CAPITAL CREEK STRATEGY

Two Texans by the Fireside

Ed Hyman and Scott Slayton Discuss the Key Issues
Affecting Today's Global Economy and Financial Markets

Scott T. Slayton, CFA & Isaac Arnold

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 Ed Hyman

Founder and Chairman of Evercore ISI and Head of Economic Research

Ed Hyman is the Founder and Chairman of Evercore ISI, where he also serves as the Head of Economic Research in New York. For the past 47 years, Mr. Hyman has been ranked by the *Institutional Investor* poll of investors for Economics, ranking No. 1 for 42 years. He previously chaired ISI Group LLC and ISI Inc., and before that, he worked at C.J. Lawrence Inc. and Data Resources Inc. Mr. Hyman is involved in various boards and committees, such as the China Institute, The New York Public Library's Financial Services Leadership Forum, and Bowdoin College's Finance Committee. He holds an engineering degree from the University of Texas and an MBA from MIT.

CAPITAL CREEK PARTNERS

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.

Event Summary

Austin, TX - October 24, 2023

On October 24, 2023, Ed Hyman, Founder and Chairman of Evercore ISI and Head of Economic Research, and Scott Slayton, CFA, Partner, and Chief Strategist of Capital Creek Partners, met virtually to discuss key topics and issues in today's global economy. Together, they discussed inflation, the U.S. economy, the U.S. Presidential election, global conflict, and key learnings from their careers.

You can watch the full-length webinar on our website here or read on for a detailed discussion summary.

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Inflation, Today's Key Market Driver (3:11)

Beginning in the late 1960s, Ed Hyman launched his career just as inflation began to surge higher in the U.S. In the '70s and early '80s, Milton Friedman's hypothesis that inflation is a monetary phenomenon began to gain popularity on the Street. Since Ed met Dr. Friedman, he has considered monetary metrics his north star in understanding inflation. The growth rate of the U.S. M2 monetary supply has declined this year, which leads Ed to believe that inflation will continue to slow. Ed expects the Fed to reach their inflation target of 2% by the end of 2024.

Exhibit 1: The YoY Percentage Change in the M2 Growth Rate

Source: Capital Creek Research, Bloomberg

Scott agreed with Ed that the current trend in inflation will be lower for several more quarters. He also highlighted several structural factors that could elevate future inflation levels, including the transition to green energy, deglobalization, global conflicts, and shortages in U.S. labor and housing markets. Moreover, he identified profligate fiscal policies as a potential driver of sustained higher inflation. Scott sees a departure from the previous era of 1-2% inflation (1990-2020) to a new phase characterized by a baseline inflation rate ranging from 3-5%. Additionally, due to these structural factors, he anticipates greater inflation volatility in the years ahead. Scott believes we are in a new investment era defined by heightened inflation, shorter economic cycles, and increased geopolitical risks.

Understanding Where We Are in the Market Cycle (12:45)

When Ed was asked where he believes we are in the broader market cycle, he pointed to the following guideposts:

The Inverted Yield Curve

An inverted yield curve is a noteworthy phenomenon with historical implications. In previous instances of an inverted yield curve, a recession typically followed within 18 months. On July 5th, 2022, the 2-year-to-10-year Treasury yield curve became inverted. In other words, 2-year notes had a higher yield than 10-year notes. Since that date, the curve has remained in this inverted state without a return to its normal upward-sloping pattern. This current inversion is the longest continuous inversion in modern history.[1]

If an inverted yield curve is a warning of an oncoming recession, Scott's perspective is that the dis-inversion, or a return to a positively sloped yield curve, is the trigger for a recession to begin. A return to a positively sloped yield curve after a period of inversion has marked the beginning of the last six recessions since 1977. See Exhibit 2 below.

