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CAPITAL CREEK STRATEGY – JANUARY 2024

2024 Market Outlook – Staying the Course

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About Scott Slayton

Partner, Chief Strategist

Scott is a partner of the firm and Chief Strategist. Before joining Capital Creek, Scott was the Head of Asset Allocation at UTIMCO, where he served on the firm's Management, Investment, and Risk Committees. Scott has 35 years of investment experience as a strategist, portfolio manager, and asset allocator. Scott spent most of his career in New York, working at Kidder Peabody, Morgan Stanley, and Tudor Investments. Scott studied at the University of Texas at Austin, where he received a BBA in finance in 1988. Scott is also a Chartered Financial Analyst, CFA.

About Capital Creek Partners

A Private Investment Firm, Founded by Families.

We are an investment partner organized to serve the needs of family offices, foundations, endowments, and private investment companies. Established in 2018, Capital Creek Partners was founded as a boutique multi-family office to serve a small number of prominent families. Our firm's culture is rooted in Integrity, Humility, and Excellence.

CAPITAL CREEK PARTNERS

**ChatGPT was a research assistant in the writing of this report.*

Austin, TX – January 31, 2024

"A ship is safe in harbor, but that's not what ships are for."
William G.T. Shedd

Executive Summary

- Global equities and bonds are in clear bull markets in early 2024. The US (SPX), Europe (SX5E), and Japan (NKY) have recently hit all-time or multi-decade highs.
- We see the global liquidity backdrop improving steadily in 2024 as the Fed cuts policy rates and tapers Quantitative Tightening (QT), developed and emerging market Central banks continue to lower rates, and China stimulates more aggressively and decisively.
- We believe the US economy has a high probability of avoiding recession again this year.
- Core PCE Inflation should continue to grind lower toward the Fed's 2% target.
- US equities and 10-year US Treasury bonds will likely produce above-historical average total returns this year.

We advise our clients to Stay the Course in 2024 because we see liquidity rising in the context of slowing economic growth along with moderate inflation in the year ahead. This combination leads us to expect 4-5% nominal GDP growth leading to 6-7% earnings growth for the S&P 500 Index (SPX) and the potential for modest multiple expansion as the Federal Funds Rate and market-based interest rates fall. We are urging clients not to fixate on what is admittedly an extraordinarily complex geopolitical backdrop and a potentially brutal US presidential election cycle on the horizon. Stay the course and reap what we expect to be historically average or above-average returns for both stocks and bonds in 2024. In the US, we are attracted to out-of-favor equities such as small (SML) and mid-caps (MID) along with Real Estate Investment Trusts (REITs-IYR) and healthcare (IYH). We continue to see US technology equities in the preliminary stages of an AI-driven up-cycle that could bloom into full regalia in 2024. Outside the US, we are especially bullish on emerging market value and the continuing equity renaissance in Japan. We are also intrigued by the potential for China to positively re-engage with the world and embark on a meaningful stimulus campaign.

2023 in Review

2023 marked a rebound from the challenges of 2022, with inflation's persistent decline enabling a Fed pivot to a more dovish monetary stance. This shift facilitated a bull market in stocks, particularly in technology, driven by AI advancements and significant earnings growth among leading tech companies. The resilience of the U.S. housing market and lower energy prices also contributed positively to market dynamics.

