SAGE 2024 INVESTMENT OUTLOOK

2023 in Review: A Bitter Start for Financial Markets with a Sweet Ending

- Last year brought a collective rebound for major economies and financial markets. There were unsettling moments and expectations of a domestic recession that caused uncertainty and short-term discomfort, including the failure of a handful of banking institutions over a short period in March and war, with all its violence and distress, persisting on in Ukraine and erupting in the Middle East.
- Nonetheless, the U.S. consumer and economy proved particularly resilient, and the year closed with a "noteworthy financial markets rally" in the fourth quarter that provided an uplifting finish.
- After 2022 delivered an outlier year of negative stock and bond returns, this past year was a welcome experience for investors as both provided positive returns.
- Fixed-income markets ebbed and flowed throughout the year, almost syncing with the seasons.
    - U.S. bond yields fell strongly in the first quarter of 2023 during the banking uncertainty. The yield on the U.S. 10-year Treasury Note declined from 3.9% to 3.4% in just three months.
    - But the stress eased during the second quarter when U.S. regulators and the Fed provided a backstop for depositors concerned with the stability of U.S. banks.
    - However, by the middle of the summer, it became apparent that most major central banks had not finished raising interest rates, and U.S. investment-grade core bonds fell back into negative territory.
    - From mid-October onward, incoming data and constructive commentary from central banks that rate cuts could begin earlier than expected in 2024 led to a significant bond rally. The yield on the U.S. 10-year Treasury Note fell from nearly 5% in mid-October to 3.9% by the end of the year, ending the year almost exactly where it started.
    - Notably, U.S. municipal bonds increased 6.40%, taxable U.S. investment-grade bonds climbed 5.53%, while emerging markets debt stood out, returning 11.90% in 2023.
- Global equity markets navigated through all the headlines and experienced positive returns in 2023. A strengthening economy, reflected by a 5.2% annualized Q3 GDP growth, coupled with decreasing inflation leading to anticipated lower interest rates, drove equity returns during the latter part of the year.
    - U.S. large-cap equities returned 26.53%, the second strongest calendar year gain over the last ten years, although an equal-weighted version of the index rose only 13.87%. This is reflected by the fact that U.S. large-cap equities were led by seven mega-cap technology stocks spurred by the markets' growing excitement about the prospects for wider spread adoption of artificial intelligence.
    - Known as the "Magnificent 7," these large technology companies became investor favorites due to their resiliently high margin and sales growth. The seven stocks now make up 28.1% of the large-cap market cap but only about 20% of earnings.
    - Mid- and small-cap equities struggled after the banking crisis and the Fed's restrictive monetary policy. However, similar to bonds, U.S. small and mid-cap equities rallied strongly after the Federal Reserve indicated it may ease rates in early 2024. Mid-cap equities returned 17.23% for the year, and small-cap equities returned 16.93%.
    - International large-cap stocks and emerging market stocks also posted strong positive returns of 15.62% and 9.83%, respectively. This reflects the ongoing preference of U.S.-based investors to overweight domestic stocks amid a strong U.S. dollar and global geopolitical uncertainty.

Category	December	2023	5-Year (2019-2023)	10-Year (2014-2023)
U.S. Municipal Bonds	2.32	6.40	2.25	3.02
U.S. Taxable Bonds	3.83	5.53	1.10	1.80
Emerging Market Bonds	3.97	11.90	1.40	1.65
Global Equities	4.80	22.20	11.68	7.90
U.S. Large-Cap Equities	4.94	26.53	15.47	11.77
U.S. Mid-Cap Equities	7.73	17.23	12.64	9.39
U.S. Small-Cap Equities	12.22	16.93	9.94	7.13
International Equities	5.02	15.62	7.06	3.82
Emerging Market Equities	3.91	9.83	3.67	2.65
Multi-Asset Alternatives	0.40	4.42	2.58	1.38

Source: FactSet, Sage Financial Group. Current year performance is through December 31st, 2023. U.S. Municipal Bonds are represented by the Bloomberg Barclays Muncipal Bond Index. U.S. Taxable Bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Emerging Market Bonds are represented by the JPM EMBI Global Diversified Index and JPM GBI-EM Global Diversified Index (50% USD/ 50% Local Currency). Global Equities are represented by the MSCI All Country World Index. U.S. Large-Cap Equities are represented by the Russell 1000 Index. U.S. Mid-Cap Equities are represented by the Russell Mid Cap Index. U.S. Small-Cap Equities are represented by the Russell 2000 Index. International Equities are represented by the MSCI All Country World ex USA Index. Emerging Market Equities are represented by the MSCI EM Index. Multi-Asset Alternatives are represented by the Wilshire Liquid Alternatives Index.

