Q4 2023 investment outlook:

Will higher interest rates force the proverbial runner to slow down?

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Executive summary

Diversified portfolios have had a strong start to 2023, but the third quarter reflected some concerns about the forward path. Consumer spending is resilient, thanks to a healthy domestic labor market, stimulus savings, ongoing business capital expenditures and pockets of global economic strength. Further, despite higher interest rates and compelling yields relative to recent history, investors continue to show enthusiasm for stocks despite a shallow recession in Germany and disappointing Chinese growth impulses.

Interest rates and inflationary pressures remain the dominant factors shaping the capital market landscape. The U.S. Federal Reserve (Fed) and other major central banks' interest rate increases intend to thwart inflationary pressures that remain persistent and above central bank target levels. We have used a visual of central banks acting as the personal trainer to their respective economies, continuously elevating the treadmill ramp height in the form of successive interest rate increases. As those ramps remain elevated or potentially move higher, the runner — the economy — will likely fatigue, and the extent of the runner's slowdown may lead to more challenging conditions for diversified portfolios than what we have seen thus far in 2023.

We have emphasized a more balanced forward outlook for diversified portfolios, not wanting to get overly bearish due to still-strong consumer fundamentals but also respecting higher interest rates' impact on the economic runner's pace. Higher bond yields, which move in the opposite direction of bond prices, offer investors the chance to collect income as they await the consumer's forward path. Our viewpoints that follow factor in global considerations across asset classes, but please do not hesitate with questions on topics we have not addressed that are important to you.

Global economic views

The global economy continues to shrug off elevated inflation and rising interest rates, though growth is likely to moderate into year-end.

Despite higher interest rates and still-elevated inflation for the U.S., Eurozone and many other developed and emerging economies, 2023 has still delivered solid economic results. The U.S. gross domestic product averaged more than 2% annualized growth in the first half of 2023 despite more than five percentage points of Federal Reserve interest rate increases in the past year. Japan also surprised with strong growth, averaging 4.8% annualized growth for the same period. The Eurozone, China and the United Kingdom delivered much softer, but still positive, results. Growth trends are likely to moderate in coming quarters as economic activity adjusts to higher global interest rates.

Global inflation trends are below 2022 peak levels, though still well above most global central bank targets. Year-over-year, the U.S. Consumer Price Index rose 3.7% through August, well below the 9% peak in June of 2022, but well above the Federal Reserve's stated target of 2%. Inflation rates in Europe, the United Kingdom, Japan and China are all slowing from recent peaks as well. Weak reopening activity in China coupled with deflationary pressures have been 2023 hallmarks thus far. Global inflation is likely to continue to moderate slowly with some supply constraints a key risk. Supplies of oil and metals, reflecting low investment in exploration and development, remain modest, though slowing growth is alleviating pressures.

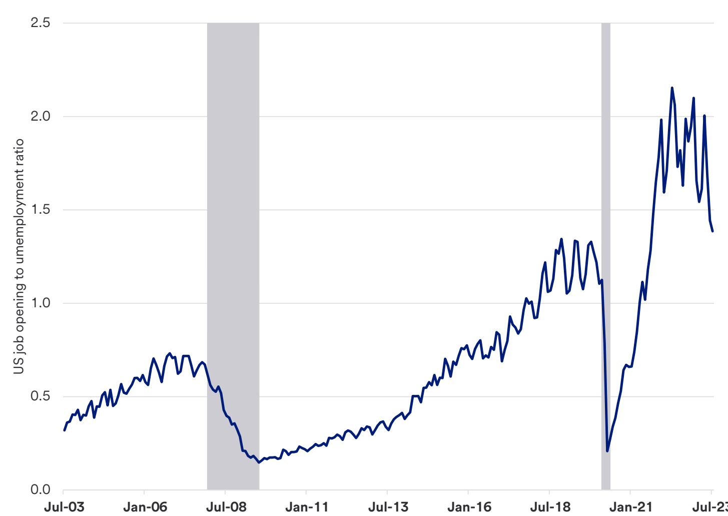
After a strong first half, headwinds are likely to dampen U.S. consumer spending.