Exhibit 1: Core CPE Inflation Fell Hard All Year in 2023

Source: Capital Creek Research, Bloomberg

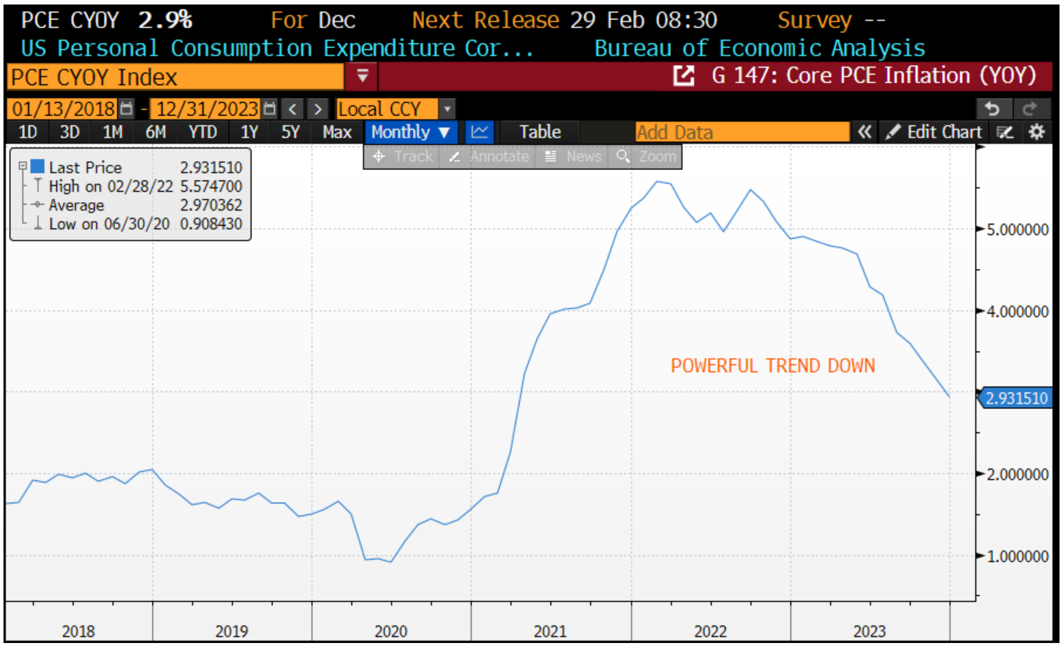


Exhibit 2: Lower Energy Prices Were to Key to 2023

Source: Capital Creek Research, Bloomberg

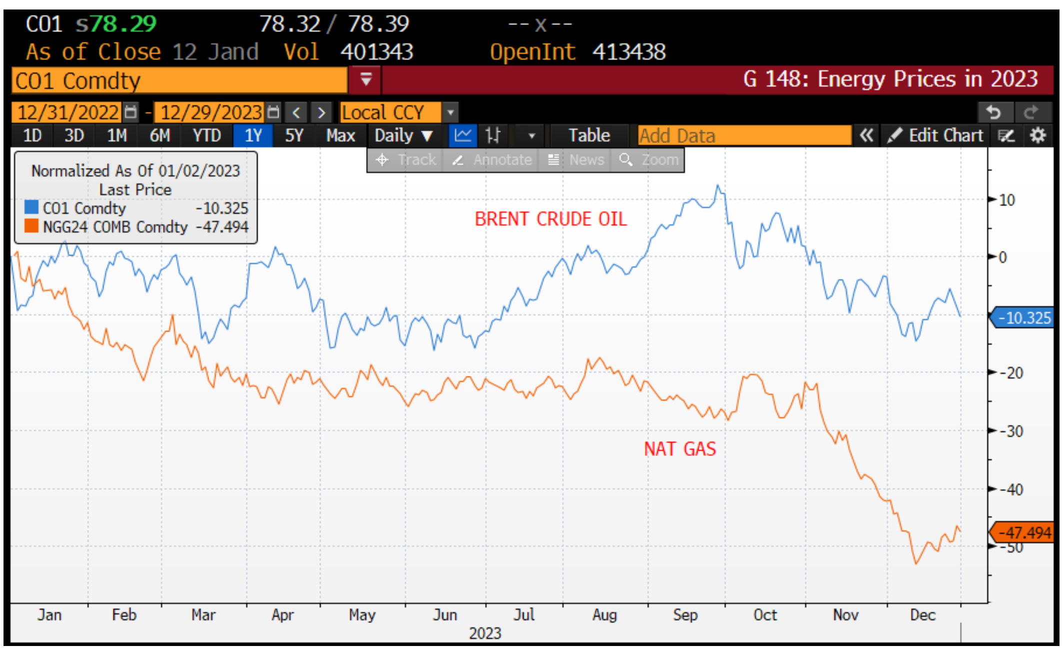


Exhibit 3: Bloomberg Magnificent Seven Total Return Index (MB7T) Was Up an Incredible 107% in 2023

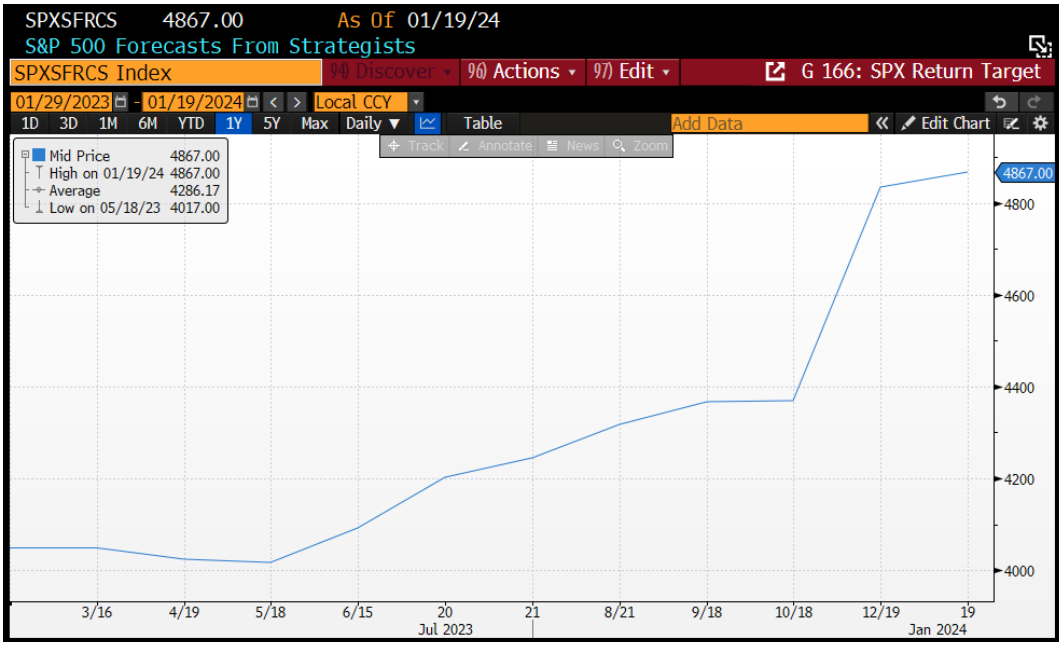
Source: Capital Creek Research, Bloomberg

The Outlook for 2024

We have a constructive investment view of the year ahead. We see both global bonds and stocks in clear bull markets and effectively climbing a "Mt. Everest" sized wall of worry. While we are bullish on bonds and stocks, we expect moderately above-historical average returns from financial assets in 2024. Our S&P 500 Index (SPX) target range is 5100-to-5300 or around an 8%-to-12% total return. By comparison, we expect the US 10-year Treasury bond to end the year with around a 3.0%-to-3.5% yield, equating to around a 10% total return, including coupons. Our expectations are far from exuberant but still solidly above what the consensus is calling for in 2024. According to Bloomberg, the SPX is already trading above the mean year-end return target for Wall Street Strategists.

Exhibit 4: S&P 500 Forecasts from Wall Street Strategists

Source: Capital Creek Research, Bloomberg



We think positive returns are likely because we expect inflation to move gradually closer to the 2% target on Core PCE, and we forecast the US economy to produce nominal GDP growth of around 4% to 5%, down from 6.2% in 2023. We anticipate energy and food prices to continue to trend lower along with the lagged effects of Owners' Equivalent Rent (OER) to keep pressure on inflation to the downside well into 2024. We agree with the market consensus that the Fed will eventually cut policy rates. However, we are less aggressive than the current market pricing, only expecting 75-100 basis points of rate cuts, and most of these to come in the second half of the year. We view the coming rate-cutting cycle as more of a surgical recalibration of policy to reduce real policy rates from currently highly restrictive levels. We see no recession coming in 2024; thus, we see no need for dramatic policy action from the Fed.

