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Market Backdrop and Investment Outlook

August 2023

Market Backdrop and Investment Outlook
Executive Summary

- Continued global economic expansion along with moderating inflation provided a favorable backdrop for riskier assets thus far in 2023
  - However, major central banks hinted at more monetary tightening as core inflation pressures persisted

	Macro Backdrop	Financial Markets
Review	▪ The US economy has been more resilient than most expected through the first half of the year, defying predictions of a recession ▪ Inflation continued to fall from its peak, but remained above the Fed's 2% target	▪ Global equities have rallied thus far in 2023, with unusually narrow leadership from US mega-cap technology stocks ▪ First quarter corporate earnings were better than expected, which has improved investor sentiment
Outlook	▪ Forward-looking recession indicators such as the inverted Treasury yield curve, tighter bank lending standards, and weak manufacturing activity are all flashing warning signs ▪ While recessions are hard to predict, corporate earnings typically fall at the end of rate hiking cycles ▪ Inflation rates should continue to moderate, but greater economic slowing may be necessary to bring core inflation down sustainably ▪ The Fed and other central banks are likely nearing the end of their hiking cycles, but seem committed to keeping policy tight	▪ Markets may be overly sanguine about the lagged impact of monetary tightening ▪ Slower liquidity growth and greater monetary policy uncertainty rase the odds that market volatility will return ▪ Despite the strong first half 2023 rally, we continue to project sub-par returns from overvalued equities and recommend maintaining modest underweights ▪ Policy rates staying tight bolsters the appeal of income and the investment case for short-term bonds ▪ In private markets, we believe that distressed and secondaries managers present attractive opportunities

Note: Based on research and opinion provided by Fidelity Investments as of July 2023.

Market Backdrop
Broad Asset Category Performance

- After the broad-based downturn in 2022, most asset categories have rebounded thus far in 2023 amid falling commodity prices and a weaker US dollar
  - The chart below illustrates broad asset category performance defined by market benchmarks

	Global Stocks	High Yield Corporate Bonds	Investment Grade Municipal Bonds	Investment Grade Taxable Bonds	Commodities
Year-to-Date 2023	11.5%	5.7%	1.0%	1.1%	-4.6%
Full Year 2022	-18.4%	-11.2%	-4.8%	-8.2%	16.1%

Note: Performance data as of August 18, 2023. Benchmark data obtained from Addepar. Past performance is not indicative of future results. Global stocks (MSCI All Country World Index), high yield corporate bonds (Bloomberg US Corporate High Yield Index), commodities (Bloomberg Commodity Index), investment grade municipal bonds (Bloomberg 1-10 Year Municipal Bond Index Index), and investment grade taxable bonds (Bloomberg Intermediate US Government/Credit Index).

Market Backdrop
US Equity Market Performance

- This year's US market rebound remained "narrow" as less than 30% of S&P 500 constituents beat the index return—a rally in mega-cap tech stocks was fueled by excitement about artificial intelligence
  - The chart below illustrates the percentage of S&P 500 stocks that outperformed the S&P 500 Index by calendar year

70.0%
65.0%
60.0%
55.0%
50.0%
45.0%
40.0%
35.0%
30.0%
25.0%

1973 1976 1979 1982 1985 1988 1991 1994 1997 2000 2003 2006 2009 2012 2015 2018 2021

Percentage of S&P 500 Stocks that Outperformed the S&P 500 Index — Average

Source: Litman Gregory AdvisorIntelligence and Ned Davis Research as of August 7, 2023.

Market Backdrop
Periodic Table of Returns

- With the exception of commodities, most asset categories have produced positive returns thus far in 2023 with US large cap growth stocks leading the rally in riskier asset prices
  - The table below illustrates annual returns for various asset classes ranked in order of performance

