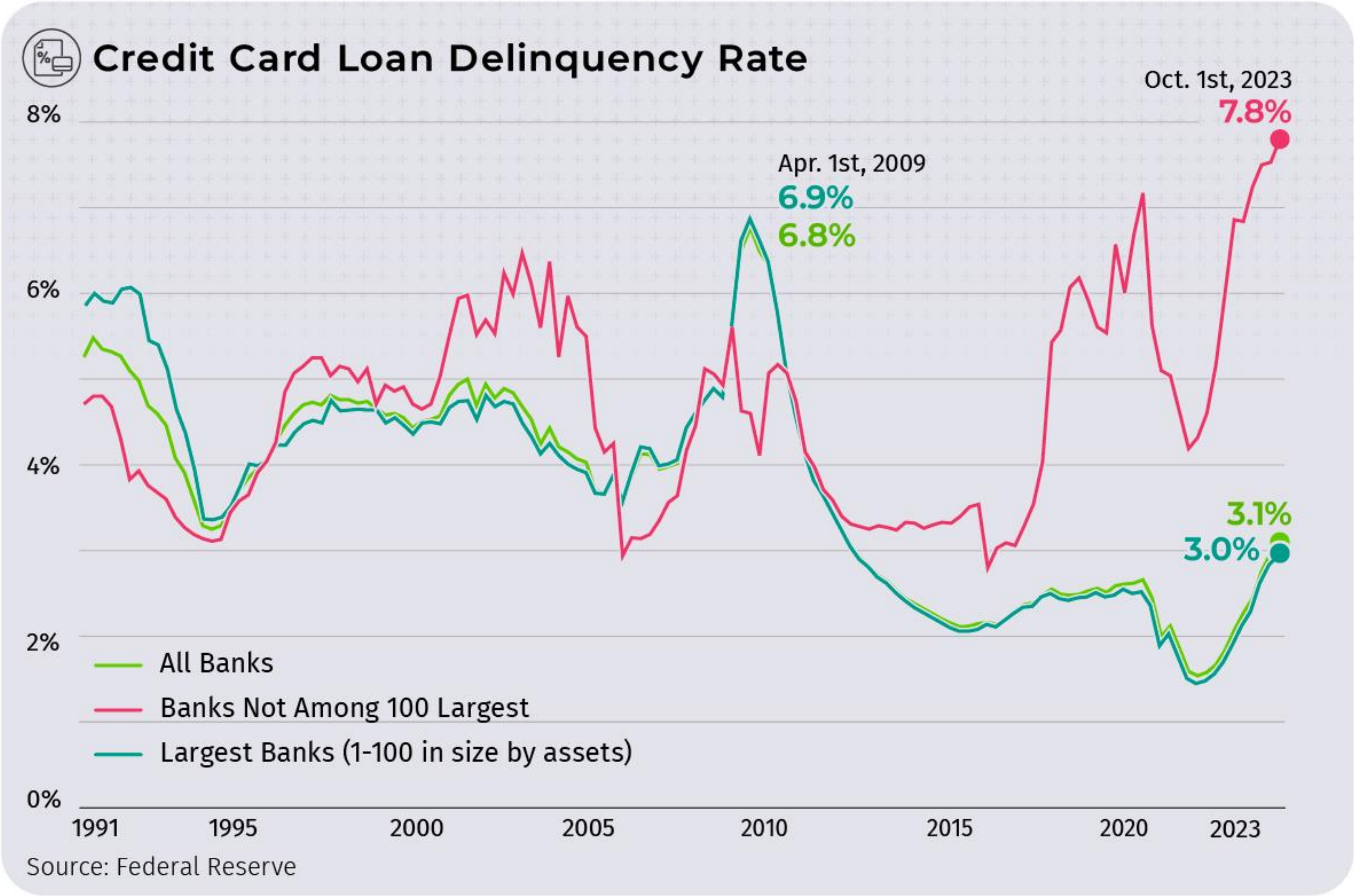


Key Take Aways:

