Bitterroot
CAPITAL ADVISORS

CAPITAL MARKETS REVIEW

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All public market data are as of 01/19/24 unless indicated otherwise.

Executive Summary

Capital Markets

Strategic Asset Allocation View (7-years)

Macroeconomic Conditions

Shorter-tem View: Key Issues & Scenarios

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EXECUTIVE SUMMARY

Capital Markets

Equity markets (ACWI Index) appreciated by 8.1% in Q1 and are up 3.6% YTD through April 18th.

All regions gained during Q1 but US large-cap stocks dominated while EM stocks lagged (S&P 500 up 10.4% while MSCI EM index up 2.1%) in USD terms.

Better than expected economic data coupled with strong corporate earnings drove strong equity market performance in Q1.

However, markets have pulled back 5.1% in April as US inflation was higher than expected, geopolitical unrest in the Middle East intensified, and US bond yields rose swiftly.

US government and investment-grade corporate bonds modestly declined during Q1, but losses have increased sharply during Q2 as interest rates have swiftly risen post quarter-end.

The Barclays US Aggregate Index was down 0.8% during Q1 and -3.1% YTD through April 19th.

US Treasuries and investment grade corporate bonds both declined during Q1 (-1.0% and -0.4%) and both are down 3.1% YTD.

Bond yields gradually appreciated by 30bps-40bps across the curve during the quarter. However, yields have risen swiftly by another 40bps-50bps since quarter-end. The 10-year US Treasury is now yielding 4.63% vs. 3.87% at YE 2023.

US high-yield bonds and leveraged loans (riskier corporate credit) performed better during Q1 and YTD.

High yield bonds were up 1.5% in Q1 and are down -0.3% YTD. Leveraged loans were up 2.5% and 2.7% during Q1and YTD respectively.

Q1 high yield and leveraged loan returns were driven by high coupon yields and modest spread compression.

However, the swift increase in interest rates coupled with modest spread widening hurt high-yield bond performance since quarter-end.

Credit spreads have remained in a tight range as corporate earnings performance has accelerated during the latter half of 2023. In fact, high-yield bond spreads of 323bps are now below historical averages (430bps) and are well-below the 800bps level normally seen during recessions.

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CAPITAL MARKETS (CONTINUED)

Hedge funds performed well during Q1 with the HFRX Global Hedge Fund Index up 2.5%.

Global macro and trend following strategies performed best (+5.9%) followed by long-short equity hedge funds (+3.4%). Merger-arbitrage strategies performed worst (-0.7%).

Private equity was up 6.2% YTD through Q3 2023 (latest data available) with anecdotal reports pointing toward further gains in Q4.

Private equity managers report with a 60-to-120-day lag. As such, Q4 2023 and Q1 benchmark data is not yet available. However, most PE firms are reporting increased returns of low-SD during Q4 2023 driven primarily by underlying EBITDA growth at portfolio companies.

New deal activity for US PE buyouts has stabilized around $140-$160bln for the last several quarters. Entry valuation multiples increased in Q1 2024 to 11.9x from 2023 troughs of 10.6x (however, they remain below 2021 peaks of 13.8x). Leverage has continued to decline and now averages 5.2x Debt / EBITDA (45% of total deal value) vs. 5.9x Debt / EBITDA in 2021 (52% of total deal value).

During Q1 2024, exit activity remained subdued and was 23% lower than Q4 2023 levels. High-interest rates, have particularly dampened sponsor-to-sponsor transactions. However, continuation fund (GP-led secondary transactions) formation continued to accelerate in Q1 2024. Overall secondary market activity has also picked up, thus providing liquidity to LPs.

Private credit performed well in 2023. (latest data available given lagged reporting)

The Cliffwater Private Credit Index was up 12.6% in 2023 as portfolios benefitted from high current yields with stable pricing. Anecdotal reports point to 3%+ returns in Q1 2024.

The near-term outlook for existing funds is relatively positive. Increases in SOFR base rates has led to unlevered current yields of north of 10%. However, the percentage of loans with non-accrual status is starting to rise and may foreshadow increased defaults or markdowns for legacy loan books.

Private real estate pricing continued to decline in Q4 2023 (latest data available) with transaction volumes remaining low.

The NCREIF Index was down 3.0% in Q4 2023 (fifth consecutive quarterly decline) and was down 7.9% for full-year 2023. Cap-rates have begun to stabilize, although there is very limited data following the recent uptick in rates.

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CAPITAL MARKETS (CONTINUED)

Market rental growth has decelerated for almost all property types as high levels of supply came online in 2022 and 2023. However, new supply is expected to decline considerably in 2025 and 2026.

Underlying property fundamentals remain reasonably strong across industrial properties but have stagnated for multi-family properties (rents up 3.6% YOY on a national level in Q1). Office fundamentals are generally under significant pressure except for the highest-quality, best located properties.

We see a favorable outlook for new private investment funds (currently raising money for 2024 vintage and 2025 vintages) with lower valuations and reduced leverage use, and in certain cases less capital chasing opportunities.

While the chances of a soft or no landing (especially in the US) have markedly increased, the level of economic and geopolitical uncertainty remains extremely high.

As such, we see a wider than normal range of possible outcomes (especially for public equity markets) over the remainder of the year.

We are incorporating these views into portfolio positioning by:

Adding duration to portfolios by purchasing Treasury bonds of intermediate maturities (5-10 years)

Continued allocations to new private investment strategies, especially private equity secondaries and private credit.

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EXECUTIVE SUMMARY

Strategic Asset Allocation View (7-years)

We consider the following factors when developing our 7-year forecasts.

Interest rates are likely to decline from current levels but will not return to the ultra-low-levels experienced between 2009-2021.

Corporate profit margins will be influenced by two opposing factors. On the one hand, onshoring and less labor flexibility may dampen margins. On the other hand, AI adoption may increase productivity and expand margins (especially in the US).

Geopolitical uncertainty is increasing regarding the US-China relationship and potential for other episodic military conflicts (especially a potential widening of the war in the Middle East).

With equity valuations having increased over the past 18 months, we now expect mid-single digit nominal pre-tax annual equity returns (6.0%-7.0%) over a seven-year forecast period.

While we expect US stocks to outperform international markets, we anticipate greater convergence between US and International equity market returns.

In addition, we expect quality and growth stocks to outperform value stocks over the forecast period, the rate of outperformance is likely to be lower than that over the past seven years.

US equity market valuations are stretched while international equity market valuations are generally in-line with historical averages. Thus, earnings growth and dividends, rather than multiple expansion, are likely to drive returns.