The U.S. Bank Economic team sees U.S. economic conditions consistent with a soft landing, with the economy decelerating into early next year. Risks to their forecast are skewed to the downside, from sticky inflation that could force the Fed to aggressively raise interest rates, leaving odds of a mild recession in the next year uncomfortably high. Resilient consumer spending supported solid economic activity amid a tight labor market and strong wage gains. However, these strengths are likely to moderate in coming months, coupled with headwinds including an end to the student loan payment holiday, declining savings balances, higher borrowing costs brought on by Federal Reserve interest rate increases and tightening lending standards. Declining industrial activity for the better part of this year remains a domestic economic headwind and inventories, while contracting, do not yet appear low enough to bring a rebound this year. Services businesses continue to benefit from consumer spending on experiences as spending returns to pre-pandemic levels.

Disinflation is likely to gather steam in the U.S. but will likely not reach the Fed's target rate until late next year and is a risk to near-term economic activity, according to the U.S. Bank Economics team. The labor market is still quite tight, with 1.5 job openings per unemployed job seeker in July supporting year-over-year wage gains of 4.8%. Higher borrowing costs are also a risk to the economy as consumers and business adapt. Housing market activity has adjusted for the most part, but other real estate segments are facing loan maturities amid adjusting trends in office demand as the economy incorporates new post-pandemic work habits. Higher interest rates are also a challenge for government budgets; federal debt service costs now total 14% of federal spending as of July 2023[1].

U.S. job openings to unemployment ratio

Sources: U.S. Bank Asset Management Group analysis, Bloomberg data. Data period: July 31, 2003-July 31, 2023. Gray bars indicate recessionary periods.



Inflation and central bank interest rate hikes remain headwinds for Europe, though Japan remains a bright spot.

Inflation remains the major risk for Europe and the United Kingdom as the European Central Bank and the Bank of England raise interest rates to tamp inflation. Inflation data remains elevated across Great Britain and continental Europe as wage gains work through the economy. However, the region as a whole has so far avoided recession with a few exceptions at the country level. Purchasing manager surveys indicate slowing manufacturing and services, with Germany the primary economy in recession. Energy costs are a key risk to the region as we head into winter with no Russian supplies amid the ongoing conflict between Russia and Ukraine.

Japan's growth is a bright spot for the global economy, emerging from a short recession early this year. In contrast to other global central banks, the Bank of Japan maintained low interest rate polices, instead welcoming some reflation in its economy after decades of deflation. The economy appears likely to sustain its modest pace of real economic growth into year-end with this support as consumer spending improves.

Weak global manufacturing hurts most emerging market economies, except for India.

Activity in China, the world's second-largest economy, moderated in the second quarter despite ending coronavirus-related restrictions. Consumer activity remains low and concentrated in experiences such as travel, although many foreign travel restrictions have only recently lifted. Purchasing manager surveys for August improved back toward modest expansion, though loan growth and retail spending indicators remain modest. Stimulus measures remain focused on slightly lowering interest rates and rekindling lending activity. Growth is likely to remain modest into year-end without more significant stimulus measures. China's challenging relationship with the U.S., especially around key items such as semiconductors, is also likely to weigh on year-end activity.

Other emerging market economies remain more dependent than China on global trade and economic activity. South Korea and Taiwan are cyclically oriented and are therefore sensitive to global trade and manufacturing. Global manufacturing business surveys indicate slowing activity and weak new orders. India remains a bright spot as the manufacturing economy focuses on growing international sales. Other major economies, such as Brazil, depend heavily on natural resources. Slow global economic growth is dampening global natural resources demand and commodity prices are generally flat.

U.S. equity markets

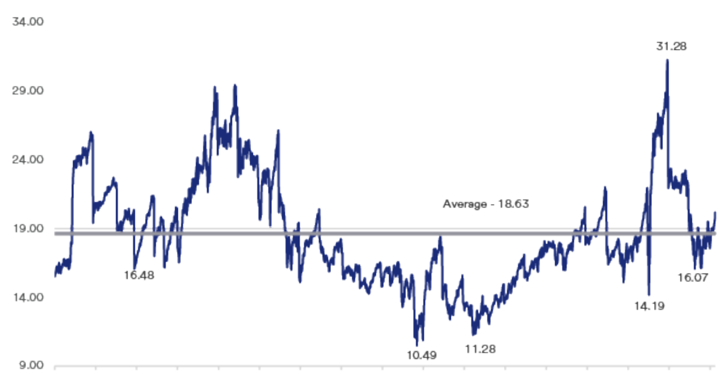
U.S. equities are navigating competing factors, balancing the tug-of-war between bull and bear camps.

