Entasis
ASSET MANAGEMENT

Quarterly Chartbook
4Q2023

Summary Comments

The end of 2023 was a strong period for market returns – notably on the equity side, but also on the fixed income side. The equity trend has continued into the beginning of 2024, though bonds have tapered off a bit. The catalyst, that we will dig into throughout these pages, was an expectation of the end of interest rate hikes by the U.S. Federal Reserve (Fed).

- The “Magnificent Seven” (Apple, Microsoft, Nvidia, Amazon, Meta, Tesla, Alphabet) were the primary contributors to the overall S&P 500® Index return for the quarter and 2023. This resulted in a significant expansion of earnings multiples (P/E) from 19.4x at the beginning of the year to roughly 30.8x at the end of 2023 for that group of stocks.
- Concentration in markets may persist over the short- to intermediate-term, but if we were to use history as a guide, the current levels of concentration will inevitably decline. Whether this will be the result of a correction in the largest companies’ share prices, or instead will come from the rest of the market “catching up” on a relative basis, is something we will be closely monitoring in the coming quarters.
- We prefer a diversified approach to investing in high-quality stocks, which we believe helps to lessen company-specific risk and results in a more sustainable approach for investors. As always, we are tasked not only with generating a return *on* capital for clients, but also a return *of* capital.
- Recent economic resilience, moderating inflation, and the anticipation of lower interest rates, financial markets are currently pricing in a higher likelihood of a soft economic landing – no recession. We believe the economy still has a few hurdles to clear before the all-clear signal can be given.
- In December 2023, the Consumer Price Index (CPI) inflation stood at +3.3% year over year, while the Personal Consumption Expenditures (PCE) Price Index inflation was recorded at +2.6%. The notable moderation in inflation, primarily driven by energy and durable goods, is now accompanied by broader disinflationary pressures.
- We continue to invest the bulk of client bond assets in actively managed mutual funds with flexible mandates. The mutual funds are balanced against low cost passively managed ETFs to manage duration and yield curve exposures. We believe this combination is the best way to navigate a potentially volatile interest rate and credit environment.

Thank you for reading. Please let us know if you would like to delve deeper into anything we have shared. We would welcome the conversation.

Bob David

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Market Performance (As of 12/31/23)

Annualized % Returns (As of 12/31/23)

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	26.29	10.00	15.69	12.03
Russell 1000 Index	Mid/Large Cap Stocks	26.53	8.97	15.52	11.80
Russell 1000 Growth Index	Growth Stocks	42.68	8.86	19.50	14.86
Russell 1000 Value Index	Value Stocks	11.46	8.86	10.91	8.40
Russell 2000 Index	Small Cap Stocks	16.93	2.22	9.97	7.16
MSCI EAFE Index	Non-U.S. Developed Market Stocks	18.24	4.02	8.16	4.28
MSCI Emerging Markets Index	Emerging Markets Stocks	9.83	-5.08	3.69	2.66
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	15.66	1.49	7.89	4.88
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	10.21	-1.28	3.91	4.99
Barclays Municipal Bond Index	U.S. Municipal Bonds	6.40	-0.40	2.25	3.03
Barclays Aggregate Bond Index	U.S. Bonds	5.53	-3.31	1.10	1.81
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	5.24	-1.63	1.59	1.72
BofAML U.S. Treasury Master Index	Treasury Bonds	3.87	-4.04	0.46	1.34
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	4.98	-2.96	0.26	1.38
BofAML U.S. Corporate Master Index	Corporate Bonds	8.40	-3.17	2.63	2.98
BofAML U.S. High Yield Master II Index	High Yield Bonds	13.47	2.01	5.19	4.51
BofAML Euro Broad Market Index	European Bonds	10.57	-7.99	-1.67	-1.11
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	10.00	-3.18	2.01	0.76

Calendar Year % Returns (YTD as of 12/31/2023)

	2023	2022	2021	2020	2019
S&P 500 Index	26.29	-18.11	28.71	18.40	31.49
Russell 1000 Index	26.53	-19.13	26.45	20.96	31.43
Russell 1000 Growth Index	42.68	-29.14	27.60	38.49	36.39
Russell 1000 Value Index	11.46	-7.54	25.16	2.80	26.54
Russell 2000 Index	16.93	-20.44	14.82	19.96	25.52
MSCI EAFE Index	18.24	-14.45	11.26	7.82	22.01
MSCI Emerging Markets Index	9.83	-20.09	-2.54	18.31	18.44
MSCI ACWI Ex USA Small Cap Index	15.66	-19.97	12.93	14.24	22.42
BofAML Preferred Stock Fixed Rate Index	10.21	-14.60	2.24	6.95	17.71
Barclays Municipal Bond Index	6.40	-8.53	1.52	5.21	7.54
Barclays Aggregate Bond Index	5.53	-13.01	-1.54	7.51	8.72
Barclays Intermediate U.S. Gov/Credit Index	5.24	-8.23	-1.44	6.43	6.80
BofAML U.S. Treasury Master Index	3.87	-12.85	-2.38	8.22	6.99
BofAML U.S. Mortgage Backed Securities Index	4.98	-11.88	-1.21	4.09	6.51
BofAML U.S. Corporate Master Index	8.40	-15.44	-0.95	9.81	14.23
BofAML U.S. High Yield Master II Index	13.47	-11.21	5.35	6.07	14.41
BofAML Euro Broad Market Index	10.57	-22.04	-9.66	13.35	4.11
BofAML Local Debt Market Plus Index	10.00	-11.73	-6.53	4.50	16.44

Source: Morningstar Direct

Market Performance (As of 01/31/24)

Annualized % Returns (As of 01/31/24)

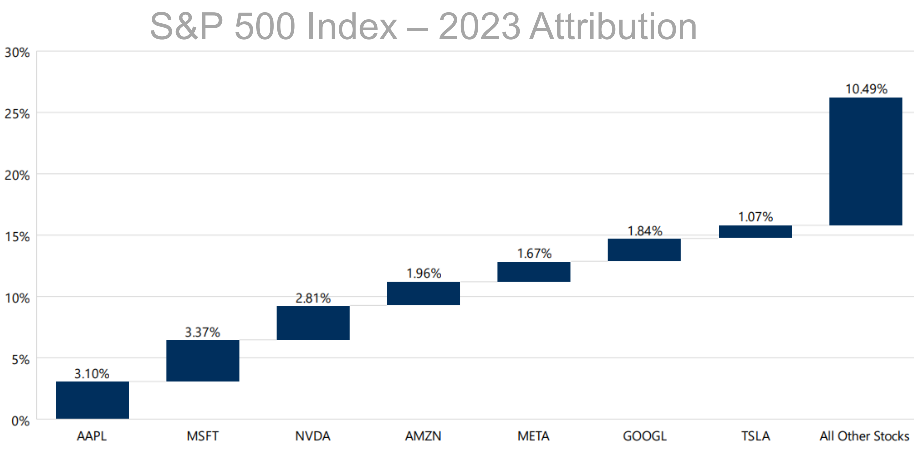
Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	20.82	10.99	14.30	12.62
Russell 1000 Index	Mid/Large Cap Stocks	20.23	9.78	13.99	12.32
Russell 1000 Growth Index	Growth Stocks	34.99	10.03	18.04	15.48
Russell 1000 Value Index	Value Stocks	6.08	9.23	9.28	8.80
Russell 2000 Index	Small Cap Stocks	2.40	-0.76	6.80	7.03
MSCI EAFE Index	Non-U.S. Developed Market Stocks	10.01	4.59	6.92	4.77
MSCI Emerging Markets Index	Emerging Markets Stocks	-2.94	-7.50	0.99	2.86
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	6.04	0.96	5.91	4.90
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	3.69	0.09	3.33	4.95
Barclays Municipal Bond Index	U.S. Municipal Bonds	2.90	-0.78	2.00	2.78
Barclays Aggregate Bond Index	U.S. Bonds	2.10	-3.17	0.83	1.63
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	3.53	-1.47	1.46	1.65
BofAML U.S. Treasury Master Index	Treasury Bonds	1.06	-3.73	0.33	1.16
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	1.32	-3.13	0.01	1.18
BofAML U.S. Corporate Master Index	Corporate Bonds	4.49	-2.73	2.24	2.82
BofAML U.S. High Yield Master II Index	High Yield Bonds	9.23	1.88	4.26	4.44
BofAML Euro Broad Market Index	European Bonds	4.49	-8.27	-2.33	-1.28
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	4.83	-3.14	0.74	1.06

