

Investment Review & Outlook

March 31, 2024

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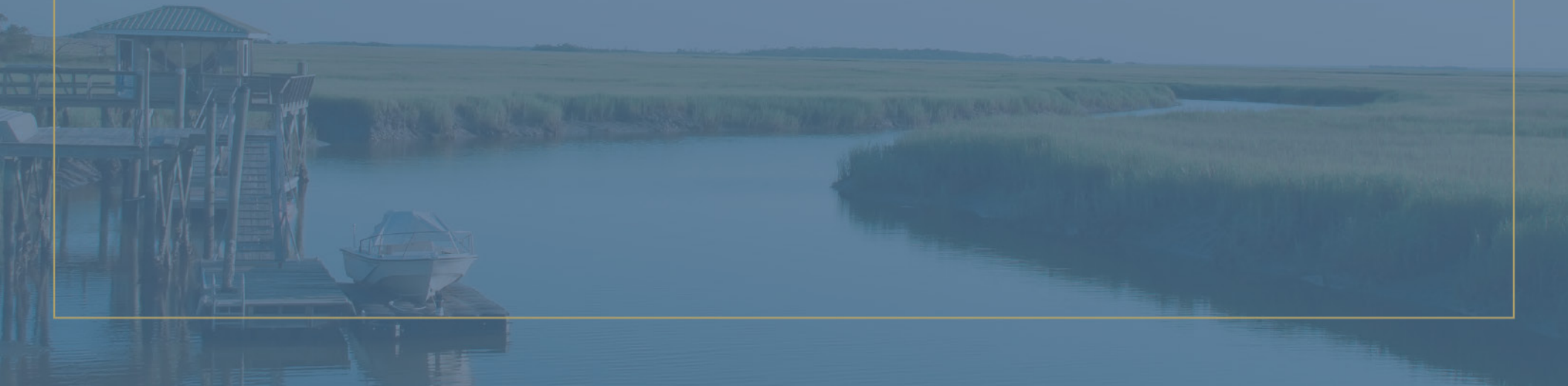
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REVIEW – FIRST QUARTER

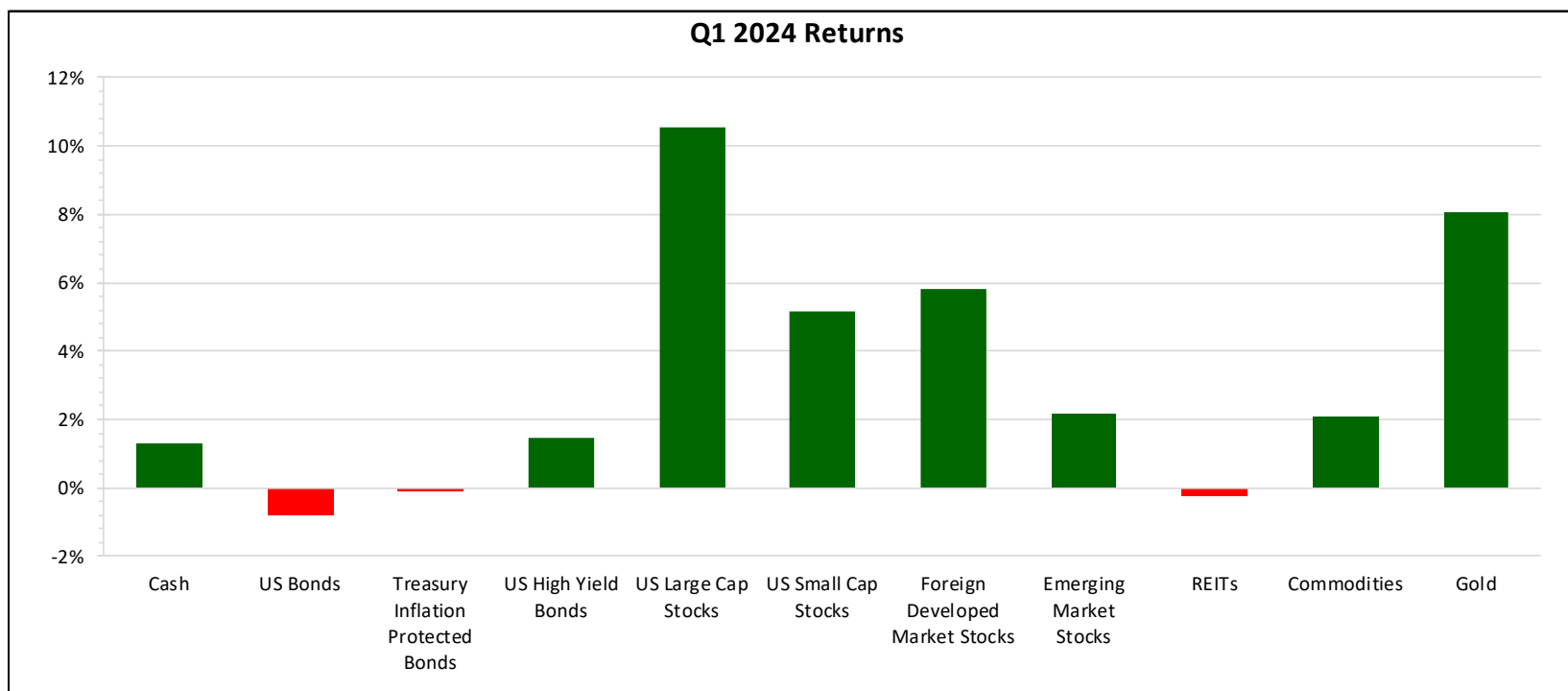
Events

- Compared to the remarks made in his November 2023 press conference, Federal Reserve Chair Jay Powell was more explicit about lowering short-term interest rates in 2024 during his press conferences on January 31 and March 20.
- Inflation continued to moderate, although it remains above the Federal Reserve's 2% target.
- The rate of economic growth has exceeded consensus expectations.
- In recent quarters, housing had been the weakest segment of the economy, declining for 16 out of 18 months. However, the rate of housing starts turned positive in three of the past four months.
- Confidence of consumers, business leaders, and investors shifted significantly from low levels to high.

