GIA PARTNERS

3rd Quarter 2023

Highlights

- **Interest rates increased further while credit spreads held steady leading credit sectors to outperform. Our portfolios benefited from their positioning during the quarter and year-to-date.**
- **The economy remained strong despite a July rate hike and hawkish commentary. A pause in September came with indications rates would be high for longer. We do not expect another hike.**
- **China is at a crossroad positioning itself as an alternative to western ideology and economic policy. This is occurring at a challenging time for the economy and under increasing authoritarianism.**

Markets

		Returns (%)			
GIA	Average Quality	3Q23 Gross	3Q23 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**-2.23**	**-2.31**	**3.59**	**3.23**
Global Investment Grade Composite	**(A)**	**-2.55**	**-2.64**	**4.34**	**3.92**
Global Credit Plus Composite	**(BBB+)**	**-1.04**	**-1.16**	**5.99**	**5.46**
High Yield Composite	**(B+)**	**0.70**	**0.56**	**11.17**	**10.56**
Emerging Market Corporate Debt Composite	**(BB+)**	**0.40**	**0.25**	**10.65**	**9.99**
Benchmark Bonds					
Bloomberg U.S. Agg. Index	(AA)	-3.23		0.64	
Treasury	(AA+)	-3.06		-0.81	
Corporate	(A-)	-3.09		3.65	
Mortgage	(AA+)	-4.05		-0.17	
Government/Credit	(AA)	-3.00		0.93	
ICE BofA U.S. Corporate & Yankees	(A-)	-2.61		3.79	
ICE BofA U.S. Corporate	(A-)	-2.70		3.99	
ICE BofA U.S. High Yield	(B+)	0.53		10.20	
ICE BofA EM Corporate Plus	(BBB)	-1.21		6.11	
ICE BofA Global Gov't ex-US	(AA-)	-2.53		-2.20	
JPM Emerging Markets EMBI GD	(BB+)	-2.23		10.01	
JPM CEMBI Broad Diversified	(BBB-)	-0.26		8.25	
JPM GBI-EM Global Diversified	(BBB+)	-3.26		13.10	
Benchmark Equities					
S&P 500	NA	-3.65		19.59	
Nasdaq Composite	NA	-4.12		25.00	
Russell 2000	NA	-5.49		7.23	
MSCI EAFE	NA	-4.71		22.26	
MSCI Europe	NA	-5.52		25.41	
MSCI Japan	NA	-2.61		23.11	
MSCI Emerging Markets Equity	NA	-3.71		8.79	

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

Markets

At times, financial markets respond to economic data as expected, and at times not. The third quarter of 2023 is one of those quarters where the data and the markets seemed at odds. Despite rate hikes in the first half of the year, the economy entered the third quarter with solid economic momentum. From the start, the Atlanta Fed's GDPNow estimate exceeded consensus forecasts for 3Q growth, and the model's projection rose to a near 6.0% pace by mid-August. In the meantime, activity sensitive indicators like inflation, consumer confidence, and purchasing manager indexes provided little or no supportive evidence of such robust activity. The Fed raised rates in July for the third time this year and delivered a hawkish message that the equity market initially disregarded. Toward the end of August, with little new data, market sentiment flipped. The S&P 500 index, which had handsome gains began to erode, ending September down 4.9% and the quarter down 3.65%. The more unexpected and damaging change for many markets and investors was the relentless increase in longer-term interest rates. For the quarter, the 10-year U.S. treasury rose 73 b.p. in yield, and the long bond was higher by 84 b.p. These shifts caused the Bloomberg Aggregate Index to decline 3.23% for the quarter erasing prior gains to drag bonds down 1.21% year-to-date. Higher rates affected markets globally as reflected by the -5.55% quarterly returns for non-U.S. government bonds which included a -3.02% hit from an appreciating U.S. dollar.

Investment grade credit performed surprisingly well considering the drawdown from higher rates and worries about economic deterioration. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down 2.70%, although the sector remained positive 0.45% year-to-date. Corporate bonds generated 71 b.p. of duration adjusted excess returns for the quarter and 222 b.p. year-to-date as the U.S. treasury index (G0Q0) slid -3.34% and -1.76% over the same periods. Corporate option adjusted spreads (OAS) narrowed 9 b.p. to 123 b.p., while the yield to worst of the index increased from 5.55% to 6.05%. Investment grade issuance recovered in September despite rising rates. For the quarter, issuance totaled a healthy $317.5 billion, which was slightly below last year's $325.2 billion in the third quarter. Year-to-date issuance totaled $1.21 trillion, surpassing last year's nine-month tally of $1.18 trillion.