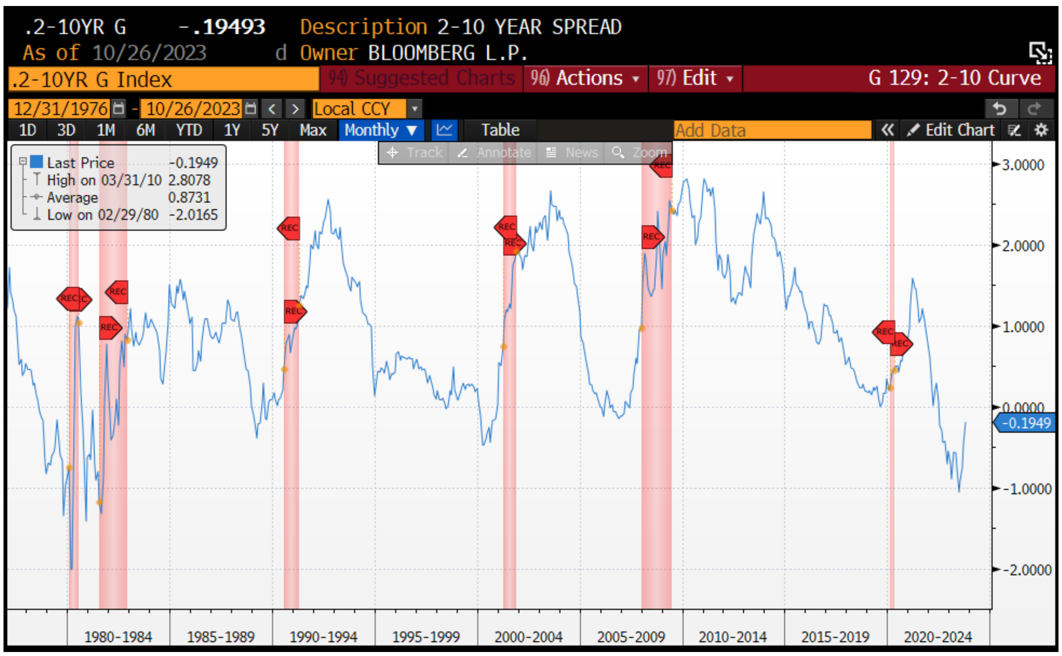


Exhibit 2: 2-Year and 10-Year Treasury Note Yield Curve, Overlayed with Past Recessions

Source: Capital Creek Research, Bloomberg

Fed Policy

Ed noted that the Fed has raised rates significantly over the past 18 months, raising rates 500 basis points across 11 occasions in one of the sharpest monetary tightening events in modern history.[2] Fed Policy today does not amount to economic reaction tomorrow. According to Hyman, policy changes by the Fed historically take many months to be made manifest, likely in the spring of 2024. Ed pointed out the San Francisco Fed estimates an effective Fed Funds rate of ~7%, a

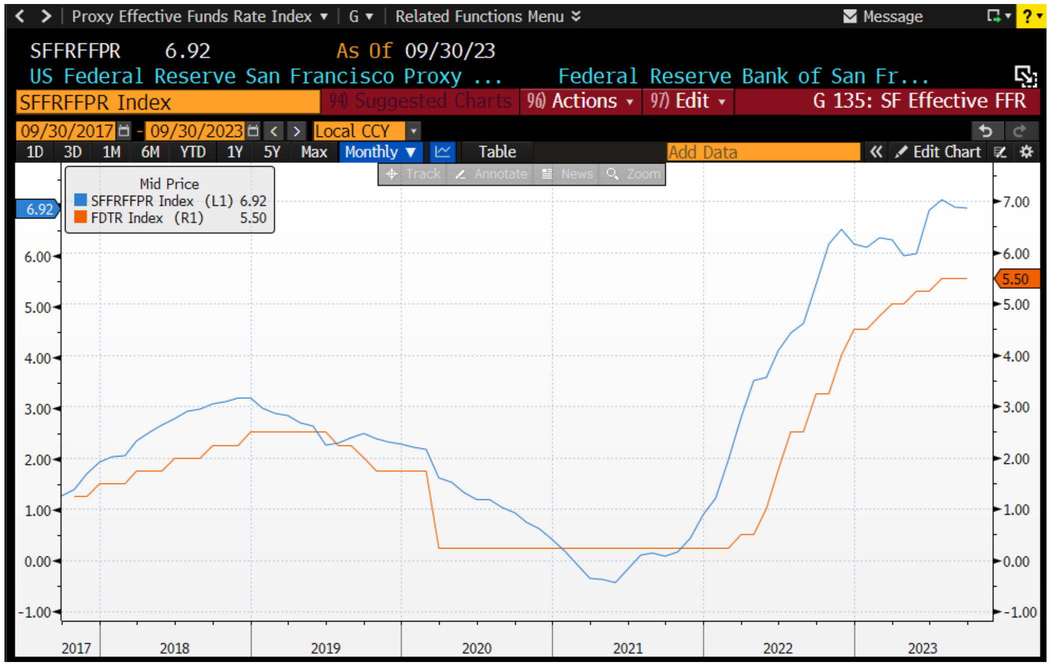
[1] Paul, Trina. "Understanding the Yield Curve: Why Economists Use It to Predict Recessions." Fortune Recommends, Fortune, 23 Oct. 2023, fortune.com/recommends/investing/the-inverted-yield-curve-recession/

