

OUTLOOK

A TURNING POINT

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A TURNING POINT

I**N 2024, WE BELIEVE MARKETS** will make a definitive turn to a more recognizable place. En route, the transition will be marked by meaningful shifts in a few key areas. Inflation is going down. The risk of a recession is bubbling up again as the effect of post-pandemic stimulus wanes. And the end of the Federal Reserve's (Fed) rate-hiking campaign is indeed upon us.

Where the last two years had investors focused on inflation, market volatility, and striving for a sense of economic balance, we now can expect to see some return to the previous status quo—that is, a less-stringent Fed, normalizing inflation, and a slower-growth environment. We've seen indications of this reset—receding inflation, rates stabilizing, more modest equity market performance, and go-forward economic forecasts that have been dwindling. From our perspective, this turning point for the markets and economic landscape can be characterized as a return to familiar economic and market patterns, leaving behind the volatility of policy and economic swings experienced in recent years, and moving toward a steadier environment.

All of this said, it doesn't mean that 2024 won't have its own surprises or potential challenges. Reflecting on 2023, we certainly experienced our fair share of unexpected events. There was positive news: The U.S. economy was strong and the stock market performed relatively well, despite the Fed tightening monetary policy and raising interest rates. On the downside, we faced a regional banking crisis driven by interest rate risk and saw escalating conflict in the Middle East, reminding us that markets are seemingly constantly overcoming obstacles.

LPL Research's *Outlook 2024: A Turning Point* provides insight and analysis into next year's opportunities, challenges, and potential surprises. We understand that making progress toward long-term financial goals requires a strong plan and sound advice. The insights in this report, combined with guidance from a financial professional, will help position investors to navigate this turning point and work toward achieving their objectives.



ECONOMY: The economy grew faster than expected in recent quarters, unemployment remained historically low, and activity in some sectors grew (e.g., homebuilding), despite the macro headwinds. The labor market seemed to be a boon for workers in prime position to bargain for better pay and more benefits. In 2024, we believe a recession is likely to emerge as consumers buckle under debt burdens and use up their excess savings, but a Fed that is sensitive to risk management might provide an offset by taking interest rates down again in the new year. Inflation may still remain a concern, but the Fed will likely be less laser-focused given the trajectory is going in the right direction. In sum, we expect a mild recession to occur in 2024, although that may usher in some interest rate decreases from the Fed and offset some of the economic and market impact.



STOCKS: Following the Fed's aggressive rate-hiking campaign in 2022 and 2023, stocks are entering a phase in which market participants will be focused on interest-rate stability—as inflation, we believe, comes down further. Meanwhile, interest rate stabilization should help support stock valuations. And while rates may be the most impactful driver of stock valuations, corporate profits are moving into a sweet spot. Stocks look fully valued at current interest rates, but if rates ease as we expect, we see upside to a year-end 2024 fair-value target range of 4,850 to 4,950. This is based on a price-to-earnings ratio (P/E) of near 19.5 and our 2025 S&P 500 earnings per share (EPS) estimate of \$250. Thus, we believe stocks could provide mid-to-high single digit returns in 2024. Risks include a potential widening conflict in the Middle East or Europe, an increase in U.S.-China tensions, and reacceleration in inflation that pushes interest rates higher.



BONDS: The move higher in yields in 2023 was unrelenting, rising alongside a U.S. economy that continued to outperform expectations. With a still-resilient economy to-date, we think Treasury yields could stay relatively high in the near-term, although rates may subside a bit versus the 2023 volatility we have witnessed. Issuance of Treasury securities to fund budget deficits and the potential for the Bank of Japan (BOJ) to finally end its aggressively loose monetary policies in 2024 could keep some upward pressure on yields. However, the big move in yields may have already taken place, and with a potential directional change in interest rates likely coming in 2024, we believe bonds offer compelling value.



GEOPOLITICS: With the onset of the war in the Middle East, geopolitical concerns have broadened as global leaders and diplomats attempt to forge agreements and try to encourage containment of the war. Meanwhile, losses continue to be absorbed by both Russia and Ukraine—amid debates across NATO about the monetary and political costs associated with supplying Ukraine with military equipment. As part of this backdrop, the U.S. has focused on keeping China from acquiring advanced semiconductor technology that can be applied to its expanding military buildup. We are not expecting the geopolitical backdrop to get materially better in 2024, yet history tells us that this risk alone is often not enough to derail opportunities in capital markets.



COMMODITIES: With renewed expectations that the Chinese economy could be supported by a broad fiscal package, coupled with forecasts that many global central banks have completed their respective rate-hiking campaigns, the economic backdrop should remain constructive for oil demand. A potential widening of the Middle East conflict could send prices sharply higher amid tight stockpiles of crude and OPEC+ production cuts. However, should the global economy slow materially more than projected, crude demand may be somewhat offset. A more aggressive fiscal package from China, targeted for infrastructure spending, is a possible catalyst for industrial metals. Precious metals, especially gold, have seen prices rise amid heightened geopolitical and currency risk, and will garner further support in 2024 if the markets continue to consider those risks.



CURRENCIES: The U.S. dollar staged a strong comeback over the second half of 2023. Capital usually goes where it is treated best, and global capital was enticed back to the U.S. on clearer prospects of economic growth and higher rates of return. The dollar remains quite overvalued, however, on a purchasing power parity basis against currencies like the yen, euro, and British pound. But unless global markets witness a more persistent shift toward synchronized global growth, a scenario we are not expecting, foreign currencies as a whole will likely struggle to meaningfully outpace the dollar. Meanwhile, the clear risk for the euro heading into 2024 is that the European Central Bank (ECB) will be forced to aggressively reverse its current tighter policy stance.



ALTERNATIVE INVESTMENTS: After the strong recovery of the equity markets this year and the continued rise of short-term yields, markets have started to calibrate for the new market era. This new direction includes greater dispersion and volatility amid continued decoupling of global economic and policy actions, slowing economic activity, and rising geopolitical risks. All of this adds up to an environment that's conducive for strategies that are nimble, can generate excess returns from both top-down macroeconomic forecasts as well as bottom-up fundamental analysis, have limited stock market sensitivity, and benefit from the rise in volatility. In our view, this could be an opportunity to own global macro hedge fund strategies as well as select private credit and infrastructure investments.

ECONOMY: EXPECTED TO SLOW DOWN

TURNING POINTS ARE often marked by a series of significant events, but it's also valuable to put those events in context. For the U.S. economy, the event that might accompany this time of change could be a recession. However, if we look back on the post-pandemic economy, many things have gone better than expected.

THE RECESSION CALL

The economy grew faster than expected in recent quarters, unemployment remained historically low, and activity in some sectors (e.g., multi-family homebuilding) grew despite the macro headwinds. And then there was the labor market. It appeared to be a boon for workers, who seemingly have been in prime positions to bargain for better pay and more benefits.

The efforts to combat inflation have also turned out better than expected. Inflation continues to slow down and so far, the Fed's efforts have not caused as much pain as Chairman Jerome Powell had warned earlier in the tightening cycle. By the time we enter 2024, the

Fed will have pushed the fed funds target rate up 5.25 percentage points to reach an upper bound of 5.50%. While we've felt the pain of higher interest rates, easing inflation will help the Fed pivot to a more wait-and-see approach. Committee members will likely view the risk of raising rates to be in balance with the risk of not raising them enough.