Recent data indicates inflation's pace is waning, suggesting the Fed may soon pause its interest rate hiking campaign. Additionally, the data highlights the economy's strength despite higher rates, bolstering prospects for modest economic slowing toward year-end. Finally, better-than-forecasted earnings growth, ongoing artificial intelligence-induced growth drivers and resilient consumer spending trends are among factors supporting upward-trending equity prices.

Conversely, we also find factors warranting a cautious bias. Inflation, interest rates and earnings are interrelated keys to equity price movements, with inflation's persistence above the Fed's price stability target entrenching a period of higher interest rates. Higher interest rates increase competition from bond investments, which pressures valuation measures such as the price-to-earnings ratio, or the share price equity investors are willing to pay for realized or future earnings. Additionally, narrow year-to-date equity sector performance leadership, potential for economic and corporate earnings pressures emerging later in the fourth quarter and already-elevated valuations are among factors tempering our forward outlook. The S&P 500 ended the third quarter trading at roughly 17.8 times the consensus next-12-months earnings estimate, according to Bloomberg, FactSet and S&P Cap IQ, modestly above its 25-year historical average of 16.6 times.

S&P 500 next 12 months price/earnings ratio

Sources:: U.S. Bank, Bloomberg, September 6, 2023.



Consumers continue to spend on experiences and essentials while spending on discretionary items has lagged.

Spending on experiences following COVID-related restrictions continues, benefiting travel and entertainment companies. A pick-up in discretionary spending such as electronics, home furnishings and general merchandise would signal improving economic strength and goods spending will be a key focal area for third quarter company releases beginning in mid-October.

Fast is getting faster, and speed, scale and efficiencies do not occur without technology.

Artificial intelligence (AI) remains salient, impacting how we live, work and play while helping bolster performance of related Information Technology companies. Through the third quarter, the seven largest companies by market capitalization in the S&P 500 are up year-to-date between a range of 32% and 198%. Corporate spending on AI, cloud computing, software and data security-related spending remains solid as companies leverage growth opportunities and enhanced productivity associated with accelerated computing.

Opportunities exist in all market environments.

Traditionally defensive sectors such as Utilities, Healthcare and Consumer Staples can benefit investors with shorter time horizons (less than a year) or who have a lower tolerance for risk. Defensive sectors' generally lower volatility and relatively higher dividend yields are attractive characteristics during an uncertain economic environment. We favor defensive-oriented companies as well as select companies in cyclically sensitive sectors such as Financials, Real Estate and Energy with dividend yields close to the S&P 500 but with higher dividend growth rates, which helps offset the effects of inflation.

Longer-term, we regard opportunities within growth sectors such as Information Technology, Communication Services and Consumer Discretionary as compelling for investors with time horizons of a year or more and a greater tolerance for price volatility. While these growth-oriented sectors are outperforming in 2023, secular tailwinds behind AI, machine learning, cloud computing and anywhere, anytime connectivity should continue to support associated companies over the longer term. Moreover, many of these companies offer compelling revenue and cash flow profiles.

Foreign equity markets

Positive revenue and earnings growth provide ongoing price support for foreign developed equities; a strengthening dollar and persistent inflation temper forward risk and return prospects heading into the year's final quarter.

Analysts forecast foreign developed 2023 revenues and earnings, represented by the MSCI EAFE (Europe, Australasia, and Far East) Index, to increase by 6.6% and 8.0%, respectively, according to Bloomberg. Positive fundamentals have provided price support for the region in 2023, with the MSCI EAFE Index rising 7.6% year-to-date through the third quarter's close. Contrasting with narrow U.S. sector leadership, foreign developed performance gains have been broad based this year, with 10 out of 11 sectors posting positive returns.

Additionally, energy supply risks have receded, further supporting the region's near-term outlook. The European Union achieved its goal of securing 90% of its gas storage supplies for the 2023-2024 winter season, according to Gas Infrastructure Europe, an association of gas infrastructure operators in Europe. The EU attained its storage goal nearly two-and-a-half months ahead of its November 1 deadline, helping avert a potential energy supply shock amid the ongoing Russia/Ukraine conflict.

