Market Perspectives
Outlook 2024

TURTLE CREEK WEALTH ADVISORS

KEY HIGHLIGHTS

- Economy – Resilient and Tracking Back to Trend
- The Fed – Less of a Problem
- Inflation – Progress but Watchful of Second Wave
- Election – Historical Impacts on Markets & Policy
- Stocks – Earnings & Valuations
- Bonds – Persistent Tailwinds from Lower Yields
- Portfolios – Measured Optimism

Given valuation concerns for stocks in the near term, we believe it makes sense to consider alternative investments in areas where we find ourselves opportunity long and capital short.

EXECUTIVE SUMMARY

Markets finished 2023 strongly thanks in large part to the pivot the Fed made in October which signaled the end of rate hikes. Both stocks and bond markets responded with impressive gains in the 4th quarter which cast an improved light on full-year performance for the two asset classes. In a year during which the Fed stopped hiking rates after 11 increases, the fact we have yet to see any discernable signs of a recession makes us thankful but also causes us to view 2024 data with an inquisitive eye.

We expect economic growth to return to pre-pandemic levels of 2% during 2024. Headwinds in the first half of the year from previous rate hikes should turn into gentle tailwinds in the second half of 2024 as Fed policy becomes less restrictive thanks in part to continued disinflationary trends. Trend-like growth in the U.S. economy should drive positive earnings growth for stocks albeit at reduced levels than what analysts currently expect. Directional trends lower in interest rates were at the center of focus in the 4th quarter. These trends should re-establish themselves, which should benefit fixed income prices and lead to less volatility.

2024 is lining up to be a positive year for stocks and an average-to-better year for bond markets, which means a balanced portfolio of stocks and bonds is likely the best bet this year. Given valuation concerns for stocks in the near term, and the fact that market gains last year were driven almost entirely by P/E multiple expansion instead of earnings growth, we believe it makes sense to consider alternative investments in areas where we find ourselves opportunity long and capital short.

As we begin 2024 our list of risks that could potentially upset the applecart is formidable. Highest on our minds is the resilience of the U.S. economy and if the Fed will be able to

Index	MTD	QTD	YTD	1 Year	2022
S&P 500	4.54	11.69	26.29	26.29	-18.11
Dow Jones Industrial Average	4.93	13.09	16.18	16.18	-6.86
Russell 2000	12.22	14.03	16.93	16.93	-20.44
NASDAQ Composite	5.58	13.79	44.64	44.64	-32.61
Europe, Australia, & Far East (EAFE)	5.33	10.47	18.85	18.85	-14.05
MSCI Emerging Markets	3.95	7.93	10.27	10.27	-19.78
Bloomberg Barclays U.S. Aggregate Bond	3.83	6.82	5.53	5.53	-13.04

As of 12.31.23; Returns in percent

manage continued disinflation without a recession. Unrealistic expectations in the market for earnings growth and Fed cuts could lead to imbalances which rarely end without volatility. Finally, it isn't hard to become uncomfortable when considering the current fiscal position of the U.S. government. Spending deficits are running at 7% of GDP while at full employment. The country's finances are operating on a razor thin margin and that leaves little room for flexibility when we may need it most.

ECONOMY

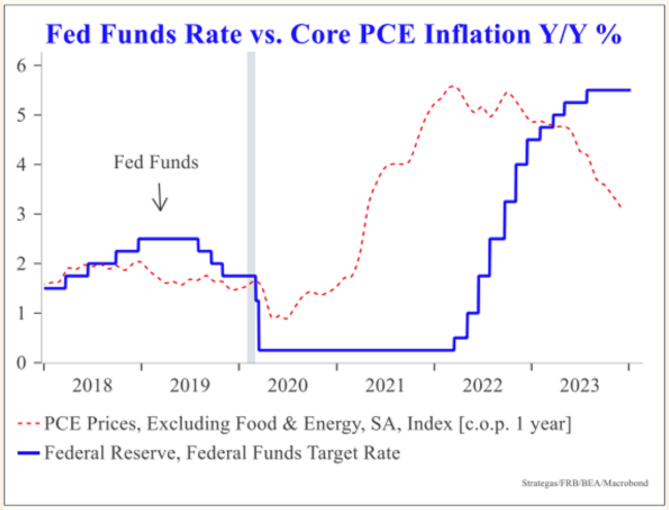
The much talked about recession that was expected to unfold in late 2023 or early 2024 has yet to take place. We have been pleasantly surprised by the ability of the U.S. economy to shake an otherwise daunting set up of restrictive monetary policy driven by stubborn inflationary pressures for much of 2023. There have been areas of the economy that have suffered, specifically manufacturing, real estate, and other interest rate sensitive industries but the U.S. economy broadly surprised to the upside in 2023.