The key here is deciding to what degree the Fed rate-hiking campaign

will affect the broader economy. We believe a recession is likely to emerge in 2024 as consumers, under increasing debt burdens, deplete their excess savings and are no longer able to keep up with debt payments. Leading indicators that we're watching include an increase in serious delinquencies in credit cards and auto loans. We expect the spending splurge to end, with consumers reverting to trend [Fig.1]. In 2024, the consumer

KEY EXPECTATIONS

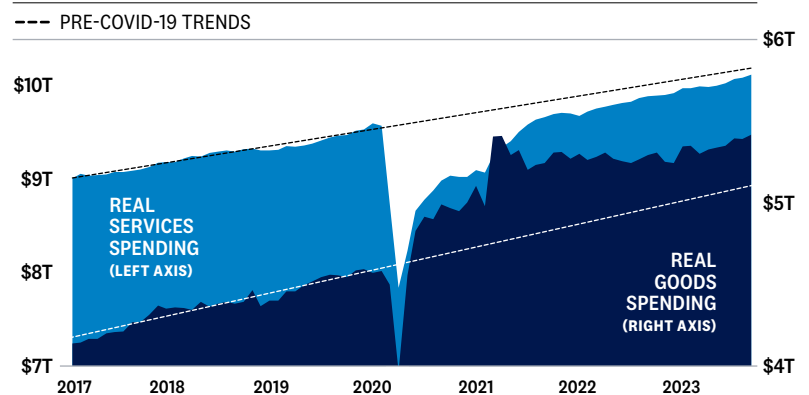
- Mild early/mid-year recession
- Less robust consumer spending
- Interest rates edge down
- Higher home prices should persist given light inventory



1 Services spending back to pre-pandemic trend

FIG.

And goods spending will likely revert down to trend



Source: LPL Research, Bureau of Economic Analysis 11/27/23

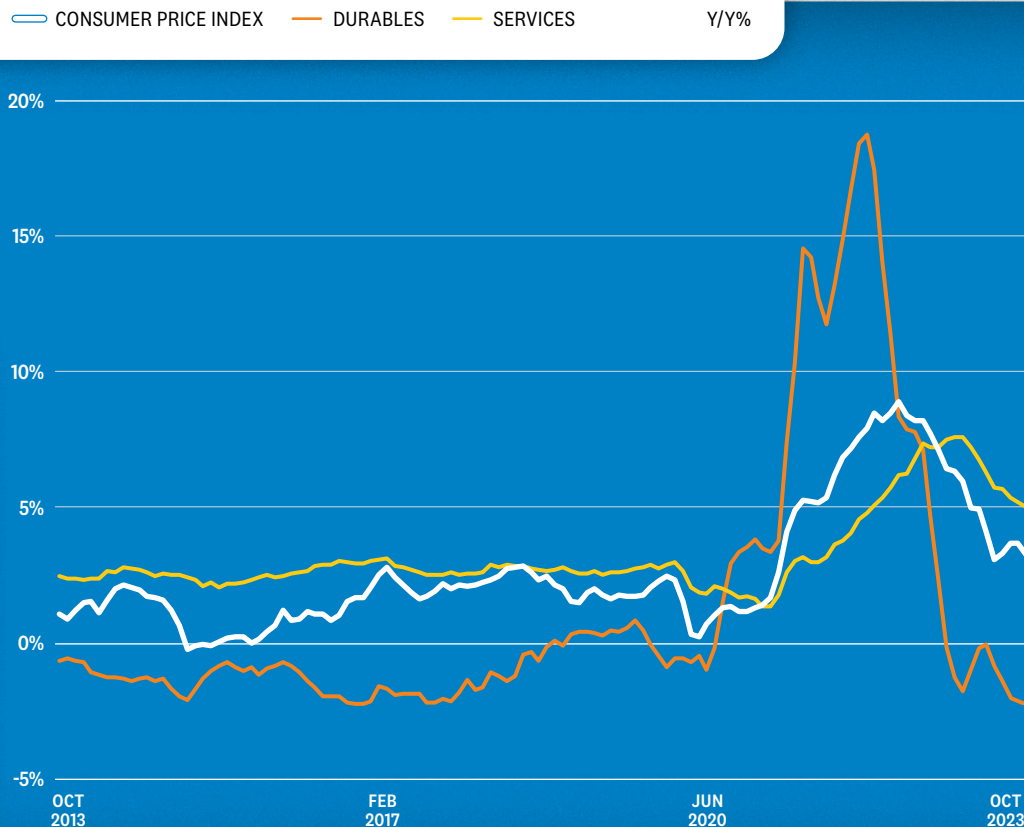
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FIG.

Markets are seeing a downward trend in service prices

And durable goods prices keep falling

Source: LPL Research,
U.S. Bureau of Labor Statistics
11/27/23



will no longer be willing to spend, as they did in 2023.

However, a Fed that's sensitive to risk management might provide the salve necessary for more risk appetite. Investing is a relative game, meaning the U.S. could experience the "3 Ds" of an economic contraction—depth, diffusion, and duration (the three things needed for a recession)—but at the same time, still outperform other markets. What we are indicating here is that while recession is our base-case call for 2024, that does not mean equity investments should be off limits.

So while a recession could be an event that marks this turning point, in context it could turn out better than expected. A shallow recession would increase the odds that the Fed cuts rates, and it would bring the labor market into better balance. And as history shows, markets tend to do fairly well when the Fed pivots from

higher rates and begins to lower them again. In fact, we believe the most likely outcome in 2024 is a scenario in which the stock market looks past the negatives of recession.

WHAT TO WATCH FOR IN 2024

Inflation remains top of mind. Although it's come down, especially as services inflation cools, there's a portion that persists. The surge in rent prices was a key driver of headline inflation in recent months, but its impact will likely wane in the near future as rent prices are off their peak, according to industry reports. It's also important for investors to remember that there is a sizable lag in time between a reported movement in rental data and the official government metrics. Excluding housing, core inflation is more benign. Clearly, the inflation experience on homeowners is quite different than the experience felt by renters.

Inflation & retirement

The inflation experience can be quite different for those who are nearing or in retirement. Without the income stream from a salary, those investors can experience losses simply from the rising costs caused by inflation. For those investors, it's important to have a portfolio that takes into account the need for growth and inflation protection, which we expect equities to provide over the long term.

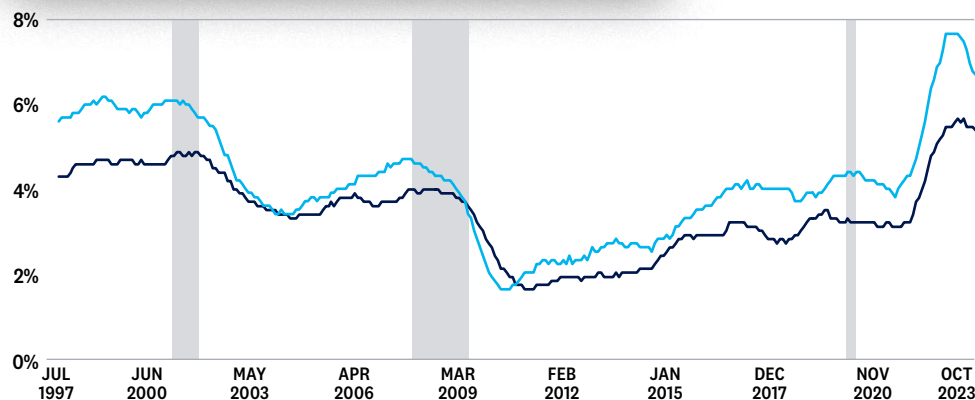
Turning to the Fed, we expect to see a Fed focused less on inflation and more on the other part of their dual mandate—stable growth. As already highlighted, inflation will still hover above the 2% long-run target and remain a concern, but the Fed will likely be less laser-focused given that the trajectory is going in the right direction [Fig.2].

