AUGUSTINE ASSET MANAGEMENT

January 2024

Goldilocks…And Three Bears

Market Summary

Equities

MSCI AC World	727
Price / Earnings	18.5x
Dividend Yield	2.1%
S&P 500	4769
Price / Earnings	22.1x
Dividend Yield	1.5%

US Interest Rates

2 Year Treasury	4.2%
10 Year Treasury	3.9%
30 Year Treasury	4.0%
Bloomberg US Agg.	4.5%

US Corporate Spreads

Investment Grade	1.5%
High Yield	3.8%

Equity Volatility

CBOE SPX Volatility	12.5

US Economic Figures

GDP Growth 3Q23	4.9%
Unemployment	3.7%
Inflation (core)	3.9%
Fed Funds Rate (mid)	5.4%
3 Month SOFR	5.3%

Commodities

Oil (Brent)	$77
Natural Gas	$2.51
Copper ($/lb.)	$3.89
Gold ($/oz.)	$2063

Foreign Exchange

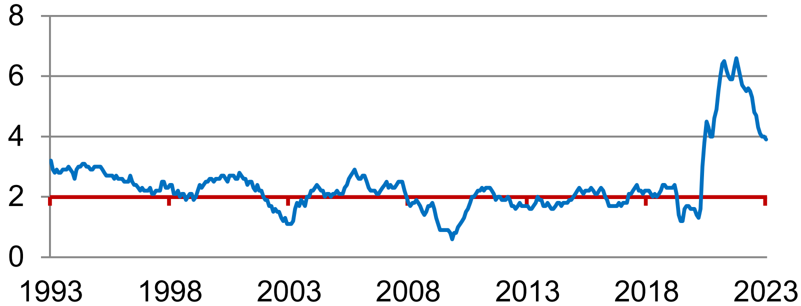
Euro	$/€	1.10
Japanese Yen	¥/$	141
Chinese Yuan	元/$	7.13

Market summary data as of:
December 31, 2023

Financial markets finished 2023 on an unusually strong note. After modest returns through October that saw global equities up 6.7% and US dollar bonds down 2.8%, both asset classes "caught fire" to end the year up 22.2% and 5.5%, respectively. It was the strongest two-month index return for the "classic" 60/40 stock/bond portfolio since the bottoming of the great financial crisis fifteen years ago.

Reduced inflation, with the US core consumer price index ending the year at 3.9%, helped make the case that the current Fed Funds rate of 5.5% is high enough to eventually push inflation down to 2%. More important were steps by the US government to drive down interest rate expectations.

Exhibit 1: US Core CPI % vs 2% Target
Better. More Work to Do.



To ease upward pressure on long-term rates that rose in October to a 15-year high, the US Treasury shifted its bond sales to short-term maturities. Meanwhile, the Federal Reserve did a surprise U-turn from a tightening to an easing bias. Rather than considering a further increase in the Fed Funds rate, it is now looking toward cuts. Also surprising, the Fed has begun to consider a lower run rate or earlier end to its balance sheet reduction program known as Quantitative Tightening. Contradictory statements by Federal Open Market Committee members portrayed a sudden, if not chaotic, pivot.

Exhibit 2: Fed Speak
What Are You Saying?

> Chairman Powell, December 1: *"It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease."*
>
> Chairman Powell, December 13: *"People are not writing down rate hikes... That's us thinking we've done enough… But of course, the question is 'when will it become appropriate to begin dialing back?'"*
>
> NY Fed President Williams, December 15: *"We aren't really talking about rate cuts right now… I just think it's just premature to be even thinking about that."*

Market participants are highly attuned to the Fed's stance, especially in the modern era of central banking that followed the great financial crisis with historically unusual rate and balance sheet policies. They have taken recent note of policy makers' desire for lower rates, especially the Fed's volte face when core inflation is still double their target, unemployment just 0.3% off the record low and 2.5% below its 50-year average, and wage growth running at a 4.1% annual pace. The consensus expectation is now for 1.5% in rate cuts before year end.

Exhibit 3: US Unemployment %
Near Record Low.

