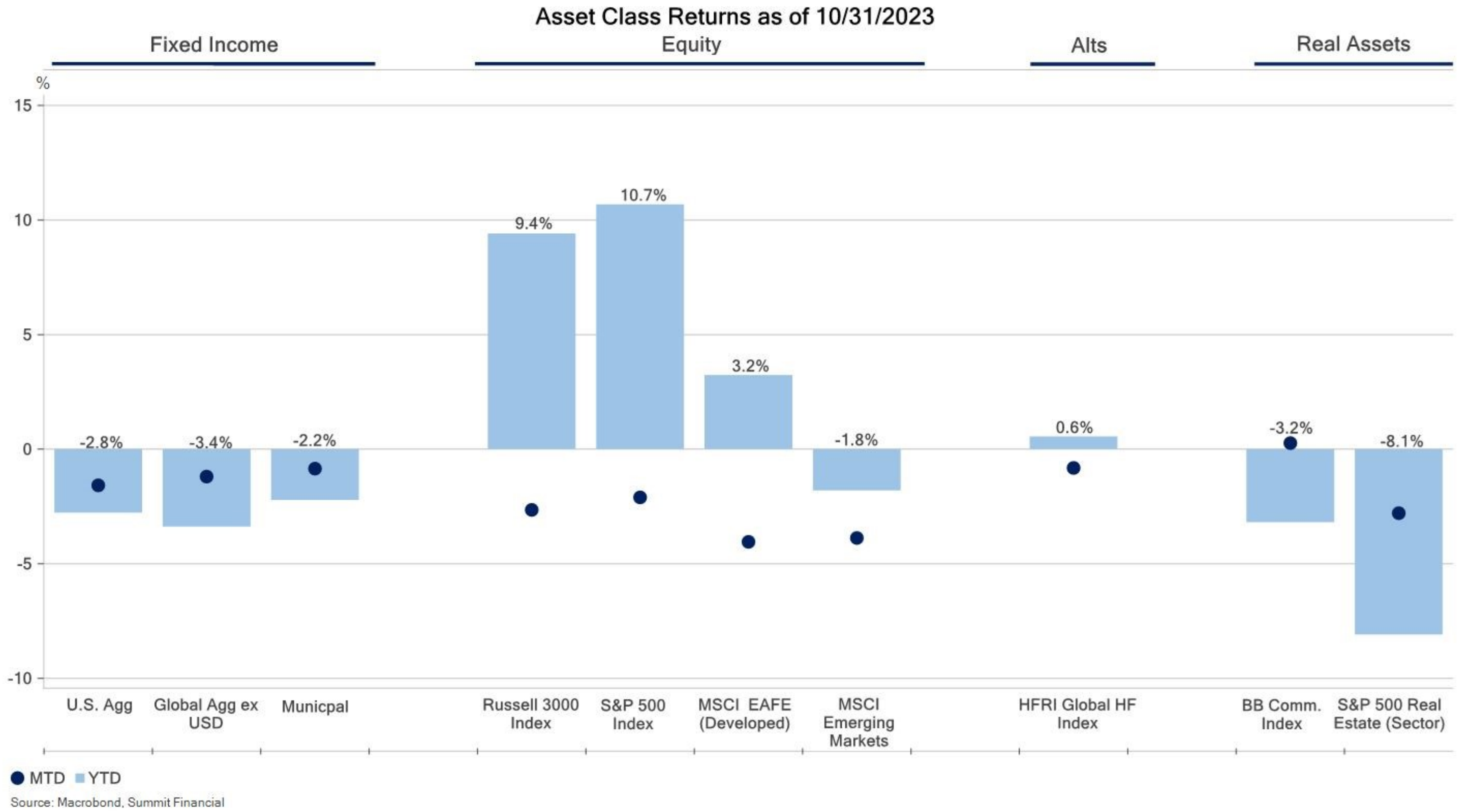
Investment Newsletter

October 2023

Key Takeaways

- U.S. economy delivered strong growth in Q3 2023, in sharp contrast to Europe, Japan and China.
- Unemployment remains low at 3.9% and the labor market remained steady in October.
- Employees won large wage gains in automotive, fast food sectors. Wages grew 4.1% year over year.
- Higher interest rates seem to be impacting real estate and fixed investment the most, consumption the least.
- Inflation moved lower but remained above the Fed's target level.
- U.S. equity markets, as measured by the S&P 500, were lower for the third month in a row.
- U.S. fixed income markets, as measured by the Bloomberg Aggregate Index, fell for the sixth consecutive month.
- U.S. 3-month Treasury Bill yields reached 5.6%, a new high for this economic cycle.
- Federal Reserve held rates steady without indicating rate cuts are imminent.
- Federal Reserve believes its 'restrictive stance is putting downward pressure on economic activity and inflation'.
- Federal Reserve reduced its balance sheet by $1T and noted higher long rates are tightening financial conditions.
- Bank loan growth, which remained flat from April to September, ticked marginally lower in October.
- As bank lending slows, private credit managers remain optimistic about the lending environment.
- Given high levels of dispersion across public equity markets and reasonable deal activity, many hedge funds have noted a favorable backdrop for their strategies.
