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Letter from the Chief Investment Officer

The Next Level Up

Investors, it's time to *power up*! With technology changing the way we live, we are taking a trip down memory lane to look back at a piece of technology that has entertained generations: classic video games. Why? Because whether you are in a fictional gaming world or the real-life investment world, you need to be well prepared and ready for any challenges that come your way. We have these two worlds collide as we get set for the next level of play in the financial markets. Let's *hit the start button* and go!

The US economy has eluded obstacles and defied recessionary predictions like players in *Frogger* dodging cars and alligators to arrive safely home. Our economist believes that while the economy will slow meaningfully from its recent *leaping* pace, recessionary concerns are fading. Yes, consumer spending is likely to be challenged by rising credit card balances, falling savings rates, and less robust employment growth, but record household net worth will keep spending from collapsing. In addition, healthy government-induced corporate investments through the CHIPS and Science Act, Inflation Reduction Act, and Bipartisan Infrastructure Law are likely to offset any consumer weakness. As a result, rather than the mildest recession of all time, we slightly tilt our forecast to the softest of soft landings, pushing our GDP forecast from 1.7% to 2.1% for 2024.

Of course, that also depends on how the Federal Reserve (Fed) plays its high-stakes *Minecraft* game of monetary policy. Fed Chairman Jerome Powell has the *blocks* to build a solid foundation under the economy, nourishing it with rate cuts if he chooses to use them. We expect three this year. But he must be on guard against the inflation *monster* as it might keep the Fed from paring rates as soon or as much as we expect. Current rates are already starting to hobble the economy, particularly small business lending. But with short-term cash investments still yielding north of 5% and rates expected to come down slowly, investors do not have to rush to deploy outsized levels of cash to other asset classes. Patience is important as time will likely present better opportunities as we progress through the year.

Two people focused on the economy are Presidents Biden and Trump—as the robustness of the economy has historically been influential in determining election outcomes. As we approach the 2024 election, both are already tossing *barrels* at each other like *Donkey Kong* to differentiate their platforms in an effort to secure a second term in the White House. Regardless of the winner, our most likely scenario is a split government, which will make any significant policy changes in Washington next year very difficult.

Ms. Pac-Man characterizes our fixed income strategy: consistently gobble up coupon payments like the small pac-dots! That's one of the benefits of last year's dramatic rise in rates—bonds provide more attractive income potential. And, if interest rates fall as we expect, you'll experience some long-awaited *power-pellet* performance via price appreciation. Rates may be volatile in the near term, due to the *ghosts* of monetary policy, inflation, and growth scares. But the biggest antagonist could be weak auctions of US government debt. While the appetite for these bonds remains healthy, any weakness in demand could lead to a spike in interest rates. But be sure to use any uptick in interest rates as the *bonus fruits* to temporary opportunities. The reason: our year-end target for the 10-year Treasury yield is ~3.75%. With solid corporate fundamentals and recession prospects dwindling, we favor high quality investment grade bonds. Corporate credit spreads may have narrowed to historically tight levels, but yields remain attractive.

Major US equity indices have notched new high scores in recent months. Large-cap tech stocks got a boost from the AI tailwind, like Super Mario powering up after eating a *mushroom*. However, the *levels* of the market get more difficult and challenging as the investor moves on. Overly optimistic sentiment raises the bar for both earnings and economic results. Disappointment could lead to pullbacks. But near-term volatility will not dampen the long-term prospects of the equity market. Remember, Mario often must backtrack before finding a way forward. *Stay in the game*: this isn't the final stage of this bull market.

The positive news is that our more favorable economic outlook allows us to upgrade our 2024 earnings forecast to $240 (from $225), which increases our year-end target for the S&P 500 to 5,200. Small-cap equities remain attractively priced and should benefit as

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interest rates come down and growth remains resilient. From a sector perspective, our favorite players are Technology, Health Care, and Industrials. The evolution in tech is analogous to the progress we have seen in the sophistication of video games. From the limited up-and-down movement of a *joystick*, to increased buttons and commands on the controller, to motion-sensing remotes to full-on *virtual reality* immersion in another world—innovation continues to unfold as the power of tech explodes.

The US dominates the video game industry with its vast number of *developers*. Similarly, we expect the US equity market, with the best economic growth (and strongest upward revisions) in the developed world, to dominate. Contrast that with economic weakness throughout the European Union. Even European Central Bank rate cutting will likely have a limited near-term impact on those economies with structural concerns. However, one developed market country that may be able to continue to *score* is Japan. Despite soaring to record highs, Japanese equities remain attractive. They benefit from the weakness in the yen, investment fund flows out of China, and shareholder-friendly actions like buybacks. Shifting to the emerging markets, our long-term positive outlook is unchanged. Asia, particularly India, is experiencing some of the best growth estimates in the world, which should drive earnings. The shift in manufacturing to India away from China should spur its growth. That same trend of 'friendshoring' will likely continue to help Latin America, particularly Mexico.

It's been more than half a century since the debut of *Pong*, one of the first video games. These days, investors have been watching the oil market bounce between supply and demand. Supply has remained relatively stable as OPEC+ nations stick to their production cuts while the US and non-OPEC nations fill the gap with ramped-up drilling. Demand is likely to rise as a global easing cycle gets underway and weakness in the worldwide economy recedes. As a result, we reiterate our year-end oil target of $85 a barrel.

When it comes to asset allocation, a few vintage games come to mind. The first is the *Midway Arcade* car racing games, which allow players to choose the course (tricky and winding or straight and simple) and customize their cars, just as investors map their investment paths and select the risk/return profile they want to ride in the markets. The second is *Tetris*, which teaches evergreen lessons about fitting pieces together just right. Ensuring the right fit of all the pieces of your asset allocation is essential to maximizing the risk-adjusted performance of your portfolio. Finally, the *Madden NFL* football series, named after Hall of Fame coach and commentator John Madden, allows you to build ideal teams according to the skills of individual players—just like selecting the best investment vehicles for each asset class in your portfolio. In the end, with the proper asset allocation and guidance from your advisor, we hope you experience the 'extended play' of your financial resources to achieve all your goals and objectives and place your initials at the top of the *leaderboard*.

Challenge Accepted!

Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer

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Post-Pandemic US Economy: Different Strokes

Eugenio J. Alemán, PhD, *Chief Economist,* Raymond James
Giampiero Fuentes, *Economist,* Raymond James

We are normally reluctant to use trendy phrases to explain either our good and/or bad calls regarding the US economy. However, saying that 'this time is different' is more than fitting today to understand what has happened to the US economy since the recovery from the COVID-19 pandemic. US economic growth surprised friends and foes during 2023 as both the post-pandemic normalization process continued and the Federal Reserve's (Fed) attempt to bring down the surge in inflation contributed to the asynchronous performance of the US economy. During a typical economic cycle, as the economy hits the peak of the cycle, the Fed increases interest rates to slow economic activity to avoid inflation becoming a problem down the road. That is, at the peak of the cycle, resources are fully utilized and thus any further pressure on the utilization of these resources typically puts upward pressure on the price of these resources. However, this is not what happened at the end of the pandemic. The truth is that prices started to increase for several reasons, but none related to the actual workings of a typical economic cycle.

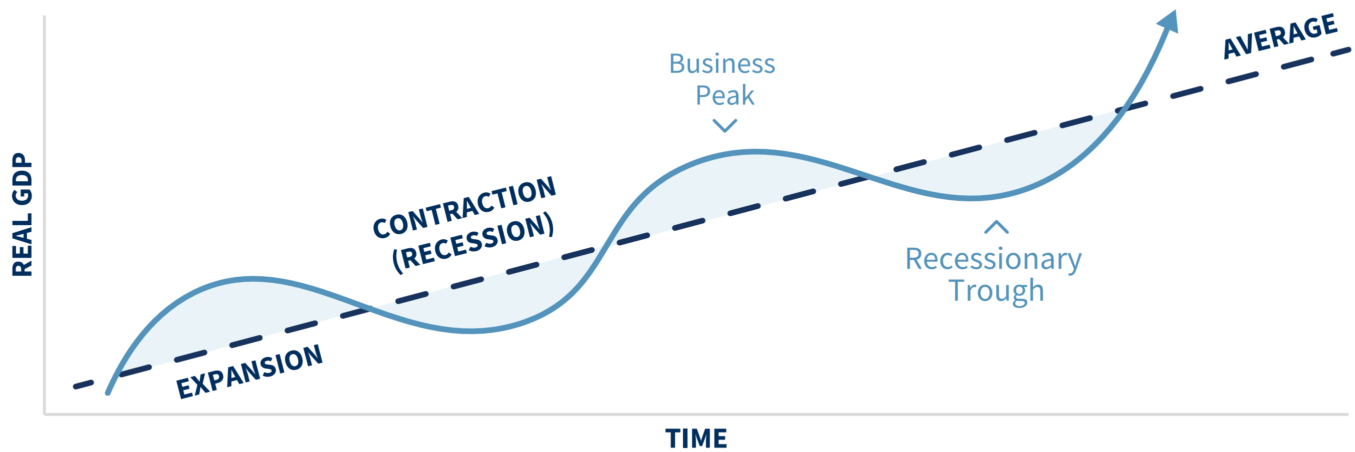
> **"This time is different."**

NAVIGATING THE PERFECT STORM

First, the total collapse of global production during the pandemic reduced the supply of goods while at the same time supply chain issues made the remaining goods very scarce and the acquisition of them extremely expensive. This meant that the increase in the price of the goods was not due to high economic growth but more to the inability to acquire goods cheaply and in a timely fashion. Second, the decline in the labor force participation rate due to the fear of contagion plus all the extra help given by the federal government meant that firms needed to entice workers to return to the labor force through increases in salaries/wages, especially in the service sector of the economy. This also contributed to a

