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2Q 2023 investment outlook: Hurry up and wait

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Executive summary

Asset prices remain volatile following 2022's gyrations that saw both stocks and bonds simultaneously decline in value over a calendar year for the first time since stock and bond index measurement began. The current capital market environment includes questions about financial sector health, global interest rate policy and economic trajectory. Investors await answers to these questions, but we expect more waiting for definitive answers and likely more volatility ahead.

Our overall view remains that the confluence of higher interest rates inside a resilient yet gradually slowing economic landscape will lead to a tougher corporate profit backdrop. That said, we anticipate a more shallow dip in corporate and consumer activity, shaped by how high central bank target interest rates ascend to thwart inflationary pressures and how long those rates remain elevated. Higher interest rates pressure asset prices, consumer and business demand, and as we have witnessed with recent banking sector casualties, elevated interest rates can adversely impact functioning within select institutions. If we see less credit extension and tighter financial conditions, economic growth impulses may further decline, hampering consumer and business activity. We anticipate the Federal Reserve and other major central banks to remain steadfast in their attempts to thwart inflation through higher interest rates, the current financial sector issues to remain contained and for economic growth to weaken but not to a point of a prolonged recession, per our U.S. Bank Economics group's forecast. Investors tend to overshoot with optimism and pessimism, and we expect opportunities to emerge as answers evolve in coming quarters.

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Global economic views

The global economy started 2023 on a solid note, with a warm winter and softer energy prices supporting consumer activity.

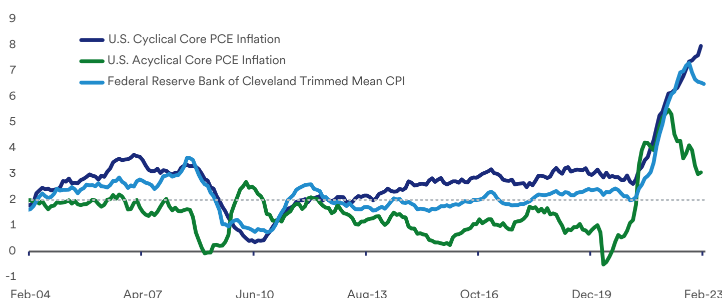
The strong U.S. job market supported consumer spending and domestic economic growth to start the year, though the recent failure of Silicon Valley Bank is tempering expectations. China's "reopening" from strict anti-coronavirus measures boosted travel around the Lunar New Year holiday. Meanwhile, a warm European winter eased energy costs, supporting spending. Global economic data reflects resilient consumer and business activity despite challenges from higher global interest rates, slipping liquidity and geopolitical risks. Still, global growth likely remains modest into year end, though China's reopening may provide some lift later in the year. Significantly higher global interest rates, another inflation spike or increasing geopolitical conflict are risks to our tempered outlook as the Federal Reserve (Fed) balances combatting inflation with ensuring financial market stability.

Continued strong U.S consumer spending registered in early 2023 is unlikely to last, but solid consumer and business balance sheets may mean the U.S. avoids a near-term recession.

The U.S. economy remains resilient due to solid wage growth and a tight labor market. Despite a weakening housing market and a manufacturing slowdown, consumers continue to pursue experiences, focusing spending on travel and leisure activities. Still-solid wage growth and access to previously accumulated savings should support modest consumer spending growth through the year. The investment component of the gross domestic product, including housing, is likely a key headwind to growth since higher borrowing costs dampen demand and slow activity. Additionally, recent failures of Silicon Valley Bank and Signature Bank may weigh on future loan growth as banks tighten lending standards. These headwinds should help ease inflation, though price gains are likely to remain well above the Fed's 2% target well into next year.

U.S. inflation measures

Sources: U.S. Bank Asset Management Group, Bloomberg.



Developed foreign economies in aggregate may avoid a near term recession as energy costs ease.