We have had analytical difficulty pushing our return assumptions significantly higher for SPX due to our moderate earnings growth assumptions of 5% to 7% and existing rich valuations. Our SPX target range of 5100-to-5300 is arrived at by blending our 2024 and 2025 earnings estimates of $240 and $260, then applying an earnings multiple of 21-22. Arriving at the proper multiple of earnings is more art than science. What we do know is that we are in a global bull market for equities, so the benefit of the doubt should be given to multiple expansion, especially with the Fed and other Central Banks poised to ease monetary policy.

No Recession

We are in the "no recession camp" for 2024. We envision modest real GDP growth of 1.5%-to-2.5% and nominal growth of 4%-to-5%. The lagged effects of monetary tightening will continue to be felt well into the new year, so we do incorporate more slowing into our forecast. The case against recession rests on looser financial conditions, still massively strong fiscal stimulus, policy interest rate cuts later in the year, a tight labor market, and household net worth at all-time highs. It will take significant labor market stress to tip the economy into recession outside of a geopolitical bolt from the blue. Simple demographics dictate that baby boomers will continue to exit the workforce in masse. This trend just reinforces a tight labor market for years to come. When people have jobs, they continue to consume. When Americans consume at a healthy rate, we do not experience recessions.

We would put the odds of a US recession in 2024 at around 15%-to-20%. Bloomberg has an interesting recession probability survey asking top economists about their expectations for a recession in the next 12 months. A recession forecast is still the central case for about half of market participants in 2024. As recession forecasts slowly get squeezed out of the market, risk assets have further room to rally.

Our observation over thirty-five years of participating in markets is that equities forecast the economy, not vice versa. Based upon the extraordinarily strong and broadening performance by the US equity markets in 4Q23 and in January of this year, we think the odds of recession anytime soon are quite low.

Exhibit 5: Bloomberg Recession Probability Index

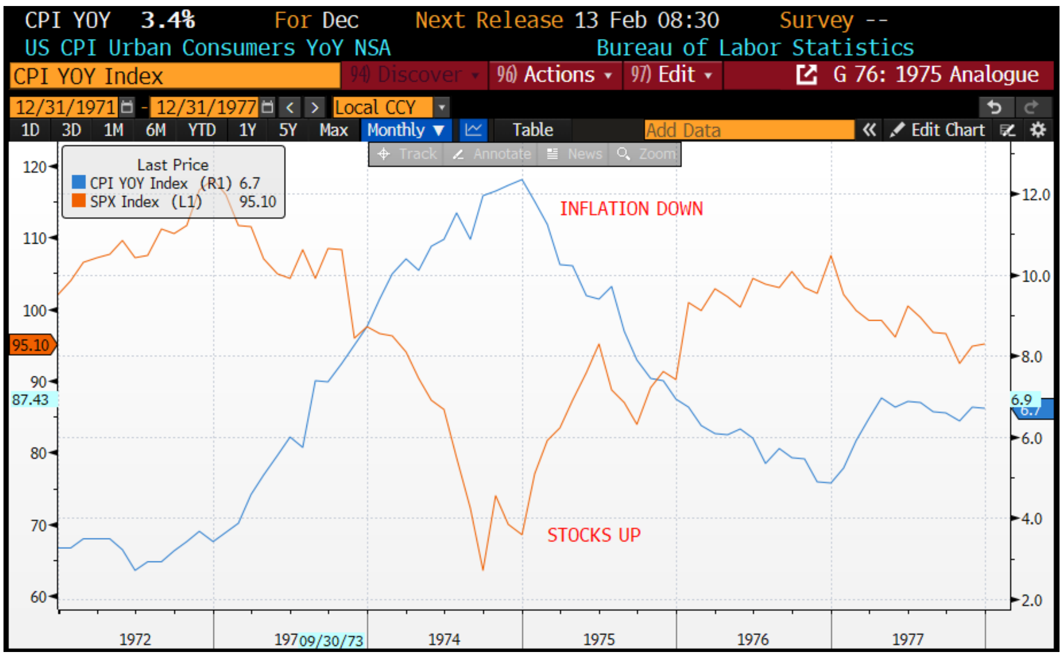
Source: Capital Creek Research, Bloomberg

Still Following the 1974-1976 Analogue

In 4Q22, we discovered the 1974-76 inflation analog. We envisioned this being a potential roadmap for the coming decline in the inflation rate. It worked. It is still working. Inflation peaked in December 1974 and fell persistently for two solid years. Stocks responded and rallied for two solid years. Beginning in 1Q77 the game was up and inflation reaccelerated on the back of higher energy prices. The rally in equities was also over, as seen in the chart below. The significant difference between the 1974-77 period and today is the Fed was cutting rates aggressively from 2Q74 through 1Q76. In the current era, the Fed has been steadfast in hiking and is now holding rates higher for longer to bring inflation down. The rate easing of 1974-76 proved to be premature as inflation was not dead but only hibernating for the next move higher. We think this roadmap runs out of track at the end of 2Q24. This is when we would become more alert to any potential reacceleration in inflation that could stop the equity rally cold.

Exhibit 6: 1974-76 Analogue Still the Road Map

Source: Capital Creek Research, Bloomberg



The Mixed Message from Our Models

As we enter 2024, we receive mixed messages from our two primary market models. Our Tactical Equity Strategy Model ("TES") turned bullish last December for the first time since the fall of 2022. This was a major change since the model had been neutral all last year. In contrast, our Tactical Asset Allocation model (TAA) remains solidly bearish on equities, bearish on bonds, bearish on commodities, and neutral on public credit. The TAA model continues to have a strong preference for cash. The TAA model continues to be driven by leading indicators predicting a recession. It has been two years since these models were coordinated and gave a similar signal. Other outside models we follow are becoming more constructive on global equities. The post-pandemic economic cycle appears to be quite different from prior cycles.

This cycle has experienced much faster nominal growth driven by highly robust fiscal stimulus and more rapid inflation rates. The unusual nature of the post-pandemic cycle has wreaked havoc on leading indicators and models of all kinds. An example is the Conference Board Leading Indicator, which has been negative for 18 months in a row. This is completely unprecedented outside of a recession. We are not in a recession today. Consequently, we are still leaning on our models but less than we did in the pre-pandemic regime.