Calendar Year % Returns (YTD as of 01/31/2024)

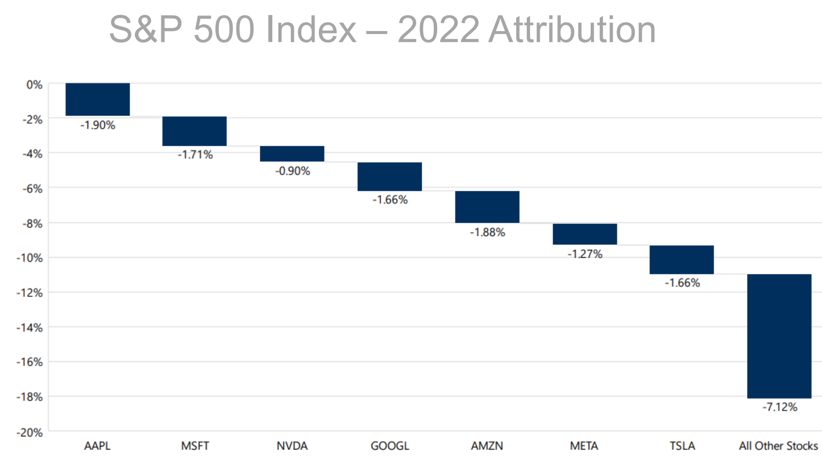
	YTD	2023	2022	2021	2020	2019
S&P 500 Index	1.68	26.29	-18.11	28.71	18.40	31.49
Russell 1000 Index	1.39	26.53	-19.13	26.45	20.96	31.43
Russell 1000 Growth Index	2.49	42.68	-29.14	27.60	38.49	36.39
Russell 1000 Value Index	0.10	11.46	-7.54	25.16	2.80	26.54
Russell 2000 Index	-3.89	16.93	-20.44	14.82	19.96	25.52
MSCI EAFE Index	0.58	18.24	-14.45	11.26	7.82	22.01
MSCI Emerging Markets Index	-4.64	9.83	-20.09	-2.54	18.31	18.44
MSCI ACWI Ex USA Small Cap Index	-1.72	15.66	-19.97	12.93	14.24	22.42
BofAML Preferred Stock Fixed Rate Index	2.79	10.21	-14.60	2.24	6.95	17.71
Barclays Municipal Bond Index	-0.51	6.40	-8.53	1.52	5.21	7.54
Barclays Aggregate Bond Index	-0.27	5.53	-13.01	-1.54	7.51	8.72
Barclays Intermediate U.S. Gov/Credit Index	0.21	5.24	-8.23	-1.44	6.43	6.80
BofAML U.S. Treasury Master Index	-0.18	3.87	-12.85	-2.38	8.22	6.99
BofAML U.S. Mortgage Backed Securities Index	-0.41	4.98	-11.88	-1.21	4.09	6.51
BofAML U.S. Corporate Master Index	0.15	8.40	-15.44	-0.95	9.81	14.23
BofAML U.S. High Yield Master II Index	0.02	13.47	-11.21	5.35	6.07	14.41
BofAML Euro Broad Market Index	-2.02	10.57	-22.04	-9.66	13.35	4.11
BofAML Local Debt Market Plus Index	-1.20	10.00	-11.73	-6.53	4.50	16.44

Source: Morningstar Direct

U.S. Equity – Concentrated Returns



Source: First Trust – Monthly Strategy Deck (December 2023)



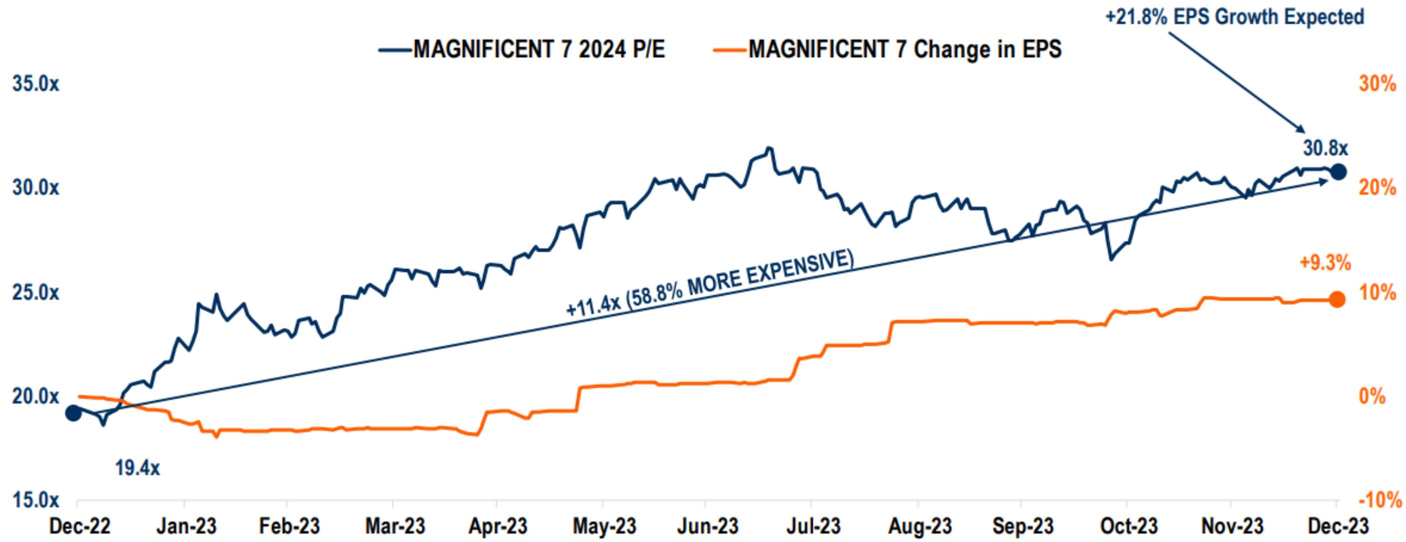
Source: First Trust – Monthly Strategy Deck (December 2023)

After a rocky start to the fourth quarter, stocks pushed higher on speculation the Fed had concluded its cycle of rate increases. This led investor attention to quickly shift to the possibility of interest rate cuts during 2024. The potential of a relatively less restrictive monetary environment drove purchases of growth-oriented stocks, particularly mega-cap technology stocks.