With monetary policy there is always a lagged effect of interest rates which economists argue can be as long as 12-18 months. Using the short end of that range means that interest rate increases in the 1st-2nd quarter are just now being felt. We agree there is a lagged effect and are therefore keeping close watch on economic indicators especially during the first half of 2024. Currently the Purchasing Managers' Index details on manufacturing and services are signaling caution and the yield curve remains inverted. We believe as long as the economy can weather the next six months without issue, then we should see improving economic conditions in the 2nd half of the year. The last rate hike was July of 2023 which now seems like a distant memory. Furthermore, labor markets continue to remain robust but are cooling in a positive manner so far as indicated by the reduced number of job openings and steady wage growth.

With inflation moving lower across most parts of the economy and the labor market in good shape, we're expecting the U.S. economy to return to pre-pandemic, trend-like GDP growth in the 2% range.

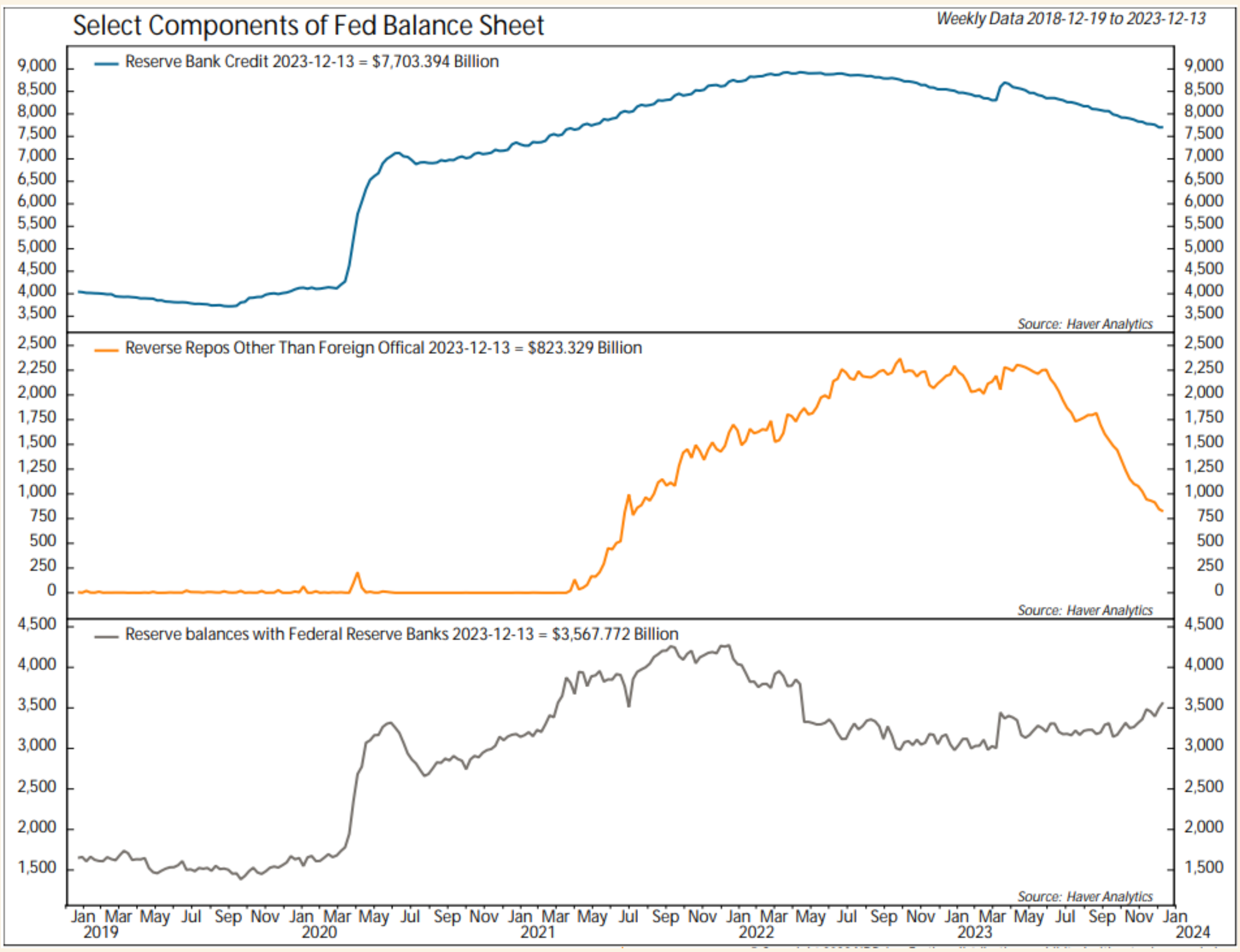
THE FED

After a historic run of interest rate increases which kicked off in March of 2022, the Fed has all but confirmed they are done hiking rates, as of their last FOMC meeting in December. The biggest question on investors' minds now turns to when might rate cuts begin. The summary of economic expectations that was delivered after the Fed's December meeting showed on average 3 rate cuts projected by Fed governors, the first of which is expected to be mid-2024. The market, as is often the case, has a different expectation in terms of timing and magnitude, expecting between four and five rate cuts over the year. Per FactSet, market participants place a 67% chance of the first rate cut coming at their March 20th meeting.