The high yield market continued to defy expectations, outperforming investment grade sectors despite the move higher in rates, negative fund flows, and strategists downgrading the sector due to tight spreads. The ICE BofA U.S High Yield Index (H0A0) was up 0.53% for the quarter and a healthy 5.97% year-to-date. At quarter-end the spread to worst for the sector was narrower by 11 b.p. from 426 b.p. to 415 b.p. High yield continued to be boosted by the riskiest securities. By ratings, quarterly returns were: BB -0.34%, B +0.95%, and CCC +2.83%. The rise in treasury yields increased the yield-to-worst for the sector from 8.55% to 8.89%. Despite outperformance, fund flows reversed in August and September bringing the outflow to -$3.5 billion for the quarter and -$14.5 billion year-to-date. During the quarter, there were $9.97 billion in bond defaults and distressed exchanges. The default rate including distressed exchanges declined to 2.11% from 2.71% at the end of the third quarter (1.32% not including distressed exchanges), which remained well below the historical average of 3.1%. The new issue market showed signs of life in September completing $24.6 billion in transactions for a quarterly total of $40.3 billion. Year-to-date issuance reached $136.6 billion, exceeding last year's nine-month total by $46.6 billion.

Emerging markets bonds experienced mixed results during the quarter with countries like China underperforming due to an underwhelming re-opening and Brazil outperforming on better-than-expected domestic activity. Tightening financial conditions from higher international interest rates were partly offset by stable domestic rates and weaker currencies. Going forward the sector will likely depend on better performance in China, as the U.S. and Europe move to slower rates of growth. The JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was down 2.20% for the quarter, but remained up 1.80% year-to-date. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) declined 0.26% during the quarter and remained ahead 3.38% over the nine months. The JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, lost 3.26% for the quarter and was higher by 4.28% year-to-date.

Economy

We, and many economists, repeatedly underestimated the economy's resilience. The most anticipated recession in history failed to materialize and may be so slow to arrive that policy makers risk strangling an economy that no longer needs restraint. Ironically, after 525 b.p. of rate hikes in 16 months, economic conditions look ideal with low unemployment, gradually slowing growth, and declining inflation. After the Fed's colossal misjudgment on inflation's emergence in 2021, it would be a shame to tank an economy that is likely to trough without painful dislocations.

A notable observation about the economy's state given the widespread expectations for recession, is the lack of stress across industries and consumers. Most companies continue to display robust credit metrics, and many have prepared for a slower growth period ahead. Banks raised allowances for non-performing debt despite modest increases in delinquencies. Even for dented commercial real estate, most of the country's large banks have reserves that fully cover non-performing loans.

Across industries, performance appears consistent with macro indicators on consumption trends. Goods producing entities are anticipating slower sales while services continue to forecast healthy demand. A common challenge is increased costs primarily related to labor, with indicators confirming margins are getting squeezed. Industries like transportation, consumer products, and chemicals are experiencing pricing pressure which suggests inflationary pressures on the broader economy may continue to abate.

Consumers also remain in good shape, although excess savings that supported post Covid spending have begun to dwindle. The household debt service ratio remains well below pre-2008 levels, even with recent increases in credit card borrowing. We expect the restart of student loan repayments to cut into consumption without causing outsized delinquencies in credit card or mortgage payments.

Conditions abroad show most regions gaining after Covid but at modest rates. Starting with China, consumption has disappointed forcing the government to accelerate stimulus. In Europe, central bank tightening probably ended in September with regional growth barely positive. Having resolved constraints related to the Russia/Ukraine crisis, the region will likely resume a slow growth phase. Other emerging economies are benefiting from early anti-inflationary policies and still robust commodity pricing.

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 about 1.0% to 1.5% in 4Q and at a slower annual rate of 0.0 to 0.5% in 1Q 2024. Momentum from a surprisingly strong 3Q will likely keep the economy running above prior forecasts during the fourth quarter. While student loan repayments and higher interest rates should temper consumption, demand for services like travel and entertainment remains robust. In addition, government programs still support corporate investment which should continue through the end of the year.
   PROBABILITY 60%

2. A second scenario has the economy slowing to a rate of 0.0% to -1.0% at an annual rate during the next six months. In this scenario, the Fed's rate hikes continue into November with economic and financial conditions worsening at an accelerating pace. Longer-term rates remain elevated, lending becomes more restrictive, and consumers, burdened by loan repayments, downshift their expenditures. In addition, unemployment rises further dampening consumer confidence. PROBABILITY 25%

3. A third scenario has the economy expanding at the same or even stronger pace of 2.0% to 2.5% at an annual rate during the next six months. In this scenario, personal consumption remains robust aided by low

unemployment and reasonable wage growth. In a "Goldilocks-like" manner, inflation remains contained because the pressure on prices from energy and housing abates due to weaker global demand and high mortgage rates. Furthermore, the Fed stops raising rates and longer-term interest rates decline on the improved inflation outlook. PROBABILITY 15%

Market Outlook

The economic outlook remains confusing because the Fed insists on slowing an economy that refuses to buckle. Ironically, monetary authorities should be thrilled considering employment has been resilient while inflation appears to be easing. Despite seemingly good news, investors are skeptical a soft landing can be achieved and, instead, are reacting to favorable economic news by pushing interest rates higher and selling riskier assets. We continue to believe the economy will experience a few quarters of near-zero growth without reigniting inflation. We also believe China, other emerging economies, and Europe are poised for a period of improved performance. On those expectations, we believe longer-term interest rates already discount higher inflation than is likely and are attractive for investment. In addition, we believe credit and securitized markets will remain healthy, making fixed income an especially compelling asset class as we near 2024.

October 15, 2023

Important Information

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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.