Portfolio Themes

First Quarter Report, 2024

Portfolio Themes for Q1 2024:

Introduction

In the last scene of the late 90s David Fincher cult-classic, Fight Club, Edward Norton tells Helena Bonham Carter that “You met me at a Very Strange Time in my Life”. For those new to TAG Invest and our quarterly portfolio themes, the line takes on a new meaning, in that you are meeting us at a very strange time in markets.

We approach forecasting not as a crystal ball to predict the future, but as a tool to reduce surprises. Just consider the unexpected events of 2023: the unprecedented bank failures ranking among the largest in U.S. history, China’s reopening flop, the geopolitical shockwaves from the Hamas invasion of Israel, the surprising resurgence of cryptocurrencies, and the U.S. stock market reaching for fresh all-time highs.

Despite the looming concerns over global economic slowdowns, markets have shown resilience, supported by a mix of robust labor markets and adaptive monetary commentary. The treasury curve has further inverted, however markets have largely taken the reduction in intermediate term rates as a sign of anticipated monetary loosening, as expectations that the Fed’s rate hiking cycle has come to an end and cuts are imminent. As we step into a new year, our investment philosophy remains steadfast. We continue to prioritize diversification and selective active management. Our focus is to navigate these evolving markets, harnessing opportunities while cushioning against the unforeseen