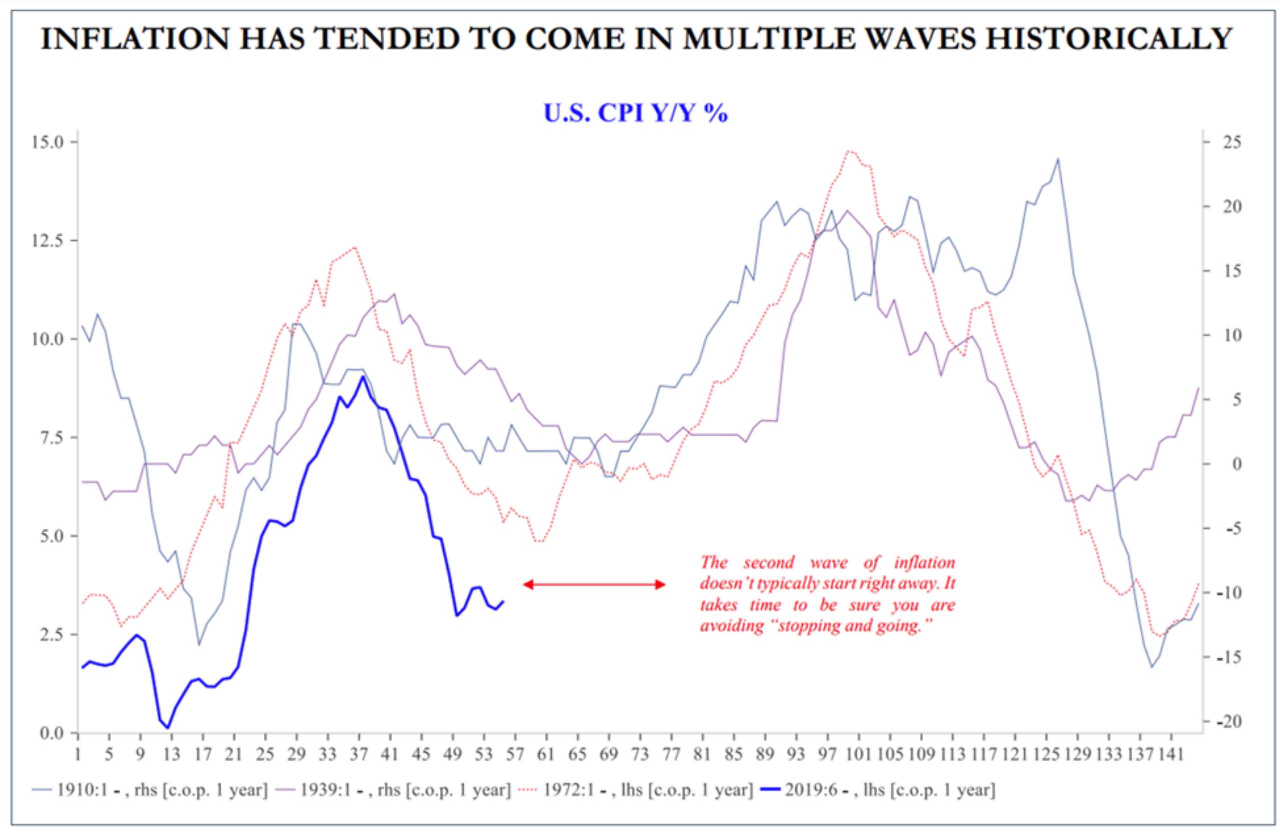


Source: Strategas; As of 12.31.23

Much is written about the details of Fed policy, but we believe it's most useful to widen the aperture of the conversation and look for directional tailwinds or headwinds. Doing so allows us to worry less about the details and more about the bigger forces at work. In the case of the Fed, 2024 should be a year where the Fed is much more "friendly" to markets than it has been in the last two years. Both stock and bond markets have benefitted from the expectations of less restrictive Fed policy in 2023. It's difficult to expect the same magnitude of impact to markets in 2024 given how much is already "priced in". Thus far most of the conversation with respect to the Fed has been related to interest rate policy. Investors shouldn't forget the other aspect of their tightening campaign has been the wind down of their balance sheet through so-called quantitative tightening or "QT". The Fed's balance sheet swelled to over $9T during the pandemic and the months that followed. Since the summer of 2022 the Fed has allowed as much as $95B of U.S. Treasury and Mortgage-Backed Securities it owned to mature without replacing them. These actions have shrunk the balance sheet so far by close to $2T. In recent commentary Fed governors have alluded to the possibility of reducing QT or at least beginning to communicate a construct and timeframe by which it will be completed. With inflation trending lower each month, the "real rate" in the U.S. economy, that is the Fed Funds rate less the current inflation rate, is getting higher, thus further restricting growth. The Fed will likely look to normalize this impact by curtailing the net impact of maturities in their portfolio which should be received positively by the market.



