ELEMENT POINTE®
FAMILY OFFICE

Market Outlook:
Top Ten Investment Themes for 2024

January 2024

Please see page 33 for important disclosures.

January 2024

Top Ten Investment Themes for 2024

1. **The Lingering Effects of the Pandemic:** The unprecedented events of the pandemic have made this economic cycle particularly difficult to predict, confounding economists and investors alike.

2. **Inflation Outlook:** The economy is experiencing strong disinflationary trends that are expected to carry into the early part of 2024. However, services inflation will likely prove sticky, preventing the Fed from hitting its 2% target in 2024.

3. **Monetary Policy:** The Federal Reserve's ("Fed") pivot in December is an implicit abandonment of its two percent inflation target. While the change is a boon for risk assets and the economy in the short term, it raises the risk of a resurgence of inflation in the back half of the year.

4. **The US Economy:** Economic growth will slow in 2024, but the most-anticipated recession of all-time will likely have to wait another year.

5. **Higher-for-Longer:** Despite the Fed's plans for rate cuts in 2024, an amalgamation of elevated treasury issuance, weakening foreign demand, and price-sensitive domestic buyers, we believe, will lead to a higher-for-longer rate regime throughout this cycle.

6. **Outlook for Equities:** The S&P 500 will, in our view, end the year flat; but not before racing to a significant new all-time high in the first quarter.

7. **Private Credit:** We continue to favor the private credit markets for yield given a volatile interest rate environment.

8. **International Markets:** While the outlook for most developed economies appears lukewarm, some specific international markets have unique characteristics that we believe can provide outperformance and diversification benefits for US investors in 2024.

9. **The 2024 US Presidential Election:** The 2024 election looks primed to be one of the most complicated and unpredictable elections in our nation's history, with the outcome likely to upset half of the country.

10. **Geopolitics:** As we look ahead to the remainder of 2024, geopolitics looms large, and a multitude of geopolitical factors have the potential to be disruptive forces impacting the economy and financial markets.

TOP 10 INVESTMENT THEMES FOR 2024

1. The Lingering Effects of the Pandemic

The unprecedented events of the pandemic have made this economic cycle particularly difficult to predict, confounding economists and investors alike. To the surprise of many people, the US economy avoided recession in 2023 despite the Fed's aggressive 16-month rate-hiking campaign that saw the federal funds rate target go from 0% - 0.25% to 5.25% - 5.50%. The Fed had to tighten monetary policy aggressively in order to combat a sharp rise in inflation brought about by pandemic-era stimulus measures and economic effects. The combination of restricted supply and excessive demand unleashed an inflationary impulse that the US economy has not experienced since the early 1980s. The supply side of the economy was strained by government shutdowns, disrupted supply chains, and Covid-stricken workers, who were forced to either miss work or drop out of the labor force. Concurrently, the economy experienced a surge in demand for goods and housing, boosted by large government transfers and ultra-accommodative Fed policy that inflated asset prices. Some of these imbalances are still with us today and are the reason why this economic cycle has been so unique.

Looking at the supply-side of the economy, supply chains and shipping costs have now normalized, but the labor market remains tight. Death, disability, and early retirements drove a shortage of workers, which has been slow to correct. Scarred from their experience during the pandemic, many companies are reluctant to let employees go, keeping unemployment at near record-low levels. While the Job Openings and Labor Turnover Survey ("JOLTS") has improved of late, the data still shows a large imbalance in the labor market (see Exhibit 1).

Exhibit 1: US Job Openings & Labor Turnover Survey (JOLTS)

Source: Bloomberg, as of 11/30/2023

Manufacturing PMI has been in contraction territory for fourteen straight months. That has never before happened without the economy in recession. This indicator appears to have lost some of its relevance this cycle due to the nature of the pandemic. Recall that demand for goods exploded for a multi-year period during the pandemic when most people where sheltering at home and severely restricting social contact with others. This created a mini-boom in manufacturing that lasted until early 2022. Once most people were vaccinated and comfortable resuming social gatherings, demand for goods dropped off sharply and demand for services like travel and leisure exploded. In essence, demand for goods was pulled forward several years at the onset of the pandemic, and now consumers are prioritizing services over goods. This is driving a manufacturing recession while the service economy is booming. We can see evidence of this in the inflation numbers, which show elevated services inflation while goods inflation has turned negative.

While a broad recession has so far been avoided, the pandemic has set off a series of booms and rolling recessions in different parts of the economy. As previously mentioned, the US economy experienced a manufacturing boom that has been followed by fourteen months of manufacturing contraction. Travel and leisure were depressed in 2020 and 2021, but those areas are now booming. Sporting events and concerts are among the most coveted activities today. With respect to labor, unemployment spiked to depression-era levels early in the pandemic, but now the labor market is strong and resilient. Housing boomed for several years as people relocated to different parts of the country, yet high interest rates have now caused housing activity to grind to a halt.

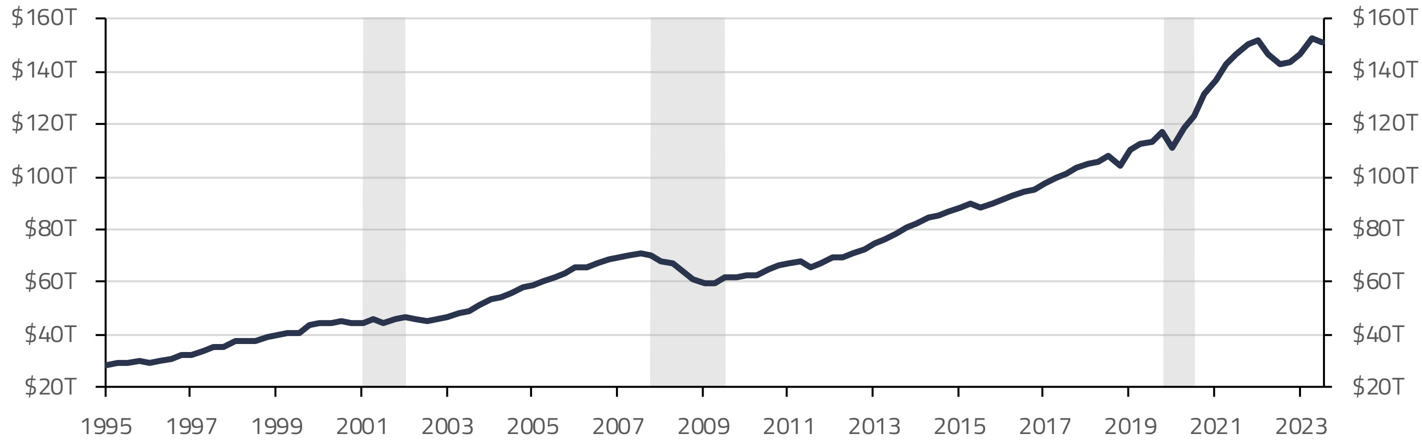
One reason why economic growth has yet to suffer meaningfully from the Fed's rate hikes is that a large swath of the economy reduced their sensitivity to higher rates during the pandemic. When mortgage rates collapsed during the pandemic, most homeowners were able to secure long-term, low-rate financing for their homes. Since these were fixed-rate mortgages, most homeowners have not been impacted by the Fed's actions other than acting as a disincentive for them to move. This is why the housing market suffers from a limited inventory of homes for sale and why home prices have remained elevated despite a sluggish demand environment.

Similarly, investment-grade corporate borrowers took advantage of the low-rate environment several years ago to term out their debt for many years. The end result is that the debt maturity wall has been manageable so far, and it does not pose much risk for investment-grade borrowers for several more years. High-yield borrowers also benefitted from terming out their debt, but generally only for five years. Consequently, their maturity wall is set to accelerate over the next few years, putting them at a higher risk of default.

With homeowners and fixed-rate corporate borrowers still benefitting from low-cost financing, the impact from the Fed's rate hikes has been dulled, but not delayed indefinitely. Higher interest rates have already impacted areas of the economy that rely on variable-rate financing, such as small-business loans, leveraged loans, lines-of-credit, and some commercial real estate loans. It is only a matter of time before higher rates start to bite homeowners and large corporate borrowers as well.

The biggest reason why the economy has seemed immune to the Fed's rate hikes thus far is the massive wealth effect households experienced during the pandemic (see Exhibit 2). The pandemic recession was the only time in history when households experienced a huge increase in net worth during a recession, and that trend has continued, mostly unabated, since the recession ended. The two big drivers of this surge in household net worth were 1) direct government transfers and 2) ultra-accommodative Fed policy.

Exhibit 2: Households and Nonprofit Organizations Net Worth



Source: Apollo, Federal Reserve Bank of St. Louis, as of 07/01/2023

Through the end of September 2023, the US government has spent over $4.3 trillion dollars in response to Covid-19.[1] A substantial portion took the form of direct government transfers like paycheck protection program ("PPP") loans, three rounds of stimulus checks, the moratorium on student loan payments, extended unemployment insurance, the expanded Child Tax Credit, and the Employment Retention Credit (ERC) tax refund, to name a few. In total, US consumers built a war chest of excess savings on their balance sheets, which has resulted in strong consumption growth since the pandemic. At the same time that the government was spending freely, the Fed cut rates to zero and embarked on a massive round of quantitative easing. As a result, the prices of all risk assets exploded higher. Homes, which for most people is by far their largest asset, saw their values almost double in many areas in a short period of time. The ensuing bull market in real estate, stocks, digital assets, art, boats, cars, collectibles, etc., created a huge wealth effect that has supported the economy, but it has also been a major source of inflationary pressure.

One significant and enduring impact of the pandemic is an increase in fiscal policy activism and surging government deficits. The US government took an active role in supporting the economy through the aforementioned programs, and it played a key role in funding the development of Covid-19 vaccines. During Biden's term in office, the government has passed three major laws (CHIPS, IRA and IIJA) that advance the President's agenda with respect to clean energy, transportation, infrastructure, healthcare, domestic manufacturing, semiconductors, and tax enforcement. As the world continues to trend towards de-globalization, we believe the US government will resort to more fiscal policy activism to achieve its goals.

However, interference in the economy generally comes at a significant cost. As a consequence of the Covid-19 relief programs and government activism, the national debt has increased nearly 50% in the last four years and now stands at a staggering $33.9 trillion.[2] With inflation and interest rates elevated, the cost to service the debt is exploding and will soon reach a level that has historically triggered fiscal restraint. To date, government officials have kicked the can down the road, but the day will undoubtedly come when market forces will demand a retrenchment. Until that time, the pandemic has left US households with higher wealth, but also much higher inflation, and a general uneasiness about the future.

The unique nature of the pandemic and its aftermath, along with the government's response, have helped the economy avoid a recession thus far, befuddling most economists. We believe that 2024 will be another year where the US economy defies the skeptics, but the check is coming due in 2025. By then, excess savings are expected to be depleted and the government will likely be facing difficult tax and spending choices. There is a strong likelihood that we will experience another bout of inflation and that interest rates will need to remain higher for longer. This combination likely assures that a broad recession cannot be avoided in 2025.

1. "The Federal Response to COVID-19." USAspending.Gov, United States Government, Oct. 2023, www.usaspending.gov/disaster/covid-19.
2. Bloomberg.

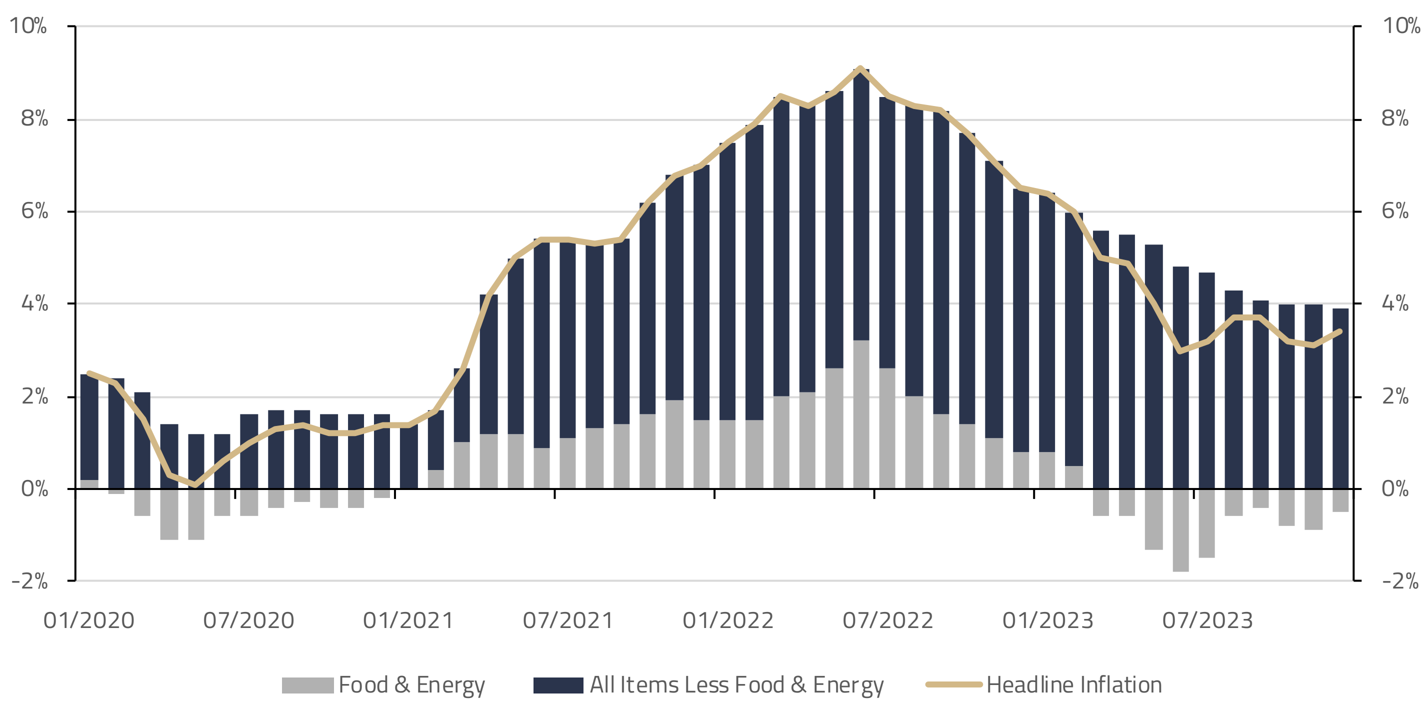
TOP 10 INVESTMENT THEMES FOR 2024

2. Inflation Outlook

Restrictive monetary policy and normalizing supply chains created strong disinflationary trends in 2023. The headline Consumer Price Index ("CPI") measured 3.1% year-over-year in November 2023, a significant reduction from a high of 9.1% recorded in June 2022.[3] Core CPI, which excludes more volatile food and energy prices, also declined significantly over the year to 4.0% in November.[4] However, both measurements remain well above the Federal Reserve's stated target of 2%. Disinflationary trends look to persist into 2024, but the last mile of inflation reduction tends to prove most challenging, and we anticipate inflation to remain above the Fed's target through year-end. Further, a tight labor market, rebounding shelter inflation, geopolitical conflicts, deglobalization, expanding federal deficits, and loosening monetary policy all present potential risks towards a reacceleration of inflation.

The great disinflation observed throughout 2023 has led many economists to believe that inflation may have been transitory after all. While we disagree with the notion that inflation as a whole is transitory, there have proven to be elements of the underlying measurements that have experienced material disinflation due to post-lockdown normalizations. Exhibit 3 highlights how the majority of the decline in headline inflation can be attributed to price normalization in the historically volatile food and energy components. Food and energy prices soared throughout 2021 and 2022 as economies reopened, leading to increased demand for energy and disruptions in supply chains. Geopolitical conflict in Europe added further price shocks to these components; however, as supply chains have corrected over the past year, food and energy prices have normalized. Inflation expectations followed suit, given consumer sensitivity to food and energy prices. Nonetheless, escalating tensions in the Middle East and the ongoing war in Ukraine present a risk of future price shocks to both components that may cause the headline number to revert at some point during the year.