A warm winter and contained energy costs helped to avert recessionary fears, especially for Europe, as we started 2023. However, European Central Bank and Bank of England interest rate hikes likely dampen growth prospects, with both economies still battling robust inflation pressures. The United Kingdom appears likely to enter recession, with extremely high wage growth, a weak consumer and subdued consumer sentiment. In contrast, business surveys for Europe and Japan are improving, moving back into expansion territory. Growth throughout foreign developed economies is likely to remain modest over the course of the year as rising borrowing costs offset hopes for improving demand from China. The Russian invasion of Ukraine is a risk to European economic prospects, especially as sanctions limit the flow of energy into Europe and perhaps lead to further inflation acceleration.

While most global central banks are battling inflation, the Bank of Japan maintained stimulative monetary policy, including low interest rates and asset purchase programs. After decades of deflationary pressures, Japan is embracing price and wage inflation for now. Economic growth improved from its third quarter contraction and appears poised to continue with support from China's economic reopening.

Emerging market economies likely see recovery in 2023, led by China's reopening and easing inflation pressures.

China's reopening from COVID-19 restrictions led a recovery in travel for the Lunar New Year holiday. Consumer spending is likely to follow in coming quarters, though full-year growth is likely to be modest when compared to the past decade, with China's National People's Congress setting a 5% target for 2023. Economic maturity and slowing working age population growth in addition to the ongoing recovery from housing market problems serve

as headwinds to the recovery. However, some rebound in spending after more than two years of restrictions is likely to emerge over the course of 2023, likely starting toward the middle of the year. China's acceleration along with an end to Fed rate hikes should lift growth prospects for other emerging market economies in the latter portion of the year.

Conflict and trade risks could weigh heavily for emerging markets' 2023 economic results. An escalating Russia/Ukraine conflict could challenge global energy supplies, rekindling inflation and constraining consumer spending. Additionally, U.S.-China trade relations remain a challenge. Tariffs remain in place and further escalation of trade limitations could dampen economic activity.

U.S. equity markets

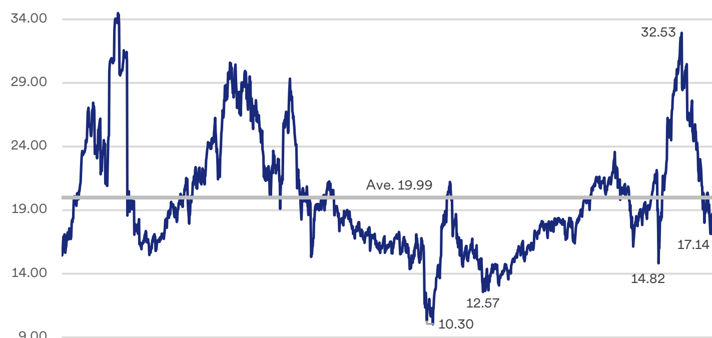
U.S. equities trended higher in the first quarter; however, we maintain our cautious near-term outlook. Persistent inflation, elevated interest rates and uncertain 2023 earnings growth weigh on return prospects while financial stability concerns complicate the Fed's ongoing battle with inflation.

Elevated inflation erodes the purchasing power of earnings streams and future dividend payments. Early-year strength among growth-oriented equities reflected investors' anticipation of a sustained slowing in inflation, which has yet to materialize. Meanwhile, elevated interest rates, economic uncertainty and recent bank failures make higher-yielding, safer assets such as U.S. Treasuries more attractive, causing investors to demand higher compensation for taking on equity price risk by paying lower prices relative to anticipated earnings.

Broad-market valuation, or the price investors are willing to pay for actual or estimated future earnings, is near historical averages dating back to 1990, neither at high nor low extremes. As of March 31, the S&P 500 trades at approximately 18.5 times last 12-months (LTM) and next 12-months (NTM) earnings projections, levels we regard to be within a "zone of okay." Analysts project S&P 500 earnings of roughly $220 per share for this year, down from the $250 estimate level as of mid-2022. While analysts have moderated 2023 expectations, we expect more downside lies ahead due to economic uncertainty following first quarter earnings reports and forward guidance, which begin in mid-April.