REVIEW – FIRST QUARTER

Capital Market Returns

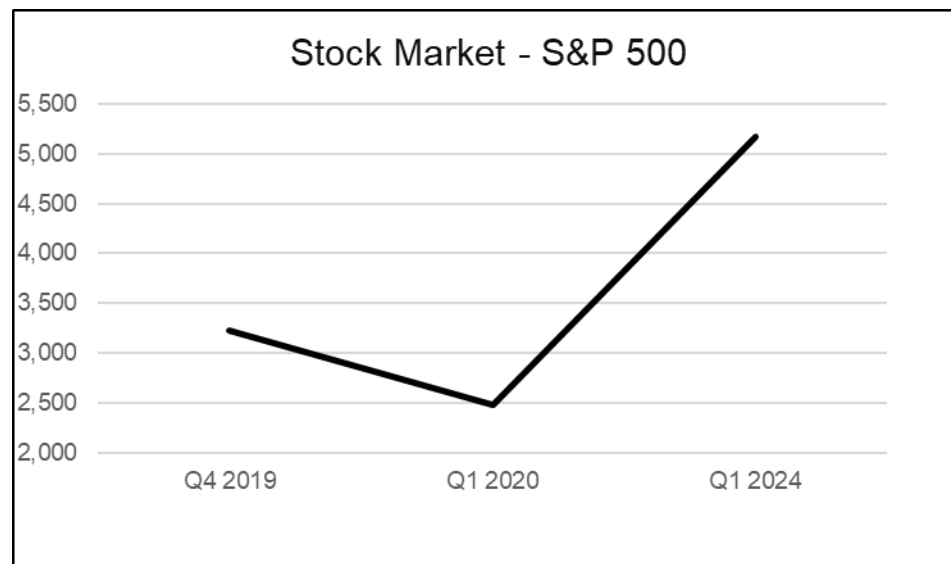
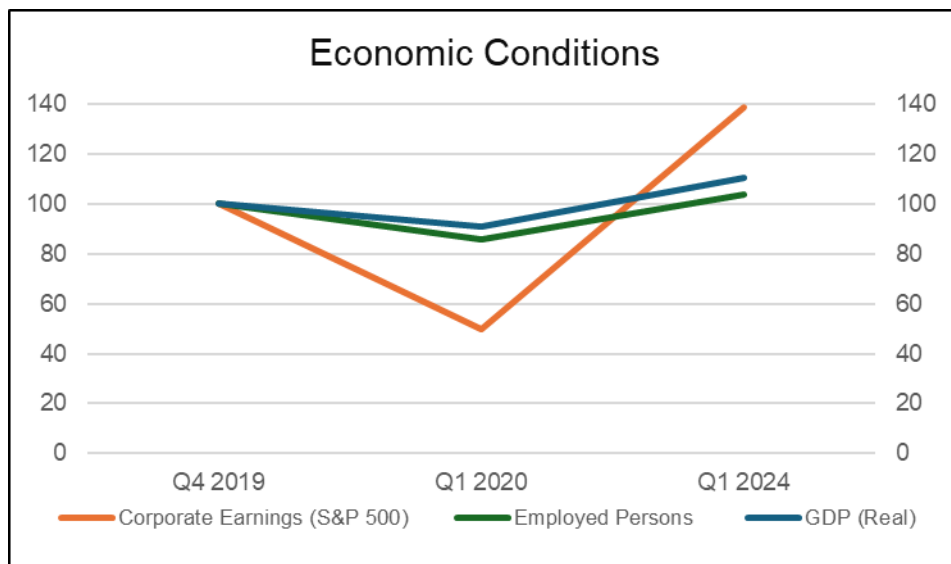
- Stronger than expected growth, the prospect of lower short-term interest rates, and improving confidence led to positive returns on equities.
- The yield on long-term bonds rose, causing their prices to decline. This often happens when the Federal Reserve announces its intention to lower short-term rates.
- Gold ended the first quarter at a new all-time high driven primarily by foreign Central Banks purchases.



REVIEW – Q1 2020 TO TODAY

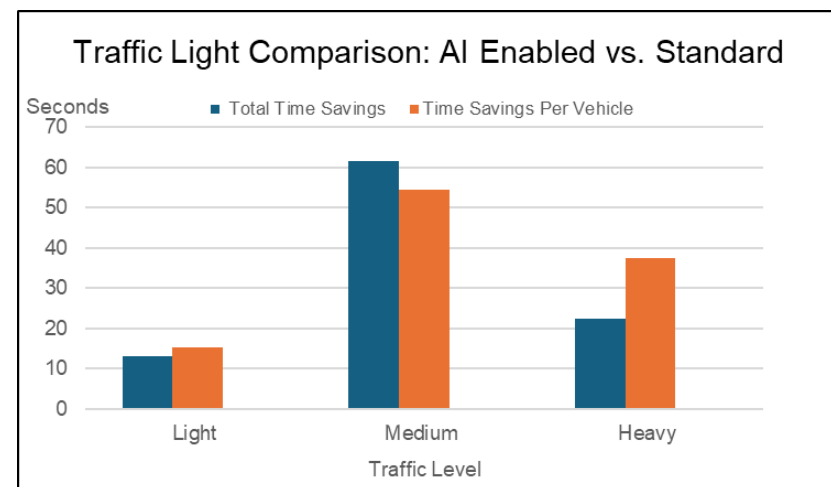
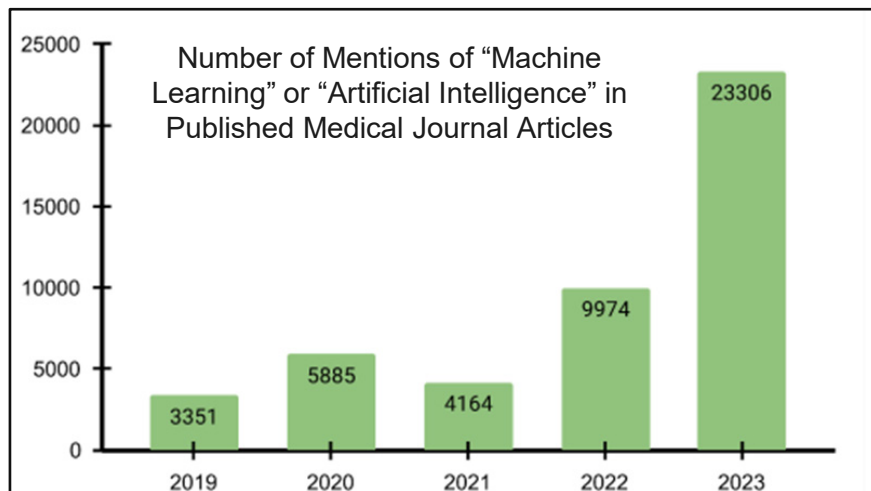
Recovery From Covid Shock

- At the onset of Covid, economic and capital market conditions deteriorated at the fastest pace since World War II.
- The recovery since Q1 2020 and its persistence has been remarkable.



