



# THE GLOBAL ECONOMIC & INVESTMENT ENVIRONMENT AND STRATEGY

## 42<sup>nd</sup> Annual Client Workshop

Park Hyatt Aviara Resort, Carlsbad, CA

February 15 - 18, 2024

*Presented by:*

**Roger J. Sit**

CEO & Chief Investment Officer



Sit Investment  
Associates



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## **Global Economic & Investment Environment**

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### **Investment Strategy:**

Tax Exempt Bonds

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Taxable Bonds

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Global Equities

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# GLOBAL ECONOMIC & INVESTMENT ENVIRONMENT

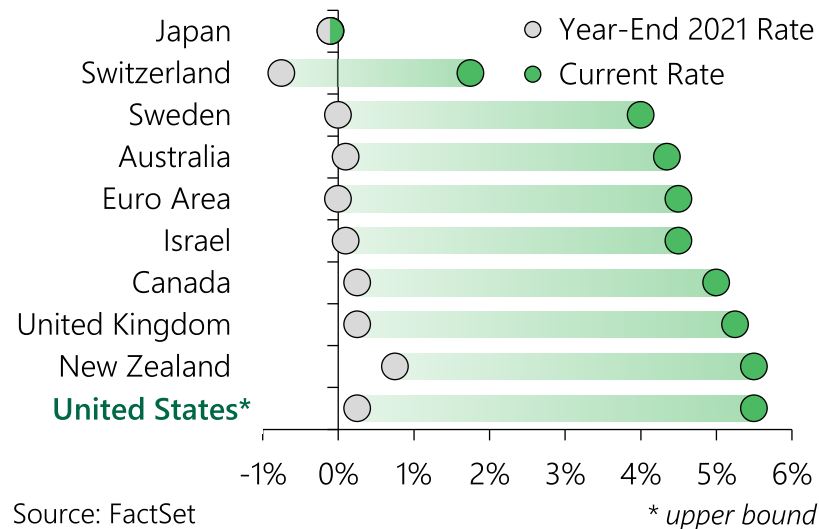
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- I. **We think a short, shallow recession will occur in the first half of 2024, but do recognize the increased possibility of a soft landing. Still expect economic growth to improve in late 2024.**
- Interest rate increases and quantitative tightening are downshifting economic growth and causing disinflation.
  - 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.
  - Tighter lending standards due to two U.S. bank failures and a nervous banking system will further stifle growth.
  - China economic growth is struggling due to real estate problems, trade restrictions, and structural issues.
  - Europe is in a mild recession due to export declines and geopolitical issues.
  - Material Federal debt in the U.S. and rest of the world will further limit ability to grow.
  - Geopolitical issues surfacing all over the world create more uncertainty and slow economic activity.
  - More accommodative monetary policies are not likely in the immediate term. We think interest rates have peaked but will stay high for longer.
    - Inflation moderating due to demand destruction resulting from tighter monetary policies and excessive stimulus money having burned off. Central bankers' inflation targets, however, are taking longer to reach than desired.
    - We anticipate in the U.S. three or four rate cuts in 2024 resulting from more visible economic slowing and better inflation picture. The first rate cut will likely occur mid-year. Euro area and the UK will likely cut by late summer.
- II. **Markets are likely to be volatile through the first half of 2024.**
- Investor focus is on the health of the economy and future path of interest rates. Markets are worried that central bankers will make a policy mistake and cause a deeper recession.
  - The difficulty 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 mid-2024. This clarity should calm the markets.
- III. **We think the markets should be looking past any slowdown in early 2024 to an eventual recovery in late 2024.**
- The markets are an anticipatory (or discounting) mechanism and are focused roughly 12 months out.
  - With our expected return to growth in late 2024 and inflation moderating further, the yield curve should normalize and the stock market should move higher 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.

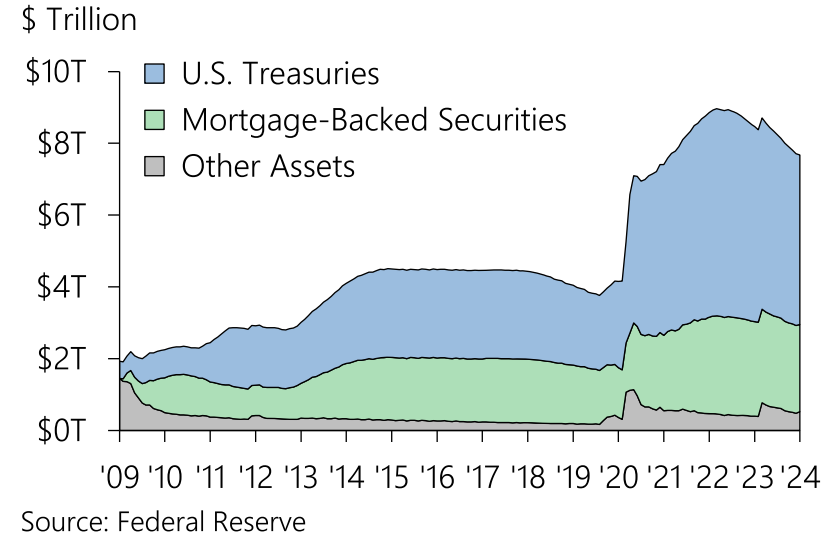


# MONETARY POLICIES HAVE BEEN AGGRESSIVE TO REDUCE INFLATION

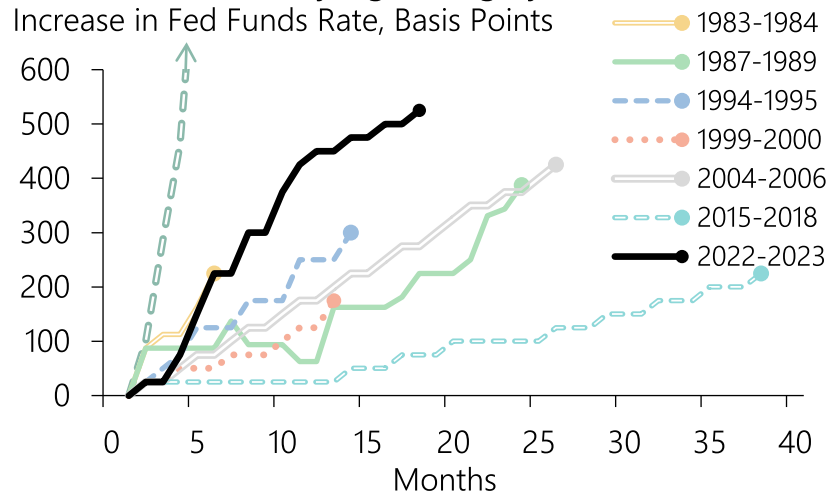
## Policy Rate Changes, Developed Markets



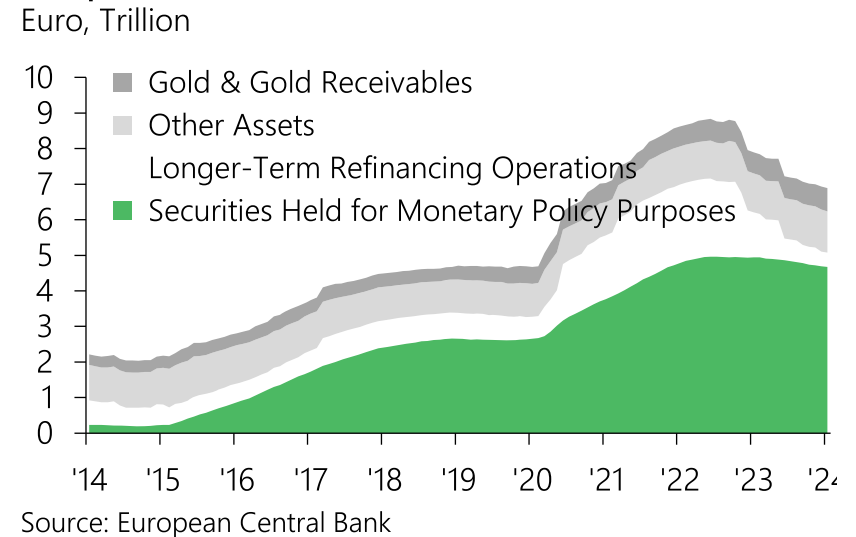
## U.S. Federal Reserve Assets



## Pace of U.S. Monetary Tightening Cycles

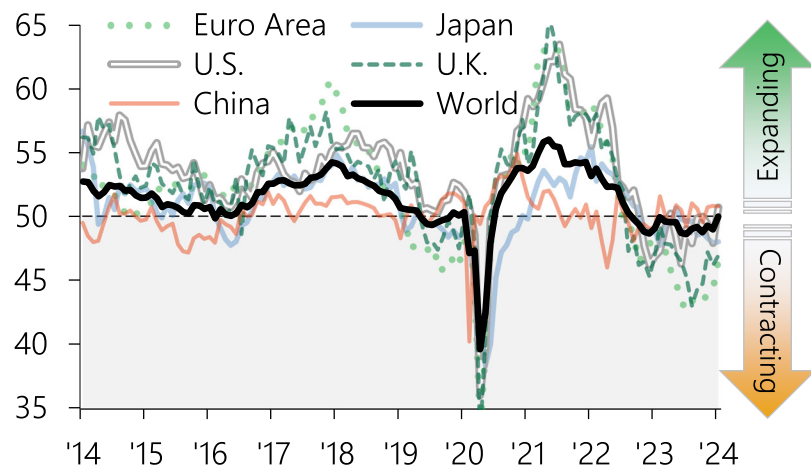


## European Central Bank Assets



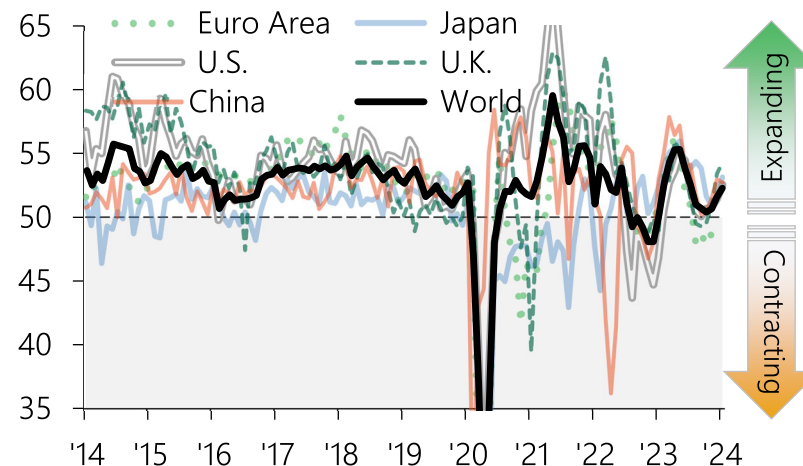
# GLOBAL PURCHASING MANAGERS' INDICES SHOW SLOWING ACTIVITY

## Manufacturing Purchasing Managers' Indices



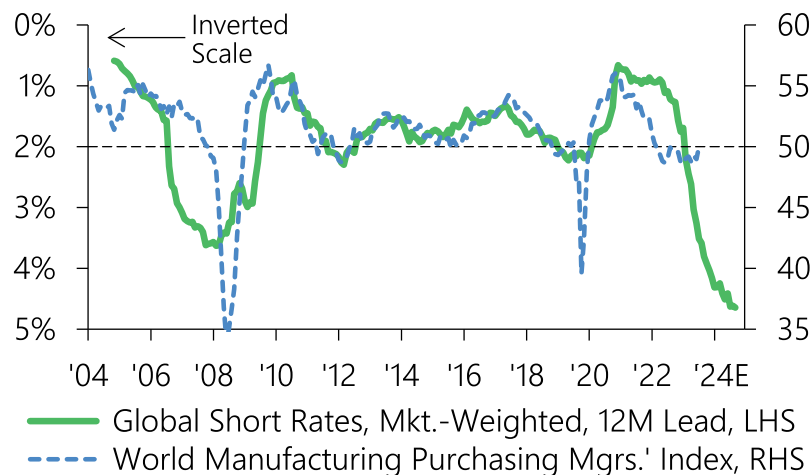
Source: S&P Global

## Services Purchasing Managers' Indices



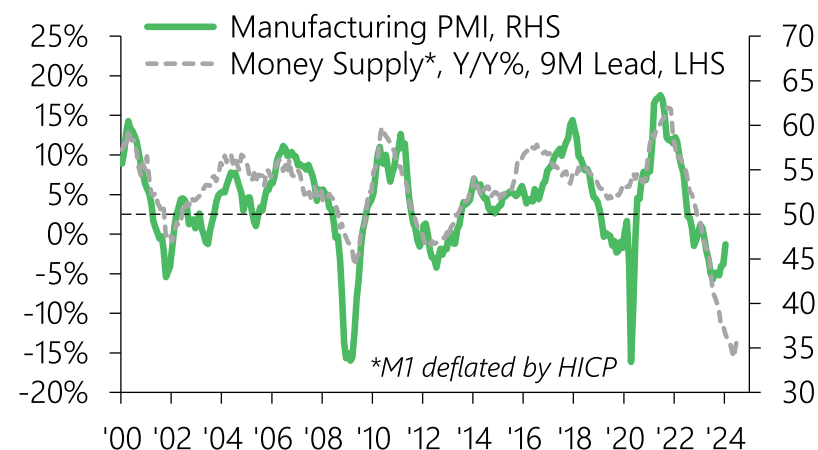
Source: S&P Global

## Global Short-Term Interest Rates vs. Manufacturing PMI



Source: S&P Global, FactSet

## Purchasing Managers' Index vs. Money Supply Growth Euro Area

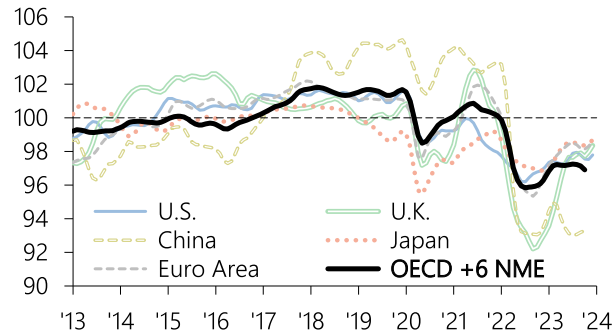


Source: European Central Bank, S&P Global

# CONSUMER DATA AND HOUSING SHOWING SLOWDOWN

## Consumer Confidence

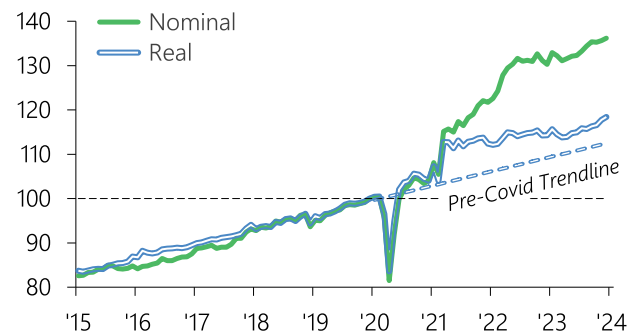
Normal = 100, Seasonally-Adjusted



Source: OECD

## U.S. Retail & Food Services Sales, ex. Autos

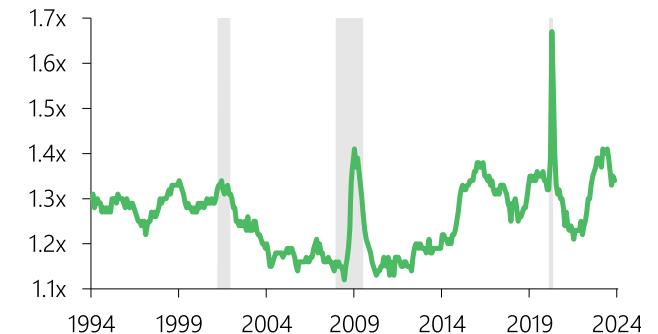
Seasonally-Adjusted, December 2019 = 100



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

## U.S. Wholesale Trade Inventory-to-Sales Ratio

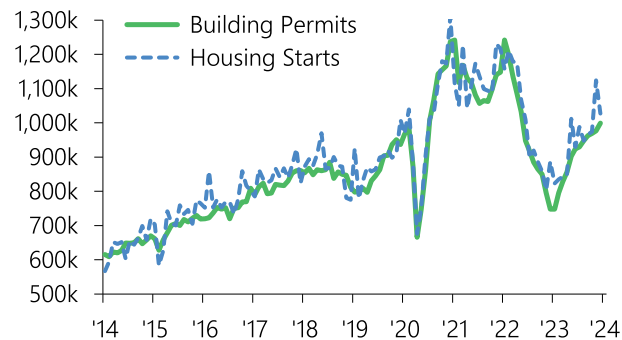
Seasonally-Adjusted



Source: Census Bureau

## U.S. Single-Family Building Permits and Housing Starts

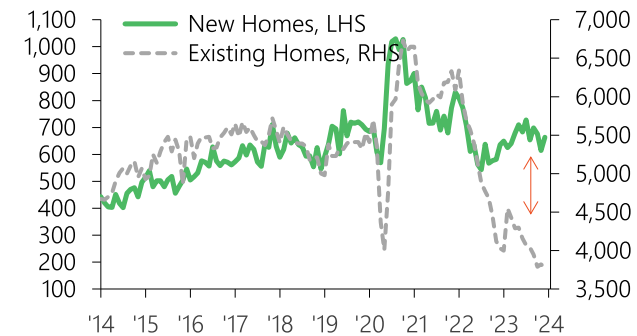
Seasonally-Adjusted Annualized Rate, Thousands



Source: Census Bureau

## U.S. Home Sales

Seasonally-Adjusted Annualized Rate, Thousands

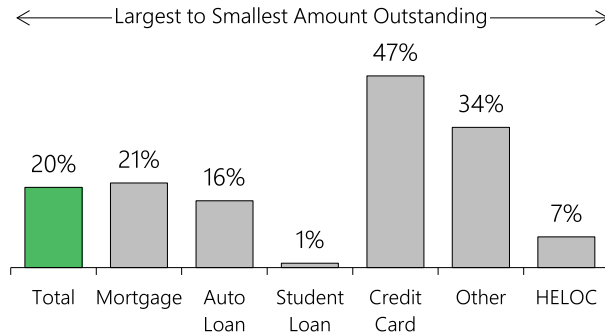


Source: Census Bureau, National Association of Realtors

Source: Bureau of Economic Analysis 2/5/24, U.S. Census Bureau 2/5/24, National Association of Realtors 2/5/24, OECD 2/5/24, Bank of America Global Research 2/5/24

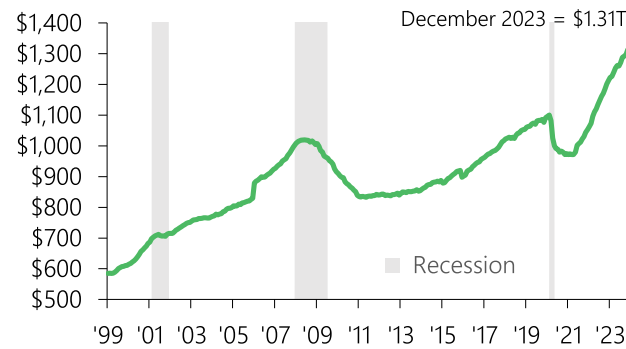
# U.S. CONSUMERS FEELING THE DEBT PAIN

**U.S. Household Debt Outstanding by Category**  
Percent Change Since Q1 2021



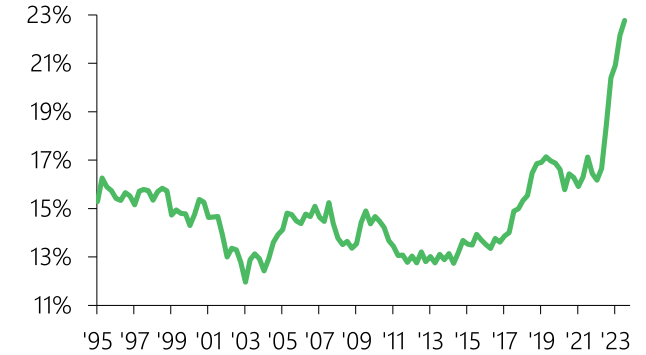
Source: Federal Reserve Bank of New York

**U.S. Revolving Consumer Credit Outstanding**  
Billion



Source: Federal Reserve

**Average Interest Rate on Credit Cards**



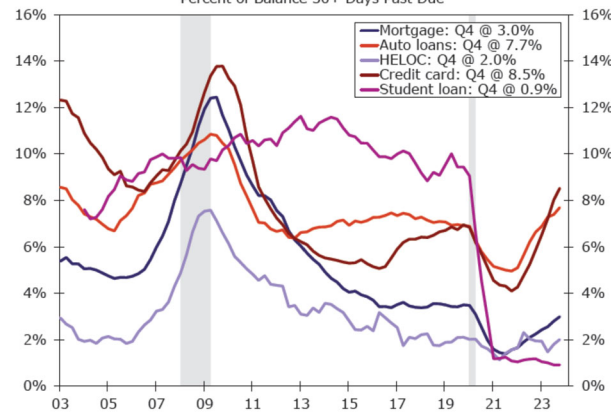
Source: Federal Reserve

**Personal interest payments (% of personal income)**



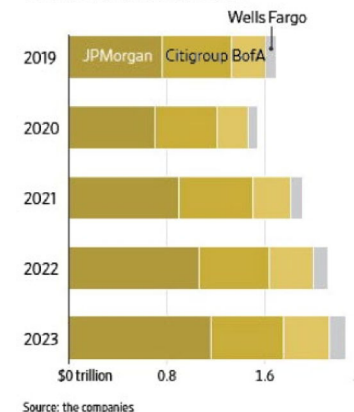
Source: UBS Research

**Transition into Delinquency by Loan Type**  
Percent of Balance 30+ Days Past Due



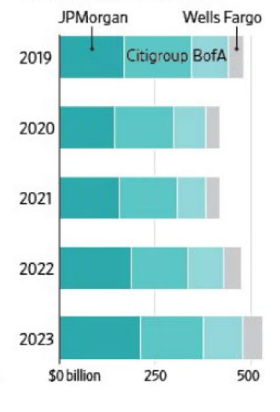
Source: New York Fed Consumer Credit Panel, Equifax and Wells Fargo Economics