S&P 500 last 12 months' price/earnings ratio

Source: U.S. Bank Wealth Management, Bloomberg, March 6, 2023.



Consumers are spending on experiences while business spending has a technology bias.

We see select opportunities within all sectors. Consumer spending remains resilient, directed largely toward experiences such as travel and entertainment; in contrast, consumer spending on discretionary items such as home furnishings remains soft. Following fourth quarter earnings releases, company managements cited steady business spending on technology, particularly software and cloud-related expenditures, although they reported lengthening sales cycles as firms look to leverage current spending levels. While labor costs remain elevated, profit margins are holding up — down from recent peak levels but still at or above pre-pandemic levels. Supply chain bottlenecks are resolving and many retailers are streamlining inventories, which reduces the likelihood of widespread markdowns and should help support profit margins in coming quarters.

Traditionally defensive, dividend-paying equities offer near-term appeal when weighing the prospects for a growth slowdown or recession, while secular growth sectors remain well-positioned for longer-term growth.

Dividend-paying equities afford investors both income and growth potential during times of uncertainty, which helps offset increasingly attractive bonds yields. The 10-year Treasury yield remains elevated, ending the quarter at 3.5%, while a modest 13% of S&P 500 companies currently offer a higher dividend yield. However, a significant proportion of S&P 500 companies pay dividends that are growing in excess of 3.5% per year; 26% of S&P 500 companies pay dividends with a three-year compound annual growth rate of 10% or higher, while 50% offer dividends with a three-year growth rate of 5% or higher.

Technological advancements and longer-term demographic trends continue to bolster prospects among select secular growth sector firms. Fast is getting faster, and speed, scale and efficiencies do not occur without technological advances. The interaction of artificial intelligence, machine learning, e-commerce, cloud computing, data security and analytics provides a platform for new tools and outcomes that favorably position companies within the Technology sector. Within the Consumer Discretionary sector, we favor companies that combine an internet presence, require or encourage in-store traffic and rank high on experiential metrics. Finally, we find opportunities within a bifurcated Communication sector, split between telecommunications and media-related companies. We favor the growth-oriented media companies that are moving to online platforms where consumer targeting and analytics, in many cases, provide better return potential than traditional media sources.

Foreign equity markets

Improving investor sentiment provides equity price support as warm weather and sufficient gas supplies help Europe avoid a winter energy crisis.

Entering 2023, we regarded the unsettled Russia/Ukraine conflict, China's ongoing COVID restrictions and central banks tightening monetary policy to combat elevated inflation as key factors supporting a cautious near-term outlook for foreign developed and emerging market equity prospects.

Despite a disruption in Russian energy imports, Europe accumulated sufficient natural gas supplies through alternative sources for the region's 2022-2023 winter season heating and industrial needs. Meanwhile, the region is experiencing a historically warm winter, with several countries reporting the highest January temperatures on record, leading to lower heating demand. Finally, while the Russia/Ukraine war remains an ongoing human tragedy, the conflict has yet to spread beyond Ukraine's borders or draw North Atlantic Treaty Organization (NATO) members into a broader conflict.

As a result, foreign companies' 2023 corporate earnings estimates have stabilized. Analysts' consensus estimates imply a 9% corporate profit growth rate relative to 2022, reflecting a modestly positive outlook. The trend in valuation, or the price investors are willing to pay for anticipated earnings, also evidences improved sentiment toward foreign developed equities. By the end of last year's third quarter, elevated inflation, tightening financial conditions and energy supply concerns had precipitated a decline in foreign equities' price-to-earnings ratio to 11.5 times, representing a discount of more than 20% relative to historical average. Europe avoiding a worst-case scenario has coincided with improved investor sentiment, with the price-to-earnings ratio rising to 13.3. Stabilizing earnings estimates and improved investor sentiment has provided support for equity prices as we conclude the first quarter.