- Throughout 2023, Sage proactively sought to enhance portfolios in anticipation of opportunities created by the relatively high yields on investment-grade fixed income.
- Specifically, where appropriate, we made tactical additions to U.S. and global investment-grade core bonds and rebalanced overweighted U.S. equities to be consistent with Sage’s target allocations.
- In our view, combining a diversified portfolio and a disciplined commitment to your investment strategy increases the probability of achieving your financial goals and realizing the benefits of sudden, unexpected, strong market returns. For example, an investment in the S&P 500 would have realized a 10.7% return from 2007 to 2022. However, missing the ten best market days would have resulted in a return of only 5.1%, less than half of the return achieved by remaining fully invested in the market.[1]
- While we are nimble and respond to current market trends and themes, we do not let volatility distract us from our core investment objectives and client goals. As we have said before, over the long term, market returns are driven by economic growth, inflation, and productivity.
- Ultimately, 2023 was a year of recovery we prepare to build on in 2024 and beyond. We faced challenges, but we also witnessed several unexpected positive economic outcomes. Perhaps most notably, the widely predicted economic recession has not materialized to date.

[1] Source: Putnam Investments from 12/31/2007 to 12/31/2022. Data is historical. Past performance is not a guarantee of future results.

2024 Sage Outlook: Preparing for the Landing

- Our base case for 2024 is that attention will shift from elevated inflation to economic growth as the Fed and other central banks conclude their rate-hiking cycles.
    - In the U.S., we believe the economy will continue to grow, but in the range of 1.5% to 2.0%, modestly below the longer-term trend. While tight monetary policy is expected to ease over the coming quarters, the 2024 election cycle should keep both political parties from implementing impactful fiscal policy. We believe that economic growth and inflation impact financial markets more meaningfully than U.S. presidential election outcomes.
    - In developed markets, the story remains fluid around Europe and Japan. Optimism is muted in Europe as higher interest rates have dramatically lowered inflation but at the cost of consumer health. Focusing on shareholder-friendly practices has boosted corporate profitability and stock prices in Japan. However, the Bank of Japan appears poised to phase out a yield curve control program, with market implications unclear.
    - Although China continues to underwhelm investors, the spotlight within emerging markets has widened as India, Mexico, and Brazil take the stage. Balance sheet improvement across several emerging market countries and a realignment of global supply chains have provided some notable country-specific tailwinds.
- In 2024, our approach will focus on positioning for unanticipated risks and evaluating various scenarios based on evolving market conditions.
    - Also top of mind will be the health of corporate America, potential anti-trust litigation headwinds for mega-cap technology companies, and the broader geopolitical environment, the course of which we should be able to anticipate ahead of time.

2024 Major Economic Themes

We believe three themes are likely to have a meaningful impact on the broader economy and, subsequently, financial markets:

1. **Global Central Banks Begin to Cut Rates**
    - Over the last 18 months, global central banks in the developed world, including the Fed, have relied on higher interest rates (policy rates) to curb inflation. The consensus in the U.S. and abroad is that rates will be cut several times in 2024.
    - The timing and quantity of these cuts will be critical. Currently, central bankers are treading water in the soft-landing pool. Global economic growth continues to cool, but labor markets have not.
    - Economic growth outside of the U.S. is expected to remain primarily muted in 2024. As a result, we expect central banks to avoid a reactionary outcome and cut rates before inflation levels return to long-term targets. Lower interest rates should support stocks and bonds if economies are growing.