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
REITs 27.2%	Private Equity 10.0%	Energy MLPs 18.3%	Emerging Markets Equity 37.3%	Private Equity 11.2%	US Large Cap 31.5%	Private Equity 32.9%	Energy MLPs 40.2%	Energy MLPs 30.9%	Energy MLPs 15.9%
US Large Cap 13.7%	Municipal Bonds 2.5%	US Large Cap 12.0%	International Equity 25.0%	Cash 1.9%	REITs 28.1%	US Large Cap 18.4%	REITs 39.9%	Commodities 16.1%	US Large Cap 15.0%
Private Equity 12.6%	REITs 2.3%	Commodities 11.8%	US Large Cap 21.8%	Municipal Bonds 1.6%	International Equity 22.0%	Emerging Markets Equity 18.3%	Private Equity 37.9%	Cash 1.5%	Bank Loans 8.5%
Energy MLPs 4.8%	US Large Cap 1.4%	Emerging Markets Equity 11.2%	Private Equity 21.0%	Bank Loans 0.4%	Emerging Markets Equity 18.4%	International Equity 7.8%	US Large Cap 28.7%	Bank Loans -0.8%	International Equity 8.1%
Municipal Bonds 4.7%	Cash 0.1%	Bank Loans 10.2%	REITs 9.3%	US Large Cap -4.4%	Private Equity 17.7%	Hedge Funds 6.8%	Commodities 27.1%	Hedge Funds -4.4%	Cash 3.1%
Bank Loans 1.6%	Bank Loans -0.7%	REITs 9.3%	Hedge Funds 6.0%	REITs -4.4%	Bank Loans 8.6%	Municipal Bonds 4.2%	International Equity 11.3%	Municipal Bonds -4.8%	Emerging Markets Equity 2.8%
Cash 0.0%	International Equity -0.8%	Private Equity 9.0%	Bank Loans 4.1%	Hedge Funds -6.7%	Hedge Funds 8.6%	Bank Loans 3.1%	Bank Loans 5.2%	Private Equity -6.1%	Municipal Bonds 1.0%
Hedge Funds -0.6%	Hedge Funds -3.6%	Hedge Funds 2.5%	Municipal Bonds 3.5%	Commodities -11.3%	Commodities 7.7%	Cash 0.7%	Hedge Funds 3.7%	International Equity -14.5%	Hedge Funds 1.0%
Emerging Markets Equity -2.2%	Emerging Markets Equity -14.9%	International Equity 1.0%	Commodities 1.7%	Energy MLPs -12.4%	Energy MLPs 6.6%	Commodities -3.1%	Municipal Bonds 0.5%	US Large Cap -18.1%	Private Equity 0.0%
International Equity -4.9%	Commodities -24.7%	Cash 0.3%	Cash 0.9%	International Equity -13.8%	Municipal Bonds 5.6%	REITs -5.9%	Cash 0.1%	Emerging Markets Equity -20.1%	REITs -0.7%
Commodities -17.0%	Energy MLPs -32.6%	Municipal Bonds -0.1%	Energy MLPs -6.5%	Emerging Markets Equity -14.6%	Cash 2.3%	Energy MLPs -28.7%	Emerging Markets Equity -2.5%	REITs -25.1%	Commodities -4.6%

**Private Equity data is final as of December 31, 2022.*

Note: Performance data as of August 18, 2023. Benchmark data obtained from Zephyr Associates. Past performance is not indicative of future results. US Large Cap (S&P 500 Index), International Equity (MSCI EAFE Index), Emerging Markets Equity (MSCI Emerging Markets Index), REITs (FTSE Nareit All REITs Index), Bank Loans (S&P/LSTA US Leveraged Loan Index), Municipal Bonds (Bloomberg 1-10 Year Municipal Bond Index, Energy MLPs (Alerian MLP Index), Commodities (Bloomberg Commodity Index), Hedge Funds (HFRX Global Index), Private Equity (Cambridge Private Equity Index) and Cash (BofA Merrill Lynch US 3-Month Treasury Bill).

Market Backdrop
Interest Rate Environment

- After reaching all-time lows in 2020, treasury bond yields have increased with short-term rates rising sharply over the last year alongside monetary policy tightening
  - The chart below plots both the 3-month and 10-year US Treasury Yield

6.0
5.0
4.0
3.0
2.0
1.0
0.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

3-Month US Treasury Yield
10-Year US Treasury Yield

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of June 30, 2023.

Market Backdrop
Inverted Yield Curve

- The yield curve inverted in the fourth quarter of 2022 as the Fed continued to hike short-term interest rates—historically, an inversion has been a reliable leading indicator of economic recession
  - The chart below plots the 10-year US Treasury yield minus the 3-month US Treasury yield

5.0
4.0
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

10-Year US Treasury Yield minus 3-Month US Treasury Yield

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of June 30, 2023.