Potential wildcards (especially for tech-oriented US markets) include the pace of adoption of generative AI and the resulting potential for above-trend revenue growth and margin expansion.

“Safe” fixed income is highly attractive on a relative basis, especially for bonds with mid-term duration.

US 10-Year Treasuries are yielding 4.63% (up from 3.87% at YE 2023). As we believe it is more likely that 10-year Treasury yields decline below 4.0% than rise above 5.0%, we view 10-year Treasuries as highly compelling from a risk-reward standpoint.

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STRATEGIC ASSET ALLOCATION VIEW (CONTINUED)

We expect mid-single digit returns for US government debt and investment grade bonds over the forecast period.

On a risk-adjusted pre-tax basis, safe fixed income's return potential is still relatively attractive relative to equities.

Riskier credit assets (high-yield bonds and leveraged loans) are attractive over a mid-term time frame.

US high-yield bonds are now yielding 8.3% with 7-year forecasted annual returns of 6.5%-7.0% (relatively close to US Equities). Leveraged loans are currently yielding 9.8% with expected mid-term annualized returns in the 6.5%-7.0% range.

However, high yield spreads of 323bps are below historical averages and are well below those seen during recessions (600bps-800bps). Should a recession occur, these spreads will likely widen and negatively affect near-term returns.

On a relative basis, riskier credit is less attractive vs. safe government bonds based on lower spreads. However, relative to equities, riskier credit remains attractive on a pre-tax basis.

For new private market strategies (i.e., private equity and private credit,) we continue to forecast higher returns relative to public markets (over a multi-year timeframe).

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STRATEGIC ASSET ALLOCATION VIEW (CONTINUED)

Asset Class: Strategic Outlook (7-year timeframe)		
	Expected Annual Return	Relative Attractiveness*
	0% ——— 20%	Negative – Neutral – Positive
Equities		
US Large Cap (S&P 500)		
US Small Cap (Russell 2000)		
MSCI Europe		
Japan Topix		
MSCI Emerging Markets		
Fixed Income		
US Treasuries		
US Corp Investment Grade		
US Corp High Yield		
US Corp Levered Loans		
Alternatives, Private Equity, & Real Estate		
Real Estate (Private) - Unlevered		
Alternatives (Hedge Funds)		
Private Credit (New Funds)		
Private Equity (New Funds)		

Note: The attractiveness of each asset class (as depicted by the positioning of the sliders) is based upon risk-adjusted returns when considering expected returns, volatility, and liquidity. Thus, US Treasuries with mid-single digit returns are shown as quite attractive given a low-risk profile whereas public equities are only rated modestly attractive despite their higher expected return as equities have much greater volatility.

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EXECUTIVE SUMMARY

Macroeconomic Conditions

United States

The US economy continued to perform well thus far in 2024.

The US economy performed strongly in 2023 and far surpassed other developed economies. Robust consumer spending, business investment in AI, and significant fiscal spending associated with the Inflation Reduction Act (mainly supporting construction of onshore manufacturing facilities) drove robust growth.

Real GDP increased at a 3.4% annualized level in Q4 2023, and most economists are forecasting 2.5%-3.0% annualized growth on a sequential basis in Q1 2024. Employment remains strong although growth seems concentrated in certain sectors (healthcare, hospitality and government) and unemployment rates are ticking up among white collar workers as opposed to blue collar workers.

Wage growth has moderated to roughly 4% annually and the job market appears in better balance with job openings less elevated compared to 2022 and early 2023 and quit rates declining to pre-pandemic levels.

Canada

Canada's economy has strengthened during Q1 2024.

Real GDP is forecast to have increased by 3.5% annualized, the fastest Q/Q growth in several quarters.

The oil & gas, manufacturing, and finance sectors all contributed to this growth.

The strength of the US economy has also led to increased demand for Canadian exports.

Economists are forecasting a soft landing with 1.0% Real GDP growth in 2024 (similar to the 1.1% achieved in 2023). However, Q1 results suggest that growth may surprise to the upside.

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MACROECONOMIC CONDITIONS (CONTINUED)

Europe

Europe's economy flirted with recession in H2 2023. However, regional economies have performed better than expected thus far in 2024.

Manufacturing remains weak with PMI surveys remaining below the 50-level which indicates neither growth or contraction. However, green shoots are emerging with March survey results of 46 (third straight month at this level) relative to the 43-levels seen from July-October in 2023.

Services PMIs returned to positive growth territory in February and March following several months displaying contraction since August 2023.

Unemployment levels remain near historic lows and European consumers have spent less of their excess savings accumulated during the pandemic (in contrast to US consumers).

Unlike in the US, Europe's inflation is rapidly cooling which should set the stage for several rate cuts in 2024 and an acceleration in growth throughout the year.

China

China's Q1 2024 growth exceeded consensus expectations. However, growth was uneven and several causes for concern remain.

Real GDP grew 5.3% YOY during Q1, beating consensus expectations for 4.8% growth. Governmental policies aimed at stimulating investment contributed to the Q1 growth.

Investments in infrastructure such as roads and bridges grew 6.5% YOY after growing 6.0% the previous quarter. The property market remains weak despite various government support measures. Investments in property development fell 9.5% YOY during Q1 after a 9.0% YOY decline the previous quarter.

Retail sales remain mixed and grew at 4.7% YOY during Q1 although growth slowed sequentially in March.

China is targeting around 5% Real GDP growth for 2024. Achieving this goal is highly dependent on the levels of government fiscal and monetary stimulus.

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MACROECONOMIC CONDITIONS (CONTINUED)

Inflation

Inflation declined rapidly across most major economies in 2023. However, US inflation has remained higher than expected thus far in 2024.

The US Core CPI Index increased by 0.4% MOM in January, February, and March (higher than expected). This follows several months of sub 0.3% monthly increases during H2 2023. On a YOY basis, Core CPI increased by 3.8%.

Need More Room

Shelter costs (+0.4% MOM and +5.7% YOY) continue to account for most of the inflation growth. Motor vehicle insurance costs also increased substantially (+2.6% MOM and +22.2% YOY).

The US Core PCE Index (Fed's preferred measure) grew at 0.3% MOM in February following a 0.5% MOM increase in January. These increases followed several months where increases were less than 0.2% MOM.

While the Core PCE Index increased 2.8% YOY, the recent higher than expected monthly figures increase the chances that rates may need to remain higher for longer to achieve further progress towards the Fed's 2.0% annual inflation target.

Headline inflation in the Eurozone cooled to +2.4% YOY in March and core inflation cooled to 2.9% YOY as well. Both figures were below expectations.