FIG. 3 Wages grow fastest for job switchers

The gap has never been this wide

WAGE GROWTH (Y/Y%)

RECESSION
JOB STAYER
JOB SWITCHER



Source: LPL Research, Federal Reserve Bank of Atlanta 11/27/23

Meanwhile, interest rates will no longer be defined by abnormal lows or extreme highs. If the economy slows as predicted, the Fed will likely start discussing plans to cut rates. Keep in mind, those cuts may not come until the latter half of 2024, and the magnitude may not be anywhere near as aggressive as markets thought just a year ago. The mantra of “higher for longer” indicates expectations that the Fed will avoid the mistake it made in previous periods, when interest rates were near zero. When rates

are that low, it can lead to other issues, with policymakers left with one less tool at their disposal to create accommodative financial conditions in the event of a major financial crisis.

So despite the potential for a recession, the Fed probably will not cut rates aggressively, which would mean relatively higher rates would continue throughout the year. Still, we could see the fed funds target rate down to 4.50% by the end of the year, which would suppress both mortgage rates and the 10-year Treasury yield.

THE REAL ESTATE MARKET

The real estate market remains something to watch, reeling from the unintended impacts of remote and hybrid work and high borrowing costs. With this work environment, people aren’t necessarily pressured to relocate and buy homes in certain parts of the country. As a result, one unintended consequence of remote or hybrid work is an economy less sensitive to interest rates. Historically, tighter monetary policy translates to higher mortgage rates. In turn, this slows the real estate market and cools house prices.

Based on the current environment, however, home prices probably won’t normalize much—due to lean inventory and buyers who come to the closing table with cash. As households move from higher cost of living areas to lower, those with home equity now have the cash to use it toward a home, which means they skirt the credit markets. These buyers continue to generate demand and, in turn, contribute to keeping home prices up. The combined effect of these factors could mean we remain in this environment of higher home prices.

FIG. 4 2024 Annual Forecasts

| | GDP Growth (Y/Y%)* | CPI (Y/Y%)* |
|--------------------|--------------------|-------------|
| United States | 1.00% | 2.80% |
| Eurozone | 0.60% | 2.50% |
| Advances Economies | 1.10% | 3.80% |
| Emerging Markets | 3.90% | 6.20% |
| Global | 2.60% | 4.40% |

Source: LPL Research, Bloomberg, 11/27/23
Any economic forecasts set forth may not develop as predicted and are subject to change

*Annual average

STOCKS: FOLLOW THE CYCLES

THE JOB MARKET

When it comes to the job market, some call the recent shift in favor of the average worker the democratization of the workforce, considering that workers have rarely had this much bargaining power. As the American worker has had a few years to adjust to the hybrid work model, we should continue to see a fair amount of turnover. Some have seen the fastest way to higher pay is moving to a new job [Fig.3]. Of course, the hybrid model can only operate in some sectors, so its impact varies depending on the industry.

Further, many regions of the U.S. have passed pay transparency laws that require firms to disclose the salary range for job openings, meaning some firms will have relative difficulty finding qualified workers if not offering competitive wages. Even with the risk of an economic downturn, we do not expect a material rise in the unemployment rate. For many workers, this environment undoubtedly further establishes their position in the driver's seat when it comes to market power.

POTENTIAL UPSIDE

With a macro backdrop such as this, where could investors see a surprisingly favorable turn of events? A Fed entering a new period of policy easing, homebuilders able to capitalize on the unique macro environment, and workers in a historically strong position could all set up markets for a better-than-expected outcome despite a short and shallow recession [Fig.4].

F

FOLLOWING THE FED'S AGGRESSIVE rate-hiking campaign to combat the massive inflation surge, the stock market will become one where participants are focused on interest rate stability. We expect inflation will come down further, and as it does, interest rate stabilization should help support stock valuations, just as some of the biggest headwinds for corporate America begin to reverse.

ECONOMIC CYCLE

This one has been unique, to put it mildly—given the highly uneven recovery in recent years coming out of the pandemic. As previously discussed, a mild, short-lived recession in 2024, followed by recovery later in the year is our base-case scenario. The uncertainty that comes with anticipating a recession may limit stock gains as 2024 begins. But it could bolster investor sentiment midyear, as is typical coming out of an economic trough (the lowest part and

turning point of an economic cycle). Keep in mind, the market's reaction to the economic cycle in 2024 could be muted, given that stocks essentially priced in a recession in 2022 following the surge in growth of the post-pandemic economy.

BULL MARKET CYCLE

The young age of this bull market historically points to solid gains ahead. The start of the current bull market (began in Oct 2022) has been unspectacular. Through the first 12 months, the S&P 500 has gained 21.6% (dividends excluded), compared to the historical average of approximately 40% over a similar time frame. The tepid rebound off the market low was partly due to the shallow bear market in 2022 and atypically high valuations at that time that ultimately left less upside in a rebound.

Certainly sticky inflation and rising interest rates also played roles in slowing this bull, one in which banks



KEY EXPECTATIONS

- High single digit returns for the S&P 500
- Muted stock market reaction to recession
- An ease in interest rates could be an offsetting tailwind
- Solid corporate earnings growth helps drive our forecast

and small caps have underperformed (+1.2% and +4.3% respectively) based on the S&P 500 Banks and Russell 2000 indexes.

As the next 12 months of the bull gets underway, market history tells us solid gains may lie ahead. Of the 12 such periods since 1950, the S&P 500 has gained an average of 12.6% and was positive every time. A gain of this magnitude seems reasonable given the potential for support from the Fed as inflation falls [Fig.5].

RATE CYCLE

The current interest rate cycle could be impactful when it comes to stocks. With inflation still elevated, high rates remain a threat to the economy and the stock market. Stocks and bond yields became increasingly negatively

correlated (moving in opposite directions) in 2023 [Fig.6]. While that wasn't great news for the stock market, it does mean interest rates could present an opportunity, as LPL Research believes the 10-year Treasury yield could be less volatile in 2024.

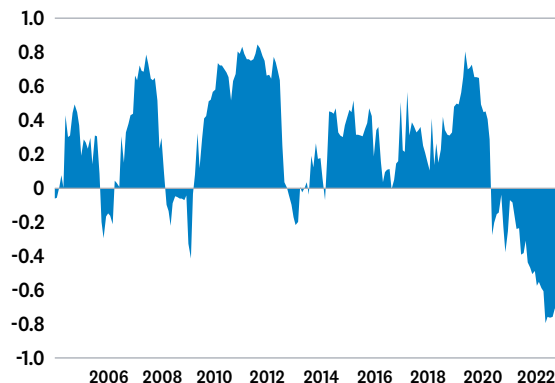
EARNINGS CYCLE

The earnings cycle is entering its sweet spot. With the earnings recession now over, earnings are moving into a period of growth. Analysts underestimated the economy's resilience and corporate America's ability to generate revenue and control costs amid intense cost pressures in 2023. Third quarter earnings season continued the favorable trend. Earnings came in 7.7% above estimates on average, while estimates for the subsequent