The Economic Cycle

Economies fluctuate over time through a process called the business cycle. The cycle has several stages: expansion, slowdown, contraction, and recovery. These cycles usually span several years.



further increase in the cost of production and thus in the price of goods and services. Third, the immense amount of federal income transfers during the Trump and early Biden administrations helped Americans accumulate enormous amounts of money at a time when it was almost impossible to spend because the economy was shut down. This money was accumulated during the pandemic and contributed to putting even more pressure on prices as demand for goods skyrocketed during the pandemic while demand for services surged once the US economy reopened after the COVID-19 pandemic ended.

ENTER THE FEDERAL RESERVE

Since price stability is one of the two mandates the Fed has, the other being low unemployment, and one of the only instruments the Fed has to bring down prices is by conducting monetary policy to slow down economic activity, the Fed embarked on one of the most aggressive interest rate campaigns in history to rein in prices.

However, the truth is that traditional monetary policy did not work, and it is still not working. The reason for this is that this wasn't a normal cycle where a reversal in monetary expansion, i.e., higher interest rates, would help keep economic growth contained or slow down economic growth to keep inflationary pressures at bay. This cycle was created by the COVID-19 pandemic recession as well as by a massive fiscal expansion. Once the production, supply chain, and labor scarcity generated by the COVID-19 pandemic recession were over, the federal government should have taken back, if not completely at least partially, the fiscal expansion created during the COVID-19 pandemic recession. Of course, this would have been political suicide, so it was not even discussed, let alone implemented.

> The increase in the price of the goods was due to the inability to acquire goods cheaply and in a timely fashion, the decline in labor force participation, and fiscal stimulus.

But monetary policy has not been benign during this tightening campaign. The housing markets felt the pain and real residential investment remained in recession territory for nine consecutive quarters. Furthermore, last year's banking crisis was also triggered by the inability of some banks to adapt quickly to much higher interest rates by adjusting their investments appropriately. Thus, regulators had to intervene and provide liquidity to stop runs on vulnerable institutions.

WATERFALL OF FISCAL SPENDING

As if this was not enough, after the end of the COVID pandemic, the federal government engineered an industrial policy that would keep non-residential investment surprisingly afloat even under otherwise very high interest rates. Both the passing of the Creative Helpful Incentives to Produce Semiconductors (CHIPS) Act, as well as the Inflation Reduction Act (IRA) and, to a lesser extent, the Infrastructure Investment and Jobs Act (IIJA), helped reduce the impact of much higher interest rates on non-residential investment and have contributed to keeping the US economy afloat.

The IIJA is considered a generational investment to rebuild America's infrastructure, authorizing $1.2 trillion for transportation and infrastructure spending over five years. The bill included $550 billion in new federal spending, with $110 billion for roads and bridges, $47 billion for energy policy, $65 billion for high-speed internet access, $56 billion for airports, and much more. The IIJA was a key component of President Biden's agenda, but after witnessing the supply chain disruption and shutdowns during the COVID-19 pandemic, as well as the increase of global geopolitical risk, additional efforts were deemed crucial to both US national defense and other critical sectors of the economy.

While semiconductors were invented in the US, 90% of the world's supply and 100% of the most advanced chips are currently manufactured overseas. Therefore, two industrial policy statutes were passed in 2022. First, the IRA provides incentives and uncapped tax credits for sustainability projects, clean technology, EV and battery production, and renewable energy such as solar and wind. Second, the CHIPS Act provides $39 billion in direct spending on chip production and 25% uncapped advanced manufacturing tax credits.

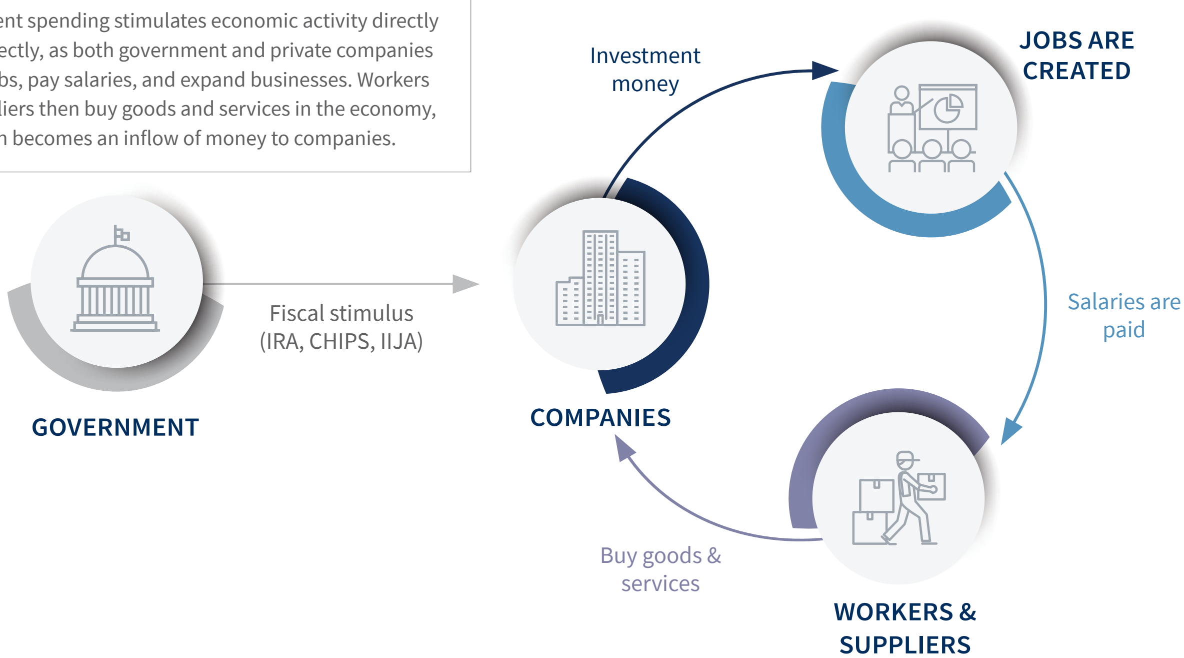
The benefits of these large investments trickle down to other sectors of the economy through a process called the government expenditures multiplier. The multiplier measures how much each one dollar increase in spending boosts the country's economic output, essentially measuring the effectiveness of the government's effort. While it is very complicated to accurately measure this number due to the multitude of factors impacting the economy at any given time, preliminary data suggests that the three packages have had and will continue to have an outsized impact on the US economy over the next several years. While the US government hasn't released many funds yet, private companies have already either announced or started making very large investments in building new factories in the US with hopes of benefiting from the various government incentives. Since the pandemic started the combination of these three packages has pushed US manufacturing construction spending higher by 175% to $213 billion per year. Moreover, construction put in place for the manufacturing of computers and electronics has increased by more than 1,000% over the last two years.