- The “Magnificent Seven” (Apple, Microsoft, Nvidia, Amazon, Meta, Tesla, Alphabet) were the primary contributors to the overall S&P 500® Index return for the quarter and 2023 (upper left). The concentration of returns in a narrow segment of the market caused many to question whether the returns were sustainable.
- However, it’s important to remember that even though 2023 returns were impressive for the Magnificent Seven, returns in the prior year were anything but, as these seven stocks were among the top negative contributors in 2022 (upper right).

We believe the Magnificent Seven will remain at the forefront of investment discussions in 2024 for a variety of reasons, including their impact on the proliferation of artificial intelligence (“AI”), distortion of investment markets, sheer size, volatile price swings, investor “FOMO” (fear of missing out), growth potential, and financial media attention.

U.S. Equity – Magnificent Seven



Source: First Trust – Monthly Strategy Deck (December 2023)

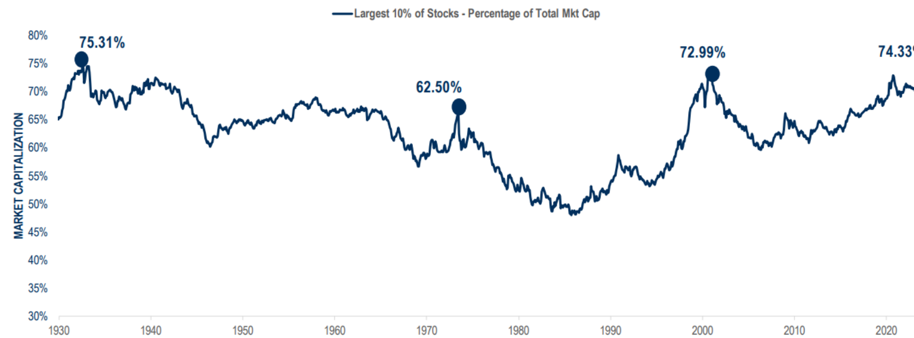
Poor returns for the Magnificent Seven in 2022 caused their price-to-earnings ratio (P/E) to decline to roughly 19.4X estimated 2024 earnings at the start of 2023. While still expensive relative to history, and the broader equity market, increased optimism regarding the potential of AI led to a sharp rally in these stocks, along with a corresponding increase in their P/E ratios.

- 2024 earnings expectations for the Magnificent Seven increased throughout the year (orange line). However, earnings growth could not keep up with the rapid increase in share prices.
- The end result was a significant expansion in earnings multiples (P/E) from 19.4x at the beginning of the year to roughly 30.8x at the end of 2023 (blue line).
- The significant rise in the P/E ratio of the Magnificent Seven reflects a high degree of optimism in these companies' ability to grow earnings at a rapid pace well into the future. Said differently, investors have "priced in" a lot of future good news into current share prices.

Looking ahead, we have no doubt these companies will remain great businesses and fixtures of the economy for the foreseeable future. However, from an investment perspective, we are concerned they are "priced to perfection." We are reminded that there is a significant difference between a great company and a great long-term investment. To qualify for the latter, price relative to long-term value must be taken into consideration.

U.S. and Global Markets – Concentration

Source: Schroders – Equity Lens (January 2024)



Source: First Trust – Monthly Strategy Deck (December 2023)

Source: ClearBridge – The Anatomy of a Recession (Fourth Quarter 2023)

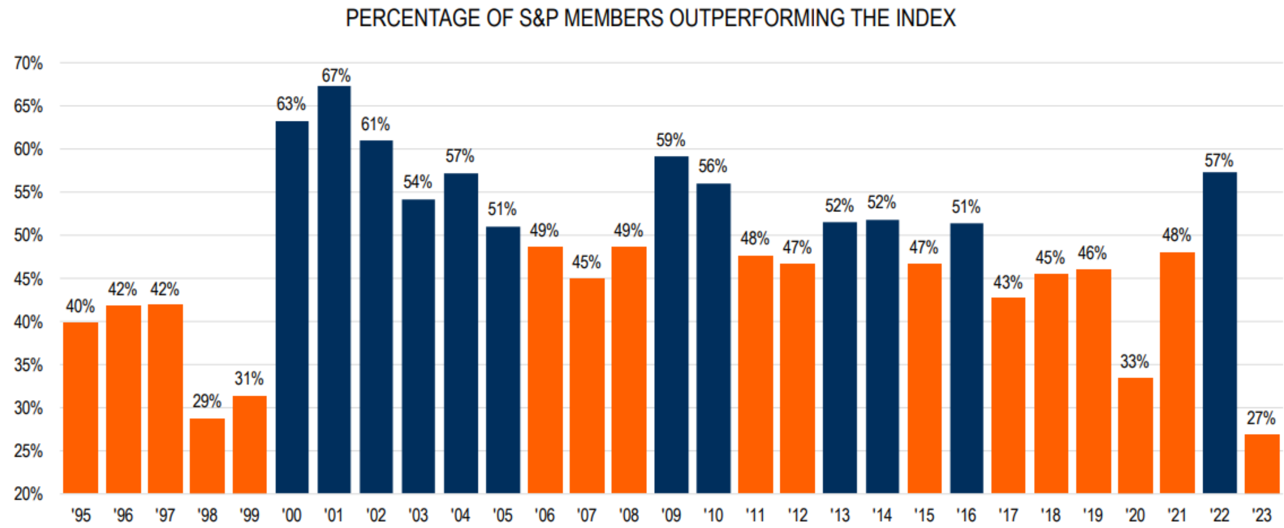
Source: ClearBridge – The Anatomy of a Recession (Fourth Quarter 2023)

The rise of the Magnificent Seven has caused distortions across U.S. and global markets because of their size relative to broad equity market indices and even entire equity markets.

- One way to provide perspective on the overwhelming size of these companies is to examine the MSCI ACWI Index (ACWI), a global market-cap weighted index that includes the U.S. market, developed foreign markets and emerging markets. Based on the data in the stacked bar charts (upper left), the Magnificent Seven now have a larger weight in the MSCI ACWI Index than the entire combined weights of Japan, the UK, China and France!
- In addition to the Magnificent Seven, large-capitalization companies more broadly have also seen their relative weights increase. In fact, the weight of the largest 10% of stocks (percentage of total market cap) is now the most concentrated it has been since the 1930's (upper right).

Concentration in markets may persist over the short- to intermediate-term, but if we were to use history as a guide, the current levels of concentration will inevitably decline. Whether this will be the result of a correction in the largest companies' share prices, or instead will come from the rest of the market "catching up" on a relative basis, is something we will be closely monitoring in the coming quarters.

