April 2024

"We are prone to overestimate how much we understand about the world and to underestimate the role of chance in events."

Daniel Kahneman

Q1 Market Recap

Q1 2024 was another banner quarter for stocks as better than expected economic momentum outweighed a higher-for-longer interest rate outlook. The U.S. employment picture looks good, the economy is growing, many stocks continue to notch all-time highs, and inflation is moderating. The S&P 500 was up over 10.6% in Q1, led by large caps. Similar to last quarter, growth beat value and small caps underperformed. Foreign stocks were up almost 6%. Emerging markets gained 2.4% despite ongoing uncertainty regarding China's growth potential. Interest rates moved higher in the quarter, driven by hotter than expected inflation reports and a patient Federal Reserve waiting for more progress on inflation before initiating rate cuts. Taxable bonds delivered a negative 0.8% return while municipal bonds were down 0.4% for the quarter. Private credit and junk bonds remained a bright spot benefitting from their floating rate profile and falling credit spreads.

Asset Class	Benchmark	March	Q1 2024
U.S. Large Cap Stocks	S&P 500 TR USD	3.2	10.6
U.S. Small & Micro Cap	Russell 2000 TR USD	3.6	5.2
Intl Dev Stocks	MSCI EAFE NR USD	3.3	5.8
Emerging Mkt Stocks	MSCI EM NR USD	2.5	2.4
Global Stocks	MSCI ACWI NR USD	3.1	8.2
U.S. Municipal Bonds	Bloomberg Municipal TR USD	0.0	-0.4
U.S. Taxable Bonds	BBgBarc US Agg Bond TR USD	0.9	-0.8
U.S. High Yield Bonds	BBgBarc US Corporate High Yield TR USD	1.2	1.5
Intl Dev Bonds	S&P International Sov Ex-US Bond TR USD	0.2	-4.3
U.S. REITs	MSCI US REIT NR USD	1.7	-0.6
Broad Commodity Futures	Bloomberg Commodity TR USD	3.3	2.2
Energy Partnerships	Alerian MLP TR USD	4.5	13.9
Gold	DJ Cmmdty Gold TR USD	8.3	7.4

Source: Morningstar as of 3/31/2024

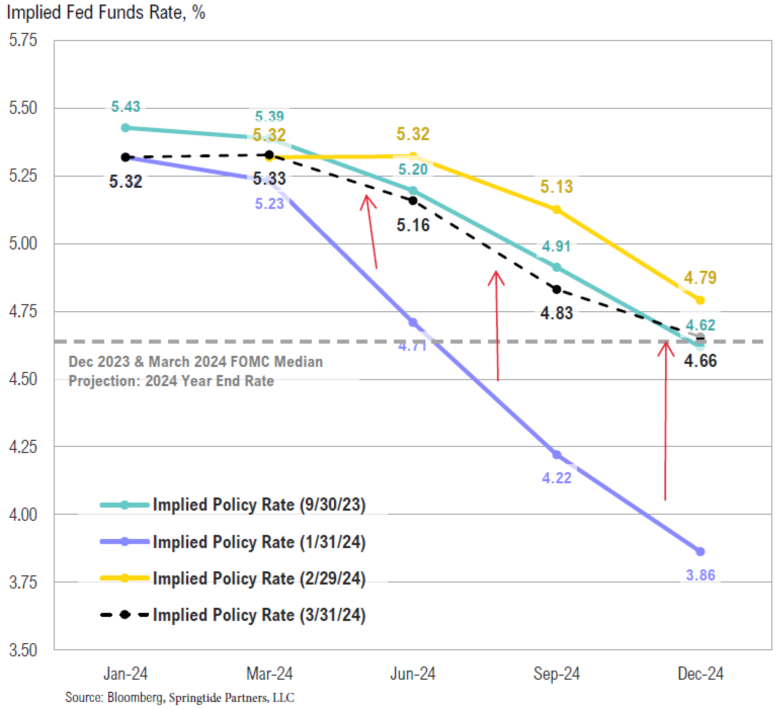
Investor sentiment and CEO optimism are high and rising. The former may be a contrarian signal while the latter may help support equity prices via corporate buybacks. U.S. manufacturing expanded in March, defying a 16-month contractionary trend, suggesting that economic momentum will continue in the first half of the year.[1] With a U.S. presidential election on deck for this fall and increasing geopolitical tensions overseas, investors will have no shortage of events and market trends to monitor this year.

