

Global Economic & Investment Environment and Strategy

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Edina, Minnesota

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GLOBAL ECONOMIC & INVESTMENT ENVIRONMENT

I. Global and U.S. economies have been resilient; however, we expect a mild recession towards the end of 2023.

- Interest rate increases and quantitative tightening are having an impact, but economic slowing and decreasing inflation are taking longer than central bankers would like.
- More impact from earlier central bank actions still to materialize. Historically it takes 12 months for monetary policy actions to impact the economy. Material rate increases started June 2022.
- Fear of a central bank policy mistake leading to a recession is the major concern.
 - Demand destruction is occurring, but inflation is still staying too high so more accommodative monetary policy is not likely in the immediate term.
 - Interest rates likely peaked but could stay higher for longer.
- Two bank failures and a nervous banking system will further stifle growth.
- Anticipate a shallow recession in the U.S. in late 2023 with a return to growth in late 2024.

II. Markets are likely to be volatile throughout the rest of 2023 and improve in 2024.

- Investor focus is on the health of the economy and future path of interest rates.
- The market continues to wrestle with one of three anticipated scenarios:
 - Nirvana outcome - economic growth continues and the pace of inflation moderates back towards 2%, allowing the central banks to cut rates (estimate 5% likelihood).
 - A mild slowdown/recession - caused by a central bank policy mistake, forcing the central banks to cut rates, leading to an economic rebound (estimate 85% likelihood).
 - A severe recession - caused by a central bank policy mistake, forcing the central banks to meaningfully cut rates, eventually leading to a new economic cycle (estimate 10% likelihood).
- The difficulty and inability in the near term to determine the strength and timing of global economic conditions, and in turn corporate business activities, are resulting in ongoing market volatility; “risk off” and “risk on” days.
- Should have more clarity on economic conditions and interest rate path by late 2023. This clarity should calm the markets.

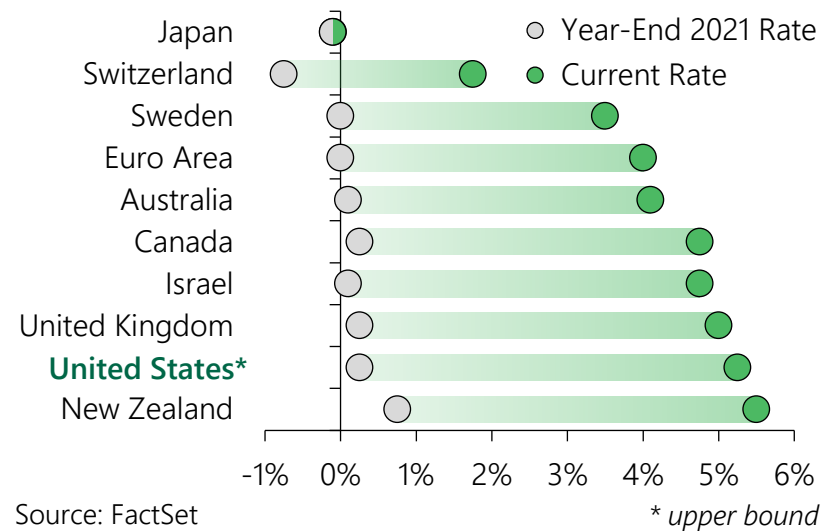
GLOBAL ECONOMIC & INVESTMENT ENVIRONMENT

III. The markets are anticipating a lot of negative news/uncertainty and are looking past 2023 into 2024.

- Recession is the consensus view – waiting for one of the most anticipated global economic recessions in history.
- The market is an anticipatory (or discounting) mechanism and is now focused on conditions in 2024. With our expected return to growth in 2024, the stock market returns should improve and broaden.
- Equity market valuations on consensus estimates look reasonable relative to history and expected level of interest rates.
- Material moderating inflation data, slowing economic activity, and dovish central bank monetary policies will be positive market catalysts.

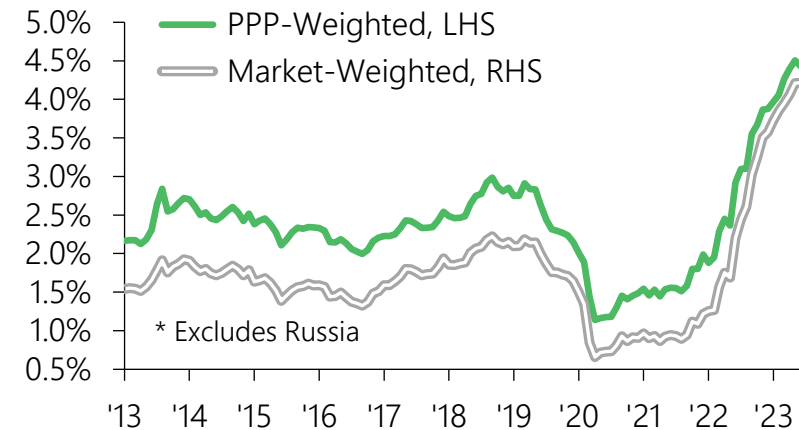
GLOBAL INTEREST RATE INCREASES HAVE BEEN AGGRESSIVE TO REDUCE ECONOMIC ACTIVITY

Policy Rate Changes, Developed Markets



Global Short-Term Interest Rates*

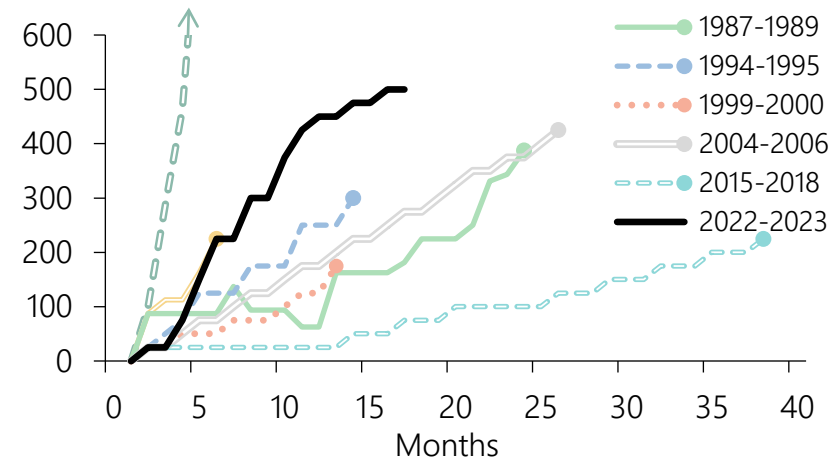
Weighted by Share of World GDP



Source: FactSet

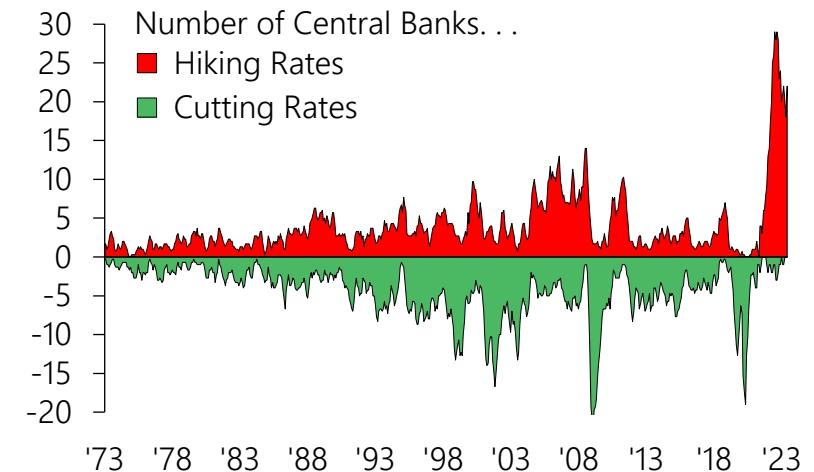
Pace of U.S. Monetary Tightening Cycles

Increase in Fed Funds Rate, Basis Points



Source: Federal Reserve, CME Group

Global Central Bank Policy Rate Cycles

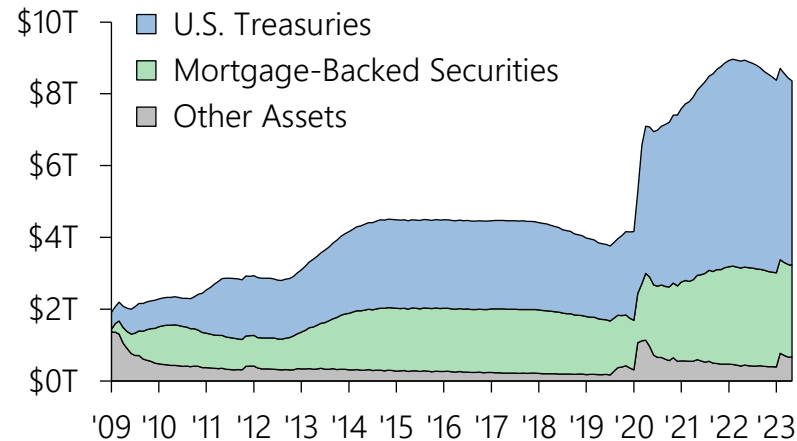


Source: World Bank, Bank for International Settlements

QUANTITATIVE TIGHTENING IS FURTHER TRYING TO REDUCE ECONOMIC ACTIVITY

U.S. Federal Reserve Assets

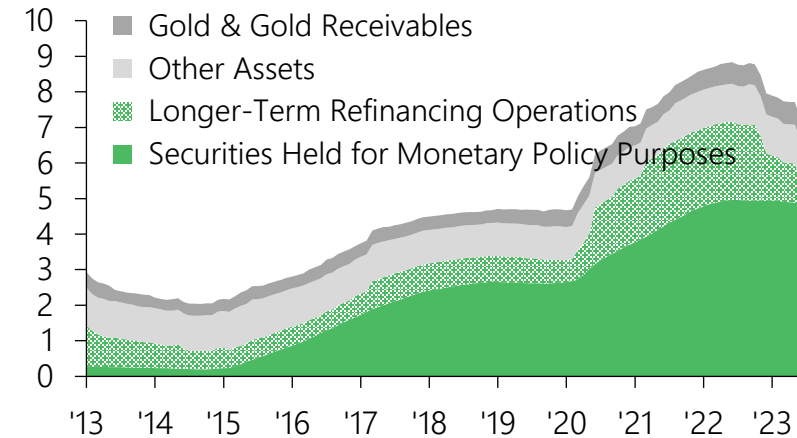
\$ Trillion



Source: Federal Reserve

European Central Bank Assets

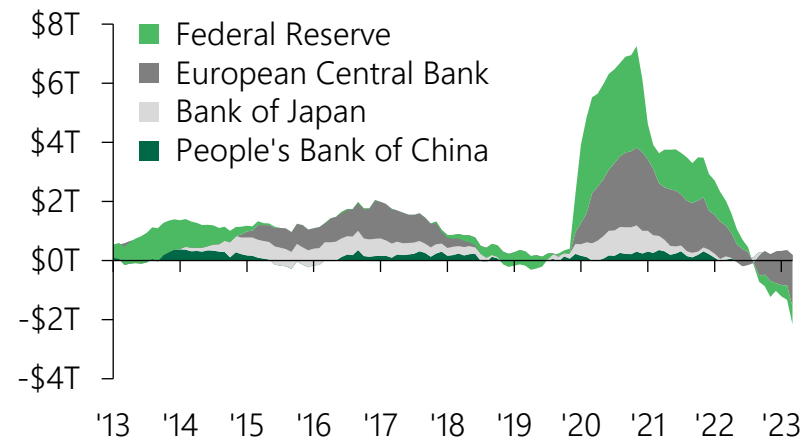
Euro, Trillion



Source: European Central Bank

Assets of Four Largest Central Banks

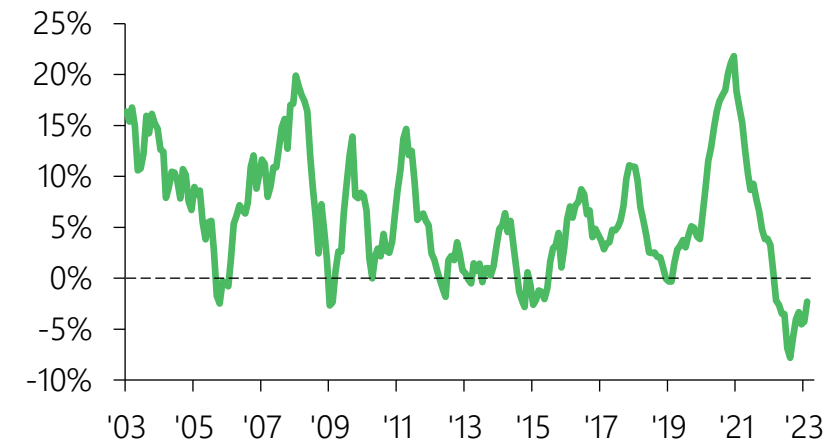
Trillions, in U.S. Dollars, 12-Month Change



Source: PBoC, BoJ, ECB, Federal Reserve

Developed Countries' Money Supply, M2

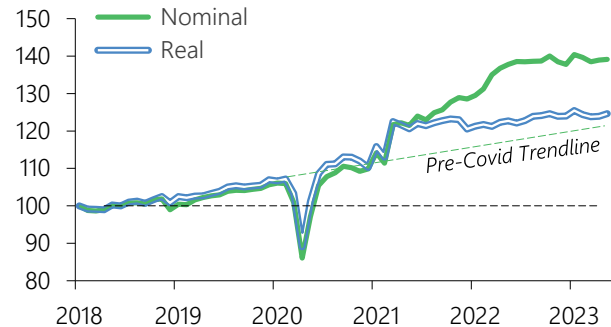
Y/Y Percent



Source: FactSet

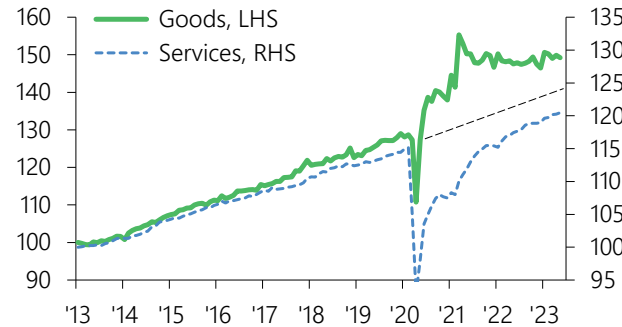
CONSUMER DATA AND HOUSING SHOWING SLOWDOWN

U.S. Retail & Food Services Sales, ex. Autos
Seasonally-Adjusted, January 2018 = 100



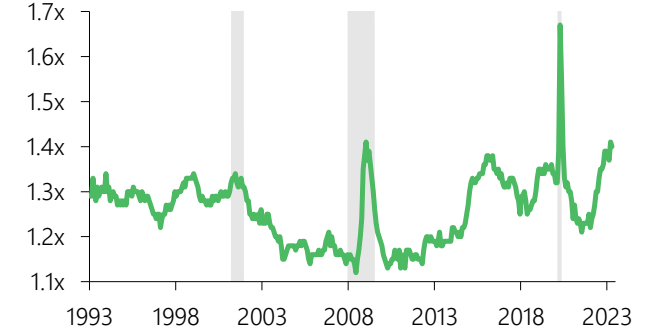
Source: U.S. Census, Bureau of Economic Analysis

U.S. Real Personal Consumption Expenditures
Indexed, 12/31/12 = 100



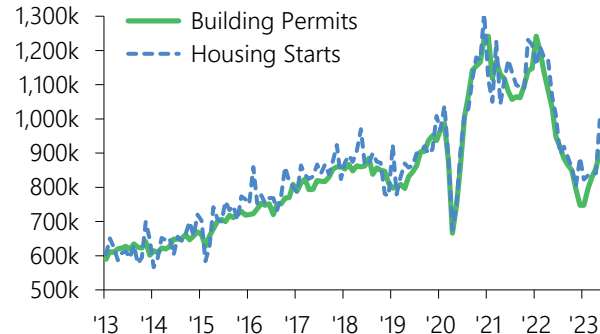
Source: Bureau of Economic Analysis

U.S. Wholesale Trade Inventory-to-Sales Ratio
Seasonally-Adjusted



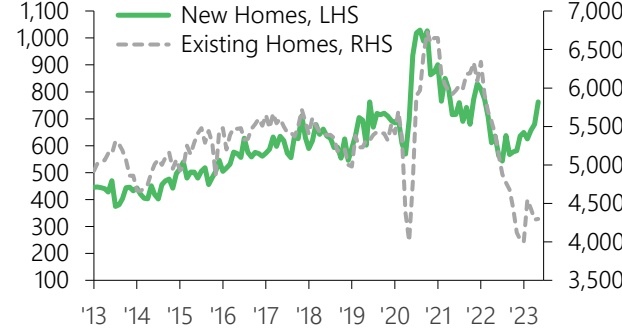
Source: U.S. Census Bureau

U.S. Single-Family Building Permits and Housing Starts
Seasonally-Adjusted Annualized Rate, Thousands



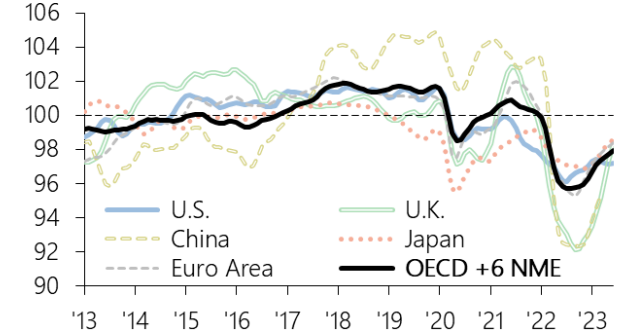
Source: U.S. Census Bureau

U.S. Home Sales
Seasonally-Adjusted Annualized Rate, Thousands



Source: U.S. Census Bureau, National Association of Realtors

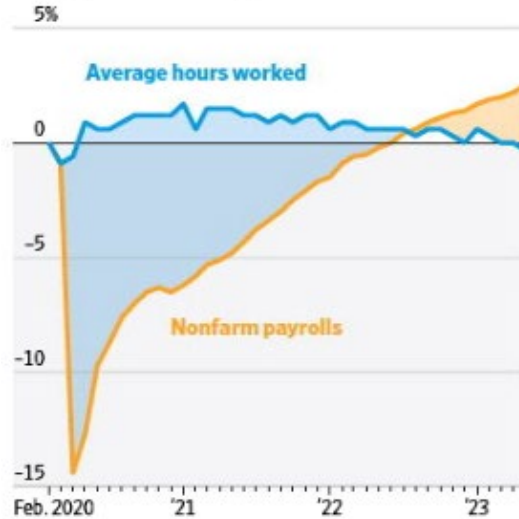
Consumer Confidence
Normal = 100, Seasonally-Adjusted



