SANCTUARY WEALTH

Sanctuary Investment Council

Investment Outlook

January 2024

Active Asset Allocation Views

Overview

The Sanctuary Investment Council (SIC) continues to see the risk-reward trade-off between equities and fixed income as roughly balanced, with the stronger equity market gains being supported by lower Treasury yields and prospects for a less restrictive Fed. Overall, the SIC outlook is bullish, with the S&P 500 expected to reach a year-end 2024 target range of 5200 to 5400, accompanied by anticipated rallies in small-cap stocks, albeit with limited earnings growth, and a potential 5-10% pullback in the first quarter. In terms of fixed income markets, the SIC retains an up in quality approach paired with a neutral duration position. There was an unexpected pivot by the Federal Reserve from its "higher for longer" interest rate stance to the potential for rate cuts, leading to an exuberant market response in December.

Economy

Economic data continues to be mixed, creating volatility as markets parse every piece of data to gauge the next move by the Fed. On the positive side, the labor market remains strong, despite efforts by the Fed to slow the economy. The unemployment rate remained at 3.7% in December, below expectations. GDP also remains strong, at 4.9% QoQ annualized, and housing starts had a strong month despite mortgage rates hovering around 7%. However, other data appears weaker. Surveys of manufacturing sentiment continue to signal contraction, and ISM services index continues to decline and hover near contractionary territory. On the inflation front, the picture also looks mixed. Overall, inflation continues to decelerate, with headline CPI down to 3.4% year-over-year in December, and core at 3.9%, both are still well above the Fed's target rate of 2%. The economic outlook remains healthy, although we expect growth to slow in the coming quarters. This is good news and is what both the markets and the Fed want. The SIC expects the market to remain volatile as investors continue to evaluate the incoming data in anticipation of the Fed pivot.

Equities

The SIC maintains its recommended neutral equities allocation based on the Council's assessment that the risk-reward trade-off between equities and fixed income is roughly balanced. Lower interest rates are supportive of equity valuations despite strong gains in 2023. If the downward trajectory in inflation remains intact and interest rates stabilize or fall, growth style stocks may outperform. The SIC favors U.S. equities over developed international due to the relatively stronger domestic economic growth outlook and superior earnings power, though the Council still finds Japanese equities attractive. Key risks to equities include renewed upward pressure on inflation and interest rates, a broader conflict in the Middle East or Europe, and escalation in U.S.-China tensions.

Fixed Income

Treasury yields were lower in December as the Fed's narrative shifted to eventual rate cuts instead of further rate hikes. Yields on high quality fixed income sectors moved lower as well, helping core bonds generate positive returns in December, which coupled with November's returns, allowed the index to avoid its first ever three-year losing streak. Importantly, yields for many fixed income markets are still at levels last seen over a decade ago, so the return prospects for fixed income remain favorable. We favor municipal bonds as a high-quality option for taxable accounts with tax-equivalent yields as attractive as they've been in over a decade. Additionally, for appropriate investors, we believe high-yield municipal bonds offer an attractive tax-equivalent yield; however, we would expect additional volatility as economic growth concerns increase. Fundamentals in both markets may have peaked but remain solid.

Alternatives

Secondary Funds are seeing opportunities to acquire stakes in companies from private equity investors who are itching for an early exit. Historically, these secondary market deals had a 5% discount on NAV, but thanks to the recent institutional overallocation and the need for liquidity, discounts are now fluctuating between 10-35%. Private Credit is currently offering a floating rate yield close to 12% on an unleveraged basis. That's a considerable pickup over high yield and leverage loans.

Asset Allocation Views

		UW			N	OW			Change	
		Conviction							Change	
BROAD ASSET CLASS	Equities				●				▲	Rallies in small caps and banks, and Value overweight market, limited earnings.
	Fixed Income				●				▼	Fed unexpectedly pivots, market reacts. Core FI underweight, high yield bonds and bank loans overweight.
	Cash					●				Maintaining overweight to cash but lock in longer maturity investment grade fixed income opportunistically.
ASSET CLASS – EQUITIES	U.S.				●					Lower interest rates are supportive of equity valuations despite strong gains in 2023.
	U.S. Large Cap				●					Valuations are elevated. Mega Cap tech stocks would benefit from lower interest rates.
	U.S. Mid Cap			●						Underweight suggesting skepticism; potential growth prospects slightly challenged.
	U.S. Small Cap					●				Attractive valuations may continue to provide support. Benefiting from optimism about a soft landing.
	U.S. Growth			●						Valuations are elevated yet could benefit from an improved macroeconomic environment. And lower interest rates.
	U.S. Value					●				Remain attractively valued and would benefit from a soft landing.
	Intl. Developed				●					International stocks face challenges with global economic and earnings growth expected to be sluggish.
	Intl. Emerging Markets				●					Emerging markets overall have tailwinds but weighed down by concerns over China economic stagnation.
ASSET CLASS – FIXED INCOME	Duration				●					The Council is maintaining our neutral duration position in fixed income.
	Credit Quality					●				Credit risk outlook is stable, with a cautious focus on risk management.
	Treasuries			●						Slight underweight; as policy-driven rates to have peaked.
	MBS				●				▼	High-quality agency MBS preferred.
	Corporate IG			●						Underweight to take advantage of tight credit spreads to fund increased risk-taking in high yield corporates.
	+ Corporate HY						●		▲	Credit risk is stable, but eye on maturity wall in 2024/25.
	+ Intl. Developed				●					Avoiding international bonds as global uncertainty credit risk is on the rise.
	+ Intl. Emerging Markets				●					Steering clear of the potential volatility in emerging markets debt.
ASSET CLASS – ALTERNATIVE	Hedge Funds					●				Favorable environment Dispersion among equities, bonds, commodities, and currencies. Positive short carry.
	Private Credit						●			Additional 400-600 basis points over SOFR, as private lenders dominate void left by a bank pullback.
	Private Equity					●				PE secondaries remain at discounts. Buyout, with Growth/Venture to follow are macro picture improves.
	Real Estate				●					Infrastructure is a relative bright spot, and CRE could rebound as cap rates compress.
	Crypto					●			▲	Bitcoin was the best performing asset class in 2023. Spot ETF SEC approval a potential long-term positive.