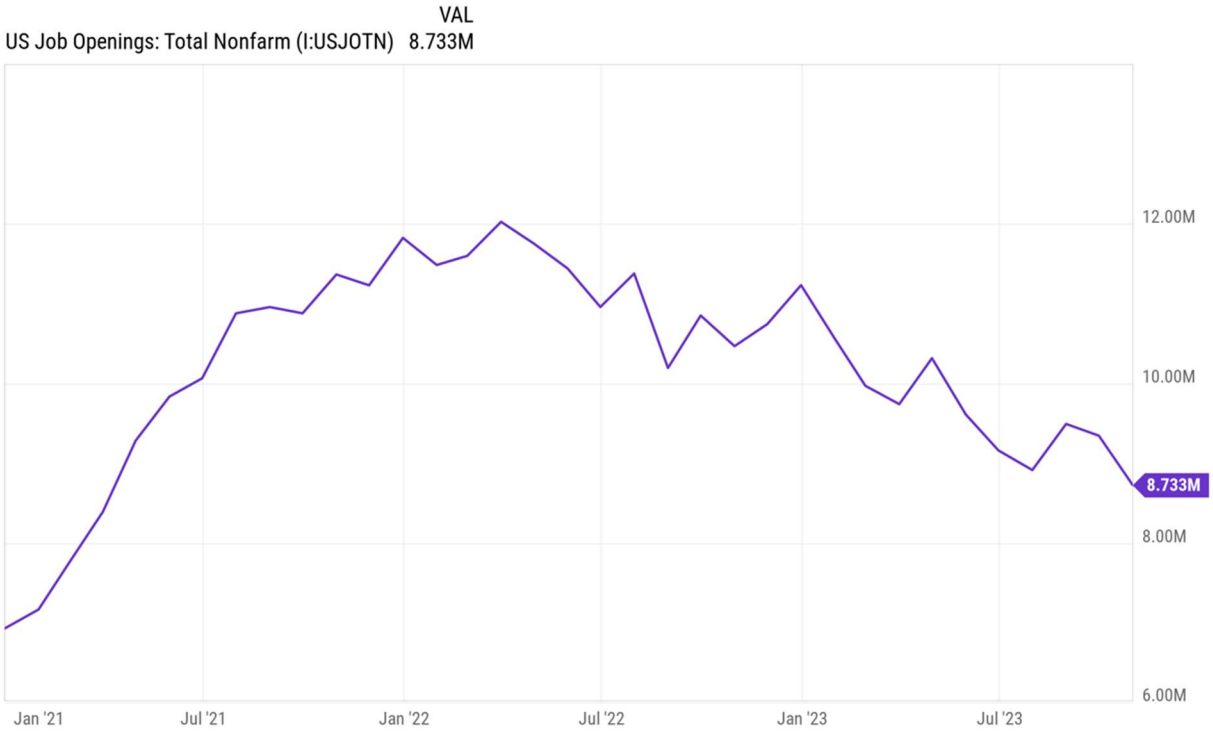
Fed & the Economy

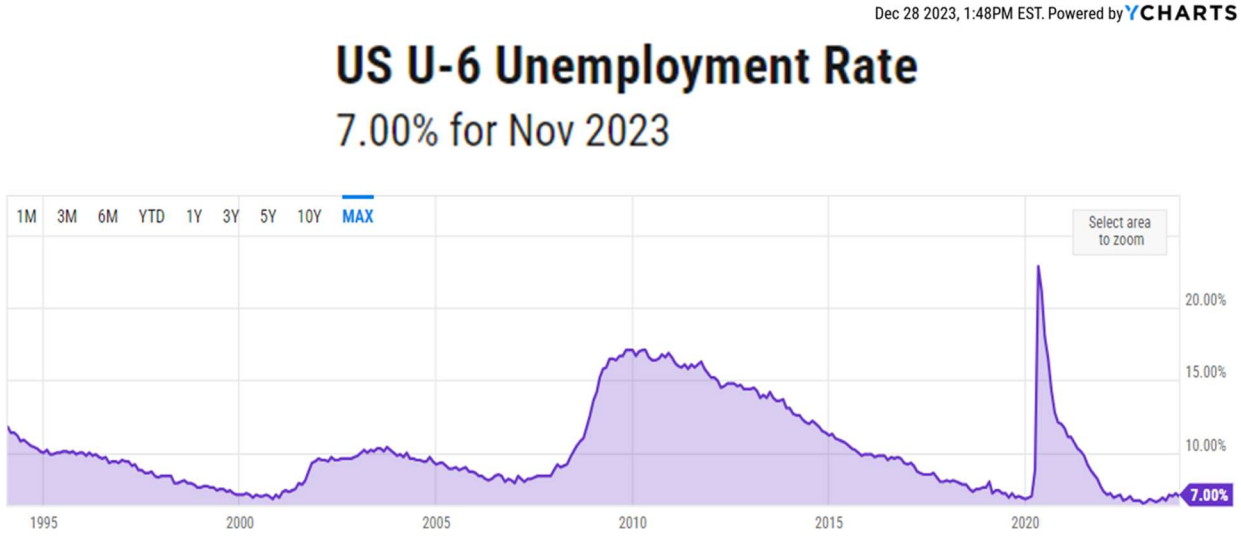
Navigating Economic Landscape:

The U.S. economy has continued to navigate complexities with a mix of resilience and caution, as the Federal Reserve's policies have paved the way for a soft landing. Europe's recovery is steady, while China and emerging markets show mixed signals of growth and volatility. The U.S. labor market remains strong, but the broader U-6 unemployment rate suggests continued vigilance in monetary policy, especially as job openings have slowed.

Holding our breath for Fed rate cuts may not be wise. Any hesitation from the FOMC could delay decisions or prolong the current rate environment. History shows that human psychology often favors inaction over action. The messaging around Fed Policy will continue to be important. Rate cuts in 2024 could be interpreted as signals of an impending slowdown or recession, potentially triggering a market reaction.

It seems central banks, including the Fed, are starting to shift their focus from inflation (price levels) to risks in economic growth and the labor market. In the U.S., this could mean the Fed prioritizing its dual mandate of maintaining near full employment. While active job openings have declined, unemployment figures have remained stable.