Exhibit 3: US Inflation Breakdown (Year-Over-Year Change)

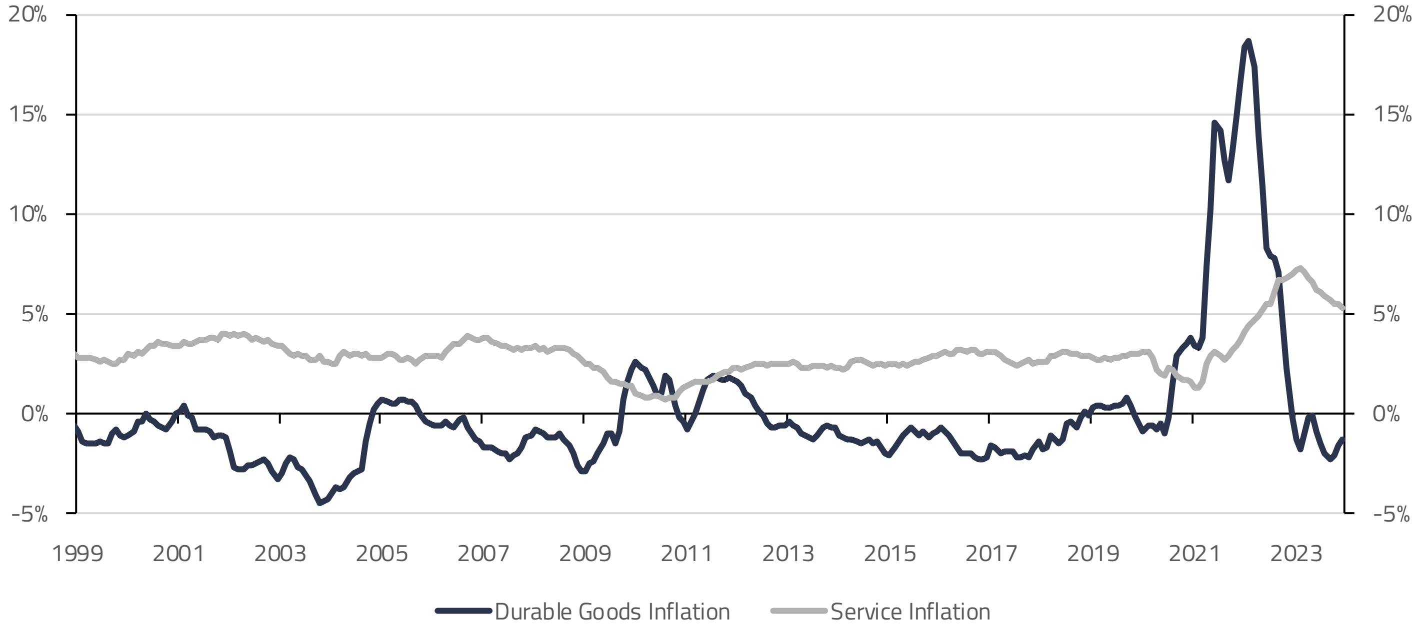


Source: Bloomberg, as of 12/31/2023

3. Bloomberg.
4. Id.

While headline CPI has fallen 6.0% since its high in 2022, core CPI has proven to be stickier. With its November reading of 4%, core CPI has declined 2.6% from its peak in September 2022. Under the surface, we observe that a meaningful amount of the core CPI deceleration is attributable to the normalization of core goods prices, as shown in Exhibit 4. Core goods prices have been roughly flat over the past year, reflecting a return to the weak core goods price trends observed pre-pandemic.[5] Core goods inflation has shown a strong correlation to the delivery times component of the Manufacturing ISM survey. This survey has signaled a trend towards declining delivery times, suggesting a normalizing supply-demand balance that should continue to pressure goods inflation. However, global initiatives towards reshoring and friend-shoring may disrupt supply chains, in which case we would anticipate a reacceleration of goods inflation.

Exhibit 4: Durable Goods Inflation vs Service Inflation (Year-Over-Year Change)



Source: Apollo, Bloomberg, as of 11/30/2023

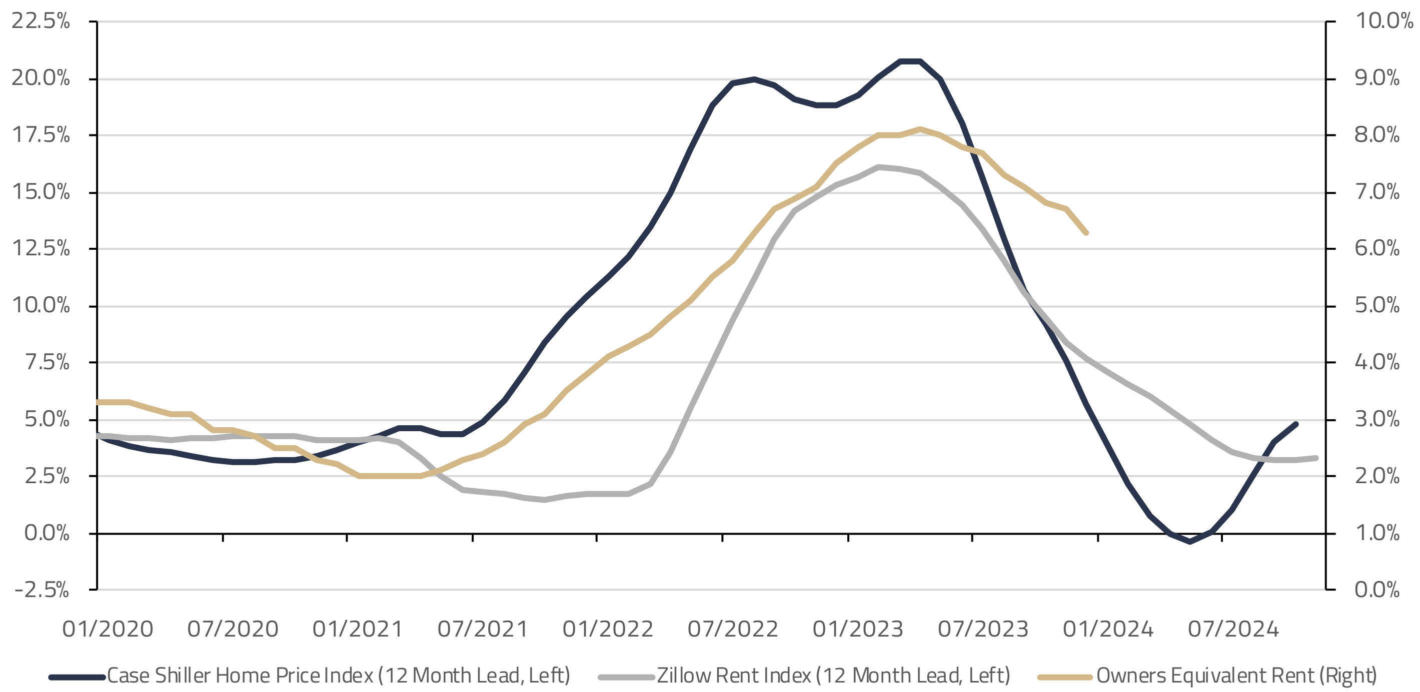
On the other hand, service sector inflation has proven stubborn, as a tight labor market and a shift of demand from goods to services have provided an inflationary impulse. We believe service sector inflation trends will be crucial in determining how successful the Fed will be at pushing inflation towards its target in 2024. The labor market is probably the most impactful factor on the trajectory of services inflation, as tighter labor markets generally lead to more substantial wage inflation that passes through into higher consumer prices. While unemployment has begun to tick up over the past few months, the labor market remains historically tight. Job openings have decreased over 2023, which has helped alleviate some of the supply-demand imbalance in the labor market post-COVID. Yet, wage gains remain at elevated levels, and it will likely require substantial job losses to reset wage inflation to pre-pandemic levels. Taken further, we anticipate that the Fed will remain challenged in reducing services inflation unless we witness a sizable increase in unemployment. We anticipate that the labor market will soften as Fed rate hikes adversely impact the economy, which would typically lead to a decline in services inflation. However, exogenous factors, such as union labor strikes, create risk that inflation will moderate slower than expected, even with a weakening labor market. Ultimately, we believe that services inflation will be the burden that hinders the Fed from reaching its inflation goal this year.

The heavily-weighted shelter inflation will remain key to watch, as it will strongly influence the trajectory of core inflation in the beginning of the year. Owner's Equivalent Rent ("OER"), the most significant part of shelter inflation, is a notoriously slow-moving measurement that reflects price changes with a considerable lag. Exhibit 5 shows that shelter disinflation as observed through alternative measurements, such as

5. Feroli, Michael, et al. "2024 US Economic Outlook: Walk the Line." J.P. Morgan Markets, J.P. Morgan, 16 Nov. 2023, markets.jpmorgan.com/#research.article_page&action=open&doc=GPS-4556279-0.

the Zillow Observed Rent Index, has yet to be fully realized by OER. We anticipate that the lagged effects of OER will continue to put downward pressure on inflation readings through the first half of the year. At the same time, a potential US recovery in housing, driven by low supply and pent-up demand boosted by falling mortgage rates, may lead to a reacceleration in shelter inflation. The S&P Case-Shiller home price index has reestablished an upward trend in its most recent readings, which may prove to be a harbinger for rebounding shelter inflation. While CPI prints should show housing disinflation for the first half of the year, we believe there is a reasonable probability that shelter inflation will reaccelerate in the latter half of the year.

Exhibit 5: US Housing Costs (Year-Over-Year Change)

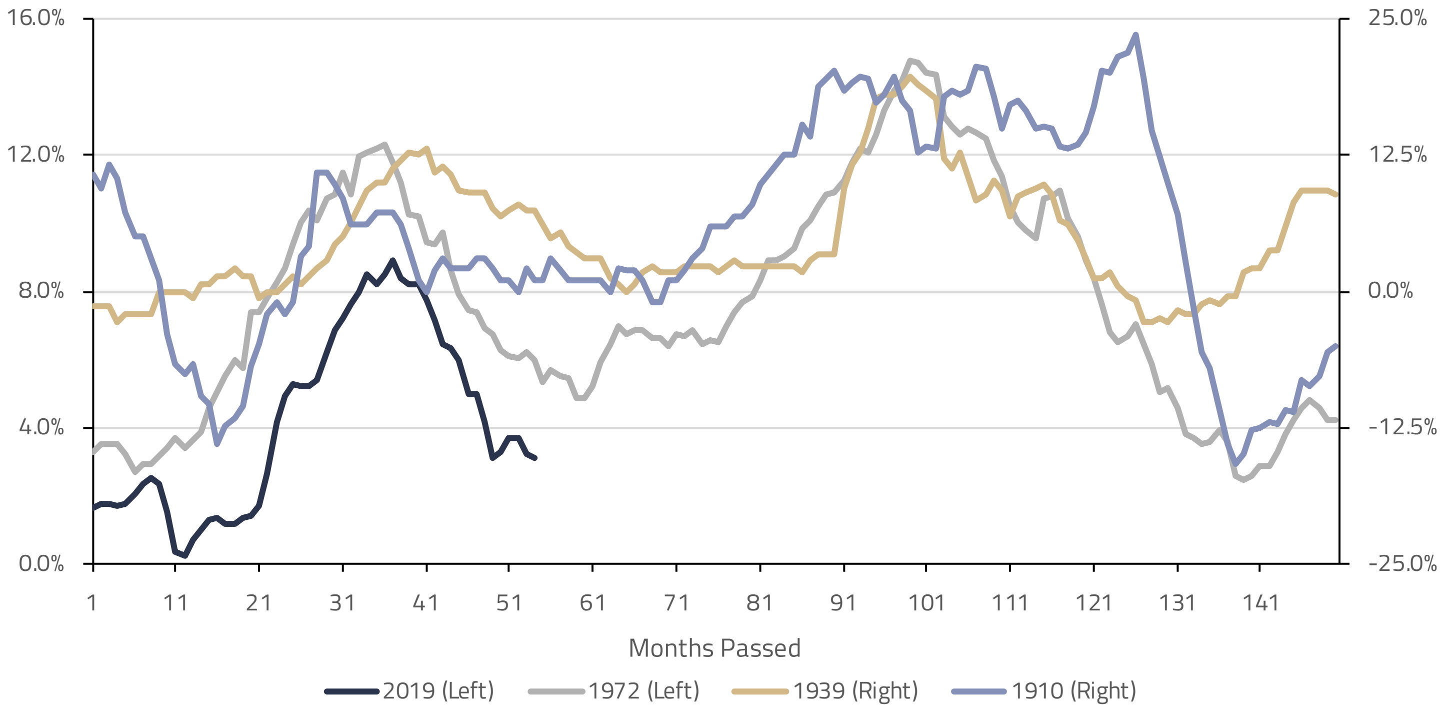


Source: Bloomberg, as of 12/31/2023

Historically, both US and global inflation have come in waves, and it is possible that the current inflation episode may experience a similar trajectory if the Fed loosens monetary policy too quickly. Exhibit 6 shows the current inflation episode compared to three previous US inflation episodes. As the chart shows, inflation meaningfully decelerated across a similar timeframe in the last three inflationary periods before reaccelerating to a new peak. A study conducted by Strategas shows that this phenomenon is consistent across most developed economies. In the study, Strategas analyzed 62 unique inflation episodes across 24 different countries, of which 87% resulted in multiple inflation waves.[6]

6. Strategas. Trennert, Jason De Sena, et al. "4Q'2023 Review in Charts." Strategas, Strategas, 3 Jan. 2024, www.strategasrp.com/Document?strResearchProductID=9ZC7iTiz6XrFBGxvfkTU0Q%3D%3D&FullScreen=True.

Exhibit 6: Inflation Path in Periods of Elevated Inflation (US CPI Year-Over-Year)



Source: Strategas, as of 11/30/2023

The Fed has previously communicated that it plans to maintain its restrictive policy until inflation has reached its target of 2%. On the contrary, Chair Powell's comments after the Fed's December 13th meeting imply that the Fed may choose to loosen conditions before the job is complete. We believe this policy pivot from the Fed will increase the probability of a resurgence in inflation in 2024. While the lagged effects of OER should promote the downward trend of inflation in the first half of the year, services inflation will likely remain elevated, barring a meaningful increase in the unemployment rate. We believe the Fed will be challenged in taming inflation in 2024, and it is likely that inflation readings will exceed current FOMC projections at year-end.

TOP 10 INVESTMENT THEMES FOR 2024

3. Monetary Policy

The Federal Reserve's (the "Fed") pivot in December is an implicit abandonment of its two percent inflation target. While the change is a boon for risk assets and the economy in the short term, it raises the risk of a resurgence of inflation in the back half of the year. At the conclusion of its most recent meeting in December, the Fed surprised markets with its sharp pivot on the monetary policy outlook. Just two weeks prior, Chairman Powell had said in a speech that it was too early for the Fed to begin rate-cutting discussions. Yet, in his post-meeting news conference on December 13, Powell admitted that such discussions had begun at this meeting, and that the time had come to focus on both parts of the Fed's dual mandate – price stability and maximum employment.

At the conclusion of the December meeting, the Fed updated its summary of economic projections ("SEP") for the first time since September. In its SEP release, the Fed went from expecting no rate cuts in 2024, to now forecasting 75 basis points ("bps") of rate cuts in 2024 and an additional 100 bps of cuts in 2025 (see Exhibit 7). While it lowered its projections for inflation, the Fed still sees its preferred measure of inflation, the core personal consumption expenditure ("PCE"), at 2.4% for 2024, and sees the core PCE only reaching its 2% target in 2026. (Note: the PCE is usually lower than the CPI, which suggests a greater tolerance for inflation).

Exhibit 7: Federal Reserve Summary of Economic Projections (SEP), as of December 13, 2023

	Median Projection				
Variable	2023	2024	2025	2026	Longer run
Change in real GDP	2.6%	1.4%	1.8%	1.9%	1.8%
September projection	*2.1%*	*1.5%*	*1.8%*	*1.8%*	*1.8%*
Unemployment rate	3.8%	4.1%	4.1%	4.1%	4.1%
September projection	*3.8%*	*4.1%*	*4.1%*	*4.0%*	*4.0%*
PCE Inflation	2.8%	2.4%	2.1%	2.0%	2.0%
September projection	*3.3%*	*2.5%*	*2.2%*	*2.0%*	*2.0%*
Core PCE Inflation	3.2%	2.4%	2.2%	2.0%	
September projection	*3.7%*	*2.6%*	*2.3%*	*2.0%*	
Federal Funds Rate	5.4%	4.6%	3.6%	2.9%	2.5%
September projection	*5.6%*	*5.1%*	*3.9%*	*2.9%*	*2.5%*

Source: Board of Governors of the Federal Reserve System, Summary of Economic Projections

The newly released SEP constitutes a significant pivot with regards to the Fed's thinking around inflation. For most of the past year, Chairman Powell had suggested that the Fed would not relent until inflation was back to its 2% target; however, the Fed is singing a different tune. The disinflationary trend over the last six months has the Fed less concerned about inflation and more confident that the post-pandemic inflation surge was predominantly transitory in nature, as the Fed originally suggested.