Source: OECD

U.S. AVERAGE HOURS WORKED STARTING TO DECLINE

Average weekly hours vs. employment, change from February 2020

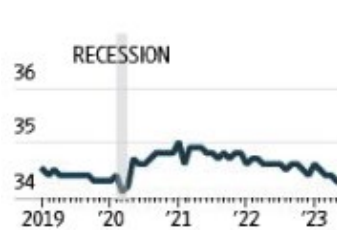


Average weekly hours worked by nonagricultural workers

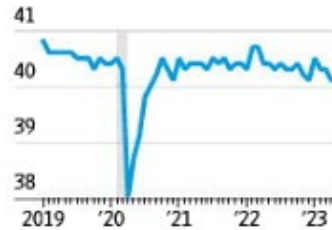


Average weekly hours worked

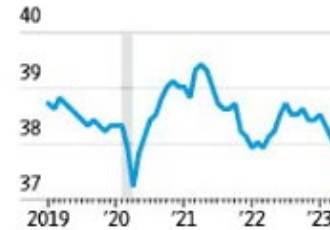
PRIVATE SECTOR



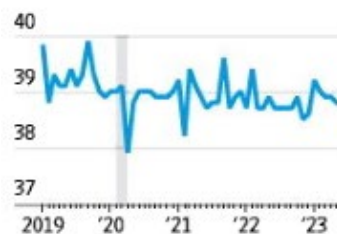
MANUFACTURING



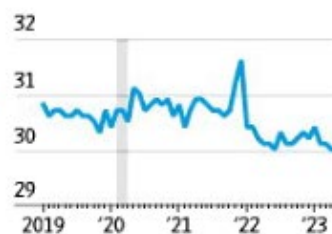
TRANSPORTATION AND WAREHOUSING



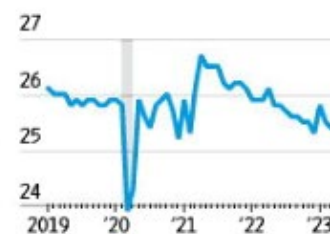
CONSTRUCTION



RETAIL



LEISURE AND HOSPITALITY

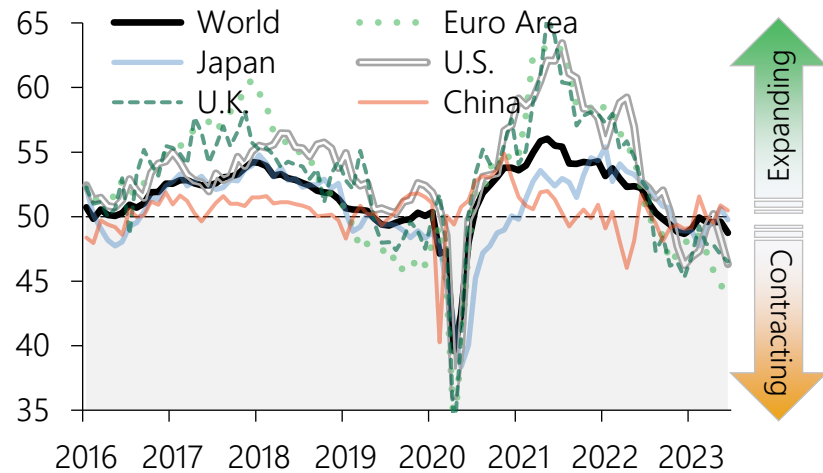


Note: Seasonally adjusted

Source: Labor Department

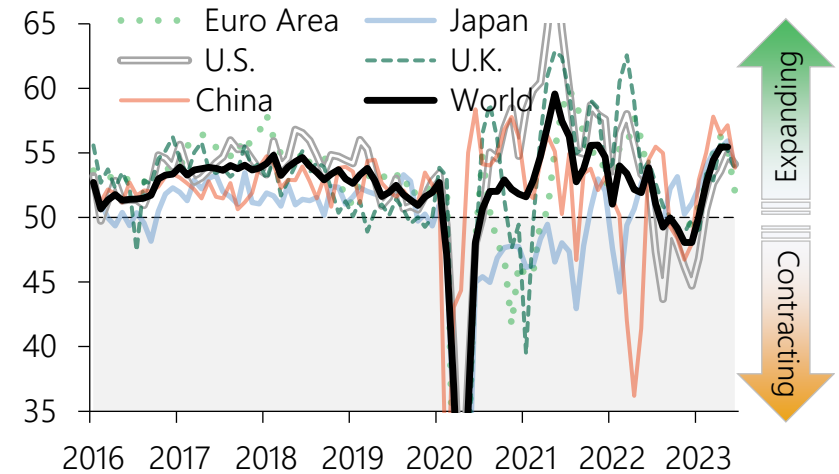
PURCHASING MANAGER'S INDEX SHOWS SLOWING ACTIVITY

Manufacturing Purchasing Managers' Indices



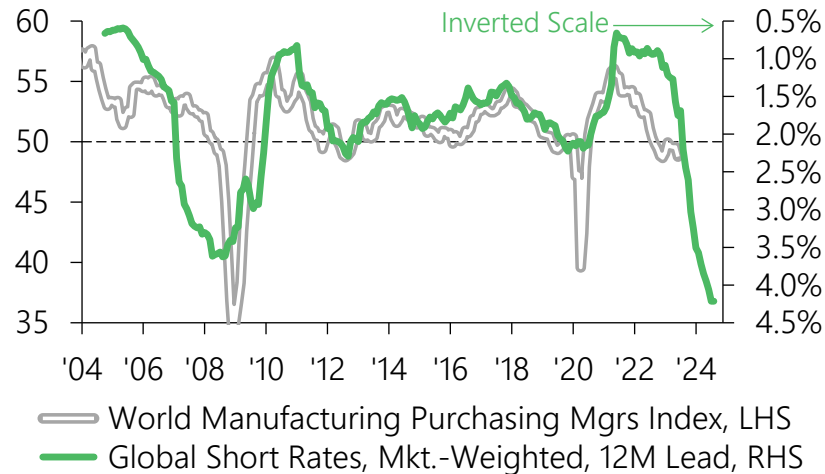
Source: S&P Global

Services Purchasing Managers' Indices



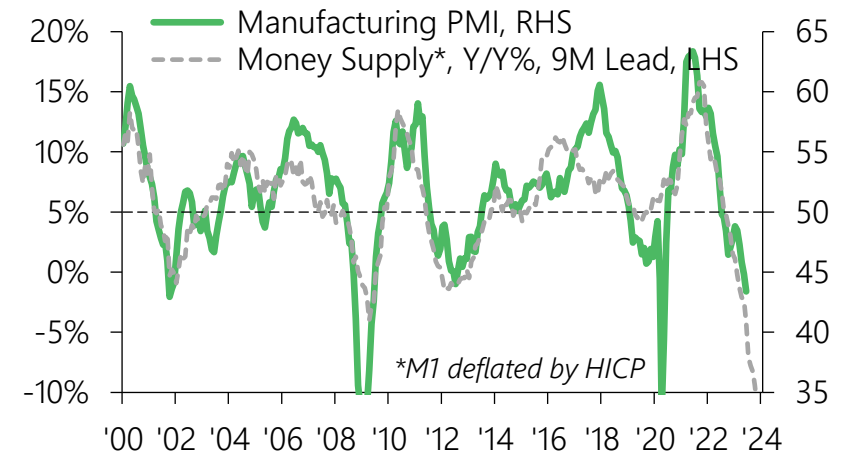
Source: S&P Global

Global Short-Term Interest Rates vs Manufacturing PMI



Source: S&P Global, FactSet

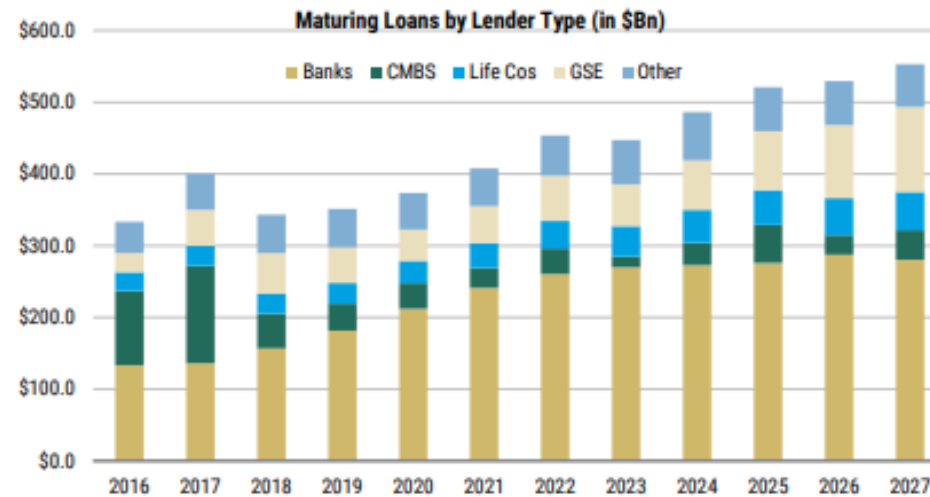
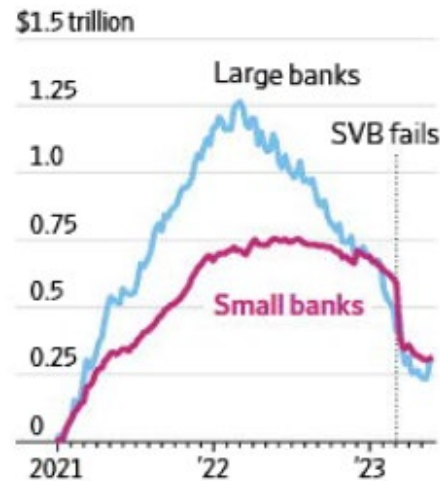
Purchasing Managers' Index vs Money Supply Growth Euro Area



Source: European Central Bank, S&P Global

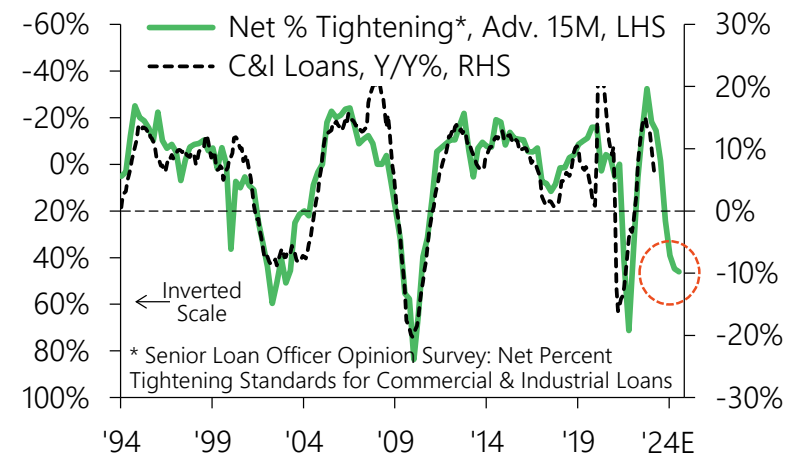
COMMERCIAL REAL ESTATE PRESSURES PRESENT CHALLENGE FOR BANKS AND U.S. ECONOMY

Change in U.S. bank deposits since January 2021, weekly*



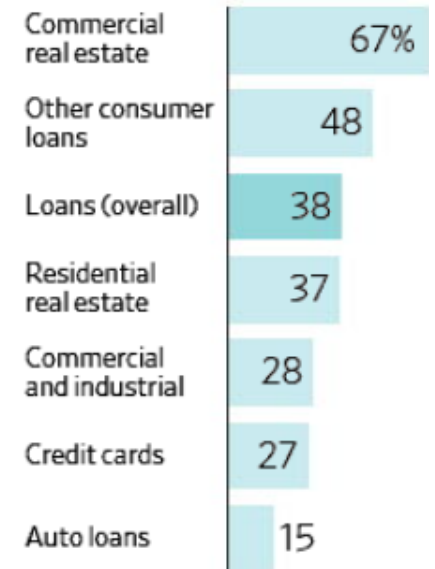
Source: Trepp, Morgan Stanley Research

U.S. C&I Credit Standards vs. Loan Growth



Source: Federal Reserve

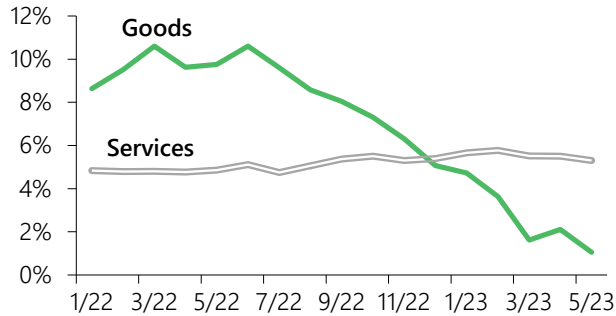
Small and medium-sized banks' share of all outstanding loans, by type



Note: Small and medium-sized banks are domestically chartered banks that are smaller than the top 25 U.S. lenders
Source: Federal Reserve

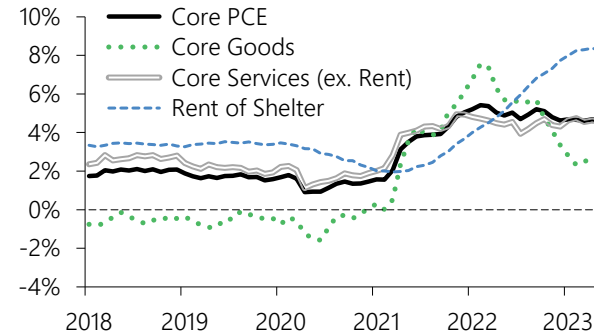
FED'S FAVORITE INFLATION GAUGES SLOWING BUT NOT FAST ENOUGH?

U.S. PCE Price Index
Change from a Year Earlier



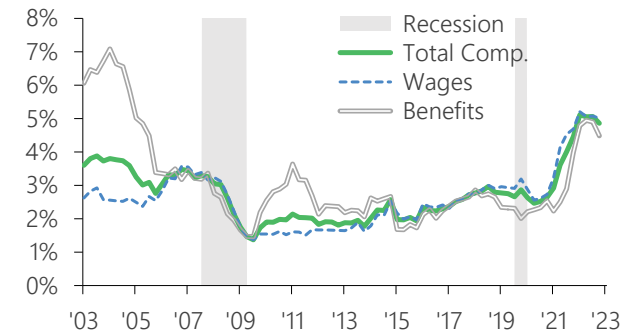
Source: Bureau of Economic Analysis

U.S. Core PCE Price Index
Y/Y Percent



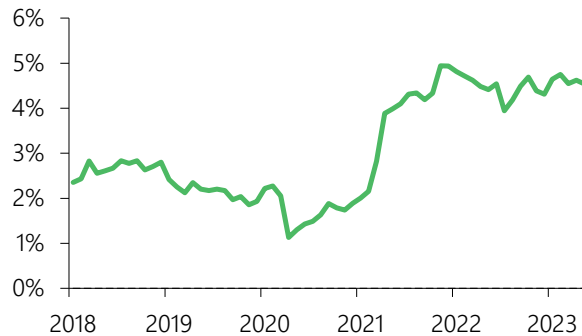
Source: Bureau of Economic Analysis

U.S. Employment Cost Index
Y/Y Percent



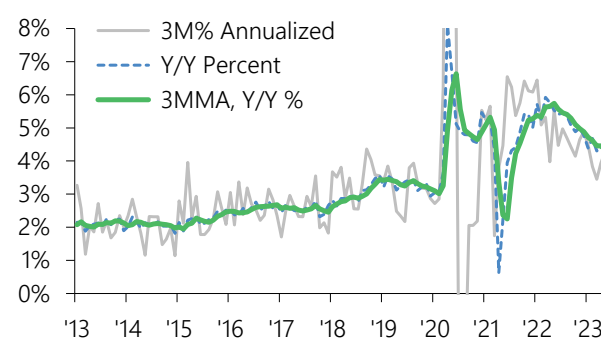
Source: Department of Labor

U.S. Core PCE Services Inflation, ex. Housing
Y/Y Percent



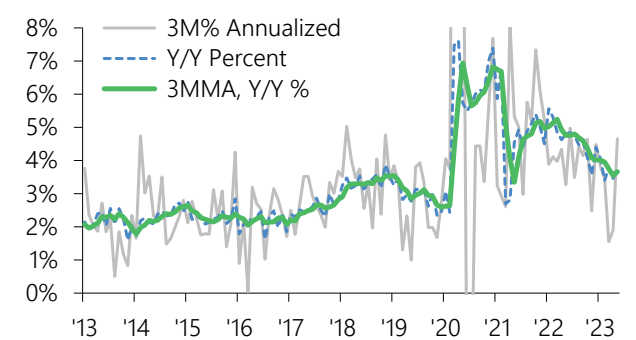
Source: Bureau of Economic Analysis

U.S. Average Hourly Earnings
All Employees, Total Private, Nominal, NSA



Source: U.S. Department of Labor

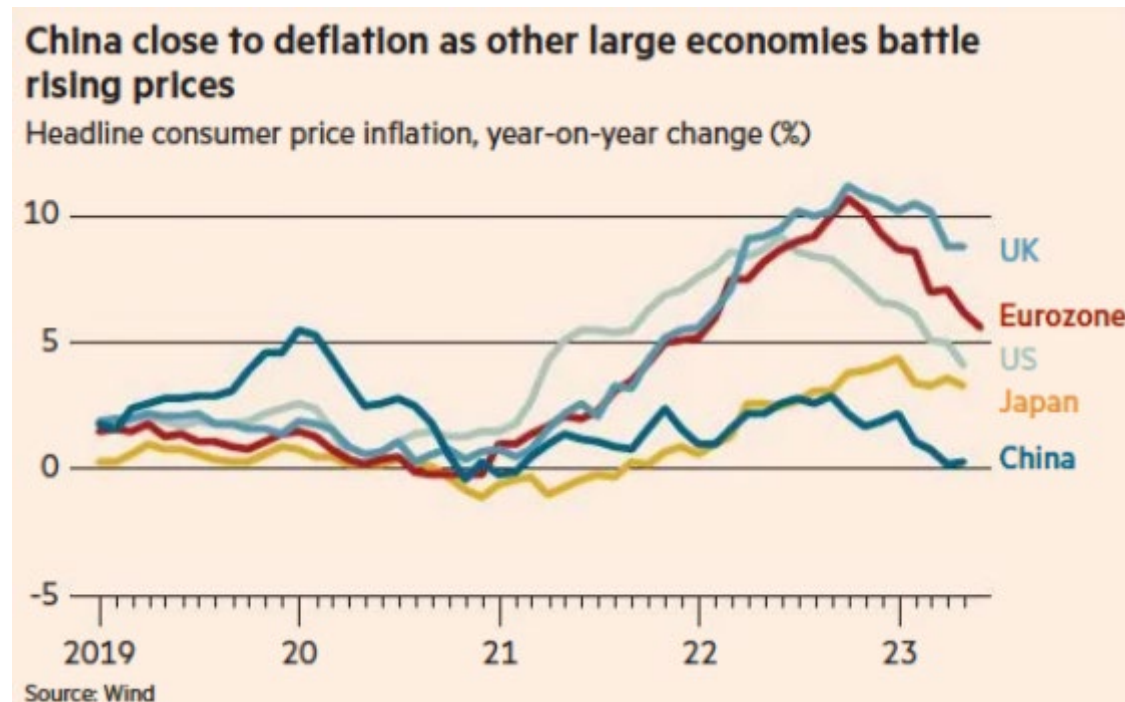
U.S. Average Weekly Earnings
All Employees, Total Private, Nominal, NSA



Source: U.S. Department of Labor

Source: Bureau of Economic Analysis 7/5/23, U.S. Department of Labor 7/5/23

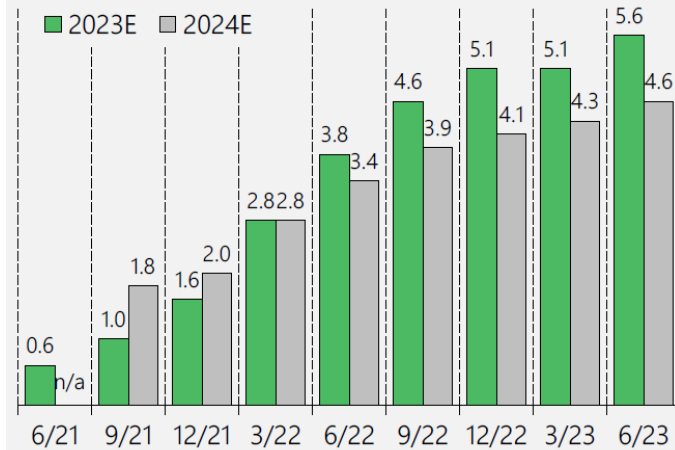
INFLATION TOO HIGH GLOBALLY EXCEPT CHINA



AGGRESSIVE RATE INCREASES CLOSE TO DONE?

