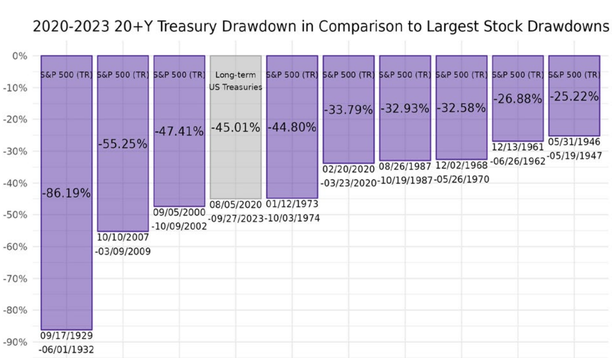
## *Market Review & Portfolio Positioning*

- ***Most financial markets sold off during the 3rd quarter, except crude oil prices. The Fed telegraphed that interest rates would stay higher for longer, negatively impacting equities and bonds.***
- ***The yield curve "dis-inverted" at a record pace, evidenced by a sharp rise in long-term bond yields, and stocks remained highly overvalued as investors continued to move to short-term cash equivalents.***

### The Markets in Review: 3rd Quarter 2023

- The recent rapid rise in bond yields suggests that interest rates may take a while to come down, suggesting a rough and volatile period for stocks and bonds. Higher crude oil prices have also acted as a tax on consumption.
- We believe that prudent risk management is crucial during all market cycles, especially now. Our defensive risk exposures across stocks and bonds remain in place but are also balanced with opportunities that are sure to benefit during an economic recovery, especially in the innovation space.
- Even our more aggressive equity exposure to innovations such as AI, EVs, Biotech, Cyber, and others is risk-managed for greater protection on the downside. We recently introduced a "Dynamic Innovation Overlay" in our more equity-like strategies.
- We believe the recent spike in US Treasury bond yields has accelerated the path to an economic recession. The higher cost of capital and burgeoning debt will most likely put the brakes on consumption and investment. The US Treasury 20-year bond has experienced one of its worst drawdowns in history.
- Portfolios should be well diversified across various equity and fixed-income exposures and alternative assets. The transition into a recession and being positioned for a return growth post-recession requires balancing safety and growth without sacrificing the long-term objectives of one's total financial plan.




*Source: Morningstar*

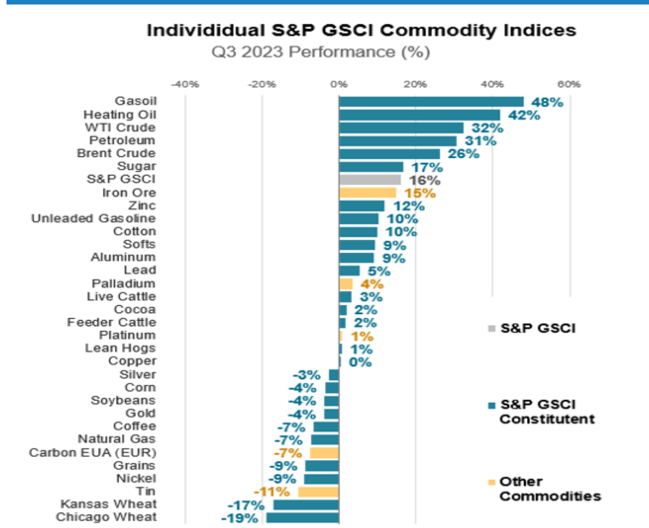
## Key Market Indicators

Bullish | Favorable | Neutral | Cautious | Bearish

| Equities | Sep 2023 | 3rd Quarter | Year to Date | Current View |
|---|---|---|---|---|
| U.S. Large Cap | -4.77% | -3.27% | 13.07% | Cautious |
| U.S. Small Cap | -5.89% | -5.13% | 2.54% | Cautious |
| International Developed | -3.42% | -4.11% | 7.08% | Neutral |
| Emerging Markets Equity | -2.62% | -2.93% | 1.82% | Cautious |
| **Fixed Income** | | | | |
| U.S. Aggregate | -2.54% | -3.23% | -1.21% | Neutral |
| U.S. Government | -2.17% | -2.99% | -1.45% | Neutral |
| U.S. Corporate | -2.60% | -3.01% | 0.03% | Neutral |
| U.S. High Yield | -1.18% | 0.46% | 5.86% | Cautious |
| Non-U.S. Developed | -4.14% | -5.54% | -4.26% | Cautious |
| **Alternatives** | | | | |
| REITs | -6.80% | -7.13% | -2.14% | Cautious |
| Commodities | -0.11% | 6.03% | -0.05% | Neutral |
| Managed Futures | 1.41% | -2.48% | -4.56% | Favorable |
| Hedge Funds | -0.10% | 0.75% | 1.38% | Favorable |