The Fed pivot was hinted at by commentary from several Fed Governors in the months leading up to the December meeting. Notably, on November 28, hawkish and influential Fed Governor Christopher Waller told the American Enterprise Institute think tank that the Fed was ready to start preemptive rate cuts if inflation continued on its current trajectory for several more months. The idea is that Fed policy, or the inflation-adjusted "real" rate, is becoming more restrictive as inflation in the economy softens and that this could unnecessarily imperil the economy. In December's post-meeting press conference, Chairman Powell said the following in response to a question about whether the Fed would cut rates with inflation above 2%: "the reason you wouldn't wait to get to 2 percent to cut rates is that policy would be, it would be too late. I mean you'd want to be reducing restriction on the economy well before 2 percent because – or before you get to 2 percent so you don't overshoot, if we think of restrictive policy as weighing on economic activity."[7] Echoing a similar thought, San Francisco Fed President Mary Daly in an interview on December 18 said, "we have to be forward looking and make sure that we don't give people price stability but take away jobs."[8]

These remarks clearly indicate that the Fed is now prioritizing the economy as much as inflation. What is interesting, and rarely discussed, is that the Fed updated its inflation mandate in August 2020 from a hard 2% target to "an average of 2% over time." At the time of this change, inflation had spent the prior decade mostly below 2%, thus, this change gave the Fed some flexibility in letting inflation run above 2% for a period of time. We believe this is one of the reasons the Fed was slow to raise rates when inflation took hold in 2021. The 2% average inflation target mandate suggests that the Fed should now be seeking an extended period of below 2% inflation to make up for the last three years of elevated inflation. Strangely, no one at the Fed is arguing for this despite growing dissatisfaction among Americans about the overall level of prices in the economy.

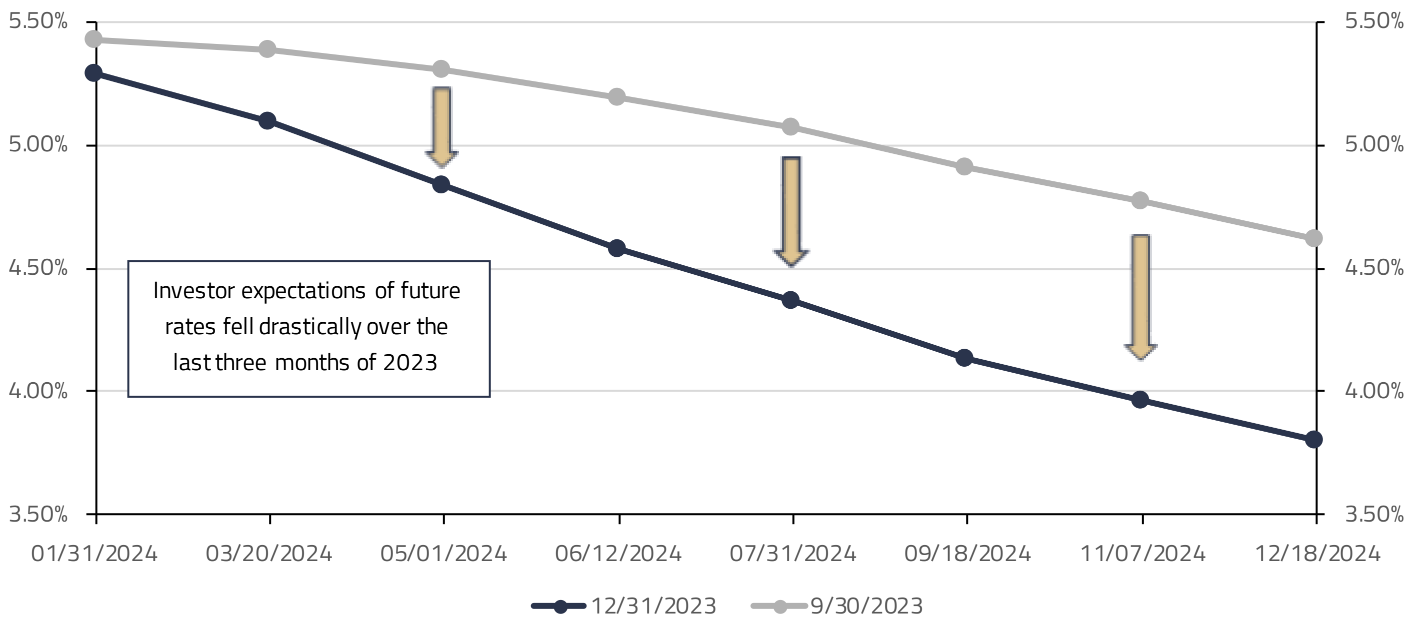
The timing of this Fed pivot has many investors, including ourselves, believing that there is a political element to it. In late October, the 10-year US Treasury yield eclipsed 5% and the stock market was in the midst of a three-month slump. On November 1, the Treasury Department surprised markets with its refunding announcement that unexpectedly shifted its quarterly treasury issuance more towards shorter-dated maturities. The adjustment was against the Treasury Department's long-established policy of being consistent and predictable with the composition of treasury issuance. The modification was clearly intended to alleviate the pressure on long-dated yields and to give a boost to equity markets. In the weeks after the Treasury's announcement, several Fed Governors became more vocal about the risks of rising inflation-adjusted rates and the need for preemptive rate cuts in 2024. The Fed embraced this line of thought with its pivot on December 13. Since the Treasury's announcement on November 1, stocks have exploded higher and the 10-year yield has dropped by more than 110 bps to end the year at 3.91%.[9] At the same time, market expectations for 2024 Fed cuts became more aggressive with the market now expecting 150 bps of rate cuts in 2024 (see Exhibit 8).

With 2024 being a critical Presidential election year, government officials have extra incentive to boost the economy and markets in order to improve incumbent re-election odds and maintain the status quo. While the Fed is supposed to be an apolitical institution, it is no secret that former President Trump would seek major changes at the Fed if he wins the election. Perhaps this Fed pivot is a form of self-preservation.

With the shelter component of inflation set to be a drag on inflation readings in the first half of 2024, the Fed has the cover it needs to start cutting rates early in the year. In total, we expect the Fed will cut rates 75 - 100 bps by the end of July, but will pause afterwards and end up disappointing consensus expectations of 150 bps of cuts in 2024. We believe the Fed will become more cautious and concerned about a relapse in inflation in the back half of the year due to core inflation readings that will prove sticky in the 2.5% range, led by services and wage inflation. Additionally, the Fed pivot unleashed animal spirits among investors and caused a sharp easing in financial conditions over the last month. This should translate into inflationary pressures that build throughout the first half of the year and manifest themselves in higher year-over-year inflation readings in the latter half of the year.

7. "Transcript of Chair Powell's Press Conference - Federal Reserve Board." Federalreserve.Gov, 13 Dec. 2023, www.federalreserve.gov/mediacenter/files/FOMCpresconf20231213.pdf.
8. Timiraos, Nick. "Fed Official Cautions on Over-Tightening." The Wall Street Journal, 19 Dec. 2023, p. A2.
9. Bloomberg.

Exhibit 8: Implied Fed Funds Rate at Next Year's Fed Meetings



Source: Bloomberg, as of 12/31/2023

The other potential risk of the Fed's pivot is that the Fed loses some of its inflation-fighting credibility. Throughout this inflationary period, the Fed has taken comfort that longer-term consumer inflation expectations have remained relatively well-anchored. By reversing its policy guidance ahead of previous indications, the Fed will face intense scrutiny if inflation starts to run higher than expectations. If that happens, it is doubtful the Fed will be quick to reverse course. And if they do reverse course, they run the risk of repeating some of the mistakes of the 1970's when Fed Chair Arthur Burns pursued a back and forth interest rate policy that was confusing and undermined confidence to the detriment of the economy and inflation.

TOP 10 INVESTMENT THEMES FOR 2024

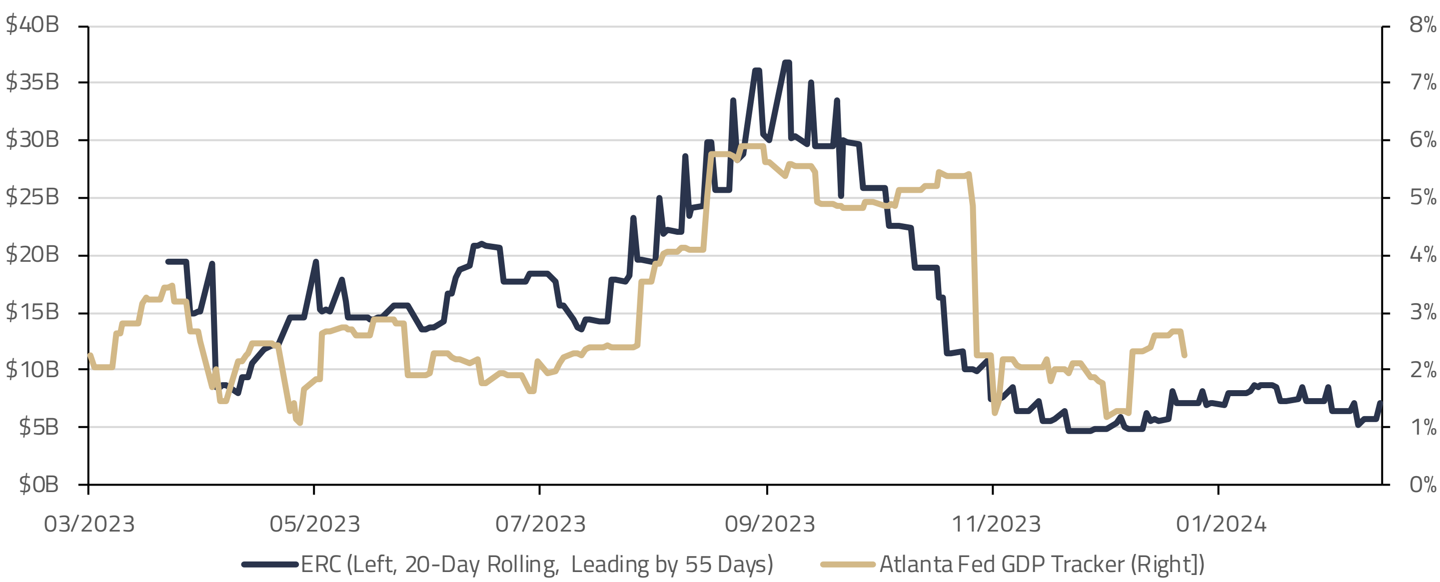
4. The US Economy

Economic growth will slow in 2024, but in our view the most-anticipated recession of all-time will have to wait another year. Most economists were humbled in 2023 as the US economy proved resilient, led by a strong labor market and consumer spending. Entering the year, many predicted that recession was a near certainty given the Fed was engaging in its most aggressive rate-hiking campaign since the early 1980's. When the regional bank crisis erupted in March with the sudden collapse of Silicon Valley Bank and Signature Bank, it looked like the pundits would be proven correct. However, swift coordinated responses by the FDIC, Fed, and Treasury gave the economy and markets the support they needed, which stemmed the crisis and averted a recession.

While the labor market has come into better balance, job growth has remained firm throughout the year and the unemployment rate in December stood at 3.7%, up only 0.2% over the past year and 0.3% from this cycle's low of 3.4%. The resilience of the labor market, combined with excess savings from the pandemic that have yet to be depleted, have translated into healthy consumer spending despite the elevated level of prices in the economy. Non-residential construction spending was also a bright spot, as companies took advantage of government incentive spending from the CHIPS and Science Act ("CHIPS") and the Infrastructure Investment and Jobs Act ("IIJA").

Fiscal spending was one of the biggest drivers of economic growth in 2023. The federal deficit increased $320 billion to $1.70 trillion (6.4% of GDP) in fiscal year 2023.[10] As a percentage of GDP, this is one of the largest-ever annual deficits during a non-recessionary or non-war period. The aforementioned government incentive programs and the student debt moratorium were significant contributors, but one of the most impactful programs was the ERC. Established as a pandemic-relief tax credit program, ERC tax refund distributions surged during the summer and served as a catalyst for robust economic growth of 4.9% in the third quarter (see Exhibit 9). By September, the IRS had paid out over $230 billion in ERC claims, mostly in 2023, and suspended new claims due to suspicions of widespread fraud. [11]

Exhibit 9: Employee Retention Tax Credit (ERC) & Atlanta Fed GDP Now Tracker



Source: Strategas, as of 12/22/2023

10. "Fiscal Data Explains the National Deficit." National Deficit | U.S. Treasury Fiscal Data, Dec. 2023, fiscaldata.treasury.gov/americas-finance-guide/national-deficit/#:~:text=Understanding%20the%20National%20Deficit&text=In%20FY%202023%2C%20the%20federal,referred%20to%20as%20deficit%20spending.
11. Rogers, Kate, and Paige Tortorelli. "How Innovation Refunds Cashed in on the Employee Retention Credit." CNBC, CNBC, 28 Oct. 2023, www.cnbc.com/2023/10/27/how-innovation-refunds-cashed-in-on-the-employee-retention-credit.html.

The US economy grew approximately 2.7% in 2023 (final figures will not be confirmed until later). GDP growth was surprisingly firm considering widespread recession expectations coming into the year and the amount of monetary tightening conducted by the Fed. As we look to 2024, we believe the US economy will avoid a recession, but growth will decelerate to 1.5%. We expect job growth to average 100,000 per month, which is enough to keep unemployment from rising meaningfully. Consumers are showing early signs of fatigue, but we expect them to keep spending as long as they are employed. Overall, we expect spending growth to slow but stay positive. Most importantly, we do not anticipate much change to government spending since the President is uniquely incentivized to support the economy in this important re-election year.

The economy enters the year with good momentum. The Atlanta Fed estimates that fourth quarter GDP growth will come in at 2.3% after posting 4.9% growth in the third quarter. In addition, a huge tailwind has emerged from a significant loosening in financial conditions over the past two months. The sharp drop in bond yields, rally in equities, and tightening of credit spreads should give the economy a boost as we start 2024. Consumer confidence and expectations surveys have already registered meaningful increases in response to the Fed's December pivot and the sharp drop in rates.

If rates continue to fall, we may see an unexpected economic boost from rate-sensitive areas like housing and autos. Housing activity is showing early signs of picking up due to declining mortgage rates, but rates are still at elevated levels and affordability remains a big challenge. According to the National Association of Realtors ("NAR"), home buying affordability fell in October to the worst level since 1985.[12] While lower mortgage rates help, the affordability gap remains too wide; thus, we expect any recovery in housing to be muted. Auto demand has been sluggish and inventories of electric vehicles are at elevated levels. Cheaper auto financing could spark renewed demand for autos.

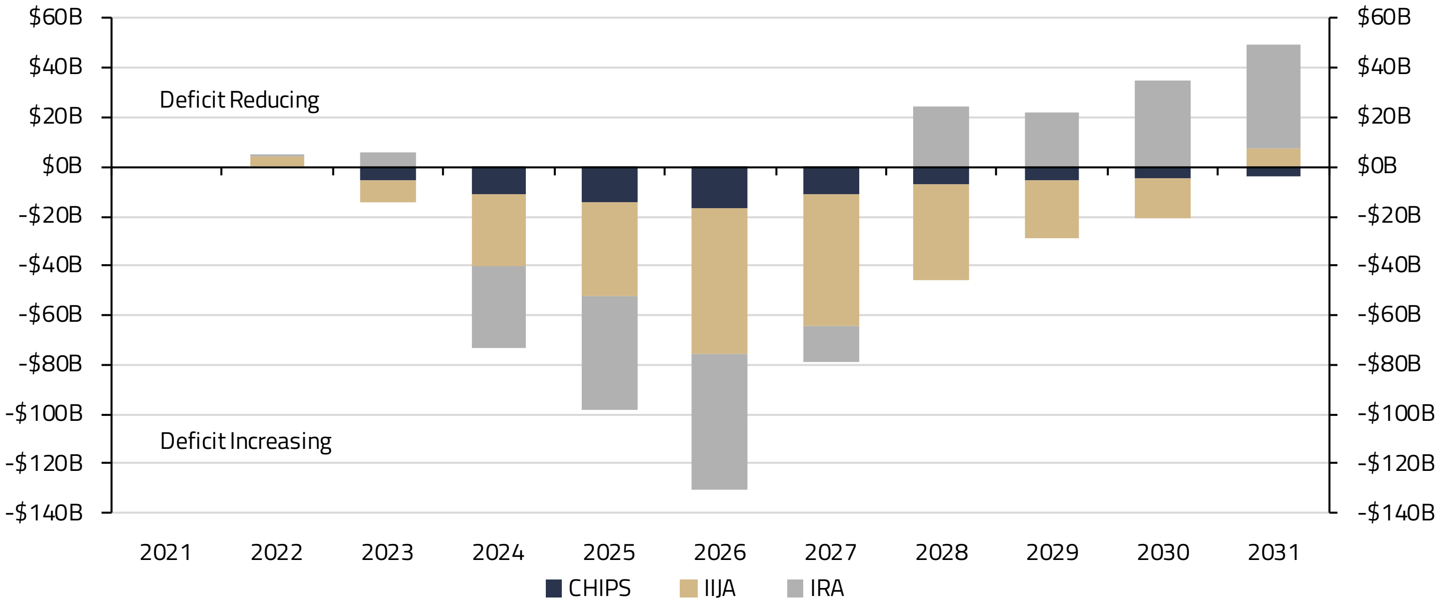
The health of the consumer is a hotly debated topic. Consumer spending held up well throughout 2023, but early warning signs have emerged. The savings rate has dropped well below pre-pandemic levels, and it is estimated that excess savings have been depleted for the bottom cohorts of consumers. Credit-card and auto-loan delinquencies are on the rise and are well above pre-pandemic levels for consumers under forty years old.[13] There are clear stresses at the lower end of the market, but spending at the upper end of the market remains firm, primarily driven by the wealth effect since these consumers have been the biggest beneficiaries of rising asset prices from the pandemic. This bodes well for aggregate spending because households earning over $100,000 per year typically account for approximately two-thirds of US spending.[14]

The recently completed holiday season did little to quell the debate. While spending got off to a strong start during the Thanksgiving weekend, recently released MasterCard SpendingPulse data suggests retail spending ex-autos rose 3.1% this holiday season through December 24, down significantly from growth of 7.6% during the 2022 holiday season.[15] As mentioned previously, we believe consumer spending will remain positive as long as the job market remains relatively stable, which is our forecast. Consequently, weekly jobless claims and continuing claims are two of the most timely and important indicators to monitor in 2024.