Market Backdrop
Monetary Policy

- Global central banks continued to tighten monetary policy by raising short-term interest rates to their highest levels in more than a decade, along with shrinking their balance sheets
  - The chart below illustrates the size of the Federal Reserve's balance sheet (measured in trillions)

$10.0
$9.0
$8.0
$7.0
$6.0
$5.0
$4.0
$3.0
$2.0
$1.0
$0.0
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

Federal Reserve Balance Sheet: Total Assets ($ Trillions)

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of June 30, 2023.

Market Backdrop
US Labor Market

- Labor markets have showed some signs of cooling, but conditions remain tight as there are many more unfilled openings than unemployed workers
  - The chart below plots the total nonfarm job openings in the United States

Recession
Job Openings, Total Nonfarm (millions of persons)

Source: Federal Reserve Bank of St. Louis, Economic Research Division, U.S. Bureau of Labor Statistics as of June 30, 2023.

Market Backdrop
US Inflation

- The most extreme supply-related inflation pressures are easing, particularly for manufacturing, but some sectors where price changes tend to be more persistent—such as housing and food—remain elevated
  - The chart below plots the CPI and PCE Price Index (excluding food and energy) compared to the Fed's long-term inflation target of 2%

10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

Consumer Price Index
Personal Consumption Expenditures Price Index (Ex Food and Energy)
Fed's Inflation Target

Source: Federal Reserve Bank of St. Louis, Economic Research Division, U.S. Bureau of Labor Statistics. Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) Price Index data as of June 30, 2023.

Market Backdrop
US Inflation Expectations

- While US consumers' short-term inflation expectations remain elevated, longer-term inflation expectations remain mostly "anchored" in a range consistent with the Fed's target
  - The chart below plots two measures of inflation expectations based on the University of Michigan's survey and the 10-Year Breakeven Rate

10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

University of Michigan Inflation Expectations (Next 12 Months) | 10-Year Breakeven Inflation Rate | Fed's Inflation Target

Source: Federal Reserve Bank of St. Louis, Economic Research Division, U.S. Bureau of Labor Statistics. The University of Michigan Inflation Expectations survey of consumers presents the median expected price changes for the next 12 months, based on data as of June 30, 2023. The 10-Year Breakeven Rate measures the difference or gap between 10-Year Treasury Bond and Treasury Inflation Protected Securities (TIPS), based on data as of June 30, 2023. The 10-Year Breakeven Rate serves as an indication of the markets' inflation expectations over the 10-year horizon.

Market Outlook
Economic Scenarios

- The table below summarizes three scenarios designed to characterize a broad range of potential outcomes for the global macroeconomic backdrop and capital markets over the next few years
  - We refer to these scenarios as the base, bull, and bear cases

Scenario	Probability	Description
Base Case	55%	**Turbulence settling into a partial rebound** ▪ While recessions are hard to predict, earnings growth typically falls for up to a year or more after the end of rate tightening cycles, followed by a multi-year rebound ▪ We assume earnings growth below analyst's forecasts over the 3-year horizon while valuations decline from current levels, especially where most overvalued
Bull Case	20%	**Soft landing** ▪ Core inflation falls, the labor market is balanced, the consumer remains strong, and the Fed cutes rates to forestall overtightening ▪ Attention returns to potential productivity enhancements on the horizon and geopolitical risk fades from current levels
Bear Case	25%	**Stagflation and/or systemic risk** ▪ The Fed interprets the trajectory of falling inflation sufficient and cuts rates too early, leading to a second round of rate hikes creating enormous uncertainty and a contraction in risk taking ▪ Or a combination of financial pressures possibly related to the banking sector, commercial real estate, or geopolitical risk, triggers a systemic event

Note: Based on research and opinion provided by Greycourt & Co. as of July 2023.