U.S. Equity – Market Participation



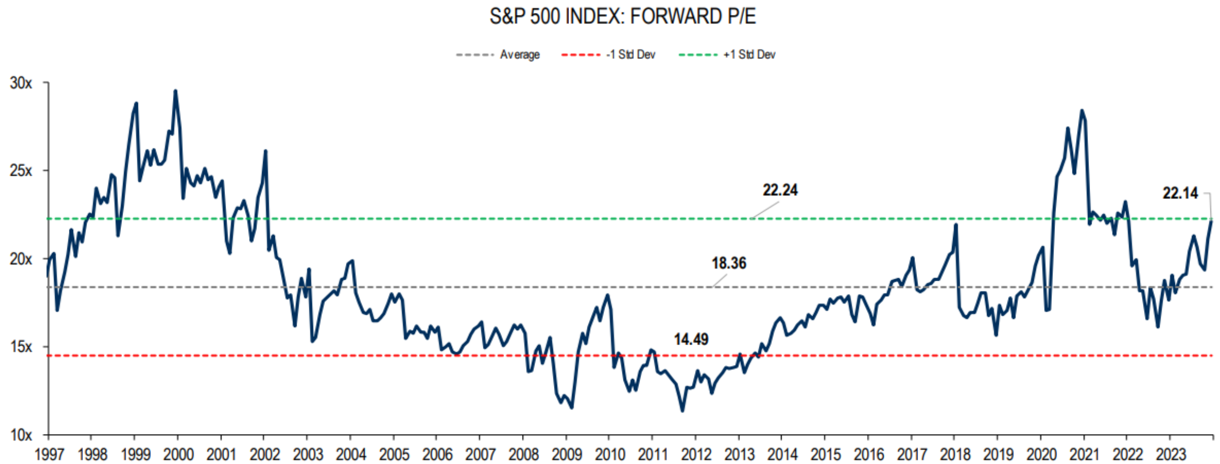
Source: First Trust – Monthly Strategy Deck (December 2023)

One of the ways to measure the overall health of markets is to examine individual company participation. Typically, during an extended, positive move higher in markets, investors like to see broad participation of companies across sectors and industries.

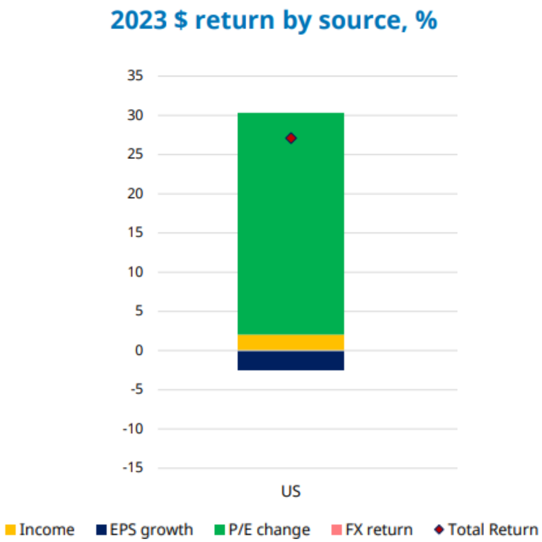
- Unfortunately, 2023 proved to be one of the narrowest markets in history, as only 27% of the stocks in the S&P 500® beat the overall index return.
- The last time markets witnessed the degree of concentrated returns investors experienced in 2023 was during the 1998-1999 period. The latter period was another timeframe when investors heavily favored large, "blue chip" companies that were either dominant leaders in their respective industries or were expected to generate significant future growth from new technologies well into the future. Many of these companies saw their share prices post large losses in subsequent years as investor expectations receded to more reasonable levels (P/E contraction).

We continue to have exposure to the Magnificent Seven in portfolios. However, we have not invested a significantly large (relative to the concentrated broad market) portion of client assets into these companies. We believe their business prospects remain bright, but we believe other areas of the market are more attractively priced and present relatively more attractive investment opportunities over the intermediate- to long-term.

Equity – U.S. Valuations



Source: First Trust – Monthly Strategy Deck (December 2023)



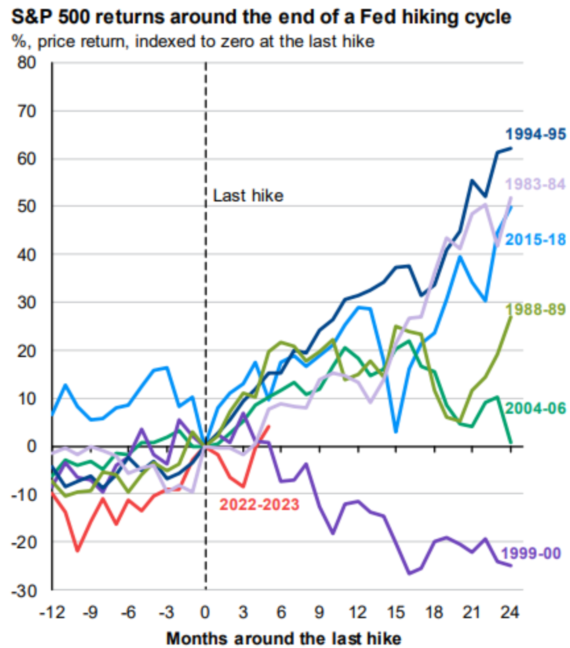
Source: Schroders – Equity Lens (January 2024)

The P/E for the S&P 500® Index increased sharply in 2023 as investors looked past meager 2023 earnings and instead focused on earnings in 2024 and beyond.

- If we were to deconstruct 2023 equity returns by examining the source of the returns (upper right), almost the entire calendar year return was because of an increase in the P/E (i.e. multiple expansion – green portion of stacked bar). This means that investors were willing to pay significantly more today for $1 dollar of future earnings.
- The fact investors were willing to pay a higher price for future earnings was because of the expectation that future earnings would increase. The caveat to this is that those very favorable expectations are now "priced" into current stock prices. So, if earnings do not meet lofty expectations, investors will need to "reprice" stocks to reflect revised expectations.

The "expectations game" noted in the prior bullet point can quickly develop into a slippery slope for investors. Even if companies are able to meet lofty expectations in the short run, these companies will need to continue to grow at a rapid pace into future periods to satisfy investors and the premium embedded in stock prices. Historically, this is why it becomes difficult for very large businesses to remain large and continue to grow at a rapid pace. Just as trees cannot grow to the sky, invariably growth rates (especially for trillion-dollar companies) tend to recede even if companies' business models (the"roots") remain strong.

U.S. Equity – End of Fed Hiking Cycle



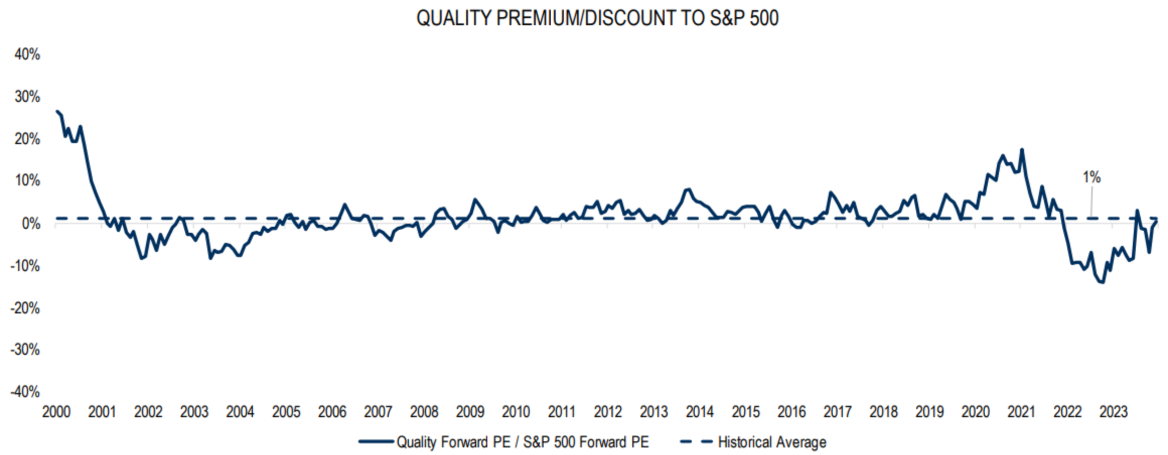
Source: JP Morgan– Guide to the Markets (1Q 2024)

One of the primary catalysts for the equity market's resurgence in the fourth quarter was the Fed's acknowledgement that inflation was improving and that there would be a "pause" in further rate increases.