Source: Strategas; As of 12.13.23



Source: Strategas; As of 1/17/24

INFLATION

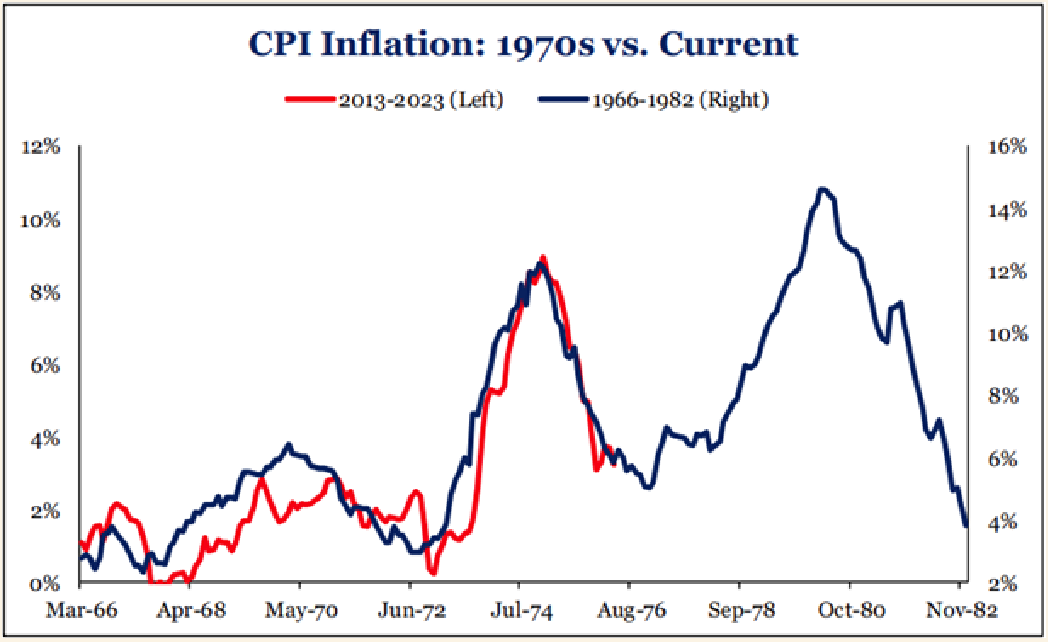
Of course, it's hard to have a robust conversation about Fed policy without considering inflation dynamics in the U.S. economy. The 40-year historical average for inflation as measured by the CPI in the U.S. is 2.8%. Current inflation trends in the U.S. are moving back to these historical averages. In December the CPI rose 0.3% vs. November and 3.4% versus a year ago. It wasn't long ago that the annualized rate was double that amount. So far, the Fed has been able to manage a somewhat orderly unwind of the "great inflation" post pandemic. The labor market normalizing with fewer quits and reduced job openings along with supply chains normalizing have been contributing factors as well.

We believe the Fed is on pace to achieve a running rate of inflation that is close to its stated target of 2%. Whether it ever gets back to 2% is a topic of ongoing debate but we believe a rate between 2-3% is likely achievable. The 3 month and 6 month annualized run rates are signaling we're close and there is an expectation for services inflation to cool a bit over the next six months as lower housing prices are fed into the CPI equation.

Consumer inflation expectations are a key component to watch as they directly impact behavior and they have been tracking to favorable range. An important indication of this has been the 5-yr forward inflation expectation which dipped back to a pre-pandemic 2.2% level. In the nearer term, the NY Fed's recent survey of 1-yr expectations fell to 3.0% with the 3-yr expectation dipping to 2.6%. The gentle downward slope of expectations is welcomed news to the Fed and investors.

There are risks that a second wave of inflation develops post-election. Looking back at available history across 20 developed economies shows 87% of inflation episodes have been followed by multiple waves. These risks are compounded by the fact that we're in an election year and there's historical precedence for incumbent administrations to stimulate the economy during election years. The current fiscal deficit is a whopping 7% of GDP and is likely to hamper these efforts. Economists estimate there is a 16-mo lag between policy moves and resulting inflation so this conversation is far from over and the Fed will remain watchful. In addition, with unemployment below 4% and wage growth above 4%, the potential for strong consumer spending (which accounts for 70% of GDP) to drive another wave of inflation is not out of the question.

For investors that either lived through or have studied the hyper-inflation of the 1970s, the chart below is a good reminder that history often rhymes. Even though what we experience firsthand seems novel and the first of its kind, if you look through the pages of history you often find similar analogs. To this point the bout of inflation we're going through has followed a similar path to that of the 1970s.



Source: Strategas; As of 12.31.23

ELECTION

The elephant in the room this year looms large. The 2024 election will likely be as debated and contentious as expected. However, it's important to remember that political events often bring much hype but very little in the way of lasting market impact. The economy, earnings, interest rates, and other fundamental factors drive markets over the intermediate and long-term, not politicians.

With that said, elections can have a near term impact on markets. Re-election years have historically brought with them an increase in fiscal and monetary policy actions as no sitting political party wants the specter of a slowing or recessionary economy hanging over their campaign. While recession in 2024 looks to be less of a risk at present, it's worth remembering how incentivized the current administration will be to make sure it stays that way.