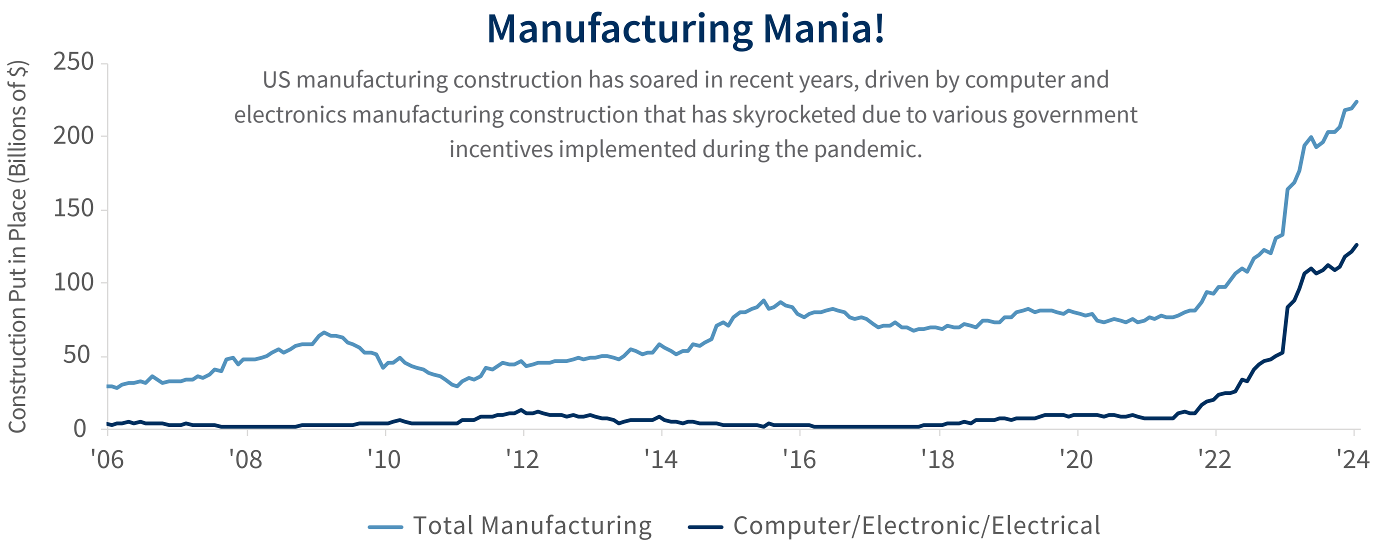
CONCLUSION

The fiscal policies implemented during the pandemic recession helped individuals and firms survive some of the most perilous times in more than a century and helped keep the economy going during the recession. However, many individuals could

Fiscal Stimulus Ripple Effects

Government spending stimulates economic activity directly and indirectly, as both government and private companies create jobs, pay salaries, and expand businesses. Workers and suppliers then buy goods and services in the economy, which becomes an inflow of money to companies.





Source: FactSet as of 3/18/24

not spend the funds due to lockdowns and supply chain disruptions, pushing the personal savings rate higher than 30% during the early stages of the pandemic. However, as the limits imposed during the pandemic were lifted and supply chains normalized, the US consumer roared back with lots of excess savings ready to be deployed.

After inflation reared its ugly head during the recovery from the pandemic recession, the Fed could not stand idle and, while late, started raising interest rates. However, few sectors reacted to the increase in rates—mostly residential investment and the housing market—while other sectors were rescued by the three federal government acts that helped keep non-residential investment from reacting to higher interest rates.

The stimulus payments in the hands of individuals and firms, coupled with the effects of the three government acts, rendered monetary policy ineffective. The Fed has increased interest rates to stall and prevent a new monetary cycle from reigniting the inflation fire, but it is currently refraining from further actions until all of these excesses are flushed out of the system.

Consequently, our outlook no longer anticipates a mild recession for the US economy. However, we still expect economic activity to slow down considerably over the next several quarters as high interest rates will continue to keep lending contained. Therefore, while our revised expectations have moved from the mildest recession in US history to a soft landing, our full-year GDP for 2024 has only moved from 1.7% to 2.1%.

“Our outlook no longer anticipates a mild recession for the US economy.”

KEY TAKEAWAYS:

- Saying ‘this time is different’ is fitting in trying to understand the economy since the recovery from a once in a lifetime event such as the global pandemic.
- Inflation rose because of the collapse of global supply and supply chain issues; the increases in salaries/wages necessary to entice workers back to the labor force; and government stimulus.
- The Fed embarked on an aggressive tightening cycle in a bid to bring inflation under control.
- Monetary policy has not worked because this is not a normal monetary cycle—it is a fiscal cycle.
- The government engineered an industrial policy that would keep non-residential investment afloat even with high interest rates.
- While we expect economic growth to slow, we do not foresee a recession in 2024.

After the Fed Pivot: Where Are the Opportunities?

Tracey Manzi, CFA, *Senior Investment Strategist,* Investment Strategy

The Federal Reserve's (Fed) pivot late last year sparked an enormous rally in the bond market. In fact, US Treasurys and nearly all fixed income sectors enjoyed some of their best quarterly returns on record. The sharp decline in yields over the final quarter of 2023 was a textbook reaction as market participants are well versed in what typically comes after the Fed pivots—softer growth, lower inflation and the commencement of an easing cycle. While the timing of the Fed's easing cycle after the final rate hike varies, historically the Fed's first rate cut has come an average of seven months after the last rate hike, based on the last six cycles.

With the Fed delivering its final rate hike in July 2023, we are now approaching the window—which has ranged from one to fourteen months—where policymakers have typically kicked off their easing cycle. While notable, this cycle has been anything but average. Case in point: after 550 basis points of tightening (one of the most aggressive cycles in history), the economy continues to show surprising resilience—strong job growth, slowing, but still above-trend growth and record low unemployment. Why? The government's ongoing fiscal expansion, where the budget deficit is now running at ~6% of GDP. While the fiscal stimulus may have lengthened the economy's runway, our economist expects growth and inflation to slow over a six to twelve month horizon. This expected cyclical slowdown should keep the bond market focused on the timing and pace of the Fed's eventual rate cuts.

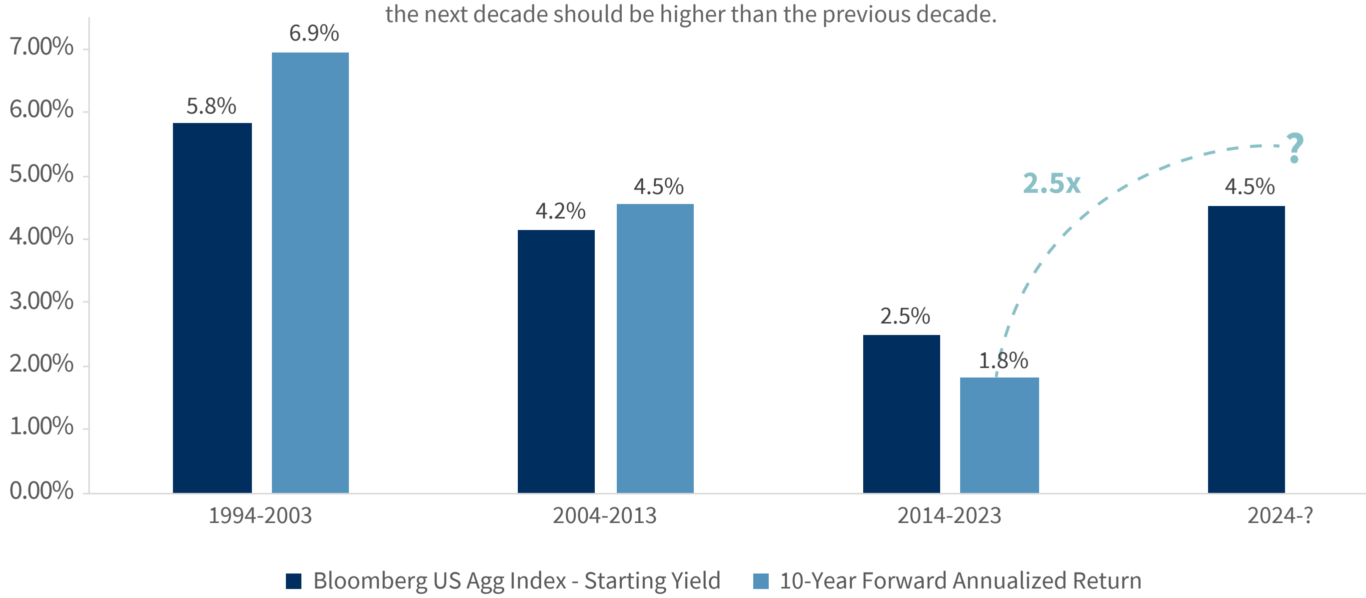
STARTING YIELDS ARE THE STRONGEST PREDICTOR OF FUTURE RETURNS

Given the ongoing strength in the labor market and still solid economic growth, the Fed can afford to exercise patience. In fact, the resilient economy has been a major factor behind why excessive rate cuts this year have been largely unwound and a key reason why Treasury yields have moved modestly higher since the start of the year. With the market now pricing in three rate cuts by year end, Treasury yields will be swayed (up or down) by the incoming data. But with the Fed telling us that interest rates have peaked for the cycle and that rate cuts are on the horizon as long

> The starting level of yields is the single best predictor of a bond's total return over longer periods of time.