- ❑ **While consumers may have deferred larger goods purchases because of higher interest rates, strong spending continues for services (for both everyday and experience spending (i.e. concerts, eclipse-chasing travel, etc.) which has been supported by higher wages and continues to be a bit of a bugaboo for the Fed's decision-making process in supporting rate cuts.**

Source: Federal Reserve (large graphic) and Bureau of Economic Analysis (BEA) (small graphic) via BlackRock

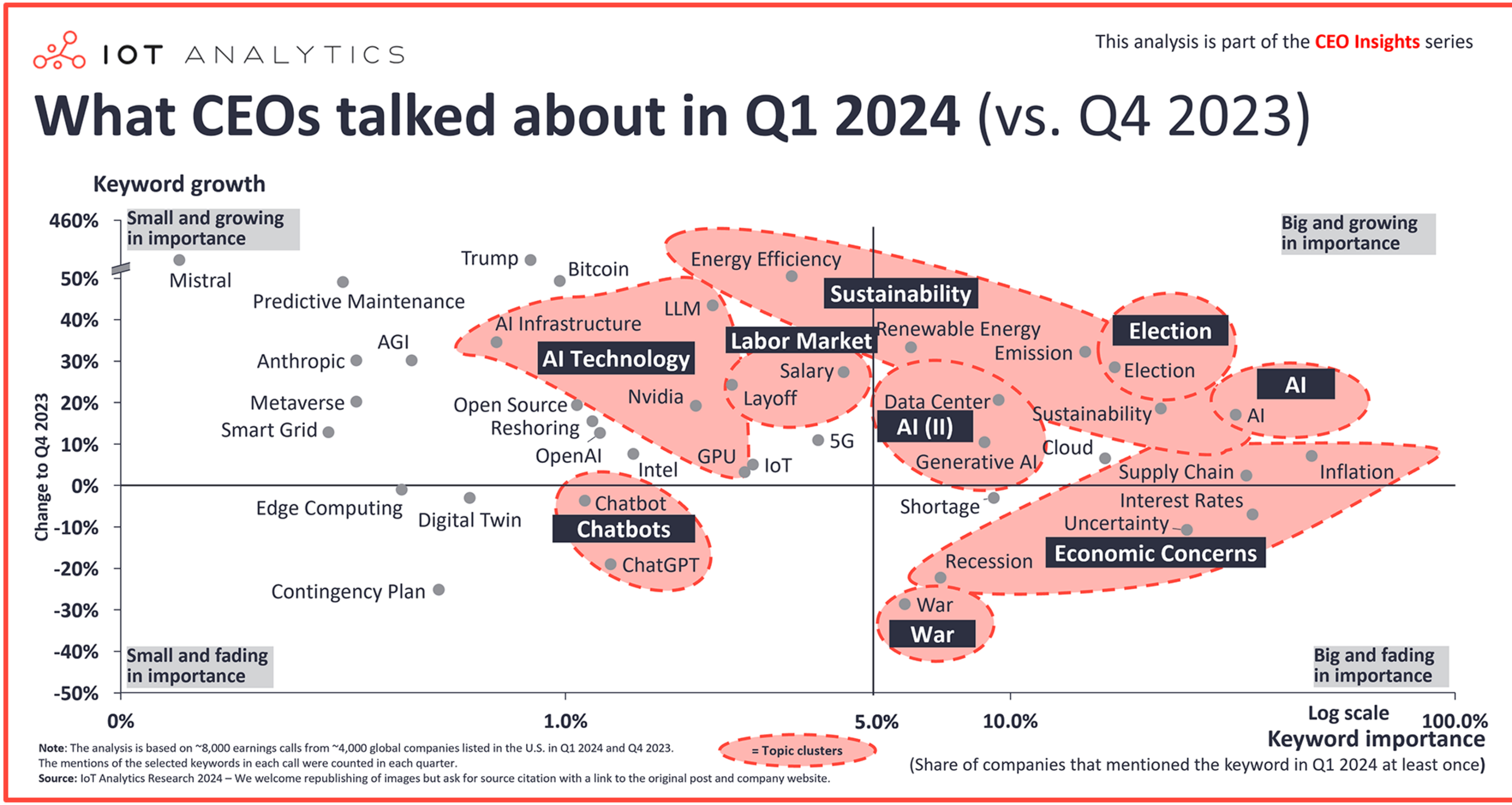
OUTLOOK – Consumer Stress Accelerating?