Interest Rates

Interest rate expectations are diverging across major economies.

Need More Room

While the interest rate hiking cycle is likely over for central banks, the current outlook around the timing of rate cuts differs materially across the US and Eurozone.

Markets now expect fewer US rate cuts in 2024 than originally forecasted and expect the timing of these rate cuts to occur later in the year.

Investors are now projecting 1-2 cuts (vs 3-4 cuts earlier in the year) and now project cuts beginning in September as opposed to March or June.
In contrast, the Eurozone remains on pace for earlier cuts this year (likely in June) as economic growth has been muted and core inflation continues to fall faster than in the US.

While we acknowledge a wide range of possible outcomes, our current thinking is for 10-year Treasury bonds to range

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EXECUTIVE SUMMARY

Government Policy and Wealth Taxes

Increased populism coupled with rising governmental deficits following years of pandemic and post-pandemic high fiscal spending levels has led to increased calls for wealth tax levies.

In the US, President Biden has proposed a minimum 25% tax rate on households with a net worth of more than $100mm.

Additionally, lawmakers in several states including Massachusetts, California, Hawaii, Illinois, Connecticut, New York, Oregon and Maryland have proposed variations of wealth taxes.

Given the significant political differences in Congress, it is unlikely that Biden's proposal makes progress in 2024. However, we expect taxation of the wealthy to remain a key issue for several years to come, particularly with control of Congress and the Presidency in play later this year.

In Canada, President Trudeau has proposed increasing capital gains taxes to fund housing.

The Trudeau government has proposed increasing the share of capital gains subject to taxation to two-thirds (as opposed to one-half currently) for individuals with annual investment profits above $250,000 CAD. This increase would also apply to corporations and trusts.

If approved, this legislation would raise the effective marginal tax on capital gains to 36.3% from 27.5% currently.

The UK recently unveiled substantial changes to the taxation of non-UK domiciled individuals (Non-Doms).

For many decades, the UK has allowed Non-Doms who are living in the UK to elect to be taxed on their foreign income and gains on a remittance basis. Under the current tax regime, Non-Doms will pay UK income tax and capital gains tax on all UK source income and capital gains realized in the UK. However, they only pay income and capital gains tax on foreign earnings and gains if and when they remit those back to the UK. This treatment enables wealthy UK Non-Doms to earn substantial income or capital gains outside of the UK which may never be taxed within the UK.

Beginning April 6, 2025, the UK government will abolish the current Non-Dom regime and replace it with a new residency-based regime. Under this regime, UK residents will be taxed in the UK on all sources of worldwide income and capital gains as they arise (however, during the first four years, individuals will not be required to pay UK tax on funds they remit to the UK form elsewhere in the world).

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EXECUTIVE SUMMARY

Shorter-term View: Key Issues

In our last quarterly report, we outlined several issues that could impact equity market performance in 2024. We revisit these issues below.

Issue 01: Inflation Trajectory

Thus far in 2024, US inflation has been higher than expected (especially for services). Bond yields have increased sharply with 10-year Treasury yields increasing from 3.87% at YE 2023 to 4.63% presently. Forecasters have dialed back expectations for rate cuts during 2024.

Thus far, equity markets have taken higher than expected inflation largely in stride. The S&P 500 was up 10.4% in Q1 as strong earnings growth more than offset initial higher than expected inflation.

However, the S&P 500 has pulled back 5.4% in April (by 4/19) as strong economic data suggests that the last mile towards achieving the Fed's 2% annual inflation target may be difficult to achieve.

We believe that US markets will be more driven by earnings data rather than inflation data unless inflation spikes and investors believe additional rate hikes are needed (rather than higher but stable rates for longer).

Issue 02: Economic Growth – no landing, soft landing, mild recession, or hard landing?

In the US, chances for no landing (strong growth but slower progress to 2% inflation target) or a soft landing (moderating growth but faster progress towards 2% annual inflation target) have markedly improved. Consumer spending is robust, and enterprise technology spending has increased following a lull in 2022. Manufacturing data has also strengthened in recent months.

The European economy is performing slightly better than expected with both Germany and France having positive GDP growth in Q1. While risks certainly remain and Europe is more exposed to global macro slowdowns should they occur, there is cautious optimism for accelerating growth throughout 2024.

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SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue 03: Corporate Earnings

Corporate earnings continue to perform well. In fact, S&P 500 earnings returned to YOY growth in Q3 and Q4 (+7.5% in Q4) after declining YOY in H1. A combination of steady to increasing demand, cost reduction initiatives, and catch-up price increases coupled with stabilizing or declining input costs led to margin stabilization or increases.

Analysts are forecasting 5% revenue growth and margin expansion driving 8% earnings growth for the S&P 500.

We believe this is quite achievable with potential upside should current trends hold. Of course, risks surrounding the sustainability of demand and any resumption in input cost increases remain.

Thus far, Q1 2024 earnings season is off to a strong start with a higher percentage of companies delivering earnings beats relative to normal periods.

Issue 04: AI Adoption

AI and actual or perceived beneficiaries continue to play a big role in stock and sector-level performance thus far in 2024.

However, markets are becoming more discerning in analyzing AI-related companies and there has been more disparity between companies showing benefits vs. those that had previously experienced AI-driven stock price hype but failed to deliver actual earnings results.

The biggest AI winners have been semiconductor companies (Nvidia, Micron, Broadcom, etc.) and the hyperscalers / cloud companies (Amazon, Meta, and Google). Software companies thought to have AI leadership positions have demonstrated muted performance early in the year.

The earnings reports this upcoming earnings season from early AI winners will be heavily scrutinized for sustainability of demand, cost creep from expense and capital expenditure pressures, and any changes in competitive dynamics.

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SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue 05: China Government Policy

On the margin, China has increased stimulus in the form of lowering bank reserve requirements and lowering interest rates.

However, more credit is flowing into production rather than into consumption, reducing the effectiveness of monetary policy tools in stimulating demand and growth.

Q1 GDP growth (+5.3%) surprised to the upside (consensus at 4.6%). However, much of this growth was fueled by infrastructure expenditures. Retail sales only grew 3.1% YOY in March and missed expectations.

It remains to be seen whether China undertakes aggressive fiscal and monetary stimulus (as they did post GFC and in 2016).

Large scale stimulus would likely lead to rallies in Chinese equity markets and emerging markets more broadly. Additionally, European markets may also benefit under this scenario as Europe is a large exporter to China.