**Credit-card spending volume**



Source: the companies

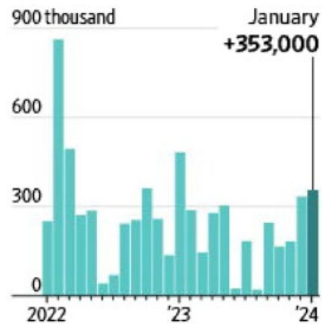
**Credit-card loan balances**



Source: Federal Reserve, Bank of New York 2/13/24, UBS Research 1/20/24, Wells Fargo Research 2/8/24, Wall Street Journal 1/25/24

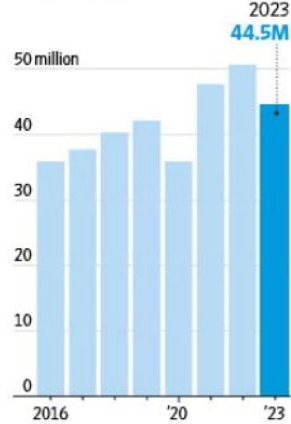
# U.S. EMPLOYMENT PICTURE SOFTENING

Nonfarm payrolls, change from a month earlier



Note: Seasonally adjusted  
Source: Labor Department

Quits per year



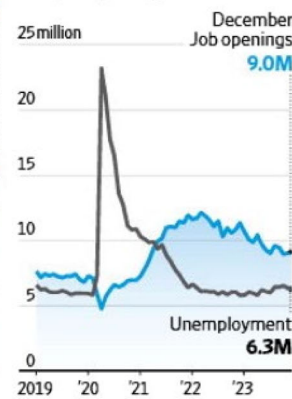
\*Seasonally adjusted

Sources: Labor Department (quits per year, unemployed people, job openings); Labor Department via St. Louis Fed (quits rate)

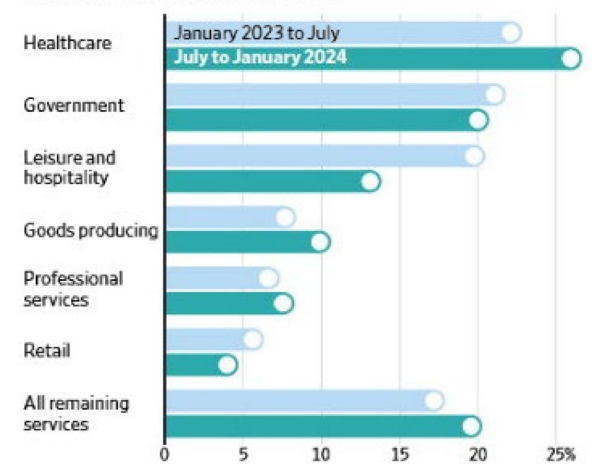
Quits rate\*



Unemployed people and job openings\*

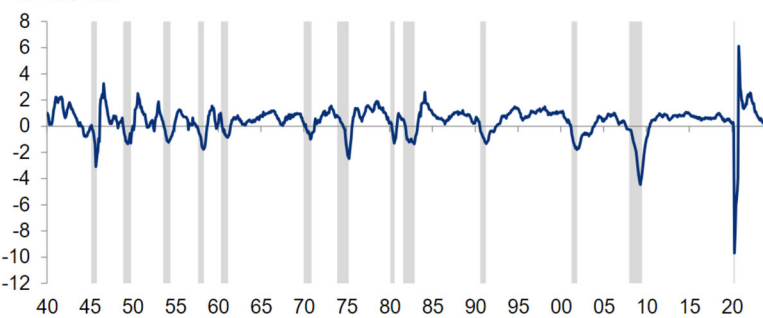


Share of total jobs added, by sector

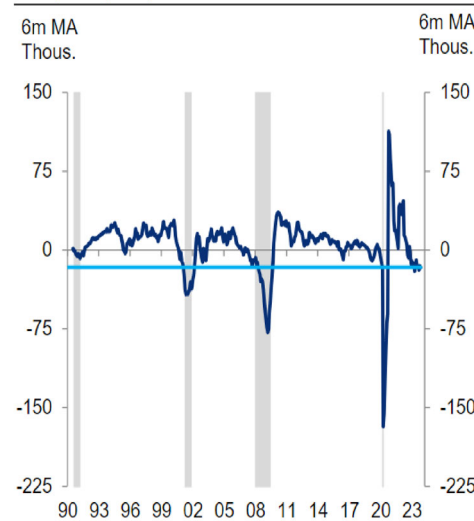


Private sector employment ex leisure & hospitality and health care & education

6m diff, Mln.



Temporary help workers



Small Business Hiring Plans

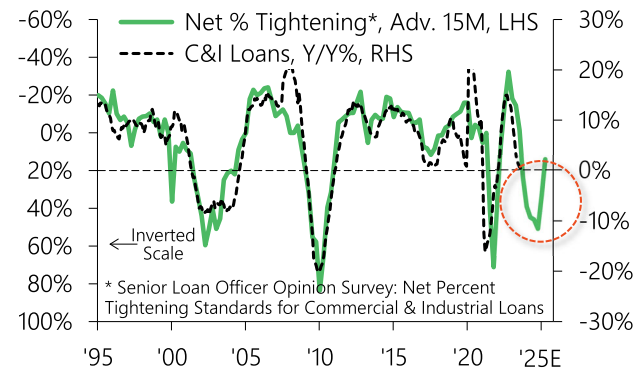
Net % of Firms That Plan to Hire in Next Three Months



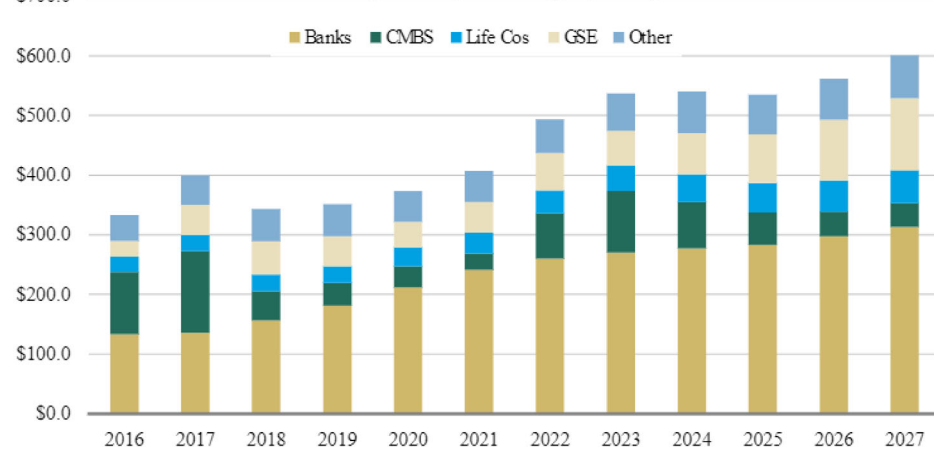
Source: NFIB and Wells Fargo Economics

# CHALLENGES FOR BANKS AND U.S. ECONOMY

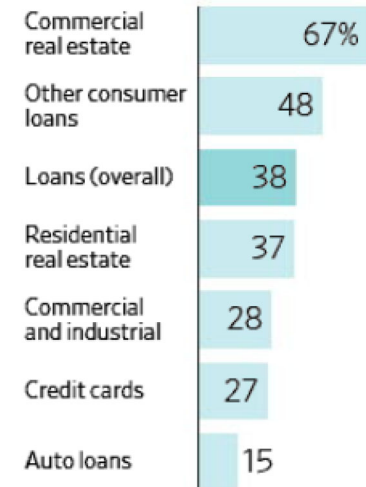
U.S. C&I Credit Standards vs. Loan Growth



Maturing Loans by Lender Type (in \$Bn)

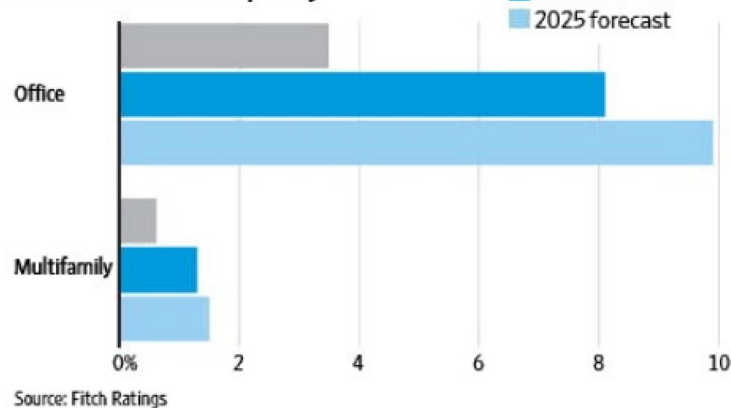


Small and medium-sized banks' share of all outstanding loans, by type



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

U.S. commercial mortgage-backed securities loan delinquency



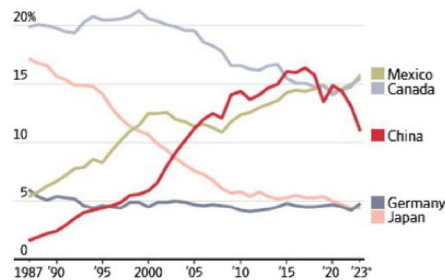
Source: Federal Reserve 2/5/24, Wall Street Journal 6/13/23 & 1/17/24, Morgan Stanley 12/14/23



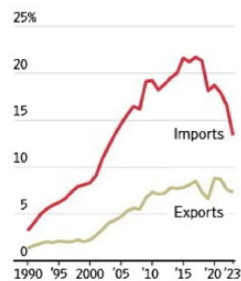
# NEGATIVE ECONOMIC DATA FROM CHINA

In the first half of 2023, China's share of U.S. imports fell to its lowest level in 20 years. The U.S. has turned to Mexico, Canada, Europe and other parts of Asia to offset its decreased appetite for electronics, toys and other goods from China.

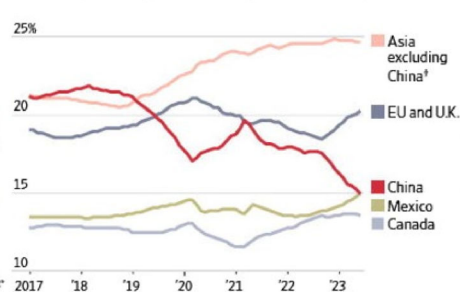
Percentage of total trade with U.S.



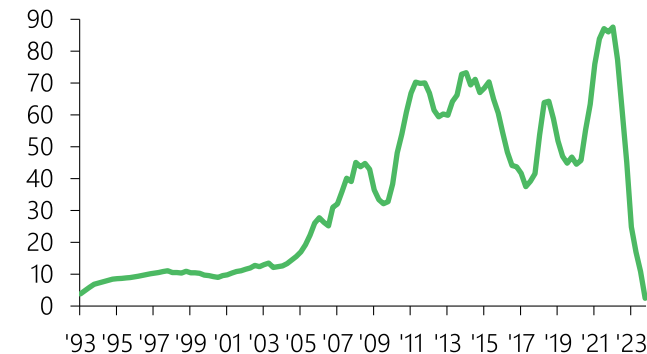
China's share of U.S. goods imports and exports



Percentage of U.S. goods imports, 12-month rolling sum

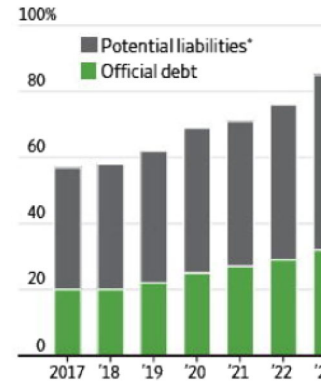


China Foreign Direct Investment, Inflows  
Four-Quarter Moving Average, Billions of USD



Source: Oxford Economics

Estimated local government debt burden in China, percentage of gross domestic product



\*Debts held through local government-owned corporate financing vehicles.

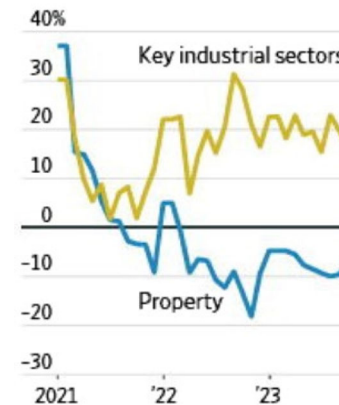
Note: 1 trillion yuan = \$137 billion

Sources: International Monetary Fund (government debt); CEIC (government funding)

Major sources of local government funding, excluding debt



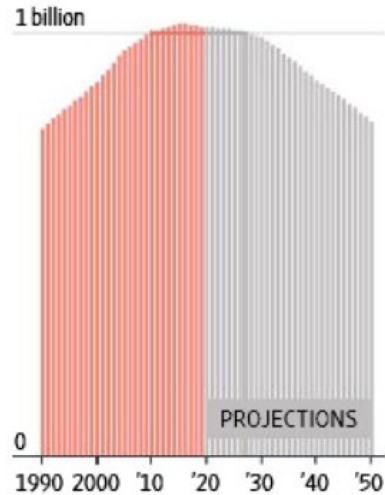
China investment, change from a year earlier



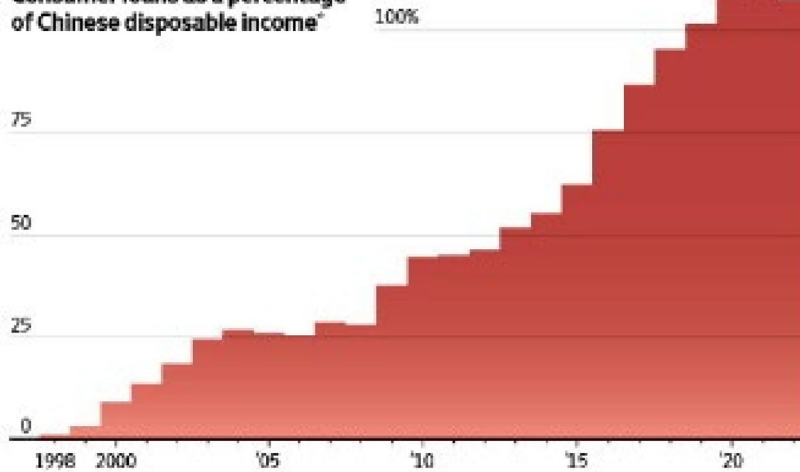
\*Includes autos, energy production, and communications and electronics equipment  
Source: GlobalData TSLombard

# POOR CHINA STRUCTURAL ISSUES

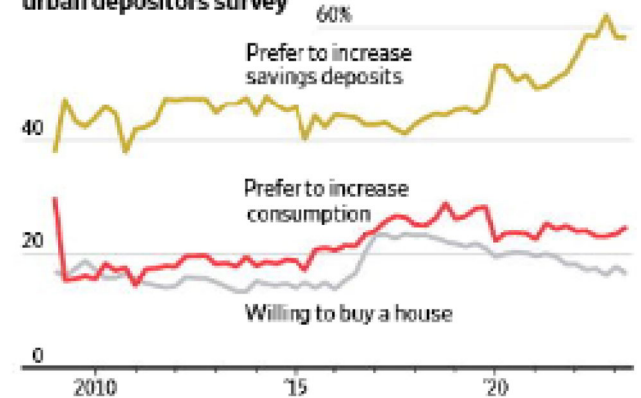
China's working-age population



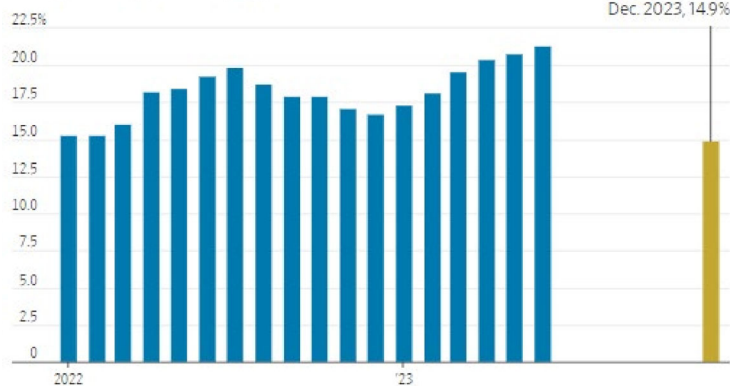
Consumer loans as a percentage of Chinese disposable income



Results from People's Bank of China urban depositors survey

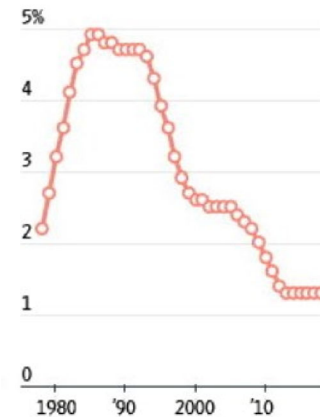


Surveyed urban youth unemployment rate

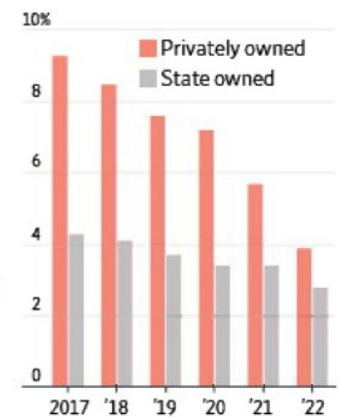


Note: Urban youth includes people ages 16-24.  
Source: China's National Bureau of Statistics

China's total factor productivity growth, annual change



Chinese corporations' average return on assets

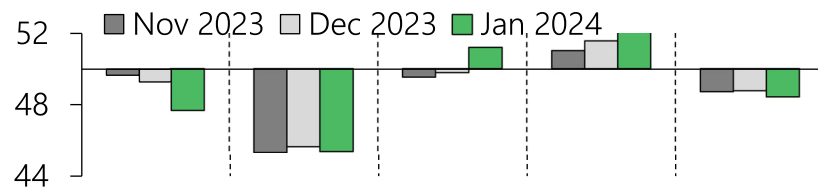


Source: Wall Street Journal 8/21/23, 8/25/23 & 1/24/24, New York Times 8/9/23

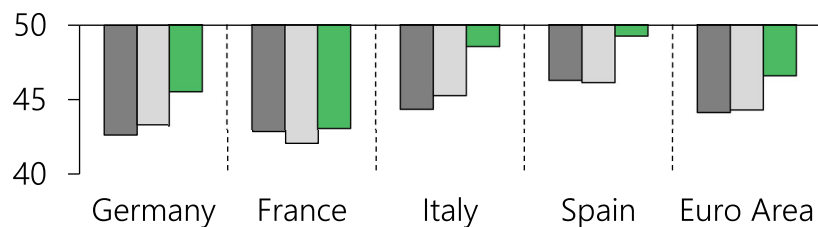


# EUROPE EXPERIENCING MATERIAL SLOWDOWN

## Services Purchasing Managers' Index



## Manufacturing Purchasing Managers' Index

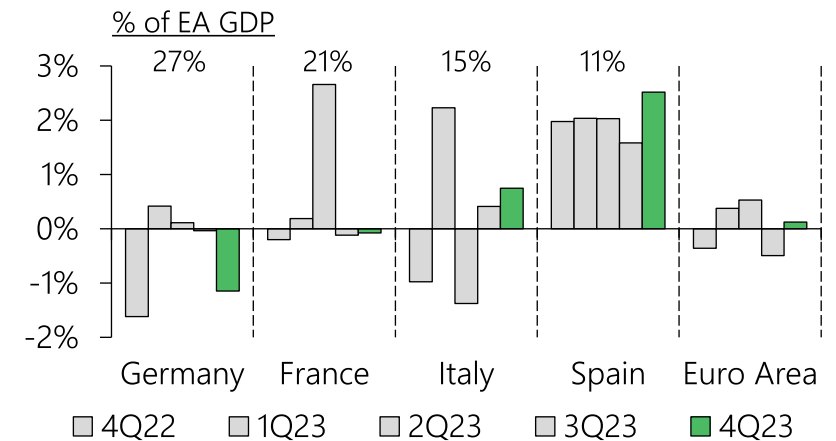


Source: S&P Global

<50 Contracting >50 Expanding

## Real GDP Growth

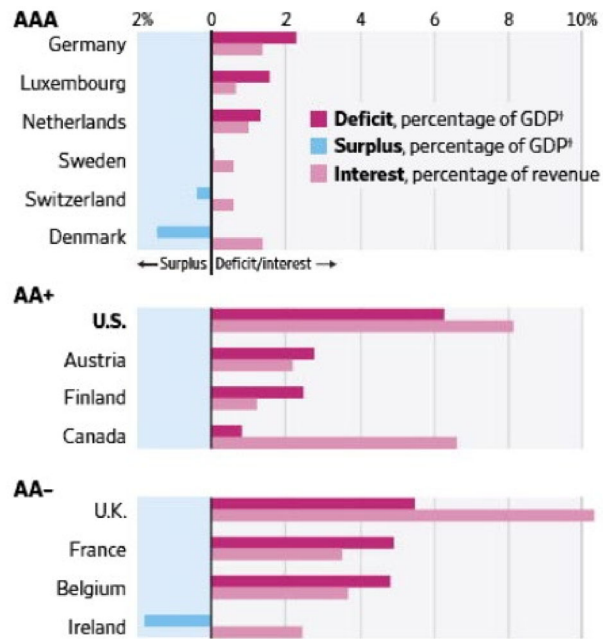
SA/CA, Q/Q Percent Annualized



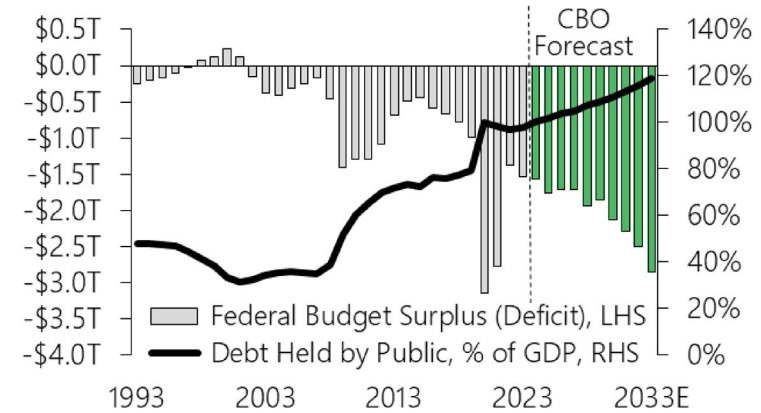
Source: Eurostat

# U.S. DOWNGRADE FLASHES WARNING SIGN

Deficits or surpluses and debt interest of countries rated AAA or AA, 2023 estimate