Recent positive equity price performance is encouraging, but persistent inflation, elevated interest rates and structural headwinds temper our return outlook.

While some near-term concerns have receded, intermediate- and longer-term challenges remain. Elevated inflation continues to erode consumers' purchasing power, while tightening monetary policy increases companies' financing costs, impairing profitability potential. Europe and Japan continue to experience slowing population growth — in some cases population declines — challenging longer-term growth prospects. Finally, secular growth sectors such as Technology, Communication Services and Consumer Discretionary represent a smaller mix in foreign equity markets (25%) relative to the United States (46%). While we respect recent positive equity price performance, we continue to view the rally's durability with skepticism given ongoing intermediate- and longer-term concerns.

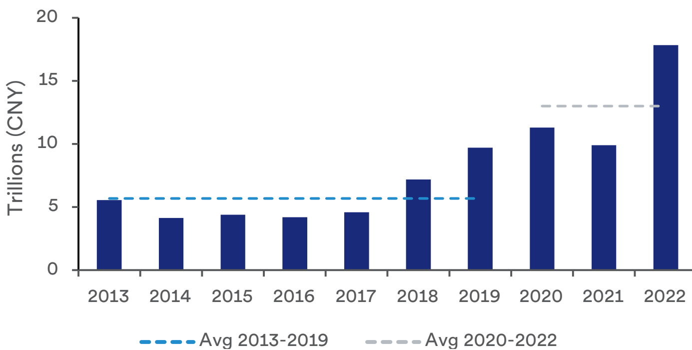
China's COVID policy reversal and Fed interest rate increases represent competing influences leading to two-sided potential outcomes for emerging market equities.

At the end of the year, Chinese authorities quickly pivoted from their restrictive "zero-COVID" policies, ending quarantines, close contact identification and border checks while shifting to voluntary testing. The ensuing case growth surge disrupted economic activity throughout January; however, a second COVID wave did not materialize during the Chinese New Year holiday and the economy recovered faster than expected in February. Manufacturers' sentiment improved to the highest reading since 2012 and China's policymakers recently set a 5% growth target for 2023, prioritizing a consumer spending recovery.

Meanwhile, China household bank deposits have increased by 49% since the pandemic's onset, representing significant pent-up consumer demand for domestic and foreign goods and services. Looking ahead, the combination of economic reopening, policy support and pent-up demand bolsters China's economic growth potential, while improved supply chain transmission would also help alleviate global inflationary pressures given the country's key position in global linkages.

Annual change in China household deposits

Source: Bloomberg.
CNY is Chinese Yuan Renminbi, the general term for the currency of the People's Republic of China.



However, ongoing Fed rate hikes represent a counterbalancing headwind for emerging market prospects. Emerging market firms that need to raise funds compete with elevated U.S. interest rates, resulting in higher interest costs to attract investors' capital which increases expenses and pressures profit margins. A reopening China and tight Fed monetary policy highlights two-sided outcomes for emerging market prospects, driving our balanced outlook.

Fixed Income

High-quality bonds offer compelling total return opportunities and can defensively position portfolios for slowing economic growth.

The increase in Treasury yields over the past year to near their highest levels in 15 years greatly improves income available on high-quality bonds. Bond prices and yields move in opposite directions, so the uptrend in yields has dragged down returns. However, we expect headwinds to bond prices could fade this year as we near a potential peak in the Fed's policy rate and as economic growth prospects slow. The eventual peak in interest rate hikes (dependent upon ongoing inflation and or growth deceleration or strained financial conditions) would support longer-term bonds, but current elevated inflation in the meantime warrants more moderate interest rate sensitivity.

Ten-year Treasury yield

Sources: U.S. Bank, Bloomberg, Federal Reserve.

Central banks must balance raising interest rates to slow inflation and avoiding exacerbating financial system stress.