- Private equity fundraising and deal activity continue to trend lower. PE drawdown figures are improving, but venture drawdowns are now lagging public market levels.



Economy

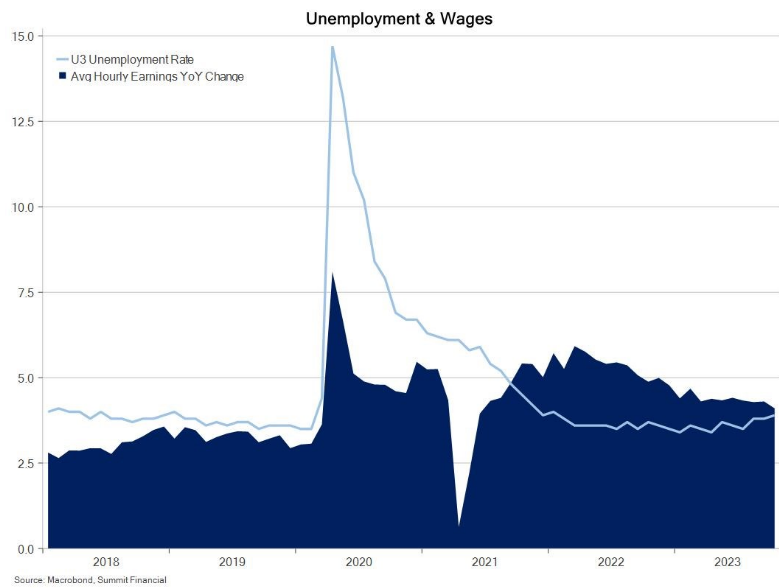
The U.S. economy grew at 4.9% during Q3, in sharp contrast to Europe which contracted –0.1% and Japan, which according to recent estimates, experienced 0% growth. Japan's slower growth was driven, in part, by reduced exports to China as Chinese growth has been hampered by a contractions in manufacturing, services, and housing. Going forward, China may need to increase stimulus measures, especially as it attempts to manage a protracted real estate crises.

The U.S. Labor market remains steady with unemployment running near 3.9%, though monthly jobs gains have been decelerating over the past few months. Unions inked wage gains near 25% in the automotive industry and certain fast food employees in California saw a minimum wage increase to $20, while work days lost to strikes reached 20-year highs.

Looking forward, Powell noted that 'reducing inflation is likely to require a period of below-potential growth and some softening of labor market conditions'. Higher rates for corporate and mortgage financing, resumption of student loan payments after a three year moratorium, reduced household savings, and contracting money supply likely point to slower economic growth.