[2] Tepper, Taylor. "Federal Funds Rate History 1990 to 2023." Forbes, Forbes Magazine, 17 Oct. 2023, www.forbes.com/advisor/investing/fed-funds-rate-history/.

full 150 basis points above the official Federal Funds rate. The proxy rate includes the impact of quantitative tightening plus banking strain. See Exhibit 3 below.

Exhibit 3: The San Francisco Fed's Proxy Fed Funds Rate

Source: Capital Creek Research, San Francisco Fed, Bloomberg



Quantitative Tightening ("QT")

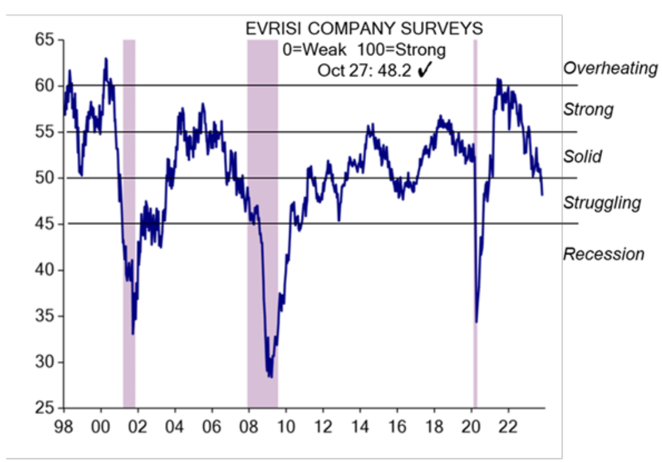
Through the execution of QT, the Fed allows its Treasury bond and mortgage-backed securities to mature without reinvesting the proceeds, thereby decreasing the size of its balance sheet. From its peak of $8.96 trillion, the Fed's balance sheet is down to $7.93 today. Nearly a one trillion-dollar decline. Ed's rule of thumb is that every trillion-dollar reduction in the balance sheet has a 100-basis point impact on the Federal Funds Rate.

Economic Slowdown

Ed noted that he is beginning to sense that the economy is weakening. Evercore ISI Company Surveys show a clear weakening that has been going on for over a year. See Exhibit 4 below.

Exhibit 4: Evercore ISI Company Surveys

Source: Evercore ISI



Fiscal Spending and the Election Cycle (17:54)

Scott discussed how President Joe Biden has been successful in passing major stimulus initiatives such as the Infrastructure Bill, the Chips Act, and the Inflation Reduction Act ("IRA"). While it's unlikely that Biden can pass more fiscal stimulus, he retains the ability to influence the pace of spending within each program and can pull forward spending into 2024. Biden has shown he is willing to tap the Strategic Petroleum Reserve (SPR) to lower energy prices. Biden has effectively blunted the Fed's monetary tightening through highly expansionary fiscal policy. Scott pointed out that historically, the 3rd year (2023) in a U.S. Presidential election cycle has been the strongest for the stock market. In contrast, the general election year (2024) is often characterized by choppy, trendless equity market performance until the outcome of the election has been discounted.

Current Economic Factors Ed and Scott Are Paying Attention To (24:56)

Global Conflict

Israel-Hamas: The Israel-Hamas conflict already exerts a global influence *(See Scott's recent piece on the conflict, Israel at War, HERE)*. This impact extends to the United States, which is simultaneously dealing with the Ukrainian-Russian conflict. History has shown that conflicts in the Middle East are prone to escalation. However, Scott's central case is that Iran does not become overtly involved and the conflict does not spread beyond Israel and Gaza.