12. Friedman, Nicole. "Existing-Home Sales Rise After 5 Months of Declines." The Wall Street Journal, 21 Dec. 2023.
13. Research and Statistics Group. "Quarterly Report on Household Debt and Credit - Federal Reserve Bank ..." Newyorkfed.Org, Center for Microeconomic Data, Nov. 2023, www.newyorkfed.org/medialibrary/Interactives/householdcredit/data/pdf/HHDC_2023Q3.pdf?sc_lang=en.
14. McVey, Henry H. "Glass Half Full - Outlook for 2024." KKR, Dec. 2023, p. 68.
15. Nassauer, Sarah, and Suzanne Kapner. "Shoppers Kept Up Holiday Spending." The Wall Street Journal, 27 Dec. 2023, ereader.wsj.net/?editionStart=The%2BWall%2BStreet%2BJournal.

Deficit spending continues to be a counter-weight to the monetary tightening that is still working its way through the economy. High interest rates and tight credit standards continue to weigh on economic growth, but fiscal stimulus should ensure that the economy stays out of recession. Spending for the IIJA, CHIPS, and Inflation Reduction Act ("IRA") is set to accelerate in 2024 and is expected to provide a multi-year tailwind (see Exhibit 10). Additionally, defense spending should increase as the US looks to continue its support for Ukraine and Israel. At some point, the level of deficit spending will have to be curtailed, but that is unlikely to happen during a re-election year. If growth were to falter, President Biden has several levers at his disposal, such as restarting ERC tax refunds or providing more student debt relief.

Exhibit 10: Impact on Surplus (Deficit) of Major Recent Fiscal Bills



*CHIPS represents the CHIPS & Science ACT, IIJA represents the Infrastructure Investments & Jobs Act & IRA represents the Inflation Reduction Act, including the updated Green Energy Measures of 05/25/2023

Source: Strategas

Taken together, the US economy enters 2024 with strong momentum. Consumer and business confidence surveys are improving as the outlook for interest rates has inflected lower. Improving odds of a soft landing has supported risk assets, including tightening credit spreads. This should translate into above-trend economic growth in the first half of the year, but we forecast that growth will meaningfully downshift in the back half of the year as the interest rate and inflationary environment becomes more challenging. We see inflation starting to once again increase in the second half of the year, putting the Fed in a difficult quandary. They will have to suspend rate cuts short of the 150 bps of cuts that is current consensus. We also project that longer-term yields will not move much lower from current levels and, if anything, will move higher on the back of strong first-half economic data. The tailwind from lower rates and soft-landing optimism will be short-lived. The latter half of the year will be significantly more challenging, and we anticipate that recession talk will once again dominate the headlines as we exit 2024.

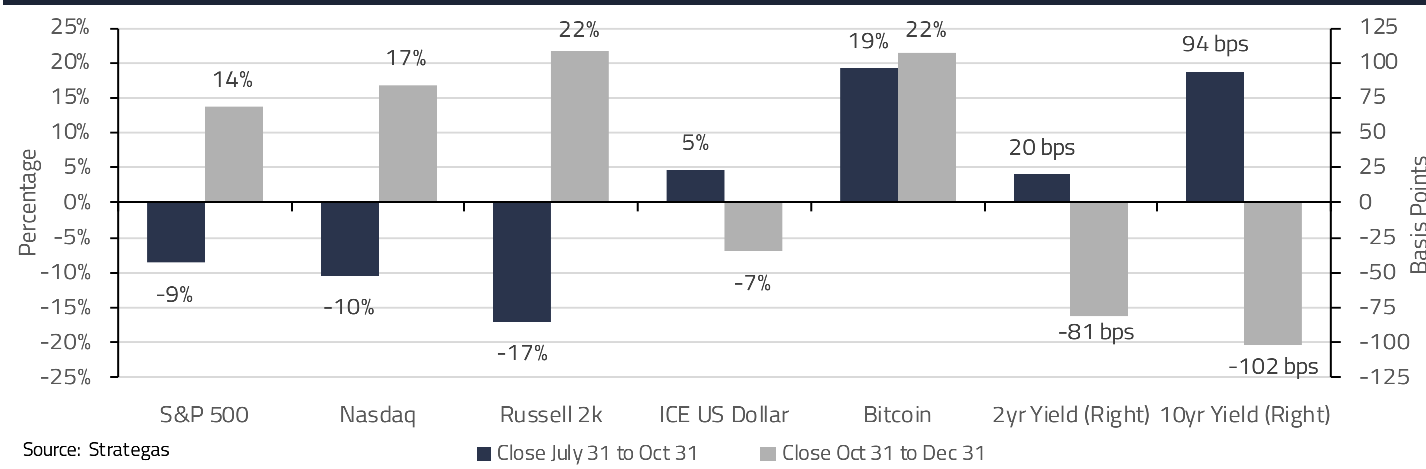
TOP 10 INVESTMENT THEMES FOR 2024

5. Higher-for-Longer

Federal Open Market Committee ("FOMC") members have since 2021 been steadily revising their forecasts upward for where they think the fed funds rate will be by the end of 2024. However, on December 13, FOMC members pivoted to a more dovish stance, signaling that the inflation outlook has improved at a faster pace than anticipated and forecasting three rate cuts in 2024. Despite likely Fed rate cuts in 2024, we believe interest rates will stay higher for longer than the market is currently pricing. An amalgamation of restrictive monetary policy, elevated treasury issuance, weakening foreign demand, and a shortage of domestic buyers will lead to a higher rate regime through this cycle.

The increased borrowing needs of the US Treasury due to expanding budget deficits will likely lead to an upward bias in rates in 2024. After the debt ceiling was lifted, the Treasury had to finance a larger-than-expected $2 trillion deficit and announced that longer-term debt issuance would increase for the first time in three years.[16] This announcement led to two-year yields rising by 20 bps while ten-year yields increased by 94 bps from July 31 to October 31 (see Exhibit 11). On November 1, the Treasury capitulated after months of rising yields and equity market declines by increasing the size of T-bill issuance in its Quarterly Refunding Statement. The Treasury's actions created undersupply at the long end of the yield curve, pushing yields lower and promoting a rally in risk assets into year-end. While favorable for financial markets in the short-term, we find the Treasury's surprise move in November as contradictory to their stated goal of providing "regular and predictable issuance" and likely to have future detrimental effects.[17] T-bills outstanding have grown significantly, currently at 21.4% of total public debt and well above the Treasury's target range of 15% to 20%. Furthermore, net interest costs have surged, causing debt servicing to become an increasing portion of Federal spending. November marked the fourth time in 2023 that monthly net interest costs exceeded defense outlays. For perspective, monthly net interest costs have not exceeded defense spending in more than twenty years prior to 2023.[18] Despite the increased cost to the taxpayer, we believe the administration has chosen to issue debt on the short-end to bolster markets as we head into a re-election year. However, Treasury auction sizes are expected to increase 23% on average across the curve, creating upward pressure on yields across all treasury maturities.[19] Given the current inverted yield curve environment, we also believe the Treasury will likely be pressured to issue longer-term bonds to mitigate rising debt-service costs. Taken together, this may push long-term rates closer to the highs seen in 2023.

Exhibit 11: Market Performance July 31 - Oct 31 vs Oct 31 - Dec 31



Source: Strategas

16. Trennert, Jason De Sena, et al. "4Q'2023 Review in Charts." Strategas, Strategas, 3 Jan. 2024, www.strategasrp.com/Document?strResearchProductID=9ZC7iTiz6XrFBGxvfkTU0Q%3D%3D&FullScreen=True.
17. Levin, Jonathan. "Druckenmiller Mistakes the US Treasury for a Hedge Fund in Yellen Criticism." Bloomberg.Com, Bloomberg, 6 Nov. 2023, www.bloomberg.com/opinion/articles/2023-11-06/druckenmiller-mistakes-the-us-treasury-for-a-hedge-fund-in-yellen-criticism.
18. Clifton, Daniel, et al. "US ELECTION IS ALREADY PRICING INTO SECTORS." Strategas, 12 Dec. 2023, www.strategasrp.com/Document?strResearchProductID=Mf%2FYjGD5vkv3K47lsYiZXw%3D%3D&FullScreen=True.
19. Slok, Torsten. 2024 Economic and Capital Markets Outlook: What's next after the "Fed ..., Apollo, Dec. 2023, www.apollo.com/content/dam/apolloaem/documents/insights/Apollo-Global-2024-Economic-and-Capital-Markets-Outlook-White-Paper.pdf.

Weakening foreign demand should further bias rates upward, as historically significant buyers of US debt continue to reduce their purchases. In Japan, the Bank of Japan ("BOJ") has long supported its domestic bond market by purchasing government debt, effectively capping yields, and keeping borrowing costs down. The BOJ's market intervention has led to unattractive yields on Japanese bonds for domestic investors, prompting Japanese investors to invest in US treasuries in search of yield. However, with the BOJ tightening monetary policy and exiting yield curve control, we expect Japanese investors to rotate out of the US treasury market back towards their domestic market. In China, exports to the US have slowed significantly over the past few years. Slowing exports has led to China having less US dollars to recycle into US treasuries, causing China to hold approximately $300 billion less in US treasuries today than in the second quarter of 2021, as shown in Exhibit 12.[20] Beyond China, central banks and sovereign wealth funds have been net sellers of treasuries since 2015; however, foreign private buyers have offset some of that slowing demand. Yet, in 2023, foreign buyers have slowed their purchases, accelerating the decline in foreign ownership of US government bonds and likely leading to upward pressures on treasury yields.

Exhibit 12: Chinese Holdings of US Treasuries

Source: Apollo, Bloomberg, as of 10/31/2023

Structurally, restrictive Fed monetary policy should continue to support a higher rate regime even with the Fed signaling for rate cuts in 2024. The end-of-year yield collapse accelerated after the December 13 FOMC meeting, where the Fed confirmed a halt to its rate-hiking campaign and suggested rate cuts were coming in 2024. The Fed funds rate would end the year between 4.5% and 4.75% if the Fed cuts rates three times in 2024, as was suggested in their dot plot projections at the December meeting. The Fed funds rate would remain significantly higher than the 0% to 0.25% level it was at when the Fed started its tightening campaign in March 2022. The Fed will need to maintain restrictive policy until it can bring inflation towards its 2% target, which should anchor short-end rates higher. As we opine in our Inflation outlook, there is a confluence of factors that will make the last mile of inflation reduction challenging for the Fed. Furthermore, there is a risk of inflation reaccelerating, as is historically the trend, which could lead the Fed to pause rate cuts or even provide additional hikes. We should expect to

20. Slok, Torsten. 2024 Economic and Capital Markets Outlook: What's next after the "Fed ..., Apollo, Dec. 2023, www.apollo.com/content/dam/apolloaem/documents/insights/Apollo-Global-2024-Economic-and-Capital-Markets-Outlook-White-Paper.pdf..

remain in a higher interest rate environment either until the Fed successfully tames inflation or it is required to aggressively cut rates to provide stimulus in a recessionary scenario.

We believe we are in the midst of a transition from the zero interest rate policy ("ZIRP") regime that defined the post-Global Financial Crisis era to a "higher-for-longer" interest rate environment that will prove impactful to both global economies and capital markets. As mentioned above, higher interest rates will increase net interest costs on Federal debt. We anticipate that this will restrict the Federal government's ability to provide fiscal stimulus that has historically backstopped the economy in times of stress. Higher interest rates may also prove detrimental to consumer spending, as increased debt servicing costs on mortgages, credit cards, and auto loans cannibalize discretionary spending. While corporations opportunistically termed out their debt during the pandemic, a prolonged high-interest rate environment will lead to companies refinancing at substantially higher rates. Higher costs for corporate debt could eventually hinder corporate profits and increase unemployment.

A higher interest rate regime should also pressure risk asset valuations. In the ZIRP era, abundant liquidity and easy financing led to multiple expansion in high-growth areas, such as technology and venture capital. While innovation and productivity growth should still create attractive investment opportunities in these areas, focusing on solid fundamentals will be essential for investing successfully in growth sectors amid a higher interest rate environment. Moreover, a higher interest rate environment should lead to yield becoming an essential aspect of an investment portfolio. Within the ZIRP era, traditional fixed income served primarily as a ballast for portfolios given meager yields. With interest rates reset at higher levels, fixed income and private credit markets show attractive return potential relative to equities. Please refer to our Private Credit section for areas of that market where we have identified such opportunities.

Yields ended the year by reverting dramatically lower, leading to minimal year-over-year increases in ten and thirty-year yields, while two and five-year yields declined year-over-year. Restrictive monetary policy and elevated issuance of treasury bills are likely to anchor rates higher at the front-end of the curve. Meanwhile, a supply-demand mismatch amid expectedly elevated 2024 treasury issuance across the curve should lead to upward pressure on rates at the long-end. In summary, we expect rates to remain structurally higher as we move through this cycle.

TOP 10 INVESTMENT THEMES FOR 2024

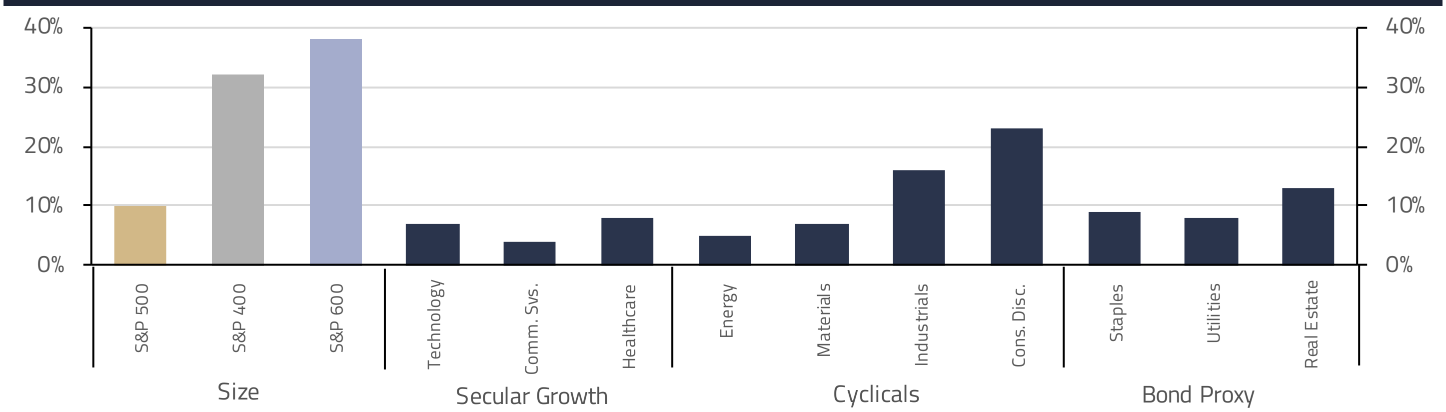
6. Outlook for Equities

We opine that the S&P 500 will end 2024 near-flat, but not before racing to a significant new all-time high in the first quarter. The S&P 500 closed within 0.6% of an all-time high on the last trading day of the year to cap an exceptional two-month run. The rally started in late-October when long-term yields began to decline from multi-decade highs on softer inflation data, and the Treasury Department surprised markets by tilting its quarterly treasury issuance towards shorter-dated maturities. The rally caught a second wind on December 13, at the conclusion of the Fed's meeting, when Chairman Powell confirmed the Fed's dovish pivot. The Fed pivot likely put a cap on yields in the short-term and opened the door for more aggressive risk-taking among market participants. It sets the stage for a strong start to the year for equities; however, we believe volatility and selling will pick up in the back half of the year as growth slows and new challenges emerge.