Starting Yield Best Predictor of Future Returns

The expected return a bond investor can achieve over the next decade should be higher than the previous decade.



Source: Bloomberg, as of 3/18/2024

as the disinflationary trend remains intact, Treasury yields will eventually be headed lower—albeit likely at a slower pace than we originally anticipated.

While our call for moderately lower yields in 2024 may be delayed as long as economic growth remains solid, we still believe the current high level of yields remains an attractive opportunity for investors. That's because the starting level of yields is the single best predictor of a bond's total return over longer periods of time. And with yields across a wide spectrum of fixed income sectors significantly higher than their COVID-era lows, bonds should deliver strong returns over the coming decade. While there will be some volatility along the way, expected returns over the next decade should be substantially higher—2.5 times higher—than the previous decade.

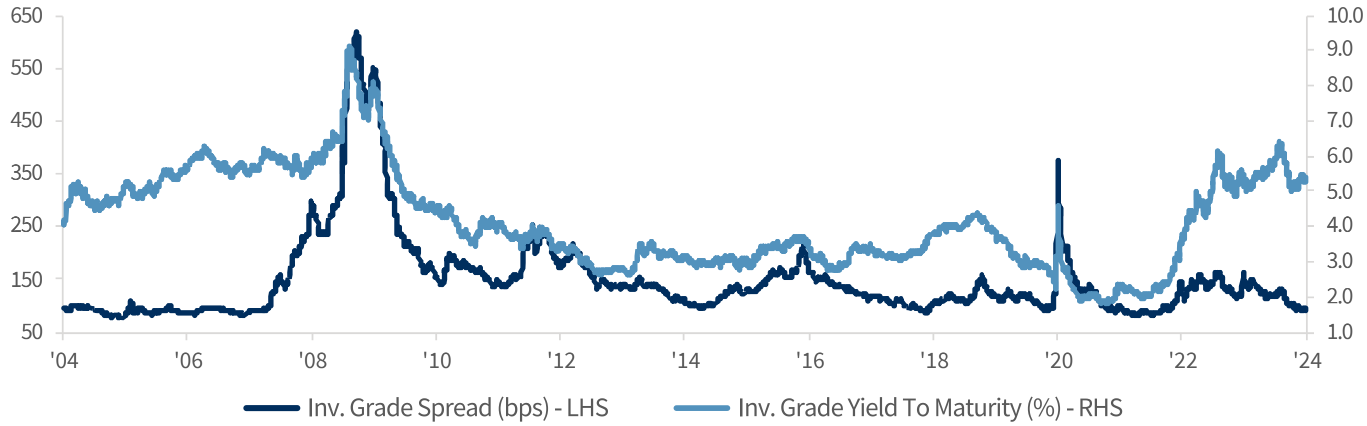
WHERE WE SEE OPPORTUNITIES

Treasury yields are likely to trade in a wide range again this year given the economy is at an inflection point. In the near term, we see scope for Treasury yields to move in either direction. For example, any weaker than expected economic news (whether on the growth, jobs or inflation front) could drive yields significantly lower as the market reprices to a more aggressive Fed easing cycle—with a move to 3.5% not out of the question. Conversely, any signs of waning demand at the upcoming Treasury auctions (2024 will be another year of heavy Treasury issuance to fund the deficit) could easily push yields higher to 4.5% again. These trading ranges should create some opportunities for investors along the way. But by year end, we believe yields should be within the ballpark of where they started the year. However, with the economy still on solid footing, we are modestly raising our 10-year Treasury yield forecast to 3.75%.

> Our preference remains for the higher quality sectors, which have strong debt-servicing capacity, better balance sheet liquidity to absorb higher borrowing costs, and limited default risk.

Turning to the corporate credit markets, we see limited room for further spread compression with the investment grade, high yield, and emerging markets credit spreads trading at historically tight levels. While we do not see credit spreads being a significant driver of returns going forward, yields remain attractive and provide reasonable 'carry'—particularly in an environment in which the economy avoids a recession, and defaults remain low. Our preference remains for the higher quality sectors, which have

Elevated Yields Are Attractive Even Though Spreads Are Historically Tight



Source: Bloomberg, as of 3/18/2024

strong debt-servicing capacity, better balance sheet liquidity to absorb higher borrowing costs, and limited default risk. The refinancing momentum since the start of the year should also temper investor concerns about upcoming maturity walls as corporations are, once again, staggering their debt maturities. We are also constructive on local emerging market debt as the combination of high real rates, central bank easing cycles, declining inflation and a potentially weaker US dollar should provide a tailwind to returns.

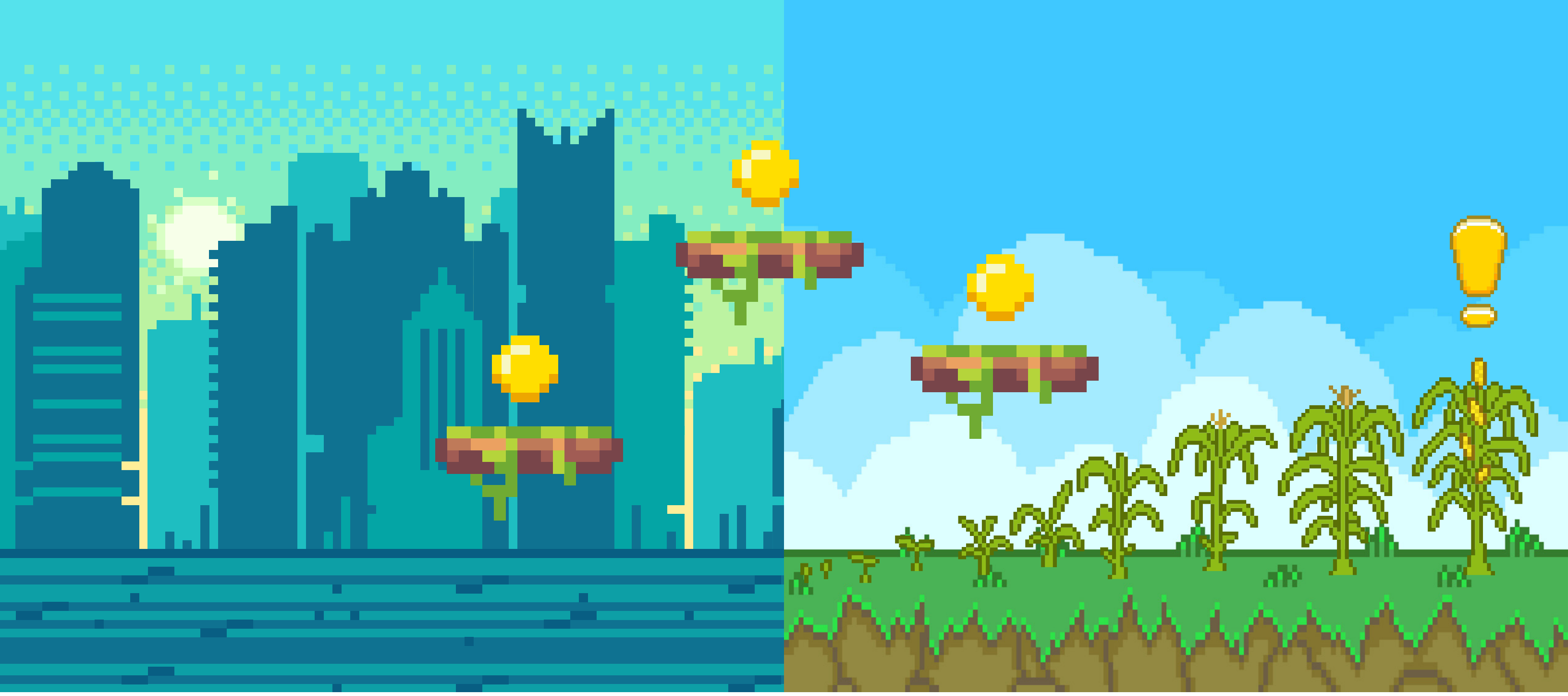
Municipal bond tax-equivalent yields are trading near their highest levels in over a decade. After the aggressive backup in bond yields over the last few years, munis provide investors, particularly those in the highest tax bracket (40.8%), a yield advantage relative to Treasurys and investment grade corporate credits. Another positive for munis is the shape of the yield curve. With the US Treasury curve inverted (i.e., shorter-maturity yields are higher than longer-maturity yields), the corporate credit curve flat, and the muni curve positively sloped (i.e., shorter-maturity yields are lower than longer-maturity yields), muni investors have the opportunity to earn some roll-down gains—the additional capital gain that is created by an investor holding a bond for a period of time as it ages closer to maturity.