Issue 06: Geopolitical Conflicts

The war between Israel and Hamas seems to have reached somewhat of a stalemate. However, there have been increased skirmishes between Israel and Iran or Iranian proxies. A widening conflict would negatively affect global equity market confidence and likely lead to surging oil prices which may reignite inflationary pressures.

As of now, both Israel and Iran have shied away from significant escalations.

The Russia / Ukraine war seems to be in a stalemate with outcomes uncertain.

Outcomes in the US presidential election could markedly alter the direction of US policy to towards Ukraine and thus could alter the trajectory of the conflict.

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SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue 07: US Presidential Election

US equity market have generally experienced higher than normal volatility during presidential election years. It remains to be seen whether there may be unexpected policy changes from either the Republican nominee (most likely Trump) or the incumbent (Biden).

As a mitigating factor, both candidates are well-known, and markets have already experienced their economic policies.

Policy proposals espousing a more widespread application of tariffs (favored by Trump) would negatively affect equity markets.

Biden favors letting some of the tax cuts enacted under Trump expire in 2025. Should that transpire, there may be negative effects on consumer and business spending.

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EXECUTIVE SUMMARY

Shorter-term View: Scenarios

We see multiple potential paths for equity returns over the remainder of 2024 (with reference to the S&P 500 which stands at 4,967 as of April 19, 2024).

Scenario A: Optimistic Case

Better than expected economic growth (Real GDP growth of 2.0%+) coupled with continued moderation in inflation. Fed cuts rates by 75bps or more despite stronger growth as inflation resumes falling towards 2.0% target levels. Consumer spending remains healthy, wage growth remains modest, and companies enact productivity measures to restrain costs resulting in margin improvement.

Under this scenario, S&P earnings could expand to $245-$253 in 2024 and $270-$280 for 2025 (versus $220 in 2023). Equity multiples may expand to 20.0x-21.0x forward earnings. The S&P 500 index could appreciate to 5,300 to 5,750 by YE 2024 (8%-17% total return).

Scenario B: Base Case

Fed holds rates steady until September 2024 and then cuts by 50bps-75bps over the remainder of the year. Economic growth slows but the US avoids a recession. Real GDP growth approximates 1.5%. Unemployment modestly rises and consumer spending slows but does not decline meaningfully.

Under this soft-landing scenario, S&P 500 earnings could expand to $235-$243 in 2024 and $255-$265 in 2025. Equity multiples range between 18.5x-19.5x forward earnings with the S&P ending 2024 between 4,750 and 5,150 (total return of -3.3% to +5.0%).

Scenario C: Pessimistic Case

Consumers exhaust remaining excess savings and the economy slows faster than expected leading to intensified layoffs. European weakness may exacerbate the swiftness of a global recession. Another pessimistic outcome could be a reacceleration in inflation which leads to additional fed hikes which then leads to a hard landing in late 2024 or early 2025.

Under this scenario, the resultant recession is likely to be deeper. S&P 500 earnings may be $225-$235 with relatively similar levels in 2025. In these scenarios, the S&P 500 could decline by 15%-20% from current levels over the next 6-9 months as investors grapple with where corporate earnings will trough. However, such events also increase the chance for

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SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Scenario C: Pessimistic Case

Consumers exhaust remaining excess savings and the economy slows faster than expected leading to intensified layoffs. European weakness may exacerbate the swiftness of a global recession. Another pessimistic outcome could be a reacceleration in inflation which leads to additional fed hikes which then leads to a hard landing in late 2024 or early 2025. Either scenario leads to faster and deeper equity market declines followed by an eventual sharp rebound once Fed policy pivots.

Under this scenario, the resultant recession is likely to be deeper. S&P 500 earnings may be $225-$235 with relatively similar levels in 2025. In these scenarios, the S&P 500 could decline by 15%-20% from current levels over the next 6-9 months as investors grapple with where corporate earnings will trough. However, such events also increase the chance for an ultimate swift Fed pivot with declining interest rates which would ultimately lead to sharp equity rallies.

At this stage, while Scenarios A or B are looking more likely than Scenario C, there are several uncertainties and external variables that are difficult to predict.

Given the significant increase in equity valuations over the last 18 months coupled with significant remaining macroeconomic risk factors, we would recommend that investors not add substantially to equities at these levels.

7-year expected returns of 6.0%-8.0% are lower than historical averages.

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Capital Markets Review

Q4 & Full Year

Equity Markets: Performance & Valuation

Fixed Income Markets: Performance & Valuation

Alternatives and Private Investments

Actionable Investment Opportunities

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CAPITAL MARKETS REVIEW

Equity Markets: Performance

Global equity markets (MSCI ACWI Index) increased by 8.1% during Q1 but have pulled back sharply since then and are now up 2.7% YTD through April 18, 2024.

US large-cap stocks (S&P 500) were up 10.4% and 4.5% in Q1 and YTD respectively. Both international developed (+5.7% Q1 and +0.8% YTD) and emerging market (+2.1% Q1 and -1.4% YTD) stocks have trailed US stocks is USD terms.

Globally, growth stocks (+9.5%) outperformed value stocks (+6.8%) during Q1. Since quarter-end, growth stocks outperformance over value stocks has narrowed (+3.0% vs 2.3%) YTD.

During Q1, technology (+12.1%), communication services (11.4%), energy (+9.4%), industrials (+9.1%) performed best while consumer staples (+2.7%) and utilities (+1.5%) performed worst.

However, in April, almost all sectors have retreated with technology and consumer discretionary stocks faring worst at -8.4%, and -6.3% respectively. Only energy stocks (+1.2%) have been positive during the April equity market pullback.

US large-cap equities (S&P 500) were up +10.4% during Q1 and +4.5% YTD through April 19th.

Q1 and YTD stock performance has largely been driven by a select number of stocks (NVIDIA, Meta),

On an equally weighted basis (as opposed to market-cap weighted), the S&P 500 is only up 1.8% YTD.

In Q1, most sectors performed well with communication services (+15.8%) and energy (+13.7%) leading and consumer staples (+7.5%) and utilities (+4.5%) lagging.

Strong corporate earnings and better than expected economic data drove performance.

Since quarter-end, the S&P 500 is down 5.4% through April 19th with technology (-8.4%) and consumer discretionary sectors (-7.0%) performing worst.

Unfavorable inflation data (indicating slower than expected progress towards the Fed's 2% inflation goal) coupled with swiftly increasing interest rates have driven the S&P 500 April pullback.

US small cap stocks have continued to underperform large cap stocks.

Small caps were up +5.2% in Q1 but have since declined 8.3%, bringing YTD performance to -3.5%.