Market Outlook
Summary Macro Views

- It's been an unusual cycle—and a wide range of potential outcomes still exists
  - Multiple sources of uncertainty suggest that market volatility may return

- We assume a continued deceleration in US and global economic growth due to the lagged effects of monetary policy tightening
  - A near-term (next 12 months) US recession has been widely anticipated by most economists and represents a reasonable base case scenario—but it's not a certainty, particularly given continued strength of the labor market
  - However, the consumer is facing headwinds—households have begun to deplete savings accumulated during the pandemic while delinquencies on consumer loans and credit cards are picking up

- Uncertainty about inflation and monetary policy remain key risks, along with the outlook for China
  - Inflation rates should continue to moderate, but persistent pressures (cost of housing) are likely to keep inflation elevated for some time
  - While central bank rate hikes may be nearing an end, policy easing is likely not imminent—the Fed's policy rate may remain higher for longer than the market expects, with the degree of financial condition tightening a key factor
  - China's economic reopening momentum is faltering, raising the odds of increased policy stimulus—but structural imbalances remain, such as excess capacity and leverage, including in the large property sector

- Equity returns, particularly in the US, will likely be constrained by declining valuation multiples and lower profit margins, along with increased competition from bond yields
  - In addition, corporate earnings growth historically falls after the end of rate hiking cycles

Note: Opinions above based on research as of July 2023. Please see our disclosures at the end of this document.

Market Outlook
Tactical Asset Allocation Views

- Within the context of a sound, long-term asset allocation framework, we believe that an active, flexible approach can enhance returns by shifting capital to attractive risk/reward opportunities
  - The table below illustrates our tactical asset allocation views, or targeted overweights and underweights across asset categories

Asset Category	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
Cash					
Cash & Short-Term Bonds				✓	
Fixed Income					
Investment Grade Municipal Bonds			✓		
Investment Grade Taxable Bonds			✓		
Bank Loans & High Yield Credit				✓	
Equities					
US Large Cap Stocks		✓			
US Small Cap Stocks			✓		
Non-US Developed Markets Stocks		✓			
Emerging Markets Stocks			✓		
Real Assets					
Commodities & Natural Resources				✓	
Public Real Estate	✓				
Flexible/Alternative Strategies					
Diversifying Hedge			✓		

Note: Based on research and as of July 2023. Tactical views reflect a three-year investment horizon. Suggested asset class weights are influenced by Greycourt's detailed quarterly tactical analysis and are used as a starting point in assessing client portfolio weights against strategic targets which typically reflect a ten-year investing horizon. Please see the disclosure pages at the end of this presentation.

Market Outlook
Portfolio Positioning Themes

- Don't tilt too far away from an appropriate strategic asset mix, but maintain a slight defensive tilt

- Increase exposure to core/investment grade fixed income given more compelling yields
  - While rising interest rates still pose a risk to high quality bonds, tax-equivalent yields on municipal bonds are relatively attractive
  - Short-term Treasuries and investment grade corporate bonds also offer attractive yields with relatively low volatility risk

- Target an underweight position in public equities (US large cap stocks in particular) while emphasizing high quality and more reasonably priced international and emerging markets
  - US equity valuations perhaps still reflect an overly optimistic outlook for near-term corporate earnings growth
  - We prefer a tilt towards high quality stocks (low debt and stable earnings) and non-US stocks that stand to benefit from lower valuations

- Continue to target a slight overweight position in real assets
  - Traditional asset classes can be vulnerable to unexpected increases in inflation, while commodities can offer a potent hedge
  - A prolonged period of limited supply-side investment along with the secular transition toward renewable energy sources could further support commodities prices and commodity-producer stocks

- Where appropriate, continue to develop private equity and private real estate investment programs
  - Secondary opportunities are attractive as GPs seek liquidity for maturing funds in a poor exit environment, while the increasing level of distressed debt should also drive an expanding opportunity set

Note: Opinions above based on research as of June 2023. Please see our disclosures at the end of this document.