Inflation remains uncomfortably high despite the Fed raising interest rates by 4.75% since early 2022. More restrictive monetary policy may be necessary to cool inflation, however, fear of spreading trouble in the banking sector favors a more patient tightening approach that reacts to evolving financial conditions. Stress on the financial system reducing lending activity may replace the need for additional hikes to slow inflation. Further, Fed policy changes work with long and variable lagged effects on economic growth and ultimately on inflation. Consequently, investors expect the Fed will begin a series of rate cuts beginning mid-year. The Fed and FDIC programs that offer overnight loans in U.S. Dollars to foreign central banks and short-term loans to financial institutions aim to contain financial system stress. However, the Fed continues to allow up to $95 billion of its Treasury and mortgage bond holdings to mature without reinvesting the proceeds, referred to as "quantitative tightening." Private investors must step in for the Fed, which can reduce investment in other assets and further tighten financial conditions. Restrictive Fed policy, through rate hikes and quantitative tightening, remains a headwind for economic growth by increasing borrowing costs and reducing market liquidity.

Fed policy uncertainty contributes to short-term Treasury yield volatility while long-term yields depend in part on the Fed successfully slowing inflation and in part on long-term economic growth prospects. The lagged impact of restrictive Fed policy to slow growth and inflation should support long-term bond prices but inflation and policy uncertainty fuel bond price volatility. However, the increase in high-quality bond yields over the last year offers a greater cushion against bond price swings.

Additional high-quality corporate and municipal bond yields relative to U.S. Treasuries are near long-term averages and, coupled with strong credit fundamentals, support future return prospects.

Typically, valuations fall when economic growth slows, which we measure by the additional yield investors require to compensate them for taking additional risk relative to safer Treasuries. Thus far, valuations remain near average historical levels but have worsened slightly (meaning investors are requiring slightly higher relative yields) due to recent unease around the banking system. However, strong credit fundamentals support high-quality issuers' ability to make interest and principal payments, supporting these valuation levels. Meanwhile, average valuations on riskier high yield corporate and municipal bonds offer little incentive to increase credit risk. Weak investor sentiment is pressuring below investment-grade bond prices and remains a risk, especially for economically sensitive issuers. Low yields in 2020 and 2021 allowed many companies and municipalities to refinance and extend maturities, but persistently high borrowing rates may eventually stress individual bond issuers that must refinance with costlier debt. Additionally, high yield companies that have been reliant upon financing tied to floating interest rates are already experiencing significantly higher interest expense. The gradual weakening of credit fundamentals presents a modest headwind to corporate and municipal bonds compared to Treasuries, but compelling absolute return opportunities exist for high quality issuers thanks to currently elevated bond yields.

Mortgage bonds not backed by the government and insurance-linked bonds offer attractive income with unique return sources. Cautious investor sentiment toward a slowing housing market creates opportunities to earn high income with strong fundamental tailwinds in the mortgage bond market not backed by the government. Most home loans originated before 2022 remain well-secured by the value of the homes collateralizing them, even if home prices continue to fall somewhat further. Slowing housing activity reduced new mortgage originations to a trickle, limiting the supply of new bonds, which in turn should support existing bond prices. Investor sentiment remains the largest near-term risk. Reinsurance, also referred to as insurance-linked securities, continues to offer compelling yields. Insurance premiums (minus insured losses from natural disasters) drive returns and remain uncorrelated with typical economic cycles that drive stock and bond returns.

Real asset markets

Despite growing income and declining vacancies, real estate markets still see re-pricing ahead due to higher interest rates.

Publicly traded real estate securities underperformed the broader market in the first quarter by 5.6%, with persistent inflation leading to rising interest rates offsetting positive property market fundamentals. Additionally, fears of an economic recession affected some sectors, such as cell towers and office properties, more than others. These sectors experienced negative returns while all other property types experienced positive performance.

Nationally, vacancy rates continue to decline across most property types and income continues to grow at an above-average pace. However, the pace of income growth is decelerating, and we expect it to taper off to more average levels through the rest of 2023. Income relative to property values rose in the publicly traded real estate market due to declining prices, but less so for private markets. Credit for property investment is still available but it is no longer cheap, making quality investments more difficult to find.