FIG. 6

At higher interest rates, stocks and yields tend to move in opposite directions

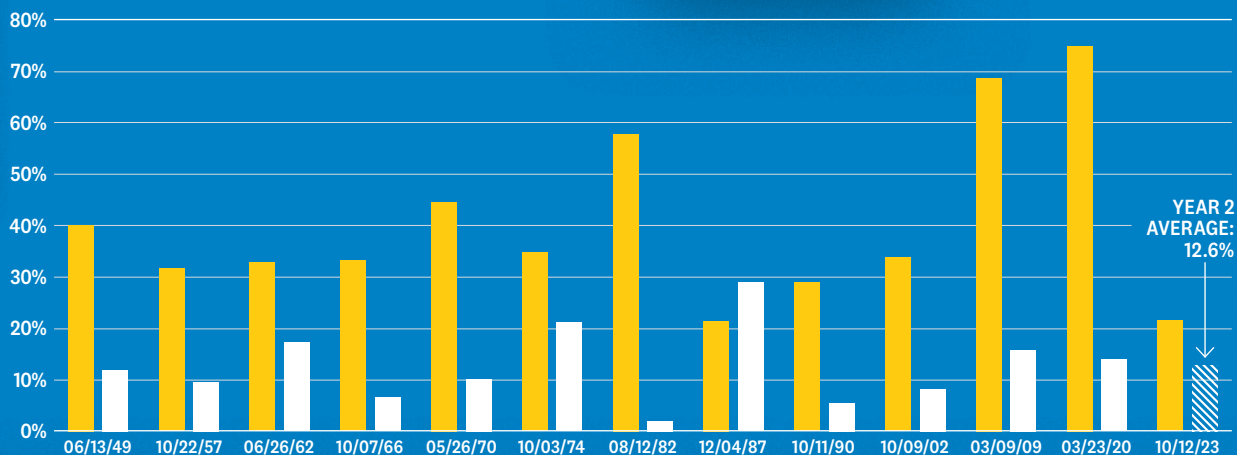
ROLLING 1-YEAR CORRELATION:
S&P 500 VS. 10-YEAR U.S. TREASURY YIELDS



Source: LPL Research, Bloomberg 11/27/23
Indexes are unmanaged and cannot be invested in directly.
Past performance is no guarantee of future results.

FIG. 5

S&P 500 bull markets have historically enjoyed solid year two returns



Source: LPL Research, FactSet 11/27/23

The current bull market began on 10/12/22 and as of 11/27/23 was still going. All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

four quarters have held up relatively well, falling just 1.4% during the reporting period.

The bar has been raised for 2024, but if we get only a mild recession as we expect and inflation continues to fall, corporate America should be able to continue its estimate-beating ways. Our 2024 S&P 500 earnings per share (EPS) forecast is \$235 per share, up from our prior estimate of \$230. The new estimate represents only about 7% earnings growth from the current 2023 consensus S&P 500 EPS estimate of \$219. Beyond economic growth, how companies manage waning pricing power as inflation falls is key to the earnings outlook. Reversals of 2023 earnings declines by the healthcare and the natural resource sectors, along with increased earnings growth in the technology sector, will help drive a turnaround in overall earnings [Fig.7].

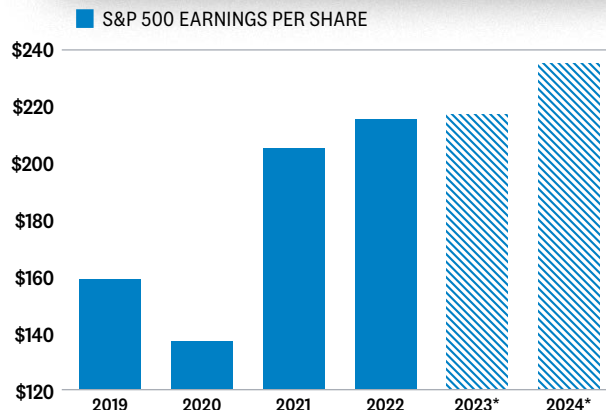
OVERALL FORECAST

Bearing all this in mind, we anticipate solid but not spectacular stock market returns in 2024. The average return for the stock market over the long term is near 10%, so a gain near average would be good. In 2024, returns may fall less than average. While earnings growth will likely help push stocks higher in 2024, the contribution from valuations may be more limited. Stocks appreciate in value primarily in two ways—either earnings grow or valuations become richer. The good news is that stocks can move higher in the coming year without much help from valuations—a different story from the past two

years. A price-to-earnings ratio (P/E) of 19.5, in line with the five-year average, represents only a slight improvement in valuations from the 18.8 level in mid-November.

Based on a P/E ratio of 19.5 times our projected 2025 S&P 500 earnings per share (EPS) of \$250, we estimate a fair-value range for the S&P 500 at the end of 2024 to be between 4,850 and 4,950. This suggests potential high-single-digit gains at the midpoint. These returns are not particularly compelling compared to potential returns from fixed income, which carry less risk. However, there is potential upside above 5,000 if lower interest rates support higher valuations, the U.S. economy avoids recession in 2024, and corporations recognize double-digit earnings growth. Wider overseas conflicts in the Middle East or Europe, an increase in U.S.-China tensions, reacceleration of inflation, or a renewed surge in interest rates are elements of a possible downside scenario in which the S&P 500 could retest its October 2023 lows near 4,120 [Fig.8].

FIG. 7 Expect earnings growth to accelerate in 2024 and support stock prices



Source: LPL Research, FactSet 11/27/23

*Estimates as of 11/27/23

Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results. Estimates may not materialize as predicted and are subject to change.

FIG. 8 S&P 500 year-end fair value target for 2024

| | |
|---|-------|
| S&P 500 level as of 11/24/23: | 4,559 |
| Current next 12 months price-to-earnings ratio for the S&P 500: | 18.8 |
| Proposed year-end 2024 price-to-earnings ratio for the S&P 500: | 19.5 |
| 2025 S&P 500 EPS forecast (6% increase): | 250 |
| S&P 500 2024 year-end fair value target: | 4,875 |
| Low end of range: | 4,850 |
| High end of range: | 4,950 |
| Upside to midpoint: | 7.5% |

Source: LPL Research

Any economic forecasts set forth may not develop as predicted and are subject to change.

EQUITY ASSET ALLOCATION RECOMMENDATIONS



Region

Our position is to favor U.S. and Japan, and underweight Europe. LPL Research expects the U.S. economy to outperform Europe's in 2024. Core Eurozone, particularly Germany, still struggles with stubbornly high inflation, even as growth stalls, making it difficult for the ECB to cut rates anytime soon. Valuations are attractive but not enough at this point to favor developed international equities in our view.

Japan, however, has grown wiser in adopting pro-growth policies to help its growing economy, and as a result, they've entered an era marked by a promising equities outlook. The Japanese market continues to look very appealing against this relatively encouraging backdrop of economic growth, pricing power for Japanese companies, accommodative monetary policy, and an increasingly shareholder-friendly corporate culture.

We'd suggest more caution on emerging market (EM) stocks despite their attractive valuations, as U.S.-China tensions and downside risk to earnings keep us largely on the sidelines. That said, Latin America and India may present opportunities as potential beneficiaries of the U.S. de-risking from China-based supply chains. Meanwhile, EM appears ripe for active managers to add value given the high dispersion of returns across developing markets.



Market cap

LPL Research favors large cap stocks relative to their small and midcap counterparts for 2024. Large caps generally perform better during periods of economic uncertainty given stronger balance sheets. Attractive valuations may bolster small and midcap stocks later in the year as economic conditions improve.



Style

If inflation comes down further and the economy slows, as we expect, interest rate volatility should subside, supporting growth stocks. Superior earnings growth outlook and artificial intelligence demand could provide additional support, though cyclical value stocks may garner support from a pickup in economic activity in the second half.