- The chart above displays the path of S&P 500® Index returns in the 12 months before the Fed's last rate hike and the 24 months following the last rate hike. Each cycle has its own unique characteristics, such as beginning rate levels, how long and how much rates had increased, economic growth, valuations, and equity market structure, among many others. Each of these factors played a part in determining the future path of equity market returns.
- Despite each cycle's uniqueness, the end of a Fed rate tightening cycle has generally coincided with positive returns for the equity market. However, this is not always the case, with the notable exception being the tech boom in 1999-2000 (dark purple line).

Even though markets have been extremely narrow and contain pockets of historically high valuations, we believe there are several attractive long-term opportunities for patient investors. As such, we plan on making further adjustments to portfolios in the coming months.

U.S. Equity – Opportunity



Source: First Trust – Monthly Strategy Deck (December 2023)

No matter how bad things have gotten historically, whether it be geopolitical events, bankruptcies, credit crises, or the like, the U.S. stock market has always gone on to new highs. Therefore, we always keep our pencils sharpened, ready to make investments when we believe investors are being adequately compensated for risk. As a wise investor once said: “Never bet on the end of the world, because it only happens once.”

- One area of the equity market we continue to find investment opportunities is among high-quality businesses. These businesses tend to be financially strong, benefit from high returns on capital, and have proven, durable business models. As would be expected, these types of companies historically trade at a slight premium to the market.
- In fact, many of the Magnificent Seven have grown to become enormous because each has a very high-quality business model. Unfortunately, simply investing in the Magnificent Seven would expose investors to a number of overlapping risks. They are highly reliant on semiconductors, are closely aligned to the future of AI, and have geopolitical risk stemming from exposure to China and Taiwan, to name a few. And that is all before considering price relative to value.

Overall, we prefer a diversified approach to investing in high-quality stocks, which we believe helps to lessen company-specific risk and results in a more sustainable approach for investors. As always, we are tasked not only with generating a return *on* capital for clients, but also a return *of* capital.

Global Equity – Opportunity

Valuation vs 15-year median (% above or below)

Equity market	Forward P/E	Trailing P/E	P/B	Dividend yield
US large caps	20 (20%)	25 (21%)	4.5 (57%)	1.4 (37%)
US small caps	19 (-6%)	26 (-12%)	2.2 (0%)	1.6 (-5%)
World ex-US large caps	13 (-3%)	15 (-8%)	1.8 (8%)	3.1 (2%)
World ex-US small caps	13 (-15%)	17 (-22%)	1.3 (-8%)	3.0 (-17%)

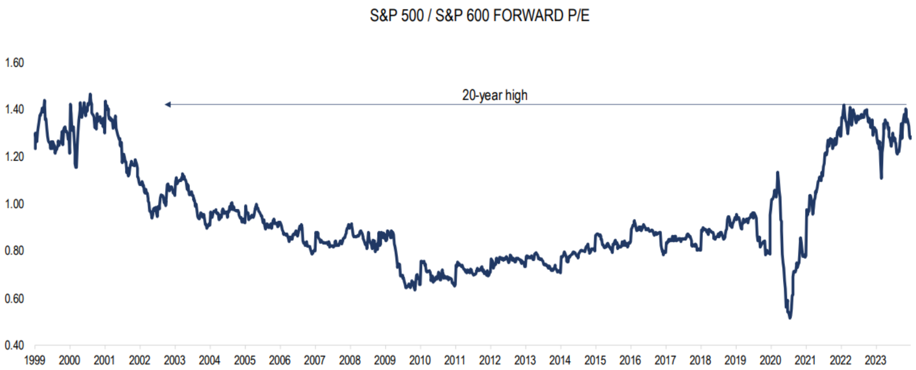
Key:	<-25%	-25% to -15%	-15% to -5%	-5% to 0%	0% to 5%	5% to 15%	15% to 25%	>25%
	Cheap			Neutral			Expensive	

Source: Schroders – Equity Lens (January 2024)

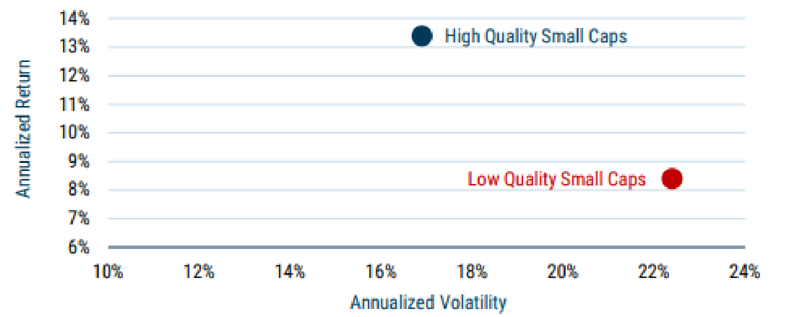
On an aggregate basis, U.S. large cap stocks (notably mega-cap stocks) remain expensive relative to history across a variety of metrics. Even though most of the focus among investors has been centered on the largest U.S. companies, there are large segments of the global equity market that are less expensive, or even cheap relative to history.

- In the U.S. market, small-cap stocks (and micro-cap stocks, which we touched on last quarter) continue to represent an attractive opportunity set for long-term investors. Many of these stocks have been left behind as mega-cap stocks and optimism surrounding AI have captured the attention of investors and the financial media.
- Foreign markets are also priced at relatively attractive levels compared to history. This is especially true for foreign small-cap companies. Like the U.S., many of these companies are not as well understood by investors as their large-cap brethren. Deep research and a patient mindset is needed for investors to take advantage of short-term mispricing.
- In addition to the opportunities highlighted by market-capitalization in the table above, we have also found attractive investment opportunities in country-specific areas of the global market. Two areas that we have made an investment on behalf of investors are Japan and India. While China continues to struggle, these economies and their equity markets have proven to be fertile ground for asset managers in search of both growth and value.

U.S. Equity – Opportunity



Source: First Trust – Monthly Strategy Deck (December 2023)



Data from 1983-2023 | Source: Worldscope, Compustat, GMO
U.S. small caps are the smallest 33% of U.S. publicly traded companies by market capitalization. GMO uses a proprietary quality model and defines high-quality companies as those with high profitability, low profit volatility and minimal use of leverage. Low-quality companies are the inverse. High quality and low quality are the top 25% and bottom 25% of stocks within the small cap universe, respectively.

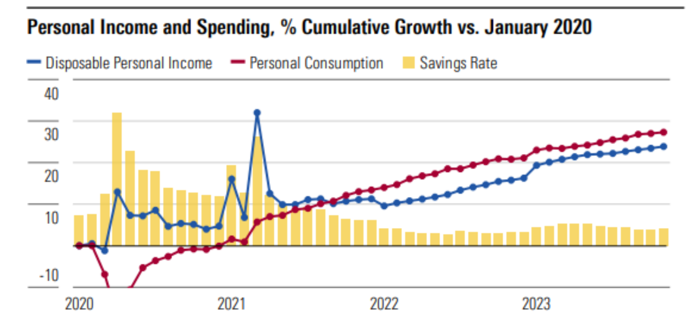
As discussed on the previous slide, U.S. small-cap stocks are relatively inexpensive compared to their own history. This becomes even more pronounced when compared directly to large-cap stocks.