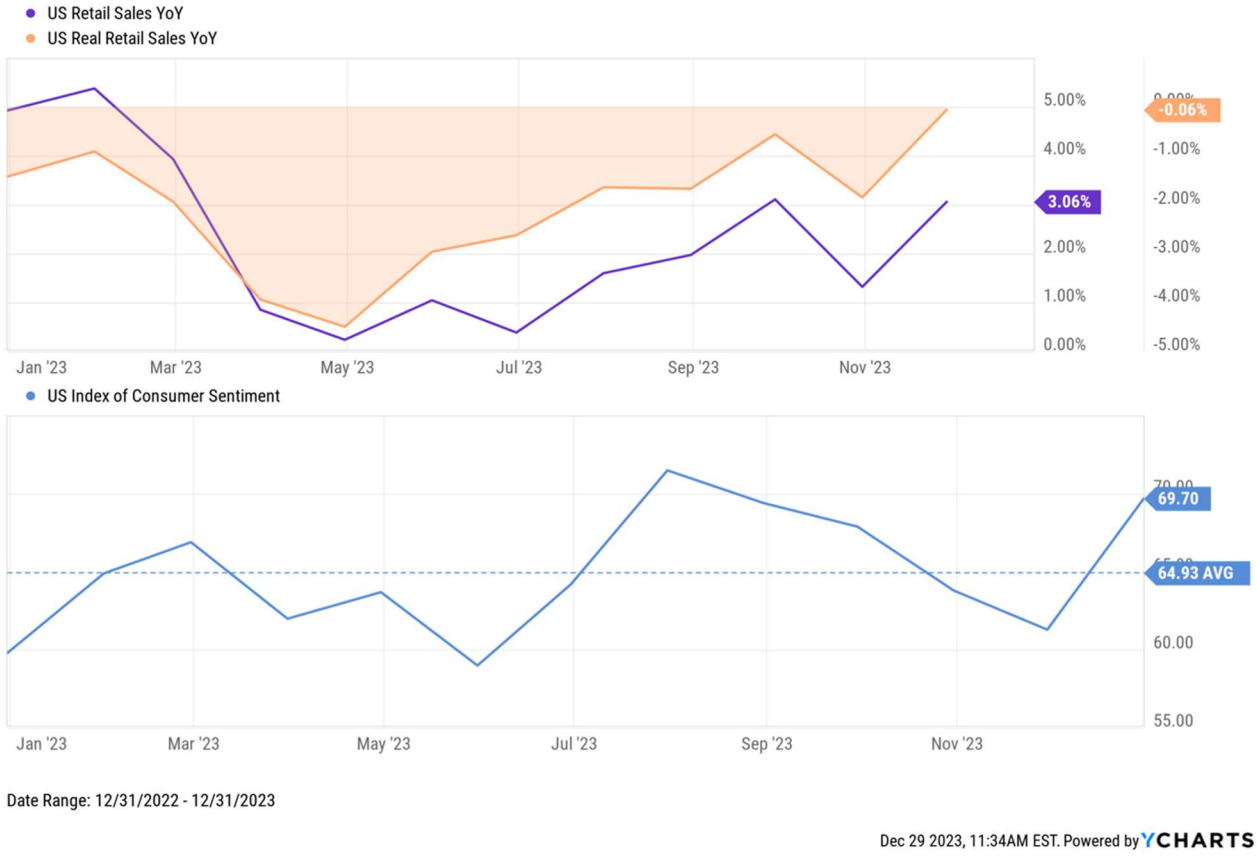




Source yCharts

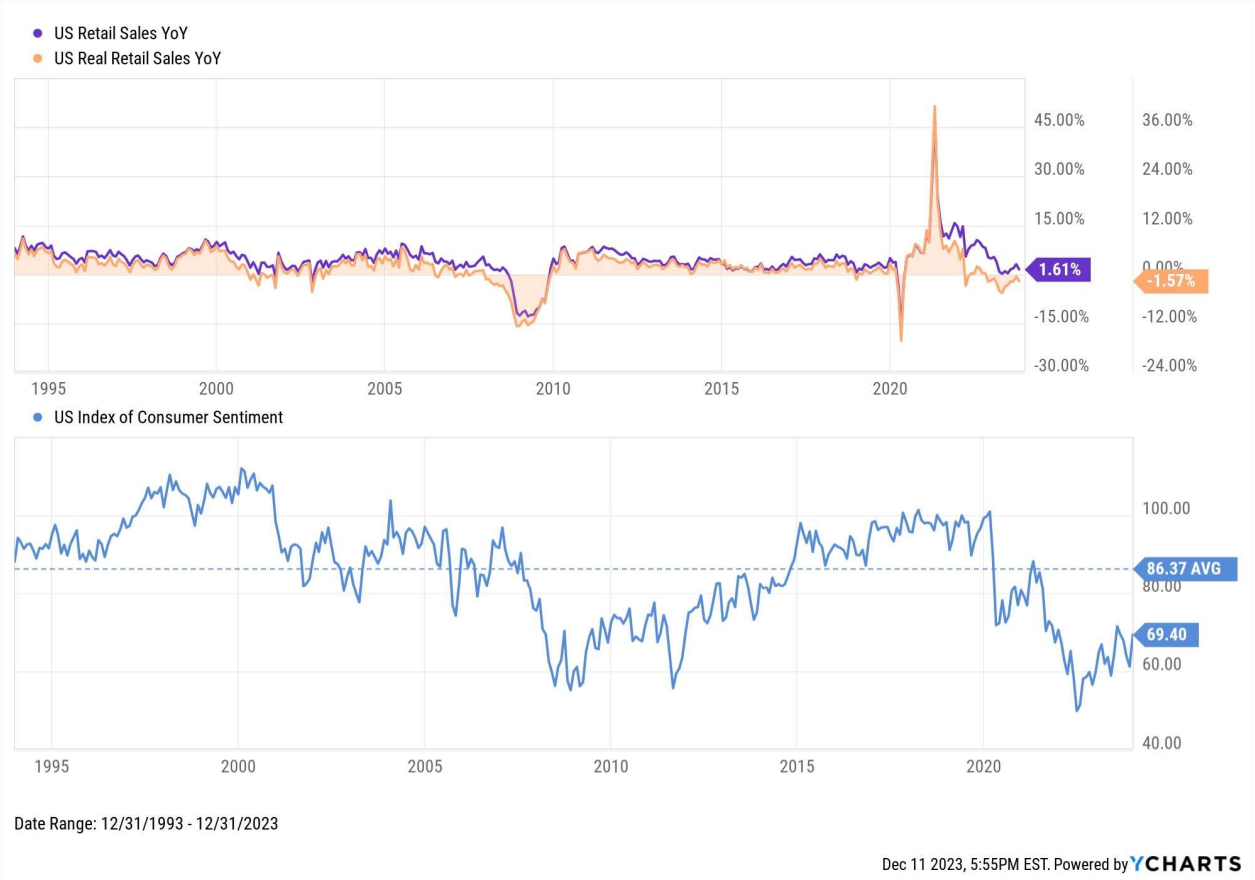
Health of the US Consumer

Although we are told that the health of the US consumer remains resilient, these graphs tell a slightly different story. It seems obvious, but although consumers are still spending, the data suggest they are getting less for their money, with a wider divergence between nominal and real (inflation adjusted) retail sales. Even as the rate of inflation has slowed, prices are not decreasing. Lower levels of inflation have continued to compound, and without wage growth or changes in savings rates, consumer spending does not appear as strong as some suggest. We find these data points important, not only as we receive data from the holiday spending season, but because personal consumption expenditures represent approximately 68% of US GDP, as of the 3rd quarter of 2023. [1]



[1] U.S. Bureau of Economic Analysis, Personal Consumption Expenditures [PCE], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=hh3, December 29, 2023

When we take the same data, and zoom out, we see the magnitude of the low points in consumer sentiment and the divergence between nominal & real retail sales.



Inflation Dynamics:
Inflation has continued its slowdown, fueling positive market reactions across many asset classes. Bond investors are experiencing a long-awaited reprieve as higher interest rates, coupled with decreasing inflation, have led to an increase in real yields. This shift marks a significant turning point, offering much-desired relief and more attractive investment opportunities within the bond market.

Lingering effects of inflation remain. The cost of housing remains elevated, and ongoing geopolitical conflicts remain in the headlines. While markets and energy prices have largely shrugged off these issues so far, developments in the Middle East could influence energy prices and global supply chain routes. Despite this, the direct impact on the U.S. has been minimal for several reasons.