Sectors

We recommend more economically sensitive, or cyclical, sectors for 2024:

- **Energy:** Expected to benefit from more shareholder-friendly management
- **Communication services:** Generating strong earnings growth and exhibiting favorable technical analysis trends

The technology sector is rated neutral due to rich valuations, though the prospects for earnings to accelerate amid the burgeoning artificial intelligence trend could lead to strong performance for the sector. The industrials sector is well positioned for re-shoring trends but capital investment has slowed some and technical price trends have weakened.

BONDS: BACK TO NORMAL

KEY EXPECTATIONS

- Some ease in interest rates could make it a good market for bonds
- Core bonds offer the most attractive risk-adjusted returns
- Preferreds are our favorite non-core opportunity



CHANGE OF ANY KIND CAN BE disruptive and have ripple effects. In 2023, stubborn inflationary pressures shook up the bond market and the ripple effects were higher yields.

Because of this, for the first time in over 10 years, we're seeing new growth opportunities in the fixed income market. Some might say the turning point for bonds is a return to normal, one where investors can expect decent returns without the risk that comes with stocks. This is a key reason we believe investors should stick to bonds for 2024.

RATES LEAD THE WAY

U.S. Treasury yields moved higher in 2023 with the interest rate on the 30-year Treasury bond briefly trading above 5% for the first time since 2007. The steady increase in interest rates (which makes bond prices go down) hit the intermediate and longer-term Treasury bonds the hardest. There are a number of reasons we saw higher yields, but rates moved higher alongside a U.S. economy that continued to outperform expectations. As the U.S. economy continued to perform better than expected, interest

rates went up, and the chances for a recession went down, which in turn led the Fed to stick to its "higher for longer" approach—rather than lowering rates to stave off a looming recession.

As the economy has continued to be better than expected, we have witnessed some spikes in Treasury bond yields. While we think the 10-year Treasury yield could stay mostly in the 3.75–4.25% range for 2024, a softer economy could put further downward pressure on yields [Fig.9].

FIG. 9

Treasury yield forecast

| Macro conditions | Traditional Recession | Flattish Growth/ Mild Recession | Re-Accelerating Environment |
|---------------------------------------|--|---|---|
| | Economic growth contracts | Economic growth slows but still slightly positive | Economic growth picks up |
| | Inflation expectations decline | Inflation expectations steady and falling | Inflation expectations increase |
| | Fed cuts rates from restrictive levels | Fed cuts rates as inflation falls | Fed hikes rates into more restrictive territory |
| | Global government bond yields fall | Global government bond yields steady | Global government bond yields elevated |
| Year-end Fed Funds Rate | 2.00% | 4.50% | 6.00% |
| Market-Implied Inflation Expectations | 2.00% | 2.50% | 3.50% |
| 2-Year Treasury Yield | 2.00% | 3.90% | 5.50% |
| 10-Year Global Bond Yields | 1.00% | 2.50% | 3.50% |
| 10-Year Treasury Yield | 3.25% | 3.75 – 4.25% | 5.75% |

Source: LPL Research 11/27/23

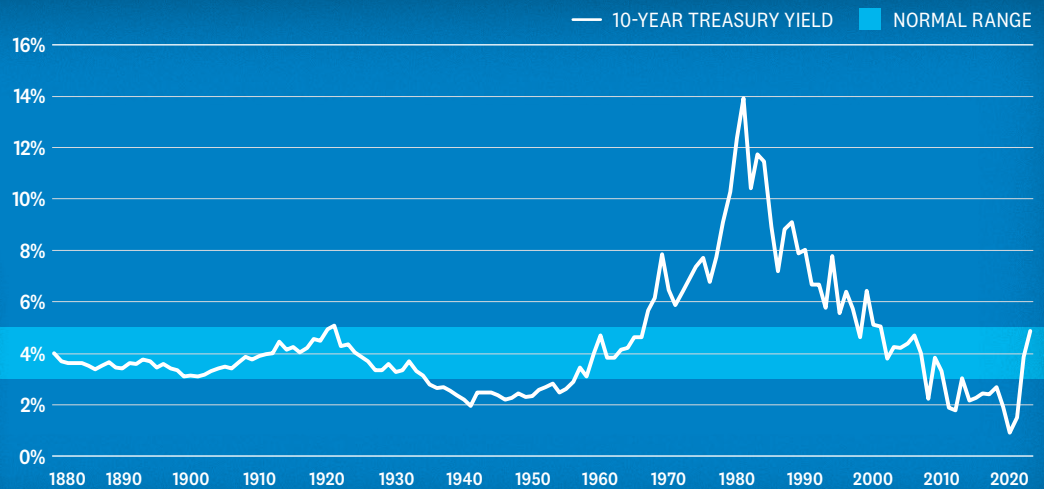
Rate forecasts may not develop as predicted and are subject to change.

FIG.

10

Will long-term rate volatility subside?

Historically, 3% to 5% has been "normal"



Source: LPL Research, Bloomberg, 10/26/23

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

WHAT'S OLD IS NEW AGAIN

Just as we study history to understand how societal and political trends change, we can also learn from a historical view of interest rates. Examining interest rates over a longer time horizon can help us determine what could be considered normal and gives some insight into where rates could go, should we not get the recession we are expecting [Fig.10].

Data since 1880 shows that interest rates were fairly consistent before they spiked in the 1980s, driving 10-year Treasury yields up with them. In fact, long-term rates mostly traded within a 3–5% range for nearly a century before moving aggressively higher as the Fed fought generationally high inflation. Periods above that 3–5% range occurred when the economy was growing with high inflation, which shaped the Fed's interest rate policy (economic growth + low inflation = normalized interest rate policy). Indeed, the sharp increase in the 10-year yield over the past few years puts the yield firmly back into the normal, historical range.

THE WATCH FOR A BUYER STRIKE

If you were hoping the recent Fitch downgrade of U.S. debt would serve as a wake-up call to Washington, it hasn't. Since the debt ceiling debate was resolved last June, the Treasury Department has steadily increased the amount of Treasury debt outstanding. As of September 30, total debt outstanding stood at a record \$33.2 trillion, which is up from the \$31.5 trillion right before Congress gave the Treasury Department unfettered borrowing capacity through January 2025.

The Congressional Budget Office expects the U.S. government to run sizable deficits over the next decade, and to fund those deficits, the Treasury will need to issue debt. This will happen at the same time the largest owners of Treasury securities (the Fed, Japan, and China) are generally reducing their impact in the Treasury market. If global central banks continue to slow down their presence at our auctions, the country will be dependent on private institutions to bid at auction. But

unlike central banks, the private sector is more focused on prices and thus may require higher yields.

It's important to remember though, as long as Treasuries are considered risk-free securities, there will always be buyers. The question is price. At what price would it take for more price-sensitive buyers to get interested? So far, we haven't seen a drop off during Treasury auctions. But there could be an eventual fatigue, which would mean yields would need to increase (or at least stay elevated) to attract that additional demand. While prices have been volatile, we believe there will always be some demand for Treasuries, especially if the Fed reduces interest rates in 2024.

CRACKS IN THE CORPORATE CREDIT MARKET?

The corporate credit markets have been resilient so far in this cycle, with credit spreads (or the additional compensation for owning risky debt) remaining around historical averages. However, with the increase in Treasury yields over the past few years, corporate interest payments are set

to increase as well. And while the health of the corporate landscape is generally positive, rating agencies are starting to adjust their outlooks based on the expected increase in debt payments, among other things.