As we look into the second quarter, decelerating economic growth should be a negative for property prices, especially in the private markets. Private real estate appraisals are slowly adjusting to the shifting economic tides, and we believe the second quarter brings further price declines, particularly to office and retail properties where excess capacity makes it highly unlikely landlords can raise rents to offset declining income growth and rising vacancies. Publicly traded real estate investment trusts (REITs), on the other hand, have re-priced significantly and now trade at cheaper levels relative to their fundamentals.

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A slowing economy may support infrastructure assets paying consistent dividends.

Global infrastructure includes companies operating in utilities, toll roads, transportation and communications infrastructure and energy storage and transportation. Economic uncertainty and slowing inflation in 2023 may lead investors to prefer investments with consistent and growing cash flows, such as global infrastructure. This has not yet come to fruition; since the market low in October 2022 infrastructure has lagged the broader market, and it underperformed the S&P 500 by 5.4% in the first quarter. Utilities led the underperformance, with defensive sectors out of favor in a more aggressive market.

Infrastructure assets may perform relatively well amid an uncertain economy and slowing, but elevated inflation. Midstream energy stocks should continue to produce outsized earnings growth, even as it decelerates, and the Utilities sector is also producing strong earnings growth. With these stocks comprising 50% of most infrastructure benchmarks, we see strong performance for the asset class throughout the remainder of 2023.

Decelerating economic growth and declining inflation is bearish for commodities.

Entering 2023 we were cautious on commodities based on the decelerating economic growth. The Russia/Ukraine conflict has led to volatility in commodities markets, which have declined relative to year-ago levels. In the first quarter, the Bloomberg Commodity Index was down 5.4%, led by an 18.7% decline in the Energy sector that was driven by a 50.9% decline in natural gas.

Decelerating economic growth should become more pronounced through 2023, reducing demand. Prices reflect the conflict between Russia/Ukraine, and the risk of a synchronized global slowdown will continue to pressure prices lower, with precious metals a possible exception.

On an intermediate-term horizon, the outlook for commodities changes given the potential for a Federal Reserve pivot on monetary policy. A Fed willing to pursue expansionary policy would quickly change the environment for commodities, considering limited investments in numerous commodities' productive capacity over the past several years. Additionally, policies supporting alternative energy networks likely require additional fossil fuels and metals in their development.

Alternative investments

A volatile market environment creates opportunities for hedge fund managers, but economic uncertainty may lead them to favor defensive positioning.

Higher interest rates have led to a market environment featuring increased volatility and significant stock price movements, providing an ample opportunity set for hedge fund managers. They pursue investments to both buy long or sell short but are challenged to find economic inflection points, so nimbleness and agility remain critical. Even tactically oriented managers skilled in trading can find these choppy markets difficult to navigate. The current economic uncertainty may favor defensive positioning with less overall exposure to the equity and credit markets. This situation does not mean hedge funds will avoid risk, but we expect them to focus more on individual stocks and bonds than the overall direction of markets. Low overall net exposure (the difference between overall long and short investments) helps position managers for potential market downside and allow for a portfolio starting point from which to tactically lean net long (more total long investments than short) or short and pursue high conviction opportunities.

Hedge funds' attractive investment characteristics include trading flexibility, strategy breadth and diversification. The current capital market environment may favor defensive strategies and strategies less correlated with broad stock and bond market movements, such as active trading and market neutral funds (strategies that seek to avoid broad market risk by using both long and short investments). In contrast, we expect fundamentally focused and directional strategies that produced consistent returns during the extended period of monetary policy stimulus may face more challenges in a tighter liquidity environment. Higher interest rates may improve long and short investing opportunities in credit markets, taking advantage of wider credit spreads (the additional yield investors demand for taking additional risk relative to safer Treasuries) and performance dispersion among individual securities.