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EQUITY MARKETS: PERFORMANCE (CONTINUED)

Small caps are perceived to strongly benefit from lower interest rates as they tend to be more highly levered. As such, these stocks have pulled back further in April as rates have risen swiftly.

International developed stocks (MSCI EAFE) were up 5.7% during Q1. However, in April, the MSCI EAFE index declined by 4.6% trimming YTD gains to 0.8%.

European stocks appreciated by 5.0% in Q1 and 1.1% YTD in USD (7.6% in Q1 and 5.1% YTD in Euro terms).

Corporate earnings have held up better than expected and inflation is continuing to decline.

Currency has detracted from YTD returns in USD terms as the USD had strengthened to 1.067 on April 19th vs. 1.104 at YE 2023.

Japanese stocks appreciated by 10.5% in Q1 and 2.7% YTD in USD (+18.8% in Q1 and +12.8% YTD in Yen terms).

In local markets, Japanese stocks have benefitted from a) reforms and increasing shareholder friendly actions on behalf of large corporations, and b) Yen weakness driving increased local currency revenues and profits as many Japanese corporations have large overseas revenues coupled with largely domestic cost bases.

However, Yen weakness (Yen has depreciated to 154 on April 19th vs. 141 at YE 2023) has also detracted from stock returns in USD terms.

Emerging markets were up 2.4% during Q1. However, in April, the MSCI EM Index declined by 3.6% and is now down -1.4%.

During Q1, Indian equities were up 5.5%, Taiwanese equities were up 12.5% and Korean equities were up 1.6% in USD.

Indian equities benefitted from strong economic data and corporate earnings and a relatively stable currency.

Korean (+6.2%) and Taiwan (+17.5%) equity markets performed even better in local currencies but currency depreciation vs. the dollar detracted from those gains in USD terms. Strong results from semiconductor companies supported by robust AI spending demand drove performance.

Since quarter-end, Korean and Taiwanese equities declined by 8.9% and 6.7% in USD terms as semiconductor companies gave back gains as part of broader technology sector declines and as currencies depreciated further vs. the dollar.

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EQUITY MARKETS: PERFORMANCE (CONTINUED)

The MSCI USA Quality and Russell 1000 Growth Indexes have substantially outperformed the broader S&P 500 over the past seven years.

Both indexes have benefitted from overweights to the US technology and communication services sectors (mainly internet companies)

However, over the past three years, there has been a bifurcation of performance within quality stocks. Non-technology stocks have materially underperformed their quality stock counterparts in technology sectors. Since active managers have high active shares, they tend to underweight exposure to the Magnificent Seven and in some cases to the broader technology sector. As such, US active managers focused on buying quality companies have generally underperformed their respective US benchmarks over the past three years.

The Quality Index has disproportionately benefitted from its significant overweight to NVDA over the past year.

US growth and quality stocks appear modestly expensive relative to historical averages.

Operating fundamentals for the technology and communication services (internet) sector have been very strong over the past 6-12 months. Revenue growth has accelerated while cost reduction continues leading to outsized earnings growth.

However, YOY comparisons become more difficult in H2 and with higher valuations coupled with lofty investor expectations, these stocks may face pullbacks if results falter or if rates continue to increase.

Investors will especially scrutinize expense levels and capital spending with regards to AI plans which seem to be accelerating. US value stocks (healthcare, energy, financials, and consumer staples) appear fairly valued relative to history.

Operating fundamentals appear mixed across sectors both in terms of underlying demand and in terms of cost pressures.

For investors with a mid-term time frame, we continue to believe that stocks of high-quality companies will outperform given their strong business models, superior revenue and earnings growth and strong returns on capital.

Over shorter-term time frames, these companies may underperform given their recent strong outperformance (especially technology and communication services stocks) and given elevated investor expectations which may prove challenging to exceed.

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EQUITY MARKETS: PERFORMANCE (CONTINUED)

Equity Indices **(as of 04/19/24)**

Total Returns (%) – USD

	YTD	Qtr	Annualized Returns 1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	4.5%	10.4%	20.9%	7.2%	12.6%	12.7%
US Small Cap (Russell 2000)		5.2%	9.9%	-3.1%	6.0%	6.6%
MSCI EAFE	0.8%	5.7%	7.1%	1.5%	5.8%	6.1%
MSCI Emerging Markets	-1.4%	2.1%	4.1%	-7.0%	0.8%	3.2%
MSCI ACWI	2.7%	8.1%	15.3%	3.6%	9.2%	9.6%
S&P 500 - Equal Weight	1.8%	7.9%	11.8%	4.9%	10.5%	10.7%
MSCI ACWI - Equal Weight	-1.8%	1.8%	0.8%	-3.3%	2.8%	4.1%
US Style Factors						
MSCI US Quality	6.0%	12.8%	29.3%	9.0%	14.5%	15.4%
Russell 1000 Growth	4.6%	11.4%	30.1%	7.8%	16.3%	17.1%
Russell 1000 Value	3.8%	9.0%	12.5%	5.3%	8.8%	8.6%

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CAPITAL MARKETS REVIEW

Equity Markets: Valuation

Equity markets are generally fairly valued relative to historical averages.

US markets modestly overvalued and international developed markets fairly valued-to-modestly undervalued.

The S&P 500's valuation is nuanced however. While the market-cap weighted S&P 500 Index trades at 19.8x NTM P/E, the equal-weighted S&P 500 trades at 16.5x NTM P/E (inline with historical averages).

The S&P 500 has high concentration among a relatively narrow set of stocks, and the technology sector accounts for 30% of the index. Although the S&P 500's valuation may look expensive relative to history, this increase seems largely due to the changing composition of the index and its shift towards much higher quality companies that have exhibited staying power while delivering attractive earnings growth.

US large-cap equity market valuations are expensive relative to government bonds.

The S&P 500 presently trades at 19.8x consensus NTM earnings.

Historically, the S&P 500 earnings yield (inverse of multiple) has averaged 200-300bps over 10-Year Treasuries.

With 10-year Treasuries yielding 4.6%, at first glance, a 13.0x-15.0x forward EPS multiple is "fair" for the S&P 500 based on relative valuations to bonds.

However, most investors do not expect the 10-year Treasury to remain at 4.6% for an extended period of a time. If the 10-year was to retreat to 3.5%, a fair valuation of 16.0x-18.0x forward EPS is more reasonable (based on historical relationships). Again, we can debate whether these historical relationships should hold given the changes in sectoral composition for the S&P 500 and the sustainable secular growth trajectories associated with several stocks within the technology sector (largest weighting in the S&P 500).