The ratings environment remains relatively calm for companies across investment grade (from AAA to BBB-). However, lower-rated companies (BB+ to CCC-) have taken the brunt of downgrades and will likely continue to in the coming quarters. By October 2023, S&P had downgraded its outlook and the outright rating on 814 companies (both investment grade and high yield) with only 512 upgrades [Fig.11]. Numbers like these mean that by the start of Q4 2023, the year was already the worst for downgrades over the past 10 years (excluding 2020).

With the higher for longer narrative coming from the Fed, corporate debt payments will likely continue to stay elevated. And while many corporate borrowers took advantage of low

interest rates and issued a lot of debt, refinancings are set to pick up at currently higher rates. As such, we remain cautious on corporate credit broadly, but we think the short-to-intermediate part of the investment-grade corporate credit curve offers compelling risk/reward. However, we still don't think the risk/reward is very attractive for high yield or bank loans given the broader macro and refinancing risks, which will likely keep rating downgrades and defaults elevated. Of course, nothing is ever certain in the markets, but there will be opportunity for investors who choose their credits wisely.

PUTTING IT ALL TOGETHER

The move higher in Treasury yields over the past few years has been unrelenting, with intermediate and longer-term Treasury yields bearing the brunt of the more recent moves. Economic growth surprised to the upside in 2023, which means that

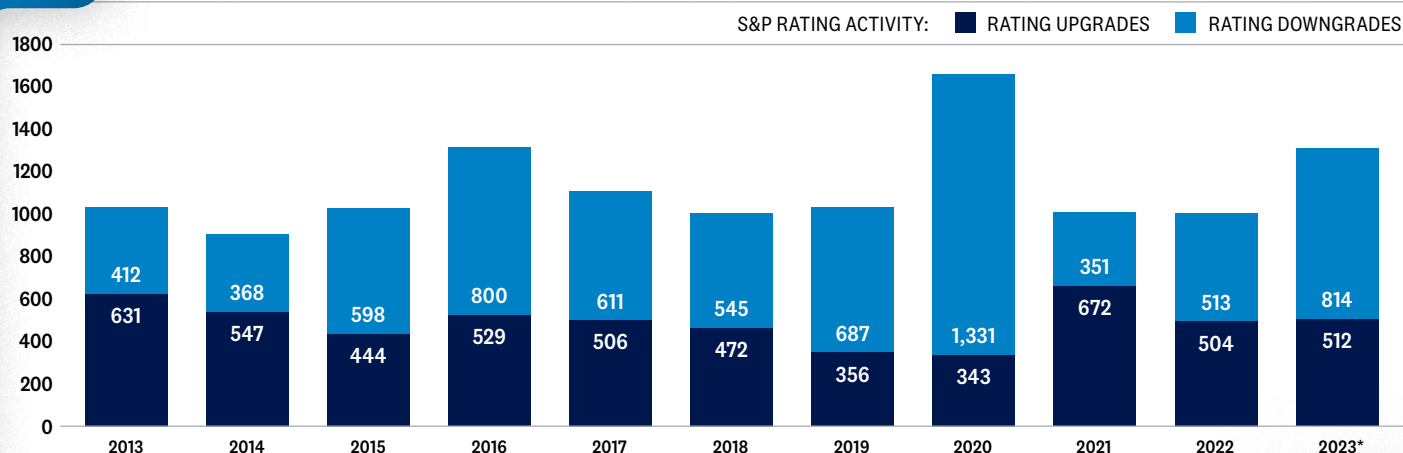
the Fed will likely keep short-term interest rates elevated for longer until economic data begins to soften.

However, with yields back to levels last seen over a decade ago, we think bonds are an attractive asset class again. There are three primary reasons to own fixed income: diversification, liquidity, and income. And with the increase in yields recently, fixed income is providing income again.

Right now, investors can build a high-quality fixed income portfolio of U.S. Treasury securities, AAA-rated agency mortgage-backed securities (MBS), and short-to-intermediate investment grade corporates that can generate attractive income. Investors don't have to "reach for yield" anymore by taking on a lot of risk to meet their income needs. And for those investors concerned about still higher yields, laddered portfolios and individual bonds held to maturity are ways to take advantage of these higher yields.

FIG. 11

Corporate downgrades are outpacing upgrades this year



Source: LPL Research, Bloomberg, 10/26/23
Past performance is no guarantee of future results.

*Through 10/25/2023

GEOPOLITICS: AN INCREASINGLY COMPLICATED LANDSCAPE

W

WE CAN'T LOOK BACK IN HISTORY

without seeing eras marked by war and conflict. With the onset of the war in the Middle East, geopolitical concerns have broadened from the ongoing Russia/Ukraine conflict and implications for a wider confrontation along the NATO border. The recent military threat imposed by Hamas has also brought the Middle East back into the spotlight, with questions around how long the Israeli/Hamas conflict will last. From an investment standpoint, any geopolitical tension has the potential to affect the markets. There's also an impact on commodities, meaning we'll want to keep a closer eye on those asset classes producing goods in these regions of conflict.

Despite rising tensions and uncertainty across the globe, investors

should keep a long-term orientation and favor a well-diversified portfolio. We believe that diversification across sectors, regions, and asset classes can help investors hedge against and make the most of volatile markets.

TECHNOLOGY'S ROLE IN U.S.-CHINA RELATIONS

Despite attempts to foster deeper commercial ties, the U.S. has two goals dominating its relations with China. The first goal is keeping China from acquiring advanced semiconductor technology that can be applied to its expanding military buildup. The second is establishing a U.S. domestic semiconductor supply chain infrastructure. Protectionism, vis-à-vis advanced semiconductor technology, enjoys bipartisan support in the U.S. as national security threats receive heightened attention.

High-level U.S. government bilateral visits to Beijing have kept a dialogue active, but increasingly, the relationship has been reduced to concerns over Beijing's determination to bring Taiwan into the "One China" orbit, with force, if necessary.

So what's China's reaction been to these export controls? Acrimony. China has attempted to limit sales of Apple products within government-sponsored offices, as they have been deemed a security threat. At the same time, Huawei has re-emerged, raising questions as to how they secured the technology to introduce "smart" products. Huawei is the sanctioned global telecommunication giant that was accused of spying on behalf of China's military. With all of this going on, it's not surprising that Apple's iPhone 15 sales have edged lower in their prime China market, while Huawei smartphone sales have galloped higher.

KEY EXPECTATIONS

- Geopolitical tensions not expected to abate
- The dollar will likely be supported by its "global currency" standing
- Precious metals, which provide a safe haven in uncertain times, will offer opportunities if turbulence continues

FIG. 12 Bloomberg Commodity Index commodity cycle comparison



Source: LPL Research, Bloomberg 11/27/23

Past performance is no guarantee of future results. All indexes are unmanaged and can't be invested in directly.

IMPACT ON OIL

China's economy is still not fully recovered from the nearly three years of COVID-19-related lockdowns and property developers mired in heavy debt burdens. As a result, Beijing has responded with a limited patchwork of targeted monetary stimulus measures, which have done little to bolster a stronger economic response.

China's lackluster reopening likely has kept oil price gains somewhat suppressed in 2023 (China is the world's largest importer of oil). Fears of recession outside of the U.S. and rising global supply have further weighed on oil. To combat the supply and demand imbalance, OPEC+ has been actively 'managing' the supply side of the equation through extended production cuts, although their efficacy is being offset by a boom in U.S. oil production.

With renewed expectations that the Chinese economy could be supported by a broad fiscal package, coupled with forecasts that global central banks have for the most part completed their respective rate-hiking campaigns, the economic backdrop should remain constructive for oil demand.