CONCLUSION

With a Fed easing cycle on the horizon, the fixed income markets are relatively attractive. Today's yields remain near their highest levels in well over a decade, providing investors with an opportunity to lock in the current levels of yield. Capital appreciation opportunities may come, particularly if economic growth turns out to be weaker than expected. But even without the added bonus of capital appreciation, the more normal level of yields suggests investors can now earn a reasonable return on their bond investment. And that return should be much higher going forward than what an investor could earn in the prior decade. Relative value opportunities exist within the fixed income sectors for those looking to augment their core fixed income exposure. We favor high quality credits, local emerging market debt and municipal bonds.

KEY TAKEAWAYS:

- With slowing growth and rate cuts on the horizon, Treasury yields will eventually be headed lower.
- We anticipate forward-looking bond returns will be much brighter than the prior decade.
- Treasury yields are likely to trade in a wide range this year given the economy is at an inflection point.



Food for Thought: Declining Crop Prices Are Helping to Alleviate Inflationary Pressures

Pavel Molchanov, *Managing Director,* Energy Analyst, Equity Research

What does inflation mean to you? For a typical consumer, the two most hot-button topics are food and energy. Both play a significant role in household spending, and just as importantly, both are highly visible. Gasoline prices are noticed every time a driver fills up at the pump, and food prices are front and center during every visit to a grocery store. Bearing in mind that everyone needs to eat, whereas it is possible to avoid spending on fuel, food tends to outweigh energy in economic importance. In the US Consumer Price Index, for example, food and energy are weighted at approximately 14% and 8%, respectively. While the media likes to write about Big Macs and cartons of eggs as indicators of food cost inflation, the building blocks of the global food chain are staple crops. Human consumers aside, some of the most important crops are also vital as animal feed. In this article, we will take a look at the world's top four crops by volume: sugarcane, corn (maize), rice, and wheat.

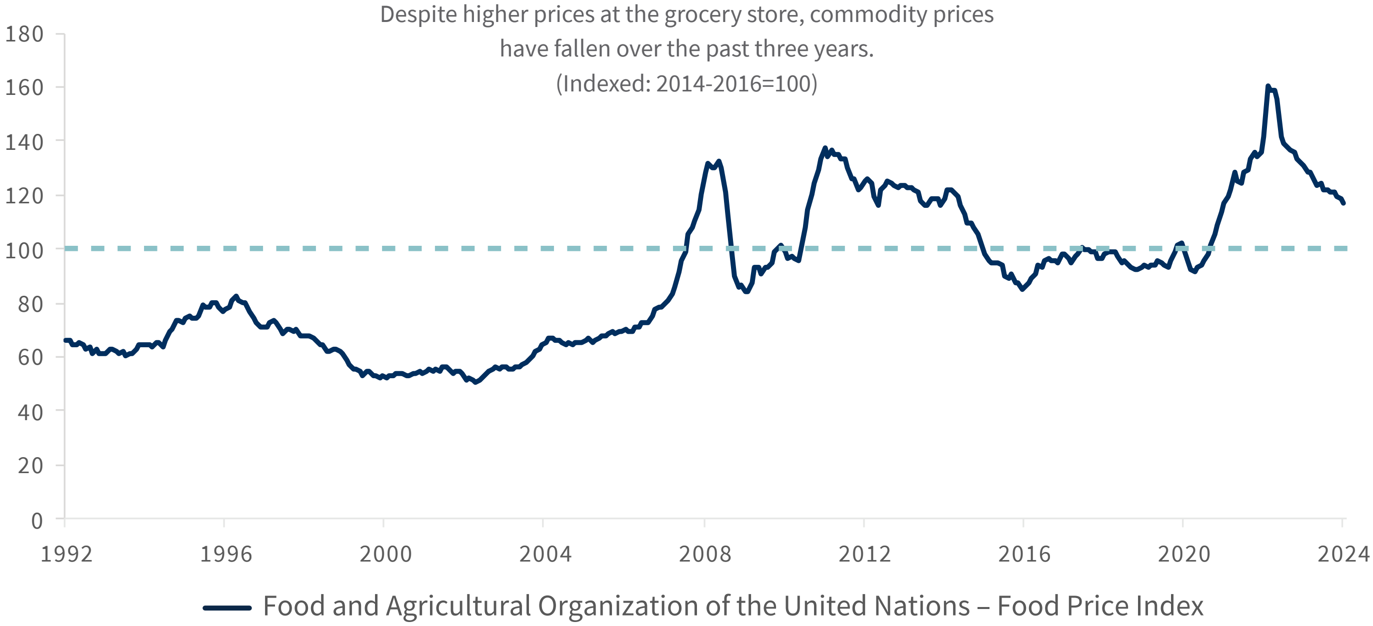
CORN PRICES: A DOUBLE-EDGED SWORD

To the extent that Americans think about crops, they are most familiar with corn—for one thing, they put it in the gasoline tank! Practically all of the fuel-grade ethanol blended into US gasoline is derived from corn. Corn is also the predominant US source of animal feed. Interestingly enough, only 1% of US corn supply is sweet corn, which is what's sold in the supermarket. The US is the world's largest corn producer, accounting for nearly one-third of global supply, or as much as second-ranked China and third-ranked Brazil combined. Corn prices fell this past February to their lowest levels since late 2020, around $4/bushel, down from a high of $8/bushel in mid-2022. This is obviously unwelcome news for farmers in the Midwest's Corn Belt, but it is good news for cattle ranchers

> The US is the world's largest corn producer, accounting for nearly one-third of global supply, or as much as second-ranked China and third-ranked Brazil combined.

Food Prices Have Gone Down Since 2021

Despite higher prices at the grocery store, commodity prices have fallen over the past three years. (Indexed: 2014-2016=100)



Source: FAO, as of 2/2024

and, by extension, anyone who enjoys a good steak. US corn plantings in 2023 were up six million acres to a near record 95 million acres—this means more supply in 2024. The US Department of Agriculture forecasts a decline to 91 million acres in 2024, which shows a response to the lower prices.

Bearing in mind that US ethanol volumes have been flattish over the past decade, to the extent that US farmers are incentivized to produce more corn, it is to ship abroad. China is the world's largest corn importer, followed by Japan—in both countries, corn is important for animal feed. China's own corn production has plateaued, so all of its incremental demand needs to come from imports. Historically, China had imported almost entirely from the US, but that is changing. After the Chinese government approved purchases from Brazil in 2022, imports from the US fell by roughly half. While there are some political overtones here vis-à-vis the complicated relationship between Washington and Beijing, it is also a fact that Latin American corn tends to be cheaper than what comes from Iowa or Kansas.

> "Lower food prices open the door to more discretionary spending and, at a macro level, alleviate inflationary pressures."

RUSSIA/UKRAINE & THE PRICE OF WHEAT

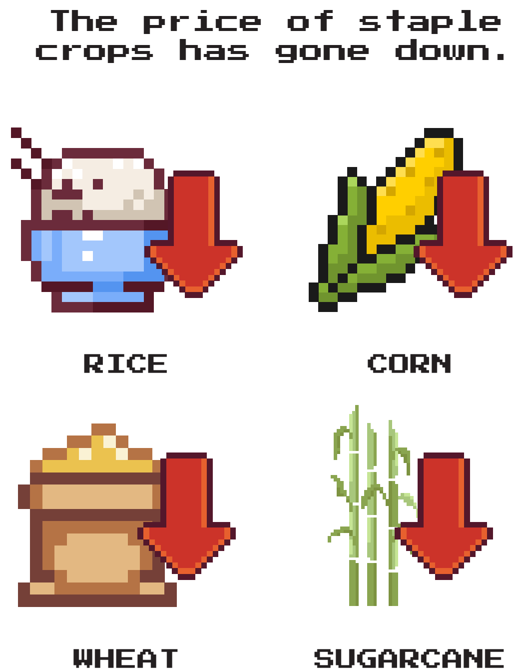
The wheat market has been the most influenced by geopolitics in recent years, because Russia is the world's third-largest producer, and Ukraine is (or rather was) ranked sixth. When Russia invaded Ukraine in early 2022, wheat prices spiked to an unprecedented $11/bushel. As with corn, prices have dropped by half since then and are currently at three-year lows—in other words, even lower than they had been just prior to the war. Recall, one of Russia's tactics in the early months of the war had been to impose a blockade of Ukrainian ports, thus halting the export of wheat. In response to intense pressure from African and Middle Eastern countries that depend on this wheat, Russia agreed to allow the resumption of Ukrainian exports in mid-2022. Although one year later this deal fell apart, Ukraine is still exporting via the Black Sea, bearing in mind 1) the weakness of Russia's navy; and 2) it is difficult to envision the Kremlin making a political decision to attack international civilian ships carrying grain. Ukraine is also shipping some wheat overland into Europe. Although supply from Ukraine is still impacted by the war, there is no longer fear of outright shortages.

