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Market Backdrop and Investment Outlook

February 2024

Market Backdrop and Investment Outlook
Executive Summary

- Global stock and bond markets experienced a strong year-end rally as the US Fed signaled a potential shift to monetary easing given continued disinflationary trends
  – Yet, positive surprises for the economy, disinflation, and Fed rate cuts may be more difficult with so much good news already priced in

	Macro Backdrop	Financial Markets
Review	▪ Economic activity held up better than expected in 2023 despite aggressive central bank tightening and geopolitical stress ▪ Inflation continued to fall from its peak, but remained above the Fed's 2% target	▪ Most asset categories produced positive returns in 2023 as US technology and growth stocks led the way ▪ Fixed income investments rebounded in the fourth quarter as yields fell, and riskier credit outperformed
Outlook	▪ The US economy remains resilient, supported by a solid consumer backdrop ▪ Yet, forward-looking recession indicators such as the inverted Treasury yield curve and tighter bank lending standards continue to flash warning signs ▪ We assume an eventual deceleration in economic growth due to the lagged effects of monetary policy tightening ▪ Inflation rates have trended lower, but the "last mile" of disinflation toward the Fed's 2% target may prove difficult ▪ The global monetary tightening cycle appears over, but the pace and magnitude of easing remains uncertain	▪ Financial markets begin 2024 with favorable momentum and easier financial conditions ▪ However, investors may be overly sanguine about the aggressiveness of Fed rate cuts ▪ We continue to recommend a modest underweight to public equities and US large cap stocks in particular, given stretched valuations and perhaps overly optimistic earnings expectations ▪ Bond yields are still near 15-year highs, offering attractive income potential and downside protection ▪ In private markets, we believe that distressed and secondaries managers present attractive opportunities

Source: Fidelity Investments.

Market Backdrop
Broad Asset Category Performance

- After the broad-based downturn in 2022, most asset categories rebounded in 2023 against a backdrop of continued global economic expansion and moderating inflation
  - The chart below illustrates broad asset category performance defined by market benchmarks

	Full Year 2023	Full Year 2022
Global Stocks	22.2%	-18.4%
High Yield Corporate Bonds	13.4%	-11.2%
Investment Grade Municipal Bonds	4.6%	-4.8%
Investment Grade Taxable Bonds	5.5%	-13.0%
Commodities	-7.9%	16.1%

Note: Performance data as of December 31, 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 US Aggregate Bond Index).

Market Backdrop
US Equity Market Performance

- The 2023 US market rebound was driven by mega-cap technology stocks and fueled by excitement about artificial intelligence—but the fourth quarter rally broadened beyond the “Magnificent Seven”
  - The chart below plots performance of the Bloomberg Magnificent Seven Index and US Large Cap Index excluding the Magnificent Seven

120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
-20.0%
108%
15%
Jan-23
Mar-23
May-23
Jul-23
Sep-23
Nov-23
Jan-24
Bloomberg Magnificent Seven Index
Bloomberg U.S. Large Cap ex. Magnificent Seven Index

Source: Litman Gregory AdvisorIntelligence and Bloomberg as of December 31, 2023. The “Magnificent Seven” socks include Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

Market Backdrop
Periodic Table of Returns

- With the exception of commodities, most asset categories produced strong positive returns 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 26.6%
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 26.3%
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%	International Equity 18.2%
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%	Bank Loans 13.3%
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%	REITs 11.5%
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 9.8%
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%	Private Equity 5.3%
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%	Cash 5.1%
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%	Municipal Bonds 4.6%
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%	Hedge Funds 3.1%
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 -7.9%

**Private Equity data is final as of June 30, 2023.*

Note: Performance data as of December 31, 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

- Short-term rates have risen sharply over the last two years alongside monetary policy tightening—and, despite the recent drop, the 10-year treasury bond yield remains near a 15-year high
  – 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 2024

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

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of December 31, 2023.