2. **Cash Moves Off the Sidelines**
    - Despite 11 Fed interest rate increases since March 2022, the road to 2% target inflation has gradually slowed. In response, the allure of cash as a defensive asset increased in 2023, with money market assets nearing $6 trillion in the latter half of the year.
    - Historically, however, cash has been an underperforming asset class in periods following a final Fed rate hike, and money markets see asset outflows as the Fed cuts rates.
    - In 2024, we expect a shift away from cash as interest rates decline, creating a performance tailwind for stocks and bonds.
3. **A Productive Economy is a Stronger Economy**
    - In addition, we believe two key factors related to productivity will help move domestic inflation toward the Fed's 2% target: the recent ramp up in corporate capital expenditures alongside ongoing initiatives to further utilize technology and integrate artificial intelligence to boost operational efficiencies and increase corporate productivity.
        - Less pressure on global supply chains and reduced costs to corporations should support the continued easing of inflation, allow for less restrictive monetary policy, and support both stocks and bonds.
        - Emerging technologies are poised to boost global economic productivity. In 2023, ChatGPT became the fastest-growing consumer application, reaching 100 million users just two months after launch.

Fixed Income Outlook: Income Has Returned Following A Great Reset

- As we have discussed, to quash inflation, the Federal Reserve increased the Fed Funds rate from 0.0% at the beginning of 2022 to 5.25% by the end of 2023. The aggressive campaign to push inflation back toward 2.0% appears to be winding down two years later.
- The Federal Reserve Open Market Committee (FOMC) suggested a "pivot" in policy is underway. Consensus projections among FOMC committee voting members expect three rate cuts in 2024.
- We favor investment-grade intermediate-term bonds, which now offer higher income levels than we have seen in more than a decade. Moreover, these bonds allow for potential price appreciation in a controlled manner, effectively mitigating the impact of interest rate fluctuations, especially if rates fall.
- Outside the U.S., several central banks, including Brazil, have begun their easing cycle. Given the high coupon bonds issued by EM countries and support from declining rates, we believe emerging markets debt provides attractive investment return opportunities.
- In our view, the double-digit income produced by bank loans offers a cushion if defaults increase. High-yield bonds provide less downside protection in a more adverse environment since high yield is less senior in the capital stack than bank loans. We believe investors are not being adequately compensated for this risk.
- We continue to think that allocating to Treasury Inflation-Protected Securities (TIPS) makes sense for more conservative portfolios with significant fixed-income exposure.
- Tactically, we continue to find opportunities across global credit and sovereign markets that should provide differentiated return streams to complement a high-quality U.S.-focused bond portfolio.

Equity Outlook: Opportunity Awaits Those Who Look

- 2023 pleasantly surprised investors in U.S. equity markets. While we expected the economy to slow in 2023, we were cautiously optimistic about equities coming into the year. This cautious optimism was met as equity investors experienced double-digit returns.
- In the year ahead, we remain cautiously optimistic about U.S. large-cap stocks. However, following the concentrated rally in 2023 in mega-cap U.S. technology stocks, we are concerned about concentration risks in this part of the market and find more opportunities in their U.S. mid and small-cap counterparts.
    - Smaller companies are more sensitive to the direction and level of interest rates in an economy, which should provide a performance tailwind if the Fed begins to cut rates.
- Looking beyond the U.S., we continue to believe that international equities are attractive from a value standpoint and can enhance returns of portfolios both in absolute terms and relative to the domestic market. We think the broader composition and more attractive valuations in place across international markets can provide beneficial diversification given correlation levels across U.S. large-cap equities.
    - Though we remain constructive on the broader opportunity outside the U.S., we are deliberately allocating portfolios to mitigate exposure to specific regions or countries, such as China, that have shown a recent propensity to impact equity markets negatively.
    - We value the merit of selective equity exposure from China in portfolios but do so by keeping an underweight position relative to the MSCI All Country World Index.
    - In Europe, current valuations are enticing, but we prefer to remain cautiously balanced in the region as we see no clear catalyst for earnings growth.
    - Another potential catalyst for international equities is the strength of the U.S. dollar, which declined by more than 2.11% in 2023. Lower policy rates in the U.S. should put additional downward pressure on the U.S. dollar.
- As we look ahead, we believe that managing portfolio equity exposure with balanced optimism should help Sage clients grow their portfolios over investors' particular time horizons. We anticipate slower global growth in 2024, which has tempered our expectations. However, if companies sustain earnings growth and defend profit margins, both U.S. and international equities should provide another year of positive performance.

As always, we will continue to closely monitor, analyze, and evaluate market, geopolitical, and economic data, consider any implications for investors, and advise you of significant developments that could impact your investments.