THE IMPACT OF FOOD SECURITY MEASURES

The top nine rice-producing countries are all in Asia, led by China and India. Although China produces twenty times more rice than the US, it still relies on a significant amount of imports. India, on the other hand, historically had been a rice-exporting country. That changed in 2022, when, in response to concerns about domestic food security, India's government banned the export of what's known as broken rice. In 2023, the ban was broadened to encompass plain, white, long-grain rice. In large part because of the absence of Indian rice on the global market, current prices near $19/hundredweight are at three-year highs and double what they were in 2020. It is understandable that India's policymakers are prioritizing more supply for their own citizens, but the flip side is higher prices in China and other import-dependent countries.

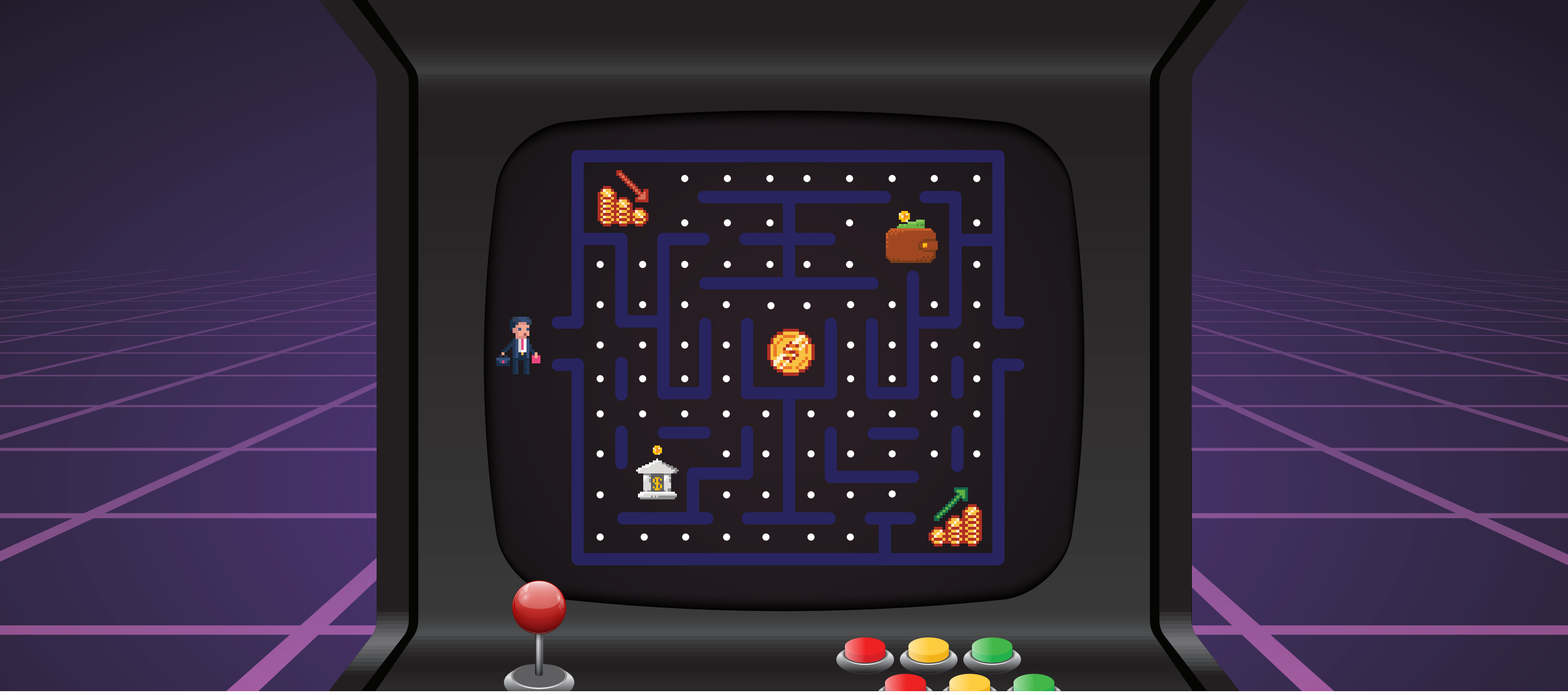
It is an underappreciated fact that sugarcane is the world's largest staple crop by volume. The sugarcane market is also interesting for the extent to which it is dominated by a single country: Brazil accounts for 40% of the production, even more than the US proportion of the corn market. Much like corn in the US, sugarcane plays the central role in Brazilian ethanol supply, and what's known as sugarcane bagasse—the fibrous, dry part of the plant—is used to generate electricity. Also, needless to say, it is hard to imagine a 21st century food system without large amounts of sugar—so much so that public health professionals have been sounding the alarm. In any case, while the sugar market has faced the challenge of periodic Brazilian droughts over the past decade, it is the second-largest producer—India—which explains why prices have doubled since 2020 to around $0.25/pound. As was the case with rice, India banned sugar exports in 2023, which means supply from Brazil is even more crucial than before.

Putting everything together, the U.N. Food and Agriculture Organization's Food Price Index started 2024 at 118, down 10% from one year ago, and with an even steeper decline versus 2022. Bottom line: good news for consumers. Let's underscore that food constitutes a larger proportion of spending in lower-income communities compared to wealthier ones, and in emerging markets compared to industrialized economies. Lower food prices open the door to more discretionary spending and, at a macro level, alleviate inflationary pressures and thus support monetary easing by central banks.



KEY TAKEAWAYS:

- The two most hot-button topics for consumers are food and energy—both are highly visible. Since everyone has to eat, food tends to outweigh energy in economic importance.
- The building blocks of the global food chain are the four staple crops—corn, wheat, rice and sugarcane.
- The wheat market has been the most influenced by geopolitics in recent years, because Russia is the world's third-largest producer, and Ukraine is (or rather was) the sixth. When Russia invaded Ukraine in early 2022, wheat prices spiked to an unprecedented $11/bushel.
- Wheat prices are currently at three-year lows—even lower than they had been just prior to the war—and corn prices have also fallen sharply.
- The U.N. Food and Agriculture Organization's Food Price Index started 2024 at 118, down 10% from one year ago, and with an even steeper decline versus 2022.



Q&A: This Isn't Your Father's Index…

Matt Orton, CFA, *Chief Market Strategist, Raymond James Investment Management**

No matter where you turn, it's impossible to avoid hearing about concerns facing the market, from valuations to stubborn inflation to elevated rates to a lack of breadth. And it's easy to see why when looking at some of the anomalies that just keep getting more extreme. Enthusiasm around artificial intelligence (AI) and the incredible top line growth we're seeing across many of the semiconductor and software beneficiaries has led to significant price gains and consequently valuation inflation. Increasing concentration at the top of the market has also significantly narrowed the top contributors to market performance in broader indices like the S&P 500, leading to extreme divergences from the average stock. But beneath the surface, the market of stocks is meaningfully healthier than these anomalies would have us believe, and there is a stealth broadening that has been, and will likely continue, taking place. This should be welcome news for investors as it is creating plenty of opportunities for those who take the time to look.