- The chart above (left) compares the large-cap S&P 500® Index forward P/E to the small-cap S&P 600 Index forward P/E. Based on this measure, small-cap stocks have not been as inexpensive relative to large-cap stocks in over 20 years.
- This does not necessarily mean that small-cap stocks are a “screaming buy” in the short-term. This is because valuation levels are not a good short-term indicator of equity performance. However, when viewed over longer timeframes (3-5 years or longer), these metrics have a better track record. There are also many “landmines” investors must navigate among small-cap stocks, such as money-losing companies, small/regional banks with questionable loan exposure, and indebted companies that may struggle to refinance at higher rates.
- Taking these factors together, we are implementing a measured approach towards increasing our allocation to domestic small-cap stocks. For instance, following a multi-year period with no direct exposure to small-cap stocks, we made our first investment on behalf of clients in 2023. We anticipate another investment in this segment of the market in the coming quarters. Similar to large-caps, we have a favorable view towards high-quality in the small-cap segment of markets.

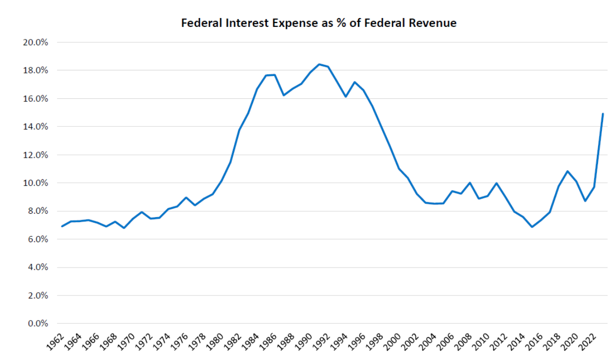
Fixed Income – Economic Growth

- Real GDP growth saw a meaningful uptick, reaching 3.3% (quarter-over-quarter, annualized) in the fourth quarter of 2023 after peaking at 4.9% in the third quarter. While the third-quarter figure was bolstered by temporary factors like inventory accumulation, the fourth quarter witnessed an unexpected pickup in net exports.
- From a full year perspective, the economy grew at 2.5% (year-over-year). Government spending increased 4.3%, providing consistent support throughout the year, but is expected to contribute less in 2024. Personal consumption growth of 2.6% was solid, but a more cautious consumer outlook is also anticipated for 2024.
- Given recent economic resilience, moderating inflation, and the anticipation of lower interest rates, financial markets are currently pricing in a higher likelihood of a soft economic landing – no recession (top chart).
- We believe the economy still has a few hurdles to clear before the all-clear signal can be given. The full impact of higher interest rates is yet to be realized, with bank credit issuance expected to contract further. On average, recessions start 29 months after the first hike in a Fed tightening cycle, which corresponds to August 2024 this cycle.
- Depletion of household excess savings is another factor expected to dampen personal consumption growth, although aggressive interest-rate cuts by the Federal Reserve may trigger a rebound. The low savings rate, currently at 4.1%, is expected to revert to pre-pandemic levels as excess savings accumulated during the pandemic are gradually depleted (middle chart). This will likely lead to a slowdown in consumption growth, especially considering rising credit card delinquencies and the temporary nature of using consumer credit to support spending.
- There is also a high probability the government's effect on growth will start to diminish in 2024, as spending from the inflation reduction act and infrastructure bills decreases and the impact of higher interest expense sets in (bottom chart).

Source: TCW Metwest



Source: Morningstar



Source: DoubleLine

Fixed Income – Market Returns

- The Bloomberg Barclays Aggregate Bond Index is a widely recognized benchmark in the investment community and serves as a key reference point for discussions pertaining to the bond market. Following a challenging 2022, the Index witnessed a notable uptick in the fourth quarter of 2023, posting a robust rally of 6.82%, primarily driven by strong performances in November and December. This rally contributed to solid overall results for the year, with a total return of 5.53%. The U.S. 10-year Treasury yield remained unchanged at 3.88% throughout the year. As a result, coupon income played a significant role in bolstering total returns. Overall, the Index began 2023 with a yield of 4.68% and concluded the year at 4.53%, reflecting spread tightening in credit-related subsectors.
- Positive excess returns were observed across various fixed income subsectors for the quarter and the year. Agency residential mortgage-backed securities notably contributed an outsized 1.33% of excess returns in the fourth quarter and 0.68% annually, amidst higher-than-average volatility. Similarly, commercial mortgage-backed securities delivered positive excess returns of 0.67% in the fourth quarter and 1.14% for the full year of 2023.
- Investment grade corporate bonds exhibited particularly strong performance in the fourth quarter, with returns reaching 8.50%, almost matching the annual figure of 8.52%, which translated to an excess return of 4.55% for the calendar year.
- The fourth quarter saw a notable rally in lower quality market segments, driven by market expectations of Fed easing and a potential economic soft landing. Consequently, below investment grade corporates and emerging market debt recorded excess returns of 3.31% and 5.31%, respectively, in the final three months of the year.

	Yield		Return			
U.S. Treasuries	**12/31/2023**	**12/31/2022**	**2023**	**Avg. Maturity**	**Correlation to 10-year**	**Correlation to S&P 500**
2-Year	4.23%	4.41%	3.65%	2 years	0.75	0.00
5-Year	3.84%	3.99%	3.93%	5	0.94	-0.02
TIPS	4.24%	4.38%	3.90%	7.1	0.68	0.32
10-Year	3.88%	3.88%	3.21%	10	1.00	-0.06
30-Year	4.03%	3.97%	1.93%	30	0.93	-0.09
Sector						
U.S. Aggregate	4.53%	4.68%	5.53%	8.5	0.87	0.26
IG Corps	5.06%	5.42%	8.52%	10.8	0.58	0.48
Convertibles	7.88%	7.58%	13.92%	-	-0.10	0.86
U.S. HY	7.59%	8.96%	13.44%	4.9	-0.03	0.72
Municipals	3.22%	3.55%	6.40%	13.3	0.62	0.22
MBS	4.68%	4.71%	5.05%	7.5	0.77	0.24
ABS	5.65%	5.89%	7.05%	3.7	0.01	0.03
Leveraged Loans	10.59%	11.41%	13.17%	2.4	-0.30	0.52

Source: JPMorgan

Fixed Income – Inflation Moderation

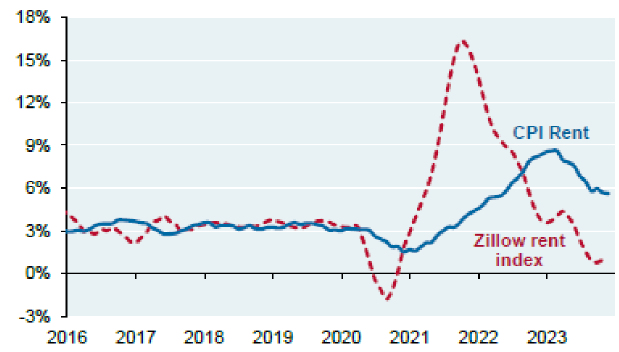
- In December 2023, the Consumer Price Index (CPI) inflation stood at +3.3% year-over-year, while the Personal Consumption Expenditures (PCE) Price Index inflation was recorded at +2.6%. The notable moderation in inflation, primarily driven by energy and durable goods, is now accompanied by broader disinflationary pressures (top chart).