Fed Keeps Upping the Ante but Close to Done

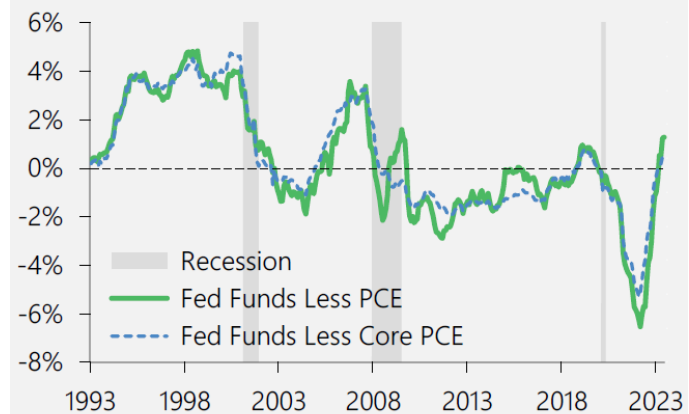
FOMC Median Fed Funds Rate Projections, Percent



Source: Federal Reserve

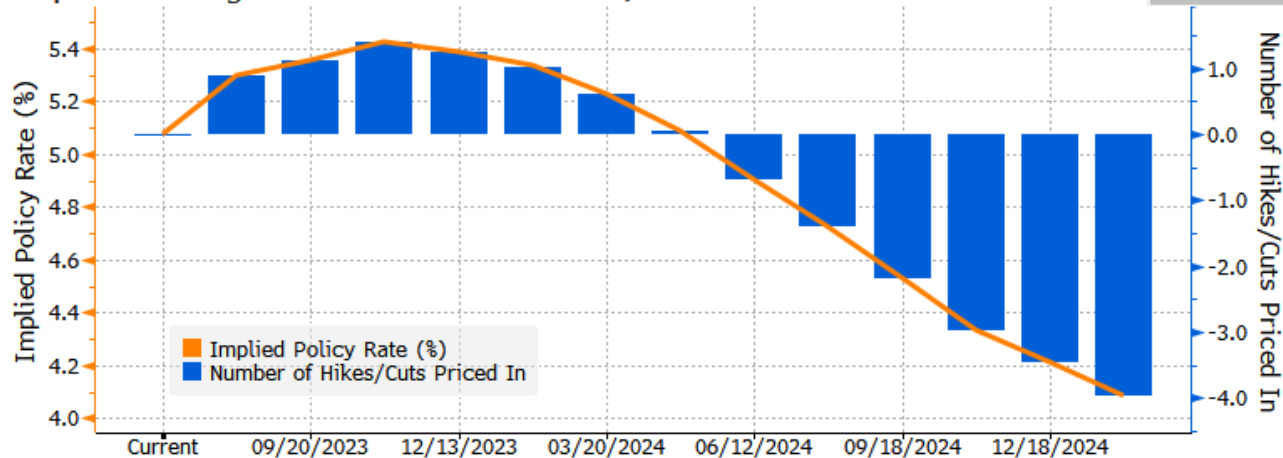
Real Fed Funds Rate Back to Restrictive

Real Fed Funds Rate
Percent



Source: Federal Reserve, Bureau of Economic Analysis, NBER, 6/30/23

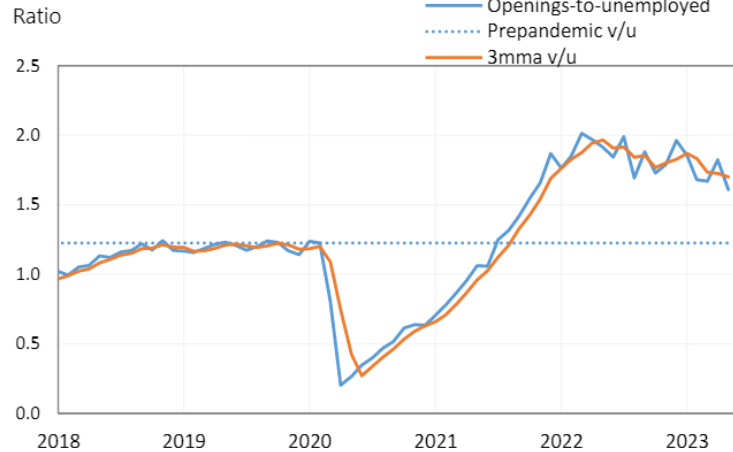
Implied Overnight Rate & Number of Hikes/Cuts



Source: Federal Reserve, Bureau of Economic Analysis, NBER 6/30/23, Bloomberg 7/10/23

LABOR MARKET NORMALIZING SLOWLY

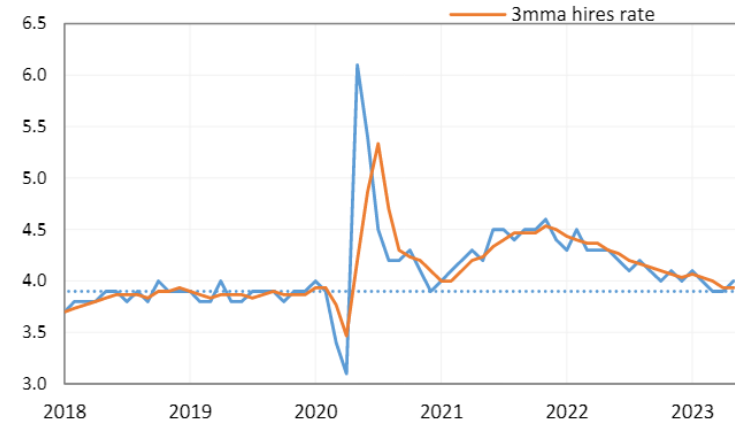
Job Openings-to-Unemployed Ratio



Source: BLS, Evercore ISI

JOLTS Hires Rate

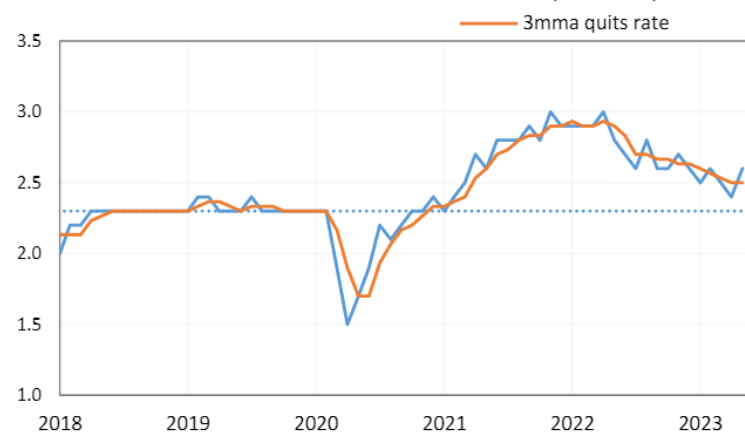
Percent, SA



Source: BLS, Evercore ISI

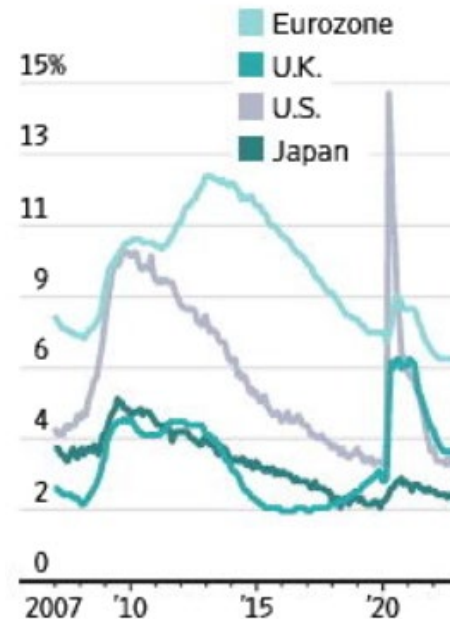
Quits Rate

Percent



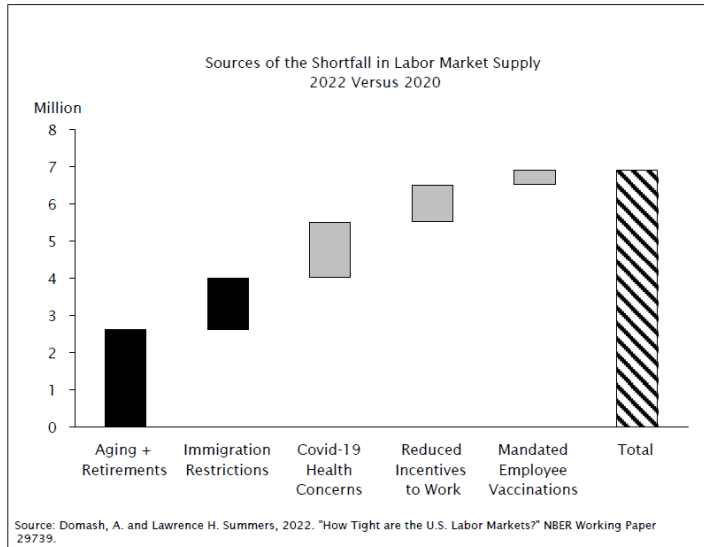
Source: BLS, Evercore ISI

Unemployment rates in select countries

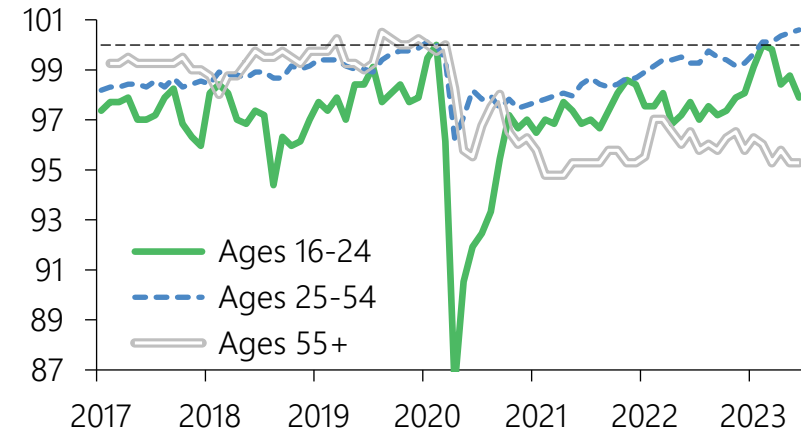


Source: Evercore ISI 7/7/23

U.S. LABOR MARKET IS TIGHT, EXACERBATED BY RETIREMENTS & COVID

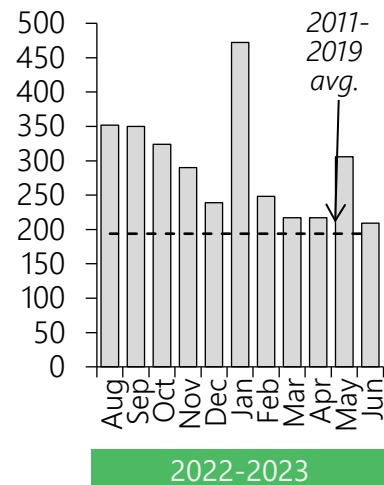


U.S. Civilian Labor Force Participation Rate
By Age Group, Seasonally-Adjusted, 2/28/20 = 100

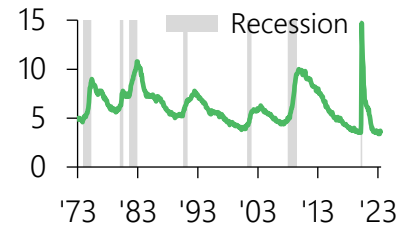


Source: Bureau of Labor Statistics

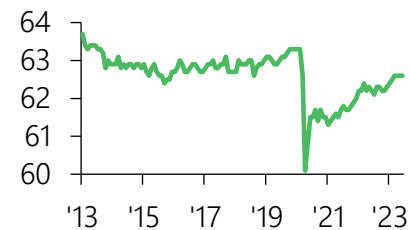
U.S. Nonfarm Payrolls
Monthly Change, 000



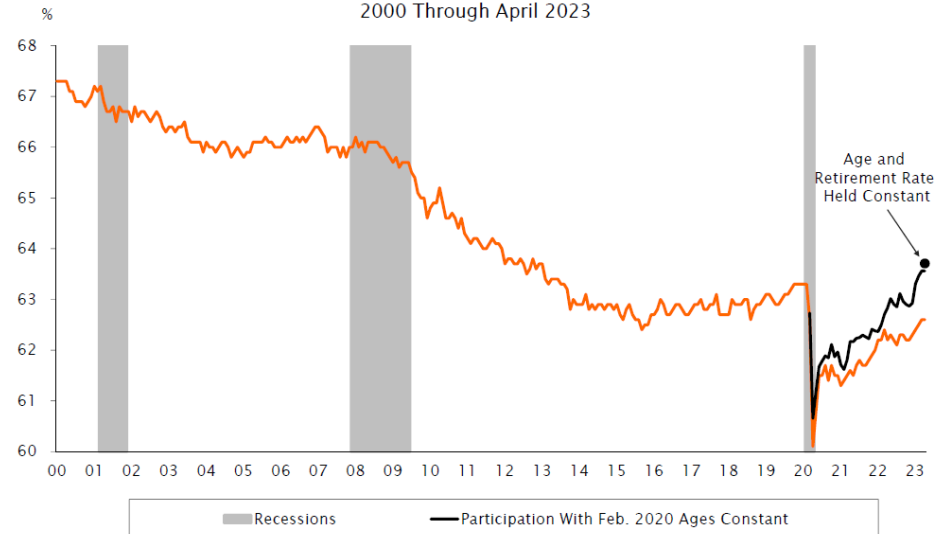
Unemployment Rate (%)



Labor Participation Rate (%)

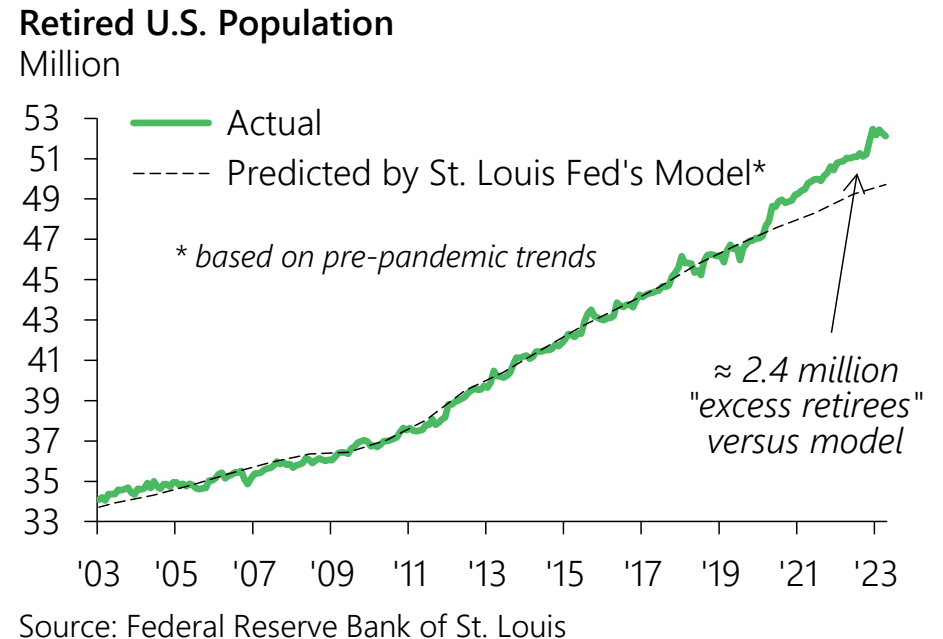
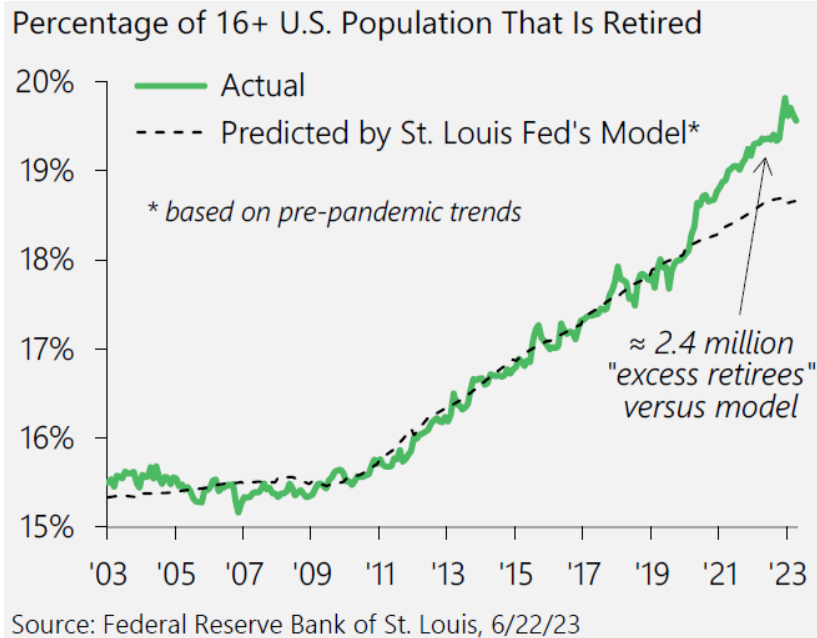


The U.S.
Labor Force Participation Rate
2000 Through April 2023



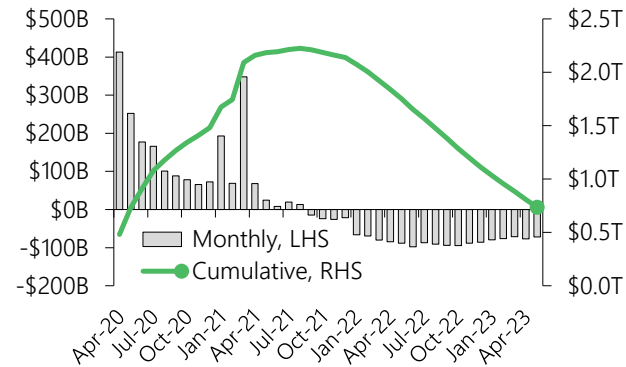
Source: Empirical Research Partners 5/25/22, Department of Labor 7/5/23, Empirical Research Partners 5/19/23

WILL RETIREES COME BACK TO THE LABOR FORCE?