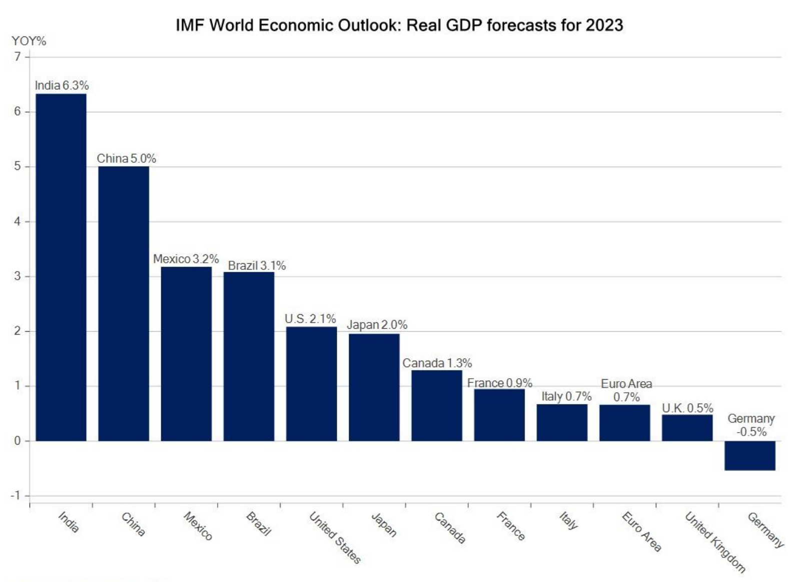
Key Indicators are Moderating but Stable

- U.S. industrial production remains in a modest contraction though services and retail consumption continue to expand.
- U.S. delinquency rates have started to rise, across credit cards and auto loans in particular, but the increases have so far been modest and are below prior recessionary levels.
- Global energy prices remain contained, for now, but an expanding Middle East conflict increases potential for supply disruptions.
- Gold, normally seen as a safe haven during times of geopolitical stress, has held steady in price. Going forward, rising real yields will likely provide strong competition.



IMF Cuts Baseline Global Forecasts

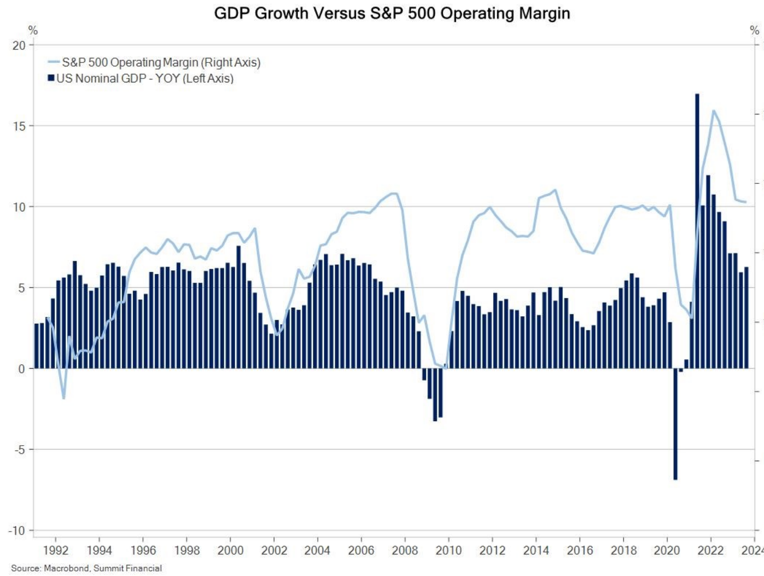
- The International Monetary Fund, in its World Economic Outlook released in October, forecasts global growth to slow from 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024.
- Growth in advanced economies is expected to slow to 1.5% in 2023 and 1.4% in 2024, versus developing economies which are forecasted to maintain a 4.0% growth rate for both 2023 and 2024.
- The IMF noted that the global recovery 'has been remarkable' given the post pandemic dislocations, the Russian invasion of Ukraine, and strong increases in inflation. It also stated that monetary policy actions 'are the key at the current juncture to keep inflation expectations anchored'.
- Growth is strongest in India, China, developing Asia, Brazil, and Mexico while weaker in Japan and Europe. Only Germany experienced a recession so far this year.