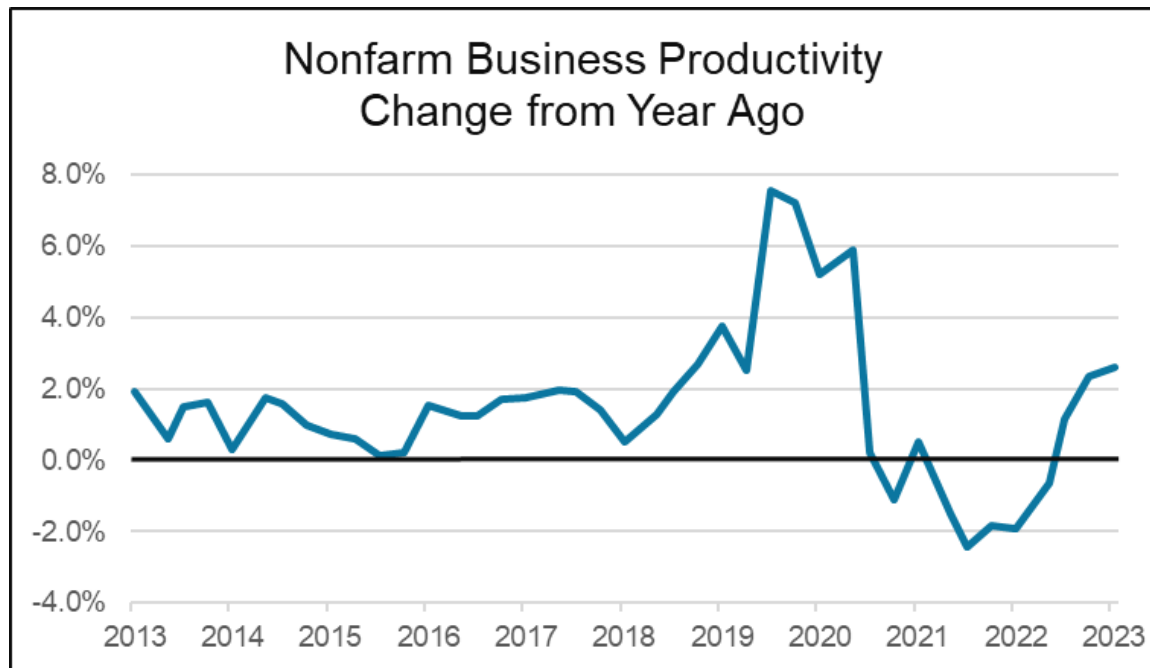
Economic Growth Through Improving Productivity

- The odds of a sustained period of productivity growth are the highest in at least two decades, driven by:
 - The pandemic accelerated by six years the rate of adoption and implementation of computer systems and software used to manage businesses.
 - Artificial intelligence is already increasing productivity and will expand over time – improving broad aspects of the economy from medical research to traffic congestion.



Economic Growth Through Improving Productivity

- The combination of the positive effects of accelerated computer systems adoption and the ongoing effects of artificial intelligence are likely to sustain the improving rate of productivity growth.
- Increasing productivity leads to higher living standards.

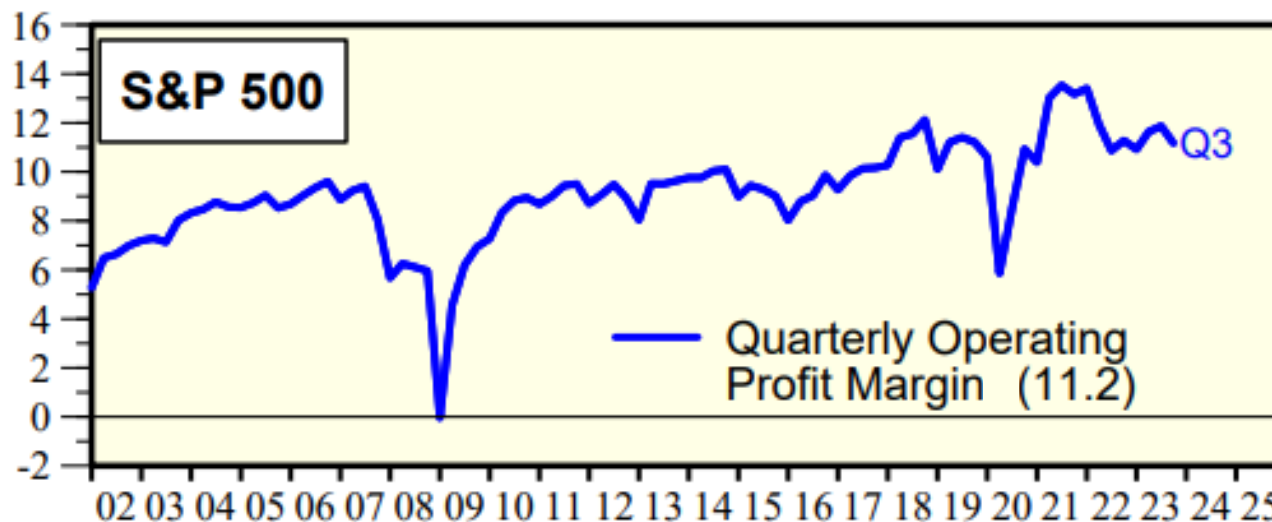




ECONOMIC OUTLOOK

Economic Growth Through Improving Productivity

- Rising productivity has driven corporate profit margins to their highest levels in years (excluding the distorted periods during the latter part of Covid).