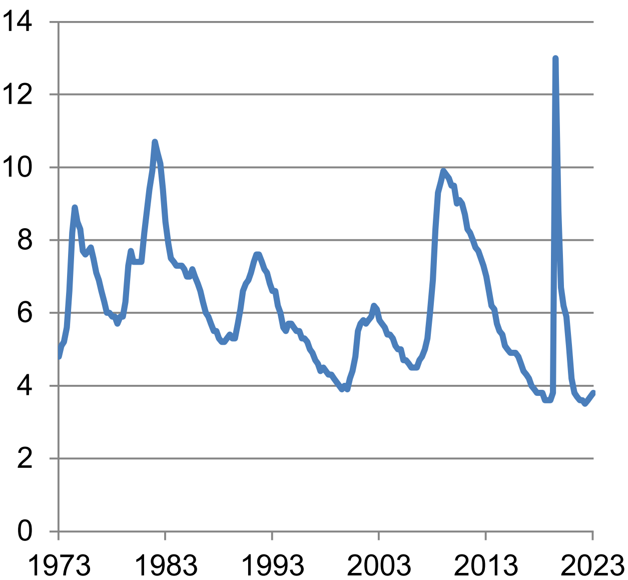


Exhibit 4: Robust Wage Growth %
Good for the Economy, Not Good for Inflation.

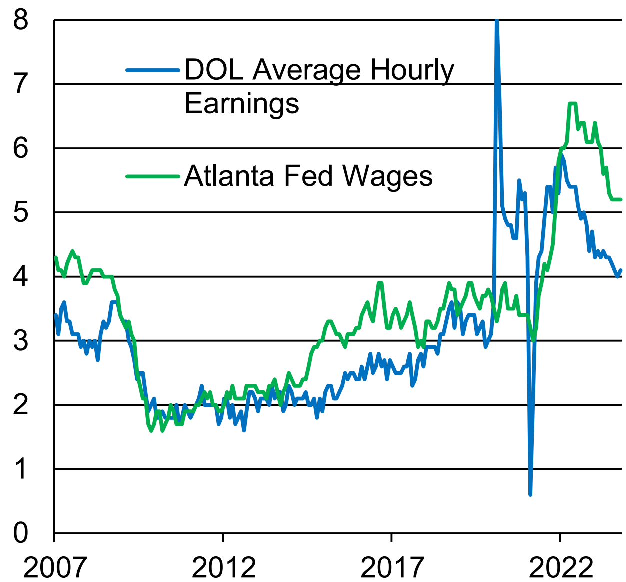
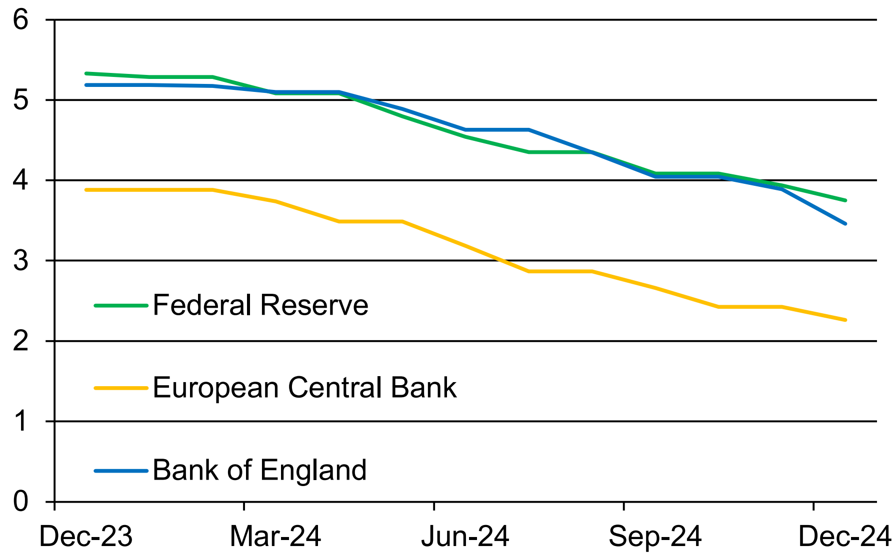


Exhibit 5: Fed Fund Futures Implied Rates
Easier, Sooner.



With the consensus 2024 growth forecast rising among major economies and particularly for US, the shift to potentially looser monetary policy that seeks “no landing” of the economy has convinced investors that they are not fighting the Fed anymore and that “goldilocks” conditions of positive growth that is neither too hot to keep inflation and interest rates from falling nor too cold to risk a recession and fall in corporate profits is the base case for 2024. As such, the highest risk assets led the charge into the year end on hopes that the days of non-recessionary easy money will soon return.