Sanctuary Asset Management

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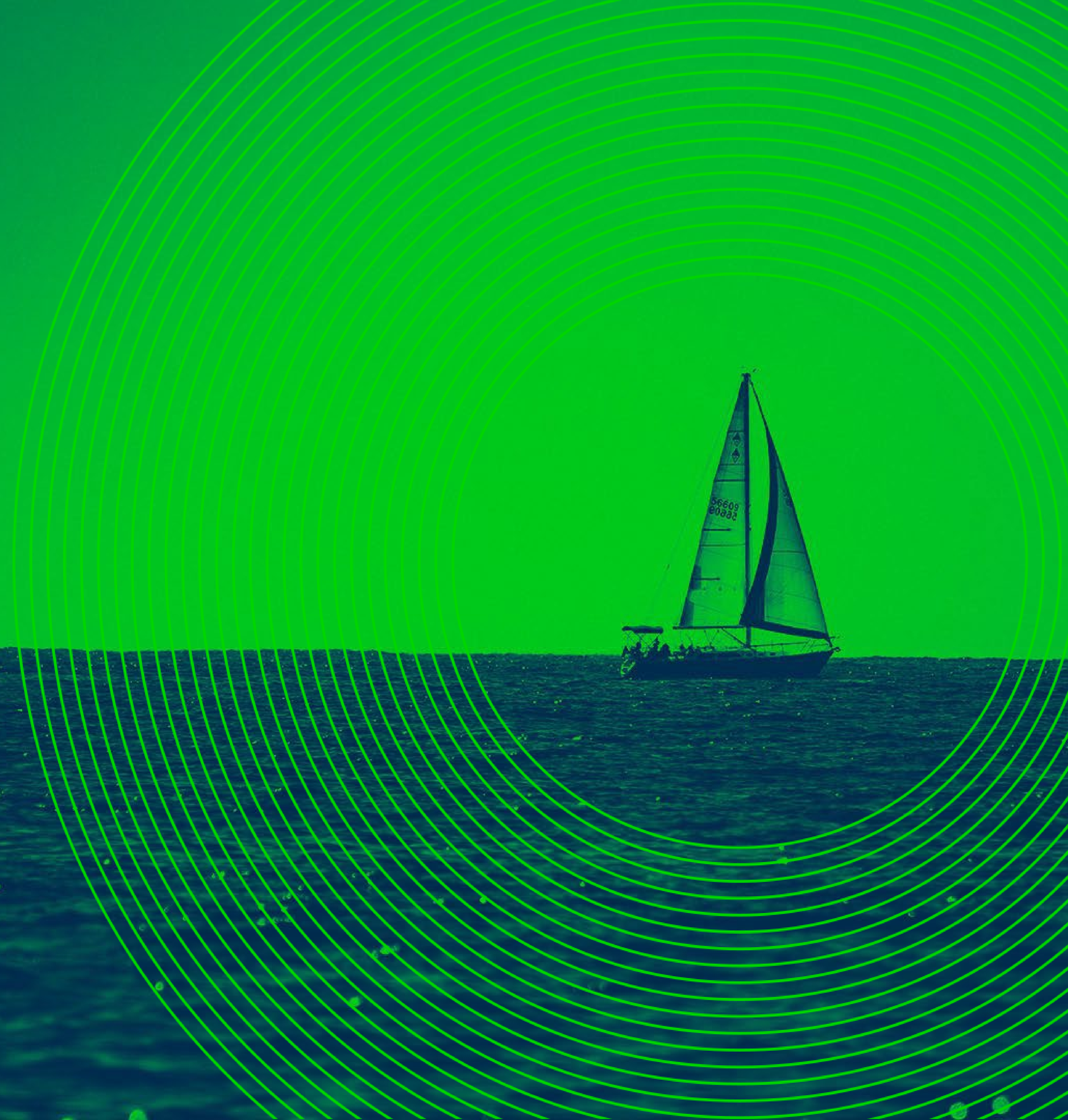


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