Sanctuary
Asset Management
Investment Outlook
March 2023

Active Asset Allocation Views

Overview

This year started off strong for both the equity and bond markets until a surprise employment number and a scare in the banking sector brought volatility back to the markets. Despite the bumpy road, markets are holding up well considering the uncertainty. The recent outperformance in US Mega-cap growth has caught our attention, however, we still think it is too early for an overweight call with rate hike uncertainty dominating the market. As we try to resolve the banking sector issues and the trajectory of inflation, we believe that market volatility will be with us for a while. Therefore, investors should be selective and focus on quality in both equities and fixed income. As major threats to the economy continue to weigh on the minds of investors, we are encouraged that technical levels for both the equity and bond markets have held up. We will continue to monitor developments here and abroad for signs of a change in market sentiment that would dictate a change in our outlook.

Economy

Despite the recent volatility due to the banking scare, the Fed raised rates by 0.25%. Inflation trends continue to cool, but remain elevated, so our view is that the Fed will continue to be data dependent. If the Fed continues to raise rates, we could see a deeper inversion of the Treasury curve with the potential for bond yields to re-test the 3.40% support level. We are prepared to make changes to our fixed income outlook as the data evolves. Services inflation is an area that we are watching closely as it has been stubbornly elevated. The shelter component of CPI continues to remain elevated as well and is another area of concern. Getting inflation from 6% to 2% may be a lofty goal for the Fed if the economy doesn't decelerate enough to close the gap. If both these data sets eventually start to roll over, we may see a deceleration of inflation back to trend, which will be a welcome sign.

Equities

Our view to slightly underweight equities is still in play. Equity valuations have become less attractive relative to fixed income following the recent upheaval in the banking sector. The Council is taking a balanced view on both size and style until there is more clarity on the outlook for the economy based on the expected credit tightening due to the banking crisis. We remain focused of quality. The Council remains neutral Domestic relative to International. Within International, we believe the resilience of Europe should be noted which supports our neutral view. As to Emerging Markets, we have moved to neutral given recent developments. We continue to monitor the U.S Dollar, the U.S. Fed, military conflict in Europe, geopolitical tensions in Asia and the progress on the reopening of the Chinese economy.

Fixed Income

We continue to recommend investors take advantage of any backup in yields by adding to high-quality fixed income. However, valuations for riskier fixed income sectors remain rich. In light of recent volatility in the banking sector, the Council maintains its preference for short duration while the market trades in the current 3.4% to 4.0% yield range. A sustained break to the upside of this range could be a signal to extend duration. We favor municipal bonds as a high-quality option for taxable accounts with attractive tax-equivalent yields. Additionally, we believe high yield municipal bonds offer an attractive tax-equivalent yield; however, we would expect additional volatility as economic growth concerns increase.

Alternatives

Real assets may not be compensating for equity risk sufficiently, as illiquidity premium has tightened in legacy REITs. Moreover, the outflow of capital from Private Funds may impact returns. Nevertheless, the commercial real estate lending sector presents numerous opportunities, particularly in low LTV industrial, warehouse, and luxury lodging properties. Direct lending, asset-backed lending, and mezzanine ABS offer spreads above liquid markets, taking advantage of liquidity chaos by providing capital relief and bankruptcy prevention. Private equity secondaries permit the acquisition of pre-existing investments with demonstrated track records at a discount. With an increase in base rates and a widening of spreads, the focus is on PE and credit opportunities in the secondary market, which currently present attractive pricing due to an ample supply. However, potential buyers might lack the necessary information to make informed decisions, as pricing fell from 92 cents to 81 cents on the dollar in Q4 22, according to Jeffries.