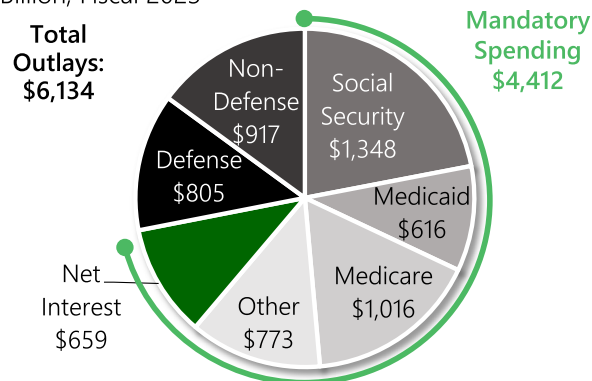


U.S. Federal Budget  
\$ Trillion, by Fiscal Year



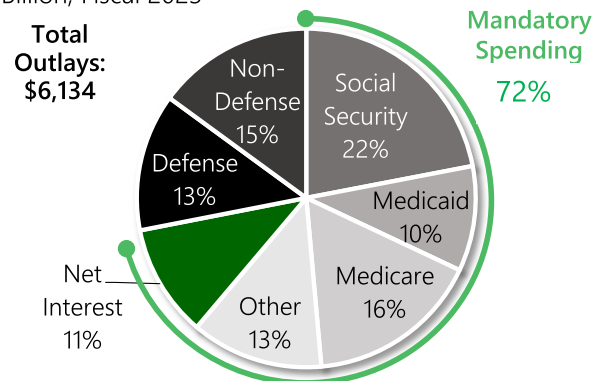
Source: Congressional Budget Office

U.S. Federal Spending  
\$ Billion, Fiscal 2023



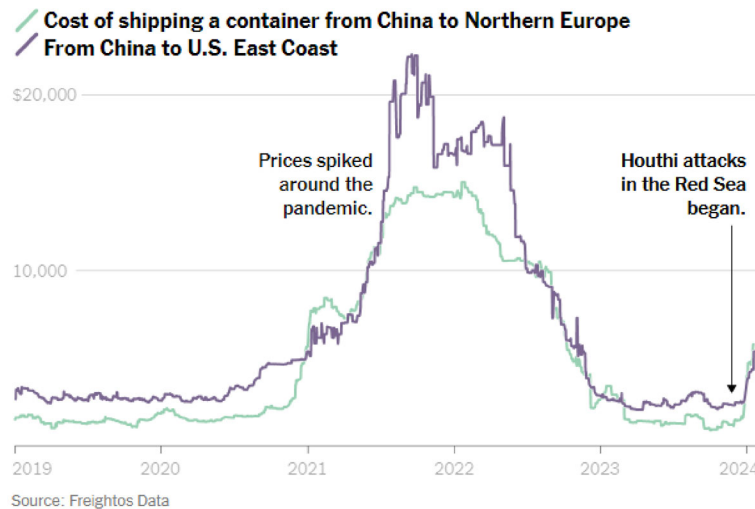
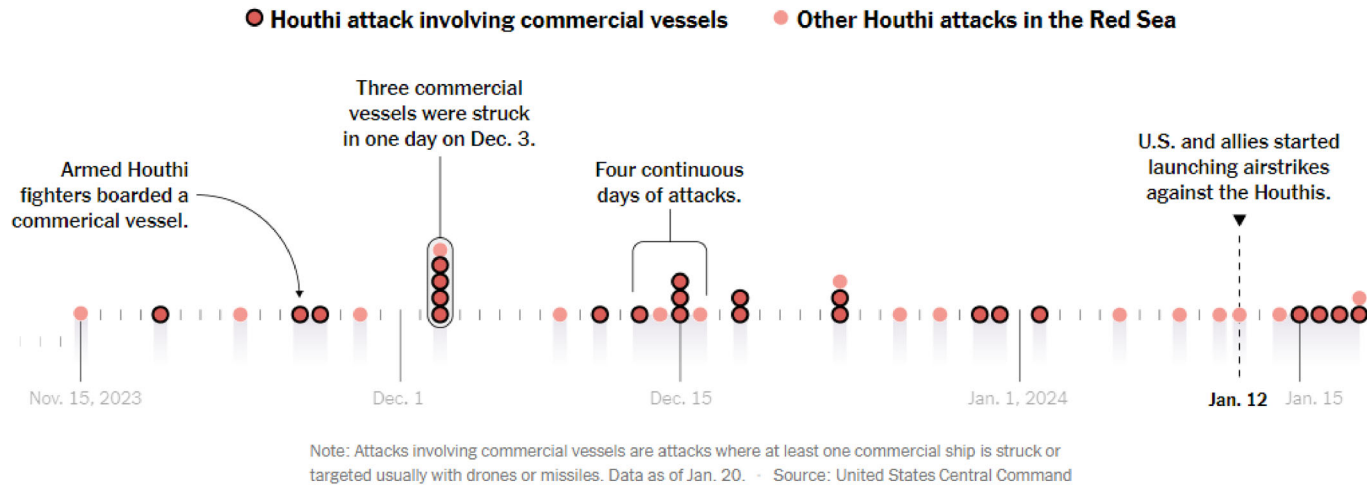
Source: Congressional Budget Office

U.S. Federal Spending  
\$ Billion, Fiscal 2023

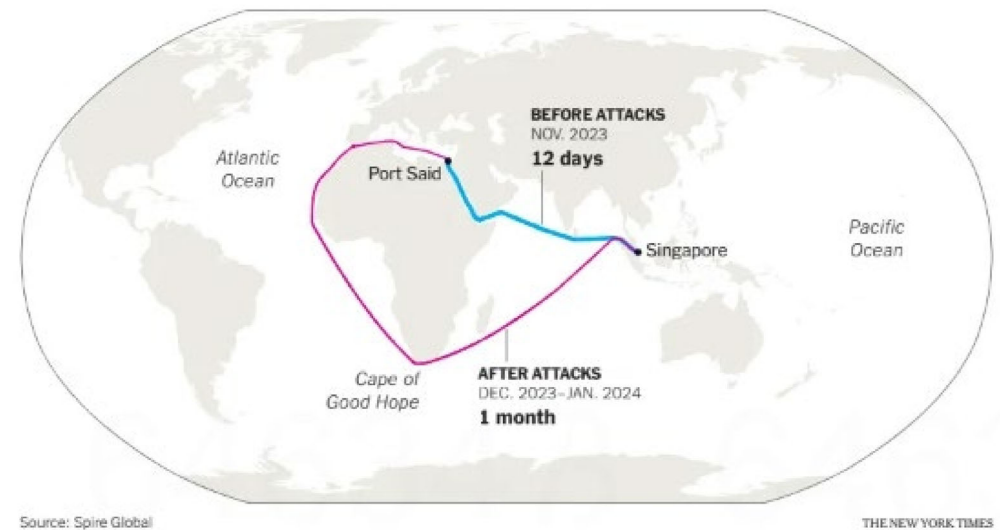


Source: Congressional Budget Office

# HOW HOUTHİ ATTACKS IN THE RED SEA HAVE UPENDED GLOBAL SHIPPING

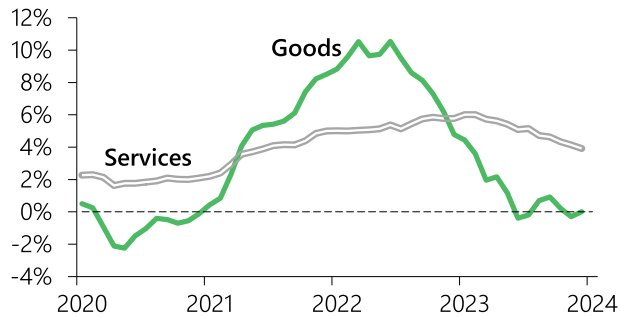


Route of the Maersk Hong Kong How the route changes affected one ship's speed



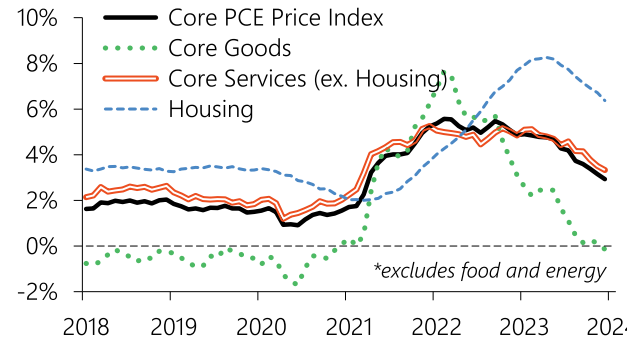
# FED'S FAVORITE INFLATION GAUGES SLOWING BUT NOT FAST ENOUGH?

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



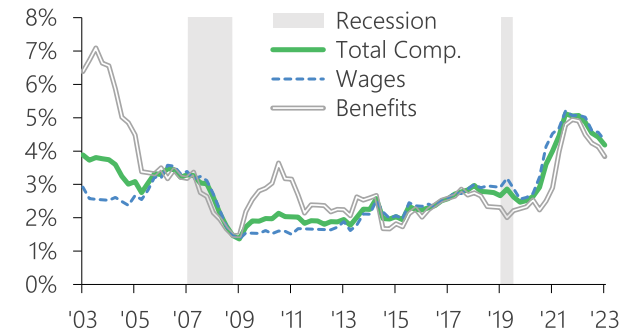
Source: Bureau of Economic Analysis

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



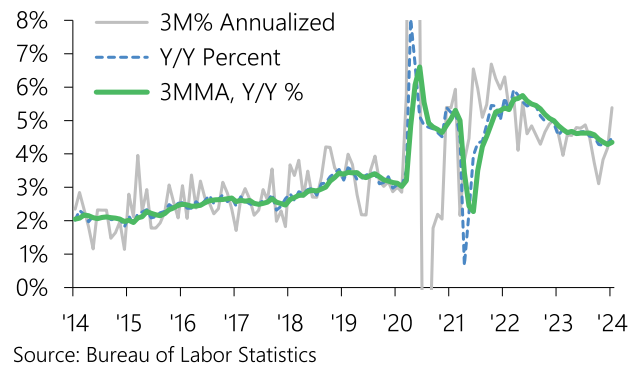
Source: Bureau of Economic Analysis

**U.S. Employment Cost Index**  
Y/Y Percent



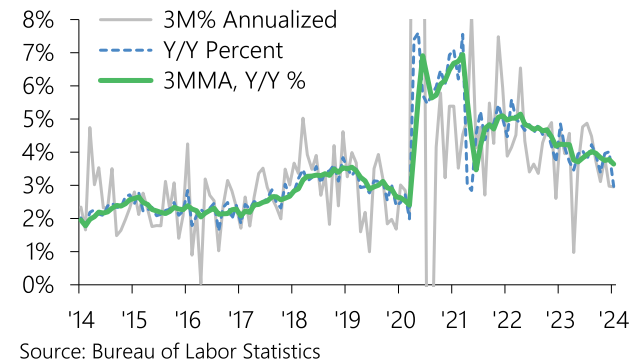
Source: Bureau of Labor Statistics

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



Source: Bureau of Labor Statistics

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



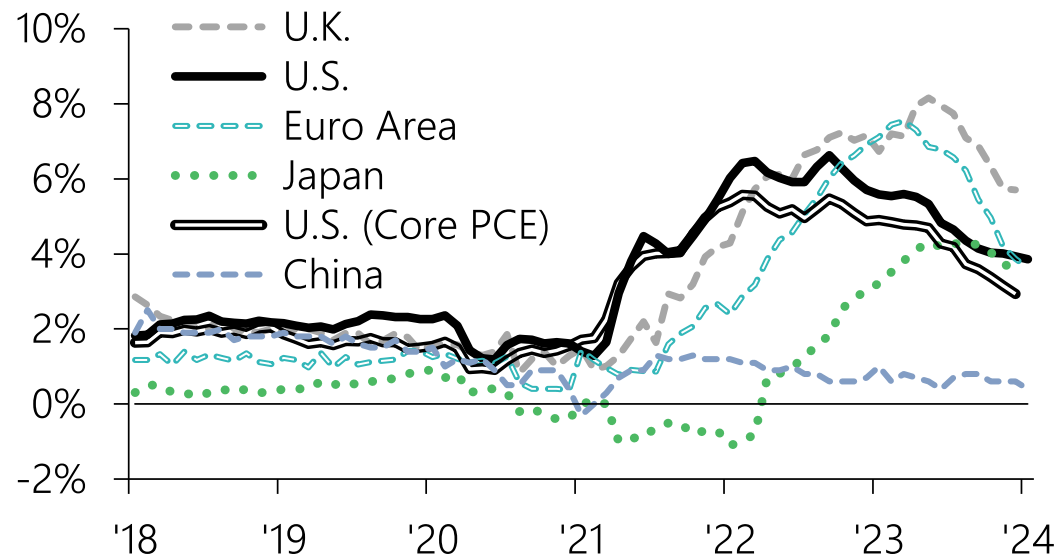
Source: Bureau of Labor Statistics

Source: Bureau of Economic Analysis 2/5/24, Bureau of Labor Statistics 2/13/24

## GLOBAL INFLATION STILL TOO HIGH

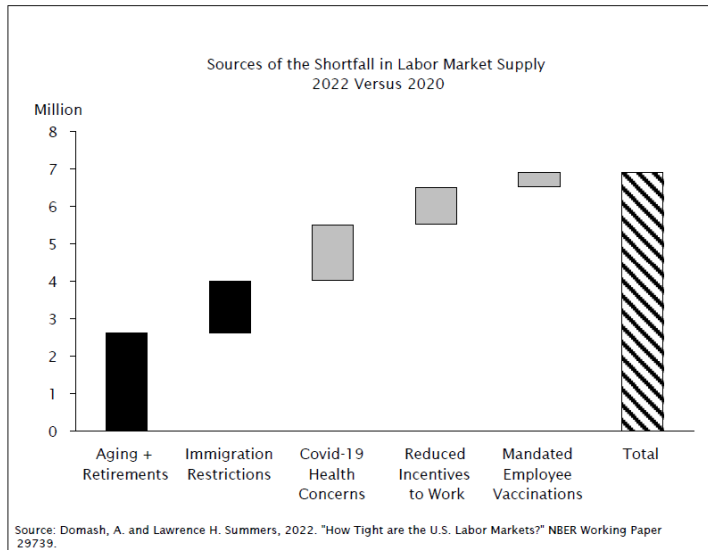
### Consumer Price Index

Excluding Food and Energy, Y/Y Percent



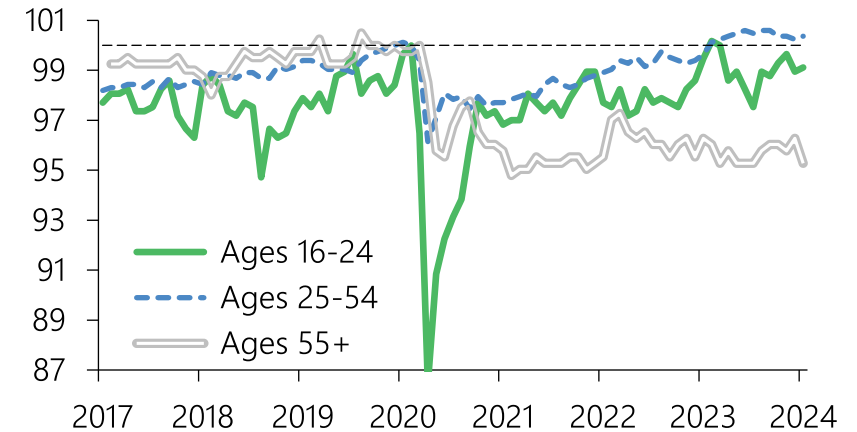
Source: FactSet

# U.S. LABOR MARKET PARTICIPATION RATE IMPROVING



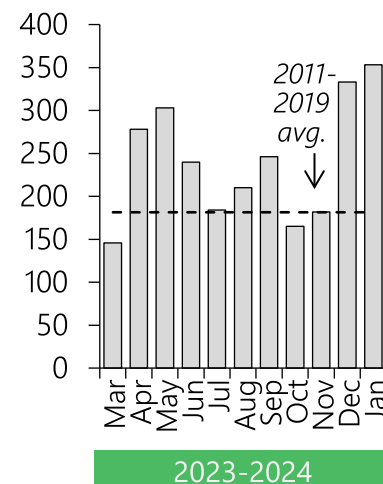
## U.S. Civilian Labor Force Participation Rate

By Age Group, Seasonally-Adjusted, 2/28/20 = 100

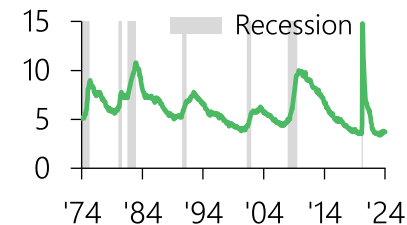


Source: Department of Labor

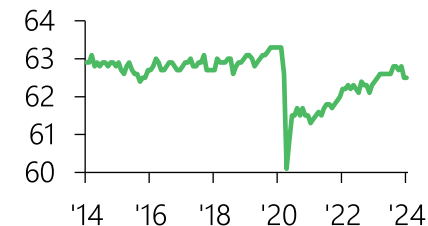
## U.S. Nonfarm Payrolls Monthly Change, 000



## Unemployment Rate (%)



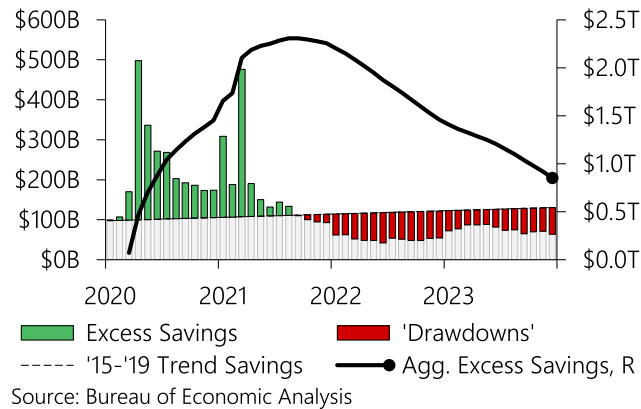
## Labor Participation Rate (%)



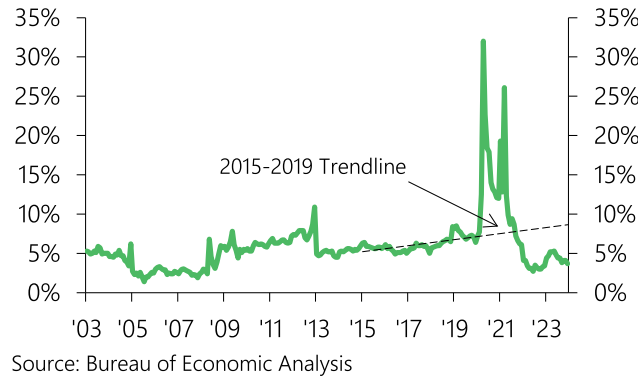
Source: Empirical Research Partners 5/25/22, Department of Labor 2/5/24