Market Backdrop
Inverted Yield Curve

- The yield curve has been inverted since October 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 2024

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

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of December 31, 2023.

Market Backdrop
US Labor Market

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

14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024

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 November 30, 2023.

Market Backdrop
US Inflation

- Measures of headline and core inflation have peaked as supply-related pressures have eased, but some sectors where price changes tend to be more persistent—such as housing—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 2024

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 November 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 2024

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 November 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 December 31, 2023. The 10-Year Breakeven Rate serves as an indication of the markets' inflation expectations over the 10-year horizon.

Market Backdrop
Financial Conditions

- The cost of debt remains high, but financial conditions have eased—a positive development for the economy, but may complicate future monetary policy decisions given the potential impact on inflation
  - The chart below plots the Federal Reserve Bank of Chicago's National Financial Conditions Credit Subindex over time

3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024

Chicago Fed National Financial Conditions Credit Subindex

Source: Federal Reserve Bank of St. Louis, Economic Research Division as of January 5, 2024. The Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets, and the traditional and "shadow" banking systems. The NFCI is constructed to have an average value of zero and a standard deviation of one over a sample period extending back to 1971. Positive values of the NFCI have been historically associated with tighter-than-average financial conditions, while negative values have been historically associated with looser-than-average financial conditions.

Market Outlook
Capital Market Assumptions and Tactical Views

	10-Year Trailing Return	10-Year Strategic Return Assumption	Current Tactical Views: Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
Inflation	2.8%	2.2%					
Cash							
Cash	1.3%					■	
Fixed Income							
US Investment Grade Bonds	1.8%	3.1%			■		
Tax-Free Municipal Bonds	3.0%	2.4%			■		
High Yield Credit	3.7%	5.3%				■	
Equities (Public & Private)							
US Large Cap	12.0%	6.3%		■			
US Small Cap	7.2%	7.6%			■		
Non-US Developed Markets	4.8%	6.9%			■		
Emerging Markets	3.1%	8.7%			■		
Private Equity		10.0%					
Real Assets (Public & Private)							
Commodities	-1.1%	4.4%				■	
Private Real Estate (Opportunistic)		8.3%					
Flexible/Alternative Strategies							
Diversifying Hedge	3.3%	5.0%			■		

Note: Trailing returns shown as of December 31, 2023. Inflation based on the Consumer Price Index (CPI). Strategic return assumptions are based on research provided by Greycourt & Co. 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. Past performance is no guarantee of future results. 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

- Remain fully invested in core/investment grade fixed income given compelling yields
  - Starting bond yields, which historically are highly correlated with future returns, are still near the highest levels in 15 years, offering both attractive income and potential downside cushion

- Maintain an underweight position in public equities (US large cap in particular) while emphasizing high quality stocks and more reasonably priced small cap and non-US stocks
  - US large cap equity valuations are stretched and perhaps still reflect an overly optimistic outlook for near-term corporate earnings growth
  - We prefer a tilt towards higher quality companies (those with strong balance sheets, stable earnings, and high margins) along with small cap and non-US stocks that appear more attractively priced relative to long-term average 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 potential 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

Market Outlook
Global Equity Valuations

- Valuations became somewhat more expensive as stocks rallied into year-end, especially for the US
  - The price-to-earnings (P/E) ratio for US stocks remained above its long-term average while non-US stock (developed and emerging markets) valuations remained at or below their long-term averages
  - The chart below plots the trailing 12-month price-to-earnings ratios for US, international developed markets, and emerging markets

Global Stock Market Price-Earnings (P/E) Ratios

EM
DM
U.S.