Equities were having a uniquely challenging year prior to the sharp end-of-the-year rally. At the end of October, the so-called "Magnificent Seven" stocks – Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla - had accounted for almost the entire S&P 500 gain at the time, and both the S&P MidCap 400 Index and the Russell 2000 SmallCap Index were negative for the year.[21] The market complexion changed quickly once it became clear that disinflation was proceeding faster than expected and that the Treasury and Fed were seeking to push yields and rates lower. Equities rallied sharply and broadly as bond yields declined over 100 bps and the Fed implied that rate cuts were coming early in 2024. By year end, all major US equity indices experienced strong gains for the year.

The Fed pivot has unleashed animal spirits that have largely been absent from markets since 2021. The S&P 500 ended the year on a 9-week winning streak, which is the longest winning streak since 2004. While there may be some profit-taking in early January, we believe the tailwind of loosening monetary conditions will push equity prices higher in the early part of the year. We expect small-caps to lead the equity rally, much as they have over the past month, for several reasons. First, small-caps are more economically sensitive than large-caps. Now that consensus has bought into the soft-landing narrative, investors should look to increase their allocation to small-caps. Second, small-cap companies finance themselves with floating-rate debt more than their large-cap peers (see Exhibit 13). As rates have moved up, their borrowing costs and earnings have been adversely impacted. Conversely, the swift move lower in yields over the past few months should provide considerable earnings relief for small-caps. Finally, small-caps currently trade at an unusually attractive forward price-to-earnings ("P/E") discount to large-caps. The relative P/E of small versus large-cap equities is at an extreme level rarely seen over the past 40 years (see Exhibit 14). The last time small-caps were this inexpensive on a relative basis was in the year 2000, and they went on to easily outperform large-caps over the following seven years.[22]

Exhibit 13: Floating Rate Debt as a Percentage of Total Debt



Source: KKR, Bloomberg, JPMorgan Global Research, as of November 30, 2023

21. Bloomberg.
22. Id.

Exhibit 14: Small Cap vs Large Cap Relative PE Ratio

Small cap represented by S&P 600 index, large cap represented by S&P 500 index, P/E calculation excludes non earning companies
Source: Bloomberg, as of 12/31/2023

Some of the other areas of the market that we believe are poised to lead include banks, biotech, and energy. Banks underperformed in 2023 following the regional bank crisis in March. Most banks found themselves with impaired balance sheets as their holdings of long-duration fixed-income securities plunged in value when interest rates moved higher. In response, banks had to curtail lending and were often forced to pay up for deposits, pressuring margins and earnings. Concerns around a looming recession and credit deterioration gave investors little reason to buy banks. Many of these headwinds have now subsided. The move lower in yields has increased the value of bank fixed-income portfolios, freeing up capital to lend anew. In addition, deposit flight has abated, soft landing odds have increased, and credit spreads have tightened. The outlook for banks is much improved, and we believe they will lead the next move higher for equities.

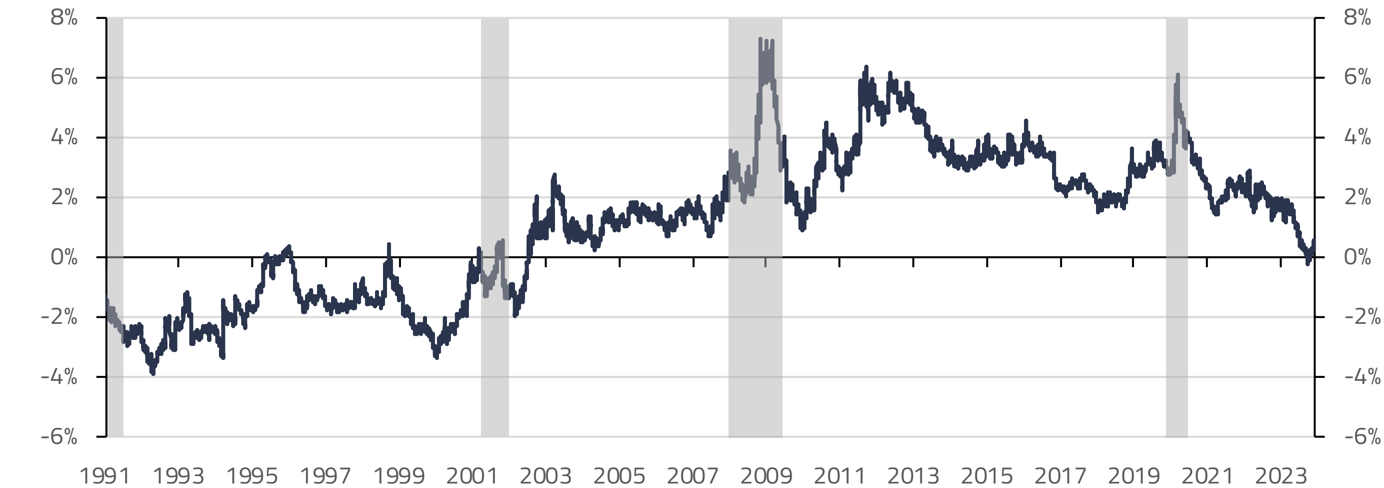
Biotech has underperformed for three straight years primarily because mergers and acquisitions ("M&A") activity has been depressed. The upward move in interest rates also caused many investors to shun the sector, as many biotech companies are unprofitable and considered long-duration equities. However, big pharma companies are flush with cash, and many have blockbuster drugs that will soon come off-patent. Most have underinvested in research and development over the last decade, leaving their drug pipelines depleted. Many will need to acquire promising drug candidates in search of their next growth avenue. With interest rates well off of their highs and growing confidence in the economic environment, we believe the M&A market will rebound strongly in 2024, to the benefit of biotech. We have already seen early evidence of this with several notable deals announced in December.

Energy is another area of the market that we believe will outperform in 2024 after underperforming in 2023. The Fed's dovish pivot likely cements an intermediate-term peak in US interest rates, which should put downward pressure on the dollar over the course of the year. A weak dollar environment is usually good for energy and commodity stocks because commodity prices are often inversely correlated with the dollar. At current oil prices, energy companies are producing hefty cash flows, are being disciplined with their spending, and generously distributing capital to shareholders. With energy stocks currently trading at a big discount to the broader market, we believe they are poised to outperform in 2024.

After a record-breaking year for the Magnificent Seven, we view it as highly unlikely that these stocks will lead the market again in 2024. That said, it is important to realize that these seven stocks were collectively down approximately 40% in 2022, and a majority of them are still trading below their 2021 highs. Artificial intelligence ("AI") euphoria drove much of their gains in 2023. We believe many of these companies are well-positioned to benefit from AI technology in the long-term, but investors often overestimate how much change can happen in one year. Accordingly, we expect more dispersion from this group in 2024, with some building on their 2023 gains while others fail to live up to elevated expectations. Thus, we believe returns across the S&P 500 will broaden out in 2024, and the equal-weight S&P 500 index will outperform the market-cap weighted index.

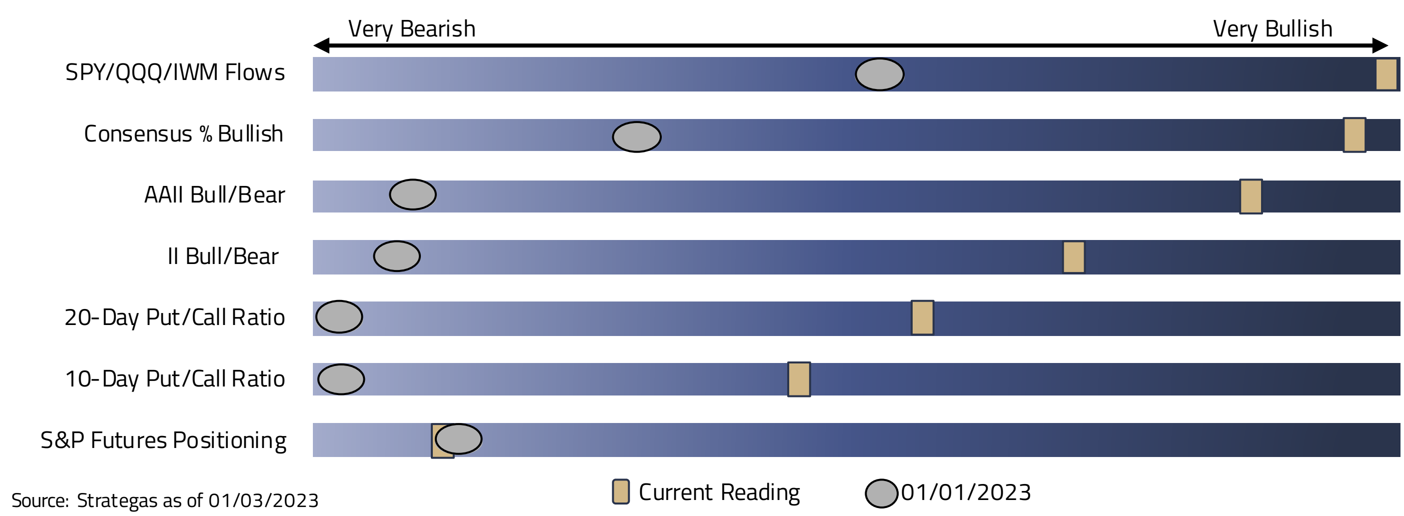
Our equity outlook for 2024 is nuanced. We expect a strong start to the year, but volatility and selling should accelerate in the second half of the year. First of all, the S&P 500 trades at an elevated P/E multiple compared to its long-term average. The S&P 500 gained 24% in 2023 yet S&P 500 earnings growth was roughly flat. This means that the P/E multiple for the S&P 500 has increased by over 20% in the past year. Looking at the equity risk premium, which compares the S&P's earnings yield (inverse P/E ratio) to bond yields, the S&P 500 is the least attractive it has been since the late 1990's (see Exhibit 15). At the start of 2023, investors were concerned about an imminent recession, the CBOE Volatility Index ("VIX") was elevated, and investors were conservatively positioned. Today, the opposite is true. A soft landing has become the consensus view, the VIX has spent the past month hovering around 13 compared to an average of 19.5 over the last 15 years, and positioning is stretched. In short, sentiment has gone from an asset to a liability (see Exhibit 16).[23] Finally, the Fed's dovish pivot and the prospects for rate cuts is a positive tailwind today, but we believe that the market is overestimating the amount of monetary stimulus that the Fed will deliver in 2024. Good economic growth in the first half of the year will reverse the current disinflationary trend, sparking a sell-off in bonds (yields will move higher) and causing the Fed to pause rate cuts short of market expectations. With higher rates and inflation back as key concerns, equities will experience a volatile and challenging second half that will leave the S&P 500 flat for the year.

Exhibit 15: Difference Between S&P 500 Earning Yield & 10-Year Treasury Yield



Source: Bloomberg, Apollo, as of 12/31/2023

Exhibit 16: Investor Sentiment Indicators



Source: Strategas as of 01/03/2023

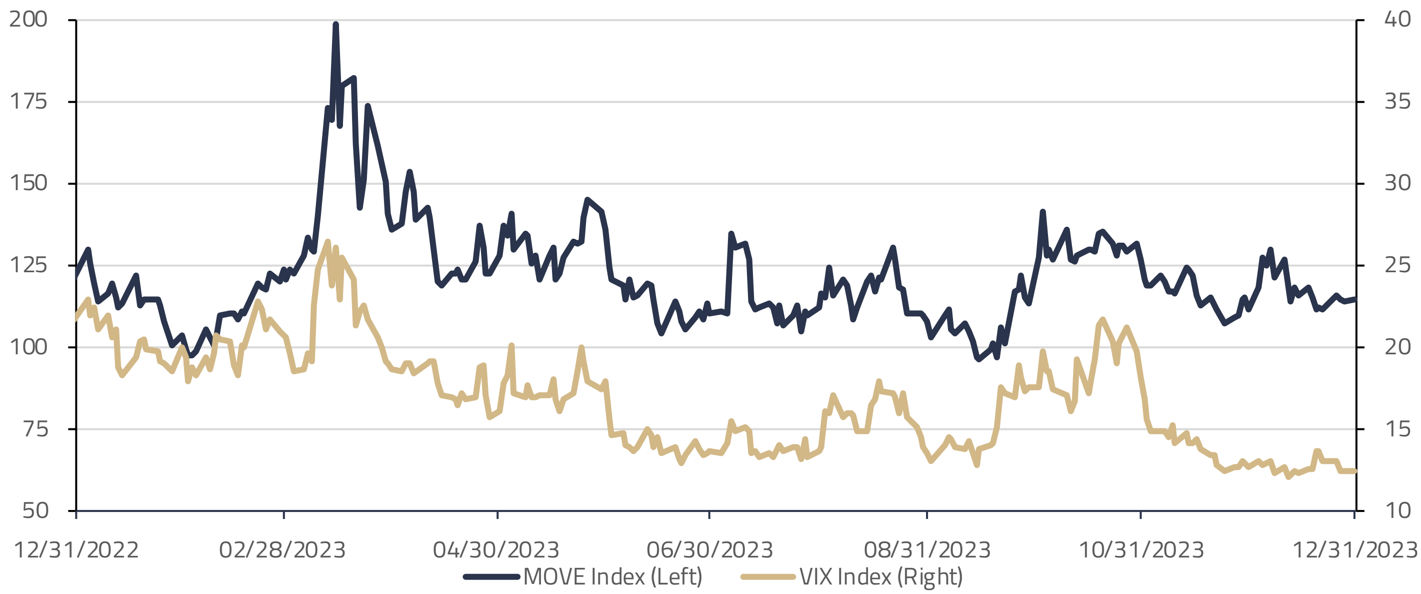
23. Kelly, David. "2024 Year Ahead Outlook - The Last Leg on the Long Road to Normal." J.P. Morgan Asset Management, Dec. 2023.

TOP 10 INVESTMENT THEMES FOR 2024

7. Private Credit

Fixed income investors have suffered immense challenges over the past few years, as high inflation and rapid rate hikes proved detrimental to fixed income, especially long duration assets. The rise in risk-free and long-dated yields was accompanied by an escalation in interest rate volatility, as observed by the MOVE index. In contrast, equity market volatility has remained relatively muted (see exhibit 17). Significant rate volatility has accompanied key data releases, notably the Consumer Price Index ("CPI") and Non-Farm Payrolls ("NFP") reports. The five-year US treasury has traded in a 20 to 50 basis point peak-to-trough range in the ten days surrounding the past several CPI and NFP reports.[24] We believe these market gyrations represent investors' attempts at predicting the Federal Reserve's reaction function to these data points; in turn, the market's attempts at forecasting monetary policy have significantly contributed to interest rate volatility over the past year. We currently view market pricing for 2024 interest rate cuts as too aggressive, likely leading to sustained interest-rate volatility if the market's views on Fed policy shift upon economic releases. Thus, while elevated rates have created opportunities across fixed income, it would behoove investors to mitigate interest-rate risk by limiting duration until interest-rate volatility normalizes.