Source: Morningstar, data as of 9/30/2023

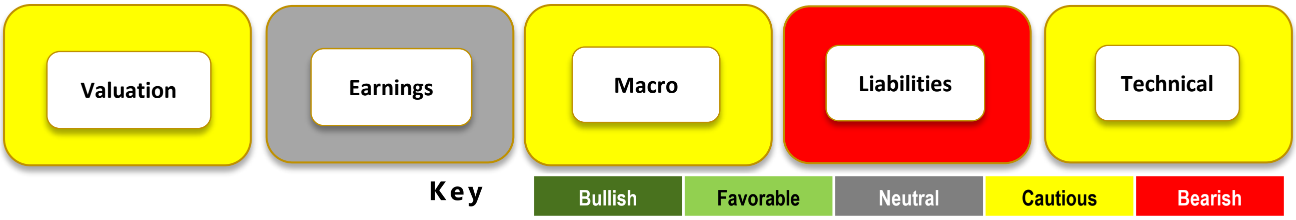
## Commodity Returns – 3rd Quarter




*Source: S&P Dow Jones Indices. Data as of Sep. 29, 2023. Total return indices. Chart is provided for illustrative purposes. Past performance is no guarantee of future results. Sign up at bit.ly/spdjidd to receive index insights.*

# Risk Examination – September 2023

***A quarterly update on our views of the complex risk factors in global markets***




## Valuation

- Equity valuations remain overvalued, especially large-cap tech stocks. Earnings will likely slow as growth slows from higher interest rates and economic slowdown. Bond valuations have improved, as longer-term yields have spiked higher, but volatility remains present.

## Earnings

- We believe the market will enter an earnings recession this year as real economic growth slows. The other negative for earnings growth is that consensus forecasts are too optimistic. Margins will be difficult to maintain with declining demand (revenue). When this happens, the market punishes stocks that deliver negative earnings surprises.

## Macroeconomic

- Our expectation of economic growth rates has moved lower as the effects of the Fed fighting off high inflation should result in a slowing labor market and higher debt servicing costs. All of this should sharply curtail household demand. Supply constraints have eased along with demand. The challenge is that we think the odds favor lower real growth and elevated inflation rates (stagflation).

## Liabilities

- Liabilities have exploded on government and corporate balance sheets over the last cycle. Household borrowing rates are not far behind. The shift now should be on balance sheet repair and debt repayment and not on earnings growth and increased individual spending. This will likely pressure growth and governments to provide extra stimulus programs to restart the global economy.

## Technical/Sentiment

- The uncertainty from the effects of the crisis in Ukraine and its broader geopolitical impact (i.e., the new Axis of Evil; Russia, China & Iran), elevated inflation rates, and lower economic growth ahead will most likely continue to feed higher volatility in the public markets.
- The consensus view calls for a global economic recession from 2023 into 2024, with the U.S. having the greatest odds of contradicting the consensus.

# 2023-2024 Economic and Investment Scenarios

***Our assessment of potential macro scenarios***

| | **Recession** | **K – Shaped Recovery** | **Return to New Normal** | **Robust Recovery** |
|---|---|---|---|---|
| Economy / Geopolitical | ▪ Negative growth precipitated by elevated interest rates, inflation & lower growth<br>▪ Civil unrest<br>▪ Demand slowdown, focus on cost-cutting | ▪ Weakness in consumer discretionary<br>▪ Strength in E-commerce/innovation<br>▪ Fed focus on 2% inflation & no room for fiscal stimulus | ▪ Gradual recovery with radically different labor market<br>▪ Inward focus<br>▪ Steady growth/low inflation | ▪ Inflation reverts to Fed target<br>▪ Job growth/higher consumption<br>▪ Infrastructure spend |
| Markets | ▪ Prolonged sell-off in risky assets<br>▪ Rush to safe-haven assets such as the U.S. dollar, gold and cash | ▪ Negative effect from inflation<br>▪ Volatility dominates<br>▪ Highly valued & concentrated markets<br>▪ Focus on risk | ▪ Extended recovery puts focus on value, small cap & higher inflation<br>▪ Pressure on Big Tech | ▪ Negative real rates, a flood of new money = continued asset inflation<br>▪ Alternative assets & equities prosper |
| Focus | ▪ Flight to quality: Short duration U.S. Treasuries, U.S. Dollar, & Gold benefit | ▪ Premium on asset diversification = liquid alts<br>▪ Commodities & non-directional investments | ▪ Focus shifts from sentiment driven markets to fundamentals | ▪ Fully invested, but highly diversified |
| Probability | **40%** | **30%** | **20%** | **10%** |