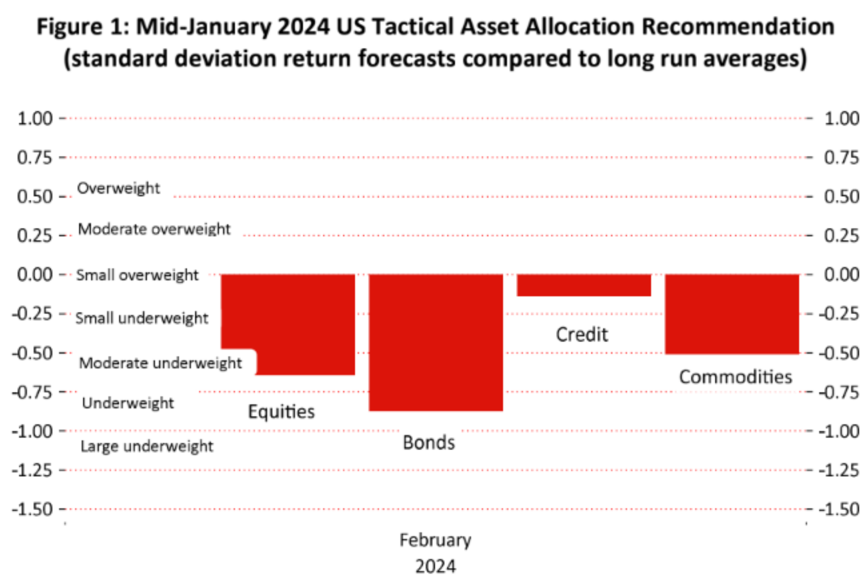
Exhibit 7: TES Model – The First Bullish Reading Since 4Q22

Source: Capital Creek Research

FIN COND		CYCLE
TREND		MODEL
POSTNING		SNTMNT
SEASONAL		FLOWS
CREDIT		VALUE
EARNINGS		STUDIES
6		2

Exhibit 8: TAA Model – Model Remains Cautious Anticipating Recession and Higher Unemployment

Source: Applied Global Macro Research



S&P 500 Scenario Analysis

Our price target discipline is to think about the potential scenarios for the year ahead and try to assign probabilities to their respective outcomes. A successful market strategy is partly about being creative and anticipating the future. In this exercise, we produce our central case outcome (base), along with our upside (bull) and downside (bear). We then assess the odds of each and assign probabilities. My experience is that the Bull Case plays out more often than I expected.

Base Case (50% Probability): The benchmark SPX Index continues to trend higher to start the year. The technology-driven Nasdaq 100 Index (NDX) remains the leadership group along with healthcare. There will likely be dips to buy as the US elections and geopolitical headwinds create opportunities. SPX makes most of its gains after Labor Day as it discounts a benign election outcome that does not result in major policy changes. SPX ends the year in the 5100-to-5300 range.

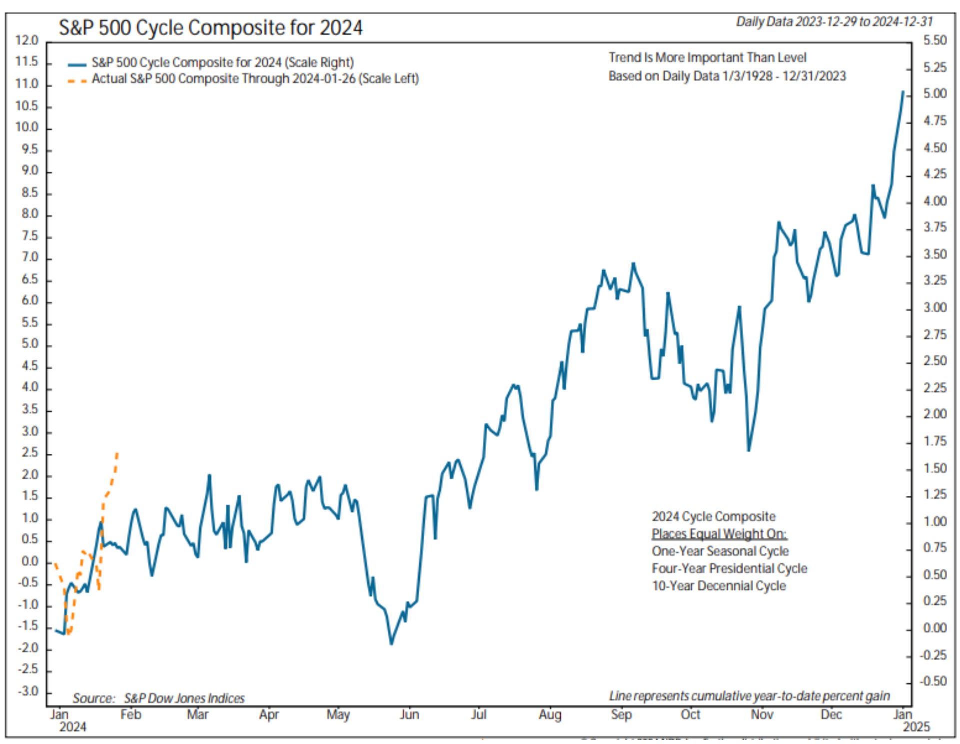
Bull Case (30% Probability): US corporate margins and earnings are stronger than expected. Productivity continues to surprise to the upside. Inflation falls faster than expected allowing the Fed to cut rates by more than one hundred basis points by year-end. The US election proceeds smoothly and there is a clear winner. Investors discount the peak of the rate cycle, pull money from cash deposits, and deploy it back into equities aggressively. SPX ends the year above 5,600.

Bear Case (20% Probability): The US economy slows sharply or accelerates sharply, thus derailing the "soft-landing" narrative. One could lead to recession and the other could lead to a reacceleration of inflation. Both outcomes are bad for equities. The downside could also be caused by an unexpected geopolitical event or outcome that markets are not currently discounting. We consider these low-probability but high-impact potential surprises. Given valuations at robust levels, SPX could trade back down into the 4,000 range or approximately 15% below current levels. It is entirely conceivable that we could be looking at mid-to-high teens multiples of $230 in blended earnings over the next couple of years if fundamentals sharply deteriorate.

When we triangulate across these three different scenarios and assign our probabilities to each case, we once again settle in a range of 5100-5300 for SPX at year-end.