US Long-Term Average
DM Long-Term Average
EM Long-Term Average

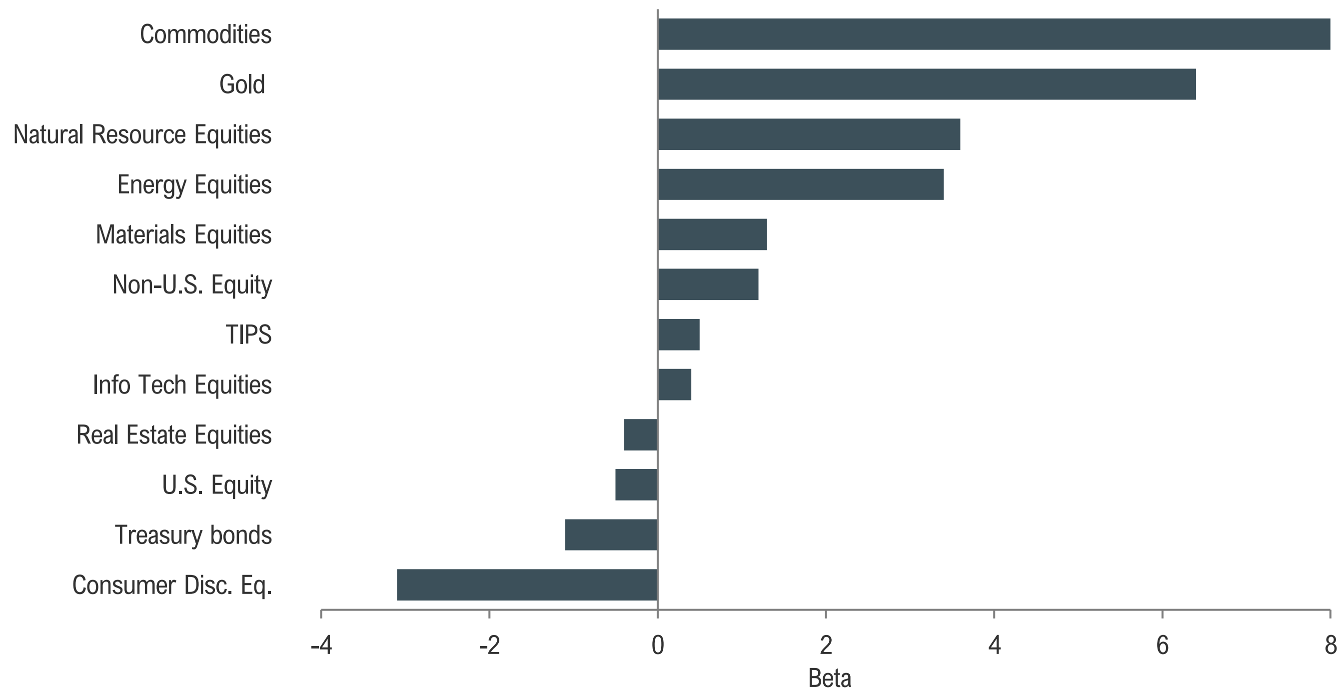
30
25
20
15
10
5

2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

Source: Fidelity Investments, FactSet, and Bloomberg as of December 31, 2023. International Developed Markets (DM – MSCI EAFE Index), U.S. (S&P 500 Index) and Emerging Markets (EM – MSCI Emerging Markets Index). Long-term average P/Es based on data since December 31, 2003. 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.

Market Outlook
Long-Term Considerations

- A combination of greater policy experimentation and "peak globalization" trends pose a longer-term inflation risk
  - Inflation and interest rates likely more volatile going forward

- The longstanding global regime of relatively stable and investment-friendly policies, politics, and regulation is likely nearing an end
  - Rising populism, geopolitical destabilization, and deglobalization pressures are driving the change
  - This transition presents a much broader distribution of potential political and economic outcomes than investors have had to consider in recent decades

- On a strategic basis, greater portfolio diversification overall is needed to help guard against a broader array of potential outcomes
  - Higher secular inflation risks argue for portfolio inclusion of an allocation to inflation-resistant assets
  - Deglobalization and idiosyncratic political risks may reduce global asset correlations, which could produce greater diversification benefits from investing across other countries

Source: Fidelity Investments.

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Appendix

Appendix
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