< < < **Downside** < < < | > > > **Upside** > > >

**Risks**

| Downside | Upside |
|---|---|
| ◂ Geopolitical risk of a misstep with Russia, China, Iran | Effective use of fiscal stimulus spurs economic growth ▸ |
| ◂ Sustained high interest rates and high energy prices | Globalization returns ▸ |
| ◂ Runaway debt growth on pace to equal Japan | A shift in focus and higher productivity ▸ |
| ◂ Higher rates of poverty and social displacement | Strong real economic growth and productive use of credit ▸ |
| ◂ Further job displacement; higher unemployment – weaker demand | Raises the wealth effect across multiple sectors ▸ |
| | Lower rates of inflation, above-trend real growth ▸ |

# Portfolio Asset Class Positioning

| PORTFOLIO SEGMENT / SEGMENT OBJECTIVE | SEGMENT CONSTITUENTS | SEGMENT COMMENTS |
|---|---|---|
| **Equity**<br><br>*Diversified risk factor exposure with an emphasis on quality, value, & innovation* | ▪ Global exposure to high-quality companies and innovators in their field<br>▪ Diversified across size, high quality, lower volatility, and rising dividend payers across global markets<br>▪ Risk-managed approach to leading-edge innovation across sectors | ▪ Systematic exposure in U.S. equity to an equal-weighted market index, & high-quality stocks with rising dividends<br>▪ Diversified non-US exposure to high-quality and small-cap developed market stocks<br>▪ Continued emphasis on actively managed beta exposures |
| **Fixed Income**<br><br>*Seek to Preserve Capital, and Diversify Equity Exposure* | ▪ Continued emphasis on short-duration & high quality<br>▪ Increased exposure to risk-free 30-60 day T-bills<br>▪ Not a time to "reach for yield"<br>▪ Reduced exposure to asset-backed and senior loans | ▪ Move toward a greater cash position<br>▪ Favor high-quality credit over duration<br>▪ Issuer selection critical for active management |
| **Opportunistic**<br><br>*Highest Conviction Ideas Based on 12-24 Month Proprietary Forecasts* | ▪ Continued exposure to medical instruments, cloud computing & cybersecurity<br>▪ The introduction of a dynamic innovation overlay process to lessen the risk of large drawdowns<br>▪ Small-cap international equity developed markets | ▪ Reflects Palladiem's shorter-term model (value and momentum)<br>▪ Seeking participation in select themes with attractive return potential based on innovative technologies such as 3D printing, gene therapies, digital wallets, *renewable energy* and AI |
| **Alternative**<br><br>*Anticipated Risk Mitigation with Alpha Opportunities* | ▪ Hedged equity<br>▪ Global macro–credit<br>▪ Carbon credits<br>▪ Systematic L/S managed futures<br>▪ Gold | ▪ Lower than average return and higher risk expectations for equities and bonds present the challenge of providing uncorrelated sources of risk and return.<br>▪ We favor exposure to risk-managed approaches to investing in liquid alternatives with an emphasis on carbon credits, absolute return, hedged equity, gold & managed futures |

*For additional information, please refer to the Disclosures at the end of this report.*

# Important Disclosures

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~~markets.~~ ***Past performance is not a guarantee of future results.*** All investments are subject to risk, including the loss of principal. Portfolio positions referenced are subject to change at any time, your portfolio may not reflect the information referenced.

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Index definitions:
- “U.S. Large Cap” represented by the S&P 500 Index.
- “U.S. Small Cap” represented by the Russell 2000 Index.
- “International” represented by the MSCI Europe, Australasia, Far East (EAFE) Net Return Index.
- “Emerging” represented by the MSCI Emerging Markets Net Return Index.
- “U.S. Aggregate” represented by the Bloomberg U.S. Aggregate Bond Index.
- “U.S. Government” represented by the Bloomberg U.S. Government Bond Index.
- “U.S. Corporate” represented by the Bloomberg U.S. Credit Bond Index.
- “U.S. High Yield” represented by the Bloomberg U.S. Corporate High Yield Index.
- “Non-U.S. Developed” represented by the S&P International Treasury ex U.S. Index.
- “Emerging Market Debt” represented by the JP Morgan GBI-EM Global Core Index
- “REITs” represented by the FTSE North American Real Estate Investment Trust (REIT) Equity REITs Index.
- “Commodities” represented by the Dow Jones Commodity Index .
- “Managed Futures” represented by the Credit Suisse Managed Futures Index.
- “Global Macro” represented by the Credit Suisse Global Macro Index

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