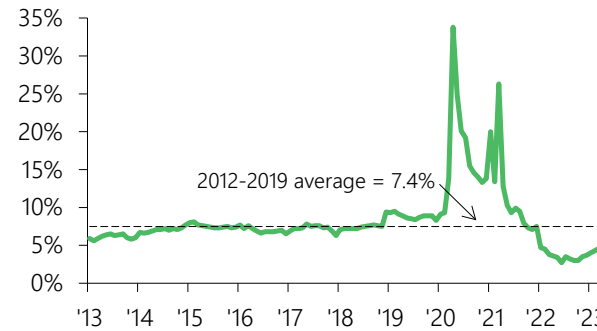
EXCESS SAVINGS REDUCED

U.S. Personal "Excess" Savings



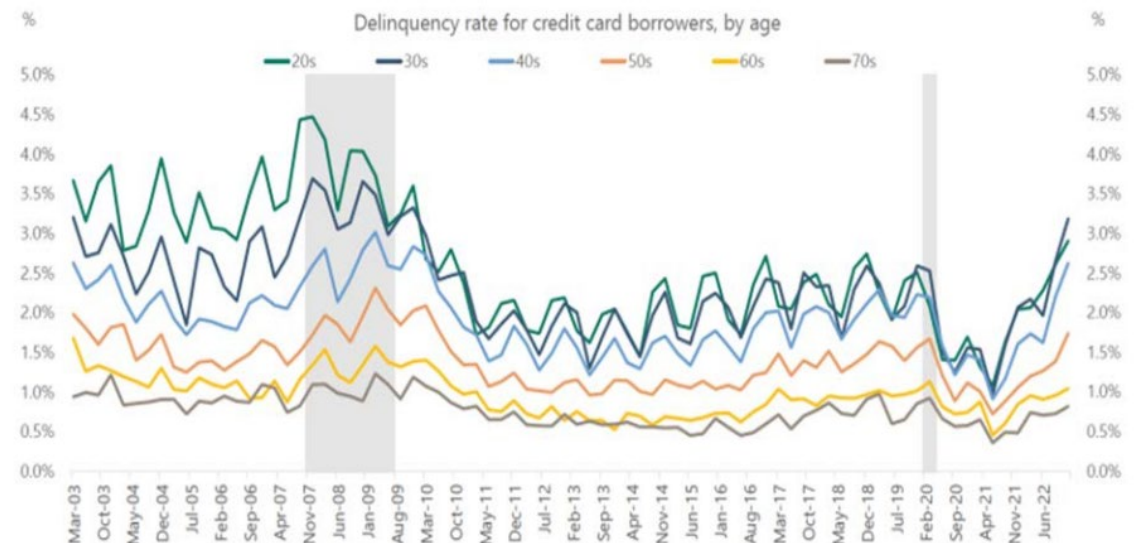
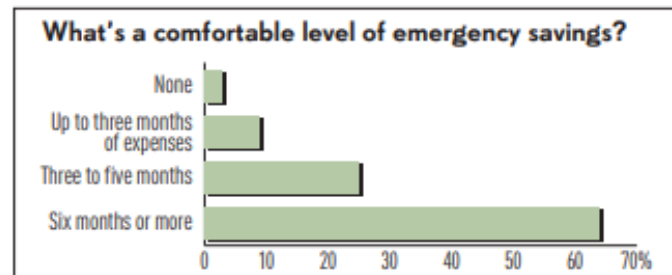
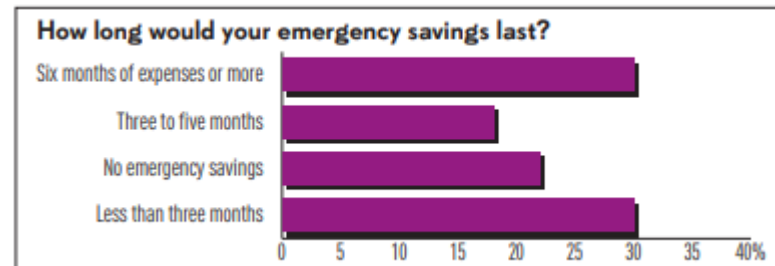
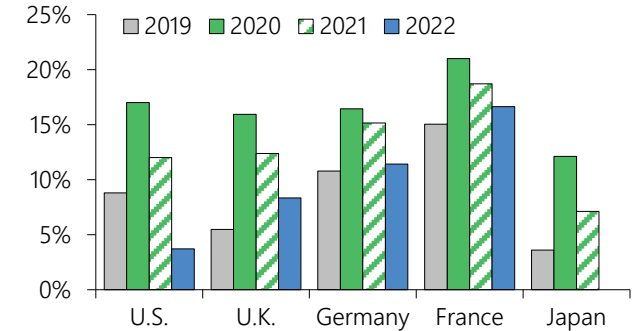
U.S. Personal Savings Rate

Savings as a Percent of Disposable Income



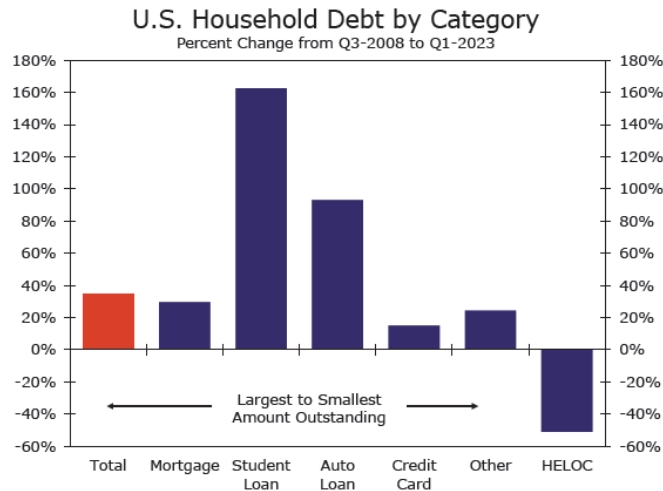
Household Savings Rates

Percent of Disposable Income

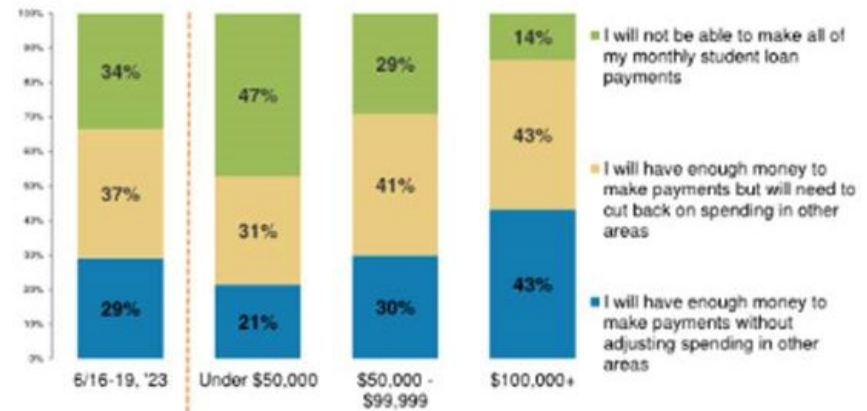


Source: Bureau of Economic Analysis 7/5/23, FactSet & National Sources 4/30/23, Bankrate Poll May 19-22, Morgan Stanley 6/26/23

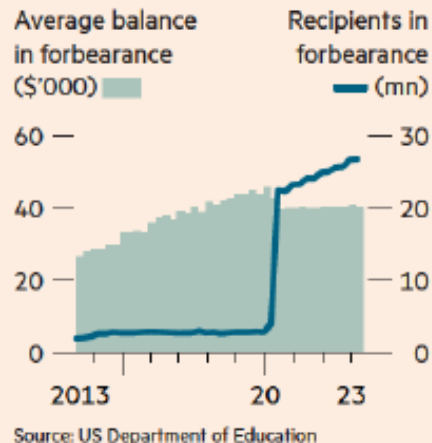
DEBT A GROWING CONCERN FOR THE CONSUMER



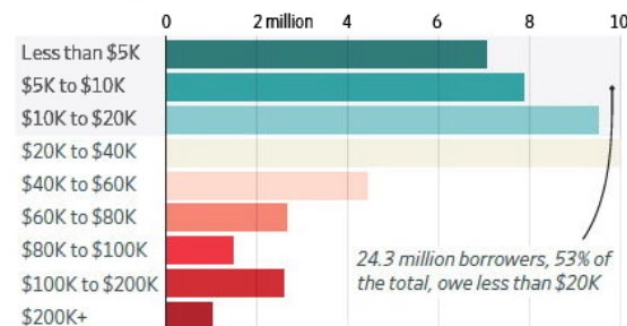
Impact of Federal Student Loan Payment Freeze Ending, by HH Income (Among Federal Student Loan Holders)



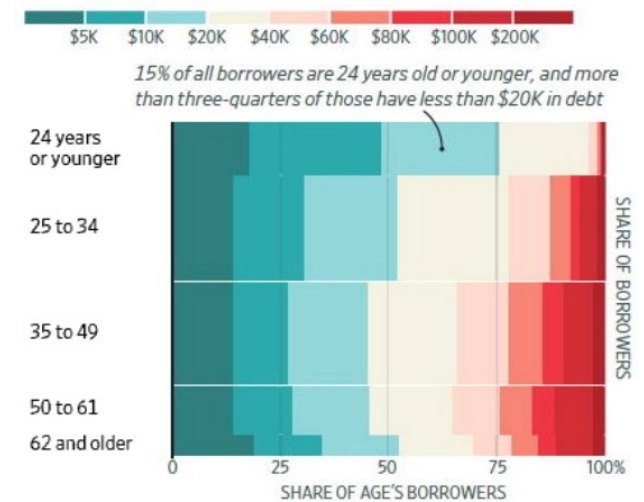
Nearly 27mn Americans have federal student loans in forbearance



Borrowers by total loan amount



Borrowers by age and debt size

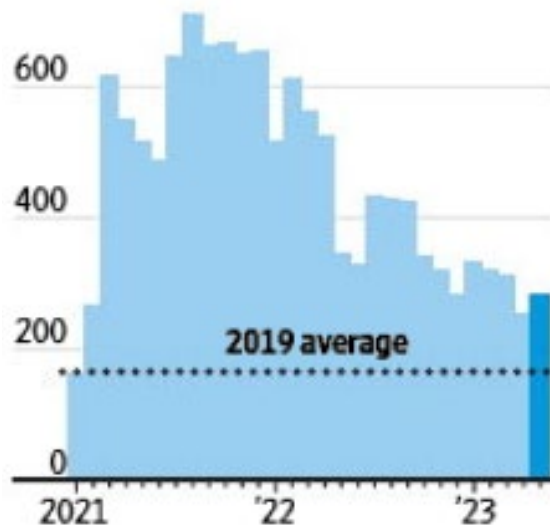


Note: Federal student-loan borrowers
Source: Education Department

U.S. PAYROLL GROWTH SLOWING

U.S. nonfarm payrolls,
one-month change*

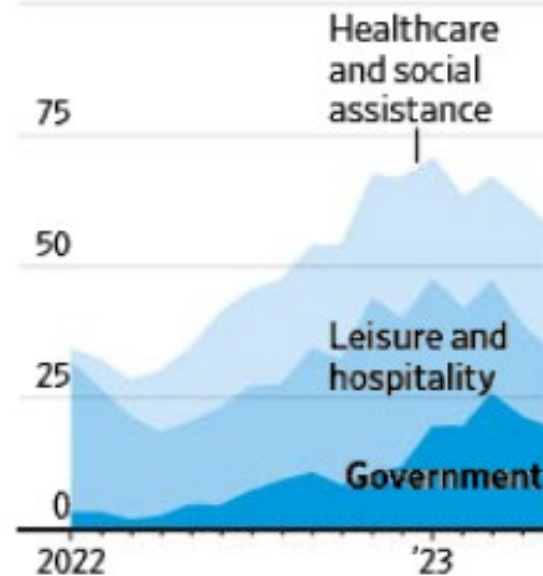
800 thousand



*3-month moving average
Note: Seasonally adjusted

Share of employment
gains* from...

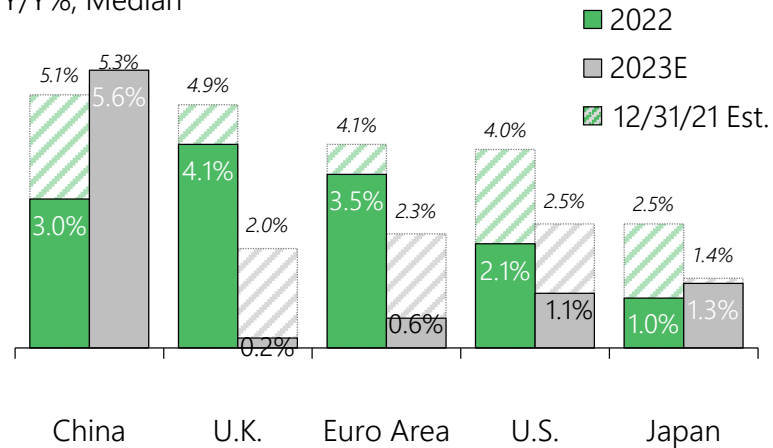
100%



Source: Labor Department

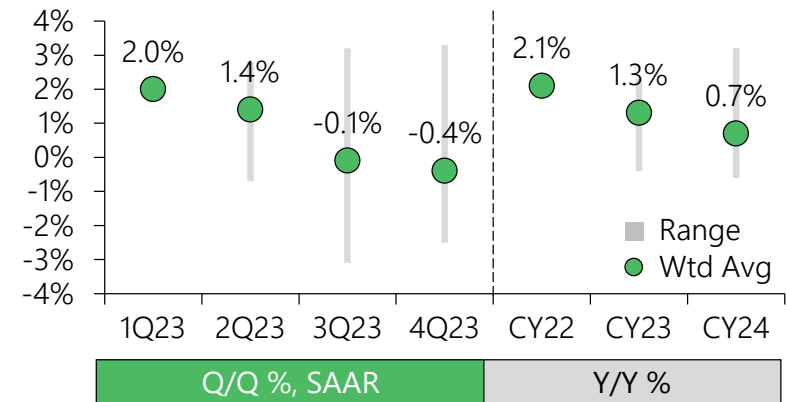
GLOBAL ECONOMIC OUTLOOK

Consensus Real GDP Growth Forecast
Y/Y%, Median



Source: FactSet

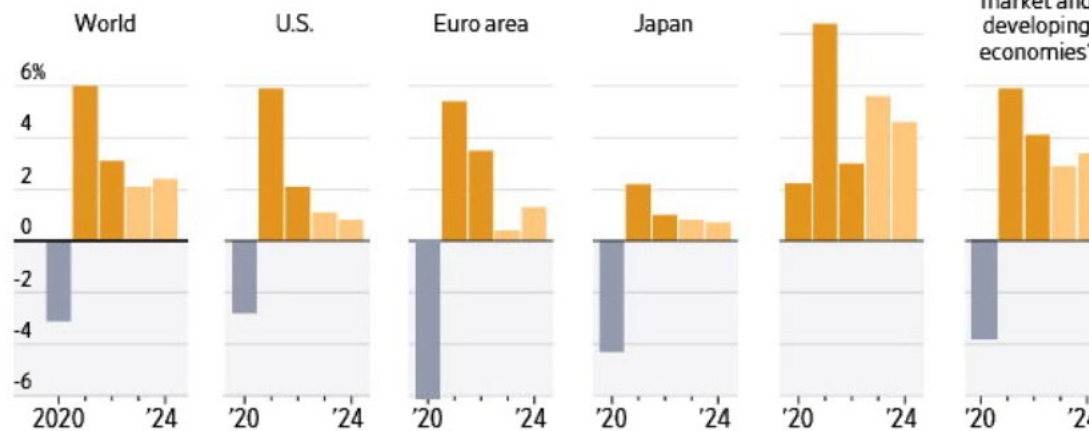
Consensus Real GDP Growth Forecast
United States



Source: Bloomberg

The World Bank estimates that the global economy will grow 2.1% this year, and forecasts growth of 2.4% in 2024.

Change in GDP from a year earlier



*Excluding China

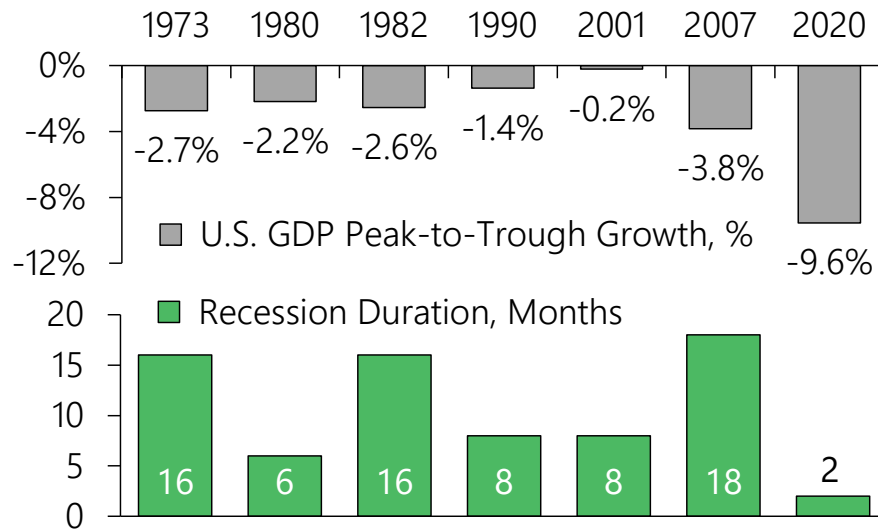
Note: GDP for 2023 are estimates; 2024 are forecasts. Adjusted for inflation, and calculated using GDP weights at average 2010-19 prices and market exchange rates.