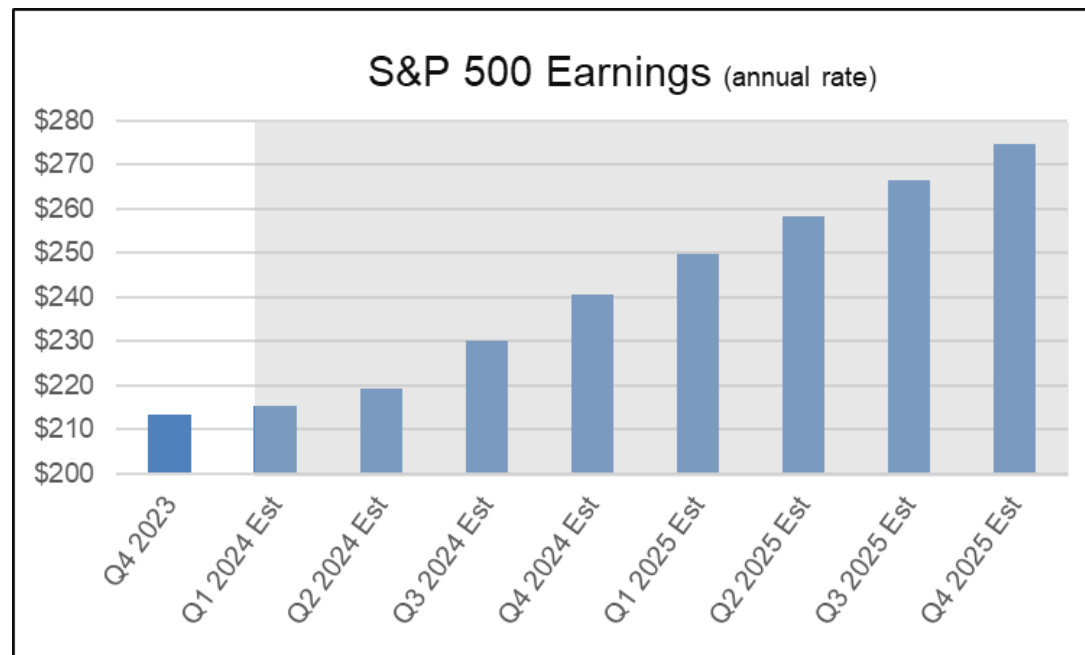




ECONOMIC OUTLOOK

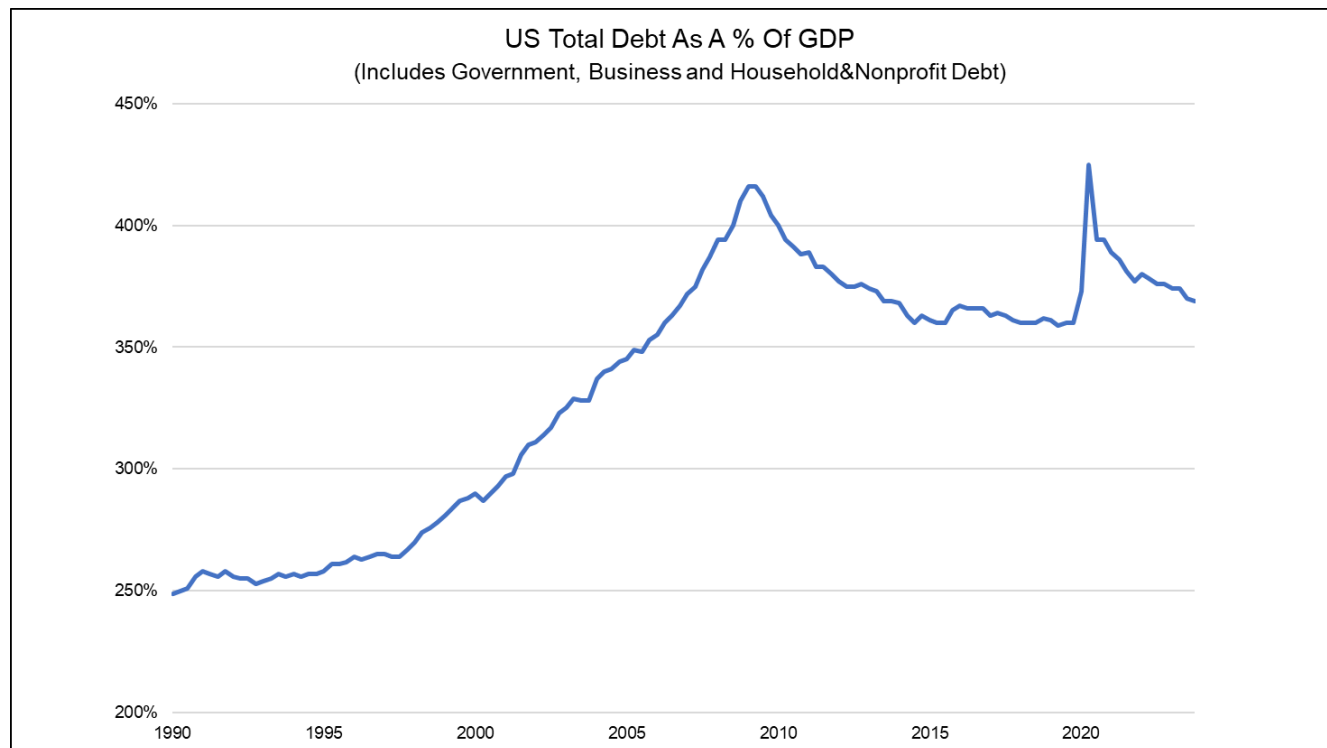
Corporate Earnings Projections

- Earnings are projected to improve further now that the shock of higher interest rates has worked through the economy.