Asset Allocation Views

		UW	N	OW	Change	
		Conviction			Change	
BROAD ASSET CLASS	Equities	●				Equity valuations have become less attractive following the recent upheaval in the Banking sector.
	Fixed Income		●		▼	Take advantage of any backup in yields.
	Cash			●		Attractive compared to the S&P 500 dividend yield.
ASSET CLASS – EQUITIES	U.S.		●			Falling inflation and resilient corporate profits should support domestic equities.
	U.S. Large Cap		●		▲	More expensive than their SMID cap peers. Technical analysis picture has weakened.
	U.S. Small/Mid		●		▼	Attractive valuations relative to Large cap and improving technical analysis trends.
	U.S. Growth		●		▲	Waiting for a stable economic environment, including lower inflation and greater interest rate stability.
	U.S. Value		●		▼	Attractive valuations, technical analysis signals still pointing towards value.
	International		●			
	Developed Ex U.S.		●			Resilience of European economies and attractive valuations. The U.S. dollar is a wildcard.
	Emerging Markets		●			Deteriorating technical due to soft earnings and geopolitical uncertainty. The U.S dollar is a wildcard.
ASSET CLASS – FIXED INCOME	Duration	●				The compensation for adding duration to portfolios is not sufficient given elevated inflationary pressures.
	Credit Quality			●		The risk/reward favors owning core bond sectors over most of the riskier Plus sectors.
	U.S. Government	●				Given elevated inflationary pressures, we could still see higher yields in the near term.
	Securitized		●			With yields and spreads at multi-year highs, we think securitized bonds remain an attractive investment option.
	Corp IG			●		The corporate credit curve remains virtually flat, there is an opportunity to invest in shorter maturity.
	Corp HY			●	▲	Yields are above historical averages, but the additional compensation for the risk is below longer-term averages.
	International Developed	●			▼	Valuations have improved but potential currency volatility remains a challenge.
	Emerging Markets	●			▼	Central banks are tightening, and a strong dollar could provide a headwind.
ASSET CLASS – ALTERNATIVE	Hedge Funds		●			Quality long/short managers and managed futures are historically good ways to weather volatility .
	Private Credit			●●		Higher Yields offset risks of increased default cycle. Attractive discounts on secondaries and traded BDCs.
	Private Equity			●		Expertise in secondary markets allows manager to capitalize on IPO dearth and secure attractive deals.
	Real Estate		●			Be selective where NOI growth can be driven by increased rents and understand sources of liquidity/exit.
	Crypto		●			Focus on the underlying blockchain technology rather than individual coins. Bitcoin holding supports.

Sector Views

EQUITY SECTOR – EQUITIES	UW	N	OW	Change	
	Conviction			Change	
Communication Services		●		▲	A strong start to 2023 and resilience displayed during the fourth quarter earnings season are notable. Traditional telecom stocks are attractive based on valuations and yield. A difficult regulatory environment for this digital media heavy sector underpins our neutral view.
Consumer Discretionary	●				Inflation is eroding purchasing power, the sector is historically not a good mid-to-late cycle performer, valuations are elevated. Not a group we would chase despite still solid consumer balance sheets, healthy job market. However, two groups performing well are homebuilders and hotels & leisure.
Consumer Staples	●				Despite Staples being a defensive sector, it remains expensive. Would prefer Staples over Discretionary but believe the Health Care sector, after correcting sharply, will be a better defensive sector.
Energy		●		▼	Recent Banking sector volatility has increased concerns of a recession and led to crude oil selling off and driven energy stocks down. We are downgrading Energy to neutral. Despite attractive valuations, the sector is likely to remain under pressure as investors take profits and position away from cyclicals into defensive areas. This sector is favored longer-term.
Financials		●			We are maintaining a neutral rating as bank stocks are down sharply with many already reflecting the crisis events. With sizeable unrealized losses creating a duration mismatch, the banks are likely to trade in a range. The hardest hit are the regional banks. Many banks are trading below book value which is historically a good buying opportunity.
Health Care			●		The sector has corrected sharply and is now trading at a discount to the market. The sector has quality companies with dividends. Still under-owned by long-only funds. Growth in Biotech but with idiosyncratic risk.
Industrials			●		Capital expenditures and defense spending trends are supportive for this sector longer-term. On shoring benefits this sector. We favor Aerospace & Defense.
Information Technology		●		▲	We are upgrading the Technology sector to neutral as investors are shifting to growth pockets of the market as they reduce cyclical exposure and the risk of a recession is rising. We favor semiconductors and software. We would be cautious with the FAANG names as they still dominate market indices with Nasdaq 100 have 47% in mega technology. .
Materials		●		▼	We are reducing the Materials sector to neutral as the commodity sector is under pressure as investors are pricing in a recession. We would favor metals, particularly gold.
Real Estate	●				Valuations have improved as the sector has corrected, but we believe with the uncertainly of the direction of interest rates keeps this sector is at risk. This sector also has competition from the bond market for income.
Utilities		●		▲	High Quality sector with dividends. Demand rising with resilient fundamentals. Higher rates historically a negative due to high leverage. If the Fed pauses on additional rate hikes, this sector could be a beneficiary.

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