- The variance between CPI and PCE is largely due to CPI's significant emphasis on housing, which experienced a 6.4% year-over-year price increase. Core PCE inflation registered at 1.5% annualized over the last three months and 1.8% over the last six months. Excluding housing, core PCE inflation was a mere 0.6% over the last three months, well below the Fed's 2% target. This trend is expected to persist, with core PCE inflation likely reaching 2% on a year-over-year basis by the second quarter of 2024. Although durables deflation may eventually moderate, rent data tells us housing inflation should normalize, albeit with uncertain timing throughout 2024 (middle chart).

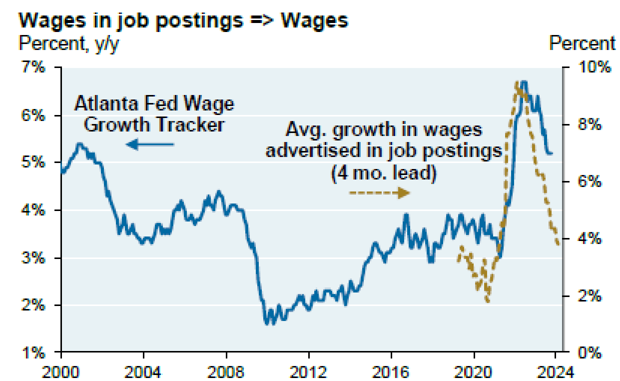
- Anticipated wage inflation is expected to decrease based on declining advertised wages, observed reductions in temporary help, manufacturing and overtime hours worked, unit labor costs, the "job switcher vs. job stayer" premium, the proportion of private industries with rising employment, and the voluntary quits rate (bottom chart). Although negotiated pay raises remain high, union workers represent only 7% of the workforce, significantly below historical levels seen in the 1970s.

	50-yr. avg.	Nov. 2023	Dec. 2023
Headline CPI	3.9%	3.1%	3.3%
Core CPI	3.9%	4.0%	3.9%
Food CPI	3.7%	3.0%	2.7%
Energy CPI	4.4%	-5.4%	-2.0%
Headline PCE deflator	3.4%	2.6%	2.6%
Core PCE deflator	3.3%	3.2%	2.9%

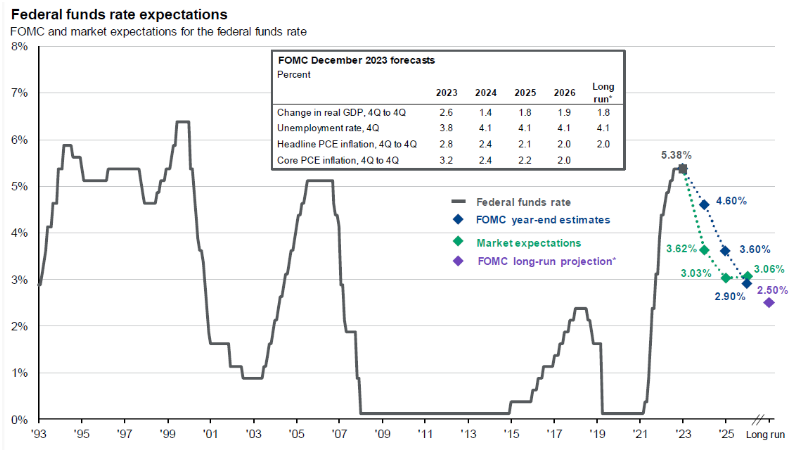
Source: JPMorgan



Source: Bloomberg, Zillow



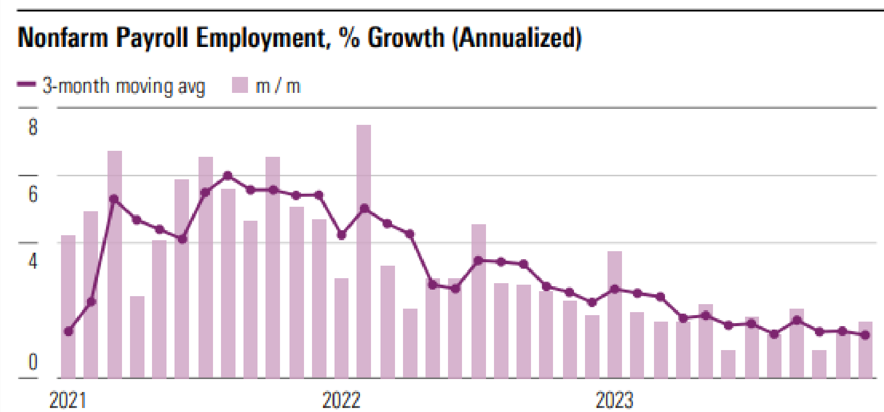
Fixed Income – Fed Policy



FOMC December 2023 forecasts
Percent

	2023	2024	2025	2026	Long run*
Change in real GDP, 4Q to 4Q	2.6	1.4	1.8	1.9	1.8
Unemployment rate, 4Q	3.8	4.1	4.1	4.1	4.1
Headline PCE inflation, 4Q to 4Q	2.8	2.4	2.1	2.0	2.0
Core PCE inflation, 4Q to 4Q	3.2	2.4	2.2	2.0	

Source: JP Morgan



Source: Morningstar

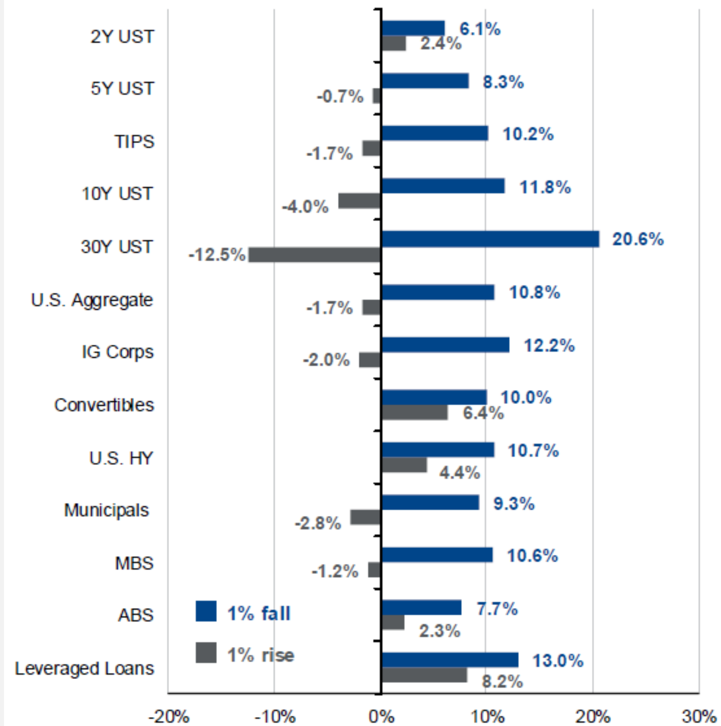
- The Fed's dual mandate is to promote maximum employment and maintain stable inflation. During the December 2023 meeting, Federal Reserve Chair Jerome Powell recognized advancements in achieving both objectives and indicated easier monetary policy was likely in the near future, as it deemed current rates to be at "restrictive" levels (top left).
- In 2023, inflation exhibited a downward trend, notably reflected in the Federal Reserve's preferred Core Personal Consumption Expenditures (PCE) metric, which decreased from nearly 5% at the beginning of the year to just over 3% by year end. This consistent decline, although still above the official 2% target rate, indicates a favorable trajectory, especially with expectations of further downward pressure on inflation due to lower rents.
- The December 2023 employment report depicted a mixed scenario, with an uptick in December overshadowed by downward revisions in October and November data. The three-month growth rate decreased to 1.3% annualized, indicating a potential renewal of the downtrend observed throughout 2022 (top right). Notably, hiring in healthcare and leisure sectors is decelerating, while the "other services" category, encompassing most white-collar jobs, has shown slight improvement. Wage growth has remained stable, with indicators like the job openings rate and quit rate returning to normal levels.
- The timing of the first interest rate cut is still up in the air, as Fed Chairman Powell indicated a reluctance to cut interest rates at the upcoming March meeting. At the end of January 2024, market expectations implied a nearly 50% probability of a May cut and 70% probability of a June cut.