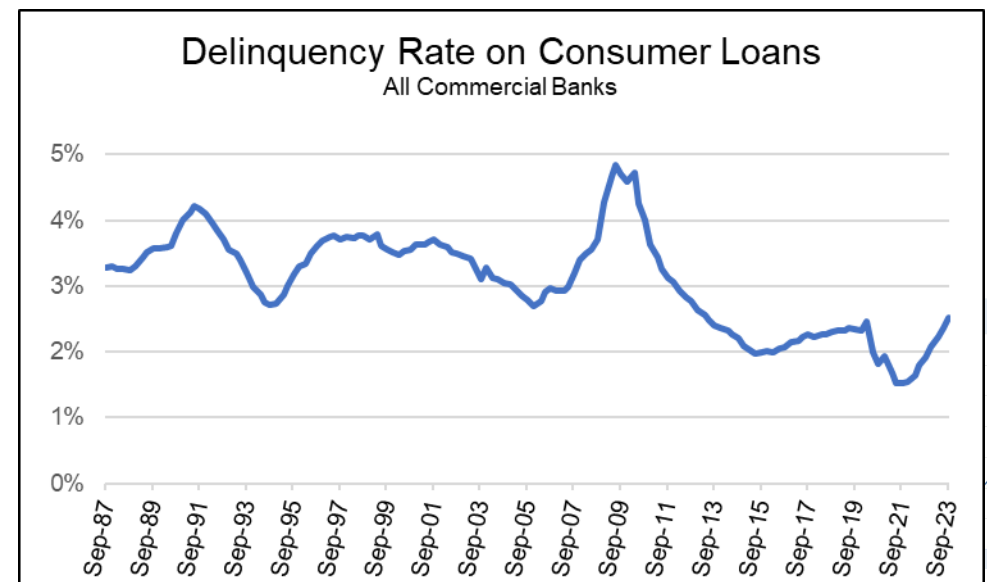
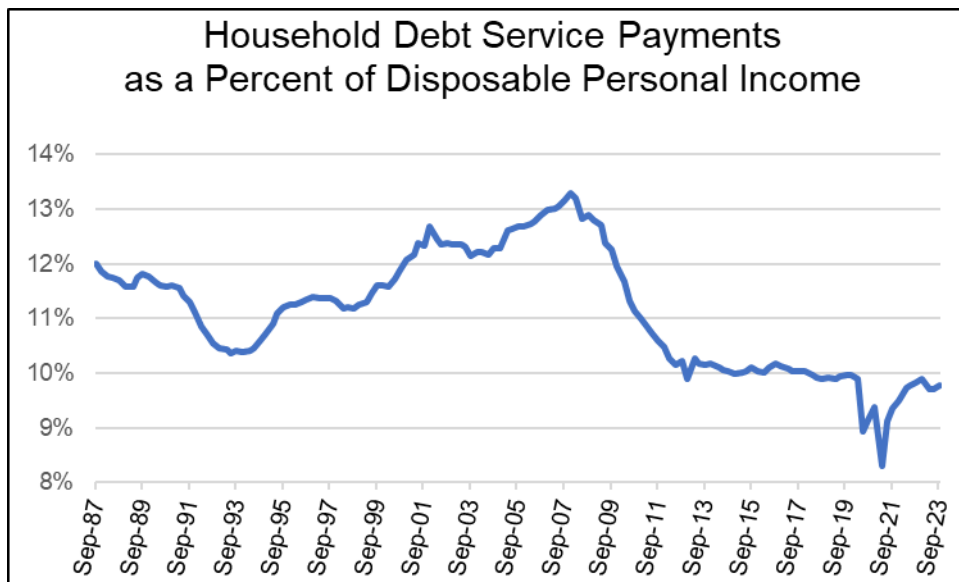
Debt – Economy-Wide

- Business, Government and Household/Nonprofit debt relative to GDP remains lower than previous peaks and has not increased for the first time in decades.



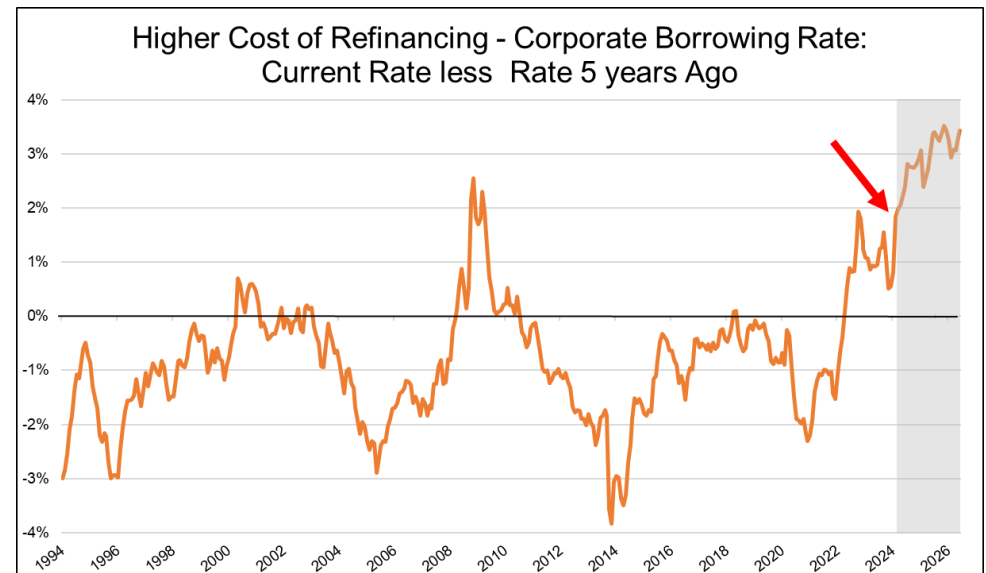
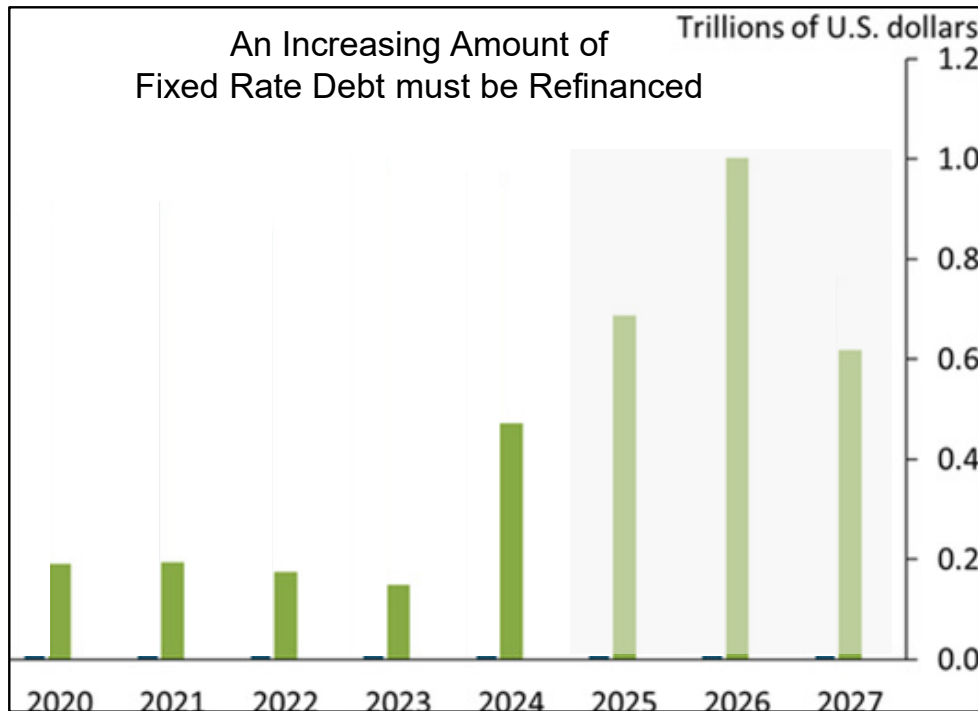
Debt – Households

- Debt payments for households have increased from pandemic lows but remain low compared to history.
- The fact that delinquencies are up indicates higher rates have disproportionately affected low-income households. However, these households account for only a fraction of economic activity.



