Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

Quarter ending
DECEMBER | 2023

On the Radar Screen

1. **Slowing inflation is good news, but it implies that revenue growth is also waning even as wage growth remains elevated.** Profit margins may be at risk. Upcoming earnings releases will shed some light on the matter.
2. **A powerful stock market rally and rapidly falling bond yields in the third quarter** have relaxed financial conditions despite a still tight Fed policy. Be mindful of a potential resurgence of inflationary pressures.
3. **Both personal and corporate bankruptcy filings rose across 2023** as higher rates gradually caught up with stressed borrowers. Watch to see if the trend persists and if it comes to infect credit spreads.
4. **Higher interest rates, depleted excess savings and slower payroll growth notwithstanding,** retail sales marched ever higher in 2023 in both nominal and real terms. Do households still have the wherewithal to keep increasing consumption?

Insights from Multi-Asset Solutions' Portfolio Managers

"What we anticipate seldom occurs; what we least expect generally happens."

– Benjamin Disraeli

Nostra Culpa. For at least a year now, we have been sounding the alarm regarding a looming recession. During this time, investors have faced a daunting array of recessionary indicators spanning financial markets (inverted yield curve), survey evidence (weak PMIs, declining capex intentions, tightening bank lending standards), and hard economic data (depressed volume of existing home sales, rising auto loan and credit card delinquencies). And yet, recession has clearly not arrived. Output growth has been robust, the job market remains healthy, household spending continues to climb, and investment in risk assets has been well rewarded. This leaves us with a great deal of egg on our faces, the discomfort of which is assuaged only modestly by the fact that we have more than a little company in that regard.

The soft landing/no landing chatter has been turned up to full volume, and contextual support for such an outcome is building. Inflation has slowed markedly, lower interest rates are widely anticipated, confidence as measured by the University of Michigan's Consumer Sentiment Index has rebounded sharply, new unemployment insurance claims have rolled back over to historically low rates, and the outlook of homebuilders has grown distinctly more favorable in sympathy with the pullback in mortgage rates. But the $64,000 question still stands: has a recession truly been avoided outright, or has it just been delayed?

We understand that pessimism/cynicism is an unproductive quality in asset management, both from an asset gathering perspective and often when it comes to generating strong investment results. Risk-taking tends to be rewarded over time, after all. With the benefit of hindsight, it is clear such was the case in 2023. Even so, we believe a measure of caution was appropriate then and remains so today. Bond yields have come down and

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short rates are expected to do so in the year ahead, but they are still much higher than they were two years ago. Those who need to refinance – households and businesses alike – will feel the pinch. Consumer spending will eventually be squeezed by higher interest costs. Business expansion plans/projects that were economically viable a short while ago may not be today, due to high borrowing required rates of return. A sharp slowdown in economic activity still looks hard to avoid.

"To every complex problem, there is a solution that is clear, simple and wrong." – H.L. Mencken. One can declare oneself a bull or a bear easily enough, but finding an efficient implementation of that view can be challenging. There is more to it than just leaning into or away from equities. It requires nuance.

As evident from the paragraphs above, we favor the bear camp, but having been so recently reminded that forecasts are inherently fallible, we are loathe to shy away from stocks or credit instruments broadly. Rather, we look to skirt some of the more hazardous corners of the market, allocating instead to segments we believe likely to hold their ground better under adverse circumstances. An example of this relates to the Magnificent 7, that grouping of mega cap companies that dominated market performance over the past year and now trade at exceptionally high price multiples. Below those seven names, the large cap universe looks far more reasonably valued and is likely to be less sensitive to economic swings than the SMID cap space. To gain exposure to large cap stocks while deemphasizing the Magnificent 7, we have built sizable positions in the equally weighted S&P 500 Index (in which the weight of the top seven companies is about 95% lower than in the standard cap-weighted version of the index – 1.4% versus almost 30%). At the same time, we well appreciate the importance of developments in artificial intelligence and the role it has played in index performance. To participate in that theme, but to do so in a manner we believe to be more constructive, we have invested in firms focused on digital infrastructure (data centers, wireless communications, fiber optic cable installations, etc.) available at more attractive valuations.

That is but one example of how our assessment of market dynamics flows through into positioning. We also favor low volatility stocks, Japan over Europe within developed international markets, smaller and faster growing economies over China within emerging markets, and specific themes such as uranium miners where structural factors provide a tailwind.

"Time is your friend; impulse is your enemy." – John Bogle. Our patience with our cautious view has been sorely tested. Call it stubborn if you will, but we are just not ready to capitulate and chase a hot market. Given restrictive monetary policy, waning bank lending, and depleted savings, it's hard for us to envision a fast-growing economy in the year ahead. And with today's rich valuations coupled with slowing top line growth and profit margins under pressure, it is equally hard to foresee another year of big returns for the S&P 500. As such, we are sticking to our knitting, staying close to our benchmark in terms of broad asset class exposure while adopting conservative and carefully targeted positioning within asset classes.

There is no assurance that the investment objectives will be met.

Past performance is no guarantee of future results, which will vary. All investments are subject to market risk and will fluctuate in value.

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About Risk

All investments are subject to market risk, including possible loss of principal.
Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.

MICHAEL HURLEY
Fort Independence Financial & Insurance
201 JONES ROAD 5TH FLOOR
WALTHAM, MA 02451-1600
www.fortindependencefi.com

ES.DBA.EagleEdge
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