# EXCESS SAVINGS REDUCED

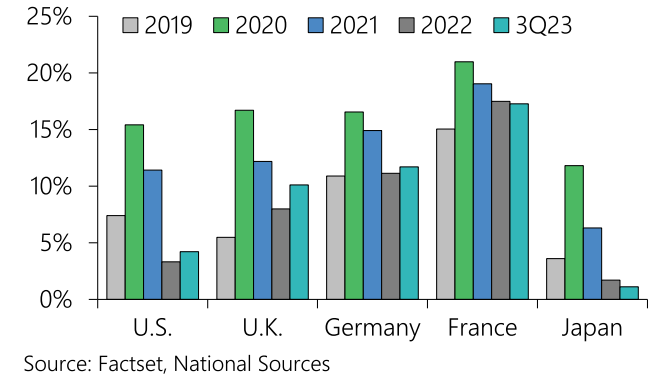
**U.S. Personal "Excess" Savings**



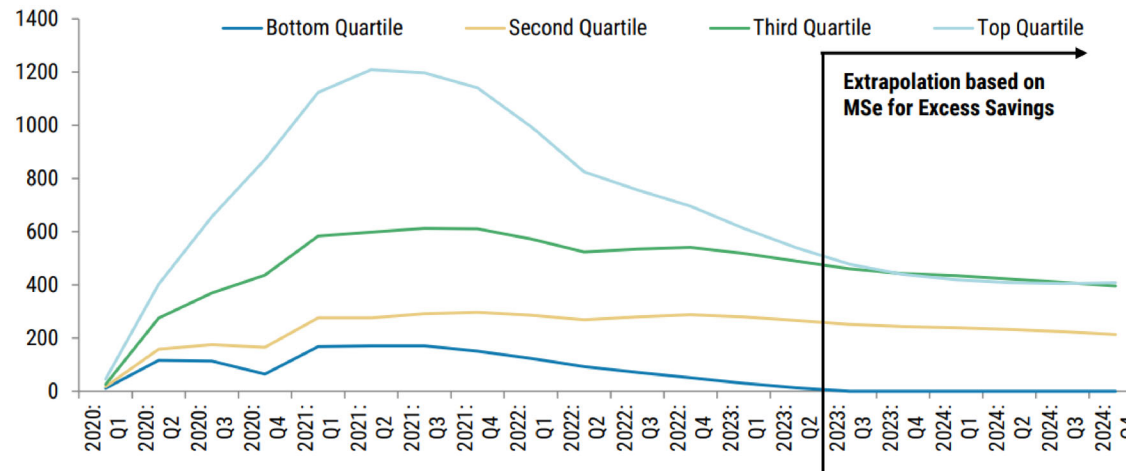
**U.S. Personal Savings Rate**  
Savings as a Percent of Disposable Income



**Household Savings Rates**  
Percent of Disposable Income



**U.S. Excess Savings by Income Quartile, \$Bil.**

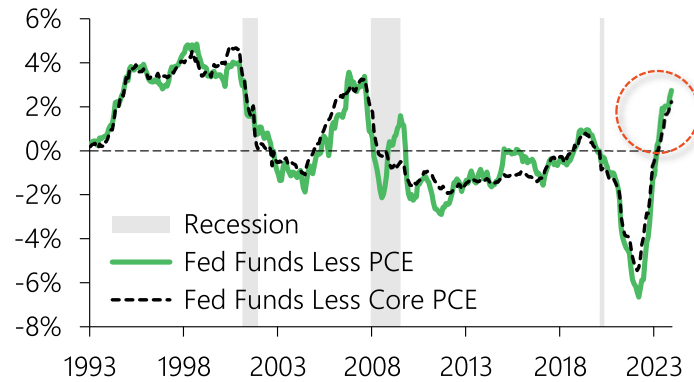


Source: Bureau of Economic Analysis 2/5/24, FactSet & National Sources 2/5/24, Morgan Stanley 11/10/23

# U.S. RATE CUTS IN THE FUTURE

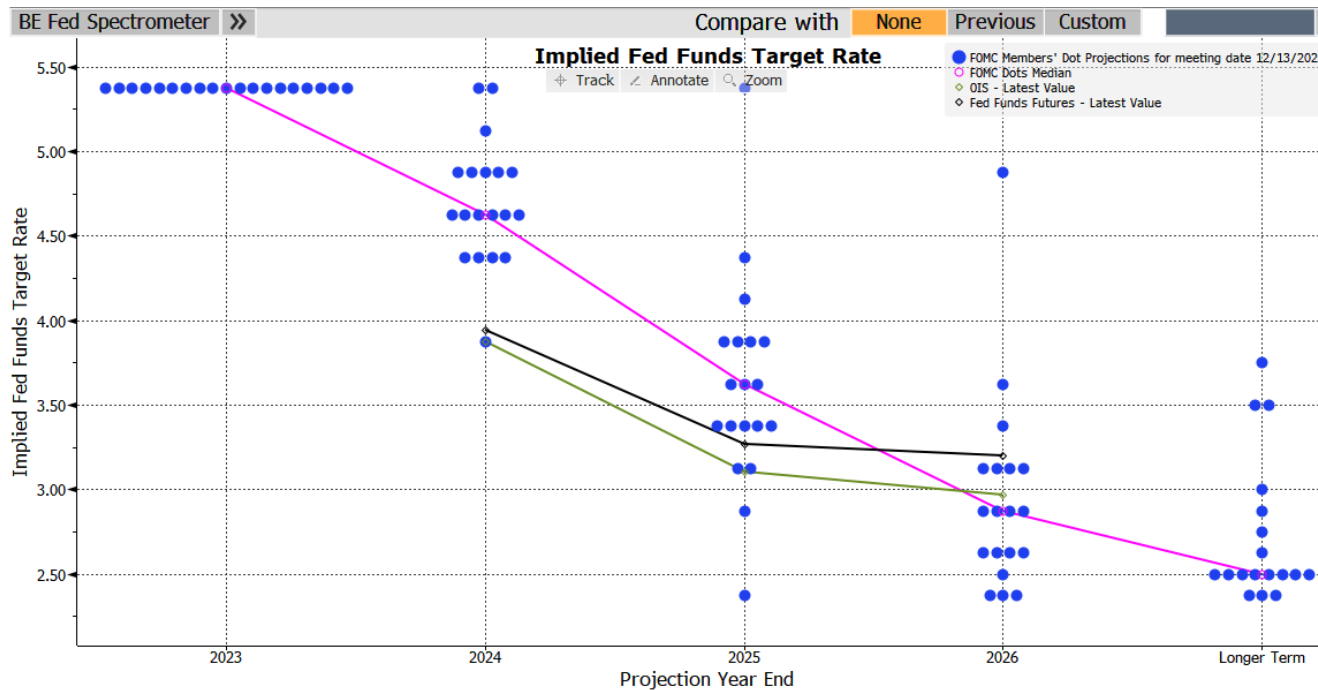
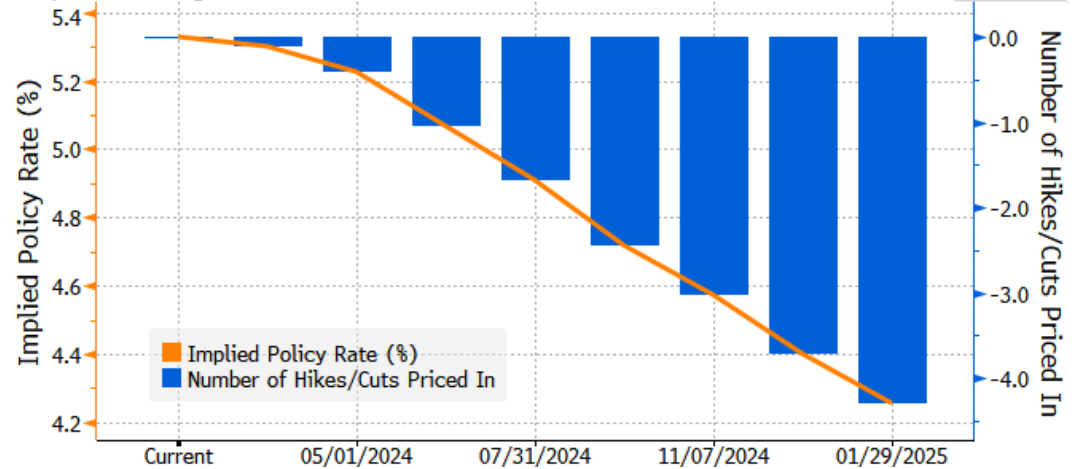
Real Fed Funds Rate

Percent



Source: Federal Reserve, BEA, NBER

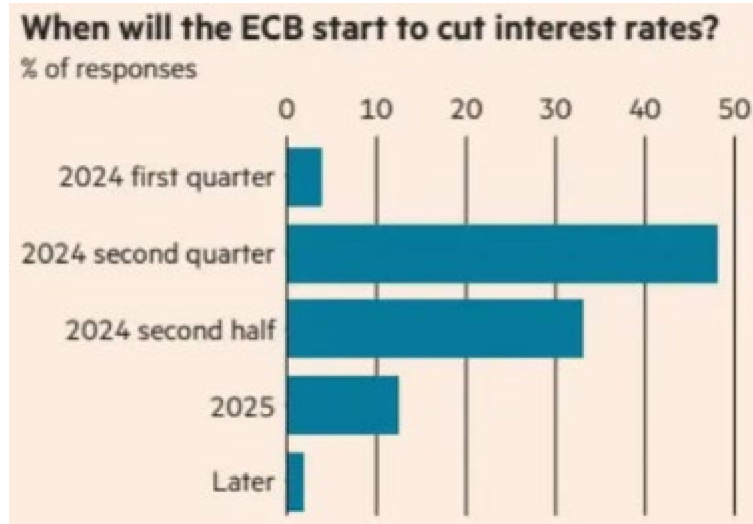
Implied Overnight Rate & Number of Hikes/Cuts



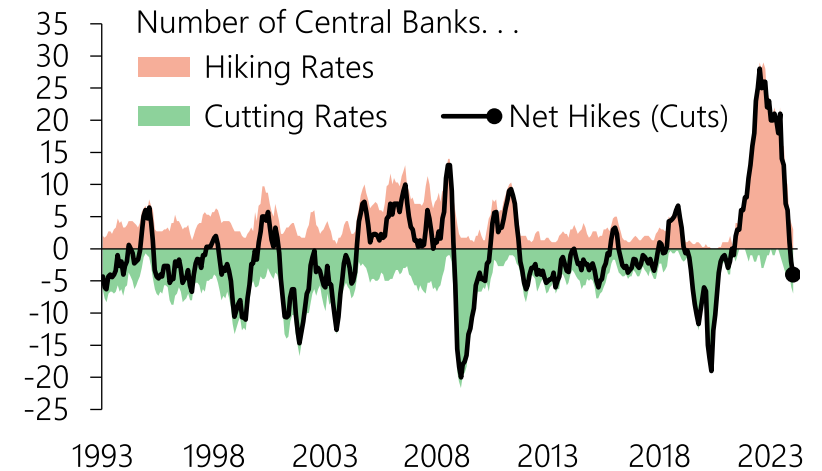
Source: Federal Reserve, BEA, NBER 2/7/24, Bloomberg 2/13/24



## INTERNATIONALLY, CUTS NOT LIKELY UNTIL MIDYEAR



### Global Central Bank Policy Rate Cycles

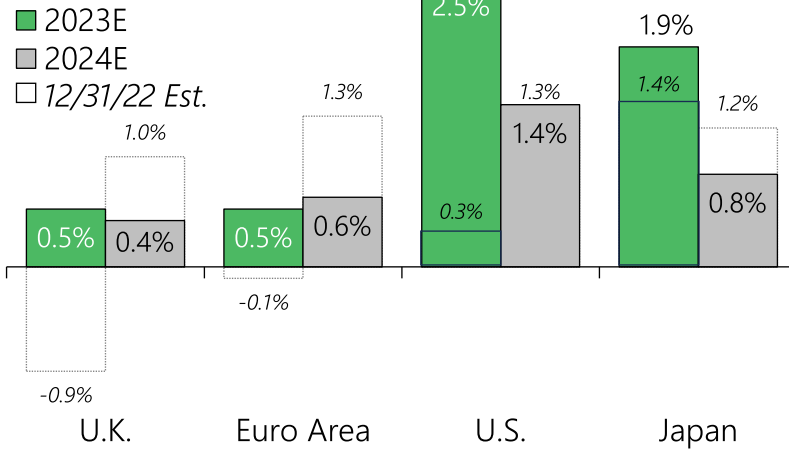


Source: World Bank, Bank for International Settlements

# GLOBAL ECONOMIC OUTLOOK

## Consensus Real GDP Growth Forecast

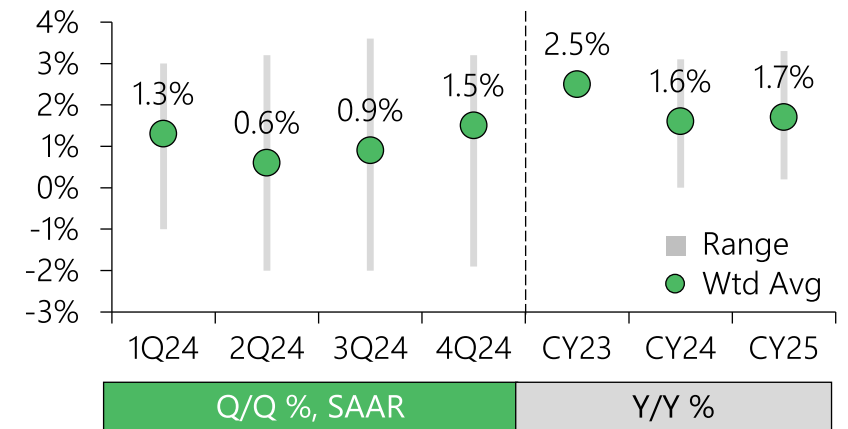
Y/Y%, Median



Source: FactSet

## Consensus Real GDP Growth Forecast

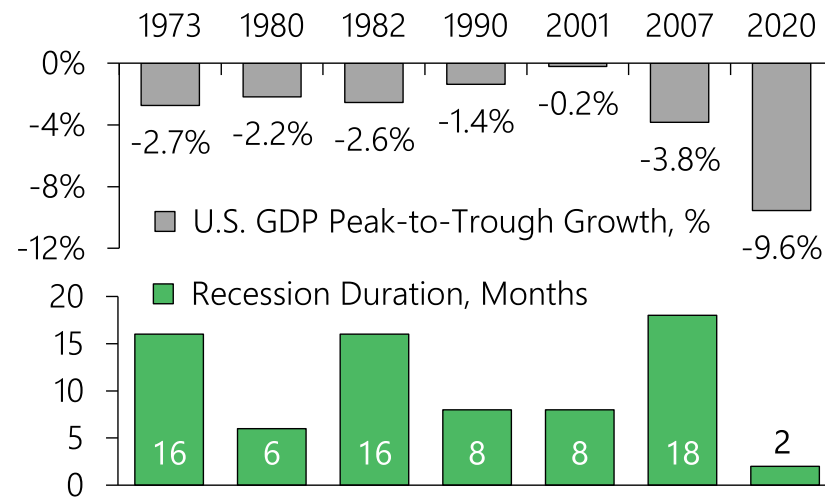
United States



Source: Bloomberg

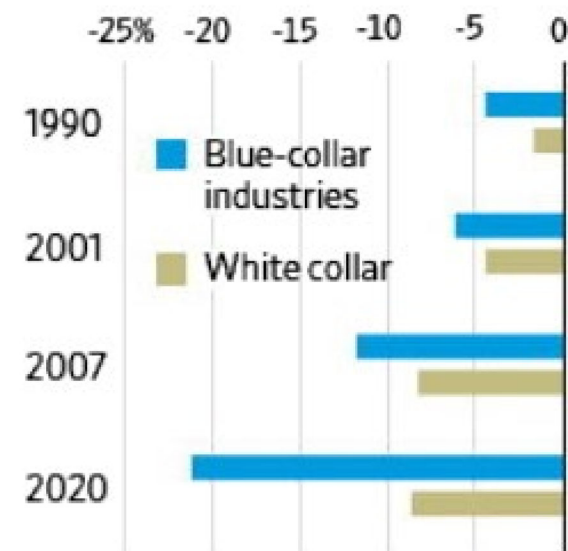
## PRIOR U.S. RECESSION COMPARISONS

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



Source: FactSet, NBER

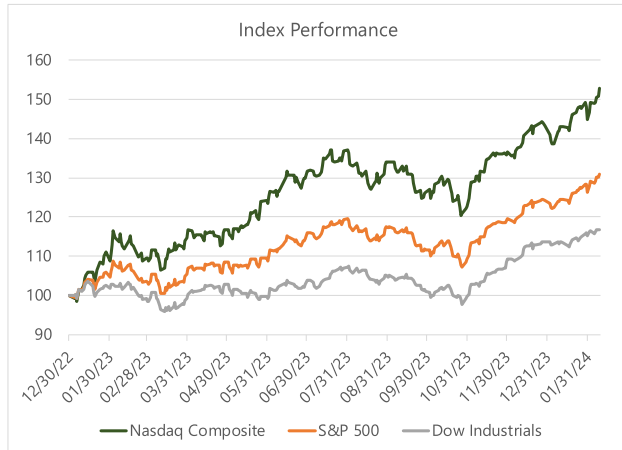
Payrolls, change from peak to trough, by recession\*



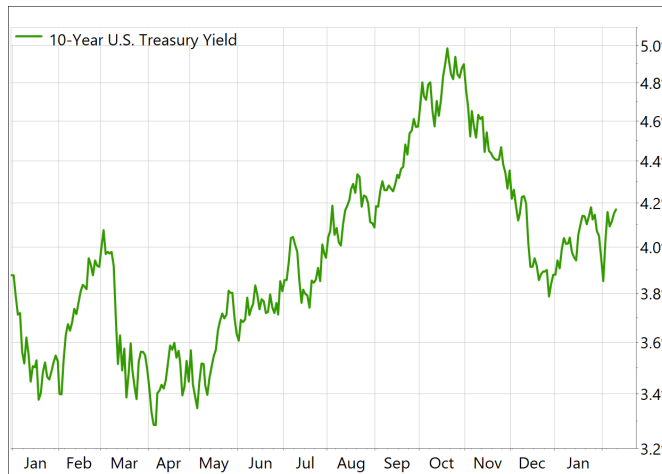
\*Seasonally adjusted. Blue collar includes mining, construction, manufacturing, retail warehousing, and leisure and hospitality. White collar includes information, finance and professional and business services. Source: Labor Department.

Source: FactSet, NBER 2/13/24, Wall Street Journal 1/9/23

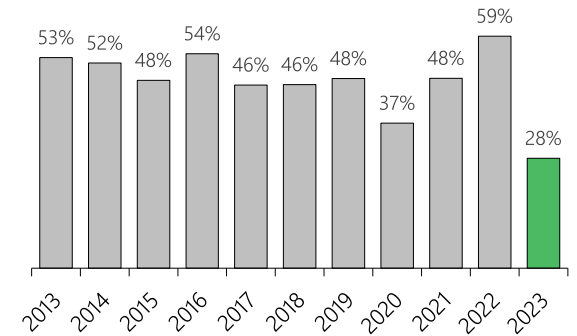
# MARKETS DEFY EXPECTATIONS IN 2023, BUT VERY NARROW LEADERSHIP



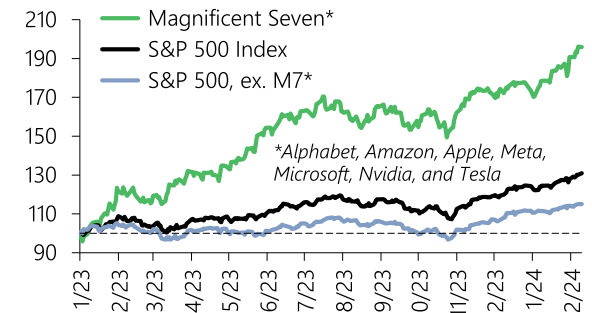
	2023	YTD 2024
Nasdaq Composite	43%	7%
S&P 500	24%	5%
Dow Industrials	14%	3%



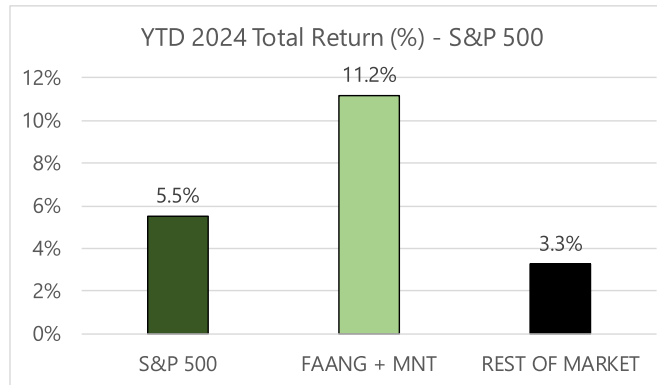
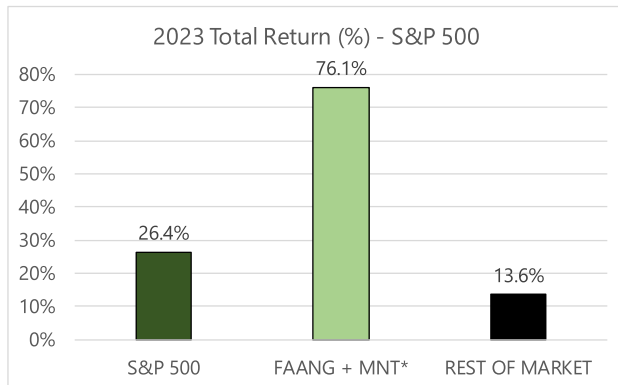
Percentage of S&P 500 Stocks Outperforming Index