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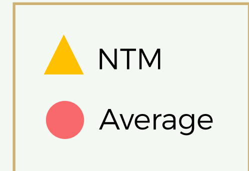
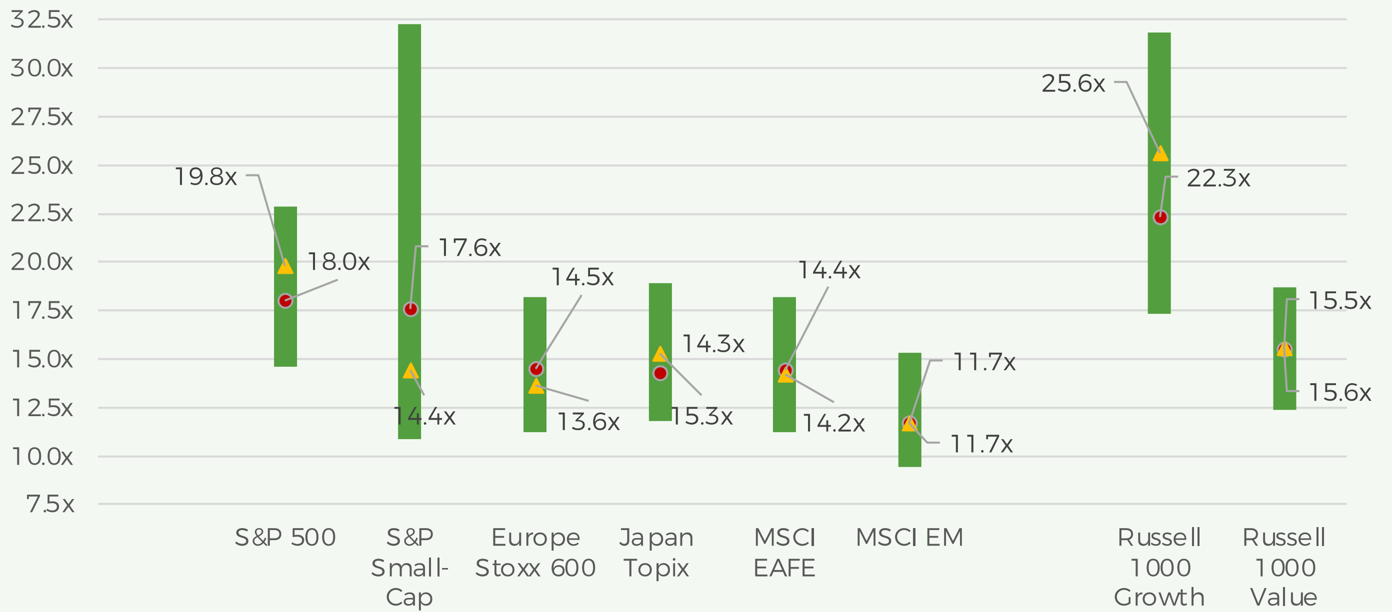
EQUITY MARKETS: VALUATION (CONTINUED)

Equity Valuation – NTM P/E Multiple Ranges (10-Year History)





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CAPITAL MARKETS REVIEW

Fixed Income Markets: Performance

Safe fixed income (government bonds and corporate investment grade bonds) declined modestly during Q1, with declines further intensifying since quarter end.

US Treasury yields appreciated gradually through Q1 and then swiftly moved upwards since quarter-end.

Yields moved up 30bps-40bps across the Treasuries curve during Q1. Since quarter-end, yields have appreciated another 30bps-40bps through April 19th.

The sharp increase in yields since quarter-end was driven by unfavorable inflation data (inflation not falling as much as expected) and continued strong economic data in terms of consumer spending and employment.

Both high yield bonds and leveraged loans appreciated strongly in Q1. However, high-yield bonds have declined since quarter-end as rates have risen.

HY bonds benefitted from high coupon rates and modest spread tightening in Q1. Since quarter-end, the performance reversal has been driven by rising interest rates and modest spread widening.

CCC-rated (the riskiest) high-yield bonds have continued to outperform the broader high-yield index YTD.

Leveraged loans (floating rate) have benefitted from high coupon rates (driven by increases in the SOFR base rate throughout 2024 while spreads have remained stable).

Fixed Income Indices – Characteristics and Performance in USD (as of 04/19/2024)

			Annualized Returns				
	YTD	Qtr	1Y	3Y	5Y	7Y	Duration yrs
US Treasury	-3.0%	-0.8%	-1.5%	-3.7%	-0.4%	0.1%	5.9
US Corp. IG	-2.9%	-1.0%	2.1%	-3.0%	1.0%	1.6%	6.9
US Corp HY	-0.2%	1.5%	8.7%	1.3%	3.6%	4.1%	3.3
US Corp Lev. Loans	2.8%	2.5%	11.8%	5.9%	5.3%	5.0%	NA
Barclays US Aggregate	-3.1%	-0.8%	-0.2%	-3.5%	-0.1%	0.6%	6.2
Barclays Canada Agg. *	-3.2%	-1.3%	0.8%	-2.2%	0.0%	0.7%	7.0

** Barclays Canada Aggregate Index returns in CAD*

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CAPITAL MARKETS REVIEW

Fixed Income Markets: Valuation

Safe fixed income (government bonds and investment grade corporate bonds) yields have risen sharply and are now at highly attractive levels.

US Treasuries are yielding roughly 5.2%, 5.0% and 4.6% for 1-year, 2-year, and 10-year maturities.

US corporate investment grade bonds are now yielding 5.6% (with risk of default very low).

Both investment grade and high-yield bond spreads remain tight reflecting strong corporate earnings performance despite rising rates.

IG spreads are presently at 92bps and HY spreads are at 323bps. These levels are well lower than 10-year averages of 125bps and 425bps respectively.

Spreads have generally widened further during prior recessionary periods (200bps for corporate bonds and 800bps for HY bonds).

However, the quality of the high yield index is much stronger now than in previous periods. When coupled with today's high base rates, it is unlikely that spreads will widen to those experienced in previous recessions (even if economic activity slows substantially).

Access to credit varies considerably depending upon borrower type.

Large corporate borrowers have ample access to credit availability via banks or through large private lenders.

Following a pause in late 2022 through mid-2023, large banks have increasingly re-entered the leveraged loan market and new issuance spreads in the large end of the market have contracted by 125bps to 150bps.

On the other hand, lower-middle-market and middle-market companies are facing constraints regarding access to capital.