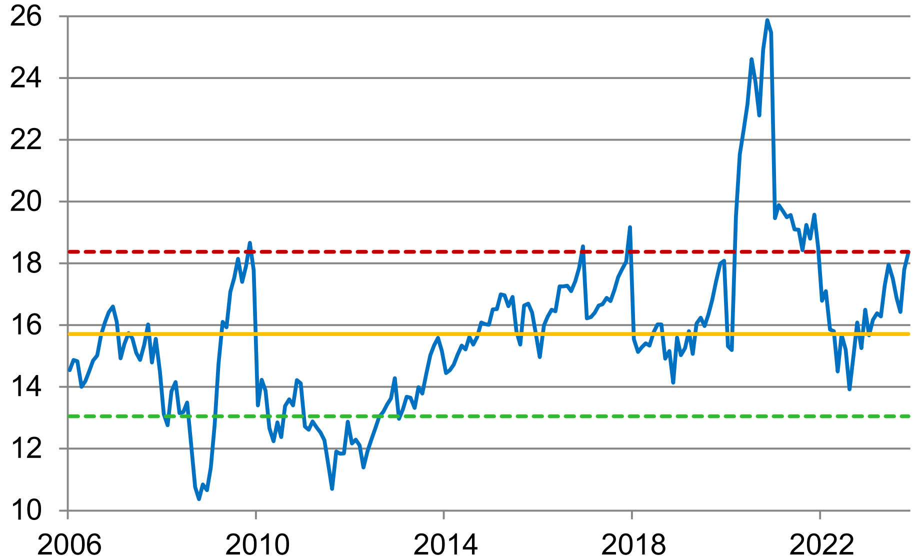
Exhibit 6: November-December 2023 Leaders
Speculative “Risk On” Across Stocks, Bonds, & Alternatives.

Goldman Sachs Non-Profitable Tech	+42%
UBS Low Quality Index	+29%
ICE CCC & Lower US Bond Index	+11%
30 Year US Treasury	+15%
Bloomberg Galaxy Crypto Index	+46%

Is a preference for riskier speculative assets the right call for the coming months and quarters? While we forecast limited risk of a deep economic contraction, we see several “bears” to the “goldilocks” expectations that investors will need to contend with – high valuations, aggressive investor sentiment, and the ongoing normalization of the yield curve.

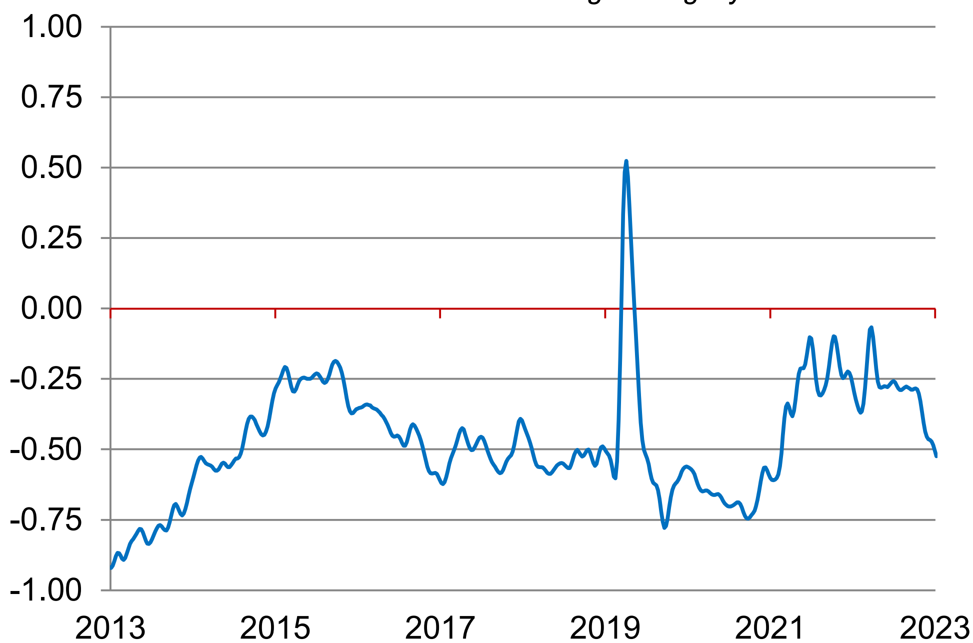
Readers of our commentary are familiar with our view that valuation provides little insight into the near-term direction of capital markets but informs investors of the prospects for future returns and the risks that will be realized along the way. With the year-end rally bringing the global equities index to a standard deviation above its historical average, investors can expect lower than historical forward returns and higher than historical drawdown risk. Higher valuation in the US sends a stronger message.