Fixed Income – Positioning

- Despite rates contracting in the fourth quarter, client portfolio yields are still in the 5.00%-5.50% range. As a result, we still believe portfolios are in a position to produce attractive returns over the intermediate- to long-term. Starting yields in this range offer a favorable risk/reward profile when stress testing against a 1% change in interest rates (right chart).
- We continue to invest the bulk of client assets in actively managed mutual funds with flexible mandates. The mutual funds are balanced against low cost passively managed ETFs to manage duration and yield curve exposures. We believe this combination is the best way to navigate a volatile interest rate and credit environment.
- With the Fed likely planning to reduce rates in 2024, we expect the yield curve to re-steepen (long-term rates to yield more than short-term rates). Historically, when this happens intermediate maturities tend to perform the best. Therefore, client portfolios are positioned to take advantage of that expected change. However, we will be cautious not to extend too far as the long-term picture remains very uncertain. A potential uptick in inflation, increased debt loads (deficit spending), and a shrinking Fed balance sheet are reasons to be careful.
- On the credit side we continue to maintain a neutral policy on investment grade and high yield corporate bonds. Our longer-term bias is to be overweight these sectors, but with credit spreads on the lower end of the spectrum and weakening fundamentals, we continue to be patient when looking for an opportunity to add exposure. We believe securitized products remain attractive across various sectors, maturities and risk profiles. Our overweight to this area is the primary driver of our yield advantage when comparing client portfolios to client benchmarks. We continue to invest in municipal bonds in tax-aware portfolios due to their attractive fundamentals but have a bias to trim as break-evens vs. taxable bonds continue to decline.

Impact of a 1% rise or fall in interest rates

Total return, assumes a parallel shift in the yield curve



Source: JP Morgan

Our Team

We are an investment firm, founded by investors.

Bob Batchelor, CFA®, CFP® is Co-Founder and Chief Executive Officer of Entasis Asset Management. Bob has 25 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee. Bob has also earned the right to use the Certified Financial Planner™ certification and SE-AWMA™ professional designation.

Charles (C.J.) Batchelor, CFA® is Co-Founder and Chief Investment Officer of Entasis Asset Management. C.J. has 19 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a voting member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee.

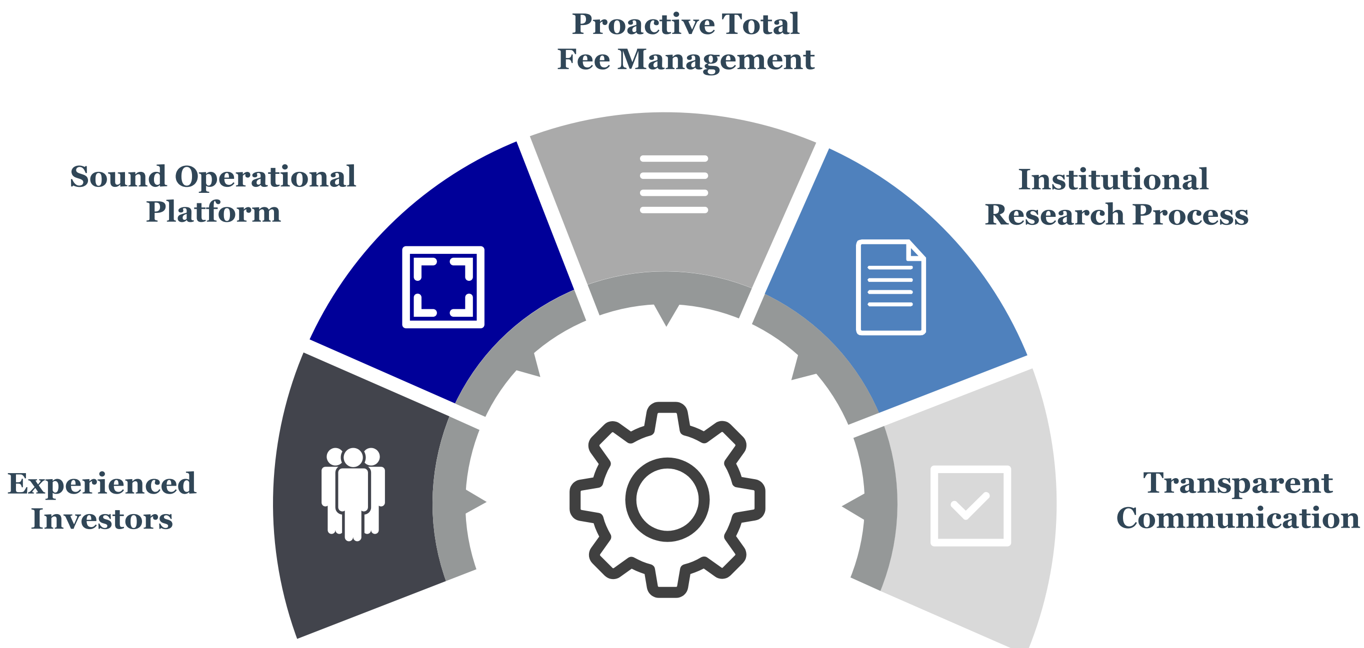
Mike Peters, CFA® is Co-Founder and Senior Wealth Advisor at Entasis Asset Management. Mike has 19 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as a voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

David LaCroix is a Senior Wealth Advisor at Entasis Asset Management. David has more than 50 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.

The Entasis Difference



Entasis
ASSET MANAGEMENT

Disclosure

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Investment Terms

Valuation levels are typically shown by calculating the price level of an index or a company relative to any number of characteristics of an index or company. For instance, the price-to-earnings valuation metric looks at the price of an index (or stock) divided by the total earnings of an index (or stock). Based on the multiple (in this instance, the multiple is how much investors are willing to pay – the price – for a given amount of earnings), it provides investors with a general sense of how expensive, or cheap, the overall market is at the present time. While there are a significant number of valuation metrics that are used in practice, and many ways to vary/modify the calculation of the price-to-earnings ratio, in this summary we are focused on the price investors are willing to pay (the level of the S&P 500® Index) divided by earnings expectations for the equity market (S&P 500 Index) over the next 12 months. This valuation metric is referred to as the forward P/E. A **yield curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to $1/100^{th}$ of 1%, or 0.01% (0.0001). **Interest coverage** is a measure of a company's ability to meet its interest payments on its debt. **Federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. It is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions, which in turn have a bearing on key aspects of the broad economy including employment, growth and inflation.

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