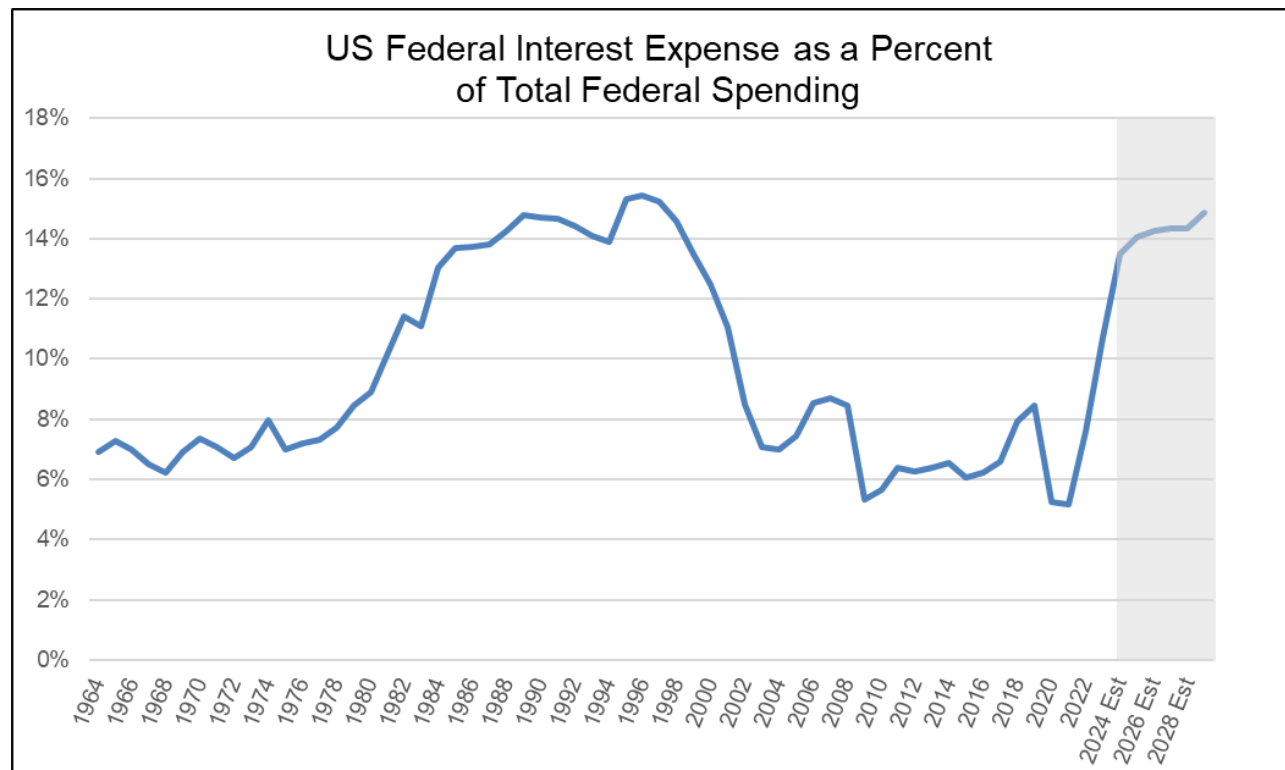
Headwinds – Effect of Higher Interest Rates – Businesses

- Businesses remain in good financial condition.
- Yet, higher interest rates will be a drag on growth as companies are forced to refinance at higher rates for the first time in more than 30 years.
- With high vacancy rates, commercial real estate is especially exposed to higher rates.



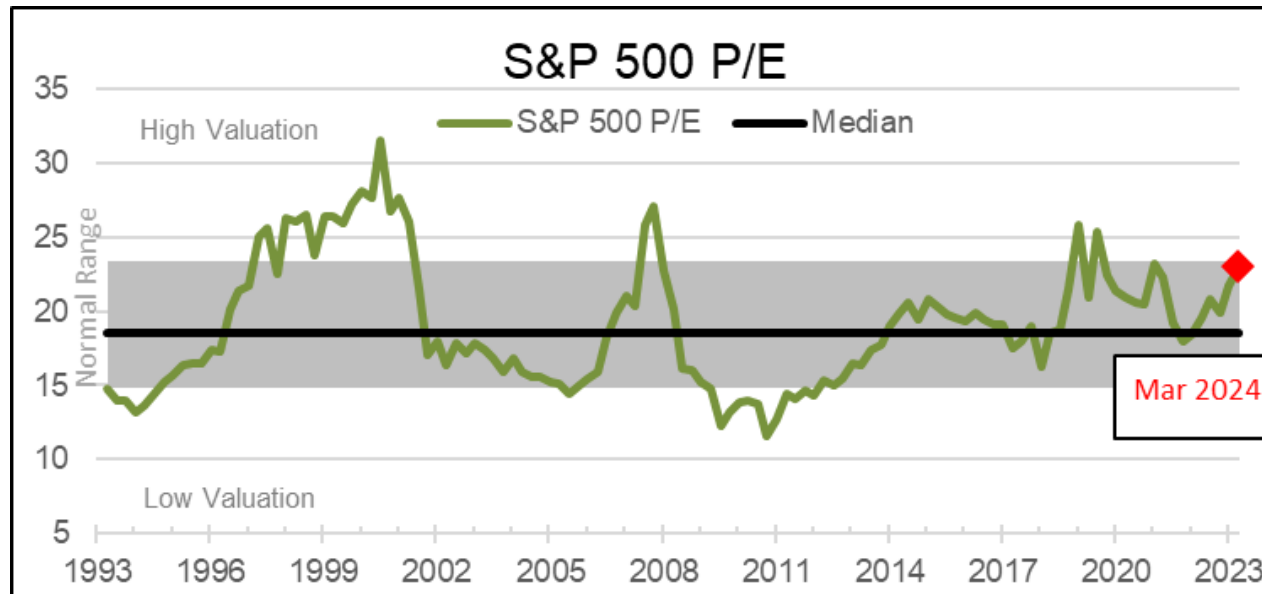
Headwinds – Effect of Higher Interest Rates – Federal Debt

- In just three years, the cost of servicing Federal debt has nearly tripled from historic lows of Federal spending at 5.2% to an estimated 13.5% in FY 2024.
- Higher interest payments displace the amount of funding available for social programs, investments, defense and other priorities.