Source: World Bank

Source: Factset Research Systems 7/5/23, Bloomberg 7/5/23, Wall Street Journal 6/7/23

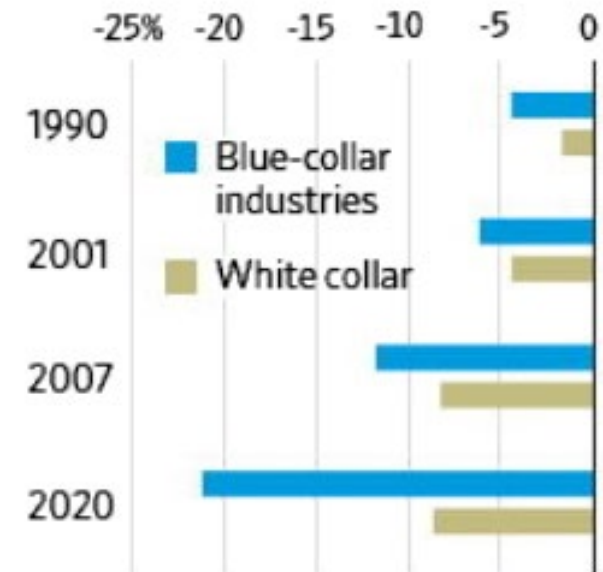
PRIOR U.S. RECESSION COMPARISONS

Peak-to-Trough GDP % & Duration of Prior Recessions



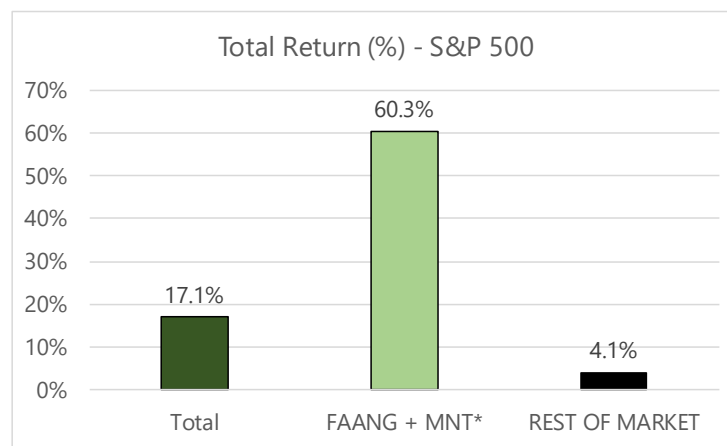
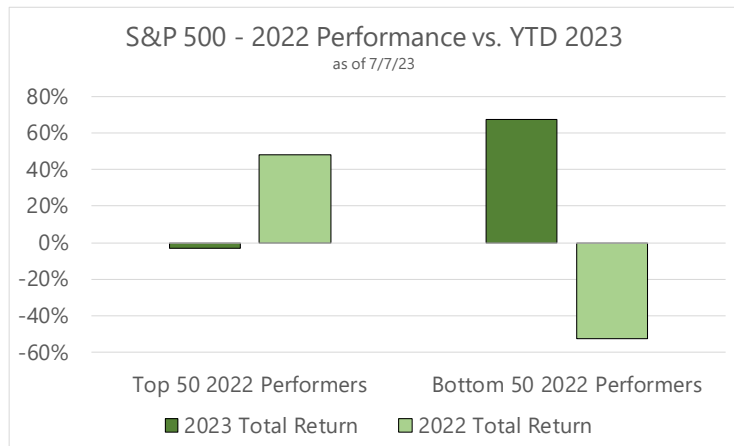
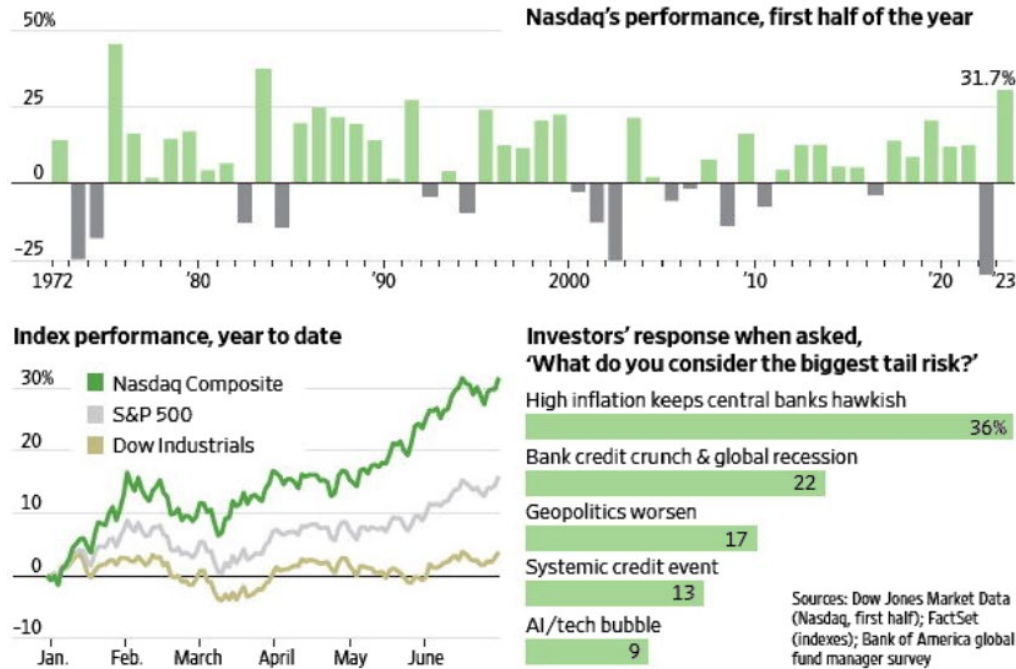
Source: FactSet, NBER

Payrolls, change from peak to trough, by recession*



*Seasonally adjusted. Blue collar includes mining, construction, manufacturing, retail warehousing, and leisure and hospitality. White collar includes information, finance and professional and business services. Source: Labor Department.

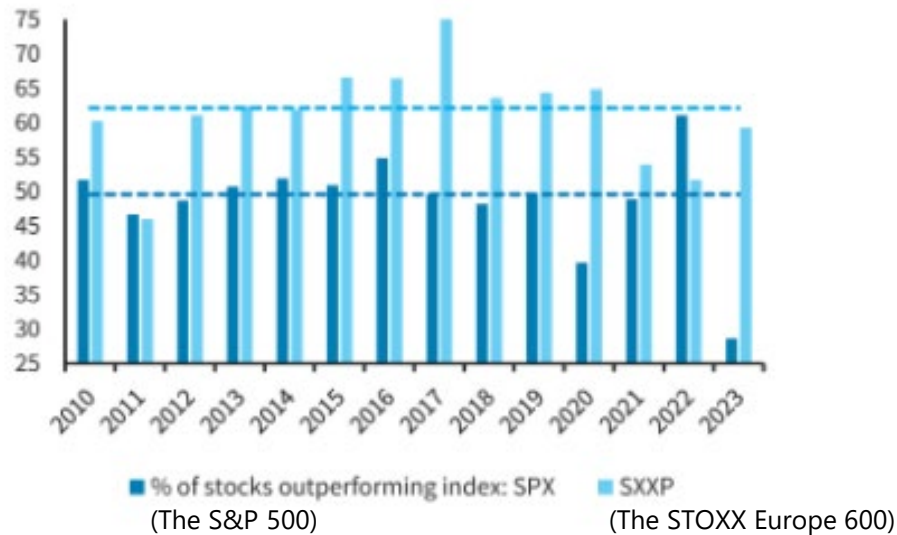
MARKETS DEFY EXPECTATIONS, BUT OUTLOOK REMAINS MURKY



FAANG + MNT contributed 80% of the total S&P 500 Return Year-to-Date

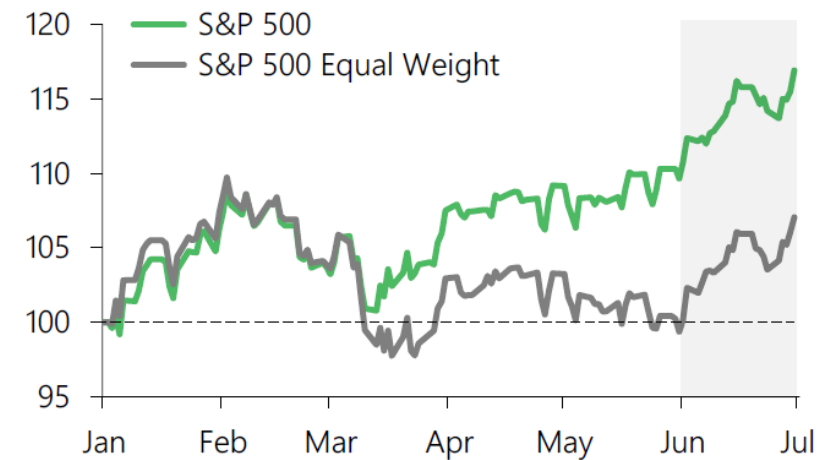
*FAANG + MNT includes: META, AMZN, AAPL, NFLX, GOOG/GOOGL, MSFT, NVDA, and TSLA

U.S. MARKET HAS ALWAYS HAD A NARROW LEADERSHIP, BUT MORE EXTREME THIS YEAR



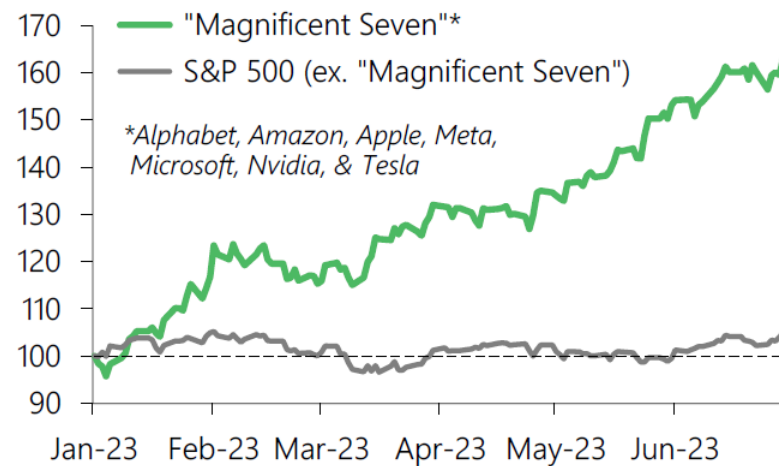
Source: Bloomberg, Barclays Research

Rebased, 12/31/22 = 100

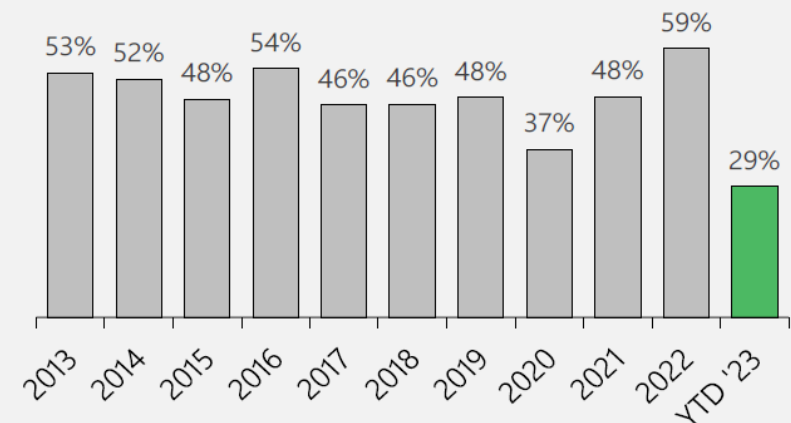


Source: FactSet, 6/30/23

S&P 500 Index Price Returns
12/31/22 = 100



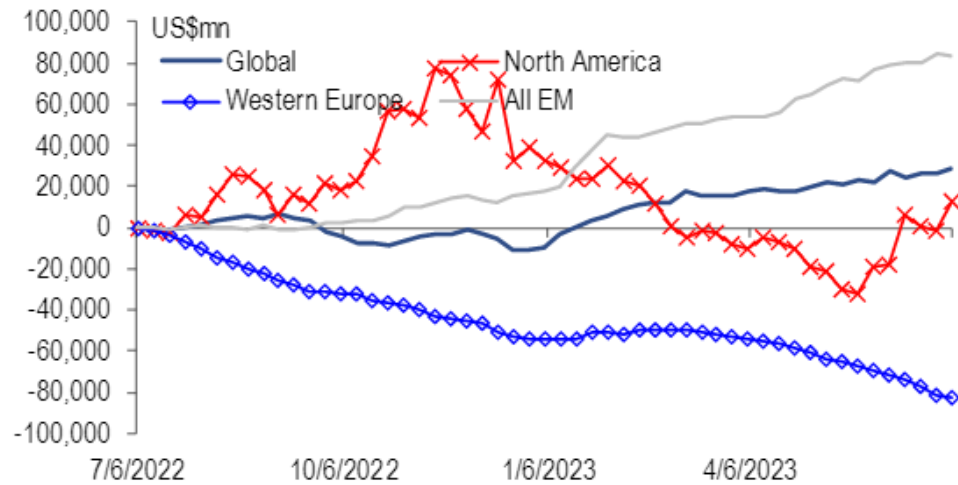
Percentage of S&P 500 Stocks Outperforming Index



Source: FactSet, 6/30/23

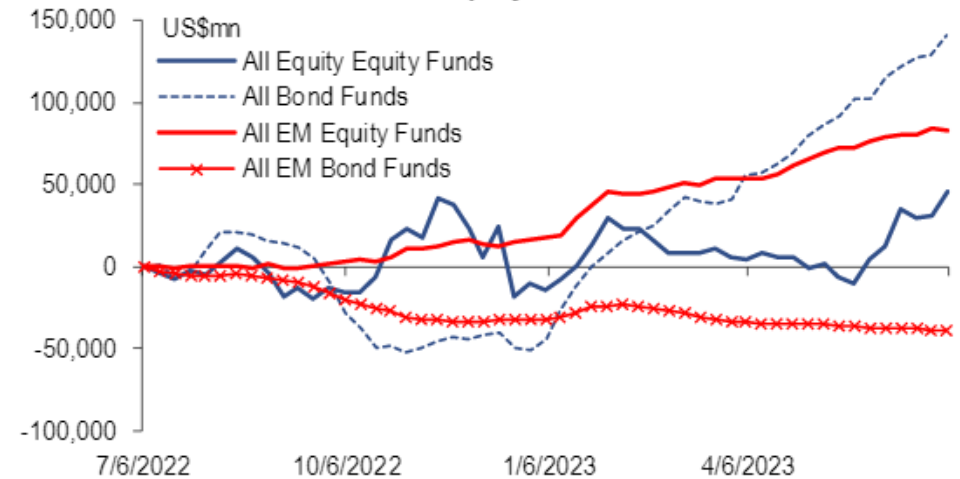
INVESTOR FUND FLOWS

52wk Cumulative Equity Fund Flows



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52wk Cumulative fund flows to equity vs bond fund



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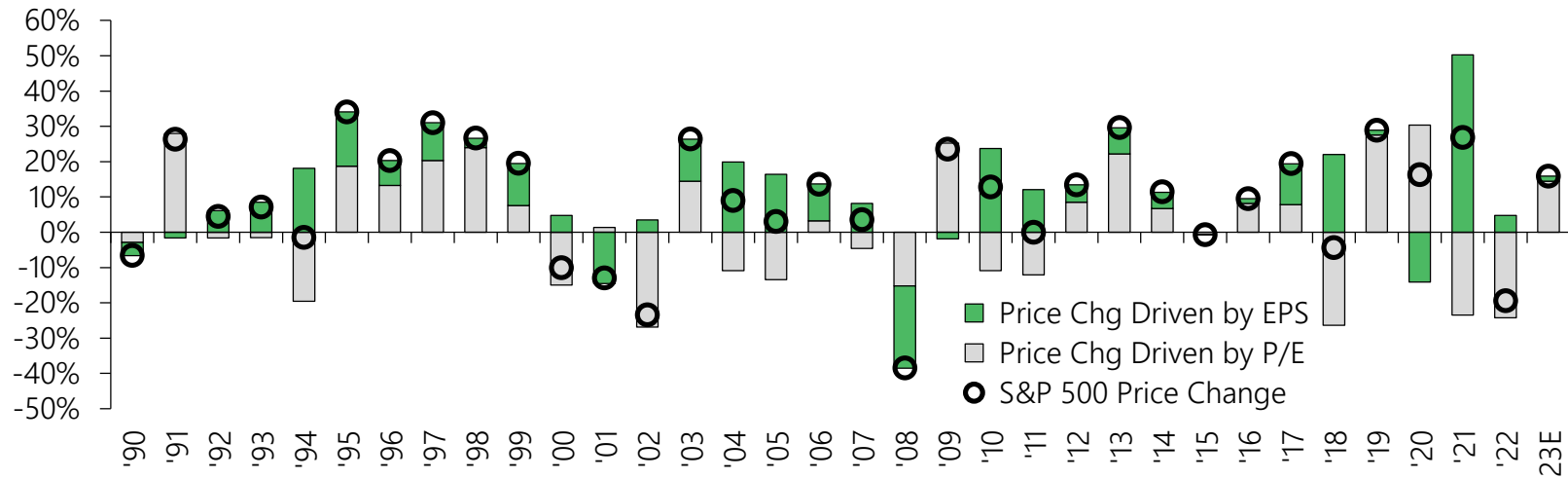
MULTIPLE EXPANSION ACCOUNTED FOR MARKET INCREASE SO FAR IN 2023

Price/Earnings Ratio ✕ Earnings = Price

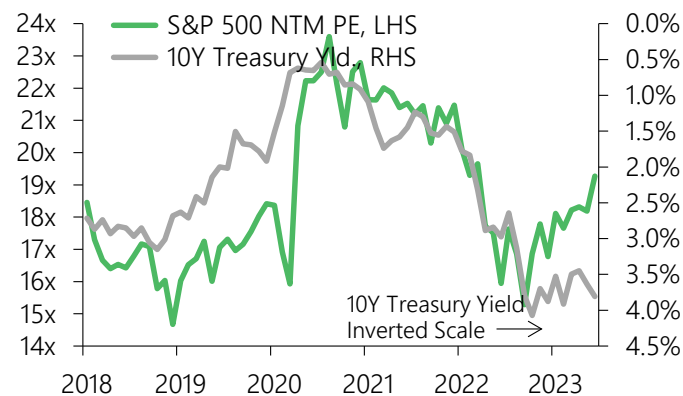
Therefore, for Price to Increase:

- Price/Earnings Ratio Has to Expand and/or
- Earnings Have to Increase

S&P 500 Price Returns, Contribution from EPS and PE



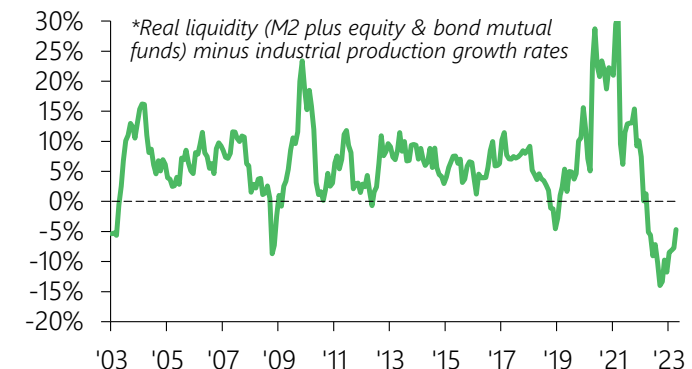
S&P 500 PE Ratio vs U.S. Treasury Yield



Source: FactSet

U.S. Excess Liquidity*

Y/Y Percent

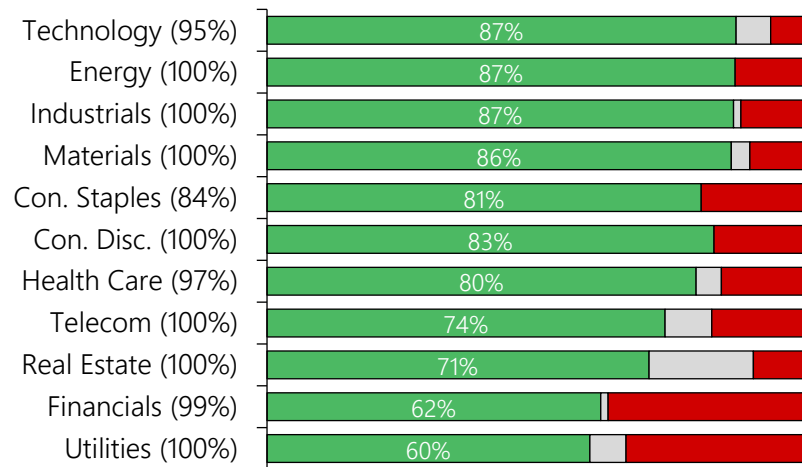


Source: Federal Reserve, Investment Company Institute

Source: FactSet 7/5/23, U.S. Federal Reserve, Investment Company Institute 7/5/23

S&P 500 CONSENSUS EPS TRENDING LOWER, BUT OK

1Q 2023 EPS Results, by S&P 500 Sector (% Reported)