Exhibit 17: Interests Rate & Equity Volatility



Source: Bloomberg, as of 12/31/2023

Private credit is an asset class that has garnered a sizable amount of attention from the investment community because it currently generates attractive yield while minimizing interest-rate risk. One such area that has attracted significant investment interest is middle-market direct lending, where lenders provide financing solutions for companies that cannot easily access the publicly-traded debt markets. Over the past twenty-five years, regulatory reform has made it challenging for banks to properly serve this market, ceding the majority of the middle-market lending space to non-bank lenders. Since the start of 2022, more than 80% of leveraged buyouts have been financed by the private credit market.[25]

Middle-market loans feature many characteristics that we find attractive in today's environment. Middle-market loan payments are typically linked to the Secured Overnight Financing Rate ("SOFR"), meaning they are floating rate in nature and carry minimal interest-rate risk. Middle-market loans are typically held until maturity, meaning they are not publicly traded, which mitigates price volatility as compared to publicly-traded loans and bonds. The loans have an average contractual life of five years and an average effective life of three years. The short-term

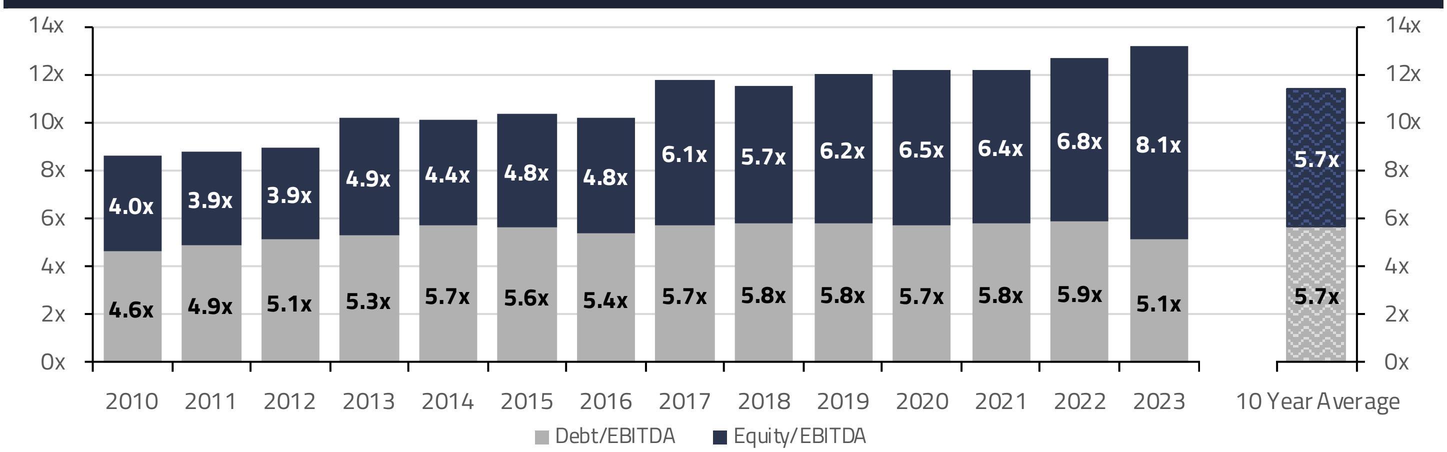
24. Reider, Rick. "The Fixed Income Opportunity for 2024." BlackRock, 19 Dec. 2023, www.blackrock.com/us/financial-professionals/insights/fixed-income-opportunity-2024?cid=emc%3AMIAT%3AWlth%3AENL%3AUS%3ANA&elq_mid=86587&elq_cid=1941181&elq_cmp=33873.

25. Carmean, Zane, et al. "2024 Allocator Outlook | Pitchbook." PitchBook, PitchBook, 15 Dec. 2023, pitchbook.com/news/reports/2024-allocator-outlook.

nature of these loans allows lenders to re-underwrite loans for repeat borrowers at a regular cadence. The broad middle-market loan market currently sports a higher yield than the public market equivalents and has achieved a higher return since its inception in 2004.[26] Further, the realized loss rate of middle-market loans has been similar to the public market, while senior-secured middle-market loans have achieved a lower loss rate while maintaining a higher yield and return than publicly-traded loans and bonds.[27] Middle-market loans have also proven to be a great diversifier for portfolios given their low beta to both publicly-traded equity and fixed income markets.

The income component of middle-market loans has improved over the past two years amid the Fed rate-hiking cycle. The current distribution yield of middle-market loans, as measured by the Cliffwater Direct Lending Index ("CDLI"), was reported at 11.57% at the end of the third quarter of 2023. This represents a sizable increase from the distribution yield of 8.7% in the first quarter of 2022 and 10.96% in the first quarter of 2023.[28] Over the past year, lenders have been able to achieve these higher yields with reduced leverage and lower loan-to-value ("LTV") ratios. Average private equity debt-to-EBITDA multiples have decreased to 5.1x as of September 2023 from 5.9x in 2022 and are now below the 10-year average of 5.7x. Similarly, the average amount of debt financing for private equity deals dropped to 43.9% from 50.8%.[29] Taken together, it appears private equity sponsors are investing more equity into transactions, creating a stronger fundamental backdrop for lenders.

Exhibit 18: Median North America and Europe PE Buyout EV/EBITDA Multiples



Source: iCapital, Pitchbook, iCapital Investment Strategy, as of 12/07/2023

Middle-market lending is not without risk, and systemic concerns have risen as capital has flowed into the asset class. While the floating-rate nature of the asset class has strengthened yields as interest rates have risen, it has also brought concern about borrowers' ability to weather higher interest-rate payments. Trailing-year realized losses of -0.91% are quickly approaching their -1.04% long-term average, and we anticipate that losses will exceed their average if rates remain elevated, even if the economy manages a soft landing.[30] Some investors even postulate that a significant rise in defaults could pose a risk to financial stability; however, Goldman Sachs' chief credit strategist, Lotfi Karoui, believes many of these concerns are overblown.

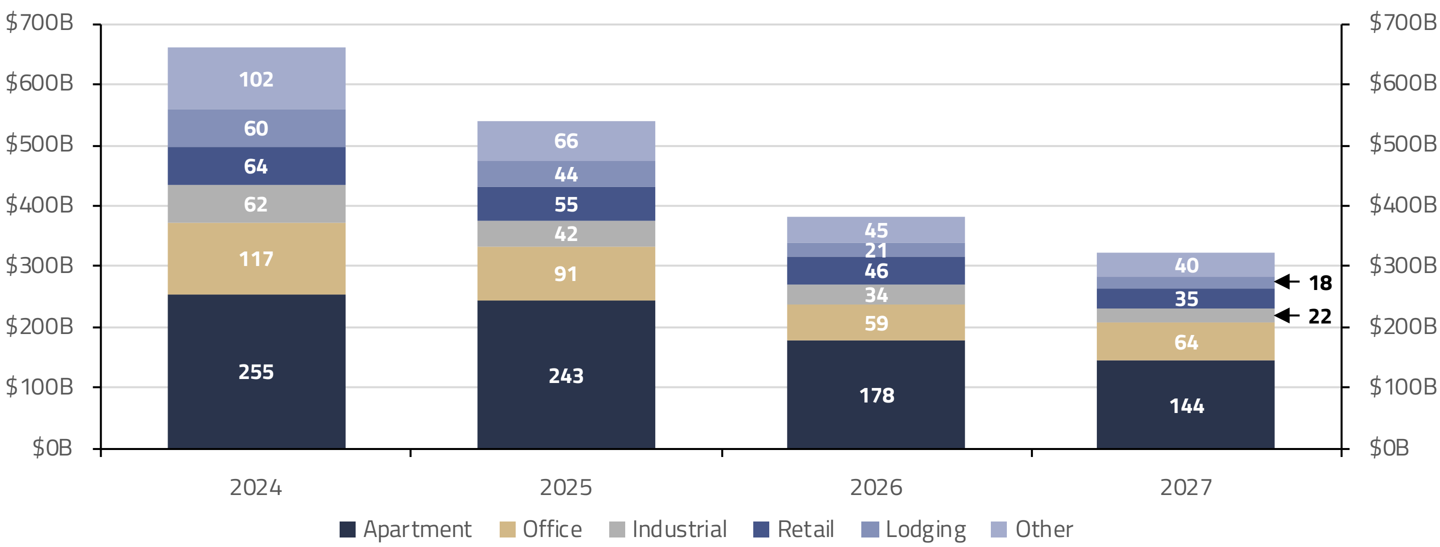
Karoui believes private credit will be more robust than public credit in transitioning to a higher cost-of-capital environment.[31] The bespoke nature of private credit should allow for faster and less costly resolution to financial distress. Lenders typically have greater control over covenants and amortization payments that generally lead to better recovery values. Nonetheless, a recession in 2024 could prove challenging for middle-market lending as defaults, and subsequent losses, would be primed to elevate substantially.

26. Cliffwater.
27. Id.
28. "2024 Market Outlook - Investor Optionality and a Broader Opportunity Set." iCapital, Dec. 2023, https://5228948.fs1.hubspotusercontent-na1.net/hubfs/5228948/07_DOCUMENTS/2023/2024-Outlook/iCapital-2024-Outlook-Final.pdf?hsCtaTracking=7f0b4a29-09ed-42c1-a7d0-d5ec9c462a9c%7Cd1f84f04-59ba-4bf2-b652-50d932954253.
29. Id.
30. Nesbitt, Stephen, et al. "2023 Q3 Report on U.S. Direct Lending - Cliffwater." Cliffwater, 7 Dec. 2023, cliffwater.com/files/cdli/docs/Cliffwater_Report_on_US_DirectLending.pdf.
31. Karoui, Lotfi. "Should We Worry about Private Credit?" Goldman Sachs, 14 Dec. 2023, www.goldmansachs.com/intelligence/pages/should-we-worry-about-private-credit.html.

Additionally, a recession would likely lead to even lower buyout deal-making activity and base rates would likely come down as the Fed provides accommodative monetary policy. On the other hand, recession would reduce competition, which has increased substantially as the market has grown in popularity. Accelerating capital flows into middle-market lending has led to a deluge of new entrants into the industry, leading to tighter spreads and worsening underwriting standards. We predict that a recession would likely filter out many less experienced lenders and improve the overall quality of the loans in the long-term. Lastly, recession would allow opportunistic lenders a chance to be a lender of last resort at attractive spreads. Since many lenders provide this type of capital in separate vehicles, we believe complimenting direct middle-market lending exposure with distressed or opportunistic credit exposure would benefit investors in times of financial distress.

Private real estate credit provides another potentially attractive investment opportunity amid a volatile interest-rate environment. The floating rate nature of commercial real estate ("CRE") debt resulted in higher funding costs for existing borrowers and catalyzed the regional banking crisis in March 2023. Regional banks are leaders in providing capital to CRE borrowers, with approximately $2.3 trillion in CRE debt held by smaller banks.[32] However, a meaningful supply-demand gap has formed within real estate with regional lenders pulling back capital. In Exhibit 19, we can see that approximately $1.2 trillion in CRE loans are set to mature within the next two years. We believe experienced real estate debt managers will be able to fill the gap and generate attractive returns. Higher base rates and wider credit spreads have given lenders attractive yield opportunities. CRE senior mortgages currently offer a 400 basis point spread over SOFR for a total yield of approximately 9%, which is favorable in comparison to real estate equity that had a one-year total net return of -13% and a ten-year return of 7% as represented by the NCREIF ODCE.[30] Furthermore, lenders sit senior to equity holders on the capital structure creating structural downside protection that we believe enhances the risk-reward of investing in real estate debt over equity.

Exhibit 19: Commercial Real Estate Debt Maturities



Source: iCapital, Mortgage Bankers Association, as of 03/10/2023

Elevated treasury issuance, expanding fiscal deficits, declining foreign ownership of treasuries, heightened geopolitical conflict, and uncertain monetary policy are just a few reasons why we believe interest-rate volatility will persist into 2024. Accordingly, we believe it prudent for investors to mitigate interest-rate risk in portfolios by rotating capital into limited-duration assets. The increased accessibility and attractive risk-adjusted yields of private credit create compelling opportunities for high-net-worth investors looking to reduce duration in 2024.

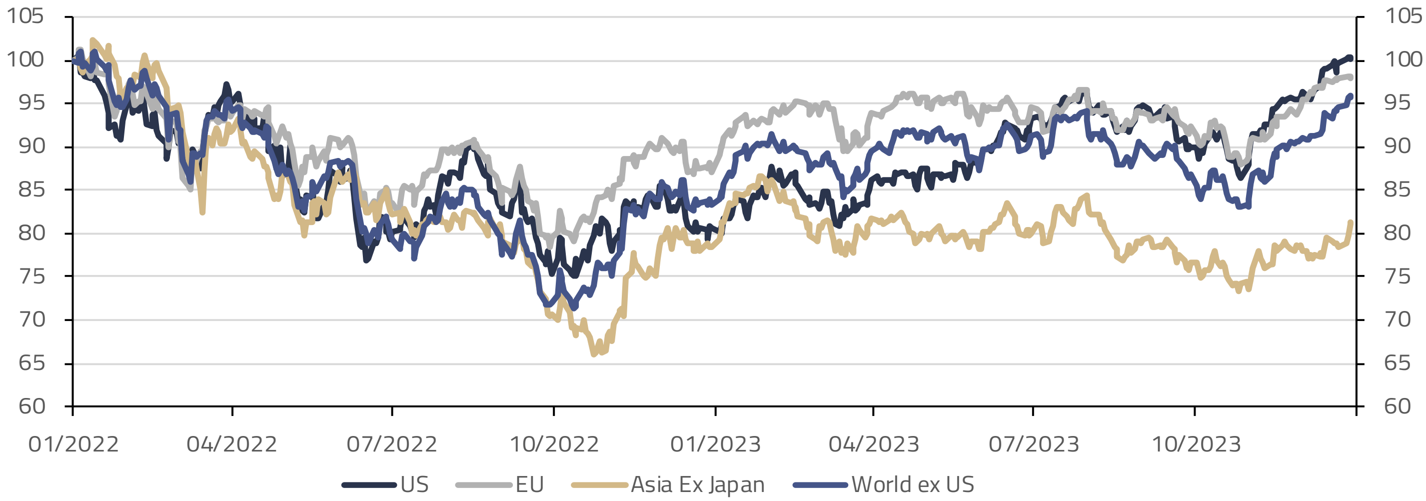
32. "2024 Market Outlook - Investor Optionality and a Broader Opportunity Set." iCapital, Dec. 2023, https://5228948.fs1.hubspotusercontent-na1.net/hubfs/5228948/07_DOCUMENTS/2023/2024-Outlook/iCapital-2024-Outlook-Final.pdf?hsCtaTracking=7f0b4a29-09ed-42c1-a7d0-d5ec9c462a9c%7Cd1f84f04-59ba-4bf2-b652-50d932954253.

TOP 10 INVESTMENT THEMES FOR 2024

8. International Markets

As we enter 2024, disinflation has become a central theme across the globe, with most central banks signaling an end to their tightening campaigns, and markets anticipating rate cuts across most developed market economies. The outlook for most developed economies appears lukewarm; however, strong US economic resilience and a higher-quality index composition lead us to retain a domestic bias in our equity allocations. Nonetheless, specific international markets have unique characteristics that we believe will provide diversification benefits and potential outperformance for US investors in 2024.

Exhibit 20: Equity Performance Across Geographies (Indexed to 100 on 01/01/2022)



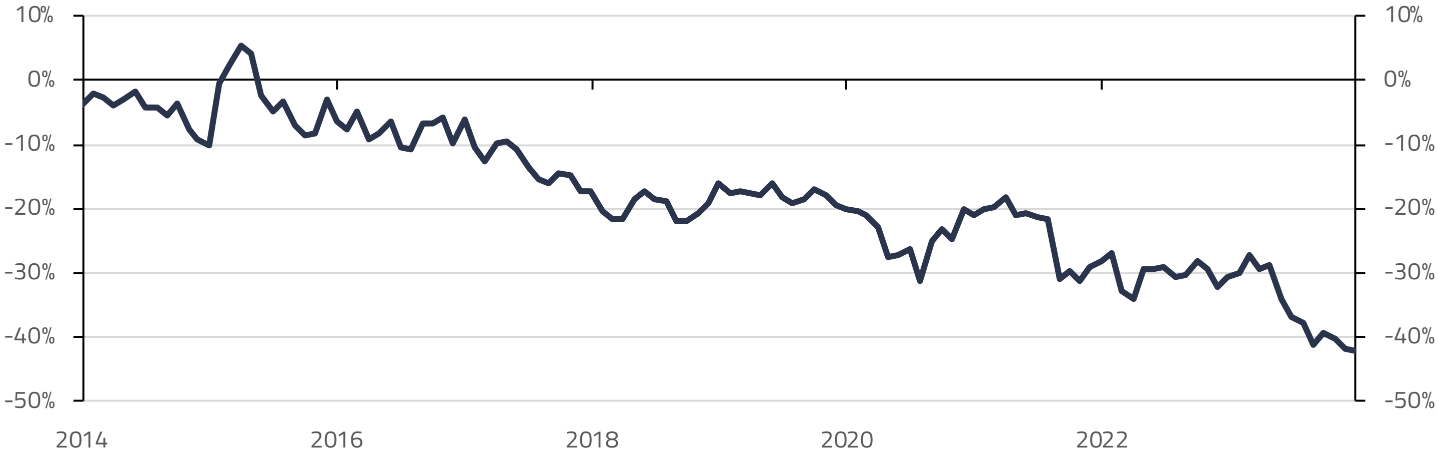
*US represented by S&P 500 Index, EU represented by STOXX 600 Index, Asia ex Japan & World ex US represented by their respective MSCI Index

Strong disinflationary trends in 2023 have led both the European Central Bank ("ECB") and Bank of England ("BoE") to pause their rate-hiking campaigns. Core inflation has come down significantly across both regions; however, elevated wage inflation should still be challenging to correct amid tight labor markets. Shelter disinflation will have a lesser impact on the Euro Area and the United Kingdom, where owner-occupied housing is excluded from key inflation measures. We find this distinction significant, as the shelter component in US measurements should pressure core inflation readings lower at the start of the year, which, in turn, will support Fed rate-cut decisions.