Exhibit 9: NDR Cycle Composite – Points to Mid-Year Correction; Strong Second Half

Source: Ned Davis Research

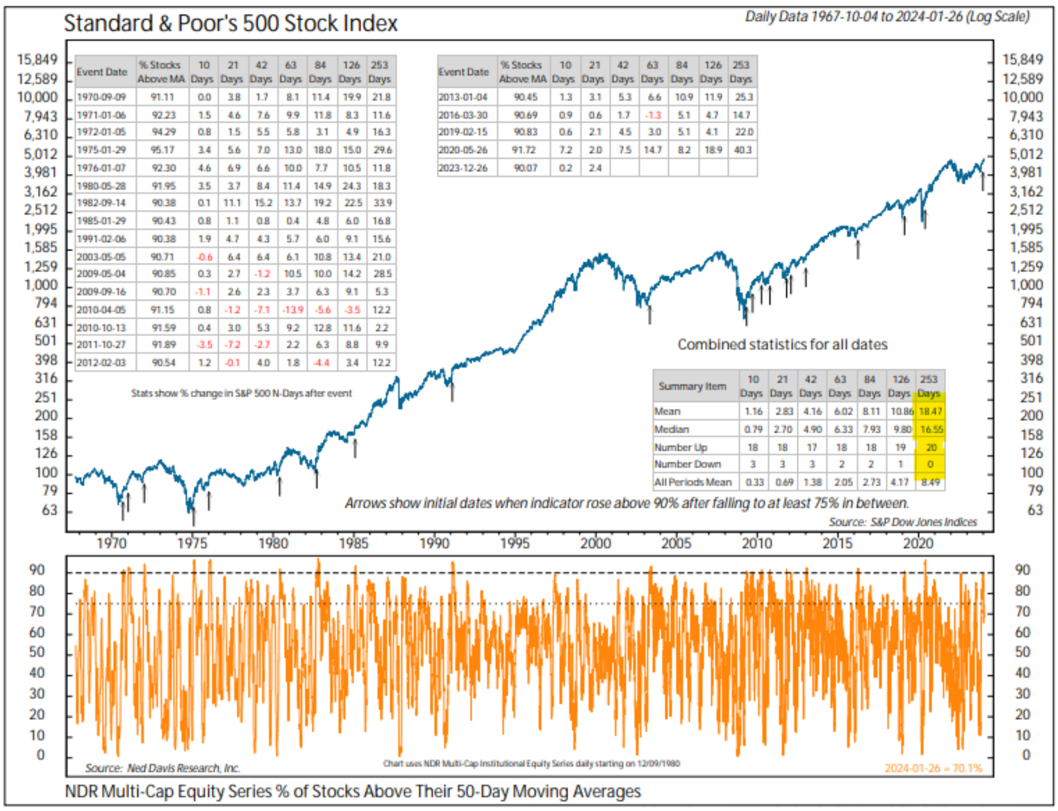


Thinking Outside the S&P 500 Box

We believe that with somewhat limited upside available in the SPX in 2024, we envision much of the positive action in the equities universe taking place outside of the S&P 500 Index. Within the US market, there are potentially more lucrative opportunities in small and mid-capitalization equities, which have underperformed the large-cap S&P 500 over the last decade. The S&P Small Cap Index (SML) is unchanged from where it was three years ago. Our analysis tells us that the US market is broadening. For example, back in December 2023, the broad NDR Multi-Cap Equity Series had over 90% of its underlying stocks trade above their 50-day moving averages. This is a major "breadth thrust" the likes of which we have only seen on twenty-one occasions since 1970. Forward returns from such a breadth thrust are highly consistent and positive as can be seen in the table below.

Exhibit 10: A Major Breadth Thrust Triggers

Source: Ned Davis Research



Event Date	% Stocks Above MA	10 Days	21 Days	42 Days	63 Days	84 Days	126 Days	253 Days
1970-09-09	91.11	0.0	3.8	1.7	8.1	11.4	19.9	21.8
1971-01-06	92.23	1.5	4.6	7.6	9.9	11.8	8.3	11.6
1972-01-05	94.29	0.8	1.5	5.5	5.8	3.1	4.9	16.3
1975-01-29	95.17	3.4	5.6	7.0	13.0	18.0	15.0	29.6
1976-01-07	92.30	4.6	6.9	6.6	10.0	7.7	10.5	11.8
1980-05-28	91.95	3.5	3.7	8.4	11.4	14.9	24.3	18.3
1982-09-14	90.38	0.1	11.1	15.2	13.7	19.2	22.5	33.9
1985-01-29	90.43	0.8	1.1	0.8	0.4	4.8	6.0	16.8
1991-02-06	90.38	1.9	4.7	4.3	5.7	6.0	9.1	15.6
2003-05-05	90.71	-0.6	6.4	6.4	6.1	10.8	13.4	21.0
2009-05-04	90.85	0.3	2.7	-1.2	10.5	10.0	14.2	28.5
2009-09-16	90.70	-1.1	2.6	2.3	3.7	6.3	9.1	5.3
2010-04-05	91.15	0.8	-1.2	-7.1	-13.9	-5.6	-3.5	12.2
2010-10-13	91.59	0.4	3.0	5.3	9.2	12.8	11.6	2.2
2011-10-27	91.89	-3.5	-7.2	-2.7	2.2	6.3	8.8	9.9
2012-02-03	90.54	1.2	-0.1	4.0	1.8	-4.4	3.4	12.2

Event Date	% Stocks Above MA	10 Days	21 Days	42 Days	63 Days	84 Days	126 Days	253 Days
2013-01-04	90.45	1.3	3.1	5.3	6.6	10.9	11.9	25.3
2016-03-30	90.69	0.9	0.6	1.7	-1.3	5.1	4.7	14.7
2019-02-15	90.83	0.6	2.1	4.5	3.0	5.1	4.1	22.0
2020-05-26	91.72	7.2	2.0	7.5	14.7	8.2	18.9	40.3
2023-12-26	90.07	0.2	2.4					

Summary Item	10 Days	21 Days	42 Days	63 Days	84 Days	126 Days	253 Days
Mean	1.16	2.83	4.16	6.02	8.11	10.86	18.47
Median	0.79	2.70	4.90	6.33	7.93	9.80	16.55
Number Up	18	18	17	18	18	19	20
Number Down	3	3	3	2	2	1	0
All Periods Mean	0.33	0.69	1.38	2.05	2.73	4.17	8.49

We also favor the US healthcare sector in the coming year. Despite it being an election year, we like healthcare for its stable and consistent earnings growth, strong demographic tailwinds, exposure to artificial intelligence driven innovation, and strong uptrend that started in the fourth quarter of last year. As the US economy slows down in 2024, we think more investors will be searching for consistent earnings growers. The iShares Healthcare ETF (IYH) has been in a trading range for three years. We think the odds favor a decisive breakout to the upside in 2024. At a minimum, we would be buyers at the bottom of the trading range.