Key Take Aways:

- **Above is an excellent example of potential trends being masked by aggregate data. Why? Looking at the credit card delinquencies rate across all banks (3.1% and rising) as compared to small/medium banks (7.8% and rising) highlights a contrast as to how an investor may interpret the overall health of the average consumer.**

OUTLOOK – CEO Focus



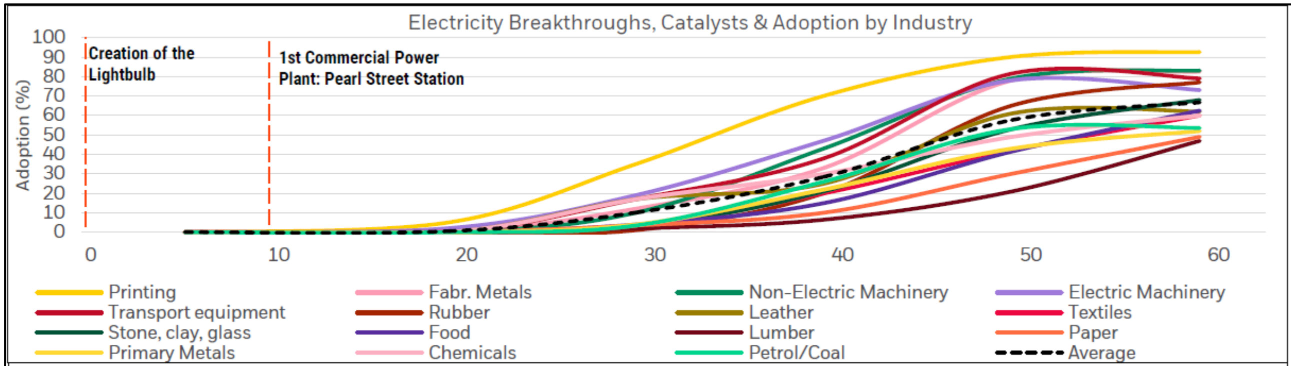
Key Take Aways:

- While most CEOs enjoy pontificating during earnings calls, the above exhibit highlights both the power of AI-driven data-aggregation tools and the expectations/concerns of CEOs over the near/intermediate term. How these expectations/concerns manifest with respect to forward looking prospects and/or capital expenditures (i.e. personnel, capital expenditures, R&D, etc.) are, of course, key elements of valuation and investor outlook.

Source: https://iot-analytics.com/what-ceos-talked-about-in-q1-2024/.