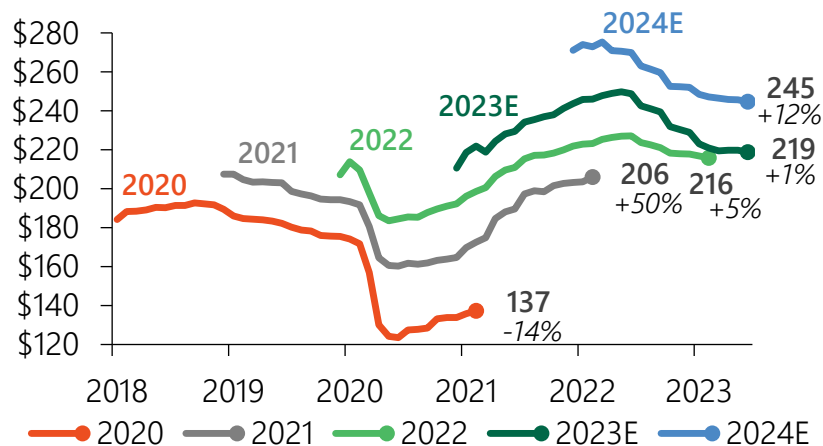


Source: FactSet

■ Beat ■ In Line ■ Miss

S&P 500 Consensus EPS Estimates

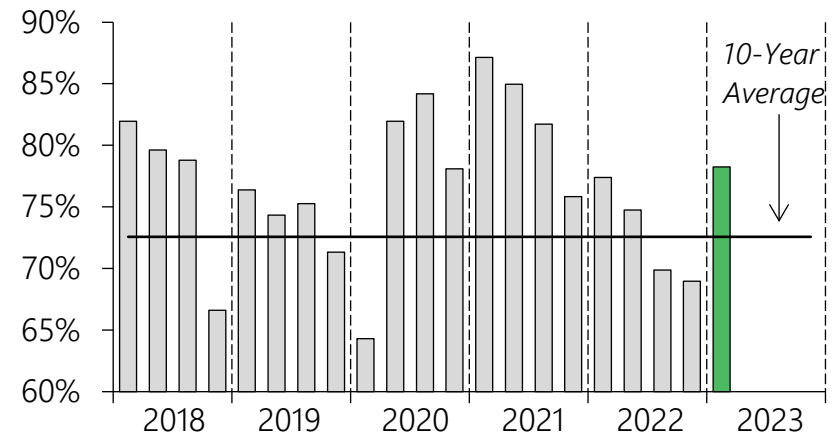
Bottom-Up, Calendar Year



Source: FactSet

Positive EPS Surprises

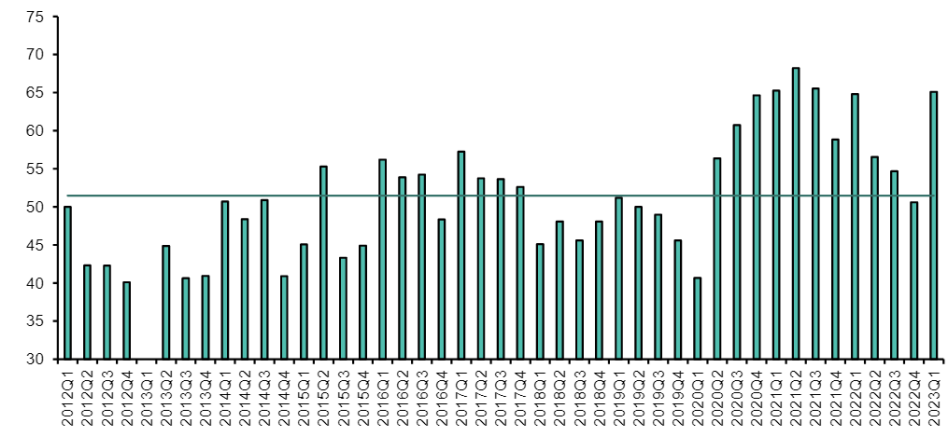
S&P 500 Index



Source: Factset

65% of European Companies have beaten EPS estimates in Q1 - Higher than the 51% historic average

% of companies beating estimates



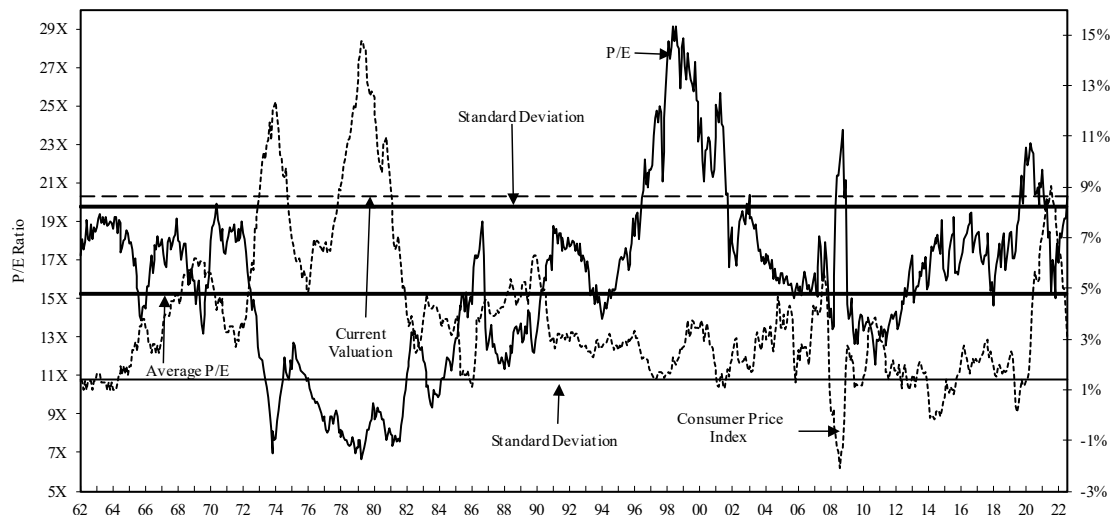
Data is factset estimate data for the constituents of the MSCI Europe Index.

Source: MSCI, Factset estimates, Bernstein analysis

Source: FactSet Research Systems 7/5/23, Bernstein Research 5/18/23

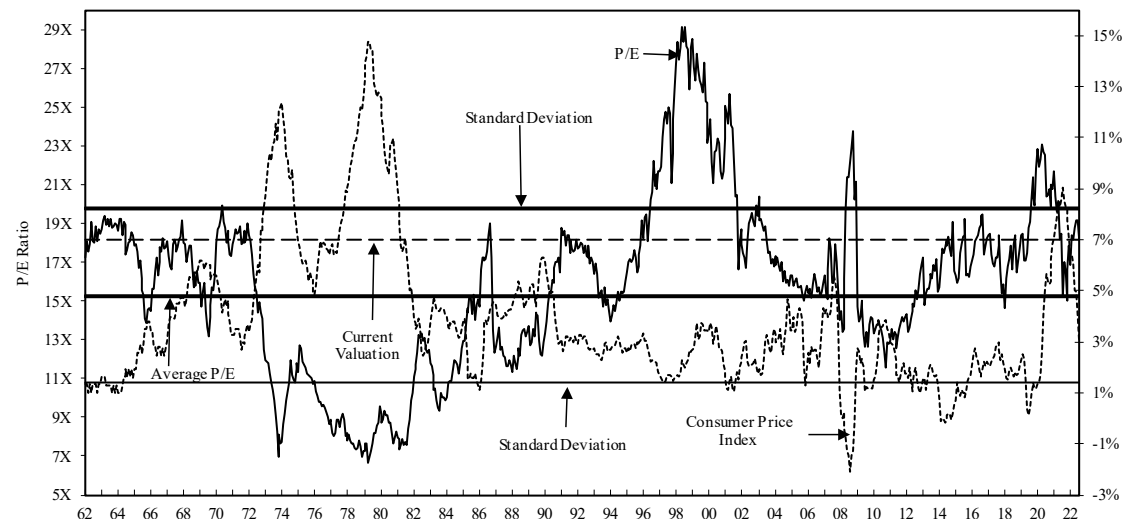
S&P 500 VALUATION TOWARDS HIGHER END OF RANGE IN 2024

S&P 500 Forward P/E (Based on 2023 Estimates)
Data Through July 7, 2023



Note: Operating EPS used to calculate P/E after 12/84; last month CPI is estimated. The current valuation of 20.3x is based on 2023 est. operating EPS of \$216.59

S&P 500 Forward P/E (Based on 2024 Estimates)
Data Through July 7, 2023



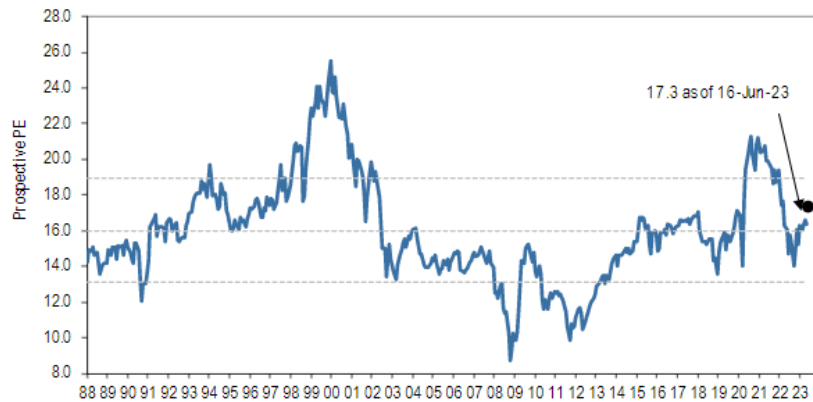
Note: Operating EPS used to calculate P/E after 12/84; last month CPI is estimated. The current valuation of 18.1x is based on 2024 est. operating EPS of \$242.80

Source: Factset Research Systems 7/7/23

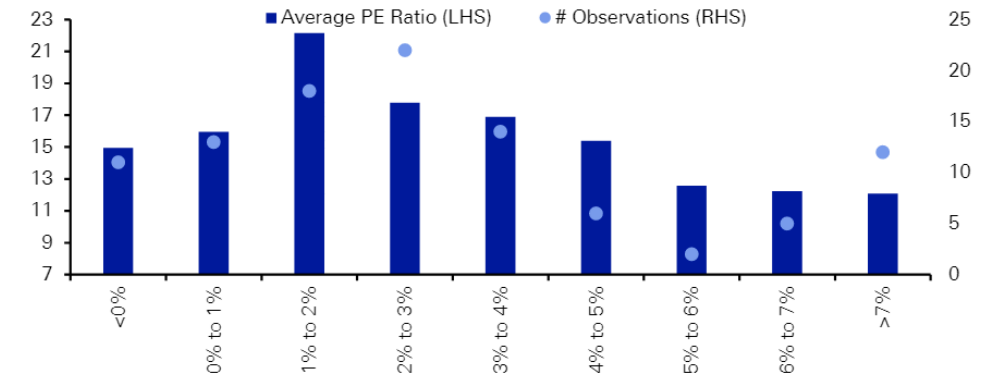
EQUITY VALUATIONS REASONABLE GLOBALLY

Global Prospective P/E

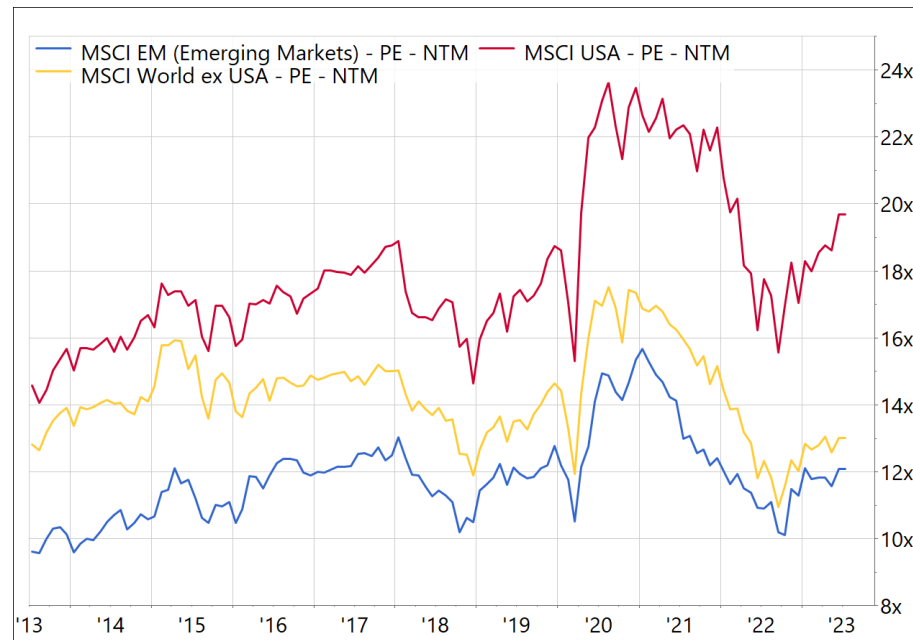
World forecast PE is currently at 17.3



US PE Ratio Since 1920 by Different Inflation Buckets



Source : GFD, Deutsche Bank



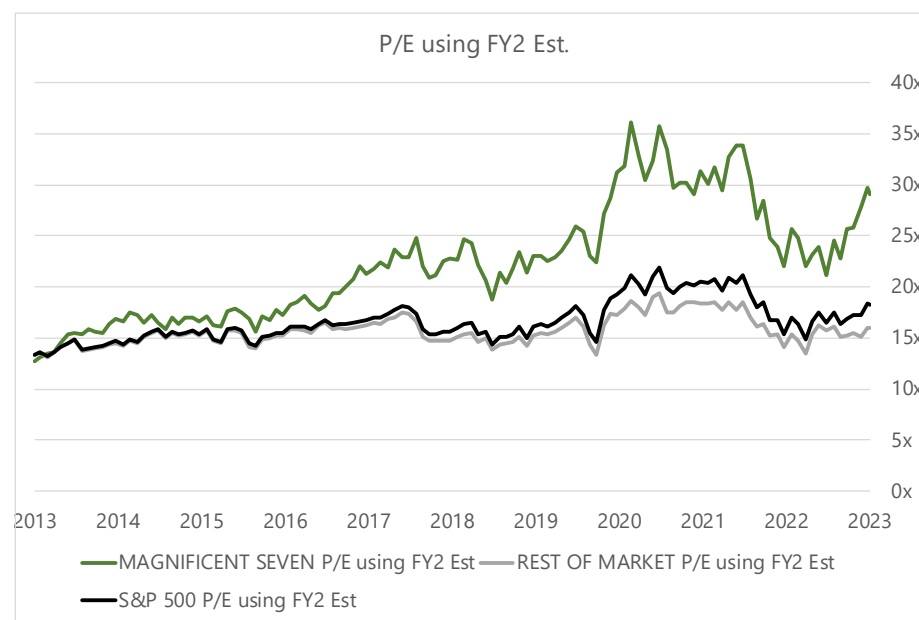
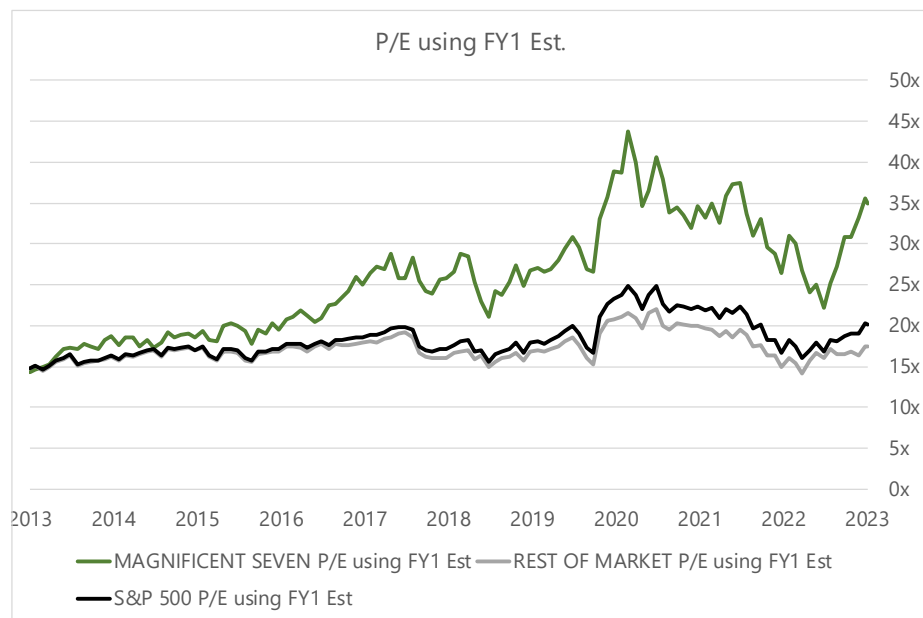
Source: Bank of America/Merrill Lynch 6/23/23, Deutsche Bank Research 9/26/22, FactSet Research Systems 7/7/23

U.S. EQUITY VALUATIONS REASONABLE EXCLUDING TECHNOLOGY SECTOR

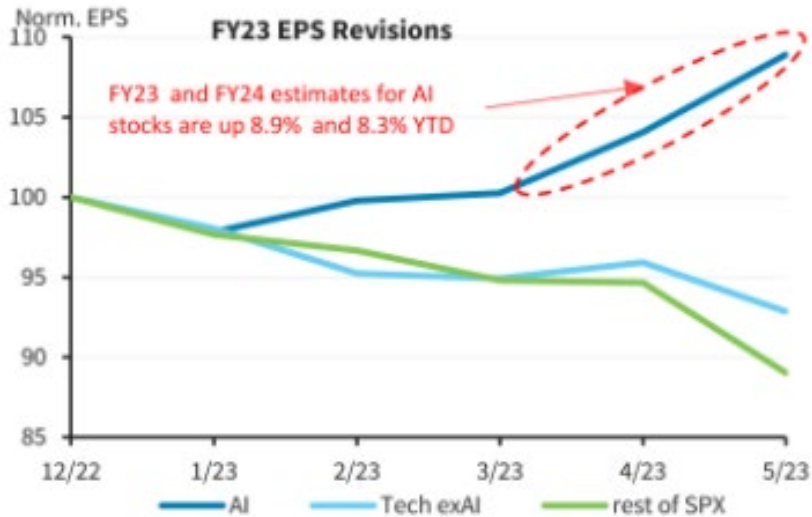
	Current NTM P/E	20 yr avg NTM P/E	<u>Premium/Discount to S&P 500</u>		
			Current	20 yr avg	Spread
S&P 500	19.0x	15.7x			
S&P 500 / Information Technology -SEC	27.0x	17.1x	8.0	1.3	6.7
S&P 500 / Consumer Discretionary -SEC	27.7x	20.5x	8.7	4.7	3.9
S&P 500 / Consumer Staples -SEC	19.9x	17.5x	0.8	1.8	-0.9
S&P 500 / Industrials -SEC	18.7x	16.5x	-0.3	0.7	-1.1
S&P 500 / Materials -SEC	17.1x	15.2x	-1.9	-0.6	-1.3
S&P 500 / Health Care -SEC	16.9x	15.0x	-2.1	-0.7	-1.4
S&P 500 / Utilities -SEC	16.9x	15.4x	-2.1	-0.3	-1.8
S&P 500 / Financials -SEC	13.2x	12.9x	-5.8	-2.8	-3.0
S&P 500 / Communication Services -SEC	17.2x	17.4x	-1.8	1.7	-3.5
S&P 500 / Energy -SEC	10.7x	15.1x	-8.3	-0.6	-7.7

	Current NTM P/E	20 yr avg NTM P/E	<u>Premium/Discount to S&P 500</u>		
			Current	20 yr avg	Spread
S&P 500 / Semiconductors -SUB	28.9x	18.0x	9.9	2.3	7.6
S&P 500 / Software -IND	29.6x	19.8x	10.5	4.0	6.5
S&P 500 / Technology Hardware & Equipment -IG	25.6x	16.0x	6.6	0.3	6.3

U.S. EQUITY VALUATIONS REASONABLE EXCLUDING “MAGNIFICENT SEVEN”