However, a strengthening dollar and persistent European inflation balances our forward outlook. Real interest rates, or a government bond's nominal or non-inflation-adjusted interest rate less the market's implied inflation rate over the bond's maturity, are significantly higher in the U.S. than in Europe. All other things equal, higher relative real interest rates attract global investors' capital away from markets with relatively lower real rates. The currency in the country with the higher real interest rate tends to appreciate due to stronger demand relative to the lower rate country's currency. Consequently, a strengthening dollar relative to Europe and Japan decreases a U.S. investors' total return from foreign developed equity investments.

Inflation represents an additional headwind. Consumer prices across the Eurozone (countries that use the euro currency) remains stickier than in the U.S., with headline prices rising 5.3% in August versus 3.7% in the U.S. and core prices (which exclude food and energy) also rising 5.3%, well above the European Central Bank's (ECB) price stability target. Persistent inflation keeps pressure on the ECB to maintain restrictive monetary policy, which serves to act as a brake on economic activity. Analysts in turn forecast only modest corporate revenue and profit growth in 2024, slowing to 2.2% and 2.6%, respectively.

Valuation remains attractive, with catch-up potential if recession fears remain unrealized.

Foreign developed equity market valuation relative to projected earnings remains modestly below the long-term median, and at a near-record (17-year) discount relative to domestic large-cap peers, suggesting global investors have already priced in a much more challenging forward scenario for foreign equities relative to U.S. companies' prospects. While U.S. companies' relative revenue and earnings growth advantages historically justified this relative valuation discount, European policymakers' progress toward achieving price stability would improve the prospects for the region's pharmaceutical, consumer staples and luxury goods franchises and a historic relative valuation discount provides attractive catch-up potential.

Weak global trade and China's stalling economy continue to weigh on emerging markets' 2023 price performance; forward prospects hinge on global technology demand and China's policy support.

Emerging market equity performance measured by the MSCI Emerging Markets Index continues to lag domestic and foreign developed peers, with the index up a modest 2.1% through September 30. Muted relative price performance mirrors relative fundamental weakness, with analysts forecasting a 10.4% profit decline across the region in 2023 versus strong profit growth forecasts in the U.S., Europe and Japan, as noted earlier. Weak global trade and technology demand have weighed on exporting countries, while China's stalling economy hurt its large consumer-oriented platform companies.

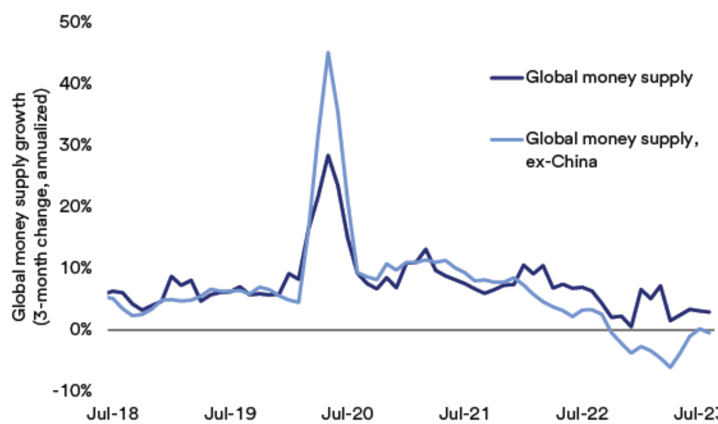
South Korean and Taiwanese companies constitute approximately 30% of emerging markets' index exposure. Leading companies are global technology, consumer and materials franchises. While South Korean and Taiwanese equities rallied in 2023's first half, share prices declined in the third quarter. Economic indicators such as world trade or global semiconductor sales reflect persistent weakness, highlighting the economic growth divergences between a resilient U.S., languishing Europe and weakening China.

China represents an additional 25% of country exposure, with recent economic data highlighting tepid consumer spending, pessimistic consumer confidence, elevated youth unemployment and property developers' ongoing financial stress. China's expansionary monetary policy stands out among global peers by providing additional liquidity this year while other central banks contract money supply.

However, China's policy initiatives to date have been largely incremental and supply-side oriented; large consumer platform companies dominate the equity index and direct fiscal policy support will likely be key in reigniting consumer confidence and spending to drive equity prices higher in the quarters ahead.