Market Outlook
Non-US Equity Relative Valuations

- Valuations moved higher for all major regions as stock prices rallied thus far in 2023
  - However, the price-to-earnings (P/E) ratios for both Europe and emerging markets stocks relative to the US are well below their long-term averages, indicating a steep discount in valuation and an attractive long-term backdrop for non-US stocks
  - The chart below plots the price-to-earnings ratios for Europe and emerging markets relative to the US

Valuation Discount: Europe and Emerging Markets versus US Stocks (Forward P/E Ratio)

Europe Valuation Discount to US
Emerging Market (EM) Valuation Discount to US
Average Europe Discount
Average EM Discount

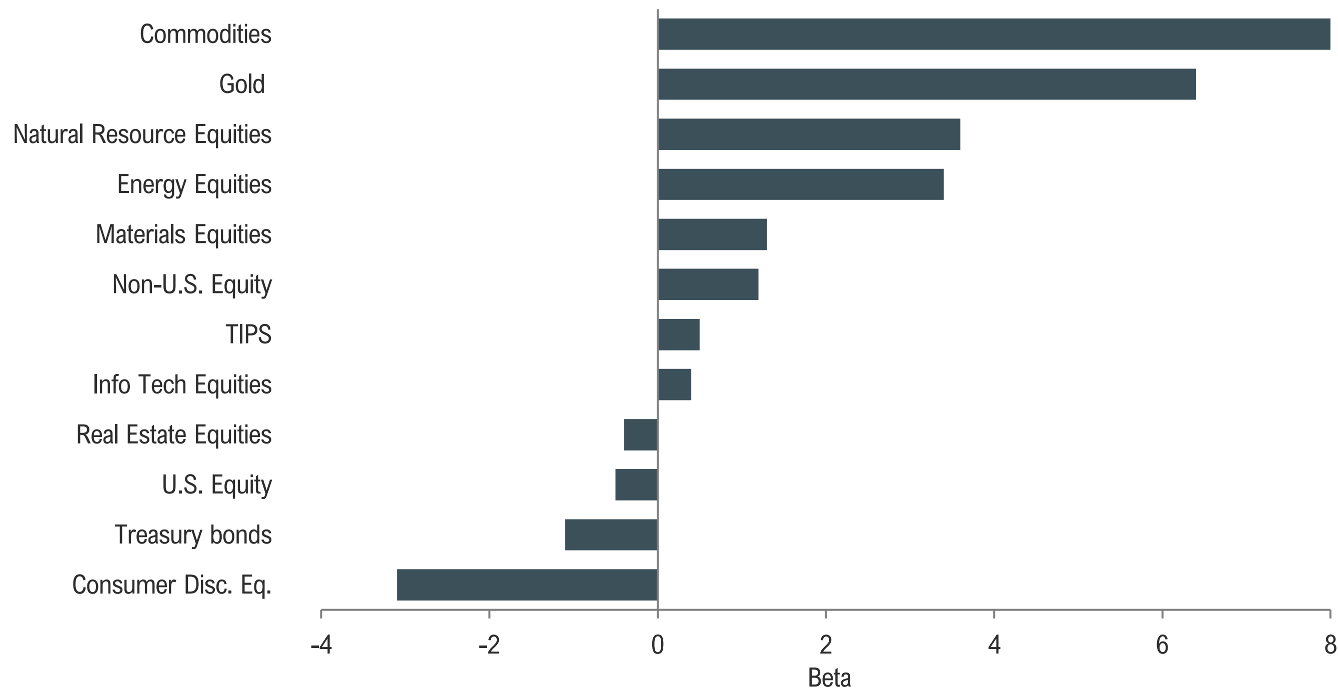
0%
-5%
-10%
-15%
-20%
-25%
-30%
-35%
-40%
-45%

2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022

Source: Litman Gregory AdvisorIntelligence and Bloomberg as of June 30, 2023. Price-to-earnings ratio (P/E) is the stock price divided by earnings per share.

Market Outlook
Inflation-Sensitive Assets

- The potential for a period of sustained higher inflation represents a risk factor for a diversified portfolio
  - Inflation-resistant assets, including commodities and commodity-producer equities, can help hedge against surprise increases in inflation while providing potential for capital appreciation in a higher nominal-growth environment
  - The chart below illustrates the historical return sensitivity (or beta) of certain asset classes (based on index proxies) to inflation surprises



Source: Bureau of Labor Statistics, Fidelity Investments, data from January 1, 1972 through February 28, 2022. Past performance is no guarantee of future results. Inflation sensitivity measured relative to CPI, an index that tracks the percentage change in the price of a specified "basket" of consumer goods and services. Beta is a measure of a variable's sensitivity (response) relative to changes (volatility) in a reference (benchmark), which has a beta of 1.

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Appendix

Appendix
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