Finally, we continue to look for tactical opportunities, including idiosyncratic distressed debt, where managers invest in securities of companies otherwise unable to refinance their debt or meet restrictions on existing debt covenants. As we noted last quarter, we remain positive on macro strategies. Discretionary approaches that incorporate

a manager's relative value outlook across asset classes and hedge funds that systematically follow security price trends are finding opportunities among changing economic growth rates, interest rate levels and currency values.

Private markets

Business fundamentals helped sustain private equity performance despite elevated interest rates and economic slowdown concerns.

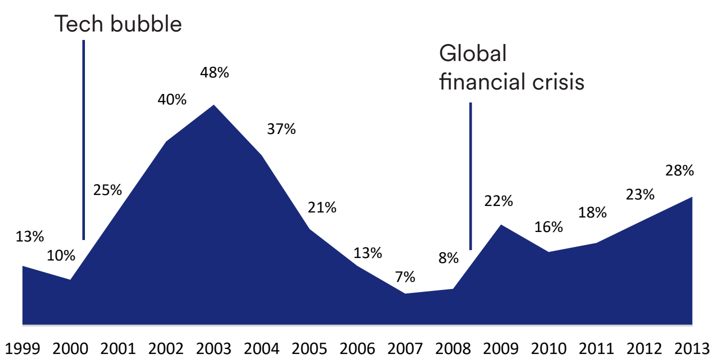
Private equity-owned companies met or exceeded their 2022 revenue and profitability goals despite a rapid rise in interest rates, inflationary pressures and economic slowdown concerns. While this resulted in less downward pressure on private equity investment performance compared to other asset classes, we do anticipate additional downward pressure on privately held company prices, reflecting the continued rise in interest rates.

After the market downturn in March 2020, private market valuations increased less than public market prices that peaked in 2021, which partially explains the muted price correction in private markets. Other key private equity return drivers have contributed to a more modest correction as well, such as fund manager expertise and control over business operations to increase revenues and profits. Managers with specific expertise in their focal sectors or industries have multiple tools to improve business performance of their portfolio companies. Private equity managers drive strategic business decisions via board membership and provide operational assistance in areas such as recruiting key executives, enhancing sales efforts, improving technology infrastructure, reducing costs, overseeing mergers and acquisitions and upgrading product offerings. If the economic environment cools further, we expect fund managers to work even harder to add value through their expertise and their toolkit. This value add will be a key determinant of investment performance going forward as the boost from investors willing to pay higher prices — a function of lower interest rates — in the prior decade is no longer a tailwind.

While past performance is not a guarantee of future returns, markets tend to overcorrect in either direction, presenting the potential for attractive opportunities to invest during a slowdown. Private equity funds launched during prior downturns have performed well. The performance figures in the chart below represent median returns of private equity buyout investments made in two prior downturns. In both cases, investments made during the downturns performed well over time.

Global buyouts' median deal internal rate of return

Source: U.S. Bank Asset Management Group, Bain Capital, DealEdge powered by CEPRES data.



Buyers and sellers disagree on company valuations, suppressing private market activity.

Buyers and sellers differ in valuing private market companies, subduing overall deal activity. Sellers are still anchoring on company values prior to the market correction and holding on to hopes for a bounce back. Buyers are wary of paying too much for those same companies given higher interest rates, fearing there could be more pain to come for the businesses if the economy slows further. However, the gap between sellers' and buyers' price expectations is narrowing as time passes. In 2022's fourth quarter, deal activity fell 41.8% compared to the fourth quarter in 2021. Activity so far in 2023 is stabilizing but still below average deal levels. We expect activity to pick up once interest rates stabilize and the gap between buyers and sellers price expectations close in the quarters ahead. As the deal activity and initial public offerings pick up, managers will start returning capital to investors; they have a backlog of mature investments ready for sale.