Global money supply growth (3-month change, annualized)

Source: Bloomberg, U.S. Bank



Analysts forecast a strong revenue and profits recovery across emerging markets in 2024, projecting 8.4% sales growth and 19.5% earnings growth according to Bloomberg. Valuation is reasonable, with the index trading at 13.2 times 2023 estimates and 11 times 2024 estimates. Recovering global trade and technology demand and China's efforts to stimulate consumer spending remain keys to emerging market's forward prospects, and our balanced outlook views risks and rewards as evenly balanced.

Fixed Income

Interest rates near 15-year highs improve future return prospects.

Yields on high-quality bonds are near their highest levels in 15 years, creating competitive income-generation opportunities versus traditionally riskier assets like stocks and real estate. Interest rate markets indicate investors anticipate the Fed may hike interest rates once more this year before cutting rates by around 0.75% in 2024. However, despite recent inflation showing signs of deceleration, lingering concern the Fed may struggle to achieve the "last mile" of pushing inflation down to its 2% target continues driving Treasury yields higher. As a reminder, yields rise when bond prices fall.

Ten-year Treasury yield

Source: Bloomberg. September 28, 2023.

Central banks expect to hold their target interest rates near peak levels to allow restrictive policy settings to work through the economy.

The Fed rapidly tightened monetary policy to temper inflation, lifting interest rates from near 0% to almost 5.5% in just over a year. Investors continue to debate whether the Fed will increase rates one more time in 2023 before ending its hiking campaign. Market prices indicate investors remain relatively confident that multiple additional hikes are unlikely and, instead, major central banks may cut rates starting in 2024. Normally, slower inflation and economic growth pressure U.S. Treasury yields when they trend higher, but two key headwinds are likely elevating interest rates.

First, higher issuance of Treasury securities by the U.S. Department of the Treasury. These bond sales fund government deficit spending and cover the cost of higher interest expenses for government debt. Coupled with the ongoing maturity of Fed Treasury holdings, this necessitates ever-rising demand from investors just to keep bond yields stable. Second, the "last mile" of inflation returning to the Fed's 2% target may be difficult, with consumer spending and wage growth remaining stronger than most anticipated. Higher inflation for longer could derail investors' hopes for aggressive rate cuts in 2024 and translate to stable or higher Treasury yields. Overall, we see risks and opportunities as relatively balanced for high-quality bond investors between compelling yield opportunities and portfolio diversification characteristics versus the risk of higher yields from elevated issuance and inflation.

Reasonable valuations on high-quality corporate and municipal bonds offer opportunities to generate incremental income over Treasuries.

The extra yield paid by investment-grade bonds are near long-term averages, fairly compensating for credit risk if corporate and municipal bond issuer fundamentals remain reasonably strong. Higher borrowing costs are starting to drag on weaker issuers' ability to cover interest payments, but high-quality issuers typically have lower debt burdens that support their ability to meet obligations as the economy decelerates. Normal exposures to high-quality corporate and municipal bonds that are less sensitive to the economy's fluctuations can help diversify portfolios while maintaining meaningful potential income from their improved yields. Potential tax benefits of certain municipal bonds make them particularly important components for investors in high income tax brackets within accounts subject to taxation.

Riskier bonds offer slightly less compensation for credit risk should the credit environment deteriorate. In aggregate, riskier issuers' ability to pay back debt remains in line with to slightly better than historical averages, but rising interest costs and tighter credit availability may begin to challenge weaker issuers. We have observed modest upticks in default activity among lower credit tiers and defaults may creep up the credit quality spectrum if consumer spending falters, but thus far consumers have bolstered corporate profits and income tax revenue for municipalities. Instead of refinancing or issuing new debt, riskier high yield corporate and municipal bond issuers used cash reserves over the past year when available, bringing them to slightly below average long-term levels, but reducing their flexibility to finance operations amid an economic slowdown. Normal, modest allocations to riskier bonds remain appropriate, but rising defaults and any faltering of investor sentiment could pressure prices.

Mortgage bonds not backed by the government and insurance-linked bonds offer attractive income with unique return sources.

