1st Quarter 2024

Highlights

- **Despite higher interest rates, credit markets did well on the back of better-than-expected economic data and increased fund flows. Our portfolios benefited with higher risk sectors outperforming.**
- **The economy performed better than forecast leading to higher interest rates and a likely delay in monetary policy easing. We believe the economy has achieved the elusive "soft landing."**
- **Inflation, as measured by CPI, rose during the first quarter raising concerns the Fed will postpone rate cuts and longer-term rates will move higher. We believe the inflation rate will remain well-behaved.**

Markets

		Returns (%)			
GIA	Average Quality	1Q24 Gross	1Q24 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A+)**	**0.18**	**0.09**	**4.71**	**4.34**
Global Investment Grade Composite	**(A-)**	**0.29**	**0.19**	**5.49**	**5.07**
Global Credit Plus Composite	**(BBB+)**	**0.93**	**0.81**	**7.76**	**7.22**
Emerging Market Corporate Debt Composite	**(BB+)**	**3.43**	**3.27**	**12.60**	**11.92**
Benchmark Bonds					
Bloomberg U.S. Agg. Index	(AA)	-0.78		1.70	
Treasury	(AA+)	-0.96		0.05	
Corporate	(A-)	-0.40		4.43	
Mortgage	(AA+)	-1.04		1.39	
Government/Credit	(AA)	-0.72		1.74	
ICE BofA U.S. Corporate & Yankees	(A-)	-0.15		4.41	
ICE BofA U.S. Corporate	(A-)	-0.08		4.70	
ICE BofA U.S. High Yield	(B+)	1.51		11.04	
ICE BofA EM Corporate Plus	(BBB)	1.41		6.76	
ICE BofA Global Gov't ex-US	(AA-)	-0.74		0.86	
JPM Emerging Markets EMBI GD	(BB+)	2.04		11.28	
JPM CEMBI Broad Diversified	(BBB-)	2.32		9.17	
JPM GBI-EM Global Diversified	(BBB+)	-2.12		4.91	
Benchmark Equities					
S&P 500	NA	10.16		27.86	
Nasdaq Composite	NA	9.11		34.02	
Russell 2000	NA	4.81		17.87	
MSCI EAFE	NA	5.06		12.27	
MSCI Europe	NA	4.33		10.90	
MSCI Japan	NA	10.06		23.20	
MSCI Emerging Markets Equity	NA	1.90		5.34	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

The financial market rally that took flight during the fourth quarter of 2023 rolled on, mostly unperturbed, during the first quarter. The original spark was the Fed's late September "pivot" which affirmed the end of the rate hiking cycle. Investor expectations quickly shifted to rate cuts, and a likely soft landing given benign economic data. During the first quarter of 2024, economic indicators that buoyed the market's enthusiasm delivered mixed signals and engendered a cautious shift higher in expectations for interest rates. Nevertheless, riskier asset classes continued their optimistic ascent. At quarter-end, the major U.S. equity indexes closed at or near record highs. Foreign stocks also rallied with many developed market indexes ending the quarter at record levels. Bond investors were not rewarded as well in absolute terms because interest rates drifted higher. However, spreads narrowed in most sectors with the highest risk ones delivering the best performance. In a further reflection of optimism, gold, energy, and bitcoin rose, with gold and bitcoin both hitting record highs in March and oil pushing higher behind an improved economic outlook across the globe.

Investment grade credit continued its resilient performance during the first quarter as solid creditworthiness got technical support from incremental fund flows. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down -0.08%. Despite negative returns, corporate bonds generated 89 b.p. of duration adjusted excess returns as the U.S. treasury index (G0Q0) lost -0.94% due to higher rates. Corporate option adjusted spreads (OAS) narrowed 11 b.p. to 93 b.p., while the yield to worst of the index rose 20 b.p. from 5.14% to 5.34%. Investment grade issuance spiked on the heels of robust demand and healthy merger-related financing. New issue supply set monthly records in both January and February, and for the quarter, at $657.7 billion. Should this pace continue, 2024 investment grade issuance may exceed 2020's record $2.1 trillion borrowing.

The high yield market outperformed again as robust creditworthiness and high absolute yields enticed investors. Despite higher rates, the sector experienced favorable fund flows and, with modest new issuance, benefited from excess demand. The ICE BofA U.S High Yield Index (H0A0) was up 1.51% for the quarter, well ahead of other fixed income sectors. At quarter-end, the spread to worst for the sector was narrower by 30 b.p., from 361 b.p. to 331 b.p. The yield to worst remained attractive at 7.66% compared to 7.64% in December 2023. Once again, the sector's returns were propelled by CCC-rated securities which returned 3.22% for the quarter. Supporting the market, investors added funds totaling $2.6 billion (primarily via ETFs), although in March the sector experienced its first monthly withdrawal in five months. The default rate including distressed exchanges decreased to 2.59% from 2.84% at the end of 2023 (1.67% not including distressed exchanges), which remained well below the historical average of 3.4%. The new issue market recovered to a respectable $87.6 billion which compared favorably to the first quarters of 2022 and 2023, although new issue volumes remained well below the pace set in 2020 and 2021.