When Will the Fed Cut Interest Rates?

Investors may have gotten ahead of themselves in Q4 2023 anticipating as many as six rate cuts in 2024. Data dependent Fed officials continue to forecast three rate cuts this year but want to see sustained

[1] ISM Report on Business. March 2024. Based on sources deemed reliable but which have not been independently verified. Please see Important Disclosure Information at the end of this presentation.

disinflation over time. Interest rates increased due to higher-than-expected inflation data in January and February. As seen on the chart below, this led interest rate traders to dramatically reduce their rate cut expectations in the first half of the year. Markets are now expecting interest rates to stay elevated for a longer time. The global economy has largely shrugged off higher interest rates. By refinancing debt in 2020 and 2021, homeowners and businesses alike benefited from historically low interest rates. Consider the fact that almost 40% of American homeowners do not have a mortgage[2], and it is easy to see why 7%+ mortgage rates have not dented the economy.

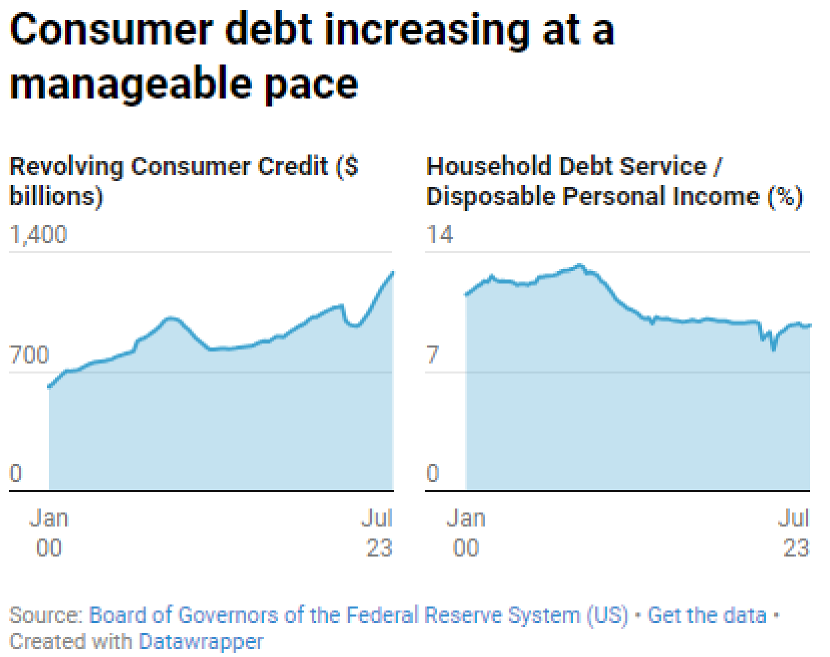


Higher rates have caused collateral damage in several sectors of the economy such as banking and real estate. There is a tremendous amount of commercial real estate debt coming due in the next few years with most of it owned by smaller banks. We anticipate those with weaker balance sheets may face tough decisions in the year ahead which may create opportunities for others. Successful real estate investors will have to do more than hope they can sell at a lower cap rate to generate profits.

The US Treasury yield curve hit the longest inversion on record in March (as measured by the 10-Year Treasury yield minus the 2-year Treasury yield) highlighting the difficulty in using traditional leading recession signals to forecast economic momentum.