Limited housing market purchase and refinancing activity due to high interest rates crimped new mortgage bond supply this year. At the same time, yields on mortgage bonds remain elevated, and consumers remain reasonably healthy, as evidenced by consumer spending patterns and low mortgage defaults. This combination of factors supports opportunities to earn high income with strong fundamental tailwinds in mortgage bonds not backed by the government. Most home loans originated before 2022 remain well-secured by the value of the homes collateralizing them, and borrowers have a strong incentive to avoid default given low fixed rate mortgages in place. Investor sentiment and deteriorating liquidity remain the largest near-term risks. Reinsurance, also referred to as insurance-linked securities, continues to offer compelling yields. Insurance premiums (minus insured losses from natural disasters) support returns and remain uncorrelated with typical economic cycles that drive stock and bond returns. Current premiums, which translate to high bond investor income, far surpass average historical insured losses, providing a compelling degree of cushion against major weather events.

Real asset markets

A challenging first three quarters of 2023 drove public real estate prices toward cheaper valuations, but fundamental headwinds remain a risk.

Publicly traded real estate securities underperformed the broader market by 3.5% in the third quarter, with elevated inflation and rising interest rates offsetting positive property market fundamentals. Many property types still trade at significant discounts to net asset value of properties owned. Moderating inflation and interest rates could serve as tailwinds to real estate investment trusts (REITs) despite a slowing growth environment.

Nationally, vacancy rates are rising from low levels across most property types and income growth is slowing, trends we expect to continue throughout 2023. Income growth relative to property values has increased in the publicly traded REIT market due to declining prices. In contrast, property values in the private market, which are instead based on property appraisals and a few transactions, typically lag public market price adjustments. The publicly traded REIT market now appears inexpensive when compared to current private market prices.

Looking to the fourth quarter, slowing economic growth may challenge property prices, which is one reason for recent discounts priced into publicly traded real estate stocks. Ongoing concerns remain with office and retail properties, but they represent small components of most broadly diversified REIT benchmarks. Moreover, most REIT indices are more heavily weighted to stronger growth areas, such as data centers, which are benefiting from the need for larger and faster server farms to process our technological infrastructure, such as artificial intelligence applications. As a result, REITs will likely generate modest returns despite decelerating growth driving declining property market fundamentals.

Infrastructure assets offer consistent dividends, but elevated inflation and high interest rates are headwinds.

Infrastructure trailed the S&P 500 by 4% during the third quarter. Positive sentiment toward growth stocks, especially in the Technology sector, hurt infrastructure assets given their more defensive characteristics. Utilities, the most defensive sub-sector within infrastructure, was the weakest component, as interest rates rose.

Into year-end, infrastructure assets could benefit if the economy slows meaningfully. However, elevated inflation and interest rates are meaningful headwinds for the asset class. Utilities comprise about half of the infrastructure asset class and their defensive characteristics, such as stable earnings growth, could benefit if interest rates decline in concert with weaker growth. Midstream energy is providing solid earnings growth, which should continue; energy prices are stable to higher and crude oil and natural gas production rates continue to climb. Additionally, free cash flow yields to equity are well above long-term averages.

The commodity complex appears torn between decelerating economic growth and constrained inventories.

The extension of output cuts through year-end by Saudi Arabia and Russia, two key members of OPEC+, the Organization of Petroleum Exporting Countries and 10 allies, further constrained global oil inventories, lifting recent oil prices. However, weaker global economic growth should dampen demand, offsetting near term price gains. The turn of the calendar to winter in the northern hemisphere brings about the weakest season for oil demand, as well.

Over the next couple of years, the picture is more constructive. Multiple years of limited investment in productive capacity for commodities, such as oil and industrial metals like copper, are hurting supply resilience. Additionally, government and investor policies offer disincentives to invest in productive capacity. Simultaneously, the transition to green energy networks may require a material increase in demand for fossil fuels and various metals to build new infrastructure.

Alternative investments

Hedge funds managers are wading through economic uncertainty to look for opportunities.

The market backdrop is still positive for many hedge fund strategies. Fixed income managers are finding ample trading opportunities amid a resilient economy and persistent inflation, signaling interest rates may stay higher for longer. Hedge funds focused on equities have benefited recently from increased stock price volatility following company earnings reports. This contrasts with the start of 2023, when bank failures and recession concerns led hedge fund managers to position defensively and remain agile. A similar performance shift is occurring at the sector level, with strong year-to-date index returns belying significant sector performance dispersion. As highlighted earlier, the traditionally defensive Utilities sector has declined 9.0% this year while secular growth sectors such as Communication Services and Information Technology have appreciated more than 40%. Hedge fund specialists in the Information Technology sector are among the best-performing strategies in 2023, benefiting from this performance dispersion. Mean reversion strategies, which benefit from converging performance trends, are positioned well over the next few quarters if dispersion falls.