Exhibit 11: iShares US Healthcare (IYH) – Range Bound for Three Years and Poised to Break Higher

Source: Capital Creek Partners, Bloomberg

US public REITs are another area of interest for us as we peer out into 2024. We wrote about the potential for REIT outperformance in our _10 Surprises Report_ last December. The bull case is that real estate is very much out of favor in today's market. Who does not know about the demise of the US office market, the death of the retail real estate market, and the vast oversupply coming in multi-family? These fundamental issues have existed for years, are well known, and likely discounted by financial markets. The sector produces solid income and as interest rates fall further in 2024, we expect REITs to produce surprisingly good risk-adjusted returns. Historically, REITs also add diversification benefits to investor portfolios.

Exhibit 12: Japan's NKY 225 Index is the Fastest Horse in the "Glo-bull" Race

Source: Capital Creek Partners, Bloomberg

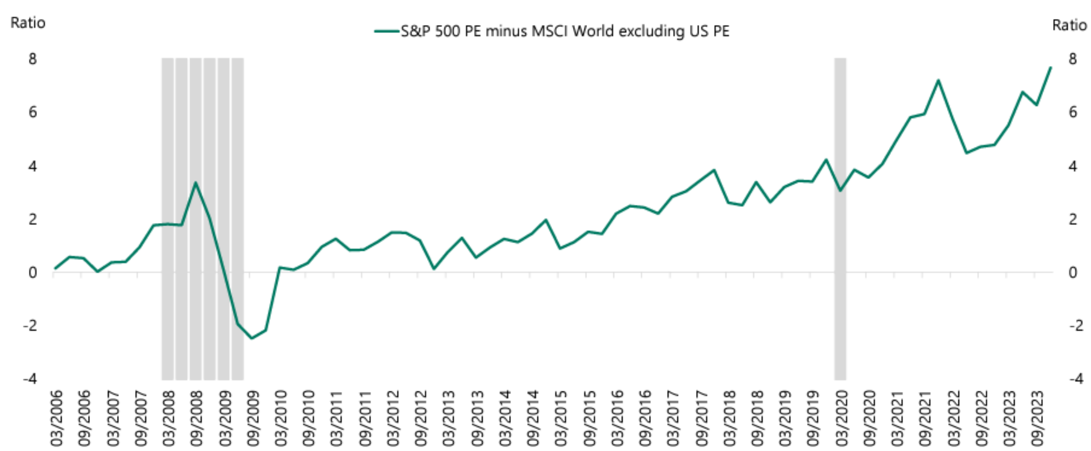
We advise clients to look for investment opportunities outside the US in 2024. Like last year, our favorite non-US equity market is Japan. Japan's Nikkei 225 Index (NKY) was one of the few markets in the world to beat the return of the S&P 500. Japan has now convincingly escaped deflation, monetary policy remains exceptionally accommodative, corporate returns on equity are consistently rising, and the Japanese Yen is by far the cheapest major currency in the world. It all adds up to secular change in Japan. As China is now thought by some to be "uninvestable," Japan has become the haven of Asia. The technical picture for Japan is the best of all developed markets in our view. It is entirely possible that the NKY could hit a fresh all-time-high for the first time since 1990!

Exhibit 13: NKY 225: The Long-View

Source: Capital Creek Partners, Bloomberg

Exhibit 14: S&P 500 is Very Expensive Compared to International Stocks

Source: Apollo Global Management Chief Economist



The Most Hated Asset in the World

Chinese equity assets have become extremely depressed. We think most of the damage has been due to poor policymaking. The list is long here over the last decade: the flawed Zero Covid Policy, residential real estate red lines, heavy-handed regulation of private enterprise, anti-corruption campaign, putting national security well ahead of growth, alienating key trading partners via "Wolf Warrior diplomacy," promoting a "no limits" friendship with Russia, and failing to use monetary or fiscal policy to improve growth and avoid deflation. These policy failures have led to a complete lack of confidence among domestic and international investors. The result has been a negative foreign direct investment (FDI) position for China, asset and consumer price deflation, and the worst major stock market performance in the world by an exceptionally large margin. The MSCI China Index (MXCN) has made no progress since 2007! The Sharpe Ratio for MXCN [(Expected return – Risk-free rate) / Standard deviation] is an incredible -1.4 over the last year. This Sharpe Ratio indicates that MXCN has declined significantly and consistently—the worst combination. This appears increasingly unsustainable to us. When markets panic, policymakers panic. It just takes more time and pain in today's China.

In addition, we sense that by now, almost everyone has given up on China. The financial journalism headlines are uniformly apocalyptic. Even passive emerging market investors have abandoned China for indices that completely exclude China. According to Bloomberg data, MXCN now trades between 8-9 times forward earnings estimates and the estimated yield on the Index is above 5%. These valuations are comparable to the US equity market in 1981 when Newsweek's infamous "The Death of Equities" made the cover. We think these two recent Economist Magazine covers illustrate how pessimistic the consensus has become toward China.

Exhibit 15: Bearish Magazine Covers Can be Contra-indicators

Source: The Economist

Given the long-term decoupling of China from the democracies of the West and Asia, China is a highly speculative investment. Due to the extent of the depression and high implied option volatilities, we think a 50% rally is possible if policymaking becomes less negative and relations continue to thaw between the US and China in 2024. China sorely needs better relations with the US and the West for many reasons. That does not guarantee that rapprochement continues, but our point is that Chinese equities are not priced for any improvement. In our view, they are priced for more deterioration and more negative policymaking. There is ample room to surprise on the upside given the heavy blanket of pessimism that currently pervades the Chinese equity market.