Markets

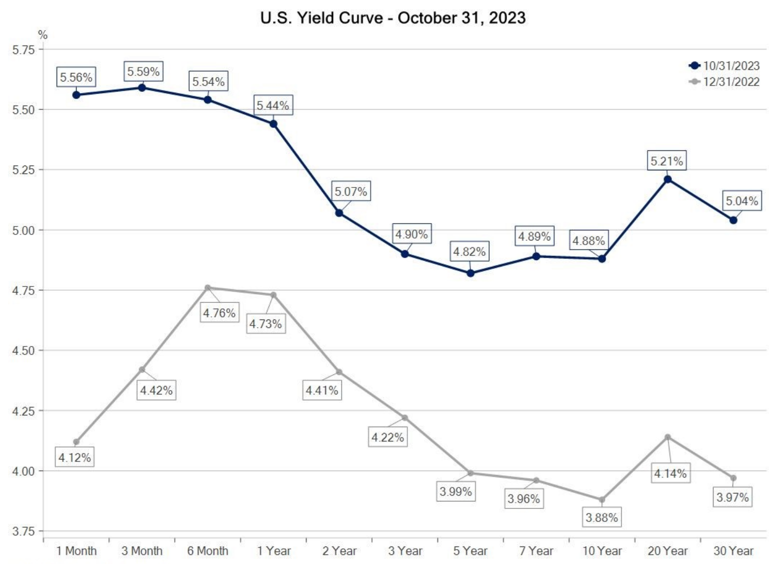
Equity - EPS Estimates for CY 24 Too High?

- Earnings growth for Q3 is 3.7%, above expectations of –0.3% at the beginning of the quarter. This is the first quarter with positive growth since Q3 2022. For Q4, analyst's have reduced expectations by close to 4.0%, but still see earnings growth near 5.0% with revenue growth near 4.0%.
- Analyst bottom up estimates for CY 24 earnings growth is 12%. This appears optimistic versus top down U.S. GDP forecasts near 1% growth, recent IMF downward revisions to global growth, and the expectation that the Fed will hold rates higher for longer.
- Given higher equity multiples versus cash and bond yields, markets remain sensitive to any downward revisions in earnings growth. Only utilities posted gains for the month.



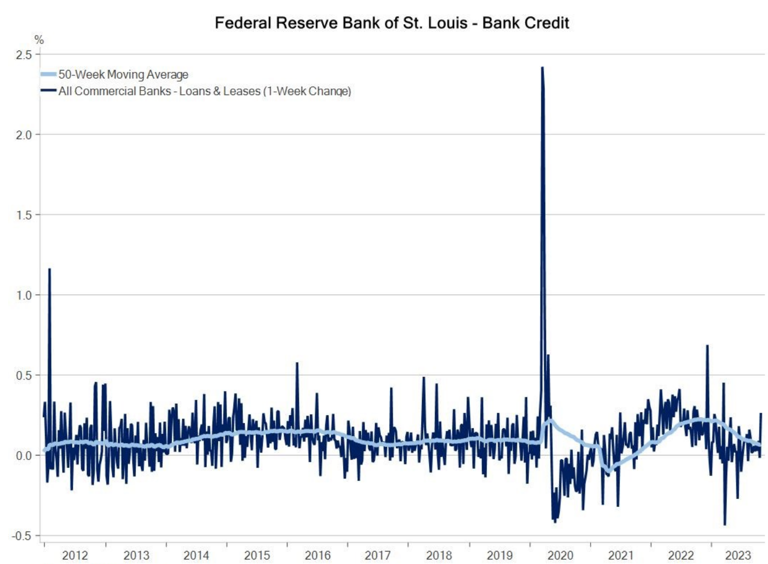
Fixed Income—Higher for Longer?

- Federal Reserve held rates steady at its November meeting, indicating that its 'stance of policy is restrictive' and 'putting downward pressure on economic activity and inflation'.
- Powell stated that 'a few months of good data are only the beginning … to build confidence that inflation is moving down .. toward our goal'. The Fed likely needs to see at least 6 months of 'good data' before it begins to consider rate cuts—that pushes the time table out towards early Q2 2024.
- Investors may consider extending duration on selective credits. However, given extended levels of bond volatility, entry price levels remain critical.



Favorable Backdrop for Private Credit

- Commercial bank lending remains flat post the regional banking crises in April.
- Slowing loan growth will lead to less economic activity, though growth in private lending markets will likely offset some of the expected slowdown.
- Private credit managers indicate opportunities abound in this environment. In particular, they are most bullish on high quality, shorter duration consumer loans and infrastructure lending.
- Credit spreads across investment grade, high yield and leveraged loans remain tight versus historic levels, implying lower risk premiums.



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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 across 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. 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. Consult your financial professional before making any investment decision. Past performance is no guarantee of future results. Diversification/asset allocation does not ensure a profit or guarantee against a loss. Economic and market forecasts presented herein reflect our judgment as of the date of this presentation and are subject to change without notice. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. 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