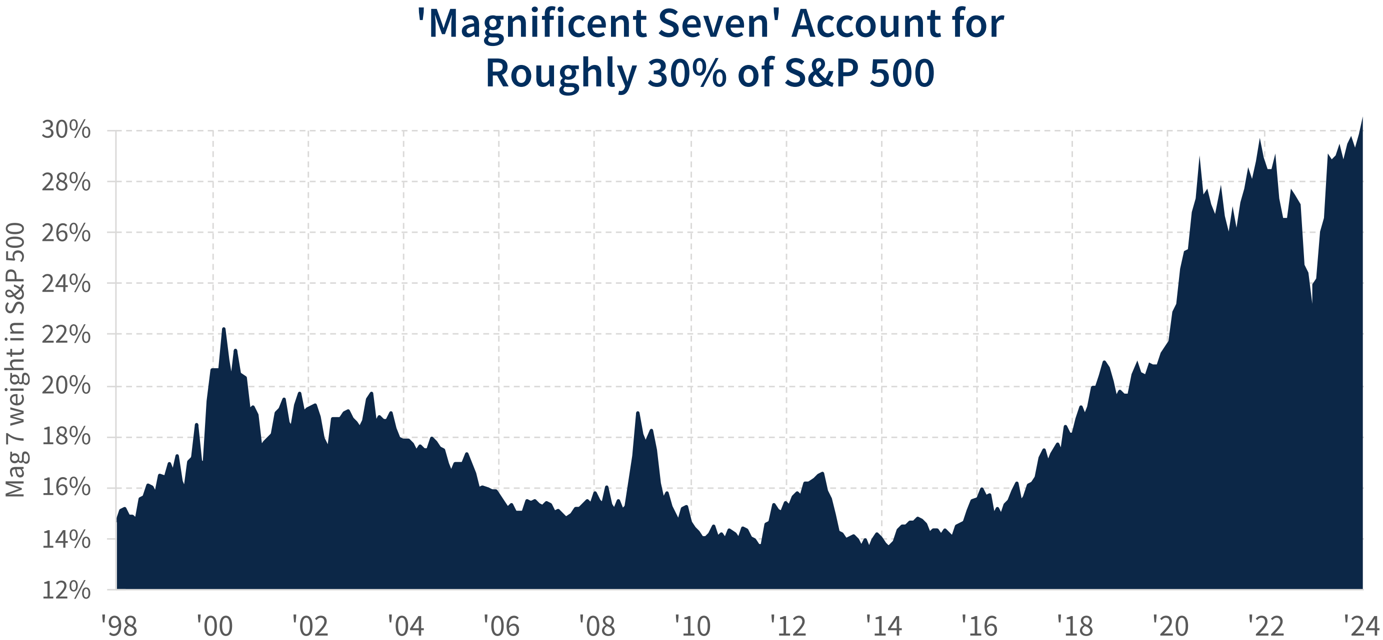
Q: What are the biggest risks from index concentration, and should investors be concerned?

A: As an index becomes more concentrated, the small handful of companies at the top will naturally have a disproportionate impact on returns. That is certainly the case right now where the 'Magnificent Seven'** are contributing approximately 60% of the returns of the S&P 500 year-to-date, and that's after contributing over 60% in 2023. However, what goes up can also come down—and unfortunately these large companies can provide meaningful headwinds to index performance, just like they provided tailwinds on the way up. Part of the fear around today's market concentration is compounded by a similar narrowness in sectors and growth drivers of these top companies. While these are certainly risks, we cannot forget that many of these largest companies have incredibly well-diversified businesses with a myriad of product verticals, strong earnings, and cash balances bigger than many of the constituents within the S&P 500.

Overall, concentration certainly poses a risk, should all the mega caps roll over, but the likelihood of this is low given the current economic backdrop. Positioning might be stretched and there are risks of near-term consolidation, but the underlying fundamentals for these companies are

*An affiliate of Raymond James $ Associates, Inc., and Raymond James Financial Services, Inc.

**The 'Magnificent Seven' refers to seven mega-cap tech stocks: Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla.



Source: Bloomberg, as of 3/18/2024

incredibly strong—much more so than at any other point when we've seen similar levels of index concentration. Additionally, we have a recency bias and forget about the challenging 2022 many of the largest stocks experienced. In many cases, these companies have only recently moved into the green.

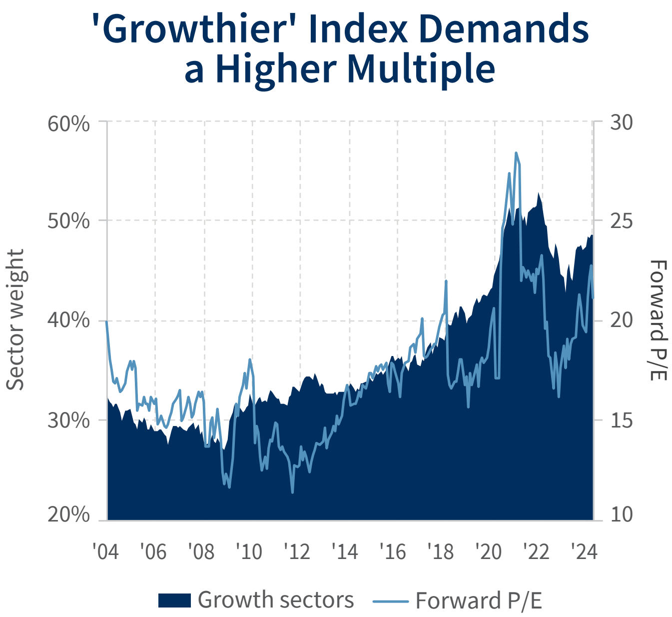
Q: Is the average stock still worth owning?

A: It would be remiss not to acknowledge some of the extreme moves this year in heavily weighted names (e.g., NVDA, META), but there are actually a growing number of stocks that are doing well, supported by strong earnings and fundamental outlooks. In fact, approximately 60% of the S&P 500 constituents are positive year-to-date, 35% of constituents are outperforming the Index, and nearly 30% are up over 10%. Clearly, there is a lot going right underneath the surface and we've specifically seen a steady improvement in the absolute performance of the average stock throughout earnings season. Unfortunately, anomalies with respect to index weighting mask this when just looking at the surface. More sectors and industries look to be approaching inflection points in their earnings cycles, which could provide further support throughout 2024.

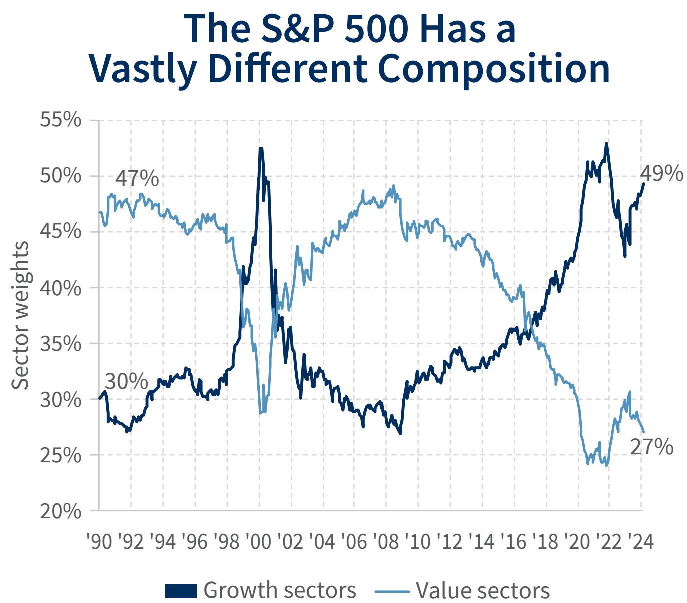
Q: Is index concentration making the market expensive?

A: We need to reframe the discussion around valuation. Following an incredible 'Fed pivot rally' that began with Fed Chair Jay Powell's dovish comments in December, the S&P 500 is trading at 24.2x trailing twelve month (TTM) and 21.0x on a 12-month forward multiple. That's back toward the peak of 2021 on a forward multiple basis, and the average stock (i.e., the equal weighted S&P 500) is meaningfully cheaper at 19.8x TTM and 17.4x forward P/E. With such a large gap between the Index and the average stock (five points above its TTM median P/E and three points above its median forward P/E), it's clear that the concentration in the largest names, many of which have rallied significantly over the past year, are inflating market valuations. It is worth noting that as we see earnings revisions increase for the broader market and the inflection across sectors ex-Technology and Communication Services, this valuation gap will likely start to shrink regardless of the market's direction.

While it's easy to point to index concentration and generalize the market as expensive, I would push back against this notion. Is the market really expensive just because the long-term medians or averages tell us so? I actually would argue that the market is so different today that there isn't much



Source: Bloomberg, as of 3/18/2024



Source: Bloomberg, as of 3/18/2024

value in utilizing these longer-term metrics—just since the Great Financial Crisis (GFC), both the US economy and the market have become much 'growthier' in nature. Pre-GCF, the sectors like Financials and Energy were among the largest weights. That is incredibly different from today. And growthier companies command a higher multiple (see chart above which that tracks growth sector weights in the S&P 500 and the forward P/E). This isn't to say that the market might be stretched right now, but it's not because a historical multiple tells us so.

Q: Are there other indices that suffer from concentration issues?

A: With so much noise surrounding the S&P 500's concentration, most would be surprised to learn that a vast number of international indices have an even worse concentration 'problem'. It makes sense when you think about it, right? The largest companies in the world operate internationally, and the US boasts the biggest and best companies in the world with the largest geographic reach. When you look at smaller countries (all of them), they have a fewer number of these international powerhouses and thus they make up a large portion of their respective country indices. The market is the most efficient allocator—the biggest companies are the biggest because they are the best.

Q: Where should investors look to find opportunities now?