Real income growth in both regions was disappointing in 2023 as energy price shocks weighed on the consumer. High energy prices also weighed on industrial activity. A rebalancing of spending towards services from goods, an inventory destocking cycle, and a disappointing economic recovery in China further hindered Europe's manufacturing sector. The prospects for Europe's growth in 2024 appear to rely on continued normalization of energy prices and rebounding Chinese demand. We believe sell-side expectations underestimate the risk of a resurgence in energy inflation and disappointing Chinese demand. Further, we anticipate the roll-off of energy-related payments and a pull-back in EU Recovery Fund spending to create a sizable fiscal drag for both economies.

The ability for certain European countries to sustain debt levels in a higher interest-rate environment is a cause for concern. Italian sovereign spreads have already widened, and we question whether the country can sustain its debt levels at elevated rates. If rates remain elevated, we suspect the looming issues occurring in Italy will surface across other less fiscally sound European sovereigns. One advantage we see in European equities is that they look inexpensive from both an absolute and relative standpoint. However, European equities have traded at large price-to-earnings discounts to US equities for years and have consistently underperformed during that time (see Exhibit 21). We think attractive valuations are not reason enough to be bullish on Europe when many fundamental issues appear to live beneath the surface. Overall, European equities look vulnerable in 2024 and will likely provide limited diversification benefits to US investors.

Exhibit 21: European Equities Price to Earnings Discount vs US Equities



Europe PE represented by the PE of MSCI Europe Index, US PE represented by PE of S&P 500 Index
Source, Bloomberg, JPM Asset Management

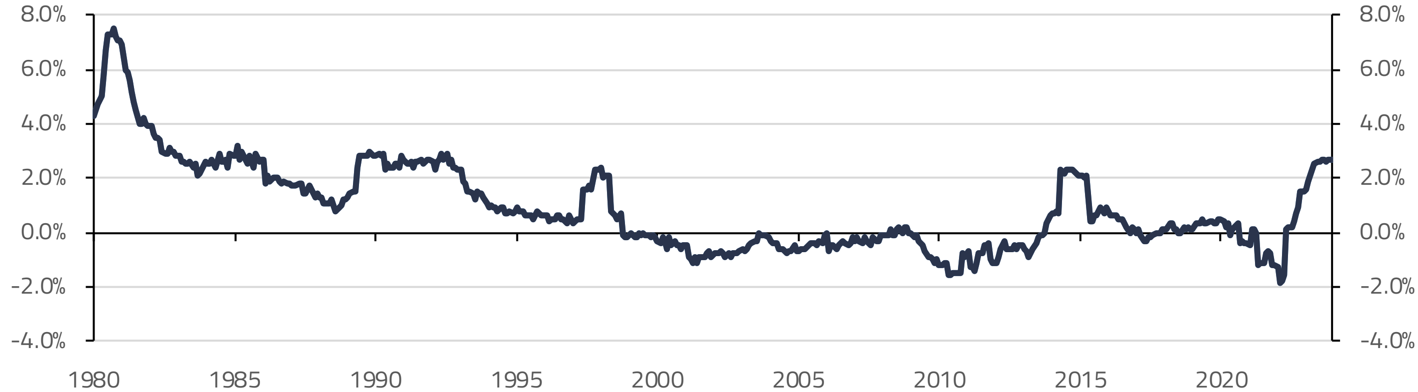
Japanese equities appear relatively attractive in 2024 as Japan's exit from deflation, reasonable valuations, structural reforms, and a weak Yen create a strong backdrop for outperformance. Japan stands apart from global economies as it welcomes the inflation pickup that led it to escape nearly three decades of anemic inflation or outright deflation. The exit from deflation has made cash less attractive compared to equities for Japanese pensions and households, which could lead to capital moving from cash into equities from these cohorts. Japanese pensions and households currently allocate approximately 25% and 11% to equities, respectively, versus US pensions and households that allocate 40% to equities, implying ample runway for Japanese equity allocations to trend higher.[33] Further, the Japanese government has created tax incentives for households to increase equity allocations while pressuring pensions to increase equity allocations to match the Government Pension Investment Fund.

Broad corporate governance reforms also create a stronger fundamental foundation for Japanese equities. The Tokyo Stock Exchange ("TSE") has threatened to delist companies trading below book value unless they enact governance reforms. The TSE adopted more demanding listing criteria for companies listed in the prime section to lure more foreign investment by promoting companies with strong profitability whose governance meets global standards. The 269 firms in the prime section that failed to meet the new criteria at the beginning of 2023 were provided a grace period until 2025 to enact improvements.[34] Already, we have seen evidence of improved governance within Japanese markets as the share of companies with more than 50% independent external directors has risen from 30% to 60%.[35] The initiatives from the TSE should promote a higher quality market that should serve Japanese equity investors well.

The Bank of Japan ("BoJ") will likely continue dismantling the central bank's decade-long accommodative policy regime by exiting yield curve control. In September 2016, the BoJ set a yield cap of around 0% on 10-year bonds to stimulate the economy by keeping borrowing costs low. The BoJ has been gradually increasing the yield cap, which now stands at 1% after its last modification in July 2023. The BoJ is likely to formally abandon yield curve control in 2024 if underlying service inflation remains firm and a wage-price linkage is established. Further, we expect the BoJ to raise interest rates modestly in 2024 if inflation exceeds its target. While the rest of the developed world is expected to ease monetary policy in 2024, Japan is poised to tighten policy. All else being equal, we imagine this should lead to a stronger Yen, creating another tailwind for investment into Japanese equities for US investors.

33. Cembalest, Michael. "Pillow Talk ." J.P. Morgan, 1 Jan. 2024, am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/eye-on-the-market/outlook-2024-amv.pdf.
34. Hamada, Hiroko, and Makiko Yamazaki. "Tokyo Bourse Proposes 2025 End of Grace Period for Listing Rules." Reuters, 25 Jan. 2023, www.reuters.com/markets/asia/tokyo-bourse-proposes-2025-end-grace-period-listing-rules-2023-01-25/.
35. Cembalest, Michael. "Pillow Talk ." J.P. Morgan, 1 Jan. 2024, am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/eye-on-the-market/outlook-2024-amv.pdf.

Exhibit 22: Japan CPI Excluding Food & Energy (Year-Over-Year Change)



Source: Bloomberg, JP Morgan Asset Management, as of 11/30/2023

The long-term outlook for Japan remains challenged. Economic growth relies on exports, which could suffer amid a strengthening Yen scenario. Real wage growth remains negative, as household consumption declined in real terms by 2.5% year-over-year in October 2023.[36] Weak demographics weigh on growth with potential GDP below 1%.[37] Overall, the long-term forecast for Japan is tepid; however, the draconian shift in policy currently unfolding can spur strong equity performance for 12 to 24 months.

Elsewhere, we remain bearish on the investment opportunities in China, considering lackluster growth in 2023 that will likely continue this year. The country's troubled property sector will likely remain problematic, with housing data trending downwards and credit issues arising among prominent players. This notion was reinforced on January 5 when Chinese shadow banking giant Zhongzhi Enterprise Group filed for bankruptcy after claiming it was insolvent. Zhongzhi's money management business was under criminal investigation after extending loans to distressed developers and purchasing assets from troubled real estate companies, including Evergrande. We view this as a harbinger that further issues revolving around China's property market are set to materialize throughout the year. Global initiatives to diversify supply chains and a shrinking working-age population will pressure China's growth potential going forward. Geopolitical tensions between China and the US are ripe to escalate, considering President Xi's recent claim that reunification with Taiwan is inevitable. All considered, we believe it prudent for US investors to limit exposure to Chinese risk assets.

Outside of China, emerging market equities of certain countries are relatively attractive given the reorganization of global supply chains, potential commodity price increases, and the possibility of incremental monetary stimulus. The US government's initiatives to push businesses to restructure supply chains away from geopolitical rivals and towards allied nations should behoove the economies of several countries in Latin America and Asia. For example, tech giant Apple has relocated some of its iPhone production to India, away from China. Continuing this trend should support growth in markets where new supply chains are created. Geopolitical risks and a weaker dollar environment will likely support commodity prices for the foreseeable future, which should benefit many emerging market countries that are heavily dependent on energy and commodity-related sectors.

Government initiatives towards the green transition could fuel increased capital spending in green energy projects that further bolster commodity-centric economies. Many emerging market central banks, such as Brazil and Poland, hiked rates early and have already begun cutting rates. These early hikers should continue steadily cutting rates this year due to significant disinflation progress. Continued rate cuts should support asset prices in these regions, barring a recession. On the other hand, a higher cost of capital environment and lagged effects from the pandemic have challenged many emerging market economies. The number of emerging market sovereigns that have defaulted or are under debt distress has risen markedly. While we believe there are some interesting opportunities in emerging markets, investors should remain selective when allocating to these countries.

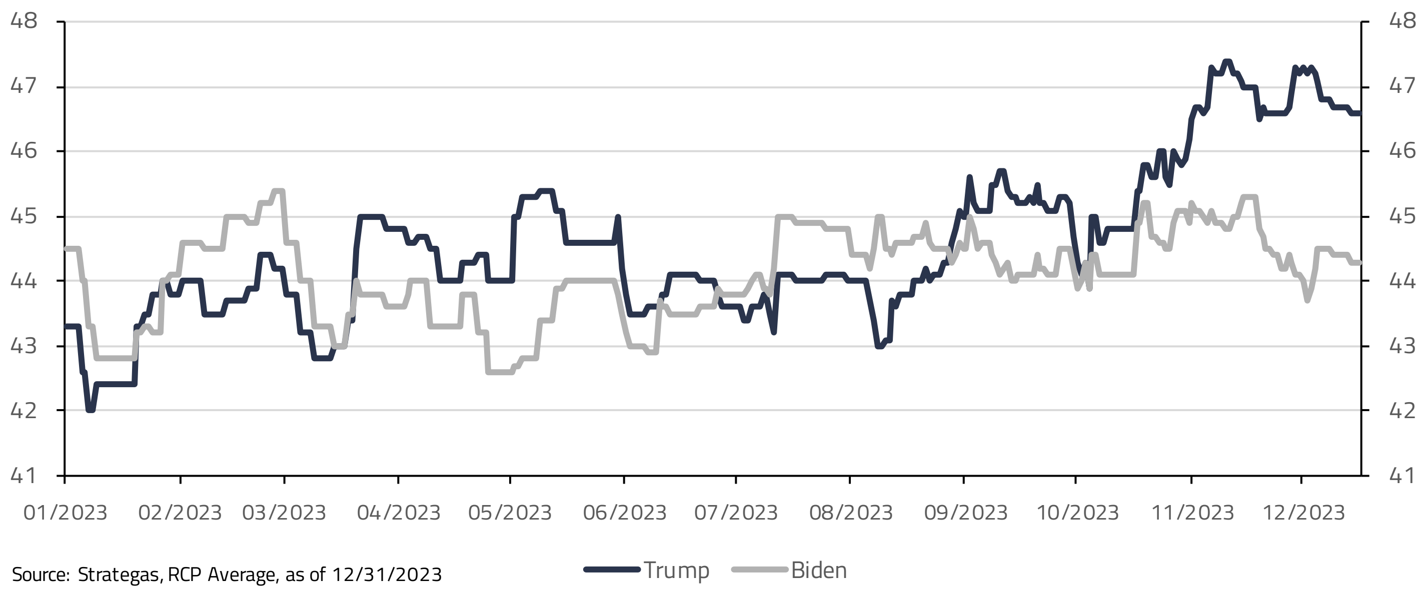
36. Bloomberg.
37. CEIC Data.

TOP 10 INVESTMENT THEMES FOR 2024

9. The 2024 US Presidential Election

The 2024 election looks primed to be one of the most complicated and unpredictable elections in our nation's history, with the outcome likely to upset half of the country. As of the time of this writing, polling implies a rematch of the 2020 election, with Trump currently holding a narrow lead over Biden in a head-to-head election.[38] However, efforts from Colorado and Maine to remove Trump from appearing on their state's ballot have escalated a national legal effort to disqualify him from office that will likely force the Supreme Court to play a significant role in the election. Intrestingly, Trump's polling has gained strength leading into 2024 despite four indictments and 91 charges against him. Unusually high support for third-party candidates further complicates our ability to forecast who will appear on the ballot in November. Nonetheless, investors should consider potential election outcomes and policy implications as the race develops in order to adjust strategy accordingly.

Exhibit 23: Biden vs Trump, National Polling (RealClearPolitics Average)

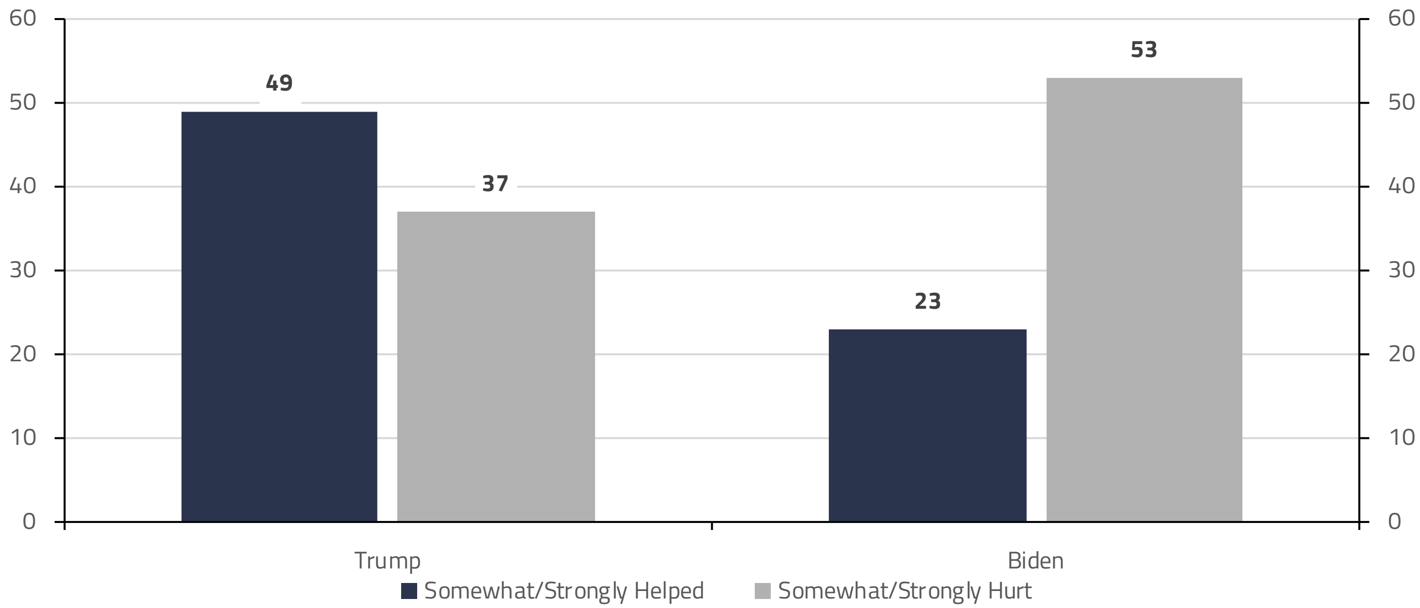


Source: Strategas, RCP Average, as of 12/31/2023

Our base case for the 2024 election is that it will be a rematch of the 2020 election between Trump and Biden; however, its winner remains unclear. Traditionally, an incumbent seeking re-election has proven victorious if recession is avoided in the two years prior to the election. As it stands, this bodes well for Biden, as the likely scenario is that a recession will be avoided in 2024. Yet, since September, the Trump campaign has noted that its polling in the general election is the best it has been over the eight years since Trump began running for President in 2015.[39] In Exhibit 24, a recent Wall Street Journal poll indicates that half of registered voters believe that Trump's policies benefit them, while just 23% say the same for Biden. We believe high inflation and heightened geopolitical conflict may be affecting voters' views toward the Biden Administration's policies despite the strong economic growth experienced during his term.

38. RealClearPolling
39. Clifton, Daniel, et al. "US ELECTION IS ALREADY PRICING INTO SECTORS." Strategas, 12 Dec. 2023, www.strategasrp.com/Document?strResearchProductID=Mf%2FYjGD5vkv3K47lsYiZXw%3D%3D&FullScreen=True.

Exhibit 24: Biden vs Trump, Personal Sentiment (Would you say Trump/Biden's Policies Helped or Hurt You?)



Source: Strategas, WSJ December Poll of Registered Voters

Similarly, voters appear to be romanticizing the pre-2020 period, when inflation was low and geopolitics was relatively calm. More than half of the country now believes Biden's policies have harmed them, and we think it is essential for Biden to reverse how voters feel about his policies if he hopes to succeed in 2024. Beyond the presidential election, the outcome of the congressional elections will determine how much the President can accomplish on many issues. Neither party appears to have an advantage in the House, but in the Senate, the Republicans appear to have an advantageous starting point. The Republicans will likely start with 50 seats, given that Democratic Senator Manchin will not seek re-election in heavily Republican West Virginia. Many other critical Senate elections appear to be tilting towards the Republicans. However, it is still early in the election season, and there is a reasonable probability that either party can ultimately control Congress in 2024.