Exhibit 16: The Jaws of Opportunity

MSCI USA VS. MSCI CHINA Last Ten Years Gains/Losses in % Terms

Source: Capital Creek Partners Research, Bloomberg

Despite the torrent of unwelcome news and price action from Chinese equities, it is interesting that USDCNH currency continues to head lower (RMB stronger). The Chinese control their currency and are clearly not using a weaker currency to stimulate the economy. This contrasts with 2023, when the Chinese currency weakened persistently. This could be another olive branch to the Biden Administration which needs and wants a weaker US dollar heading into the November election.

Another way to play China indirectly is through emerging markets. We especially like the "value" portion of emerging market equities. Our friends at Cape Ann recently pointed out that valuation spreads are currently in the 99th percentile over the last 25 years. Wide valuation spreads indicate massive uncertainty and fear. The horrendous performance of China has created this opportunity. However, the distinct lack of earnings growth out of EM is also responsible for the 15-year relative bear market. Is now the time to buy? What is the catalyst? China's improving relationship with the world is a potential catalyst. More aggressive monetary and fiscal policies are also potential catalysts. When valuations are extremely cheap, valuation spreads are wide, and dividend yields are fat, the proper approach is often to buy and let time work in your favor. In EM today, you are getting paid handsomely for a catalyst to emerge and drive a re-rating higher. The indicated dividend yield on the popular iShares Emerging Market ETF (EEM) is approaching 4%. China and Taiwan together comprise 40% of the allocation in EEM.

Exhibit 17: Chinese Yuan Stronger Despite Economic Weakness

Source: Capital Creek Partners Research, Bloomberg

US Elections

As a market strategist, I agree with Warren Buffett that it is paramount to remain objective and non-partisan in our view of geopolitical dynamics and how they relate to market prices. We are only commenting on the election because we think it has the potential to significantly influence the path and destination of financial market prices in 2024. We have analyzed the coming US election in a clinical and non-partisan fashion, mostly through the lens of history and attendant economic and market-based factors.

Based upon purely economic factors such as economic growth, the labor market, real incomes, and the level/rate of inflation, the incumbent US President has an edge in winning re-election in November. Simply put, the economy is growing at or above trend and people who want to work have jobs. To simplify even further, if an economic recession does not occur within the two-year window prior to election day, the incumbent has gone on to win in every time since 1912, when Woodrow Wilson defeated William Howard Taft.

Our base case is that the US economy will not enter an NBER-observed recession in 2024. We would put the odds of avoiding a recession at 80% plus. Thus, we expect the incumbent to win this year's presidential election.

Furthermore, we have observed that when the incumbent wins re-election, the US stock market tends to produce an above average performance overall for the year and especially in the second half. In years when the challenger wins, stocks produce meager and sometimes negative returns. If US equity returns are flat-to-negative by Labor Day, the odds will then shift to favor the challenger winning the Presidency.

In our view, the markets do not care so much who wins the Presidency, but they care very much that there is a clear and decisive winner. We expect to have a clear-cut winner in November.

Exhibit 18: No Recession – No Problem for Incumbents

Source: Strategas

No Recession Two Years Before Re-Election

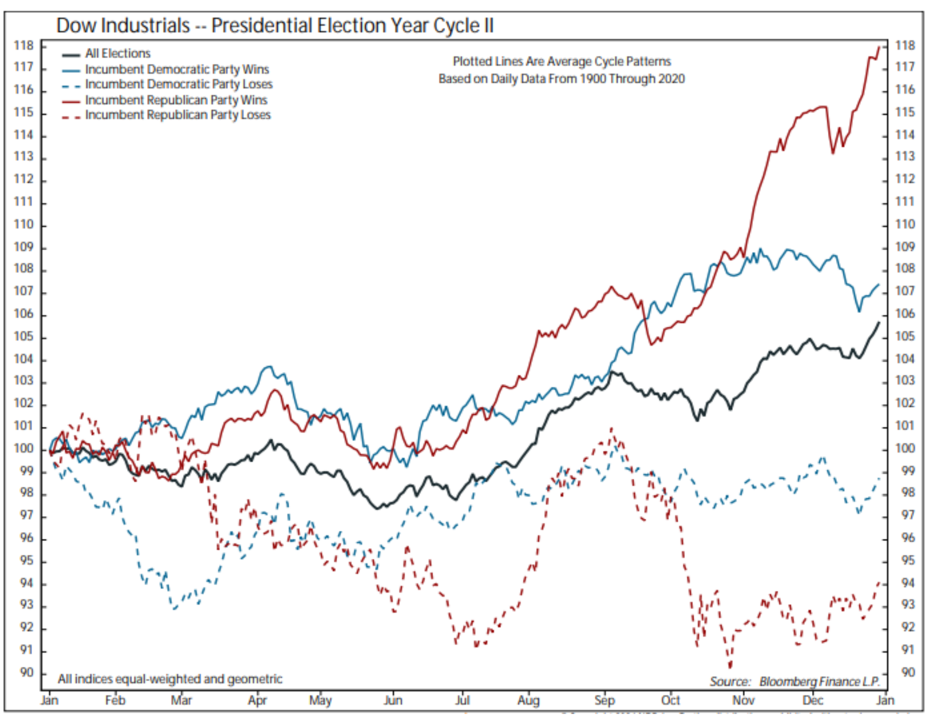
President	Recession?	Re-Elected?
Obama	No	Yes
Bush II	No	Yes
Clinton	No	Yes
Reagan	No	Yes
Nixon	No	Yes
LBJ	No	Yes
Eisenhower	No	Yes
Truman	No	Yes
FDR	No	Yes
FDR	No	Yes
FDR	No	Yes

Recession Two Years Before Re-Election

President	Recession?	Re-Elected?
Trump	Yes	No
Bush I	Yes	No
Carter	Yes	No
Ford	Yes	No
Hoover	Yes	No
Taft	Yes	No

Exhibit 19: Markets Historically Perform Well When the Incumbent President Wins Re-Election

Source: Ned Davis Research



US Treasury Bond Market Outlook

Once again, the US Treasury bond market reigns supreme in the macro universe. The US Treasury bond market is the largest, most liquid, and most consequential market in the world. It will only get bigger and more influential in the years ahead as the US government needs to sell vast amounts of paper to fund gargantuan deficits as far as the eye can see. Following one of the worst bear markets in bond market history from 2020 through 10/23, we think yields have peaked and will head lower in 2024.