A: There are plenty of opportunities for investors who are willing to be selective—Industrials, Health Care, small caps and dividend growth all offer diversification appeal. Small and mid-cap biotechnology has started to outperform, driven by the Big Pharma 'obesity drug cash windfall,' while the rest of the Health Care sector is reporting earnings well ahead of estimates. Even Energy might be starting to show some signs of life outside of the refiners and the sector offers a nice complement to ever growing Technology and semiconductor weights. At the end of the day, the current manifestation of market narrowness isn't something by itself that is all too concerning, while also offering plenty of opportunities.

Economic Snapshot

EUGENIO J. ALEMÁN, PhD
Chief Economist

After weakening more than expected in 2023, inflation has remained sticky over the last quarter, while core prices have continued their slow disinflationary process. Shelter costs should contribute to lower inflation in 2024 as lags in rent and home prices start to be reflected in the economic data. However, recent increases in home prices, if sustained, could become a headwind toward the end of the year. Last year's stronger than expected economic growth is starting to wane as consumers deal with depleted excess savings and elevated credit card balances. Weaker spending and lower prices would be welcomed by the Federal Reserve (Fed) in its effort to bring inflation under control. We still expect the Fed to lower rates three times this year starting in the summer. This, coupled with resilient business investments fueled by strong government spending, is likely to keep the economy afloat, delivering one of the softest landings in US history. Overall, the resiliency of the US economy, along with stagnant growth and the prospect of rate cuts worldwide are headwinds for foreign currencies, which should support the US dollar short term.

	ECONOMIC INDICATOR	COMMENTARY
NEUTRAL	GROWTH	GDP growth is expected to continue to moderate over the next several quarters and we expect a soft landing to occur.
NEUTRAL	EMPLOYMENT	The labor market has been cooling and we expect it to weaken further in 2024 but remain positive.
NEUTRAL	CONSUMER SPENDING	Consumer spending has started to weaken as excess savings from the pandemic are fully depleted, student debt repayments have resumed, and credit card balances remain elevated.
NEUTRAL	BUSINESS INVESTMENT	Despite higher interest rates raising borrowing costs, the passage of several bills, including the Inflation Reduction Act (IRA), the CHIPS Act, and the Infrastructure Bill are contributing positively to business investment.
NEUTRAL	INFLATION	Inflation is likely to continue its disinflationary trend as economic activity weakens over the next few quarters. Shelter costs should slow further and barring any economic shock, headline inflation should move lower over the next quarters.
NEUTRAL	MONETARY POLICY	The Fed is likely to keep rates higher for several more months before starting to lower rates as it has suggested that it is not convinced that the fight against inflation is over.
NEUTRAL	LONG-TERM INTEREST RATES	The deceleration in inflation, a cooling economy, and the Fed easing rates are all likely to contribute to lower long-term interest rates.
NEUTRAL	FISCAL POLICY	Government spending is likely to be significant because funds already spent by firms through various fiscal programs will have to be matched and honored.
NEUTRAL	THE DOLLAR	The US dollar's role as a safe-haven currency during times of global instability, as well as the expectation of slower growth overseas compared to the resilient US economy should provide stability for the US dollar in 2024.
NEUTRAL	REST OF THE WORLD	We continue to expect a weakening global economy in 2024 despite central banks worldwide turning more dovish.
UNFAVORABLE	MANUFACTURING	The ISM Manufacturing Index remained in contraction for all of 2023 but should start to recover in the second half of the year as the Fed starts to ease rates.
UNFAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	High mortgage rates and rising construction costs have kept this sector in contraction for several quarters. Despite these headwinds, the low supply of homes has kept prices somewhat stable, and lower rates in 2024 might provide some additional relief to the sector.

Sector Snapshot

TALLEY LÉGER
Senior Equity Strategist,
Investment Strategy

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. The views presented here are based on current market conditions and are not necessarily reflective of our thoughts for the entire year.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate a strategy customized to their preferences, needs and goals.

These recommendations will be displayed as such:

Overweight: favored areas to look for ideas, as we expect relative outperformance

Market Weight: expect in line relative performance

Underweight: unattractive expectations relative to the other sectors; exposure might be needed for diversification

	SECTOR	S&P WEIGHT	COMMENTARY
OVERWEIGHT	HEALTH CARE	12.3%	Health Care has been the #1 performer in the 12 months after first Federal Reserve (Fed) interest rate cuts, which we expect to occur this year. Also, we see this deeply oversold sector benefiting from an earnings rebound in 2024, driven by continued investment in innovative drugs, medical devices and procedures. A stable pharmaceutical and medicine shipments-to-inventories ratio suggests the demand for drugs and medicine has picked up relative to the supply, and that these fairly valued stocks appear overdue for a catchup phase.
OVERWEIGHT	INDUSTRIALS	8.1%	We think of Industrials as an old-economy derivative play on new-economy trends. Sector earnings growth may be bottoming alongside manufacturing output, supported by continued investments from the IRA, CHIPS and Science Act, and IIJA. The relative weakness of Industrial stocks appears overdone compared to core capital goods orders. The onshoring of US production in response to past supply-chain disruptions should boost industrial demand, resulting in a US manufacturing renaissance of sorts.
OVERWEIGHT	ENERGY	3.8%	Energy is trading near its deepest valuation discount relative to the market and history, so it wouldn't take much to spark a reprieve rally. A recovery in the US, Europe, China and India—alongside capital, drilling, and production discipline—could swing the supply/demand balance in favor of modestly higher oil & energy stock prices this year. While it isn't our base case, the sector may also provide a hedge against potential upside inflation surprises.
OVERWEIGHT	INFORMATION TECHNOLOGY	29.4%	The momentum behind artificial intelligence (AI) has generated significant outperformance for Information Technology and rightfully so, given the sector's superior fundamentals. We believe 2024 will be the year of broadening AI use cases as the innovation moves from infrastructure buildout to application deployment. With the stocks trading at 28x forward earnings on the back of an 11% gain YTD, any short-term consolidation should be viewed as an opportunity to build positions in this multi-year innovation cycle.
MARKET WEIGHT	COMMUNICATION SERVICES	9.7%	Comm Services boast some of the strongest earnings growth expectations this year. However, the sector has become highly concentrated with mega-cap tech representing ~60% of the segment's market cap. We're inclined to wait for a period of consolidation before moving to an overweight stance given the sector's strong performance over the past year and significant concentration.
MARKET WEIGHT	CONSUMER STAPLES	6.5%	We consider the defensive Consumer Staples sector as a potential means of protecting portfolios should some long overdue market turbulence arise. These stocks were the second best performers on average once the Fed began lowering interest rates, which we think should happen in 2024. The sector's relative weakness appears overdone compared to consumer spending on food services, which is robust.
MARKET WEIGHT	FINANCIALS	13.2%	Historically, Financials were among the worst-performing sectors on average in the wake of initial Fed rate cuts. Moreover, sector earnings growth continues to struggle with the lagged effects of past monetary policy tightening, an inverted yield curve and special charges related to regional bank rescues. Eventually, a more normally-sloped yield curve and improving credit conditions should help ease the pressures on this sector.

UNDERWEIGHT	REAL ESTATE	2.2%	Resilient economic data have kept interest rates firmer than many investors expected. If the economy keeps holding its ground, bond yields may remain a headwind for this highly rate-sensitive sector. It's possible for the space to become an interesting derivative play on the US industrial renaissance we see developing. However, weak earnings trends and ongoing challenges in commercial real estate urge patience with the sector.
	UTILITIES	2.1%	Electric and gas utility production benefited from a weather-related seasonal boost but Utilities stocks didn't benefit and temperatures are starting to warm up. If the economy remains resilient, this over-indebted, highly rate-sensitive sector may not receive the significant decline in bond yields required for a reprieve rally. Negative free cash flow expectations and weak earnings trends are additional headwinds this year.
	CONSUMER DISCRETIONARY	10.3%	Even if the US economy narrowly avoids a recession, consumers could face other challenges in the form of elevated interest rates, tighter lending standards, and potentially stubborn energy prices. While there may be selective opportunities in the sector through its exposure to mega-cap tech, they are unlikely to offset the heavy drag from autos related to higher borrowing costs.
	MATERIALS	2.3%	Negative money supply growth, a firm US dollar, weak raw industrial commodities and poor pricing power remain stiff headwinds for these companies. That said, raw materials are the basic building blocks of industrial revivals, potentially making the Materials sector an interesting derivative play on the US manufacturing renaissance we see developing.

Disclosure

All expressions of opinion reflect the judgment of the authors and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

US government bonds and Treasury bills are guaranteed by the US government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. US government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the US government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities.

The Russell 2000 Index is a small-cap US stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.

This is not a recommendation to purchase or sell the stocks of the companies pictured/mentioned.

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