Hedge fund managers' midyear positioning reflected diverse decisions amid myriad complex macroeconomic and geopolitical risks. Managers identify investments to both buy long and sell short, and managers' appetite for risk has generally increased this year as measured by leverage and overall net market exposure (the difference between total long positions and total short positions). However, the overall net position to markets remains low, suggesting managers remain somewhat cautious. We expect additional market pullbacks may also encourage some managers to position portfolios for upside volatility. As we noted last quarter, we expected a focal shift to individual security selection, such as stock-specific short selling. Strategies focused on idiosyncratic situations, including activism, are performing especially well this year. Activist hedge fund managers seek to engage with company managements to unlock value in depressed stock prices. Meanwhile, similar opportunities in fixed income have not been as robust. Higher interest rates may ultimately slow economic activity and improve long and short investing opportunities in credit markets due to widening yield spreads (higher yields compared to Treasuries) and a greater number of high yield bonds and leveraged loans trading at distressed levels.

Private markets

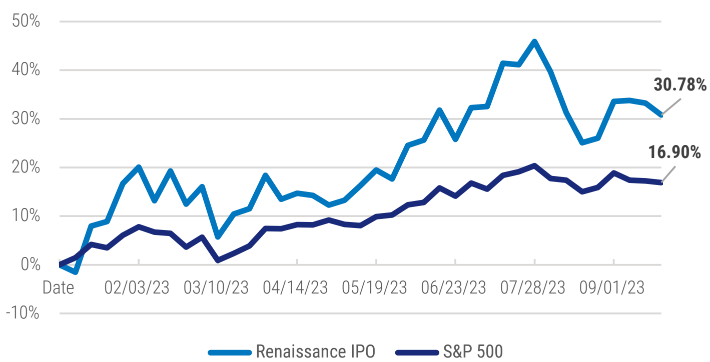
Improved investor sentiment for new public market listings shows the initial public offering (IPO) window may be opening, but investor appetite for unprofitable companies remains subdued.

The "IPO window" is loosely used to describe market conditions when public market investors are receptive to public listings of fast-growing but barely profitable or unprofitable privately held companies. Three recent filings — ARM Holdings, Instacart and Klaviyo — evidence positive sentiment toward large-company IPOs and suggests more listings may follow. The pricing that public market investors assign when a company is initially listed on a stock exchange is a key test for a cohort of large privately held, venture capital-financed companies. The first few days and weeks of how the stock price performs provides private investors with a strong indication of public market participants' appetite for new listings.

The IPO window has been essentially closed outside of occasional small company stock listings since the Federal Reserve embarked on its interest rate hiking cycle. Public market investor sentiment toward speculative technology companies has soured since November of 2021 in the face of rising interest rates after a flurry of IPO activity over the 18 months prior. However, as the Fed has slowed its rate hiking pace, investor appetite for high-growth companies has returned and the Renaissance IPO Index that tracks recent public listings has risen by 27.8% year-to-date compared to the S&P 500's 13.1% total return. Positive market receptivity provided Cava Group, a Mediterranean fast casual restaurant brand, an opportunity to list on public stock exchange via an IPO in June of this year. The company was well received, and the stock price increased by 115% on the first day of trading. Cava Group turned profitable in the first quarter since its IPO and reported 62.4% increase in year-over-year revenue growth.

Year-to-date returns of recent IPOs

Source: FactSet



The number of venture capital (VC)-backed companies with delayed IPOs due to poor market conditions in 2022 has increased considerably. Cava Group's successful listing and the strong performance of the Renaissance IPO Index has emboldened a group of private companies waiting to go public. ARM Holdings, Instacart and Klaviyo, all VC-backed companies, made their public markets debut in recent weeks. ARM Holdings, a British chipmaker offered shares that would value the company at more than $52 billion, materially higher than $32 billion that Softbank paid for ARM in 2016. Klaviyo, a marketing automation company, listed its shares at a price that values the company at about $10 billion, right around the last private funding round in 2022. Finally, Instacart, a grocery delivery service, listed its shares at a price that values the company at the $10 billion-mark, 70% lower than its last private funding round in 2021.