Regional banks have pulled back substantially from lending to these companies. As such, spreads to these borrowers have not contracted as much (only 50bps-75bps) relative to the larger borrowers.

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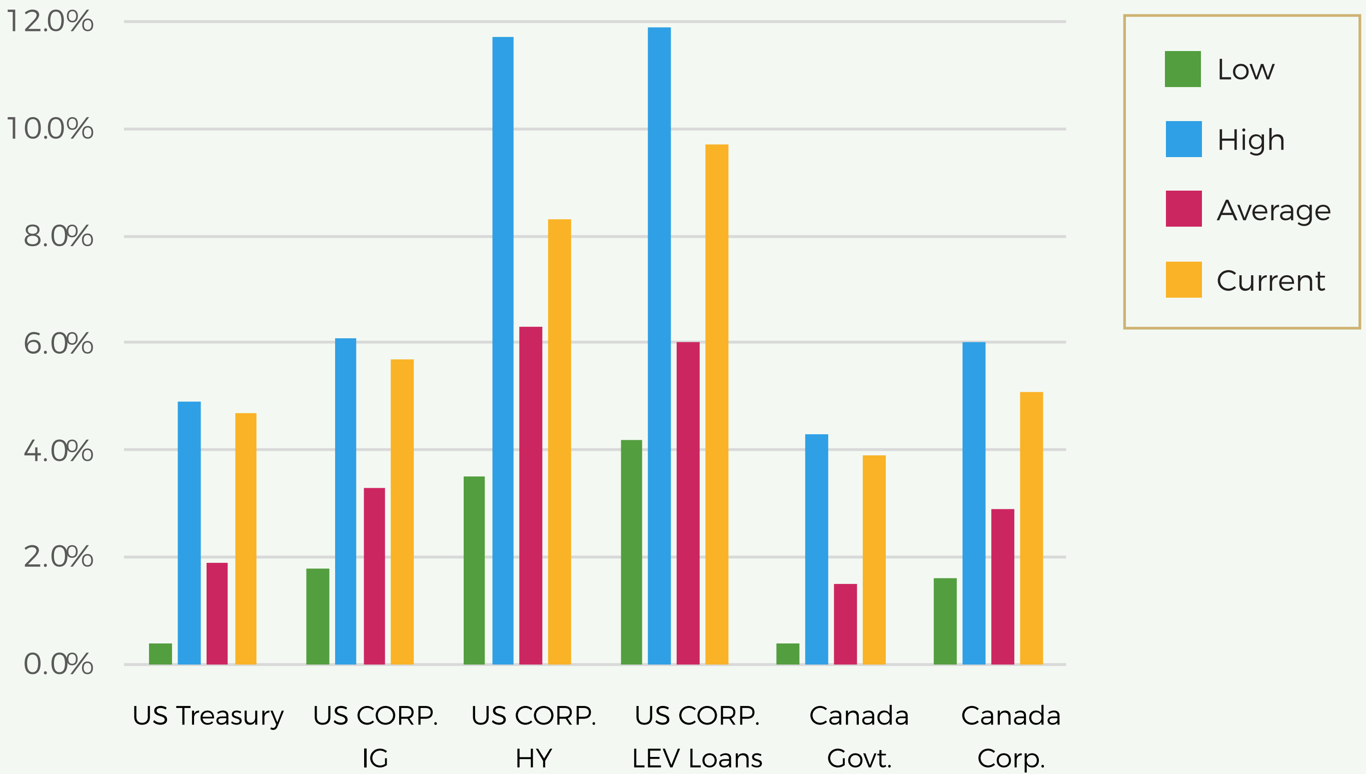
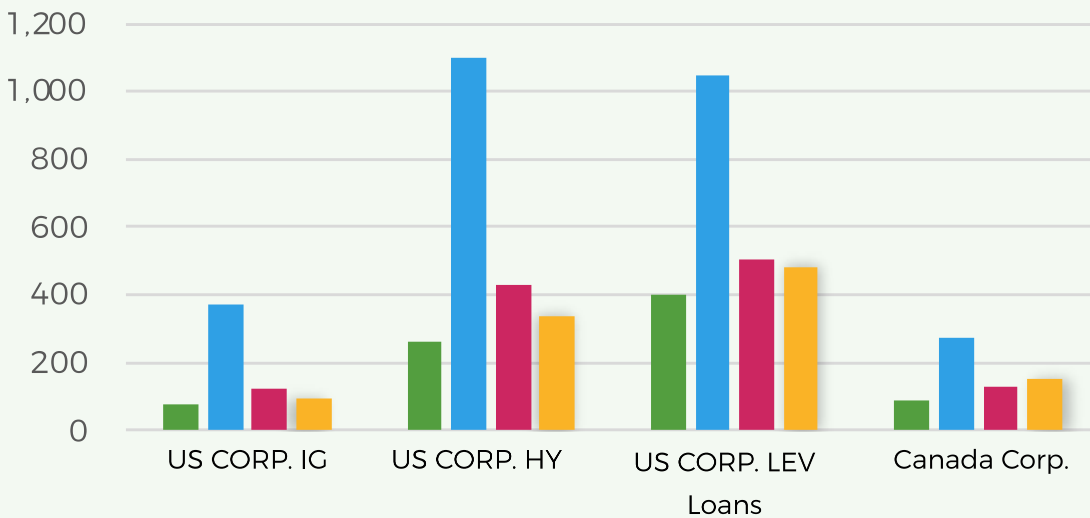
FIXED INCOME MARKETS: VALUATION (CONTINUED)

Fixed Income Yields – 10-year History



Fixed Income Spreads – 10-year History



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CAPITAL MARKETS REVIEW

Alternatives and Private Investments

The HFRX Hedge Fund Index performed well and was up 2.5% in Q1.

Almost all strategies delivered positive returns. Global macro and trend following strategies performed best (+5.9%) followed by long-short equity hedge funds (+3.4%). Merger-arbitrage strategies performed worst (-0.7%).

US private real estate operating fundamentals are mixed in terms of operating fundamentals and transaction prices.

Nationally, US apartment rents grew slightly in March from the prior month and are up 3.6% YOY.

Apartment supply jumped to a 36-year high in 2023 with occupancy rates trending downward to 94% (well below 2021-2022 peaks of 97%-98% but inline with historical averages).

2024 is projected as another record supply year which should further constrain rent growth. However, the supply pipeline is expected to drop dramatically in 2025 and 2026 which could lead to faster annual rent growth going forward.

While occupancy levels and YOY rental growth are at pre-pandemic levels, rents are still 37% higher on an absolute level relative to pre-pandemic levels.

