Year-End Market Review

- ***2023 was a banner year for risky equities, especially technology stocks and, more specifically, the "Magnificent 7" (Apple, Microsoft, Alphabet, Amazon, Tesla, Meta, and Nividia) . Bonds also ended the year near or slightly above their long-term average. Alternative asset results were mixed depending on a bias toward equity and bonds like alternative exposure or managed futures.***
- ***Diversification was an afterthought for many investors as they piled into the highly concentrated cap-weighted indexes.***

The Markets in Review: 4th Quarter 2023

- It was a banner year for global equities, mainly for those companies in the technology and communication services sectors with the best performance since 2019.
- The US equity market was dominated by the Magnificent 7 through much of 2023, with a shift toward broader gains to finish the 4th quarter. The Nasdaq was up over 40% for the year, its best performance in two decades.
- Bonds bounced back during the last half of the year as it was evident that the Fed would pause raising interest rates. Despite consensus predictions of a global recession during 2023, officially, it never arrived. The job market remained strong, the pace of inflation increases eased, and the household sector continued to spend and drive economic growth higher than expected.
- Commodity prices, particularly oil prices, surprised many and declined later in the year. Long commodities and crude oil ended 2023 with negative results; however, precious metals, specifically gold, delivered positive results for the year.
- Our position going forward is an emphasis on quality across all asset classes with a short to intermediate-duration exposure to bonds. Opportunistically, we favor a "risk-managed" approach to investing in innovation, emphasizing managing downside risk. In the Alternative space, we favor exposure to actively managed commodities, systematically managed futures, and hedged equities.
- The headwinds for equities should be less than attractive valuations and strained earnings growth as the economic growth is expected to slow with elevated interest rates. For bonds, we believe an underweight to less than investment-grade credit is warranted. Market volatility is expected to increase, given the high level of economic and geopolitical uncertainties.

Source: Morningstar

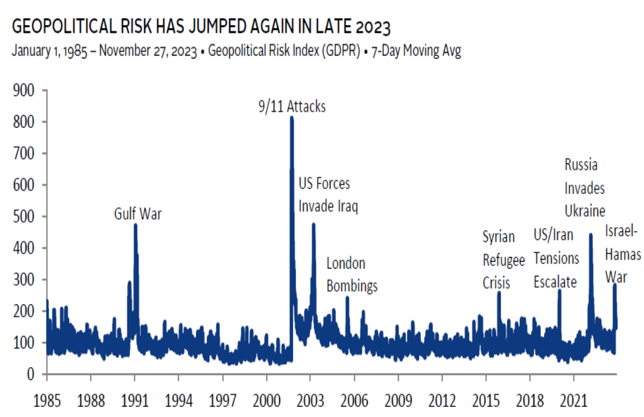
Key Market Indicators

Bullish	Favorable	Neutral	Cautious	Bearish

Equities	December	4th Quarter	1 Year	Current View
U.S. Large Cap	4.54%	11.69%	26.29%	Cautious
U.S. Small Cap	12.22%	14.03%	16.93%	Neutral
International Developed	5.31%	10.42%	18.24%	Neutral
Emerging Markets Equity	3.91%	7.86%	9.83%	Cautious
Fixed Income				
U.S. Aggregate	3.83%	6.82%	5.53%	Neutral
U.S. Government	3.33%	5.62%	4.09%	Neutral
U.S. Corporate	4.19%	8.15%	8.18%	Neutral
U.S. High Yield	3.73%	7.16%	13.44%	Cautious
Non-U.S. Developed	5.25%	10.68%	5.96%	Cautious
Alternatives				
REITs	9.92%	16.22%	13.73%	Cautious
Commodities	-2.15%	-4.08%	-4.13%	Neutral
Managed Futures	1.56%	-1.42%	-5.91%	Favorable
Hedge Funds	1.40%	1.70%	3.11%	Favorable

Source: Morningstar, data as of 12/31/2023

Geopolitical Risk



Source: Dario Caldara and Matteo Iacoviello, "Measuring Geopolitical Risk," American Economic Review.

Risk Examination – December 2023

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

Valuation	Earnings	Macro	Liabilities	Technical
Cautious	Cautious	Neutral	Bearish	Cautious

Key

Bullish	Favorable	Neutral	Cautious	Bearish

Valuation

- We believe 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, but volatility remains. Value, small-cap, mid-cap, and quality stocks appear reasonably valued, in some cases undervalued.