THE BROADER WORLD OF COMMODITIES

Broadly speaking, the commodity complex of industrial metals—with the exception of iron ore—has remained fairly muted, as the sector waits for the possibility of a more aggressive fiscal package most likely targeted for infrastructure spending. This could help propel prices within a broad swath of metals.

China has made electric vehicle (EV) production a top priority, leading to significant price increases in metals used for battery production, such as lithium. Copper, used globally in renewable energy systems, should benefit as the global economy seeks to finance large-scale projects.

Precious metals, especially gold, have also seen prices rise, which is an indication that investors are looking for safe havens. Hedging for geopolitical and currency risk, global central banks have been large buyers of gold—the People's Bank of China has been one of the largest buyers of gold over the last couple of years. If the markets continue to consider the geopolitical risks, precious metals will garner further support in 2024. [Fig.12]

The dollar strikes back

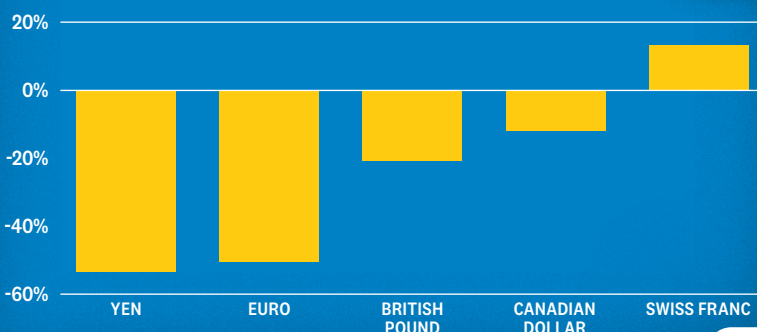
THE U.S. DOLLAR made a strong comeback against a basket of foreign currencies in the second half of 2023. This about-face in sentiment was driven primarily by interest rate differences and domestic economic growth, which moved sharply back in the dollar's favor. Capital will usually go where it is treated best, and global capital was enticed back to the U.S. on clearer prospects of economic growth and higher rates of return on USD-denominated investments. The dollar remains quite overvalued on a historical and relative basis, meaning there is likely going to be value in holding foreign denominated assets in the longer-term. Even though we're seeing currencies like the yen, euro, and British pound weaken to attractive levels, valuation extremes can take a long time to correct in currencies. Until markets see more synchronized global economic growth and/or foreign central bank led policy shifts toward higher rates, foreign currencies as a whole will likely struggle to meaningfully outpace the dollar.

The yen is the worst performing developed market currency over the last year, and on some valuation metrics it is at 50-year lows. The weakness in the currency can mostly

be attributed to a lack of action from the Japanese central bank. Despite domestic inflation reaching the highest level in 40 years, the BOJ has refused to meaningfully move away from an ultra-loose policy framework. This inaction has been contrary to market expectations. A move by the central bank to appease the markets by raising interest rates in 2024 would be very positive for the currency and likely have important ramifications across markets.

The ECB's aggressive interest rate-hiking campaign and China's slow recovery from lockdown, have put the European economy under pressure (as China is Europe's main trading partner in goods). Germany, France, and a few members on the periphery are now all at risk of entering recession in 2024. Not surprisingly, this weighed heavily on the euro in the second half of 2023. Despite this deteriorating economic outlook, the ECB has remained steadfast in its assertion that official rates will remain at high levels for "a sufficiently long duration." Barring an unexpected resurgence in European economic growth, the clear risk for the euro heading into 2024 is that the ECB will be forced to aggressively reverse its current stance to avoid a potential policy error. [Fig.13]

Major currencies deviation from fair value



Source: OECD Purchasing Power Parity Estimates, Bloomberg 10/01/23

FIG. 13

ALTERNATIVE INVESTMENTS: EMBRACING AGILITY IN A VOLATILE MARKET

KEY EXPECTATIONS

- Use alternative investments to limit market sensitivity in portfolios and take advantage of volatility
- Anticipated conditions should favor global macro hedge fund strategies
- We favor private credit and infrastructure investments as well, but leverage should be contained



A

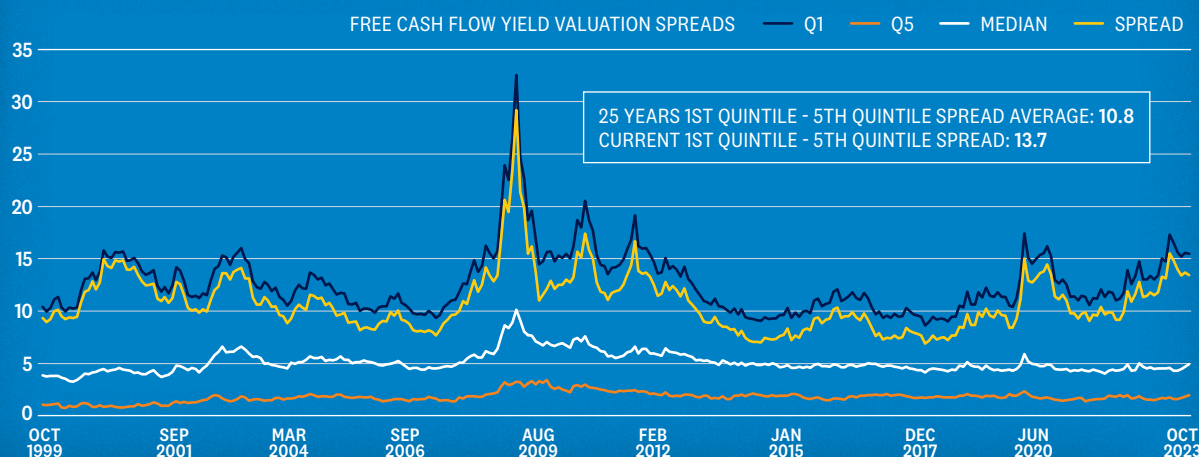
AFTER THE STRONG RECOVERY OF the stock market this year and the continued rise of short-term yields, markets have started to calibrate, moving toward markets of greater dispersion (an increasing gap between best and worst performing economies and assets) and volatility, which is brought about by a few factors. These include a continued decoupling of the global economy and policy actions, a well-anticipated slowdown in economic activity, and a rise in geopolitical risks.

All of this adds up to an environment that's potentially favorable for strategies that are nimble, can generate excess returns from both top-down macroeconomic forecasts as well as bottom up fundamental analysis, have limited market sensitivity, and can take advantage of increased volatility. It's also a time for a deeper look into each manager's investment approach. We anticipate that risk management can pay off as a greater range of performance within each strategy is expected. Staying responsive to market nuances will be key.

14

FIG.

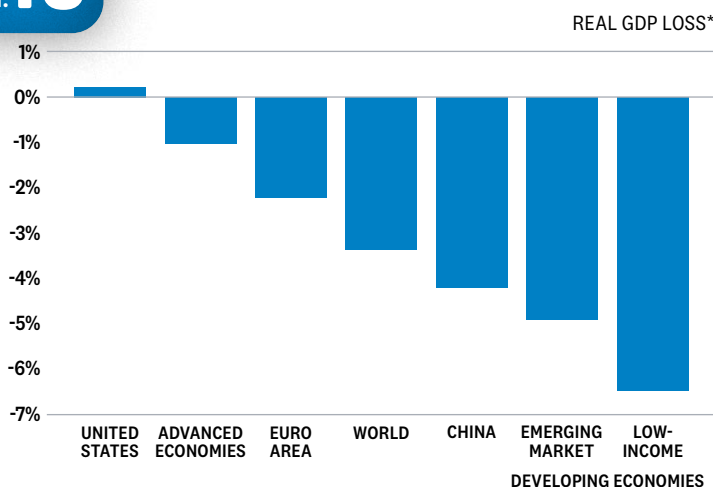
Wider valuation spread lending opportunities for stock pickers



Source: LPL Research, FactSet 11/27/2023

FIG. 15

Real GDP Expectation Dispersion Widens



Source: LPL Research,
IMF 10/01/23

*Deviation in 2023 from pre-pandemic projections.
Pre-pandemic projections refers to those from January 2020.