Exhibit 7: MSCI All Country World Forward 12 Month Price / Earnings Ratio
Higher Valuation. Below Average Returns & Above Average Risk.



An adage about the market describes rising stocks “climbing a wall of worry” as pessimistic sentiment gives way to a brighter outlook. A range of today’s sentiment indicators such as investor surveys and positioning in equity index derivatives markets suggest an aggressive optimism with little wall left to climb. Meanwhile, expectations for 9% earnings growth in the US and 8% globally leave a thin margin of error for softness in the economy. Market sentiment is reflected in asset pricing across financial markets, which the Fed’s own indicator of financial conditions reads as loose today as it was before it began raising rates and reducing its bond holdings two years ago.

Exhibit 8: Chicago Fed National Financial Conditions Index
Looser Now than Before the Tightening Cycle.



Meanwhile, we see the normalization of interest rates along the maturity curve as an incomplete process that could present an ongoing challenge to valuations and constrain fiscal and monetary policy. Geopolitical realignment of supply chains, energy transition, rising government deficits, and less aggressive forms of central bank yield curve control presage a return of positive term premium as investors demand compensation for a higher base level of inflation and as constantly rising government indebtedness meets less central bank enabling.

Exhibit 9: US Federal Fiscal Balance History & CBO Projection $ Billions
Bonds Investors Might Notice.

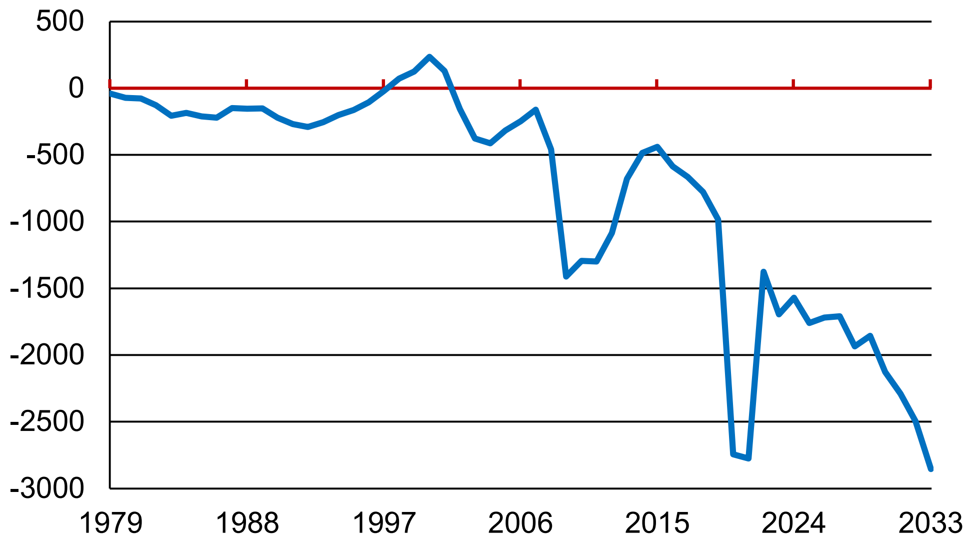
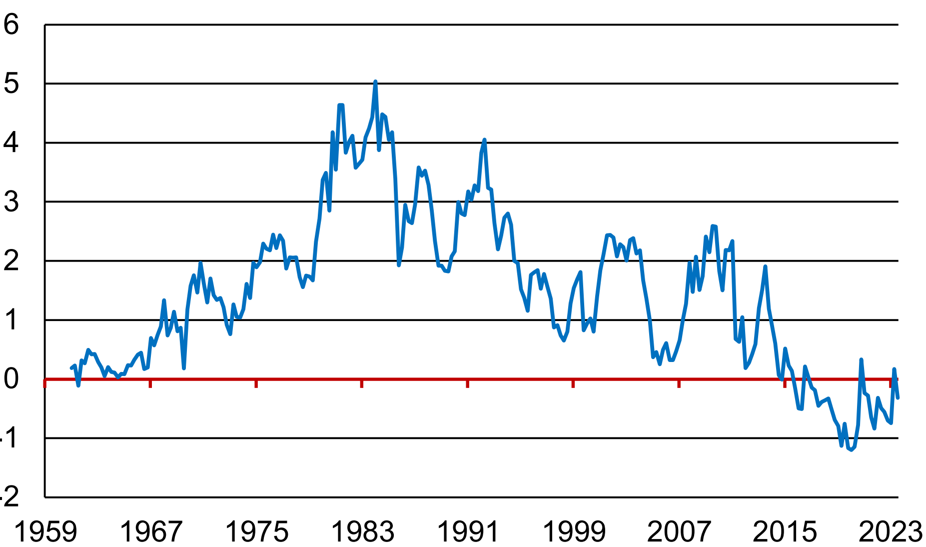