Industrial fundamentals remain strong, but market rent growth is decelerating from peak levels.

In-place rent growth was flat QOQ and increased by 6.0% YOY in Q1 2024. Vacancy rates increased to 5.7% but are still well below the 7.0% historical averages.

Demand for small-bay industrial properties remains high with supply constrained. As such, the opportunity to drive rent growth within the small-bay segment is better than within the more prevalent large-bay segment.

Office fundamentals are clearly under pressure with increasing frequency of defaults on debt.

Cap-rates have risen, given rising interest rates and the sharp increase in debt funding costs.

However, cap-rates appear to be stabilizing with interest rates peaking. This stabilization may lead to increased transaction volume as buyer and seller expectations converge.

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ALTERNATIVES AND PRIVATE INVESTMENTS (CONTINUED)

Pricing declines accelerated with the NCREIF index down 3.0% in Q4 2023 (latest data available) and 8.0% for full-year 2023. The September quarterly decline represents the fifth straight quarter of declines beginning in Q4 2022.

Sales volumes remain depressed as cap rates have risen and property valuations have declined. The bid / ask spread remains high.

Refinancing risk is an area to closely monitor as substantial commercial real estate debt matures over the next few years.

The office sector and some pockets of retail are clearly under pressure and may see defaults pick up considerably over the next 18 months. Many apartment deals done in frothy periods of 2021 and early 2022 may also experience pressure as short-term loans mature over the next twelve months.

Private equity performed well in 2023 with buyout funds experiencing solidly positive performance despite the large rise in interest rates. However, deal activity remains relatively muted and exits remain depressed thus far in 2024.

According to Cambridge Associates, US PE returned 6.2% YTD through Q3 2023 (latest data available). Anecdotally, PE returns likely improved by another 3% to 4% in Q4 resulting in full-year 2023 gains near 10%.

PE buyout returns in 2023 lagged broader public equity markets as PE held up much better in 2022 and given that most PE buyout exposure is not within the mega-cap technology space (other sectors in the public markets rallied far less in 2023).

In Q1 2024, US PE buyout deal activity remained relatively flat in $ value terms at roughly $140bln. Deal activity has stabilized in the $140bln-$160bln per quarter over the last several quarters.

Platform LBOs continue to be scarce given their high dependence on leverage.
In 2023, valuations for new deals (down 20%-25% from peaks) bottomed following a two-year reset period from peaks seen in 2021. As public market valuations increased throughout 2023, short-term interest rates stabilized, and operating fundamentals at portfolio companies largely remained strong, PE deal valuations have begun to increase again.

In Q1 2024, average deal valuations increased to 11.9x trailing EBITDA (vs. trough of 10.8x) versus 13.8x in 2021.

Debt / EBITDA levels of new deals contracted to 5.1x in Q1 2024 from 5.9x in 2022 with debt / total capital declining to 45% versus 51% in 2022 and versus the 10-year average of 55%.

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ALTERNATIVES AND PRIVATE INVESTMENTS (CONTINUED)

Exit activity remains depressed. While PE firms expect a steady increase in distributions throughout 2024, material increases in exits are yet to manifest themselves.

Q1 2024 exit activity declined by 17% QOQ vs. Q4 2023 and remains well below pre-pandemic levels. This decline follows a bounce in Q4 2023 exit activity. Over the past several quarters, exit activity seems to have stabilized at low levels.

Improved valuations and potential declines in interest rates may lead to improved exit activity in 2024.

However, if exit activity remains depressed, we expect PE firms to continue to seek liquidity via increased activity in the secondaries market.

Venture capital fund performance has experienced modest declines through Q3 2023 (latest data available).

According to Cambridge Associates, US VC returned -3.9% YTD through Q3 2023 (latest data available).

The unknown at this point is what valuations may be for companies requiring new funding rounds. Many VC portfolio companies took advantage of frothy conditions in 2021 to raise substantial amounts of cash. This cash hoard has provided cash runway through 2024 and maybe into H1 2025.

However, down rounds are increasing in frequency and companies are increasingly implementing investor friendly provisions.

Deal activity in terms of $ value remains at multi-year lows. However, venture capital fundraising has remained strong, and firms are sitting on over $300bln of dry powder.

Public market valuations for VC-backed companies have modestly improved since trough levels seen in mid-2022 but remain well lower than peak levels.

The performance of recent VC-backed IPOs has been lackluster and has trailed broader markets.

As such, VC firms are likely to continue holding better performing companies for longer and waiting until public market valuations for fast-growth companies improve further.

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CAPITAL MARKETS REVIEW

Actionable Investment Opportunities

Mid-term US government debt

We favor adding duration to fixed income holdings as US Treasury yields are 4.6% to 4.7% for bonds with maturities of 5-to-10 years. Adding duration increases the chances of meaningful bond price appreciation should 10-year Treasury yields decline by 100bps+ either due to subsiding inflation or if recessionary conditions emerge.

Private Equity

Secondary volume remains strong both for LP-led transactions and for GP-led deals.

Given low exit activity and nearing maturity walls for several PE fund vintages from 2007-2011, we expect LP-led secondary volume to increase. We also expect GP-led continuation vehicles to increase with transactions involving high-quality assets.

Growth equity is becoming increasingly attractive as a subset of private equity.

Valuations are more reasonable relative to frothy conditions in 2021 / H1 2022.

Additionally, companies are achieving a better mix of revenue growth and profitability in terms of key metrics. In prior years, companies were far too focused on revenue growth at any cost.

Private Credit (offering potential returns from low double-digits to mid-to-high teens).

Senior direct lending strategies are offering asset-level gross yields of 11%-12% with lower leverage levels and better covenants.

The opportunity set is especially interesting for middle-market borrowers as regional banks are pulling back on lending and private credit can increasingly capture share. However, spreads have tightened meaningfully on larger deals as investment banks have re-entered the market for large leveraged loans.

The demand for flexible junior capital – provision of flexible payment structures (mix of cash and PIK interest) is also increasing and offers asset-level mid-teens IRRs. Additionally, these capital solutions can demand stronger protections in terms of financial and maintenance covenants.

Asset-backed credit solutions are seeing increased demand as companies seeking liquidity are pledging high-quality sources of collateral such as receivables, inventory, and certain fixed assets.

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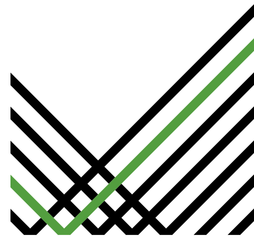

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