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 the odds favor lower real growth and elevated inflation rates (stagflation).

Fundamental, Economic & Geopolitical Risks

- Our view is that balance sheet risk has risen due to higher debt ratios and elevated interest rates. The number of zombie companies (insufficient operating cash flow to service existing debt) is rising along with credit default risk. Economic risks include slower growth, rising debt costs, and sticky inflation. Uncertainty is elevated due to politics both at home (election year) and abroad (Israel/Hamas war, Russia/Ukraine war, China, etc.).

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, and 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 during 2024 or early 2025, with the U.S. having the greatest odds of contradicting the consensus.

2024-2025 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 ▪ Civil unrest, election outcome ▪ Demand slowdown	▪ Weakness in consumer discretionary ▪ Strength in E-commerce/innovation ▪ Fed focus on 2% inflation & no room for fiscal stimulus	▪ Gradual recovery with radically different labor market ▪ Inward focus ▪ Steady growth/low inflation	▪ Inflation reverts to Fed target ▪ Job growth/higher consumption ▪ Infrastructure spend
Markets	▪ Prolonged sell-off in risky assets ▪ Rush to safe-haven assets such as the U.S. dollar, gold and cash	▪ Negative effect of elevated inflation ▪ Volatility dominates ▪ Highly valued & concentrated markets ▪ Focus on risk	▪ Extended recovery puts focus on value, small cap & higher inflation ▪ Pressure on Big Tech	▪ Negative real rates, a flood of new money = continued asset inflation ▪ Alternative assets & equities prosper
Focus	▪ Flight to quality: Short duration U.S. Treasuries, U.S. Dollar, & Gold benefit	▪ Premium on asset diversification = liquid alts ▪ 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:

- Geopolitical risk of a misstep with Russia, China, Iran
- Sustained high interest rates and higher energy prices
- Runaway debt growth on pace to equal Japan
- Higher rates of poverty and social displacement
- Further job displacement; higher unemployment – weaker demand

Upside:

- Effective use of fiscal stimulus spurs economic growth
- Globalization returns
- A shift in focus and higher productivity
- Strong real economic growth and productive use of credit
- 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 *Diversified risk factor exposure with an emphasis on quality, value, & innovation*	▪ Global exposure to high-quality companies and innovators in their field ▪ Diversified across size and high quality in both US and non-US markets. Exposure to a risk-managed approach to holding leading-edge innovation across sectors	▪ Systematic exposure in U.S. equity to an equal-weighted market index, & high-quality stocks with low debt ratios across global markets ▪ Diversified non-US exposure to high-quality and small-cap developed market stocks ▪ Continued emphasis on actively managed beta exposures
Fixed Income *Seek to Preserve Capital, and Diversify Equity Exposure*	▪ Emphasis on short to intermediate duration & and high credit quality issues ▪ Reduction in credit risk (ABS & senior bank loans) ▪ Not a time to "reach for yield"	▪ Reduction in cash exposure to high-quality credit (short-intermediate term duration) ▪ Favor high-quality credit over duration ▪ Issuer selection critical for active management
Opportunistic *Highest Conviction Ideas Based on 12-24 Month Proprietary Forecasts*	▪ Slight overweight in the energy sector ▪ The introduction of a dynamic innovation overlay process to lessen the risk of large drawdowns ▪ Small-cap international equity developed markets	▪ Reflects Palladiem's shorter-term model (value and momentum) ▪ 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 ▪ Innovation: monthly rebalance of risk (high beta and risk-off low beta) based on momentum
Alternative *Anticipated Risk Mitigation with Alpha Opportunities*	▪ Opportunistic Commodities ▪ Hedged equity ▪ Global macro–credit ▪ Carbon credits ▪ Systematic L/S managed futures ▪ Gold	▪ Lower than average return and higher risk expectations for equities and bonds present the challenge of providing uncorrelated sources of risk and return. ▪ We favor exposure to risk-managed approaches to investing in liquid alternatives with an emphasis on actively managed long/short commodities, carbon credits, 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.

Palladiem has sole discretion to change allocations to styles and vehicles at any time.

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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