Private market fund raising activity slowed significantly during 2023's first quarter, and we anticipate that trend continuing throughout the year. Some investors are over-allocated because their private market allocations held up better through 2022 while public market allocations decreased in value. Other investors are just retrenching in the uncertain environment. We believe the remaining quarters in 2023 will present attractive opportunity potential for investing in private markets.

We continue to source compelling opportunities while applying our thematic and opportunistic framework in combination with a deep bottom-up diligence process. We partner with high-quality, hard-to-find managers sourced through private market industry relationships. There are opportunities across private equity and private debt, such as lower middle-market and middle-market buyouts across certain sectors, including industrials, technology and healthcare services, with flexible solutions for companies in need of capital or business transformation and private debt in performing or stressed situations.

This commentary was prepared March 2023 and represents the opinion of U.S. Bank Wealth Management. The views are subject to change at any time based on market or other conditions and are not intended to be a forecast of future events or guarantee of future results and is not intended to provide specific advice or to be construed as an offering of securities or recommendation to invest. Not for use as a primary basis of investment decisions. Not to be construed to meet the needs of any particular investor. Not a representation or solicitation or an offer to sell/buy any security. Investors should consult with their investment professional for advice concerning their particular situation. The factual information provided has been obtained from sources believed to be reliable but is not guaranteed as to accuracy or completeness. Any organizations mentioned in this commentary are not affiliated or associated with U.S. Bank or U.S. Bancorp Investments in any way.

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Diversification and asset allocation do not guarantee returns or protect against losses. Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning the construction of portfolios and how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes will be suitable for every portfolio.

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Past performance is no guarantee of future results. All performance data, while deemed obtained from reliable sources, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for investment. The **S&P 500 Index** is an unmanaged, capitalization-weighted index of 500 widely traded stocks that are considered to represent the performance of the stock market in general. The **MSCI EAFE Index** includes approximately 1,000 companies representing the stock markets of 21 countries in Europe, Australasia and the Far East (EAFE). The **MSCI Emerging Markets Index** is designed to measure equity market performance in global emerging markets. The **Consumer Price Index** is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is one of the most frequently used statistics for identifying periods of inflation or deflation. The **Personal Consumption Expenditures** (PCE) Price Index is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. It is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. The value of **large-capitalization stocks** will rise and fall in response to the activities of the company that issued them, general market conditions and/or economic conditions. **Stocks of small-capitalization companies** involve substantial risk. These stocks historically have experienced greater price volatility than stocks of larger companies and may be expected to do so in the future. **Growth investments** focus on stocks of companies whose earnings/profitability are accelerating in the short term or have grown consistently over the long term. Such investments may provide minimal dividends, which could otherwise cushion stock prices in a market decline. Stock value may rise and fall significantly based, in part, on investors' perceptions of the company, rather than on fundamental analysis of the stocks. Investors should carefully consider the additional risks involved in growth investments. **Value investments** focus on stocks of income-producing companies whose price is low relative to one or more valuation factors, such as earnings or book value. Such investments are subject to risks that their intrinsic values may never be realized by the market, or such stocks may turn out not to have been undervalued. Investors should carefully consider the additional risks involved in value investments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults). **Hedge funds** are speculative and involve a high degree of risk. An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem or transfer interests in a fund. **Private capital investment funds** are speculative and involve a higher degree of risk. These investments usually involve a substantially more complicated set of investment strategies than traditional investments in stocks or bonds, including the risks of using derivatives, leverage, and short sales, which can magnify potential losses or gains. Always refer to a Fund's most current offering documents for a more thorough discussion of risks and other specific characteristics associated with investing in private capital and impact investment funds. Private equity investments provide investors and funds the potential to invest directly into private companies or participate in buyouts of public companies that result in a delisting of the public equity. Investors considering an investment in private equity must be fully aware that these investments are illiquid by nature, typically represent a long-term binding commitment and are not readily marketable. The valuation procedures for these holdings are often subjective in nature. **Private debt investments** may be either direct or indirect and are subject to significant risks, including the possibility of default, limited liquidity and the infrequent availability of independent credit ratings for private companies.

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