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



Source: FactSet



**FAANG + MNT  
contributed 63% of the  
total S&P 500 Return in  
2023 and 58% YTD  
2024**

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

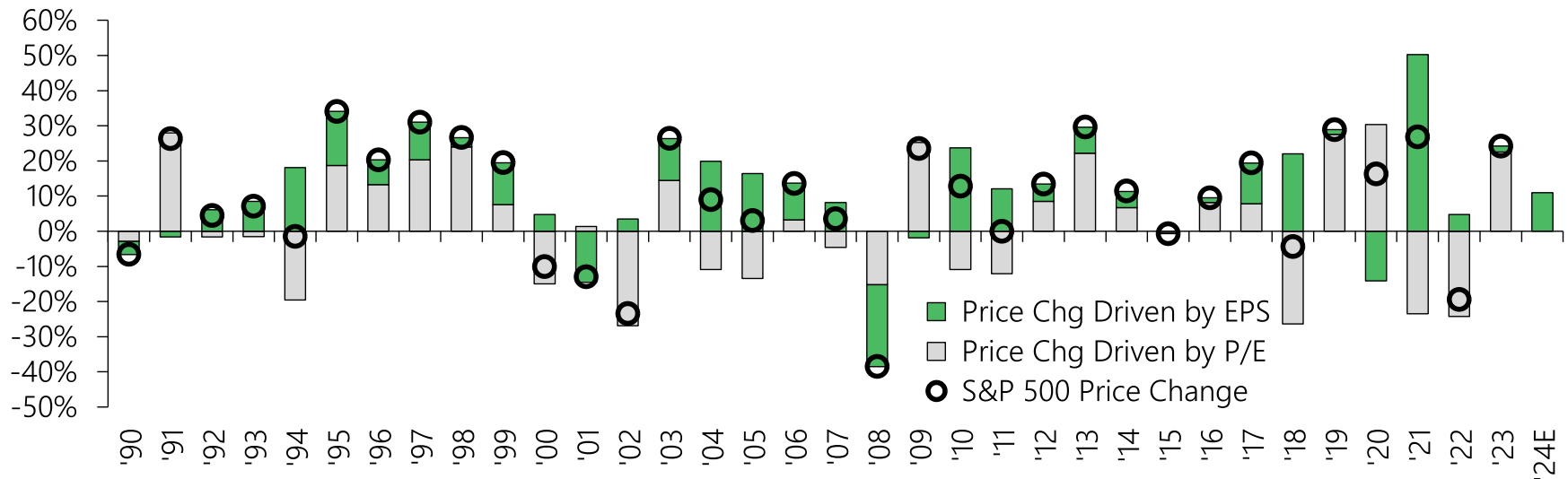
# MULTIPLE EXPANSION ACCOUNTED FOR MARKET INCREASE IN 2023

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

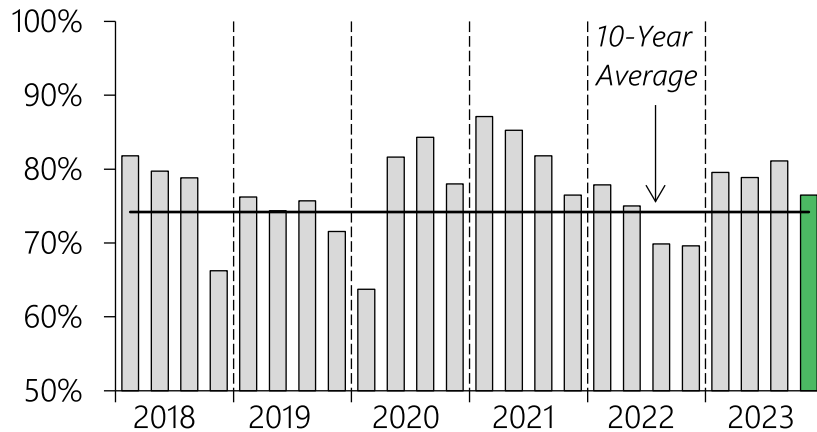


Source: FactSet Research Systems 2/5/24

# S&P 500 CONSENSUS EPS TRENDING LOWER, BUT OK

## Positive EPS Surprises

S&P 500 Index

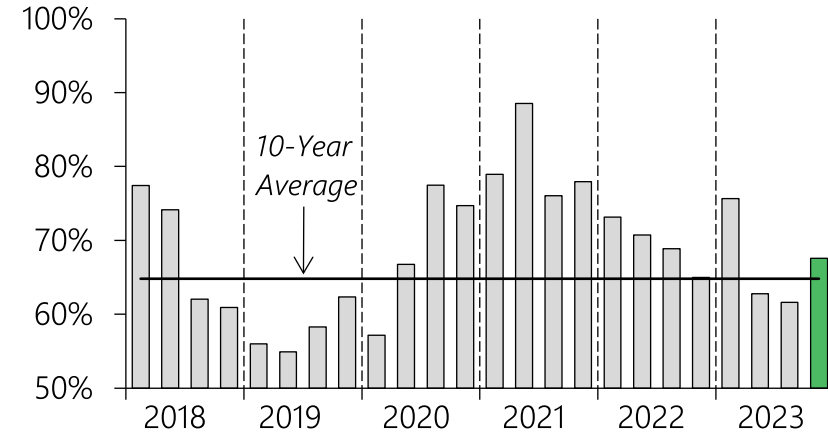


Source: Factset

## Positive Revenue Surprises

S&P 500 Index

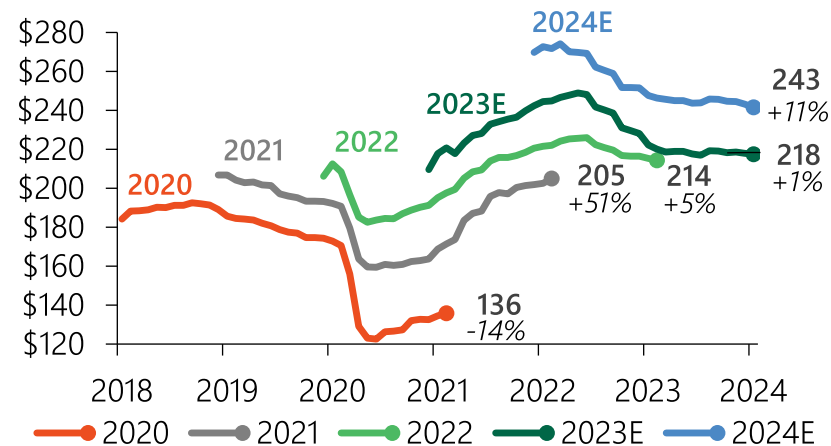
67% of S&P 500 Index constituents have reported



Source: Factset

## S&P 500 Consensus EPS Estimates

Bottom-Up, Calendar Year

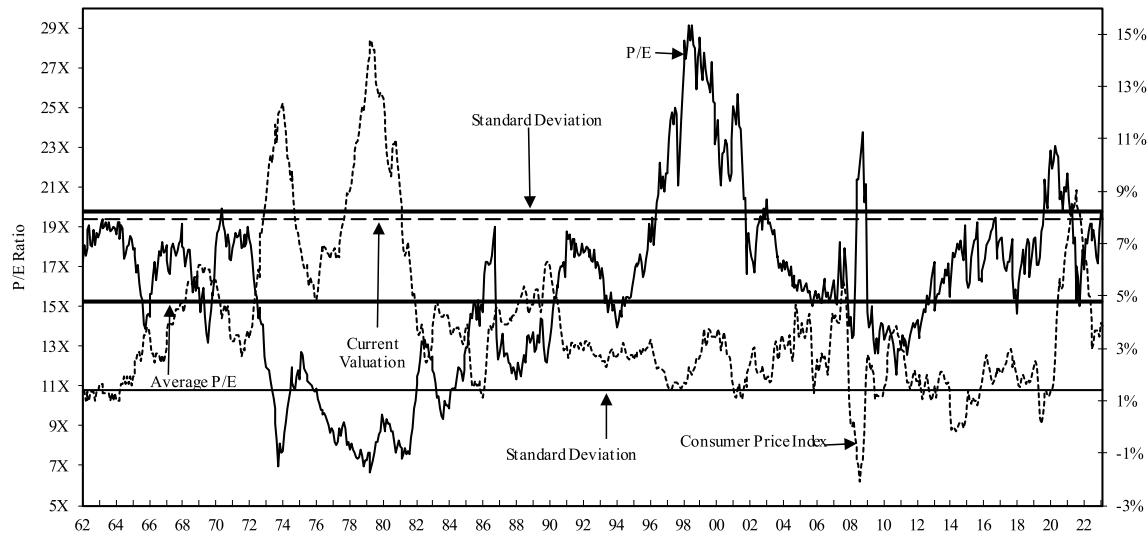


Source: FactSet

Source: FactSet Research Systems 2/13/24

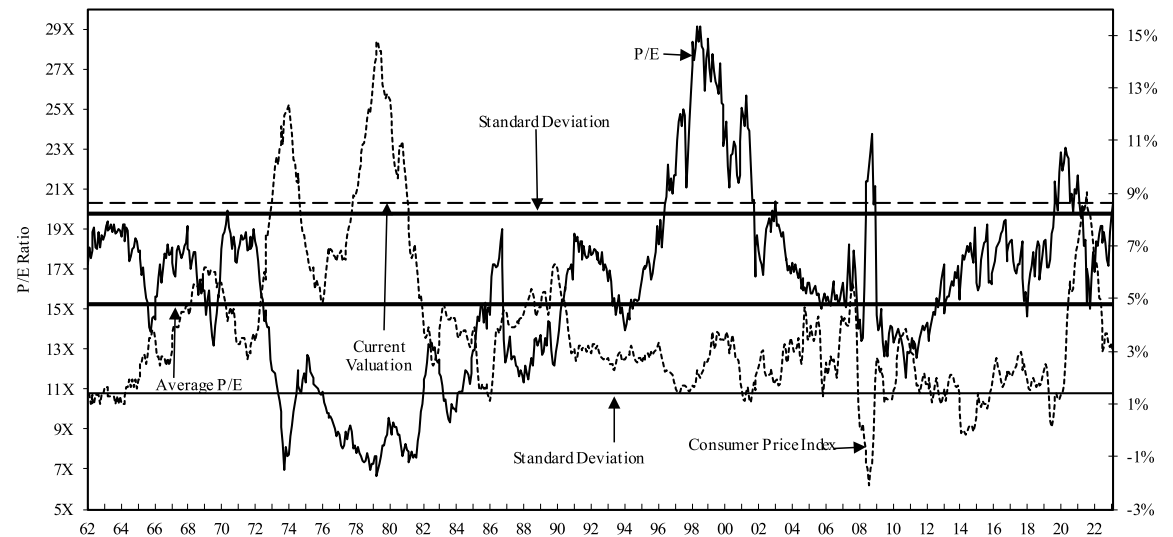
# S&P 500 VALUATION TOWARDS HIGHER END OF RANGE IN 2024

(Based on 2023 Estimates)



Note: Operating EPS used to calculate P/E after 12/84; last month CPI is estimated. The current valuation of 22.8x is based on 2023 est. operating EPS of \$212.97

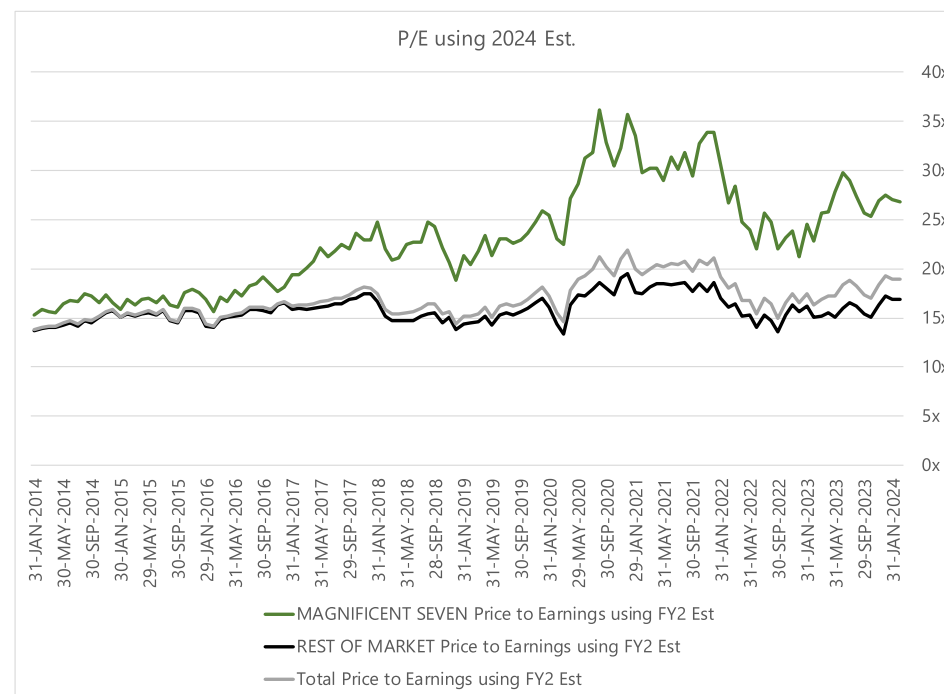
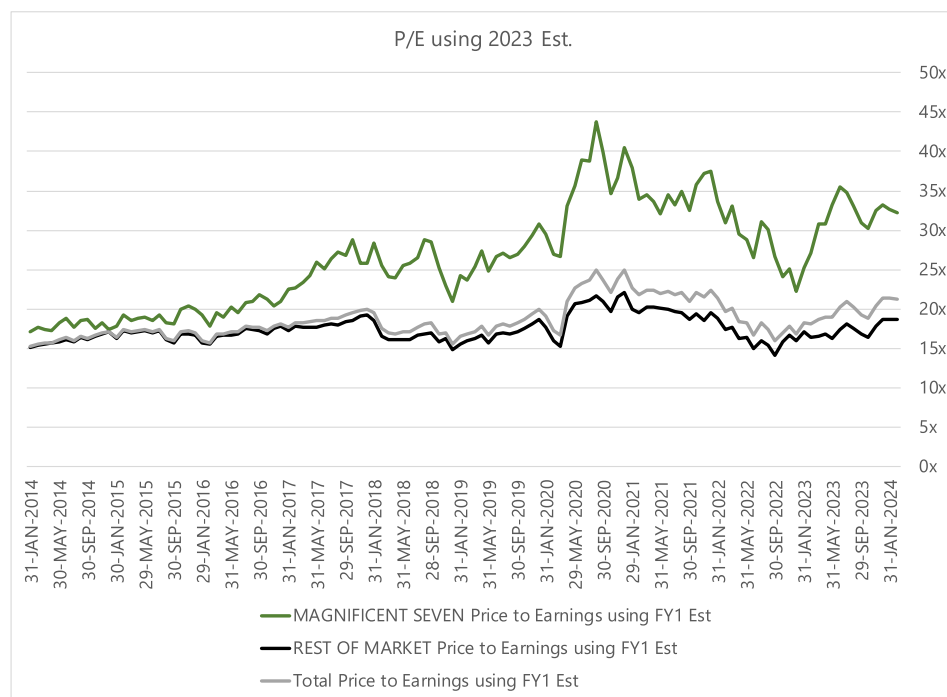
(Based on 2024 Estimates)



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 2024 est. operating EPS of \$238.95

Source: Factset Research Systems 1/31/24

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





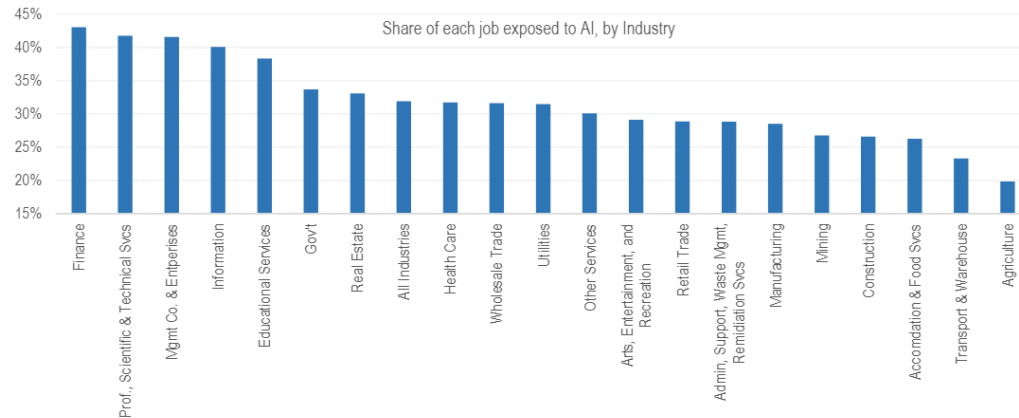
## U.S. EQUITY VALUATIONS REASONABLE EXCLUDING TECHNOLOGY SECTOR

	Current NTM P/E	20 yr avg NTM P/E	<u>Premium/Discount to S&amp;P 500</u>		
			Current	20 yr avg	Spread
S&P 500	20.5x	15.8x			
S&P 500 / Information Technology -SEC	28.8x	17.1x	8.3	1.3	7.0
S&P 500 / Consumer Discretionary -SEC	25.9x	20.9x	5.4	5.0	0.3
S&P 500 / Materials -SEC	19.3x	15.1x	-1.2	-0.7	-0.5
S&P 500 / Health Care -SEC	19.2x	15.0x	-1.3	-0.8	-0.5
S&P 500 / Industrials -SEC	20.4x	16.7x	-0.1	0.9	-1.0
S&P 500 / Consumer Staples -SEC	19.6x	17.6x	-0.9	1.7	-2.6
S&P 500 / Financials -SEC	14.9x	13.0x	-5.6	-2.8	-2.8
S&P 500 / Communication Services -SEC	18.7x	17.4x	-1.8	1.6	-3.4
S&P 500 / Utilities -SEC	15.0x	15.5x	-5.5	-0.3	-5.2
S&P 500 / Energy -SEC	11.6x	15.0x	-8.9	-0.8	-8.1

	Current NTM P/E	20 yr avg NTM P/E	<u>Premium/Discount to S&amp;P 500</u>		
			Current	20 yr avg	Spread
S&P 500 / Software -IND	32.8x	19.9x	12.4	4.1	8.2
S&P 500 / Semiconductors -SUB	30.3x	17.8x	9.8	1.9	7.9
S&P 500 / Technology Hardware & Equipment -IG	24.7x	16.0x	4.2	0.2	4.0

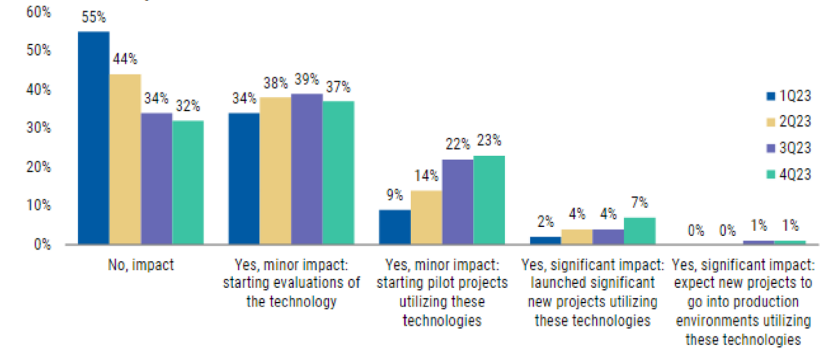
# ESTIMATES FOR AI STOCKS HAVE SEEN STRONG UPWARD REVISIONS

Share of each job's functions exposed to AI, by Industry

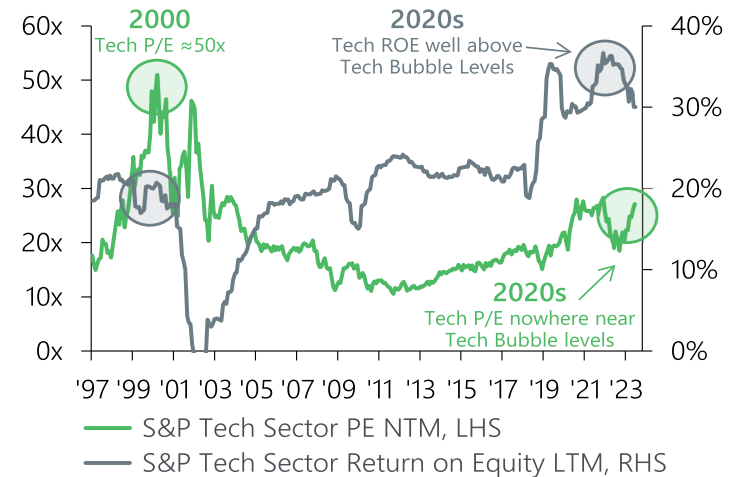
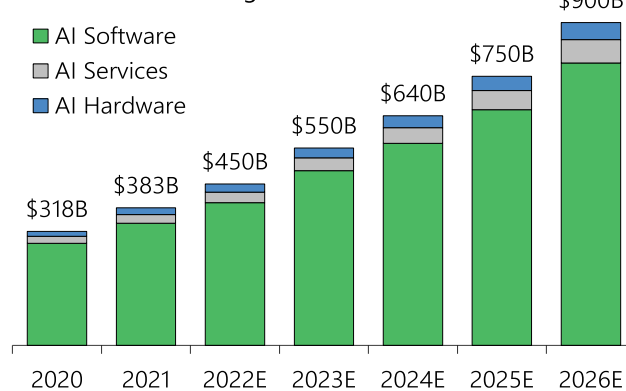