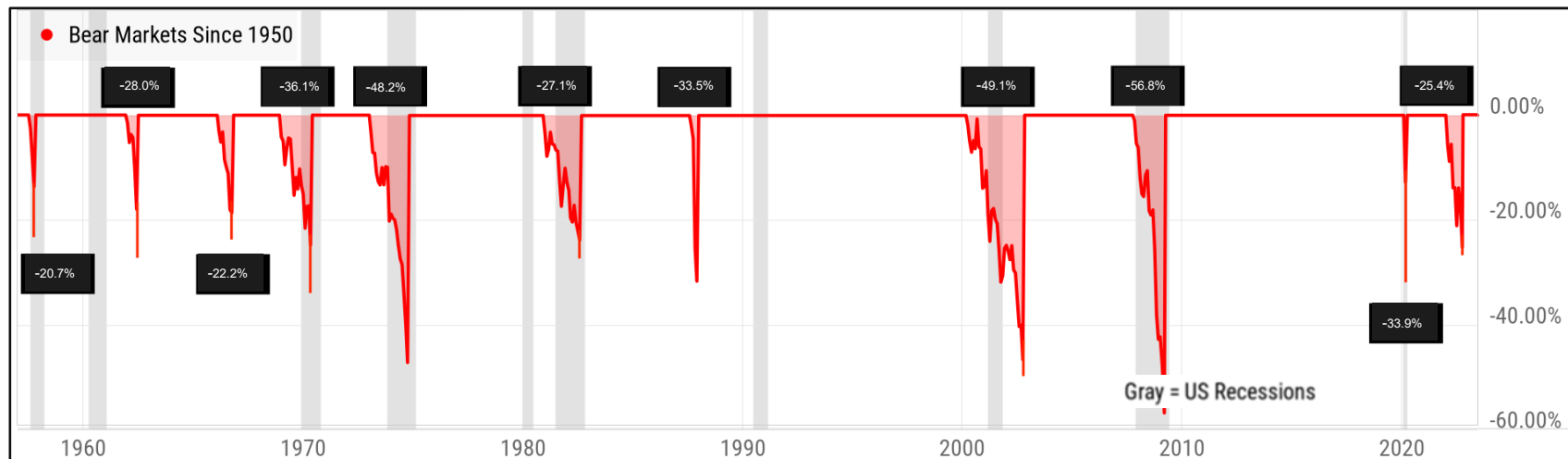
Equity Valuation

- Stock valuations are at the upper end, but within the normal range of valuations of the last thirty years, a period of predominantly low and stable inflation.



Equity Valuation

- Bear markets typically occur during recessions. Of the 11 bear markets since 1950, seven occurred around recessions. We do not anticipate a recession for the foreseeable future.

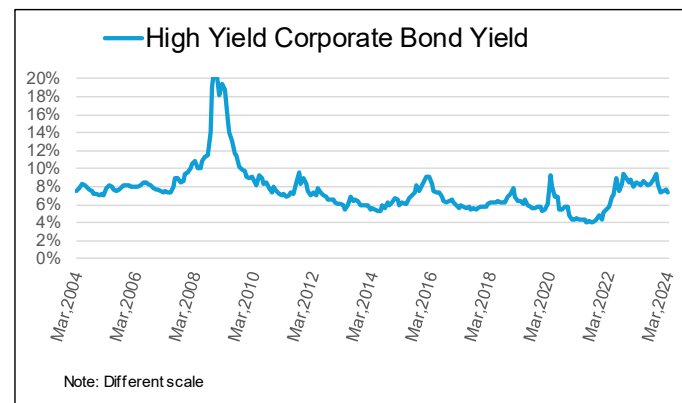
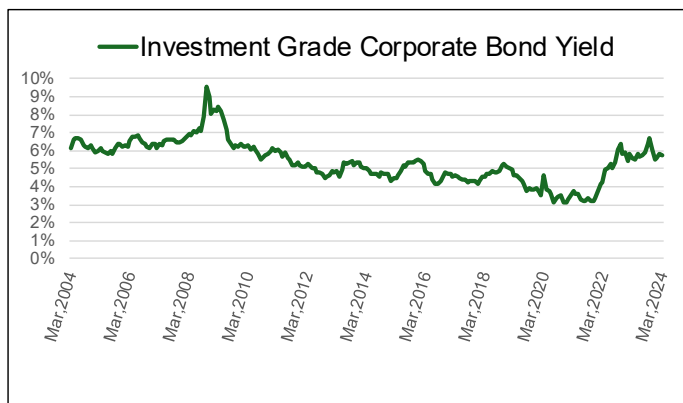
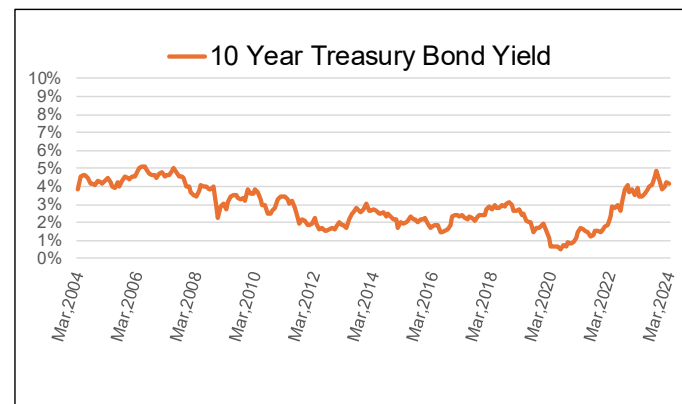
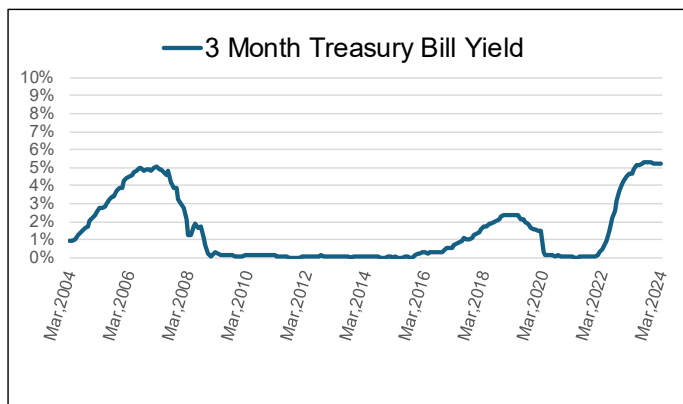


- The four bear markets that did not coincide with a recession were followed by quick recoveries, with none lasting more than two years.