China-Taiwan: Considering the global implications of the Israel-Hamas conflict, the question on many minds is, will China look to move militarily on Taiwan. Scott believes that past policy mistakes have put China in a defensive position. These policy errors include their zero-Covid strategy, contentious relations with major trading partners, the crackdown in Hong Kong, severely constraining its technology giants, and the targeting of outspoken business leaders. Such errors have put China in a challenging position, making full blown military aggression toward Taiwan less likely. With a material GDP slowdown, a real estate recession/depression, and an aging workforce, China needs a period of stability and healing which suggests it is not inclined to escalate tensions toward Taiwan anytime soon. [3]

U.S. Earnings Environment

So far, third-quarter earnings have been solid. Corporate America remains highly resilient and can take price increases while maintaining margins. Scott anticipates modest earnings growth of 5-6% in 2024. He sees earnings growth propelled by

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[3] Allen-Ebrahimian, B. (2023, October 25). China's economy hinges on a peaceful middle east - Axios. Axios. https://www.axios.com/2023/10/25/china-israel-hamas-war-energy

continued inflation, modest GDP growth, and financial engineering. Scott's 2024 S&P earnings estimate is $235, up 6.8% from $220 in 2023.

Bond Yields

Scott commented that investors have experienced an "Ursa Major" bear market in fixed income over the last 3+ years. This is what happens when inflation explodes higher while yields are below 100 basis points on 10-year Treasuries. If 10-year Treasury yields continue to rise, it will be very difficult for equities to progress upward. With high-quality corporate bonds yielding 6-8% and cash yielding 5.5%. Robust yields in fixed income represent significant competition for equities.

What has Ed Learned in his recent domestic and international travel? (33:27)

The Global Economy is Very Strong

Ed has observed that airports worldwide are full. In particular, the Tokyo airport seemed full of tourists from China and other Asian countries. When in Europe, he feels that the European economy, while not booming, also feels strong. Ed attributes this to the post-pandemic fiscal stimulation that has occurred around the globe. Further, in conversations with investors, he hears that people have loosened their grip on the certainty of an oncoming recession. In general, investors expect inflation to continue to decline, with a few exceptions. Scott added, now that investors have embraced a "soft-landing", we need to be on heightened vigilance about the potential for a recession in 2024.

Is the Fed Finished with its Rate Hiking Campaign? (35:58)

Ed's view is that the Fed has finished hiking rates. Considering the inverted yield curve, the reduction in the money supply, and a rapid increase in market interest rates now impacting all borrowers, something is bound to break. Ed hypothesizes that the inverted yield curve foretells a recession beginning in the spring of 2024. However, Ed believes that if inflation were to pick back up, the Fed would not hesitate to raise rates again. Scott echoed Ed's sentiment. Fed Chair, and added that Jerome Powell appears highly resolute in bringing inflation down to the Fed's target of 2%, despite the potential for collateral damage.

Ed's Four Keys to a Long and Successful Career (39:23)

Flexibility

The world is constantly changing, and having the ability to be flexible is crucial. Having great friends and peers to discuss, debate, and form opinions with is integral to developing such investment flexibility.

A Deep Passion for Helping Clients

A true desire to serve your clients is paramount. Ed does not know anyone who has had a long and successful career but did not have a deeper mission to serve clients.

A Real Interest in One's Craft

Ed told us he jumps out of bed daily, eager to understand and unpack why the world and markets behave as they do.

Luck

Ed has been fortunate to work for and alongside incredible industry legends willing to teach and mold him into who he is today.

Scott's Three Key Learnings from His Career (42:56)

The Importance of Policy

You can't fight the Fed. You can't fight fiscal policy. Monetary and fiscal policy have consistently been major market drivers throughout Scott's career, especially since the onset of the Global Financial Crisis (GFC). Understanding and embracing policy moves is crucial to long-term investing success.

Invest in Public and Private Equities for the Long-Haul

Over the past 100 years, the average bull market has risen by approximately 150% over 36 months. The average bear market lasts approximately 9-12 months and lowers market averages by around 30%. It pays to participate patiently in equities over the longer term.

Learning to Manage Risk Well

You must learn to survive to invest another day. Investors put themselves at great risk when they become over-leveraged, too concentrated, or become too illiquid. Proper diversification creates balance in a portfolio and allows an investor to ride through the inevitable difficult times that they will face.