Source: O\*NET, BLS, Census, Felten et al. (2021), Evercore ISI Research

Impact of Innovations in AI on IT Investment Priorities in 2023

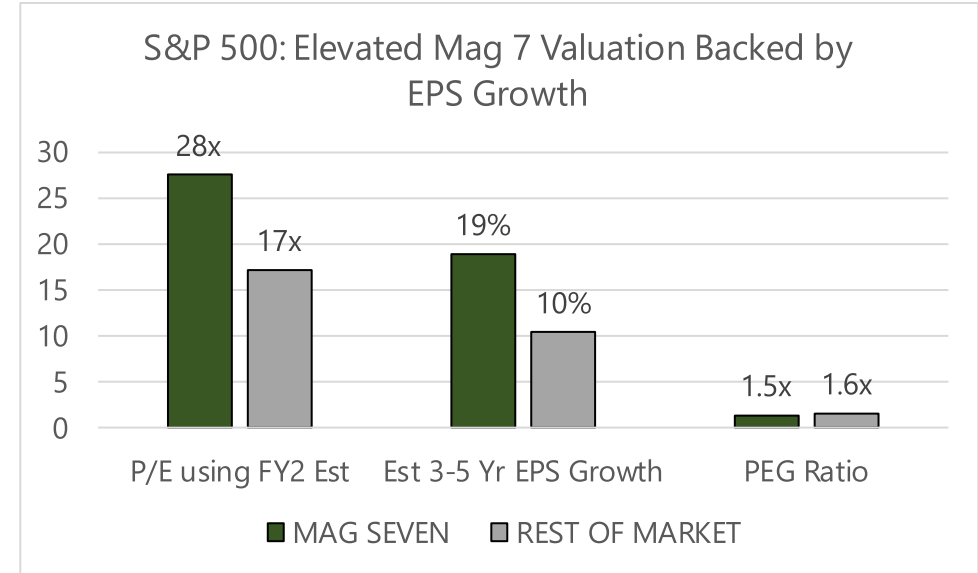
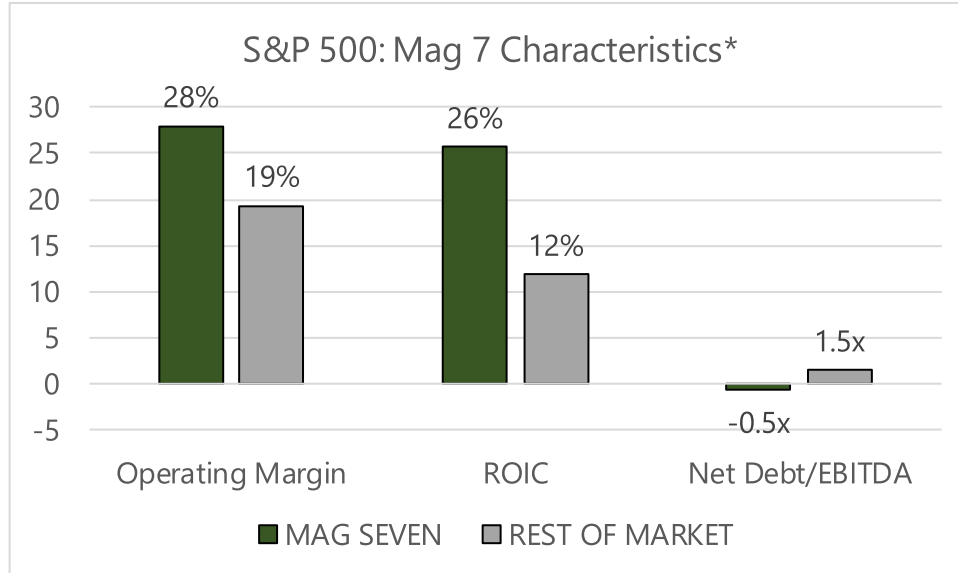
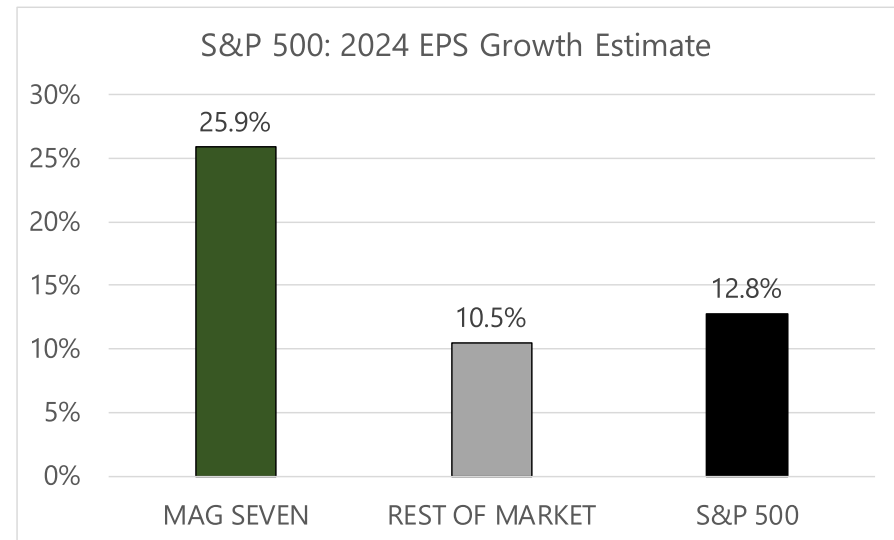
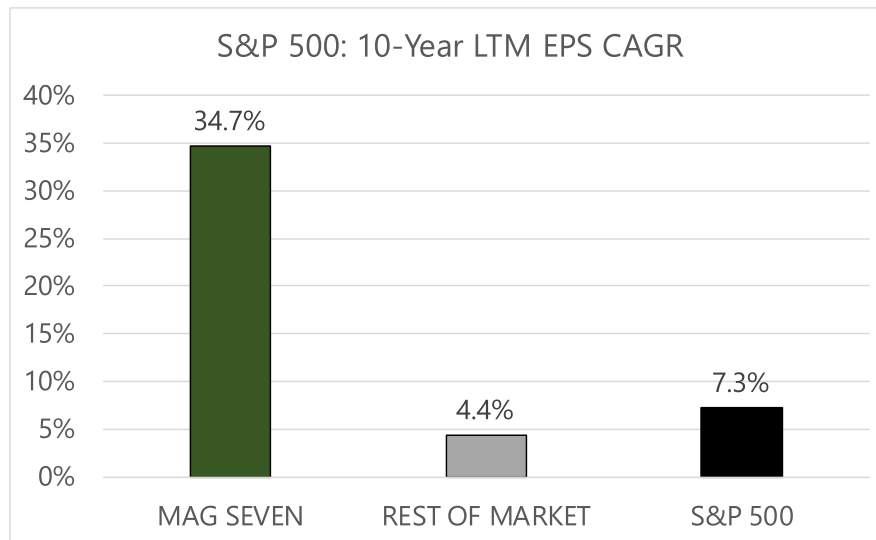


Global Artificial Intelligence Market Size



Source: Evercore ISI 8/6/23, Morgan Stanley 1/16/24, Statista, Factset, Piper Sandler, IDC 6/30/23, Credit Suisse 8/8/23

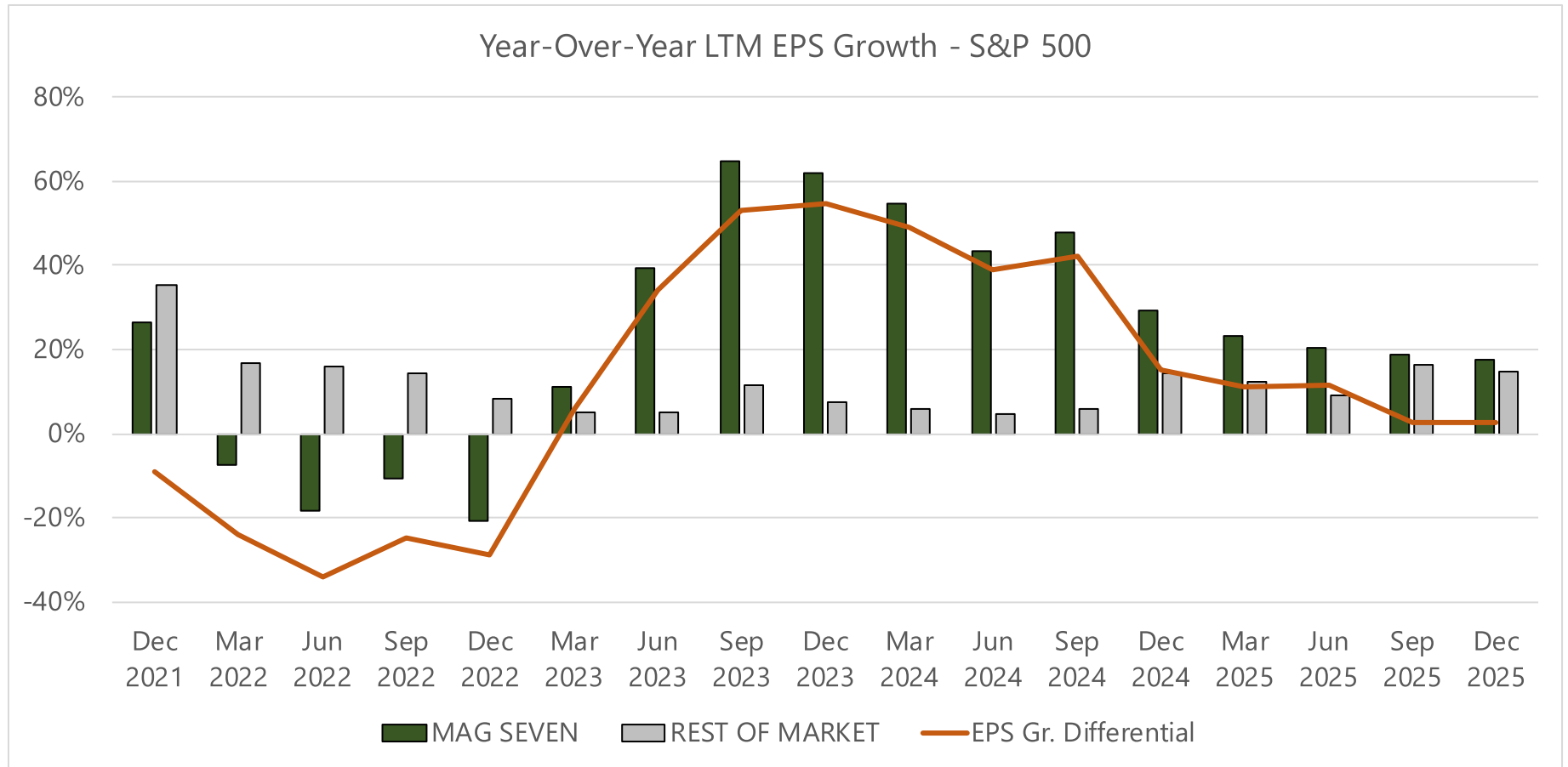
# FUNDAMENTALS SUPPORT MAGNIFICENT SEVEN VALUATIONS



\*Excludes REITs and Financials

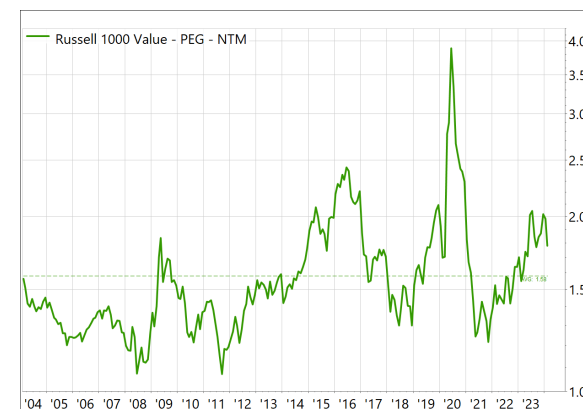
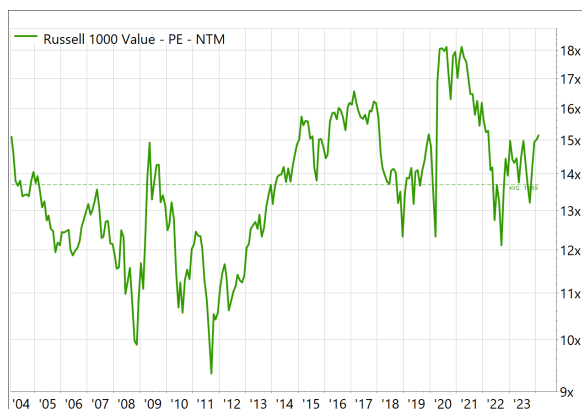
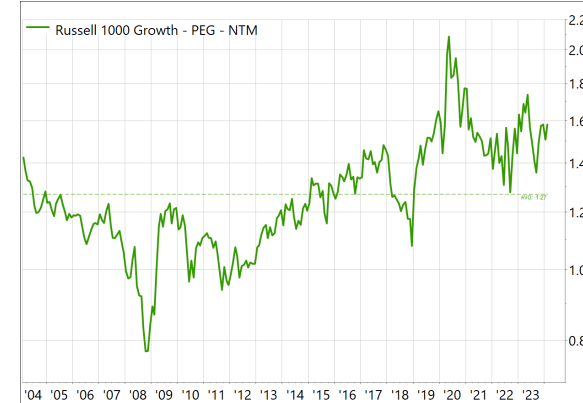
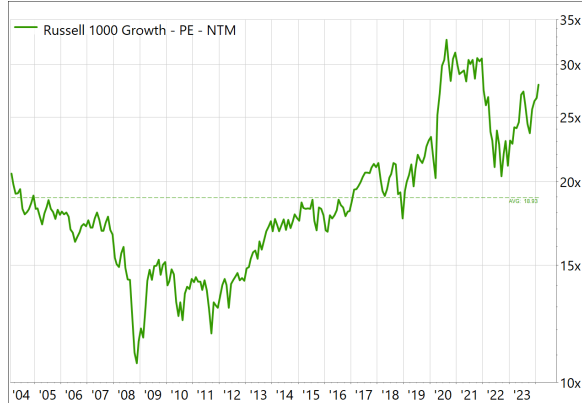
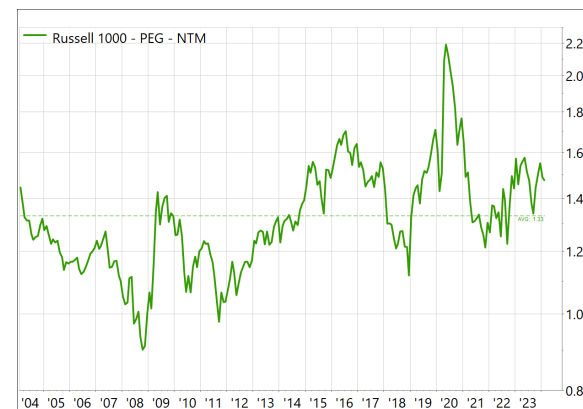
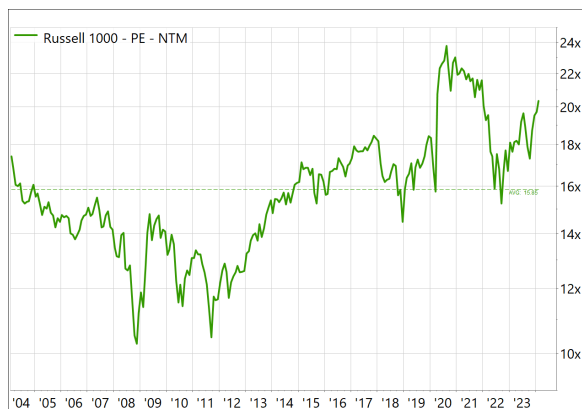
Mag. 7 includes: Apple, Amazon, Google, Meta, Microsoft, NVIDIA, and Tesla

## BROADENING OF EARNINGS KEY THEME GOING FORWARD

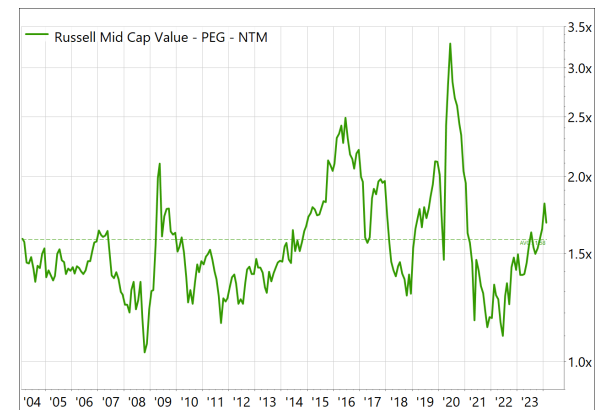
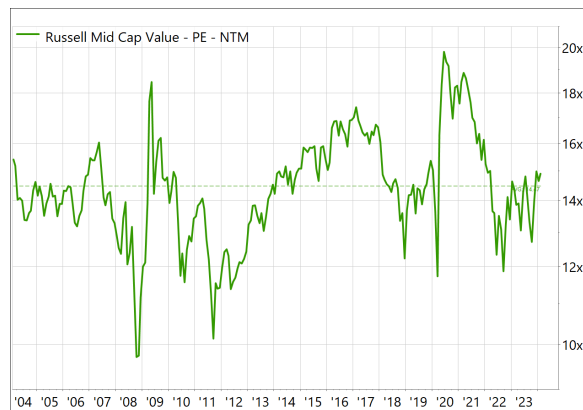
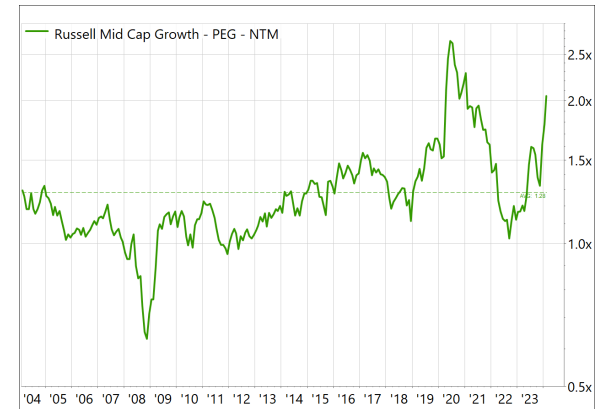
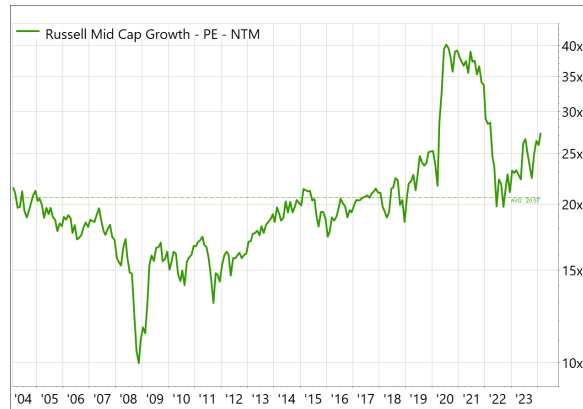
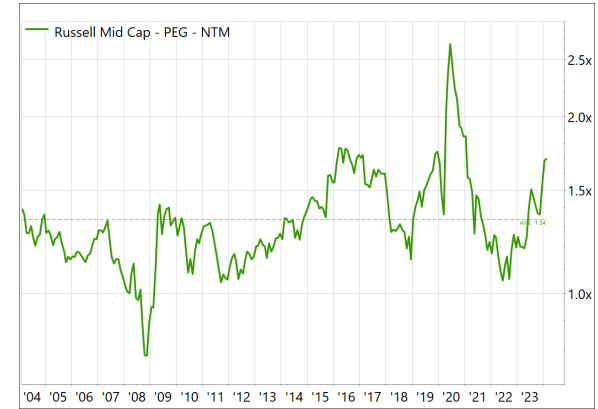
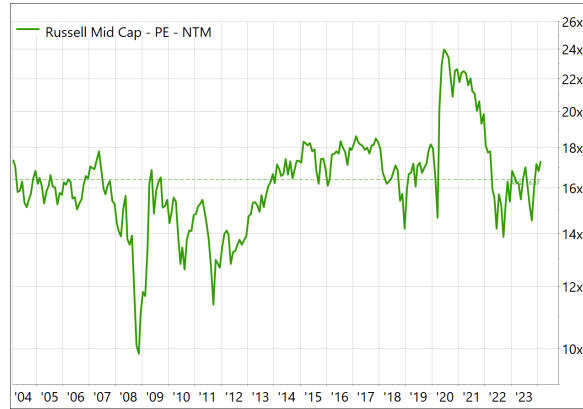


# LARGE CAP VALUATIONS

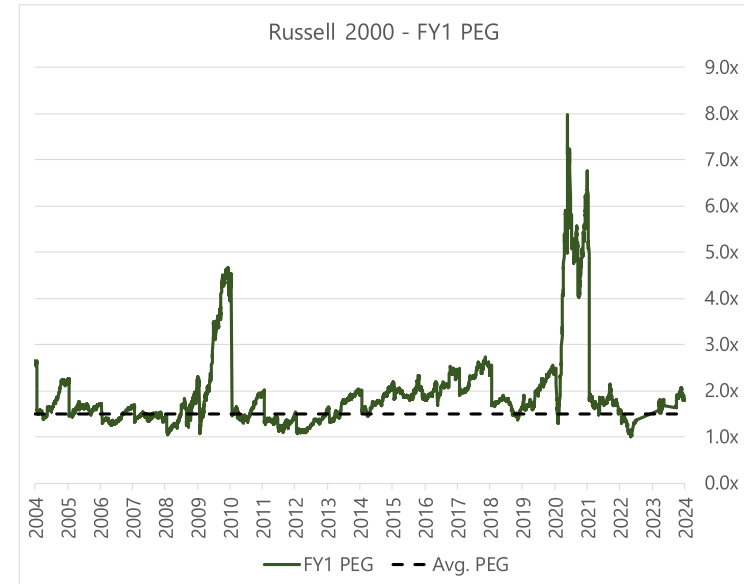
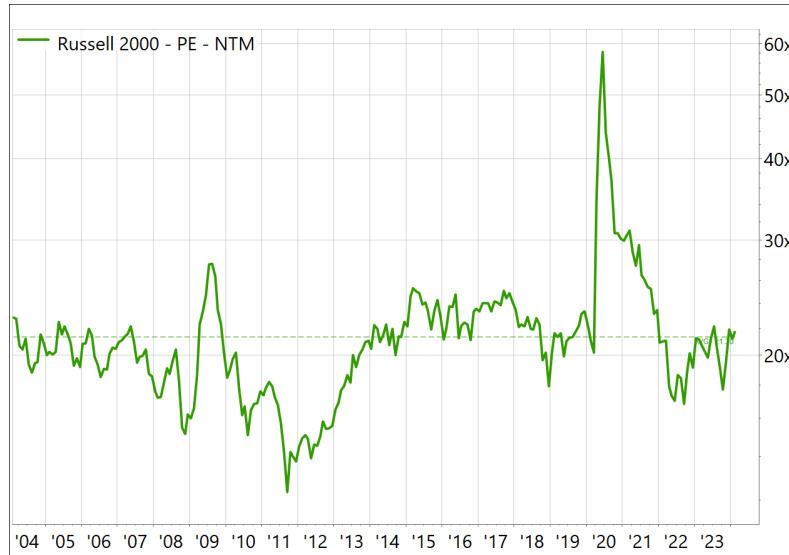
## HIGHER END OF HISTORICAL RANGE, BUT JUSTIFIED?