Regardless of the outcome, the sizeable federal deficit will likely constrain fiscal policy in the next presidential term. A second Biden term should lead to modest budgetary tightening, as the likely scenario of a divided government is usually conducive to greater fiscal restraint. A Trump victory will likely lead to sharp changes in fiscal policy, including the reversal of policies from the prior administration. The first major fiscal test after the election will be addressing the debt limit, which has been suspended until January 2, 2025. We believe the election outcome will significantly influence the government's ability to address this issue effectively.

In a second Biden term, control of Congress will be a key factor in addressing the debt limit. Democratic control of Congress would create the most straightforward scenario for Biden; however, under similar circumstances, the debt limit debate in 2021 still created uncertainty. Alternatively, Republican control of Congress would create challenges in raising the debt limit akin to what happened in 2023. The debt limit deadline in a second Trump term likely poses less risk as congressional Republicans would likely support an increase with limited conditions. Further, congressional Democrats have proven to be less willing to use the debt limit as leverage compared to their Republican counterparts, so a divided Congress or Democratic Congress may not pose much more risk than a Republican majority. The debt ceiling debate appears to have had an impact on treasury yields in 2023, and we anticipate that the bond market will price in the probability of a 2025 debt limit standoff in the latter half of 2024.

The election outcome should similarly affect the expiration of tax cuts at the end of 2025. Many of the major tax provisions of Trump's 2017 Tax Cuts and Jobs Act (TCJA) expire on January 1, 2026. The 2017 tax cuts provided sizable fiscal stimulus to the economy, and a failure of

Congress to extend them could lead to an increase in net individual tax collections that would amount to roughly 1% of GDP.[40] Under a Trump White House and Republican congress, the likely scenario would be a straightforward extension of current policy. Meanwhile, a Biden White House and Democratic congress would likely see the expiration of most of the 2017 tax law and potentially an increase in the corporate tax rate. The result of a divided government is much more challenging to forecast. Nonetheless, we anticipate that such a scenario would lead to a reversion in the top marginal tax rate and a slight adjustment to the SALT deduction limit.

Both Trump and Biden implemented hawkish policies toward China during their presidencies, and we anticipate that this will continue regardless of the election outcome. Broadly, Trump would likely implement substantial policy changes regarding international trade. Trump would likely increase tariffs, with the former President proposing a 10% across-the-board tariff on imports, although the ability of the President to enact such an initiative remains nebulous. Biden's trade policy would likely prove more conducive towards the communication services, consumer discretionary, and technology sectors where revenues and supply chains are more levered towards global economies. In a Trump victory, the administration would likely repeal manufacturing subsidies on semiconductors and green technology enacted through the Inflation Reduction Act. All considered, a Trump presidency would likely prove punitive towards the semiconductor industry.

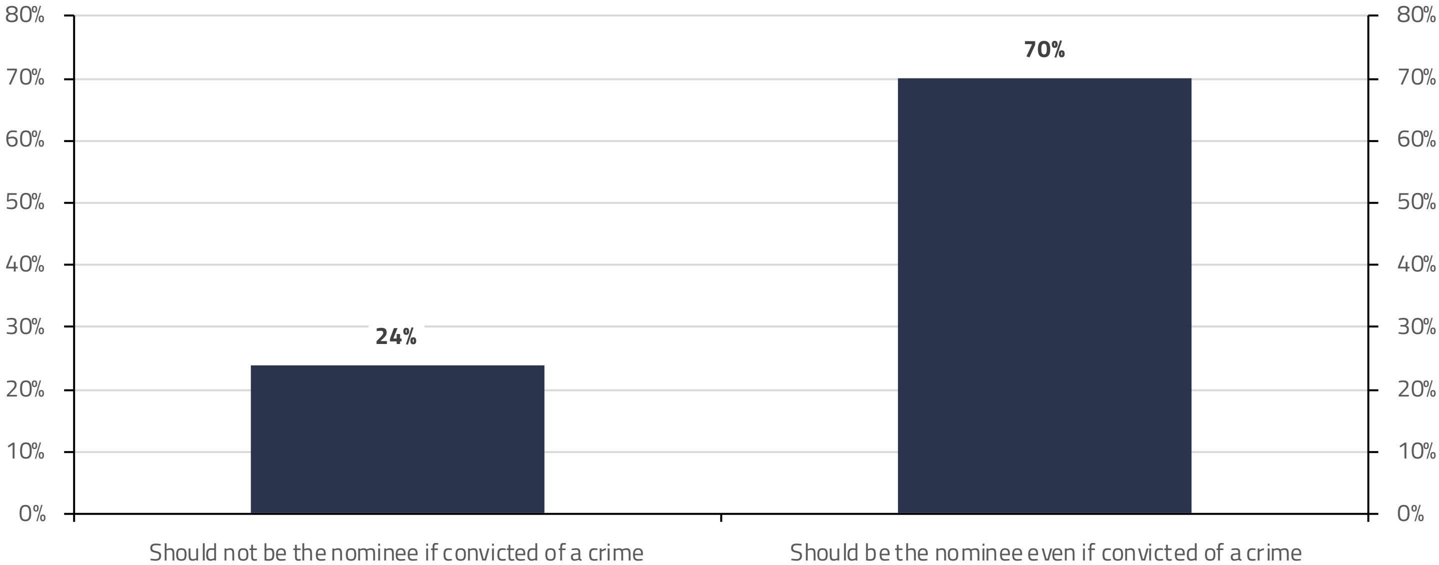
A Republican victory should benefit financials, especially the banking sector. The Republicans would likely loosen regulation that should mitigate bank capital requirements, reaccelerating lending activity and bolstering the banking sector's bottom line. Industrials should perform similarly well in a Trump administration; however, the market holds a short-term view that a Biden re-election would favor the underlying defense industry. Trump's outward criticism of Ukraine funding likely implies a short-term headwind for defense companies upon election. Still, in the long term, we anticipate Trump would spend heavily on defense and would likely show a higher willingness to provide support to Israel.

While our base case remains a Trump vs Biden election in 2024, contentiousness towards Trump's candidacy has created an additional layer of uncertainty, and developments in this saga can materially affect the forecast of the election. On December 19, the Colorado Supreme Court ruled in a 4-3 decision that Trump's behavior post-2020 election amounted to insurrection and that Trump should not be able to run for office, per the restrictions enumerated in the 14th Amendment. A week later, Maine followed suit, barring Donald Trump from appearing on the state's primary ballot, escalating a national legal effort to disqualify him from office. The Supreme Court will likely need to decide this issue. With the consensus view that the 14th Amendment would not apply to a sitting President, the likely scenario is that Trump will appear on all ballots. Still, predicting court cases is a challenging endeavor that lies outside our realm of expertise, and the ultimate ruling will significantly impact whether Trump will be convicted pre-election.

Trump will also be battling Obstruction of an Official Proceeding charges that were used to prosecute more than 300 defendants from the January 6th events at the US Capitol. Trump's lawyers argue for presidential immunity from the charges, but the judge denied their motion. Trump has appealed the ruling, creating a lengthy process requiring the appeal to move through the appellate court, and ultimately the Supreme Court, threatening to push back the March 4th case to the second half of the year. The Supreme Court will likely be tasked once again with making a decision that will have a material impact on the election outcome. In Exhibit 25, a New York Times poll shows that 24% of Trump voters believe Trump should not be the nominee if convicted, indicating that a conviction would severely hinder Trump's chances of winning the nomination.

40. Phillips, Alec, et al. "The 2024 Election: One Year Out." Goldman Sachs, 20 Nov. 2023, publishing.gs.com/content/themes/homepage.html.

Exhibit 25: 24% of Trump Supporters Believe He Should Not Be The Nominee if Convicted (NYT/Siena College Poll)



Source: Strategas, NYT/Siena College Poll, as of 12/14/2023

With an estimated seventy percent of voters not wanting either Trump or Biden as President, there remains a real chance that out-of-consensus candidates could create further uncertainty for the election outcome.[41] Polling indicates that a five-way general election would lead Trump to achieve a six-point lead over Biden. However, recent Quinnipiac polls suggest that a three-way election between Trump, Biden, and Kennedy would create a slight edge for Biden.[42] Third-party candidates typically lose steam later in the election season, so it is too early to conclude much from recent polling. Nonetheless, a strong showing from a third-party candidate in November could materially alter the outcome compared to a head-to-head matchup between Trump and Biden.

Within the Republican Party, Nikki Haley is showing strong momentum going into the primaries. Historically, the Republican nominee has won either Iowa or New Hampshire. With Trump looking likely to win Iowa on January 15, we believe Haley will need to have a strong showing in New Hampshire to have a chance at winning the nomination. On the Democratic side, Biden remains unchallenged; however, many have criticized his ability to serve a second term. It is well within the realm of possibilities for a challenger to emerge over the coming months or for the President to drop out of the race.

The 2024 presidential race remains in its early stages, and there will likely be many surprises as we draw closer to Election Day. Market participants will be keeping a close eye on the 2024 election throughout the year, and will attempt to price in the impact of potential policy changes on the economy and capital markets. Likewise, we will retain a watchful eye on the evolving political landscape to gauge how it may affect portfolios.

41. Clifton, Daniel, et al. "US ELECTION IS ALREADY PRICING INTO SECTORS." Strategas, 12 Dec. 2023, www.strategasrp.com/Document?strResearchProductID=Mf%2FYjGD5vkv3K47IsYiZXw%3D%3D&FullScreen=True.

42. RealClearPolling.

TOP 10 INVESTMENT THEMES FOR 2024

10. Geopolitics

As we look ahead to the remainder of 2024, geopolitics looms large, and a multitude of geopolitical factors have the potential to be disruptive forces impacting the economy and financial markets. The Russia-Ukraine war remains ongoing, with no signs of an end to the fighting in the near future. Despite suffering significant losses, Russia had double the number of troops in Ukraine in fall 2023 compared to the start of the invasion. In the West, many politicians have begun to express "Ukraine fatigue", as some lawmakers have balked at sending Kyiv more aid. With a long-term "war of attrition" potentially favoring the more populous Russia, pressure is building for Ukraine to pivot and seek a ceasefire. Whether Russian President Vladimir Putin would agree to halt the fighting is debatable.[43]

In the Middle East, Hamas's horrific attack against Israel on October 7th, 2023 has led to a war that is now in its fourth month, but it has yet to spur a full-scale war in the region. Israel has also faced attacks and exchanged fire with Iran-backed Hezbollah militants in the north, but as of year-end, these exchanges in the north of Israel had not yet escalated to an all-out war. Nonetheless, the situation is fragile and the region remains a potential tinderbox. Elsewhere in the Middle East, attacks on Red Sea shipping lanes by Yemen-based Houthi rebels, who are aligned with Iran, threaten to significantly disrupt the flow of cargo through the Red Sea and Suez Canal, an important route for trade between Asia and Western countries. According to Bloomberg News, Houthi attacks could theoretically close off the Bab-El-Mandeb Strait, which is the strategic chokepoint at the Red Sea's southern end. This type of disruption to supply lines could have a major economic cost.[44]

At the start of 2023, US-China tensions seemed to be easing. The prior November, Joe Biden and Xi Jinping had a productive meeting at the G-20 summit, and Secretary of State Antony Blinken was set to visit Beijing in February 2023 to discuss easing the increasingly tense geopolitical rivalry. But then a Chinese surveillance balloon appeared over the United States. The incident inflamed political tensions, prompting Blinken to postpone his visit to Beijing. Blinken did finally travel to Beijing in June for what State Department officials called "constructive" talks.[45] Nonetheless, Washington later imposed additional restrictions on trade with China, with the aim of pressuring Beijing to ease its harassment of Taiwan, the Philippines, and US military forces in Asia. Biden and Xi finally agreed to meet in November in San Francisco, but the talks produced only minor agreements.

For its part, China is contending with demographic challenges that will threaten its hegemonic aspirations – namely, it must contend with a shrinking population. China is now facing the consequences resulting from years of maintaining its "one child" policy, which it abolished in 2015. As noted by the Wall Street Journal, "When Beijing said it would abolish its 35-year-old one-child policy in 2015, officials expected a baby boom. Instead, they got a baby bust."[46] China's population, now around 1.4 billion, is projected to decline by 100 million people by mid-century. Over the same time period, China's median age will rise from thirty-nine years-old to fifty-one. In 2023, India overtook China as the country with the world's largest population. With a youthful population of 1.43 billion people, India will likely remain the most populous country for decades to come. Meanwhile, China's population is both shrinking and aging, a fact that will constrain the country's growth prospects if not reversed.[47]

We expect tensions between the US and China to remain a recurring theme in the year ahead, with China continuing its aggressions toward Taiwan and US forces in Asia. With that said, long-term demographics, regulatory stability, and legal structure undoubtedly favor the US economy vis-à-vis that of China in the long-run.

43. Lindsay, James M. "Ten Most Significant World Events in 2023." Council on Foreign Relations, Council on Foreign Relations, 8 Dec. 2023, www.cfr.org/2023-review.
44. Anstey, Chris. "Bloomberg New Economy: How Geopolitics Might Crash a 2024 Soft Landing." Bloomberg.Com, Bloomberg, 30 Dec. 2023, www.bloomberg.com/news/newsletters/2023-12-30/bloomberg-new-economy-how-geopolitics-might-crash-a-2024-soft-landing.
45. "Secretary Blinken's Meeting with People's Republic of China State Councilor and Foreign Minister Qin Gang." 18 June 2023, https://www.state.gov/secretary-blinkens-meeting-with-peoples-republic-of-china-state-councilor-and-foreign-minister-qin-gang/. Accessed 12 Jan. 2024.
46. Kevin Frayer/Getty. "China Is Pressing Women to Have More Babies. Many Are Saying No." The Wall Street Journal, Dow Jones & Company, 3 Jan. 2024, www.wsj.com/articles/china-population-births-decline-womens-rights-5af9937b.
47. "Secretary Blinken's Meeting with People's Republic of China State Councilor and Foreign Minister Qin Gang." 18 June 2023, https://www.state.gov/secretary-blinkens-meeting-with-peoples-republic-of-china-state-councilor-and-foreign-minister-qin-gang/. Accessed 12 Jan. 2024.

Arguably, the most important geopolitical factor of this year is that 2024 is a year of elections – what Ernst & Young recently referred to as the "global elections supercycle." Voters will go to the polls in markets accounting for about 54% of the global population and nearly 60% of global GDP.[48] This will create regulatory and policy uncertainty. Some of these elections, such as those in the US and EU, are arguably the most consequential elections in decades, shaping economic policy that will undoubtedly impact the global business environment.

Geopolitical risks loom as a potential spoiler that could derail the vaunted "soft landing" that is the hope of economists, investors, and many politicians. With so many geopolitical factors to consider, we remain vigilant in monitoring global events and acutely aware of the fragility of the economic outlook as it relates to geopolitical tensions.

48. McCaffrey, Courtney Rickert, et al. "Top 10 Geopolitical Developments for 2024." Top 10 Geopolitical Risks for 2024, EY, 12 Dec. 2023, www.ey.com/en_it/geostrategy/2024-geostrategic-outlook.

Important Disclosures

This publication is provided by Element Pointe Family Office ("Element Pointe") for general information and educational purposes only. Any discussion of securities or investment strategies should not be construed as research or investment advice. This material should not be construed as an offer to sell or a solicitation of an offer to buy any security.

This publication contains certain forward-looking statements that indicate future possibilities. Due to known and unknown risks, other uncertainties and factors, actual results may differ materially from the expectations portrayed in such forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of their dates.

Element Pointe does not make any representations as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party incorporated herein, and takes no responsibility therefore. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly.

Nothing herein should be construed to limit or otherwise restrict Element Pointe's investment decisions. Element Pointe customizes the portfolios it manages to suit the needs of each client. Investment advisory services are only provided to investors who become Element Pointe clients pursuant to a written account agreement, which investors are urged to read and carefully consider in determining whether such agreement is suitable for their individual facts and circumstances.

Investing in fixed income products is subject to certain risks, including interest rate, credit, inflation, call, prepayment, and reinvestment risk. Investments in alternative investment strategies is speculative, often involves a greater degree of risk than traditional investments including limited liquidity and limited transparency, among other factors and should only be considered by sophisticated investors with the financial capability to accept the loss of all or part of the assets devoted to such strategies. Investing in the stock market involves gains and losses and may not be suitable for all investors. The indexes mentioned are unmanaged and an investment cannot be made directly into them and do not include fees and charges, which would reduce an investor's return. Past performance is no guarantee of future results.

All expressions of opinion reflect the judgment of the authors as of the date of publication and are subject to change without prior notice. There is no guarantee that the views and opinions expressed herein will come to pass.