| Bear Markets Occurring Without a Recession | |
|--|--------------------------|
| | Years to New Market Peak |
| 1962 | 1.7 |
| 1966 | 1.2 |
| 1987 | 1.9 |
| 2022 | 2.0 |

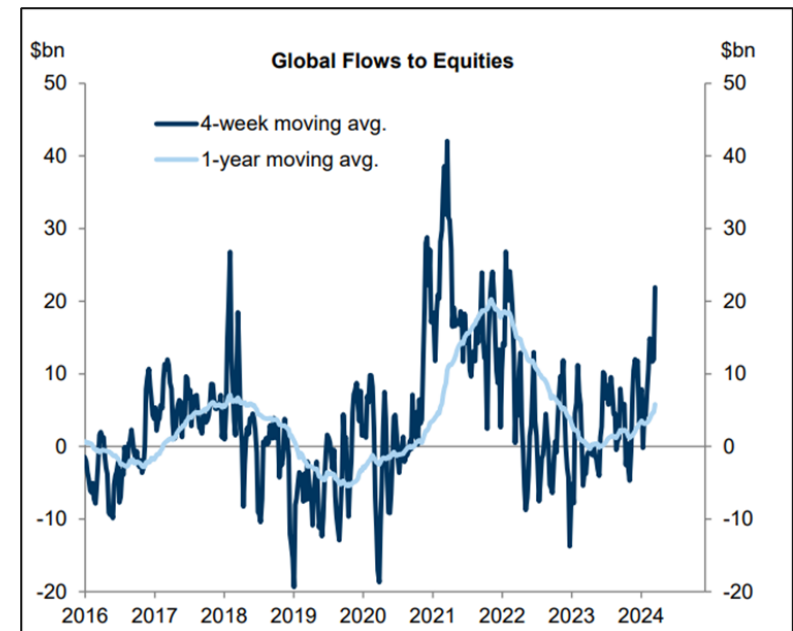
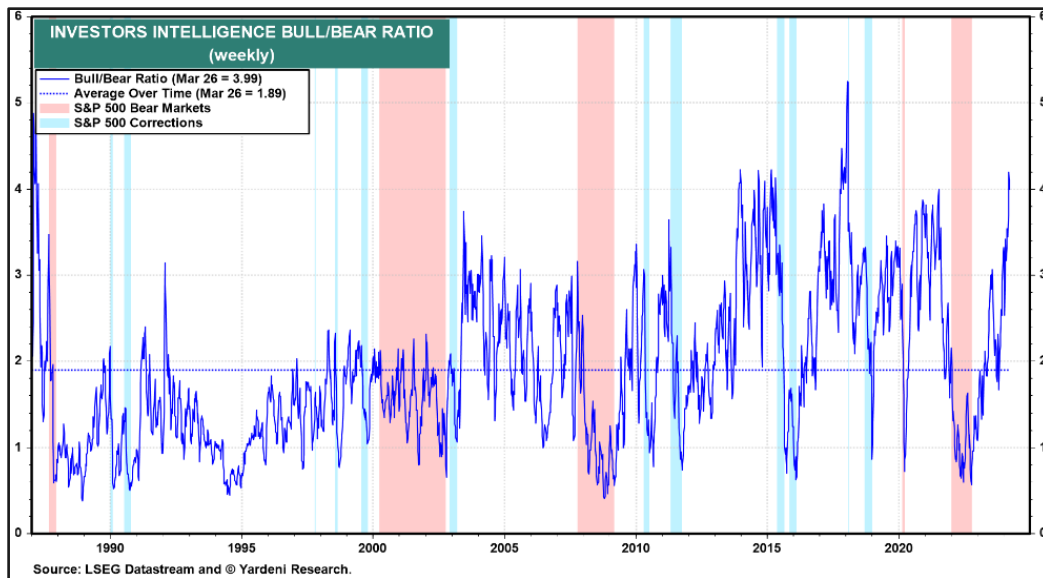
Fixed Income Valuation

- Bonds yields have increased from the pandemic lows.
- Yet, other than short-term Treasury bills, yields are merely back to pre-pandemic levels, indicating better, but still limited, return potential.



Elevated Optimism on the Stock Market

- The investment community is showing signs of high optimism, both qualitatively in terms of surveys and quantitatively in terms of money flows into equities.
- Given the appreciation that has occurred over the last six months, some pullback would be healthy for the bull market to continue longer term.





MARKETS

Elevated Optimism on the Stock Market

- One recent analysis concluded that the level of optimism is primarily limited to the largest US technology stocks, not for the rest of the market*.

| | 1920s | Dot-Com Bubble | 2007 | Jan-22 Total Market | Jan-22 Emerging Tech | Current Largest 7 Tech Stocks | Current Total Market |
|--|--------|----------------|-----------|---------------------|----------------------|-------------------------------|----------------------|
| 1 Prices are high relative to traditional measures | Bubble | Bubble | No Bubble | Somewhat Frothy | Frothy | Frothy | Frothy |
| 2 Prices are discounting unsustainable conditions | Bubble | Bubble | No Bubble | No Bubble | Frothy | Frothy | Somewhat Frothy |
| 3 New buyers have entered the market | Bubble | Bubble | Frothy | Frothy | Bubble | Somewhat Frothy | Somewhat Frothy |
| 4 Sentiment is broadly bullish | Bubble | Bubble | Frothy | No Bubble | Frothy | Frothy | No Bubble |
| 5 Purchases are being financed with high leverage | Bubble | Bubble | Bubble | Somewhat Frothy | Bubble | No Bubble | No Bubble |
| 6 Buyers/businesses have made extended forward purchases | Frothy | Bubble | Bubble | No Bubble | Somewhat Frothy | Frothy | No Bubble |

* See Chatham Capital's recent detailed analysis of the mega cap technology stocks: <https://www.chathamcapitalgroup.com/insights/stock-market-concentration>



CONCLUSIONS & STRATEGY

Economic Outlook

- Economic conditions are quite good, considering the Federal Reserve has increased interest rates by 5% in the past two years.
- Economic growth re-accelerated over the last three quarters. Corporate profit growth has also re-accelerated.
- Inflation has fallen substantially. Based on this progress, the Federal Reserve expects to lower short-term interest rates in 2024.

Portfolio Strategy

- Portfolios are positioned to participate in the favorable investment environment we see ahead and consistent with each client's objectives.
- Equities are supported by favorable economic conditions. Optimism is currently high; therefore, some near-term reversal would not be a surprise.
- Bonds are more appealing than they were several years ago, but their return potential may be limited to just coupon rates.
- Gold continues to provide a hedge against geopolitical turmoil.



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