# MID CAP VALUATIONS MIDDLE-OF-THE-ROAD



## SMALL CAP VALUATIONS ATTRACTIVE



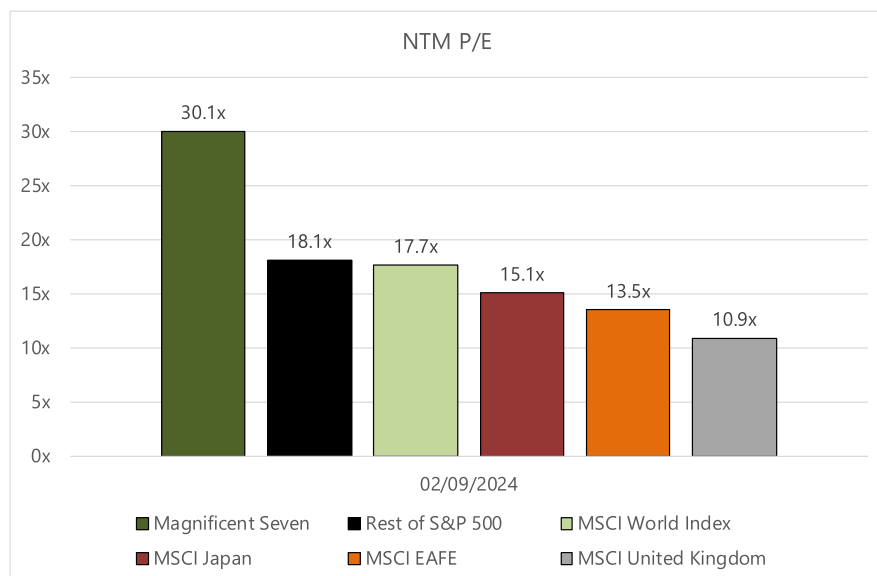
### Large caps versus small caps



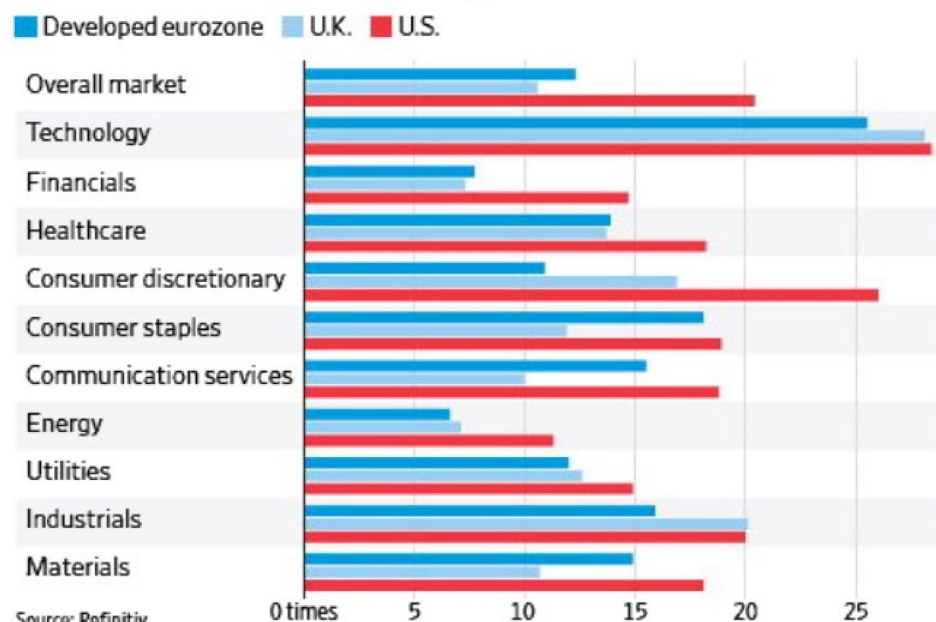
Source: FactSet

Source: Wall Street Journal 1/31/24, FactSet Research Systems 2/9/24

# VALUATION ATTRACTIVE OUTSIDE MAGNIFICENT SEVEN

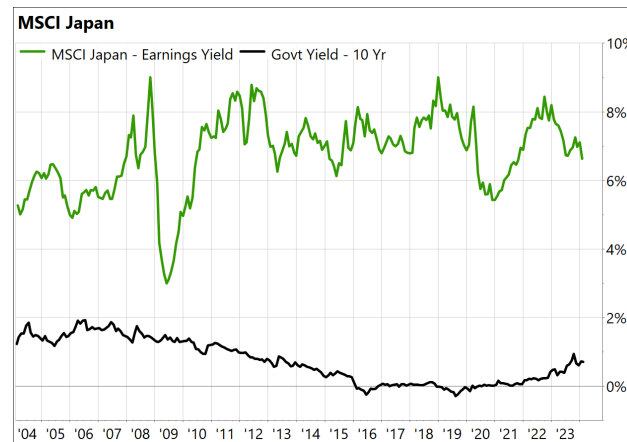
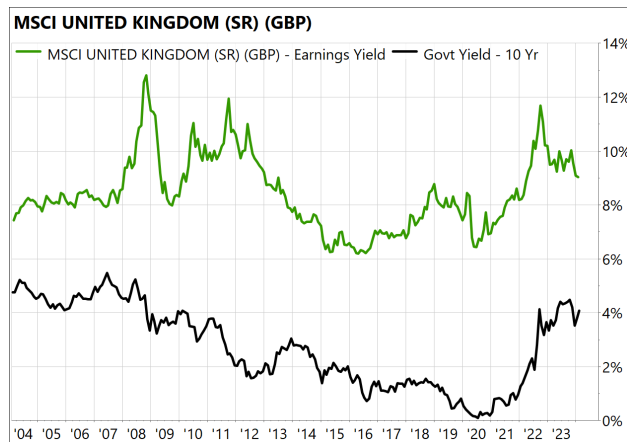
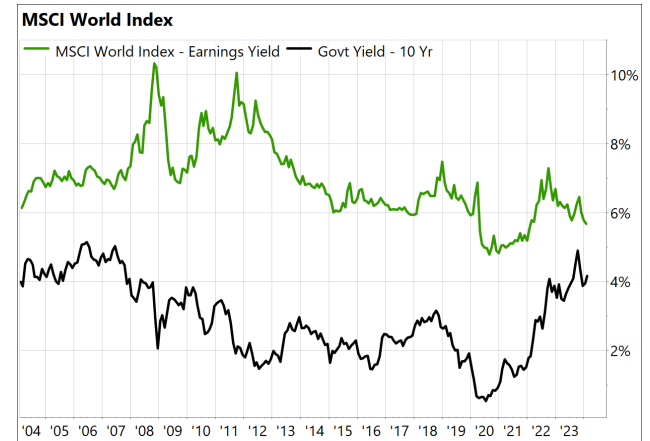
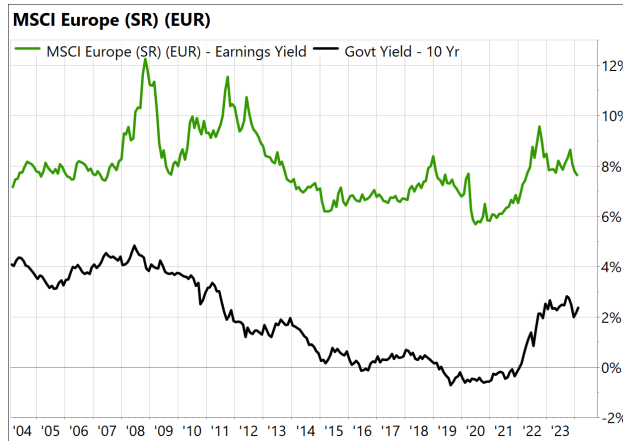
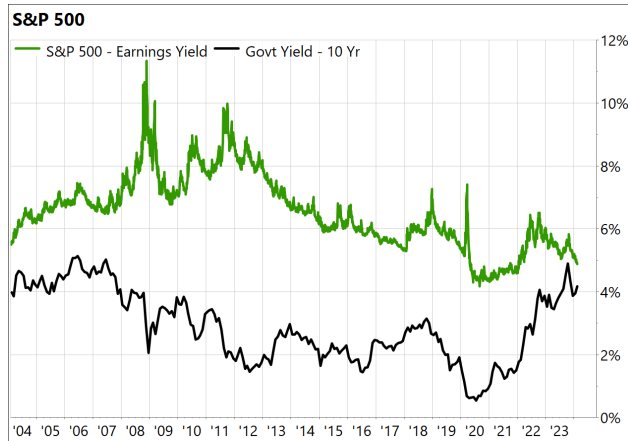


## MSCI sector forward price-to-earnings ratio



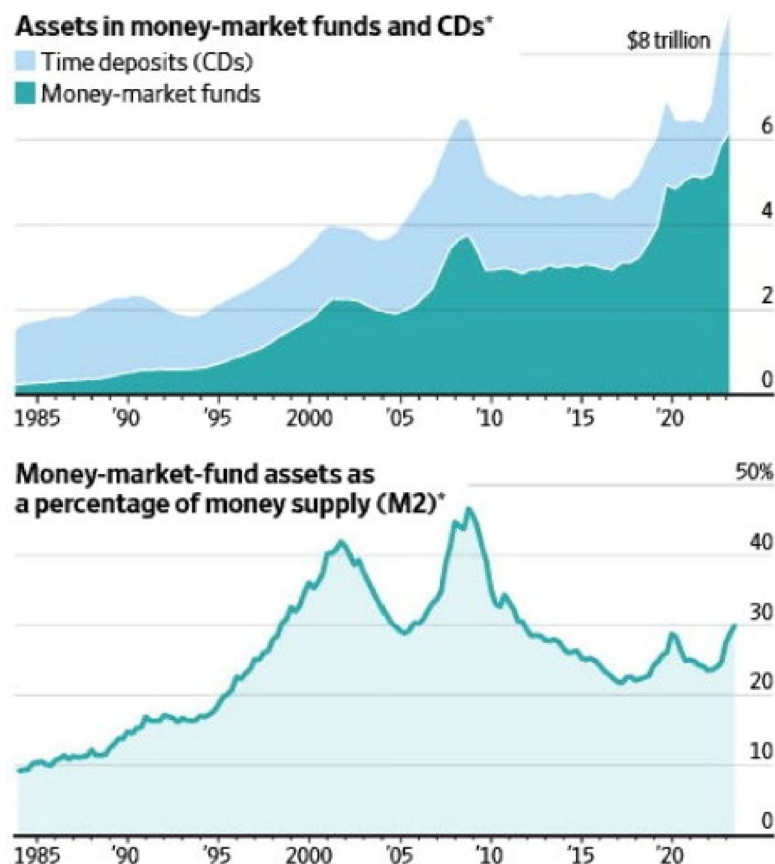


# EARNINGS YIELDS HIGHER THAN BOND YIELDS GLOBALLY



Source: FactSet Research Systems 2/9/24

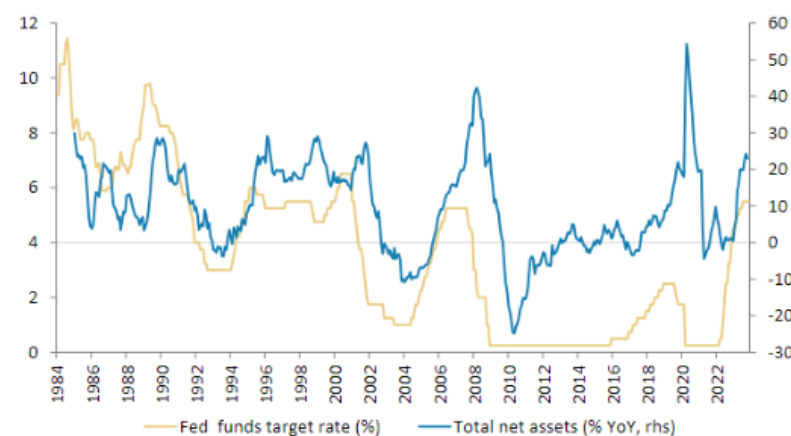
# STOCK-MARKET BULLS SALIVATE OVER \$8.8 TRILLION CASH PILE



\*Quarterly data, through third-quarter 2023  
Sources: Federal Deposit Insurance Corp. (assets in CDs);  
Federal Reserve (assets in money-market funds, money supply)

Historically, money markets tend to see outflows (benefiting equities) once rate cuts are underway

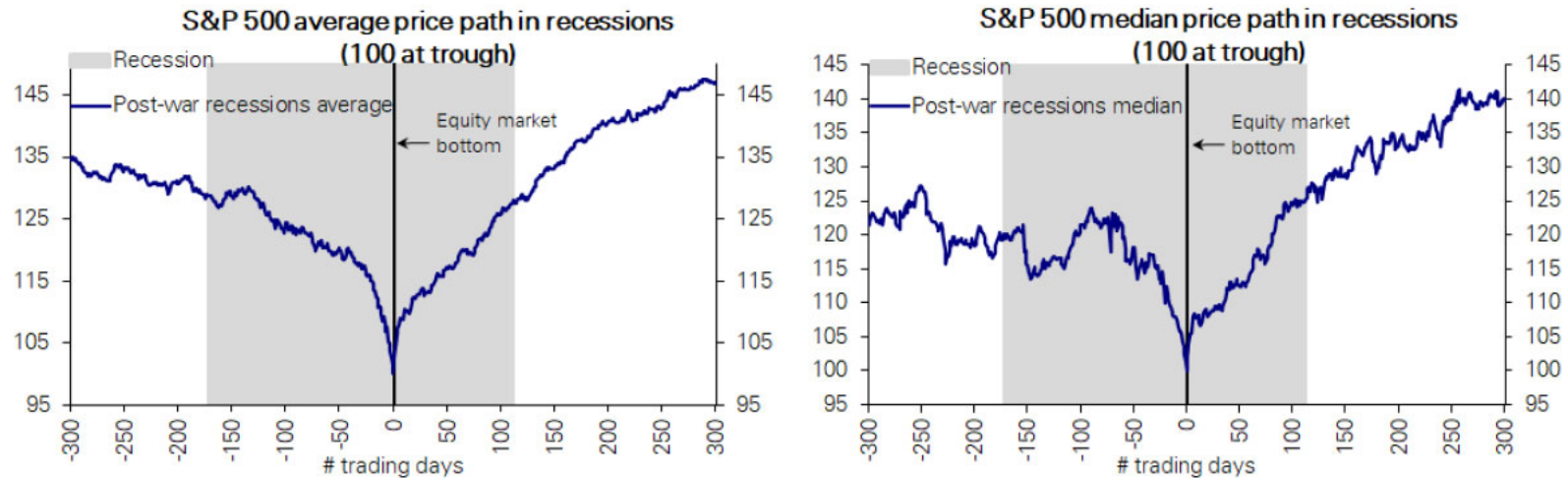
US money market mutual funds total net assets and US policy rate



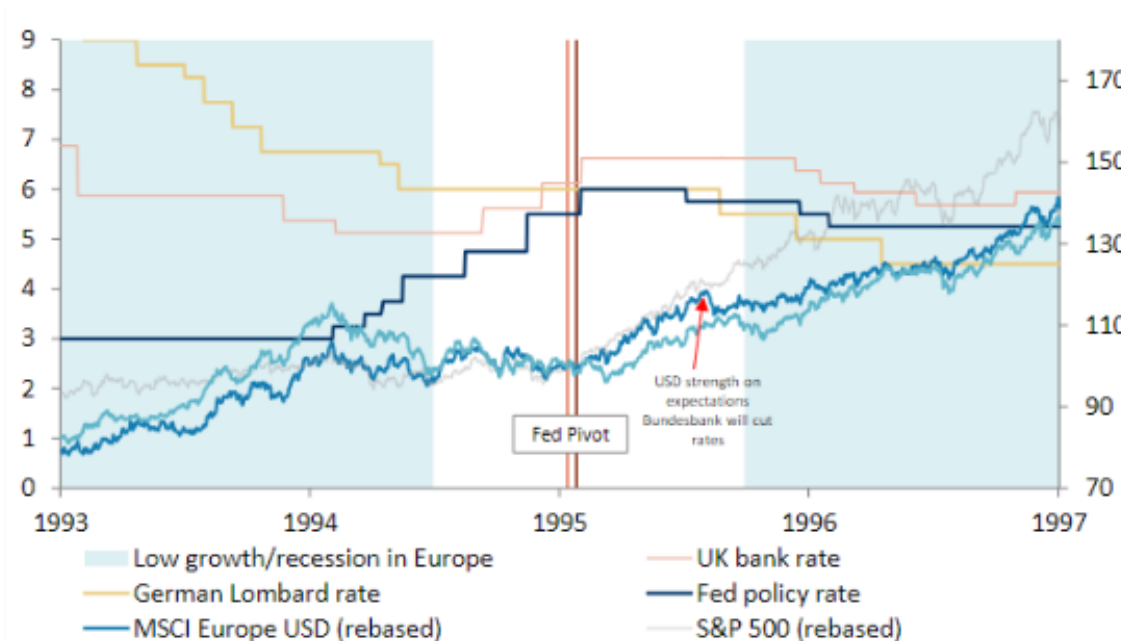
Source: ICI, Haver Analytics and Morgan Stanley Research

# MARKETS ARE ANTICIPATORY

## Equities historically bottom half-way through recessions



## Fed Pivot Likely to Support Equities



Much like today, EU equities took off following the 1995 Fed pivot into the soft landing despite a later pivot in Europe

## INVESTMENT STRATEGY: TAX-EXEMPT BONDS

---

### **I. Shorten duration modestly during the year.**

- The tax-exempt yield curve, while modestly inverted on the short end, remains steep despite the inverted U.S Treasury curve. Ratios to U.S. Treasuries are rich across the curve.
- Longer than the benchmark durations will likely be rewarded in the near term, as economic growth and inflation slows.

### **II. Remain focused on securities that provide a high level of interest income, which is the primary source of returns over longer term cycles.**

- Tax-exempt bonds continue to offer modestly attractive yields relative to taxable bonds on an after-tax basis; particularly for individuals.
  - Continue to emphasize revenue bonds with stable to growing demand fundamentals that offer attractive yields (i.e., single- and multi-family housing, hospitals with dominant market share, airports, toll roads and essential service bonds).
  - Revenue bonds typically offer higher yields than general obligation bonds.
  - Revenue bonds typically have a much lower proportion of employee costs and less exposure to pressure from pension and Other Post-Employment Benefits (OPEB) liabilities.
  - Be very selective in sectors still recovering from impacts of COVID-19, such as senior living and mass transit.
  - Emphasize security structures that provide added yield without additional credit risk (i.e., callable bonds, sinking fund or convertible coupon bonds).
- Tax-exempt closed-end bond funds, with yields close to 5.0% and discounts close to 11%, remain attractive.

### **III. Maintain a diversified portfolio of quality securities, as well as seeking yield by emphasizing structure over lower credit quality.**

- Tax-exempt credit spreads have narrowed considerably after the historic widening in the early days of the pandemic. They are historically tight.
- Yield spreads have widened on select “A” and “Baa” rated municipals. Selectivity will be key on avoiding credit issues and enhancing portfolio returns.

## INVESTMENT STRATEGY: TAX-EXEMPT BONDS

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### IV. Maintain broad issue and geographic diversification.