Consumer Leverage

Some investors are concerned that strong consumer spending is rising at an unsustainable rate financed by credit cards. While revolving consumer credit has risen meaningfully over the past year (see chart to the right), so too have personal incomes. Household debt service ratios remain below pre-COVID levels and are at multidecade lows. The rise in revolving credit looks even more benign when comparing to the overall growth in U.S. household net worth which is estimated at a staggering $150 trillion.[3]



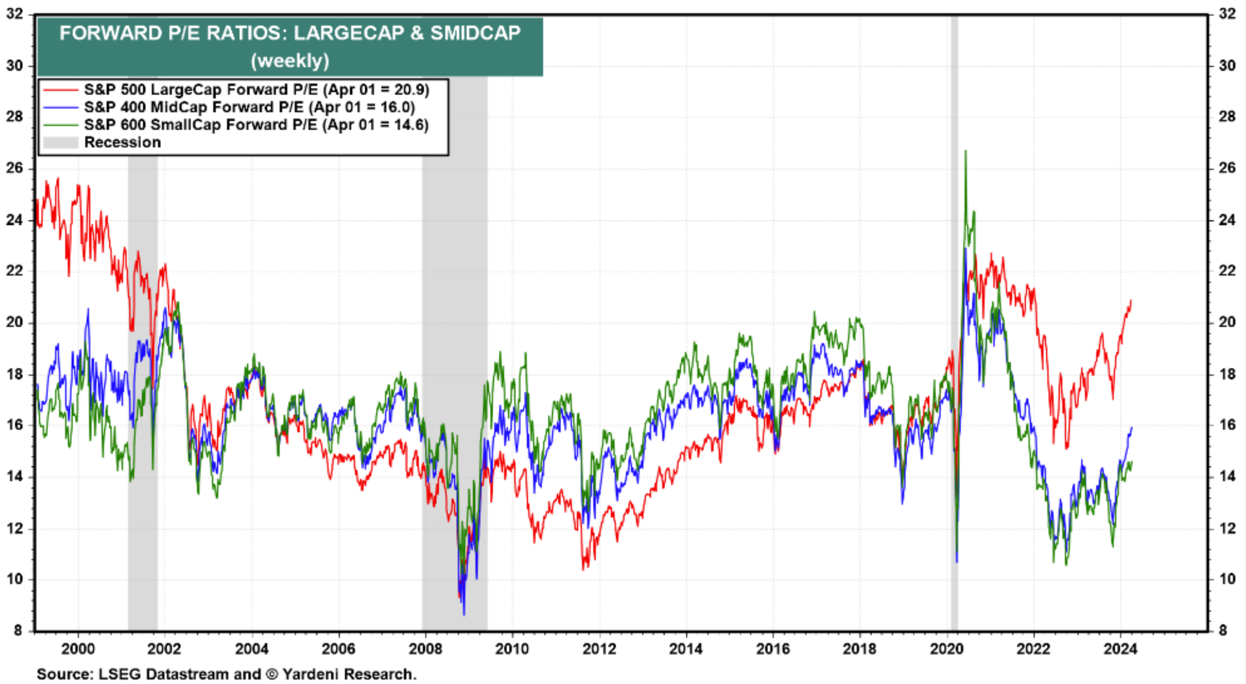
2 U.S. Census Bureau as of December 2023.

3 J.P. Morgan Guide to the Markets. Q1 2024 .

U.S. households hold an estimated $3.8 trillion in money market assets. This translates to more than $190 billion in excess annual interest income that did not exist during the zero-interest rate policy regime we grew accustomed to following the global financial crisis. Even though it is most likely being reinvested, this excess interest may be creating a wealth effect for consumers.

Stock Valuations

Large cap U.S. stocks look rich relative to 25-year average valuations but reasonable on a price to earnings growth basis. There are pocket of lower valuations in small caps, various equity sectors, and international equities. From a style perspective, growth looks expensive relative to value. This should be expected as



growth stocks have delivered larger earnings growth in this cycle. International stocks remain out of favor and continue to trade at record price to earnings discounts relative to U.S. stocks. Starting valuations matter tremendously for go-forward returns. At some point, investors may take notice and start to increase allocations to foreign stocks.