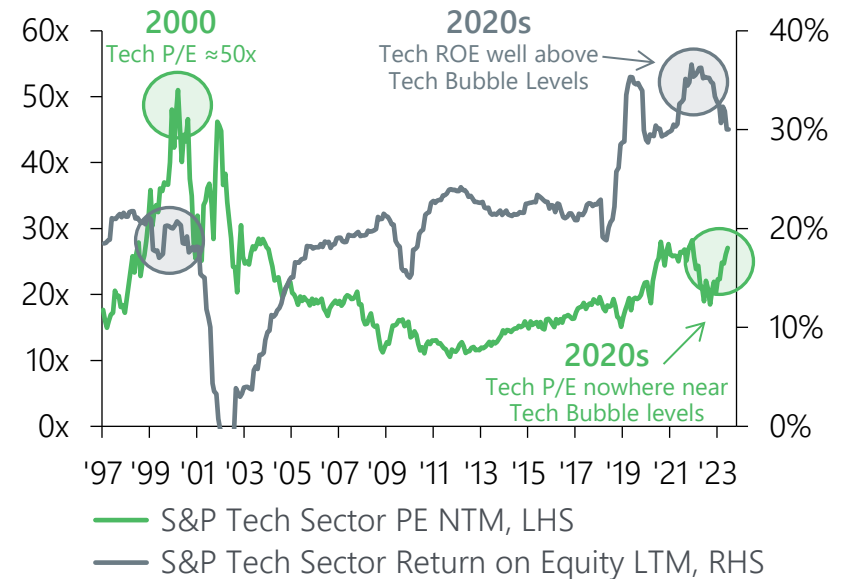


ESTIMATES FOR AI STOCKS HAVE SEEN STRONG UPWARD REVISIONS YTD

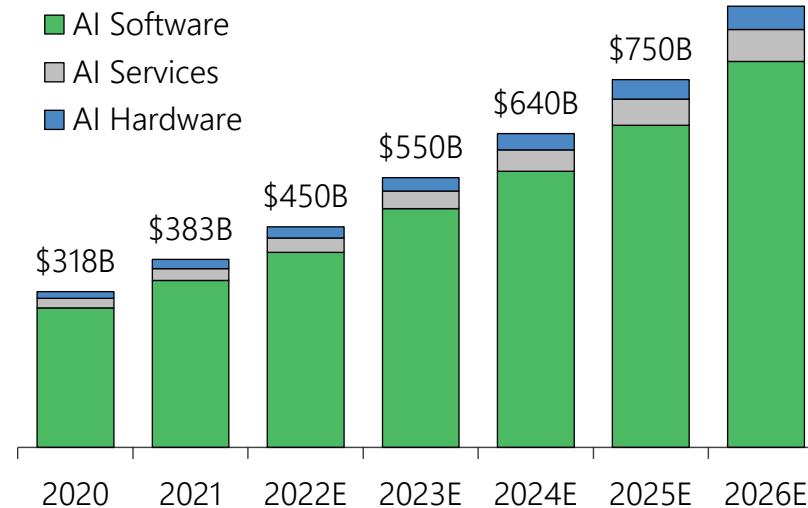


AI = BCERTCAI (except ISRG, mcap weighted), Tech exAI = Tech sector + BigTech (Meta, Alphabet, Microsoft, Amazon, Apple, Nvidia). Data as of May 31, 2023

Source: Refinitiv, Bloomberg, Barclays Research



Global Artificial Intelligence Market Size

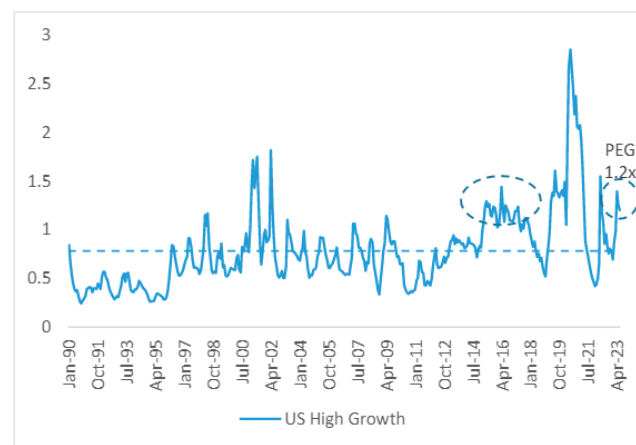


Source: Refinitiv, Bloomberg, Barclays Research 5/31/23, Statista, Factset, Piper Sandler, IDC 6/30/23, Bank of America/Merrill Lynch 2/28/23

GROWTH STOCKS NOT OVERLY EXPENSIVE BASED ON PE-TO-GROWTH (PEG) RATIOS

US Growth stocks PEG ratio is 1.2x (based on 3yr EPS growth), which is high compared to history (0.8x LR avg) but in line with pre-Covid levels

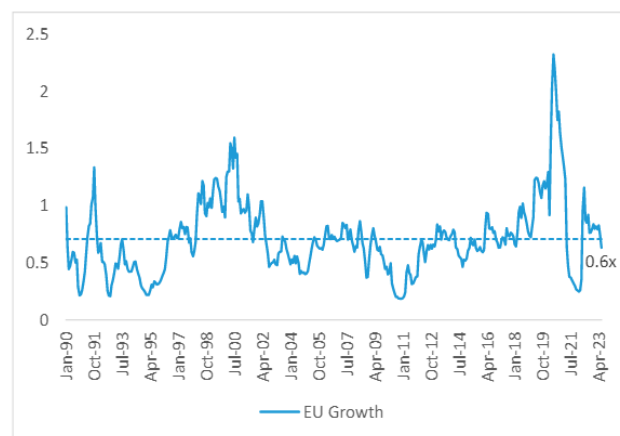
Median PE (12m fwd) / FY0-FY3 EPS Growth



Source: IBES, MSCI, Bernstein Analysis

European Growth stocks are not expensive vs. history (PEG 0.6x vs. LR average 0.7x based on 3yr EPS growth)

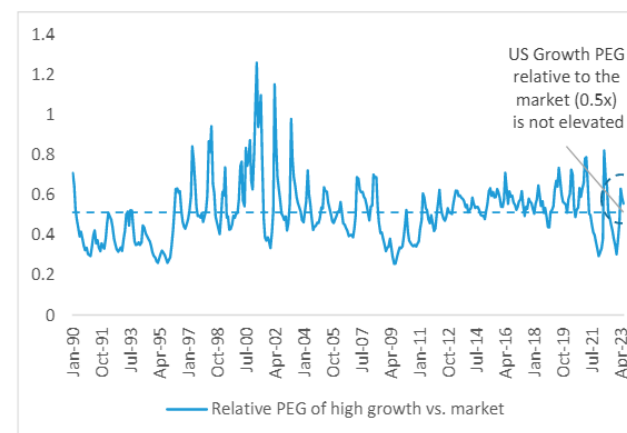
PE (12m fwd) / FY0-FY3 EPS Growth



Source: IBES, MSCI, Bernstein Analysis

US Growth stocks PEG relative to the market is not elevated

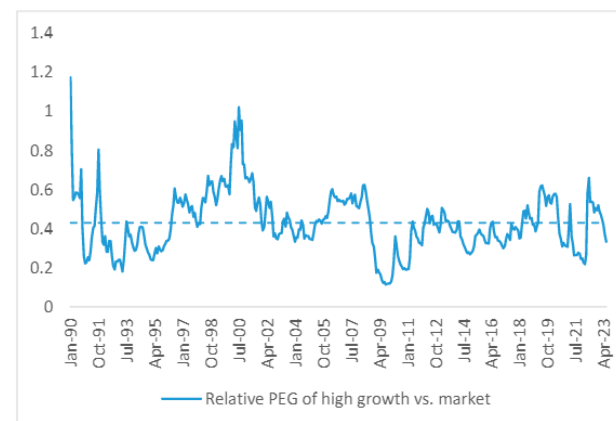
Relative PEG



Source: IBES, MSCI, Bernstein Analysis

European Growth stocks PEG relative to the market is lower than average

Relative PEG



Source: IBES, MSCI, Bernstein Analysis

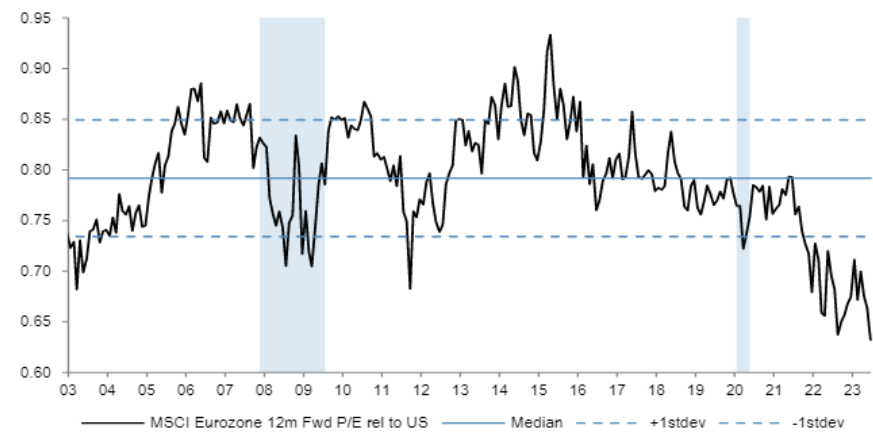
EUROPE VS. U.S. STOCKS RELATIVE VALUATIONS

MSCI Eurozone median P/E



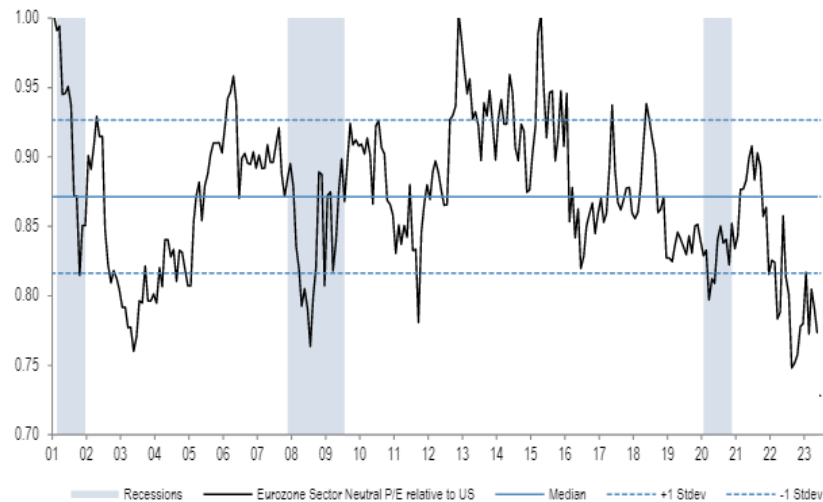
Source: IBES

MSCI Eurozone 12m Fwd PE relative to US



Source: IBES

MSCI Eurozone sector neutral P/E vs US

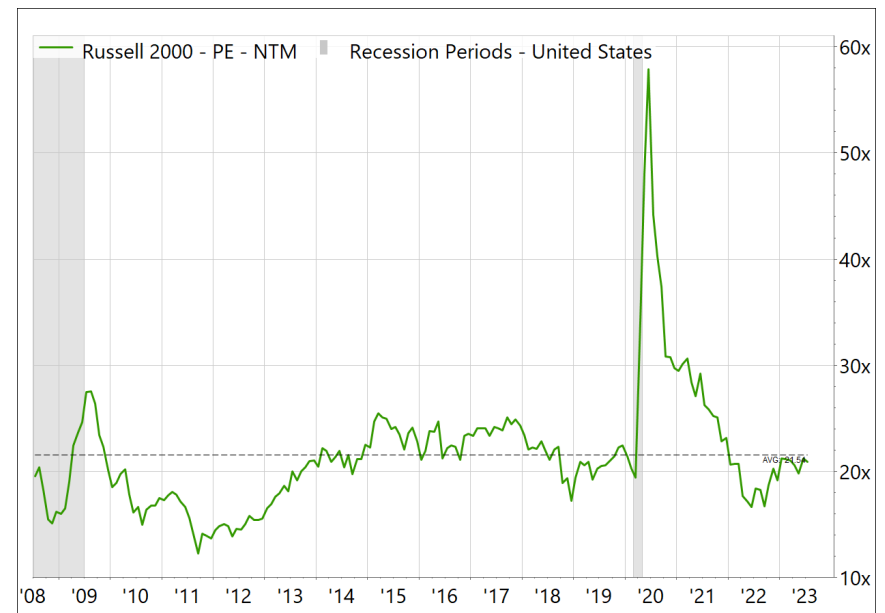
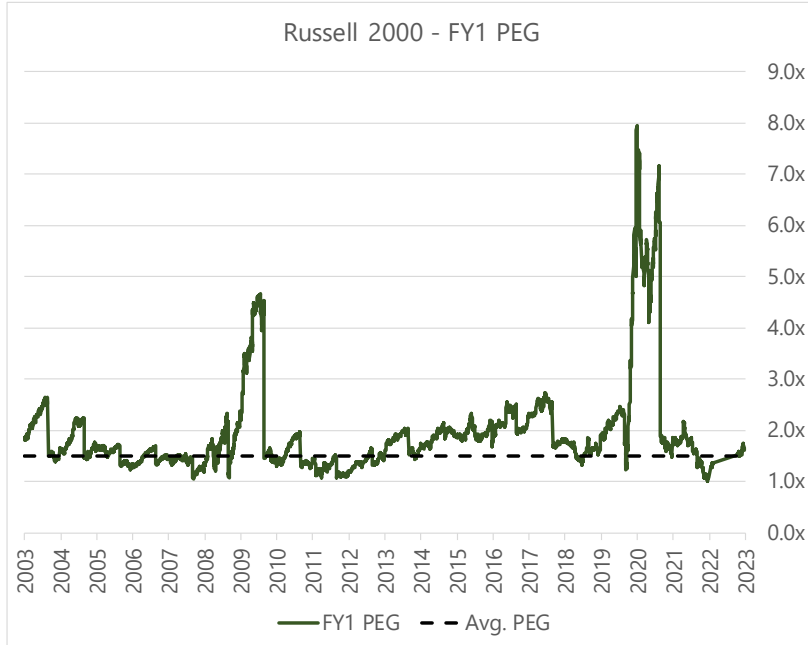
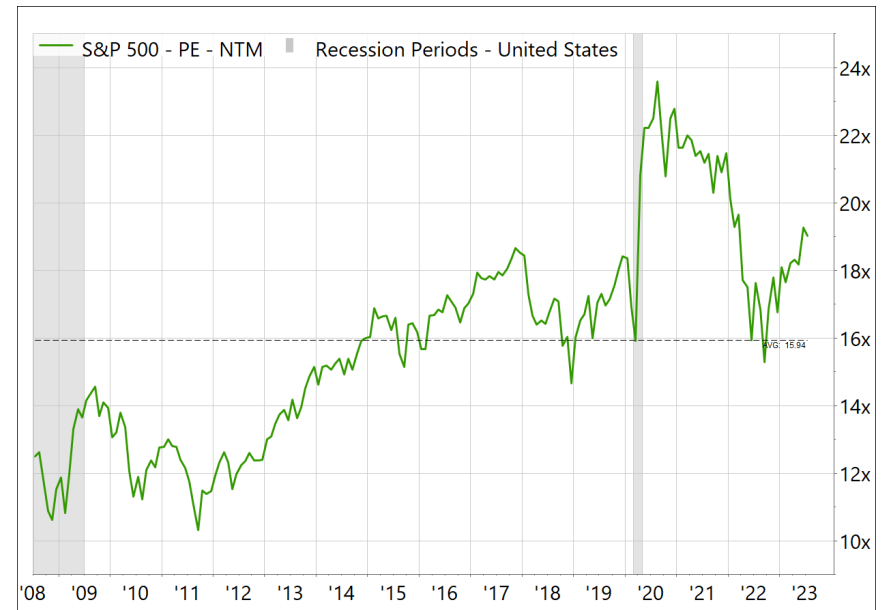
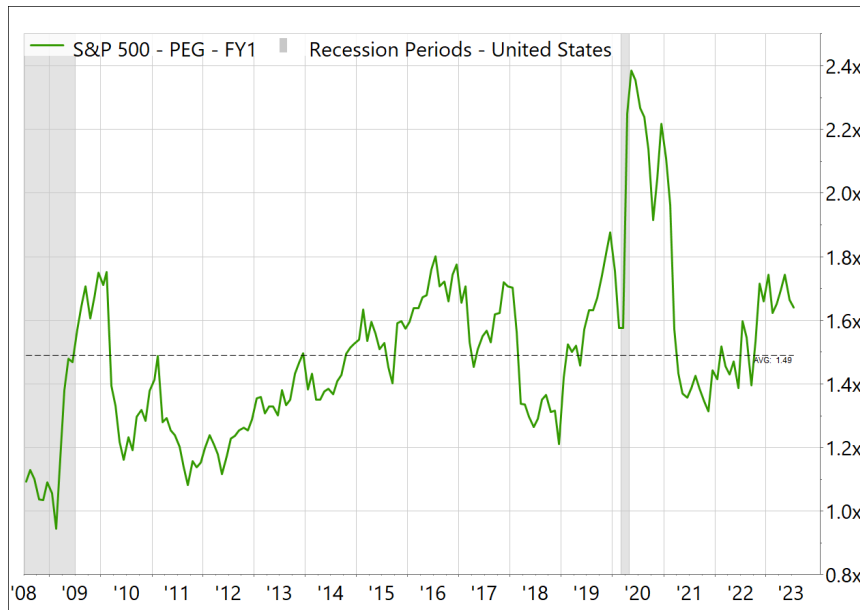


MSCI Eurozone vs US P/Book



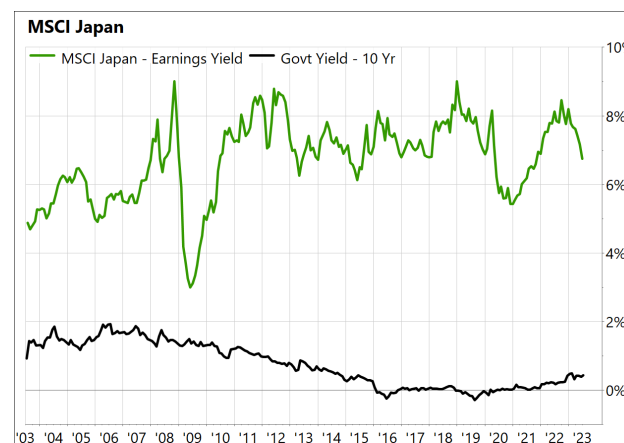
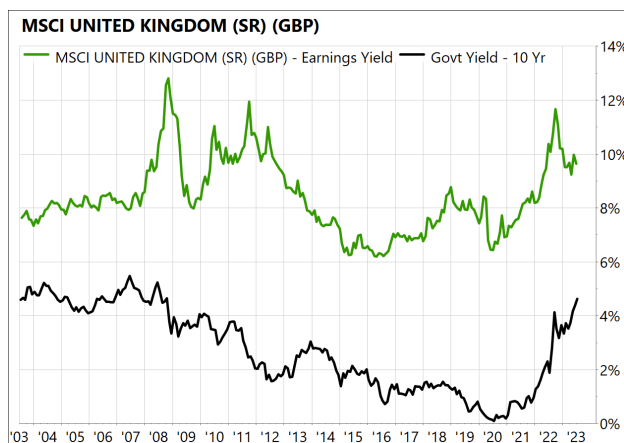
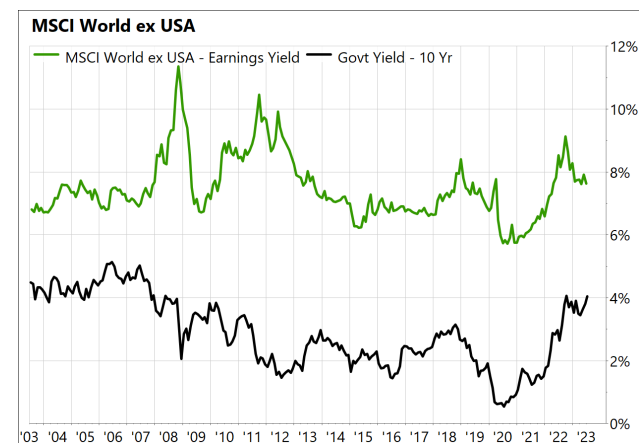
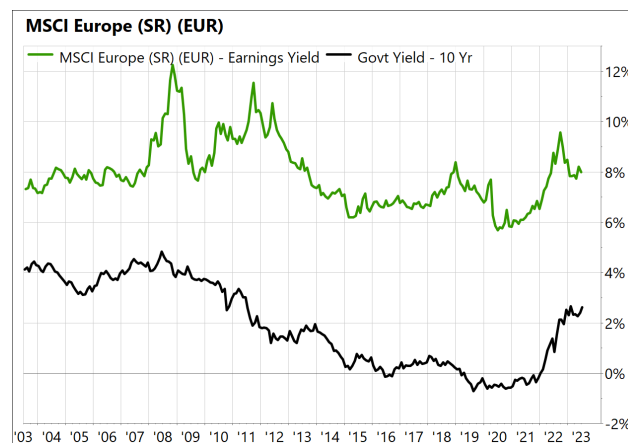
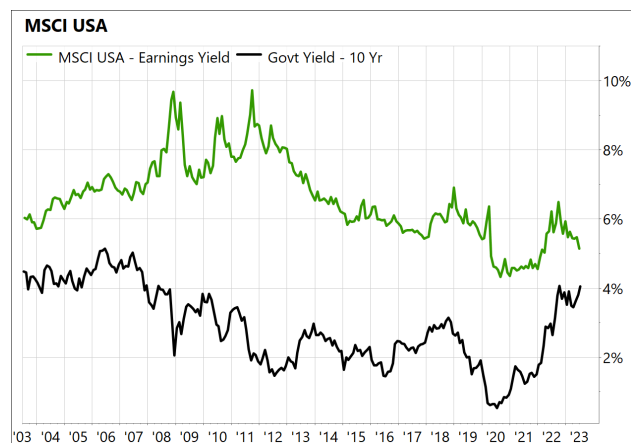
Source: JP Morgan 7/2/23

SMALL CAPS LOOK ATTRACTIVE AT CURRENT VALUATIONS



Source: FactSet Research Systems 7/10/23

EARNINGS YIELDS HIGHER THAN BOND YIELDS GLOBALLY



Source: FactSet Research Systems 7/10/23

INVESTMENT STRATEGY: GLOBAL EQUITIES

I. **We are in a stock picker's market.**

- Earnings growth is key to stock price appreciation and sustaining appreciation.
- Invest in high quality companies that have unit growth in sales, pricing power and improved margins resulting from volume/efficiency scalability. This should lead to strong, more predictable earnings growth.
- Focus on companies with strong balance sheets and are cashflow generative. We want to invest in companies that can survive tough economic times.
- Prefer dividend paying stocks.
- Focus on stocks with earnings growth fundamentals that can justify valuations.