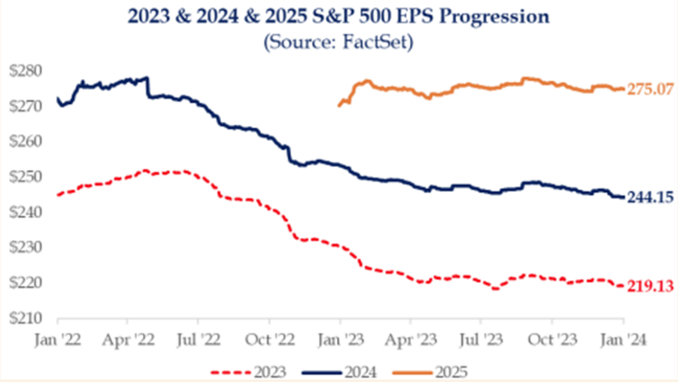
In every re-election campaign since FDR the president has been re-elected so long as there wasn't a recession in the preceding two years. There have been six presidents up for re-election that have had recessions in the preceding two year and all six have lost their election campaign, most recently Donald Trump in 2020. Consumer incomes have also historically played a key role in determining whether incumbents are re-elected, which is more incentive for the administration to act.

Accommodative policy measures during re-election campaigns have been most notable in their influence on market performance. In 13 of the last presidential re-election years the S&P 500 has increased in each year by an average of 15.8%.

STOCKS — EARNINGS

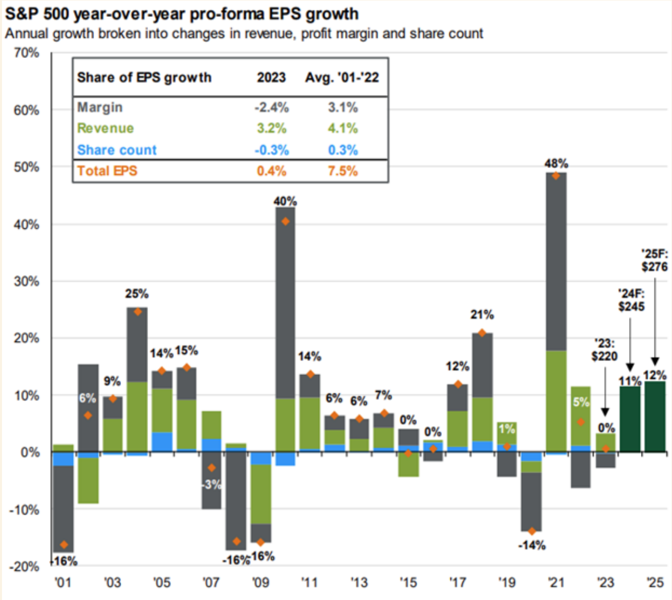
We devote much time studying the fundamental forces at work in any given asset class to determine relative investment opportunities between asset classes. For stocks, the two primary fundamental forces at work rest on economic growth and prevailing interest rates as both factors weigh heavily in the ability of stocks to grow their earnings streams.

From this standpoint we're entering 2024 with a positive outlook for stocks based on a return to trend-like economic growth which we think will drive reasonable earnings growth. Analysts are often an optimistic group and currently estimate earnings growth of 12% in 2024. This equates to earnings per share of $244 for the S&P 500 Index. While our view is not as rosy, we believe stocks can still generate earnings of $235 per share or 6.8% growth.