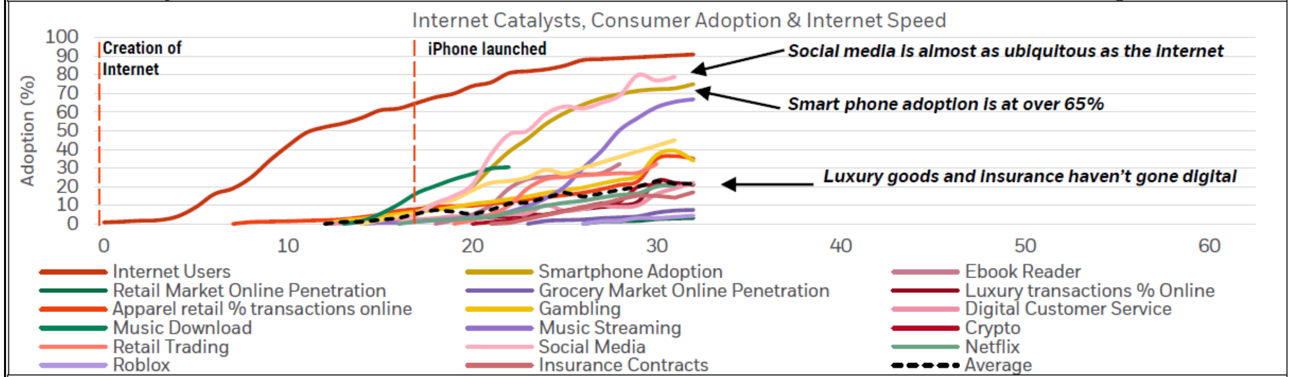
BROAD/LONG-TERM TRENDS

LONG-TERM – New Technology & Consumer Adoption

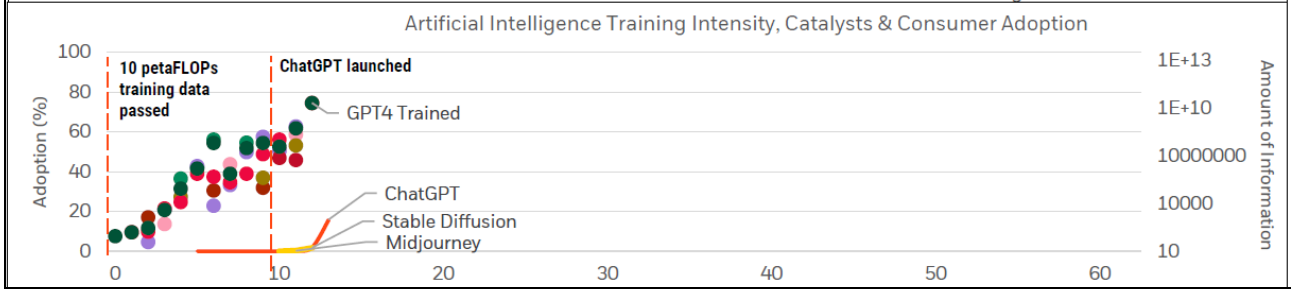


The industrial revolution took many decades to transform the world.

After the creation of the lightbulb, it took another 3 decades for just 50% market saturation/adoption.



While hardware (smart phones) and software (social media) quickly reached full adoption, some consumer behavior has been slow to go digital. Broad commerce (especially luxury transactions) and services like insurance contracts are still in digital infancy.



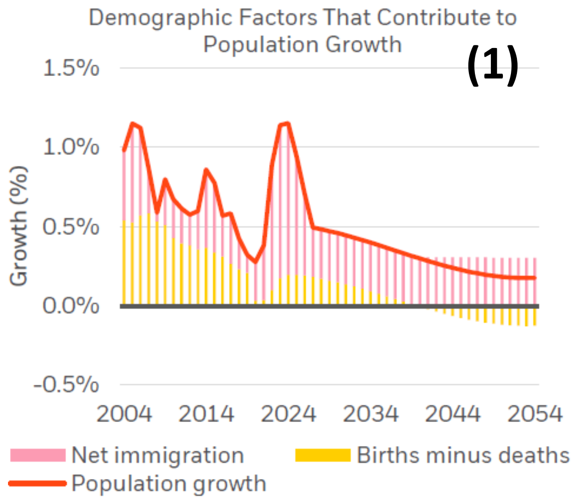
While it looks like nothing happened in the years before ChatGPT, in fact technology was advancing rapidly (left panel, RHS axis). The "10 petaflop" marker has acted as a catalyst to accelerate GPT adoption, creating the first "kink in the S-curve" for AI adoption.