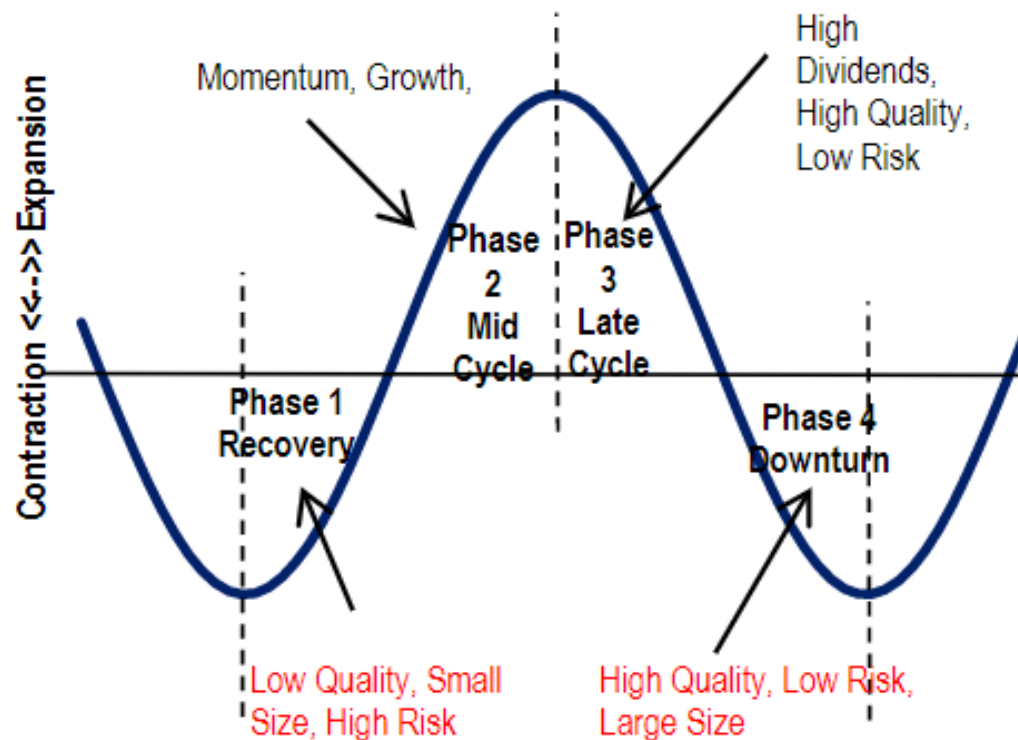
II. **Invest in a diversified portfolio.**

- Difficulty in predicting the timing and strength of economic conditions but think 2024 economic conditions will improve from 2023.
- Seek exposure to secular growth sectors, cyclical growth sectors and defensive sectors.
 - Secular growth sectors (technology, health technology, health services)
 - Cyclical growth sectors (capital goods, energy, transportation)
 - Defensive sectors (consumer non-durables, utilities)
- Secular stock growers provide ongoing growth through slow economic conditions and valuations will become more attractive in an anticipated declining interest rate environment.
- Defensive stocks should provide reduced portfolio performance volatility in the near term.

Cyclical stock growers should appreciate in anticipation of better economic conditions in 2024. Cyclical growth sectors do best when going into the depths of the recession.

ECONOMIC CYCLE PHASES – MOST DIFFICULT PHASE TO INVEST IS BETWEEN A DOWNTURN AND AN UPTURN

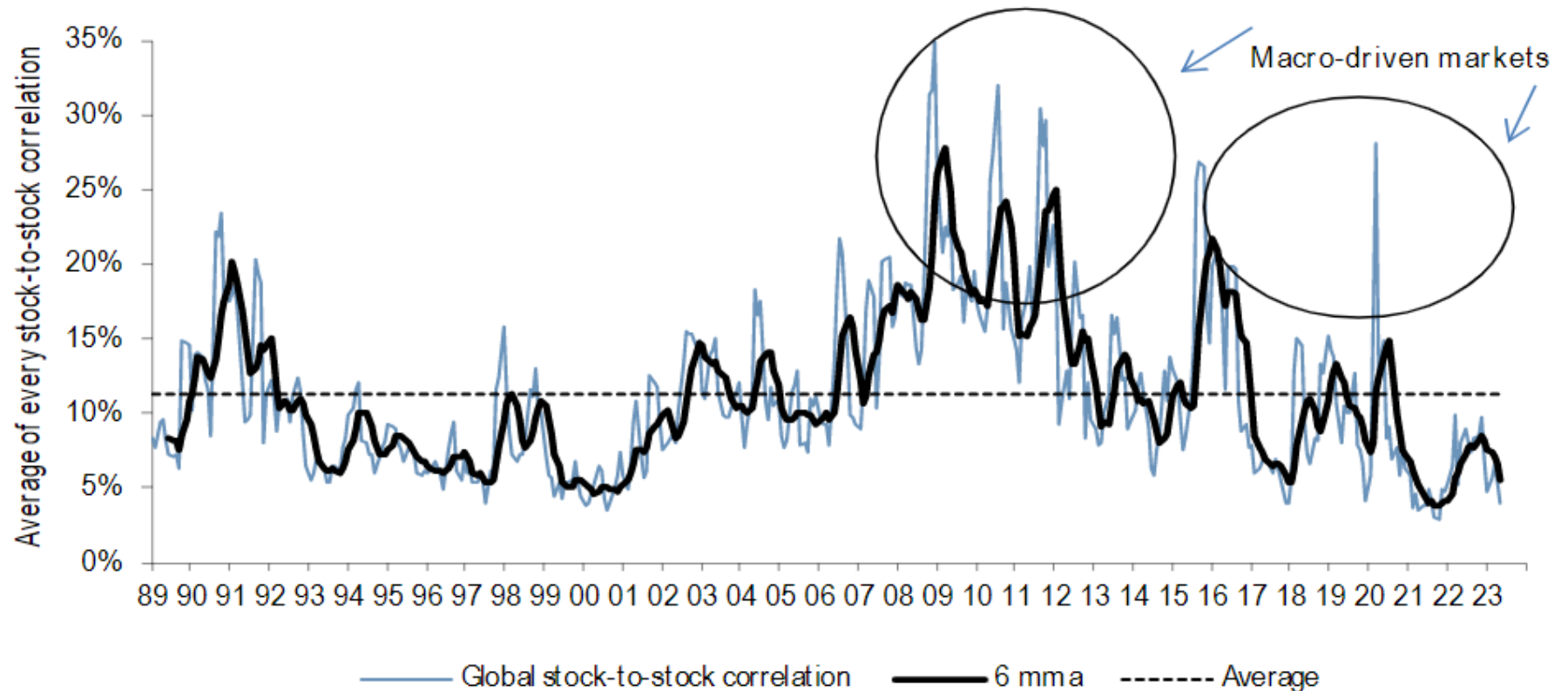
Early Cycle, Mid Cycle, Late Cycle and Recession/Downturn regimes



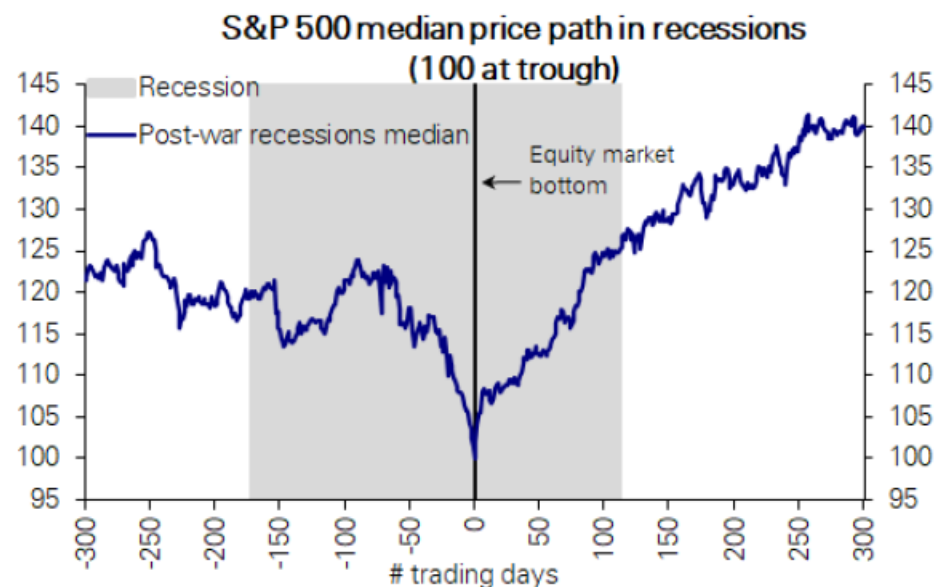
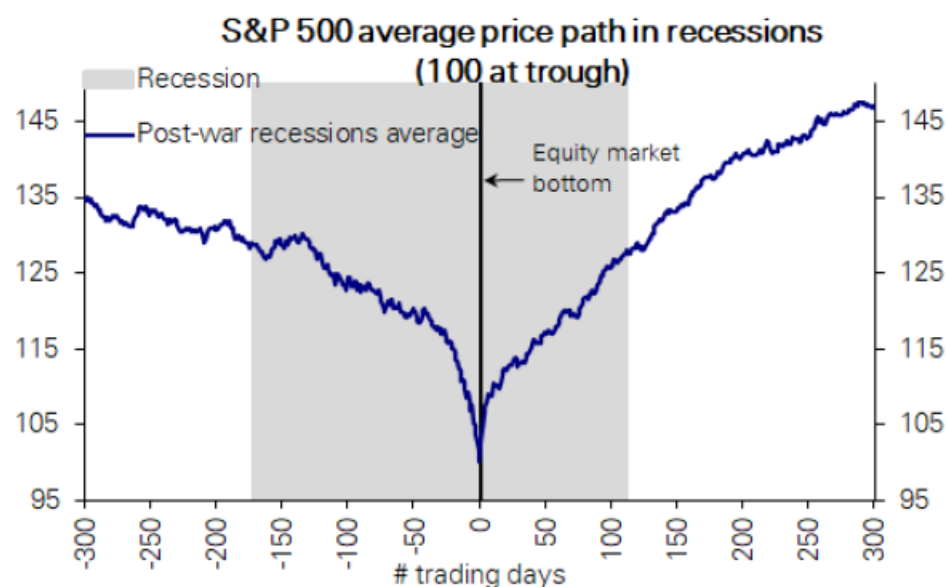
Source: Bank of America/Merrill Lynch 6/23/23

GLOBAL STOCK CORRELATIONS WELL BELOW AVERAGE

The trend in stock-to-stock correlations has been falling



EQUITIES HISTORICALLY BOTTOM HALF-WAY THROUGH RECESSIONS



Source: Deutsche Bank 12/2/22

EQUITY SECTOR STRATEGY – OVERWEIGHT

SECTOR	Fundamentals/Themes Within Sector	Favorite Names
TECHNOLOGY (OVERWEIGHT)	<ul style="list-style-type: none"> Key themes: AI, machine learning, cybersecurity, cloud computing, e-commerce and digital payments, digital transformations & workflow automation Semiconductors benefiting from all secular themes and ever-increasing utilization in consumer and industrial products Cost reductions set stage for improved operating leverage in a cyclical recovery Favor cash flow-generating secular growers and firms where 2022's multiple contraction was far too severe relative to growth prospects 	NVDA, TSMC, GOOGL, PANW, MSFT, AMZN, BKNK, ADBE, CRM, NOW, ACN
HEALTH CARE (OVERWEIGHT)	<ul style="list-style-type: none"> Demographics underpin secular growth for health care within a global economy Health care's innovation engine has never been stronger – producing curative products that improve outcomes at lower costs Valuations for the overall sector are compelling relative to other defensive/non-cyclical sectors Favor health insurers and providers bending cost-curves through efficient health delivery models, including outpatient care, telehealth, and home health Prefer medical device manufacturers addressing chronic medical needs with minimally invasive, yet powerfully effective products and tools 	ABT, ATRC, AZN, DXCM, TMO, CNC, MOH, THC, UNH
ENERGY/MATERIALS (OVERWEIGHT)	<ul style="list-style-type: none"> Structural supply-side constraints suggest extended period of elevated, if volatile, energy prices – “all-of-the-above” approach needed to meet world's growing energy needs, including both fossil fuels and renewable sources Energy price-levered companies offer a hedge against inflation and heightened geopolitical risk Favor energy companies possessing advantaged assets, participating in growing markets (e.g. LNG), and/or with the capacity to sustainably increase shareholder returns Prefer materials companies with exposure to copper, a key component in renewable energy/EV transition and estimated to be in structural supply deficit 	COP, LNG, NOG, CHRD, SHEL, GLNCY, LYSDY, MP
CAPITAL GOODS (OVERWEIGHT)	<ul style="list-style-type: none"> Surprising resilience in most major industrial markets, with incremental growth from infrastructure, secular growth end-markets (automation, EV's, electrification), and “near shoring” Strong pricing overcoming raw costs and supply chain pressures, with cost relief in sight for 2023 Despite geopolitical pressures, defense may lose “safe haven” status as budget impasse appears likely in 2023-2024 Selectivity is key as valuations are above historical averages; too high given likely US/European recession Investment focus on firms with visible growth in automation, aerospace, EV's, commodity capex, power/T&D 	SIEGY, PH, ETN, HON, J, HUBB
TRANSPORTATION (OVERWEIGHT)	<ul style="list-style-type: none"> Post-Covid shift from goods to services negatively impacting volumes on all modes Inventory destocking hurting truckers in particular, but this should abate in 2023 Strong pricing gains and cost actions providing earnings “floor” for trucks, rail, and parcels Rail fundamentals stable given relative stability from intermodal, ag, coal, and auto Travel surge boosting airlines, but capacity uptick in 2023 warrants caution Prefer rails and parcel carriers based on valuation, strong pricing, and capital returns 	UNP, FDX, KNX, TFII, ALK

EQUITY SECTOR STRATEGY – NEUTRAL/UNDERWEIGHT

SECTOR	Fundamentals/Themes Within Sector	Favorite Names
UTILITIES (NEUTRAL)	<ul style="list-style-type: none"> Absolute valuations elevated relative to history, balanced by visible rate base growth and long-term growth benefits from changing U.S. energy landscape (wind and solar powered electricity generation, gathering and processing infrastructure for shale oil and gas) Limited exposure to currency swings and inflationary cost trends Emphasis on firms with limited rate/regulatory risk and high exposure to renewables 	NEE, WEC, AES
FINANCIALS (UNDERWEIGHT)	<ul style="list-style-type: none"> Peaking conditions for banks in terms of NIM, credit, and loan growth. Commercial Real Estate represents major credit risk Rate increases are causing deposit outflows and losses in investment portfolios Banks' regulatory headwinds increasing after two regional bank failures Credit risks more prevalent outside of banking system given post-GFC regulations/lending restraint Unlike 2008-2009, banks well capitalized and proactively adding to provisions P&C insurers attractive due to major pricing upcycle, with additional boost from interest income Sector valuations attractive, but catalysts are lacking - Focus on high quality, overcapitalized firms returning capital to shareholders 	JPM, CB, AMP, GS, AJG, CG, O
COMMUNICATIONS (UNDERWEIGHT)	<ul style="list-style-type: none"> Capital intensity with subpar returns for traditional telecom providers Increasing competition in wireless market as penetration has peaked; Verizon and AT&T have been unable to add premium pricing for 5G service We favor the service providers that can best monetize the "wireless Internet" including the network edge compute function such as the tower stocks and data center providers Due to the limited range of 5G signals, more towers or small cells are needed for coverage thus benefitting the tower stocks - furthermore, the network edge compute function will likely be housed around the tower placements, again benefitting tower stocks 	AMT, CLLNY
RETAIL TRADE (UNDERWEIGHT)	<ul style="list-style-type: none"> Inflation, higher interest rates, and peaking labor markets are fundamental headwinds Consumer spending preferences for experiences (dining out, travel) over goods (hardgoods, apparel) Covid pandemic has hastened migration to e-commerce and demise of shopping mall However, most retailers, even AMZN, are finding need to have brick & mortar presence, so are omnichannel (i.e., physical stores, online, pickup, delivery) Off-price retailers benefitting from excess channel inventory and value-seeking consumers We favor companies with visible sales outlooks, scale, and differentiated business models 	AMZN, CVS, LULU, HD, TGT, TJX, ULTA
CONSUMER NON-DURABLES (UNDERWEIGHT)	<ul style="list-style-type: none"> Slow secular volume growth, due to mature developed markets Increasing competition in many categories from private label, local brands, and healthy/organic Pickup in at-home food consumption and shift to trusted name brands during Covid; these trends are beginning to wane as price increases test sustainability of market share gains for name brand manufacturers Reopening of global economies will help EL (makeup, travel) and MDLZ (emerging markets) Margin pressure from supply chain costs and higher advertising & procurement spending We favor firms with strong brands, global growth potential, and innovative new product development 	STZ, DEO, EL, MDLZ, NSRGY, PEP, PG

Source: Sit Investment Associates, Inc. 5/18/23