Source: Strategas, FactSet; As of 1.9.24

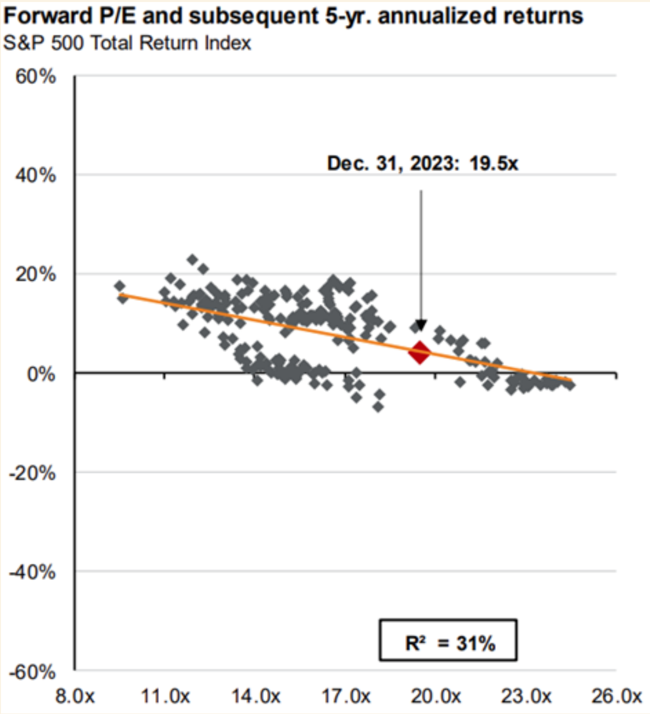
A key to Corporate America's ability to deliver these results will also rest with consumer activity and revenue growth. At present the expectation is for revenues in the S&P 500 Index to grow between 5-6%. With earnings expected to grow more than revenues, there is an imbedded expectation for operating margins to improve which may prove difficult due to prevailing trends in goods and services prices as well as persistently high wage growth. Margins have improved recently due to expense controls but many of these benefits have already been implemented. Wage growth is running around 4% currently which makes reducing employment expense difficult without workforce reductions. Productivity gains could be the key to threading the needle as companies try to leverage benefits of technology and Artificial Intelligence.

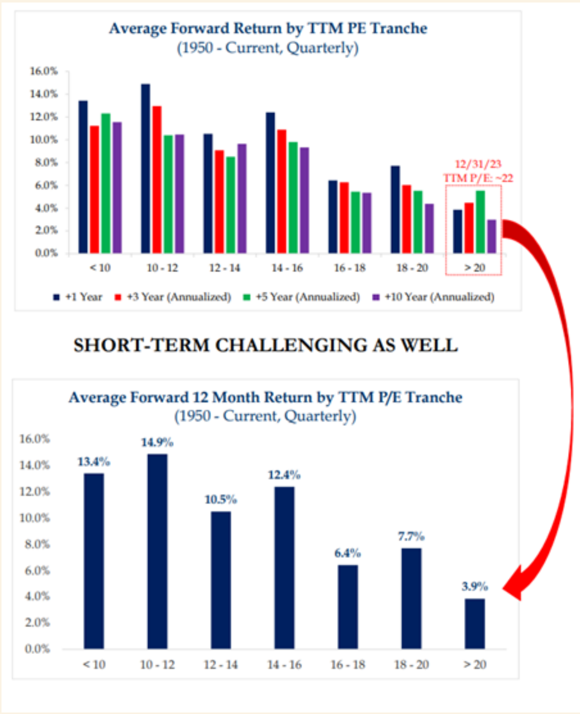