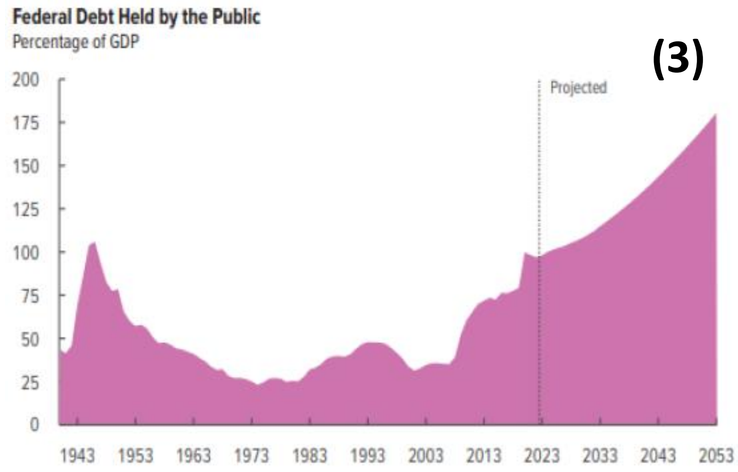
Key Take Aways:

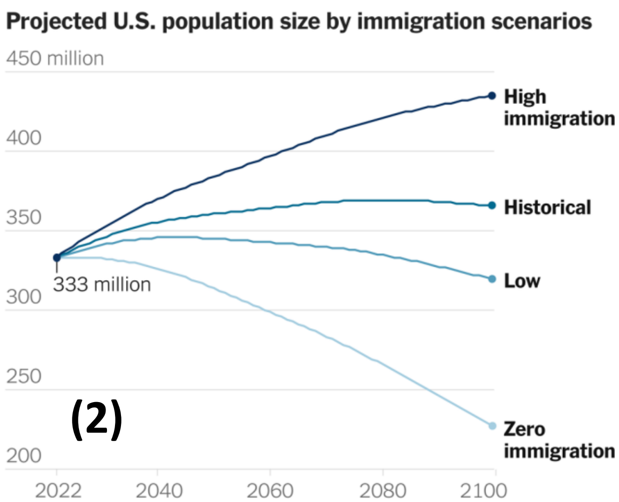
- ❑ Being in the very early stages of this AI and Digital-Driven evolution, how might this evolution impact long-term asset allocation, asset class risk/return expectations, and global (think India) vs. U.S.-centric investing?

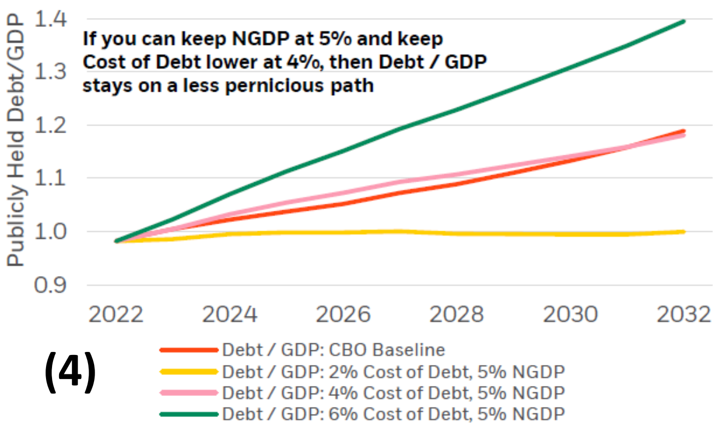
Source: BlackRock, Morgan Stanley, As of 3/26/2024

LONG-TERM – U.S. Debt, Immigration & Scenarios









Key Take Aways:

- **Without immigration (even after considering increased productivity expectation via AI and Digital Economy Transformation), projected U.S. population growth and demographic trends will be hard pressed to generate nominal GDP growth that exceeds the expected growth of U.S. Debt growth (graphic #,1 #2 and #3).**
- **While immigration issues/policies can be a "third rail" topic, the potential for "effective immigration" to support NGDP growth and wage growth moderation to help address the current unsustainable fiscal debt path is compelling (graphic #4) and a view that lower rates are required prospectively.**

Source: Source: (1) CBO, as of 1/18/2024; (2) William H. Frey, Brookings, By The New York Times; (3) CBO, Bloomberg and BlackRock as of 2/29/2024. All assumptions, opinions, estimates, models and forecasts are provided for illustrative purposes only.