Emerging markets bonds participated in the rally with other higher risk sectors. In this sector, performance was driven more by improving fundamental factors than by technical support from fund flows. Specifically, Chinese authorities took measures to boost their sluggish economy while countries like Turkey and Argentina adopted more orthodox policies. Other countries like Brazil and South Africa benefited from elevated commodity prices and Mexico received substantial foreign investment. Together, we believe these shifts augur well for growth prospects in developing economies over the next few years. The JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 2.0% for the quarter. Similarly, the JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) rose 2.30% while the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, had negative performance of -2.2% due primarily to a higher U.S. dollar.

Economy

During the first quarter of 2024, economic data was, on balance, better than expected. Most economists and strategists forecast a slower rate of growth given the drag from restrictive monetary policy and an already lengthy period of outperformance. Economic pessimists found some ammunition in mixed manufacturing data and softening consumer confidence. Optimists found reinforcement in firm labor markets, sustained demand for services, and stubbornly elevated inflation. Since the fall of 2023, the consensus economic narrative had monetary policy easing by the summer of 2024 followed by a few more rate cuts to give a slowing economy the necessary stimulus for a 2025 revival. With the data coming in better than expected and March CPI printing above consensus, bond markets quickly recalibrated the timing of an initial cut and raised the specter of higher rates along the yield curve for much of 2024.

In prior quarters, we repeatedly underestimated the U.S. economy's staying power. Eight months after the Fed's last hike in a cycle that brought the largest increase over the shortest period, we believe we are experiencing the soft landing many were looking for. Given the euphoric performance of equity markets and the steady march higher of commodity prices, we think the proper economic question involves the likely sustainability of conditions that justify current valuations. For now, corporate earnings have held up and outlooks suggest the economy can continue to expand at a slower yet acceptable pace.

In an encouraging sign for global growth, after disappointing last year, the Chinese economy had a healthy resurgence in activity during the quarter. Europe also showed signs of life led by the smaller economies. Other emerging economies are seeing the benefits of more stimulative policies after efforts to tame inflation met with some success. As the quarter ended geopolitical friction threatened to interrupt commodity and financial markets. However, the reaction in financial markets did not suggest a major global conflict was imminent.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the U.S. economy growing at a steady clip of about 2.0% in 2Q and at a modestly slower annual rate of 1.5% in 3Q 2024. Momentum from a better-than-expected start in 2024, steady labor markets, and an improving outlook abroad should keep the "soft landing" going. The likely delay in Fed easing combined with higher longer-term rates will extend restrictive financial conditions and continue to bring down economic activity. Nevertheless, consumers and businesses withstood higher rates over nearly two years which suggests the economy has the underlying strength to sustain an acceptable growth rate. While this may increase the risk of an eventual recession, it is not likely to materialize before 2025. PROBABILITY 60%

2. A second scenario has the economy slowing suddenly to a rate of 0.0% to 1.0% at an annual rate during the next six months. In this scenario, the Fed's inability to cut rates and fears of an inflationary resurgence have a debilitating effect on confidence. Longer-term rates remain elevated, lending becomes more restrictive, and consumers downshift their expenditures. In addition, businesses curtail investments, and the unemployment rate creeps higher. PROBABILITY 25%

3. A third scenario has the economy expanding at a stronger pace of 2.5% to 3.0% at an annual rate during the next six months. In this scenario, the economy's momentum is boosted by productivity enhancing investments and buoyant personal consumption. In this scenario, companies invest further keeping the unemployment rate low and wages healthy. Inflation declines at a moderate pace without damaging confidence. The Fed delays rate cuts as markets expect, although it does not reverse policy. Furthermore, China and Europe achieve better growth which helps power the global economy to better performance. PROBABILITY 15%

Market Outlook

The economic outlook remains volatile as better-than-expected economic performance generates investor enthusiasm yet entails higher rates and tighter financial conditions. We believe a lower, although positive, growth rate is a welcome development that can be sustained provided financial conditions do not get too restrictive. The move higher in rates makes fixed income more compelling and an attractive alternative to equities given current valuations. While credit spreads are tight relative to history, creditworthiness remains robust and absolute yields are compelling for diversified, high quality fixed income portfolios. With this in mind, we continue to hold a modest overweight position in credit, including in high yield and emerging markets. However, we are trimming riskier positions and favoring higher quality names that still offer some spread.

April 15, 2024

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Index Definitions

Bloomberg U.S. Aggregate Index
The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate Index
This index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. (Future Ticker: I02765US)

Bloomberg U.S. Mortgage-Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index
The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index
The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA US Emerging Markets Corporate Plus Index (EMUB)
The ICE BofA US Emerging Markets Corporate Plus Index is a subset of The ICE BofA Emerging Markets Corporate Plus Index including all securities denominated in US dollars.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

Emerging Markets Bond Index Global Diversified (EMBI® Global Diversified):
The EMBI Global Diversified is a uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index
The index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.