Exhibit 10: 10 Year Treasury Term Premium %
Still Negative. Should be Positive



While the “three bears” of high valutions, aggressive sentiment, and a still-normalizing yield curve present return and risk challenges to financial markets, equity and fixed income investing that is differentiated from the benchmark indices can mitigate those issues. Our equity investment process favors stocks of companies with improving fundamentals and quality characteristics, such as higher return on capital, lower balance sheet leverage, and more conservative accounting and corporate governance than peer companies, while trading at lower valuations relative to earnings and cash flow. These systematic preferences expressed across the holdings of the Augustine Global Equity strategy have over time produced positive return and risk results compared with the global stock market index, and we are optimistic that emphasizing higher quality and lower valuation will mitigate the market-level risks of high valuations, aggressive sentiment, and a shifting yield curve regime.

Exhibit 11: Augustine Global Equity Portfolio Characteristics
Process Favors Quality, Valuation, and Improving Fundamentals.

	AAM Global Equity	**MSCI AC World**
Quality		
Return on Assets %	2.7	2.4
Return on Capital %	7.1	6.9
Bloomberg Dividend Health	36.0	27.2
Valuation		
Price to Earnings	14.1	16.6
Price to Cash Flow	12.0	13.0
Risk		
Beta	0.9	1.0

Our fixed income investment process balances the return and risk from the level and potential changes to interest rates and from the credit risk of corporate issuers. As with our equity process, we systematically favor corporate issuers that exhibit quality (credit worthiness) and value (yield spread) that is better than issuer peers and the opinions of credit rating agencies. We anticipate the value added by our process over the return and risk of the bond market index will continue in an environment of uncertainty regarding the economic cycle and the direction and level of interest rates.

Exhibit 12: Augutine Core Plus Fixed Income Portfolio Characteristics
Process Controls for Interest Rate Risk and Favors Quality and Value in Credit

	AAM Core Plus Fixed Income	**Bloomberg US Aggregate**
Interest Rate Exposure		
Duration	4.1	6.2
Convexity	0.2	0.6
Credit Exposure		
Average Credit Rating	BBB+	AA
Yield		
Yield-to-Worst	4.9	4.5
Spread (OAS)	0.8	0.4

An Invitation

We hope this review of the economy, capital markets, and investment strategy helps to inform about our investment outlook and how we have positioned client assets to achieve attractive risk-adjusted returns. We look forward to discussing these topics further at our upcoming Investment Perspectives reception. We will be gathering at The River Club (1 Independent Drive, Jacksonville) on Wednesday January 31 at 6:00 pm for cocktails, hors d'oeuvres, and conversation. Please join us for a lively discussion on the economy, capital markets, and investment strategy.

AUGUSTINE
ASSET MANAGEMENT

Please Join Us

You and your guests are cordially invited for
conversation over cocktails and hors d'oeuvres at

Investment Perspectives 2024

Wednesday, January 31st, 2024 at 6:00 p.m.
The River Club
1 Independent Drive
Jacksonville, FL 32202

RSVP to Donna Petrina
(904) 396-6944 or dpetrina@augustineasset.com

We look forward to seeing you!

With best regards and appreciation for the opportunity to work on your behalf,

Jeffrey E. Bernardo CFA — Milena D. Spasova CFA CIPM — Neil J. Sullivan CFA

Frederick M. Blum — Sergio A. Saavedra CFA — Franco Cirelli CPA CFP® — Donna A. Petrina

Sources:
Illustration: Microsoft Dall E AI image generator. Exhibits 1, 3, & 4: Bureau of Labor Statistics. Exhibits 4, 8, & 10: US Federal Reserve. Exhibits 5, 6, & 7: Bloomberg. Exhibit 9: US Treasury, Congressional Budget Office.