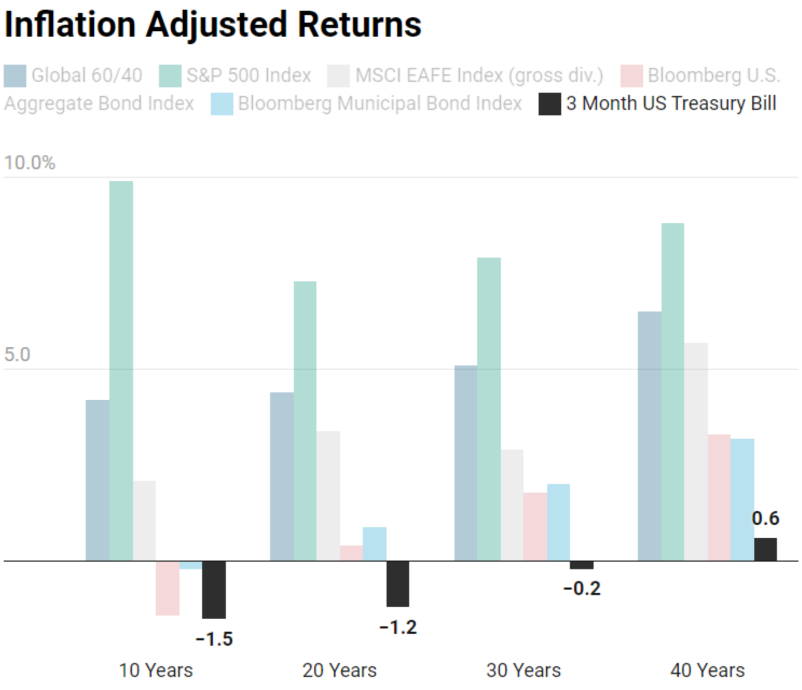
Market breadth widened during the quarter. The number of high-performing sectors broadened beyond mega cap tech and communications stocks. At the same time, corporate fundamentals as measured by earnings growth and profit margins have held up despite a rising cost of capital. This year's earnings growth estimates reflect optimism as analyst consensus calls for an 11% increase in earnings and a 5% increase in revenues.[4] Managing earnings expectations is par for the course for public company executives. If lofty growth metrics are not achieved, many high-flying growth stocks may be vulnerable at today's market valuations.

Risks Waiting to Invest

Many investors with idle cash have taken advantage of higher interest rates and are earning ~5% in money markets. Given our experience investing through low interest rates, for some, this looks like an attractive place to wait for better entry points into the market. Timing the market requires a great deal of luck and skill to get right. Good buying opportunities are only evident after the fact. Cash has delivered a 0.6% annualized

[4] FactSet. Earnings Insights. 4/5/2024. Based on sources deemed reliable but which have not been independently verified. Please see Important Disclosure Information at the end of this presentation.

real return over the past 40 years (see chart on the right) highlighting that while today's short term interest rates are relatively appealing as an investor, it carries a great deal of risk from a long-term wealth accumulation perspective.



Source: DFA. Period ending 2/29/2024. Global 60/40 (40% S&P 500 Index, 20% MSCI EAFE Index, 20% Bloomberg US Agg Bond Index, 20% Bloomberg Municipal Bond Index. Rebalanced monthly) • Created with Datawrapper

US large caps may be trading at premium valuations, but there are plenty of other opportunities to invest in markets with higher expected returns. For high income taxpayers, longer dated municipal bonds offer a compelling return profile. Investors can buy 10-year munis around 4% on a tax-exempt basis, or around 7% on a pre-tax basis for the highest income taxpayers. Interest rates may rise further if economic momentum continues but adding to a negatively correlated asset (relative to stocks) at current levels is prudent risk management. Should inflation continue to moderate and interest rates follow their historically high correlation with inflation, we should expect to see interest rates fall over time. Such a trend would further benefit investors with some exposure to longer dated bonds.

Thank you for your continued trust. Please contact your PCM advisor with any questions specific to your financial situation.

Sincerely,
The Private Capital Management Team

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