Source: JP Morgan Asset Management; As of 12.31.23

STOCKS — VALUATIONS

The market entered 2023 with a forward price-to-earnings ("P/E") multiple of 16.5x and ended with a multiple of 19.5x. This tells us that the majority (80%+) of the market's gain last year came by way of P/E multiple expansion. This is clear to see when you consider corporate earnings on average over the course of 2023 were flat, yet the market went up 24%. Valuations are not a good tool for timing a market. However, there is a correlation to market valuations and future realized

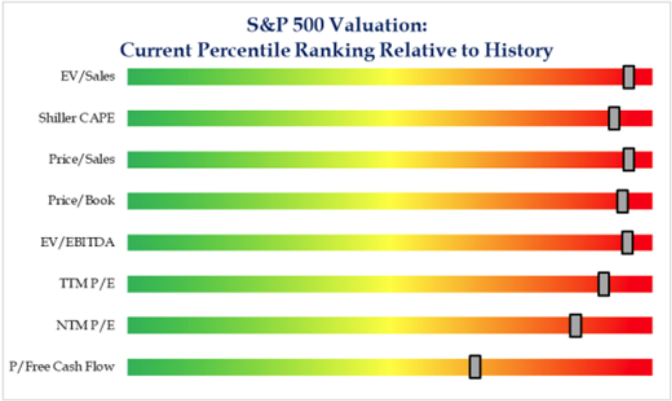




Source: JP Morgan Asset Management, Strategas; As of 12.31.23

rates of return. Generally, you see higher valuations drive lower 5-yr future annualized returns. At current valuations history tells you that 5-yr returns would fall somewhere in the 5-10% range. The same relationship holds true over shorter periods of time as well.