These listings provide a glimpse into how market sentiment has changed since 2021 when the Fed's target interest rate was 0.25%, compared to the 5.5% rate at this publication's release. All three companies are profitable, contrasting with the market environment in 2021 when interest rates were near zero and many companies that went public in 2021 were unprofitable at IPO. Given materially higher rates today, investors are less willing to pay up for future growth prospects than they were in 2021 evidenced by the significant expected valuation markdown.

As private market investors through market cycles we partner with managers targeting investments at a stage of a company's growth cycle when the company valuations are anchored in business fundamentals. We avoid managers focused on the late-stage pre-IPO private funding rounds because valuations at that stage are speculative and tend to be inflated, boosted by non-traditional investors such as hedge funds and mutual funds. We also focus specifically on profitable growth and avoid frothy market segments by seeking prudent investment partners. Ultimately, the post-IPO performance of ARM Holdings, Instacart and Klaviyo will determine whether the IPO window is finally open for the backed up pipeline of VC-backed private companies since the window shut in late 2021. The success or failure of these IPOs will have implications across the venture capital deal space and on broader private market deal activity.

The identification of named IPOs is for illustrative use only and is not intended to provide specific advice or to be construed as an offering of securities or recommendation to invest and is not a representation or solicitation or an offer to sell/buy any security.

[1] Understanding the National Debt | U.S. Treasury Fiscal Data

Past performance is no guarantee of future results. All performance data, while deemed obtained from reliable sources, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for investment. **The S&P 500 Index** is an unmanaged, capitalization-weighted index of 500 widely traded stocks that are considered to represent the performance of the stock market in general. **The S&P 500 Total Return Index** includes the same stocks but include the reinvestment of dividends. The **MSCI EAFE Index** includes approximately 1,000 companies representing the stock markets of 21 countries in Europe, Australasia and the Far East (EAFE). The **MSCI Emerging Markets Index** is designed to measure equity market performance in global emerging markets. The **Renaissance IPO Index** is a stock market index based upon a portfolio of U.S.-listed newly public companies, before their inclusion in core equity indices. The index reflects approximately the top 80% of newly public companies in capitalization terms, is weighted by float capitalization and imposes a 10% cap on the weight of large constituents.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. The value of **large-capitalization stocks** will rise and fall in response to the activities of the company that issued them, general market conditions and/or economic conditions. **Stocks of small-capitalization companies** involve substantial risk. These stocks historically have experienced greater price volatility than stocks of larger companies and may be expected to do so in the future. **Growth investments** focus on stocks of companies whose earnings/profitability are accelerating in the short term or have grown consistently over the long term. Such investments may provide minimal dividends, which could otherwise cushion stock prices in a market decline. Stock value may rise and fall significantly based, in part, on investors' perceptions of the company, rather than on fundamental analysis of the stocks. Investors should carefully consider the additional risks involved in growth investments. **Value investments** focus on stocks of income-producing companies whose price is low relative to one or more valuation factors, such as earnings or book value. Such investments are subject to risks that their intrinsic values may never be realized by the market, or such stocks may turn out not to have been undervalued. Investors should carefully consider the additional risks involved in value investments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults). Hedge funds are speculative and involve a high degree of risk. An investment in a **hedge fund** involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem or transfer interests in a fund. **Private capital investment funds** are speculative and involve a higher degree of risk. These investments usually involve a substantially more complicated set of investment strategies than traditional investments in stocks or bonds, including the risks of using derivatives, leverage, and short sales, which can magnify potential losses or gains. Always refer to a Fund's most current offering documents for a more thorough discussion of risks and other specific characteristics associated with investing in private capital and impact investment funds. **Private equity investments** provide investors and funds the potential to invest directly into private companies or participate in buyouts of public companies that result in a delisting of the public equity. Investors considering an investment in private equity must be fully aware that these investments are illiquid by nature, typically represent a long-term binding commitment and are not readily marketable. The valuation procedures for these holdings are often subjective in nature. **Private debt investments** may be either direct or indirect and are subject to significant risks, including the possibility of default, limited liquidity and the infrequent availability of independent credit ratings for private companies.