Among hedge fund strategies, we maintain a positive outlook on global macro strategies that can capitalize on the macro dispersion across the regions and tend to benefit from higher volatility. We also expect managed futures to continue to serve as a diversifier for portfolios that are mainly comprised of stocks and bonds. In addition, we believe bottom-up, fundamental-focused strategies that can limit market risk (both in stocks and bonds) now have a richer trading environment where they can generate excess returns from both the long and short sides of their portfolios amid rising dispersion in company fundamentals. Lastly, we continue to monitor distressed/special situation strategies, as we observe the high interest costs seeping into companies' fundamentals and a pickup in corporate downgrades. [Figs.14-15] While we are positive on these strategies, it is important to monitor the potential risk of economic, political and geopolitical surprises, position concentration, and the impact of leverage usage that could affect performance.

Among private market strategies, we expect private credit and infrastructure to continue to show their resilience as both strategies have long-term economic trends in their favor. For private credit, strong demand from borrowers and high base rates make current vintages quite attractive. That said, we are mindful of the potential stress that high borrowing costs could place on businesses and the overall sector.

Given sufficient yields on high-quality loans, we favor portfolios that are focused on senior secured loans with low leverage. Within private credit, we also favor portfolios with flexible and broader mandates that can diversify their positions beyond direct lending and participate in unique opportunities, such as distressed or special situations.

In addition, we see compelling opportunities in the secondary markets where managers can find better supply/demand balance and narrow the bid/ask spread. This is a positive signal for both sellers looking for liquidity and buyers looking to capitalize on discounted pricing in beaten-down sectors.

Views from the STAAC*

Tactical asset allocation views

+ OVERWEIGHT

- U.S. equities
- Growth equities
- Large caps
- Energy
- Communication services
- Preferred securities
- Short-to-intermediate high quality corporates
- Mortgage-backed securities
- Energy commodities
- Low beta liquid alts (global macro, managed futures, market neutral equity and fixed income l/s)
- Selective private market strategies — private credit, infrastructure, and secondaries

= NEUTRAL

- International equities
- Treasuries
- Duration
- Precious and industrial metals

- UNDERWEIGHT

- Emerging market equities
- Value equities
- Consumer staples
- Real estate
- Mid caps
- Small caps

*Strategic and Tactical Asset
Allocation Committee (STAAC)

FINDING THE ANGLE OF OPPORTUNITY

A **S WE TURN TO A MORE FAMILIAR** place in 2024, it's important to consider both the changes that lie ahead and what we are leaving behind. We anticipate moving away from the extreme conditions that have dominated our attention and affected the markets in the last couple of years. Inflation pressure has eased and it looks like it is no longer the singular problem that it once was. And while we don't expect aggressive cuts, we can expect interest rates to begin to move marginally lower—putting an end to the relentless upward trend we've experienced.

In spite of a challenging backdrop, the resilience of the economy has been undeniable. Looking ahead, however, it's logical to ask if this strength can persist unabated.

Although the economy has been stubbornly strong, we do expect to see a reset and definitive softening in 2024. The uncertainty surrounding a potential recession may limit stock gains as 2024 begins, but it could also bolster investor sentiment a bit if the Fed eases policy as a result. In the coming year, the rate and earnings cycles are likely to have a greater impact on stocks, as investors focus on the anticipated decline in interest rates and return of growth in earnings. With this in mind, we also see growth opportunities in the fixed income space, where investors can expect decent returns with lower risks compared to stocks.

There are several issues we'll closely monitor. These include rising energy prices, heightened geopolitical

pressures, still-tight financial conditions, and a potential slowdown in consumer spending due to increased debt burdens. Add to that the risk of global conflict that looms as a backdrop. While these factors could make the market environment somewhat challenging in 2024, we ultimately expect both stocks and bonds to perform well and provide ample opportunities.

Having an idea of the road ahead is important in navigating the inevitable twists and turns that will arise, but in the end, it will be sound planning and advice that will guide you to your goals. As always, our knowledgeable professionals will be by your side to help you stay on track and stay informed as we progress through 2024.

The opinions, statements and forecasts presented herein are general information only and are not intended to provide specific investment advice or recommendations for any individual. It does not take into account the specific investment objectives, tax and financial condition, or particular needs of any specific person. There is no assurance that the strategies or techniques discussed are suitable for all investors or will be successful. To determine which investment(s) may be appropriate for you, please consult your financial professional prior to investing.

Any forward-looking statements including the economic forecasts herein may not develop as predicted and are subject to change based on future market and other conditions. All performance referenced is historical and is no guarantee of future results.

References to markets, asset classes, and sectors are generally regarding the corresponding market index. Indexes are unmanaged statistical composites and cannot be invested into directly. Index performance is not indicative of the performance of any investment and does not reflect fees, expenses, or sales charges. All performance referenced is historical and is no guarantee of future results.

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

Event driven strategies, such as merger arbitrage, consist of buying shares of the target company in a proposed merger and fully or partially hedging the exposure to the acquirer by shorting the stock of the acquiring company or other means. This strategy involves significant risk as events may not occur as planned and disruptions to a planned merger may result in significant loss to a hedged position.

Any company names noted herein are for educational purposes only and not an indication of trading intent or a solicitation of their products or services. LPL Financial doesn't provide research on individual equities.

All index data from FactSet.

All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

GENERAL RISK DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Investing in foreign and emerging markets debt or securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

GENERAL DEFINITIONS

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually

calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

EQUITY RISK

Investing in stock includes numerous specific risks including the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time. The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

EQUITY DEFINITIONS

Cyclical stocks typically relate to equity securities of companies whose price is affected by ups and downs in the overall economy and that sell discretionary items that consumers may buy more of during an economic expansion but cut back on during a recession. Counter-cyclical stocks tend to move in the opposite direction from the overall economy and with consumer staples which people continue to demand even during a downturn.

Growth stocks are shares in a company that is anticipated to grow at a rate significantly above the average for the market due to capital appreciation. A value stock is anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Value stocks are anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Large cap stocks are issued by corporations with a market capitalization of \$10 billion or more, and small cap stocks are issued by corporations with a market capitalization between \$250 million and \$2 billion.

FIXED INCOME RISKS

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in

price. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk, as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features. Mortgage-backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. As the term implies, credit quality informs investors of a bond or bond portfolio's credit worthiness, or risk of default. Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates to the bond issue's ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade. The credit spread is the yield the corporate bonds less the yield on comparable maturity Treasury debt. This is a market-based estimate of the amount of fear in the bond market. Base-rated bonds are the lowest quality bonds that are considered investment-grade, rather than high-yield. They best reflect the stresses across the quality spectrum.

Bloomberg U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Municipal bonds are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply.

Commodities include increased risks, such as political, economic, and currency instability, and may not be suitable for all investors. The fast price swings in commodities will result in significant volatility in an investor's holdings.

Alternative Investments may not be suitable for all investors and involve special risks such as leveraging the investment, potential adverse market forces, regulatory changes and potentially illiquidity. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses."

For a list of descriptions of the indexes and economic terms referenced in this publication, please visit our website at lplresearch.com/definitions

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