We are bullish on US 10s and expect yields to fall to at least 3.30% and potentially even lower. We see a continued grind lower in Core PCE inflation, the continued fall out from five hundred basis points of tightening in 15 months combined with the continued corrosive effect of quantitative tightening (QT). With yields still north of 4%, investor appetite has returned to the US Treasury market. In our view, supply concerns are overblown and are more likely to keep yields from reaching even lower levels this year. As growth softens, there should be plenty of global appetite for Treasury paper.

In the big picture, the forty-year bull market for bonds is over. However, we think yields could fall all the way back to 2.5% before resuming their secular climb. Any number of things could cause this to happen: recession, war, a collapse in oil prices, unexpected deflation, or China descending into recession and deep deflation. Following a massive increase in 10-year yields from forty basis points in the depths of the pandemic to north of 5% in the fall of last year, some retracement should be expected.

Exhibit 20: The Big Picture for Bonds

Source: Capital Creek Partners Research, Bloomberg

A normal 38% retracement of the huge bond bear would take yields all the way back to 3.25%. That is where I think we could be headed over the next year. There is potential for low double-digit total returns in bonds, in our estimation.

Exhibit 21: U S Treasury 10 Year Yields Have Further Retracement Potential

Source: Capital Creek Partners Research, Bloomberg

Exhibit 22: US 30 Year Mortgage Rates – A Long Way to Fall

Source: Capital Creek Partners Research, Bloomberg

The spread between Treasuries and mortgage-backed securities became historically wide in 2023. The giveback in mortgage yields and spreads is in its initial stages. We see falling mortgage rates restimulating the US housing market in 2024. Existing home sales are poised to rebound from very depressed levels, another tailwind for the US economy and another reason we do not forecast a recession this year.

Where We Could be Wrong

We will be wrong if inflation reaccelerates (25% probability), the US falls into recession (20% probability), Iran provokes the US into direct conflict (5% probability), or either candidate wins a highly disputed and chaotic US presidential election (35% probability). We view all four of these as relatively low probability/high impact surprises. Any of these risks could happen and potentially more than one. To earn returns, intelligent risk must be taken. We are willing to take the above risks as part of the price of participation.

Client Portfolio Implications

We have titled this year's report, *Staying the Course*, which is exactly what we think investors should do in 2024. Our analysis points to lower inflation, lower bond yields, and rising equity prices. While we think total returns will be modestly above the historical average for SPX at around 8%-12%, we think we could see outsized returns for certain sectors of the US market and non-US markets such as Japan, Europe, Brazil, India, and even China.

Clients should begin to reduce cash balances built up during the Great Tightening of 2022/2023. Yields are likely to fall across the curve so now is the time to extend duration and lock in yields at still attractive levels.

Our game plan for this year is to use volatility to add to stocks, bonds, and potentially even commodities opportunistically. We expect to get some of these fatter pitches during the first half of this year.

The Role of Private Market Investments

Since the founding of our firm, we have stressed the importance of private market assets in portfolio construction and the benefits of diversification and improved risk-adjusted returns. The benign backdrop of continued moderate economic growth, falling inflation, and improving liquidity conditions augur well for private market investing in the year ahead. We recommend that clients Stay the Course and continue to invest a healthy portion of their assets in private markets. Accepting a prudent amount of illiquidity can go a long way toward adding meaningful percentage points of returns over time. This is the essence of the "endowment model" we have embraced since our inception in 2019.

At Capital Creek, we plan to continue allocating capital to skilled investors in the private markets that stick to a disciplined investment approach and understand the benefit of dollar cost averaging across vintage years. We will continue to work with each of our clients to determine the right amount of liquidity in their portfolios and help customize their private market allocations to reach their respective financial goals and objectives.

Conclusion: Embracing Opportunity in a Dynamic Landscape

As we conclude our 2024 Market Outlook, the investment landscape is evolving, shaped by a confluence of economic, geopolitical, and technological forces. Our comprehensive analysis leads us to a cautiously optimistic stance, underpinned by the expectation of moderate economic growth and inflation, coupled with market opportunities that demand nuanced navigation.

We enter 2024 with the strategy of *Staying the Course*, a testament to our confidence in the resilience and potential of global markets. Our focus on a diversified approach – favoring non-US equities, particularly in Japan and emerging markets, while also identifying value in underappreciated sectors such as small and mid-caps, healthcare, and REITs in the U.S. – reflects our commitment to capitalizing on both growth and value.

The backdrop of a complex geopolitical environment and an upcoming U.S. presidential election cycle adds layers of uncertainty, yet also presents opportunities for astute investors. Our analysis suggests that avoiding overreaction to these transient factors and maintaining a disciplined and long-term investment approach will be key to navigating the year ahead successfully.

China's challenging economic landscape has become so foreboding that it is now forcing policymakers to take decisive action. While exercising caution in Chinese markets, we recognize the potential for significant upside should policy and economic conditions begin to improve at the margin.

We foresee a bond market buoyed by the Fed's policy pivot, benign growth, and continued progress on returning inflation closer to the 2% target. Falling policy and market-based interest rates should underpin positive equity markets and underlying economic growth.

Our outlook is framed by a fundamental belief: the absence of an imminent recession. This view, supported by strong fiscal stimulus, a robust labor market, and a solid household net worth, shapes our optimistic yet pragmatic approach to the investment landscape in 2024.

In closing, we believe that *Staying the Course*, with an openness to adjusting our sails to the shifting winds, will allow our clients to navigate through the complexities of 2024. Our strategy is designed not just to weather potential storms, but to find and leverage the currents of opportunity that will lead to sustainable, long-term growth. At Capital Creek Partners, we remain committed to guiding our clients with insightful analysis, strategic foresight, and unwavering dedication to their investment success.