There are multiple ways to value stocks, P/E is only one such metric. Regardless of which metric you follow valuations are stretched, further increasing the importance of earnings growth this year.



Source: Strategas; As of 1.10.24

Prevailing interest rates do have an effect on P/E multiples. As rates increase, there are other options for investors to consider that could drive attractive relative returns, including Money Market Funds, with current yields of 5%+ (highest since 2007). The 30-yr average forward P/E multiple is 16.6x as of 12/31/23. Stimulative policy measures from the Fed in the post-GFC period have led to higher-than-average valuations for stocks. They remain elevated but are below the peak levels of early 2022 when forward multiples were 21.4x. The valuation set-up in stocks is unattractive to start the year and it leaves little flexibility for the market to adjust to any unforeseen bumps in the road.

BONDS

Interest rates peaked in the U.S. on Oct. 27th. Their steady rise, especially over the 3rd quarter, led to volatility in stock markets and was acutely felt amongst bond markets. Once rates peaked in October, fixed income indices had already sold off approximately 4-5% but rallied strongly into year-end as rates fell posting gains of 5.5% for the year. The past decade has taught us the perils of forecasting interest rates. However, with the Fed moving to a stable-to-cutting stance in terms of monetary policy, the stage is set for lower interest rates not withstanding a re-ramp of inflation. Importantly, we expect a normalization of interest rates, e.g. levels seen in the pre-GFC days, and less interest rate volatility. Year-end interest rate forecasts on the 10-yr U.S. Treasury range from 3.25% to 3.85% based on our research network. Taking this range of year-end forecasts, one could reasonably expect a total return of 4.0% to 6.5% in total return in Investment grade bonds for the year. This is welcome news and in stark contrast to the poor performance experienced in bonds over the last three years.

Much is dependent on the path of interest rates but given the deflationary environment and the Fed pivot to neutral we have a positive outlook for high quality fixed income positions in portfolios both in taxable and tax-free bonds.

PORTFOLIOS

After contemplating all of the possibilities of the coming year it becomes apparent there are many ways things could go in 2024. It's tempting to try to position for every risk factor no matter how minute. Our process grounds us in observable data, historical analysis, and a weight of the evidence approach.

Portfolios coming into 2024 are positioned with a bias toward stocks relative to fixed income versus our long-term targets. As deflationary pressures continue to encourage a lower interest rate path, both stocks and bonds should benefit so long as growth concerns do not take the lead as the main reason for lower rates in the case of recession.

Stocks are poised to benefit from decent earnings growth as driven by trend-like economic growth, healthy labor markets, and lower prevailing interest rates. Likewise, bond positions in portfolios will feel a tailwind from lower rates which along with improved absolute levels of yield post Fed increases are expected to provide attractive total returns in bonds.

With stocks and bonds expected to add value to portfolios over the coming year we have a fundamental basis for measured optimism in traditional portfolios. Where appropriate we continue to source differentiated private investment opportunities that provide diversified and uncorrelated sources of returns in client portfolios. The lack of institutional capital in some sectors as well as the evolution and proliferation of non-bank lenders of private capital remain attractive areas of focus. Our diligence process will remain anchored to our core tenants of sourcing opportunities with high integrity teams with proven and discernable track records of success.

Between the three levers of portfolio returns, Stocks, Bonds, and Private Investments, we are expecting ample opportunity to provide attractive risk-adjusted returns in client portfolios this year. However, risks to the economy and markets remain prominent, so a well-diversified portfolio is likely to be rewarded this year.

Sources: Ned Davis Research, Bespoke Investment Group, CME Group, St. Louis Fed, FRED, Strategas, JP Morgan Asset Management.