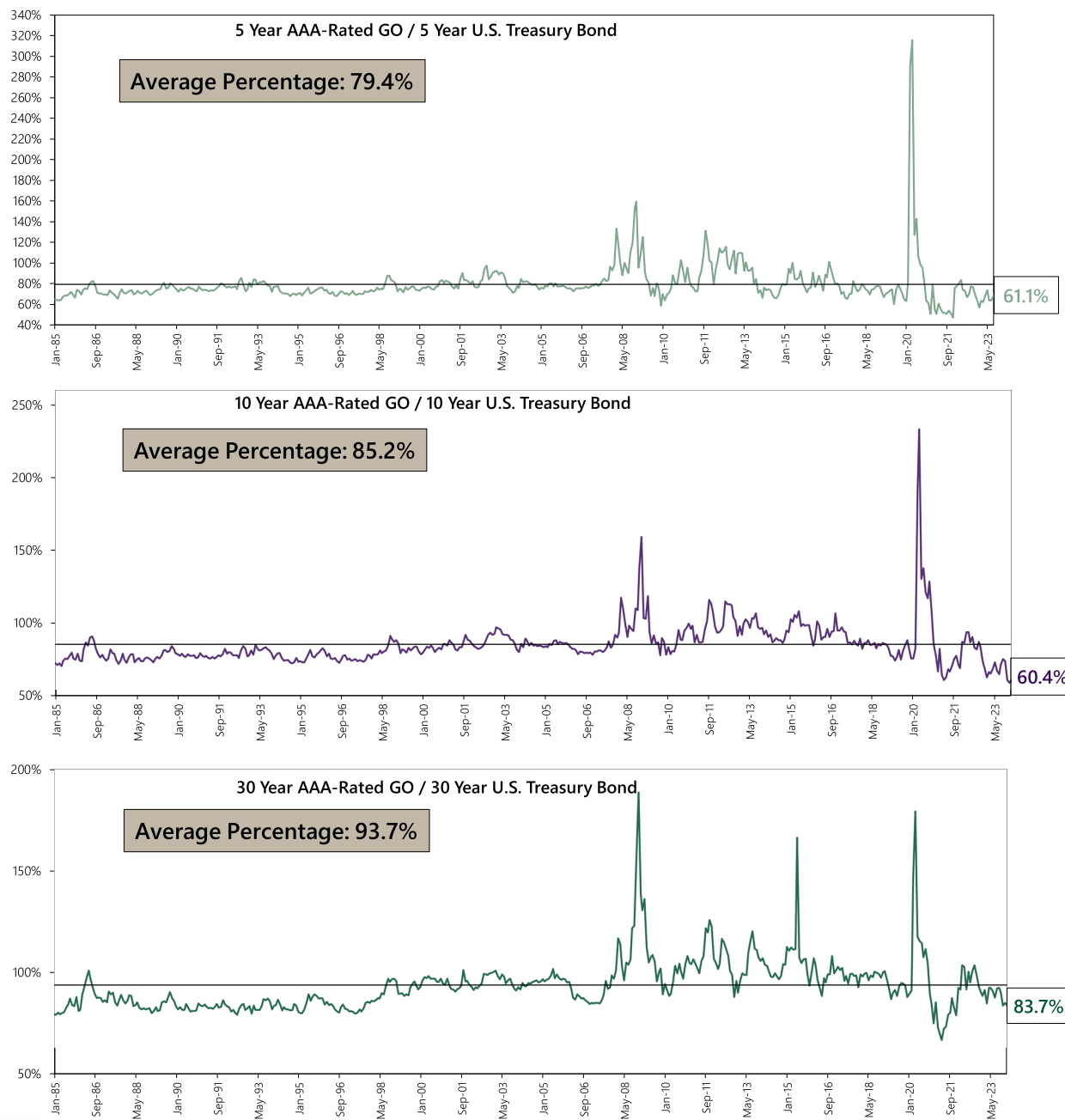
- Minimize headline risk as ratings agencies make further revisions to ratings criteria. Bond insurance, while making strides with respect to penetration, is not likely to regain its presence as a major market participant in 2024.
- Minimize impact of fiscal stresses on state and local governments.

### V. Credit Rating Downgrades

- Downgrades will accelerate modestly as a result of the COVID-19 economic stimulus payments winding down and income tax collections slowing with the economic slowdown.
- Defaults, however, should not be large in amount or number.

# TAX-EXEMPT RATIOS ARE RICH TO HISTORICAL AVERAGE

(as of January 31, 2024)



## INVESTMENT STRATEGY: TAXABLE BONDS

---

- I. We are extending bond portfolio durations to slightly longer than benchmark durations. We think the sweet spot of the yield curve will be in two-to-six-year maturities or the “belly of the curve.”**
- II. Look for the yield curve inversion to revert to a flat to modestly upward sloping yield curve. The Fed will cut rates in the second half of the year.**
- III. Despite sluggish economic growth, we expect few corporate bond defaults and for most bond sectors to outperform treasury bonds.**
- IV. Mortgage securities are posed to have an especially good year. After a disastrous 2022 and minimal market improvement in 2023, mortgage bonds, both government agency guaranteed, and non-agency guaranteed should recover as mortgage rates begin to come back down.**
- V. Wide closed-end fund discounts and 6% dividend yields make closed-end bond funds attractive. We expect the many shareholder-friendly events to continue throughout 2024.**

# 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 that are cashflow generative. We want to invest in companies that can survive tough economic times.
- Prefer growth stocks that can pay an increasing dividend.
- Focus on stocks with earnings growth fundamentals that can justify valuations.

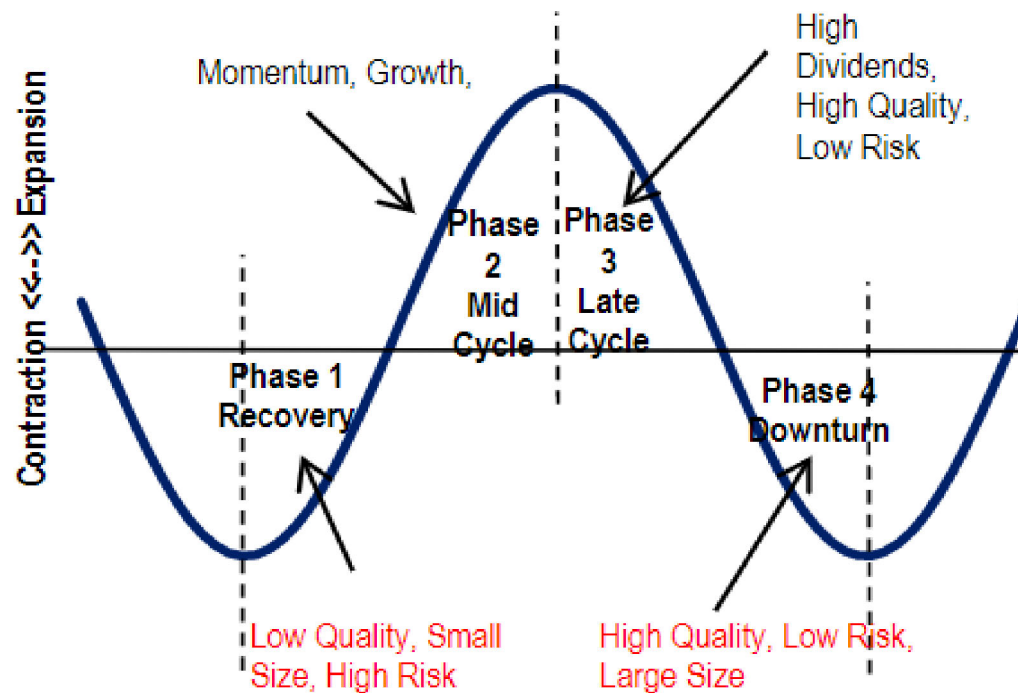
## II. Invest in a diversified portfolio.

- Difficult to predict the timing and strength of economic conditions but believe economic conditions will improve in late 2024.
- 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

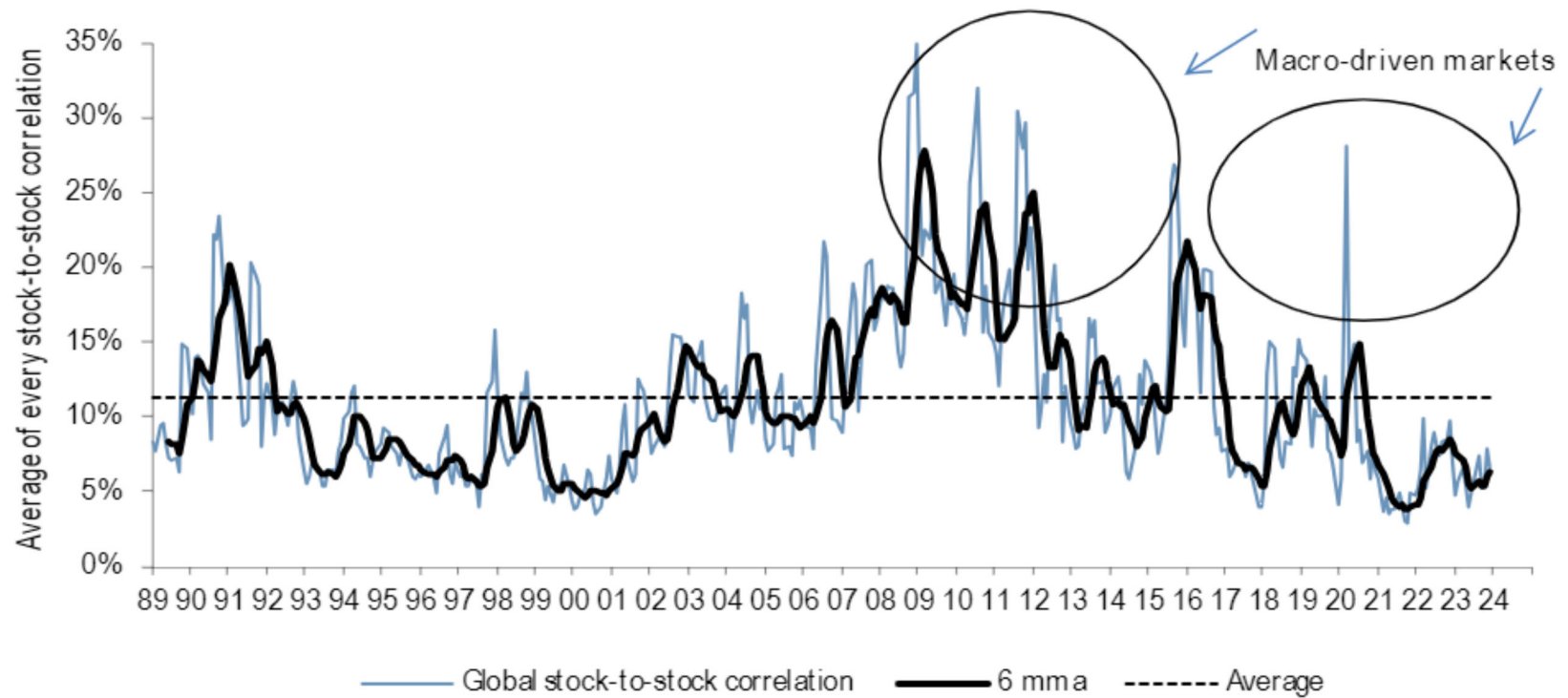
Early Cycle, Mid Cycle, Late Cycle and Recession/Downturn regimes



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

## GLOBAL STOCK CORRELATIONS WELL BELOW AVERAGE

The trend in stock-to-stock correlations remain below the long-term average



Source: Bank of America/Merrill Lynch 1/31/24

## EQUITY SECTOR STRATEGY – OVERWEIGHT

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

## EQUITY SECTOR STRATEGY – NEUTRAL/UNDERWEIGHT

SECTOR	Fundamentals/Themes Within Sector	Favorite Names
<b>FINANCIALS (NEUTRAL)</b>	<ul style="list-style-type: none"> <li>• Peaking conditions for banks in terms of NIM, credit, and loan growth. Commercial Real Estate represents ongoing credit risk</li> <li>• Rate increases led to deposit outflows and losses in investment portfolios, but some stabilization in late 2023</li> <li>• Banks' regulatory headwinds increasing after regional bank failures</li> <li>• Unlike 2008-2009, banks well capitalized and proactively adding to provisions</li> <li>• P&amp;C insurers attractive due to major pricing upcycle, with additional boost from interest income</li> <li>• Sector valuations attractive, but catalysts are lacking - focus on high quality, overcapitalized firms returning capital to shareholders</li> <li>• Underweight regional banks; prefer investment banks, insurers, wealth managers, and select REITs</li> </ul>	JPM, CB, AMP, GS, AJG, CG, O
<b>RETAIL TRADE (UNDERWEIGHT)</b>	<ul style="list-style-type: none"> <li>• Inflation, higher interest rates, and peaking job creation are fundamental headwinds</li> <li>• Consumer spending preferences for experiences (dining out, travel) over goods (hardgoods, apparel)</li> <li>• Covid pandemic has hastened migration to e-commerce and demise of shopping mall</li> <li>• However, most retailers, even AMZN, are finding need to have brick &amp; mortar presence, so are omnichannel (i.e., physical stores, online, pickup, delivery)</li> <li>• Off-price retailers benefitting from excess channel inventory and value-seeking consumers</li> <li>• We favor companies with visible sales outlooks, scale, and differentiated business models</li> </ul>	AMZN, LULU, HD, TGT, TJX, ULTA
<b>UTILITIES (UNDERWEIGHT)</b>	<ul style="list-style-type: none"> <li>• Absolute valuations attractive relative to history, but dividend yields currently less attractive given rate backdrop</li> <li>• 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)</li> <li>• Limited exposure to currency swings and inflationary cost trends</li> <li>• Emphasis on firms with limited rate/regulatory risk and high exposure to renewables</li> </ul>	WEC, PPL, NI
<b>CONSUMER NON-DURABLES (UNDERWEIGHT)</b>	<ul style="list-style-type: none"> <li>• Slow secular volume growth, due to mature developed markets</li> <li>• Increasing competition in many categories from private label, local brands, and healthy/organic</li> <li>• 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</li> <li>• Reopening of global economies will help EL (makeup, travel) and MDLZ (emerging markets)</li> <li>• Margin pressure from supply chain costs and higher advertising &amp; procurement spending</li> <li>• We favor firms with strong brands, global growth potential, and innovative new product development</li> </ul>	STZ, DEO, MDLZ, NSRGY, PEP, PG
<b>COMMUNICATIONS (UNDERWEIGHT)</b>	<ul style="list-style-type: none"> <li>• Capital intensity with subpar returns for traditional telecom providers</li> <li>• Increasing competition in wireless market as penetration has peaked; Verizon and AT&amp;T have been unable to add premium pricing for 5G service</li> <li>• 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</li> <li>• 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</li> </ul>	AMT

Source: Sit Investment Associates, Inc. 2/8/24

# EQUITY STRATEGY – MAGNIFICENT SIX

(Ordered from Most to Least Preferred)

## AMAZON

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Dominant position in secular growth markets, including e-commerce, cloud computing, and online advertising</li> <li>Prime membership strategy and massive logistics investments support “flywheel” of continuous product category expansion</li> <li>Cost-focus is boosting margins following 2020-22 investment cycle, further augmented by accelerating fees from advertising and imminent Prime price increases</li> </ul>	<ul style="list-style-type: none"> <li>E-commerce slowing more than expected now that industry has become more competitive and more mature/highly penetrated</li> <li>Greater competition in cloud, leading to pricing pressure and/or volume shortfalls</li> <li>AI investment and competition may prompt investment cycle at some point and reverse margin improvement thesis</li> <li>Regulatory risk in U.S. and Europe</li> </ul>	<ul style="list-style-type: none"> <li>AMZN valued at 13x EV/2025 EBITDA and 41x 2024 earnings</li> <li>Valuation metrics near their lowest levels in company’s history – multiple expansion possible from here</li> <li>\$100B of cash on balance sheet suggests potential capital return</li> <li>Our 12-month price target is \$220, based on 42x CY25 EPS estimates</li> </ul>

## META PLATFORMS

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Meta Platforms, the parent company of Facebook, Instagram, WhatsApp, Messenger and Oculus, represents a compelling investment opportunity in the rapidly evolving digital landscape.</li> <li>Improved usage of AI technology has enabled better ad targeting and measurement for advertisers, an improved user experience, higher user engagement, and improved monetization</li> <li>A strategic decision to move away from the Metaverse would be viewed positively.</li> </ul>	<ul style="list-style-type: none"> <li>Substantially all of Meta’s revenue is currently generated from advertising on Facebook and Instagram, and monetizing Whatsapp and Messenger messaging applications is challenging.</li> <li>The social media landscape is competitive, and Meta faces competition from existing platforms like TikTok and potential newcomers.</li> <li>The Reality Labs (virtual reality and Metaverse content) segment continues to produce massive losses (\$16.1 billion in 2023).</li> <li>Regulatory risk in the U.S. and E.U. related to data security, privacy and antitrust concerns.</li> </ul>	<ul style="list-style-type: none"> <li>Meta is currently trading at 23.3x CY24 EPS and 12.6 x EV/2004 EBITDA estimates vs. historical 5-year average multiples of 21.1x and 11.3x, respectively.</li> <li>Upside to estimates is likely given Meta’s numerous growth drivers.</li> <li>\$53 B of net cash on the balance sheet suggests substantial capital return (dividends and share repurchases).</li> <li>Our 12-month price target is \$545, based on 21x CY25 EPS of \$26</li> </ul>

## ALPHABET

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Alphabet holds the dominant position in the online advertising market.</li> <li>Well-positioned to benefit from the continued shift of advertising budgets online and a rebound in ad spending in 2024.</li> <li>Growth drivers include artificial intelligence, cloud computing, the Google Play app store and YouTube ads.</li> <li>Further cost-cutting will further boost margins.</li> </ul>	<ul style="list-style-type: none"> <li>Increased competition in the digital advertising market.</li> <li>Search ad business has been negatively impacted by changes consumers’ preferences for where they begin their online searches, such as Amazon or TikTok.</li> <li>The Google Cloud Platform remains a distant third behind Amazon Web Services and Microsoft Azure</li> <li>Regulatory risk in the U.S. and E.U. related to data security, privacy and antitrust concerns.</li> </ul>	<ul style="list-style-type: none"> <li>Currently trading at 21x CY24 EPS and 12.1 x EV/2024 EBITDA estimates vs. historical 5-year average multiples of 23.6x and 12.4x, respectively.</li> <li>Valuation discounts risk of revenue growth deceleration given AI-related risks to Alphabet’s search ad dominance and regulatory concerns.</li> <li>\$100 B of net cash on the balance sheet suggests potential capital return catalyst</li> <li>Our 12-month price target is \$170, based on 20x CY25 EPS of \$8.50</li> </ul>

# EQUITY STRATEGY – MAGNIFICENT SIX

(Ordered from Most to Least Preferred)

## MICROSOFT

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Dominant position in desktop computing and enterprise software.</li> <li>A leader in cloud computing (Microsoft Azure platform).</li> <li>Leadership position in developing and integrating AI technology in its products and services.</li> </ul>	<ul style="list-style-type: none"> <li>Cyclical risk given dependence on hardware devices including PCs and gaming consoles.</li> <li>Increased competition in cloud computing vs. Amazon and Alphabet.</li> <li>Regulatory scrutiny related to data security, privacy and antitrust concerns.</li> </ul>	<ul style="list-style-type: none"> <li>Microsoft is currently trading at 32.6x NTM EPS and 22.3x EV/NTM EBITDA estimates vs. historical 5-year averages of 28.5x and 18.9x, respectively.</li> <li>Upside to estimates is likely as Microsoft is a leader in cloud computing and will be an early beneficiary of AI technology.</li> <li>Our 12-month price target is \$475, based on 31x CY25 EPS of \$15.30</li> </ul>

## NVIDIA

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Undisputed leader in AI infrastructure and accelerated compute.</li> <li>Additional growth catalyst in high performance networking.</li> <li>Example of innovation focused culture - CUDA software ecosystem moat has enabled the GPU/AI compute leadership.</li> <li>Best revenue and free cash flow growth rate amongst large cap tech.</li> </ul>	<ul style="list-style-type: none"> <li>AI related growth could decelerate in CY24 or CY25.</li> <li>Uncertain ROI for AI use cases may lead to cycle pause.</li> <li>Competitive parallel processing technology emerges.</li> </ul>	<ul style="list-style-type: none"> <li>Currently trading at 29x CY25 EPS estimates vs. 40x historical average.</li> <li>Valuation embeds risk of deceleration given AI-related surge in 2023</li> <li>Realistic bull case: A \$30 CY25/CY26 FCF/EPS (\$800+ price target).</li> <li>Our 12-month price target is \$756, based on 28x CY25 EPS of \$27</li> </ul>

## APPLE

Investment Thesis	Risks	Valuation
<ul style="list-style-type: none"> <li>Strong product (iPhone, iPad, Mac) and services (App Store) moat.</li> <li>Brand and product quality enables high margin and free cash flow.</li> <li>Robust capital allocation - \$619B of share repurchase over the last 10 years.</li> <li>History of innovation as legacy products mature</li> </ul>	<ul style="list-style-type: none"> <li>Regulatory headwind to high App Store margins.</li> <li>Smartphone market has matured.</li> <li>China related risk – macro slowdown and new competition from Huawei.</li> <li>High valuation for relatively slower growth (2% EPS growth in CY23).</li> <li>Future growth dependent on uncertain adoption of new products like the Vision pro mixed reality headsets.</li> </ul>	<ul style="list-style-type: none"> <li>Currently trading at 28x/26x CY24/CY25 EPS estimates vs. 20x 10-yr average.</li> <li>Higher valuation underpinned by diversified revenue streams, capital return, and breadth of platform</li> <li>Multiple has likely peaked unless new products or I-phone cycle takes hold</li> <li>Our 12-month price target is \$200, based on 25x CY25 EPS estimates</li> </ul>