Firstly, the U.S. is currently the world's leading oil producer, producing more oil than at any other time in its history. Secondly, the National Weather Service anticipates a warmer than average winter across most of North America due to El Niño and higher sea surface temperatures in the

Pacific Ocean. Lastly, the trend of 'nearshoring' could mitigate the effects of geopolitical events. However, it might also contribute to sustained high inflation by shifting more goods and services through higher-wage countries in the Western Hemisphere.

Certain aspects of these trends are certainly priced into financial markets. Economists have observed that the initial phase of reducing inflation has been accomplished. However, achieving the target level of around 2% could be more challenging and time-consuming. This is especially true if minor surprises arise from these or other inflation-related events.

Entering an Election Year; Fiscal Implications of Elevated Yields

As we venture into an election year, the intersection of elevated yields and political uncertainty will take center stage. Election years often stir investor anxiety, given the potential for significant policy shifts and their corresponding impact on markets. It's worth noting that political parties in the U.S. often appear most divided during the primaries as they appeal to their base. Policies tend to moderate leading into general elections, although significant differences between parties can emerge.

History consistently tells us the American economy & the stock market have both succeeded & grown, regardless of the configuration or 'wisdom' from Washington. Many investors have strong political views, and strong viewpoints often lead to emotions creeping to the surface. Mixing emotions and investing decisions rarely lead to good outcomes, so our message is simple: don't let how you feel about politics overrule how you think about investing. If you fear your bias may be clouding your judgment, best to let a third party take over.

Fixed Income

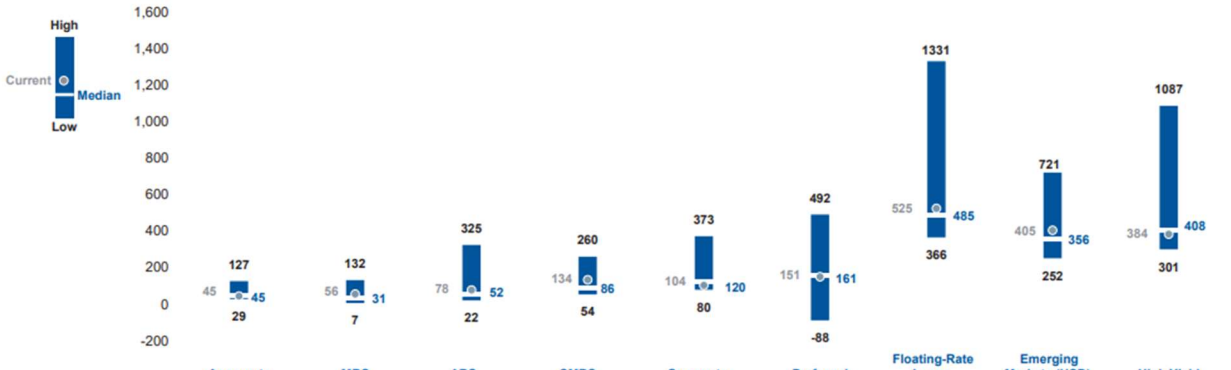
Fixed Income Recap

Fixed income markets had a very strong 4th quarter, as rates softened off their peaks in October. Total returns for the Bloomberg US aggregate index were 4.5% for the month of November, the best month since May 1985, and 5% for the Bloomberg global aggregate index, the strongest month since December 2008.[2] We have continued to maintain a shorter duration and higher credit quality positioning than the benchmarks, although we made some slight increases to duration throughout the year, adding long-dated treasuries over the summer and increasing our weight in mortgage bonds in early November.

Many fixed income asset class valuations are in line, compared to historical standards, even as yields softened. We remain tilted towards investment grade credit, as high yield spreads remain relatively tight and softened in the 4th quarter. We continue to believe that the higher-risk portion of a portfolio should be in equities, not in fixed income. This means that with the current rise in yields, fixed income is more effective in complementing portfolios and meeting clients' financial goals. There's less need to overweight fixed income with greater credit or interest rate risk.

[2] yCharts http://tinyurl.com/2e7kk62n

Spread Analysis (bps)

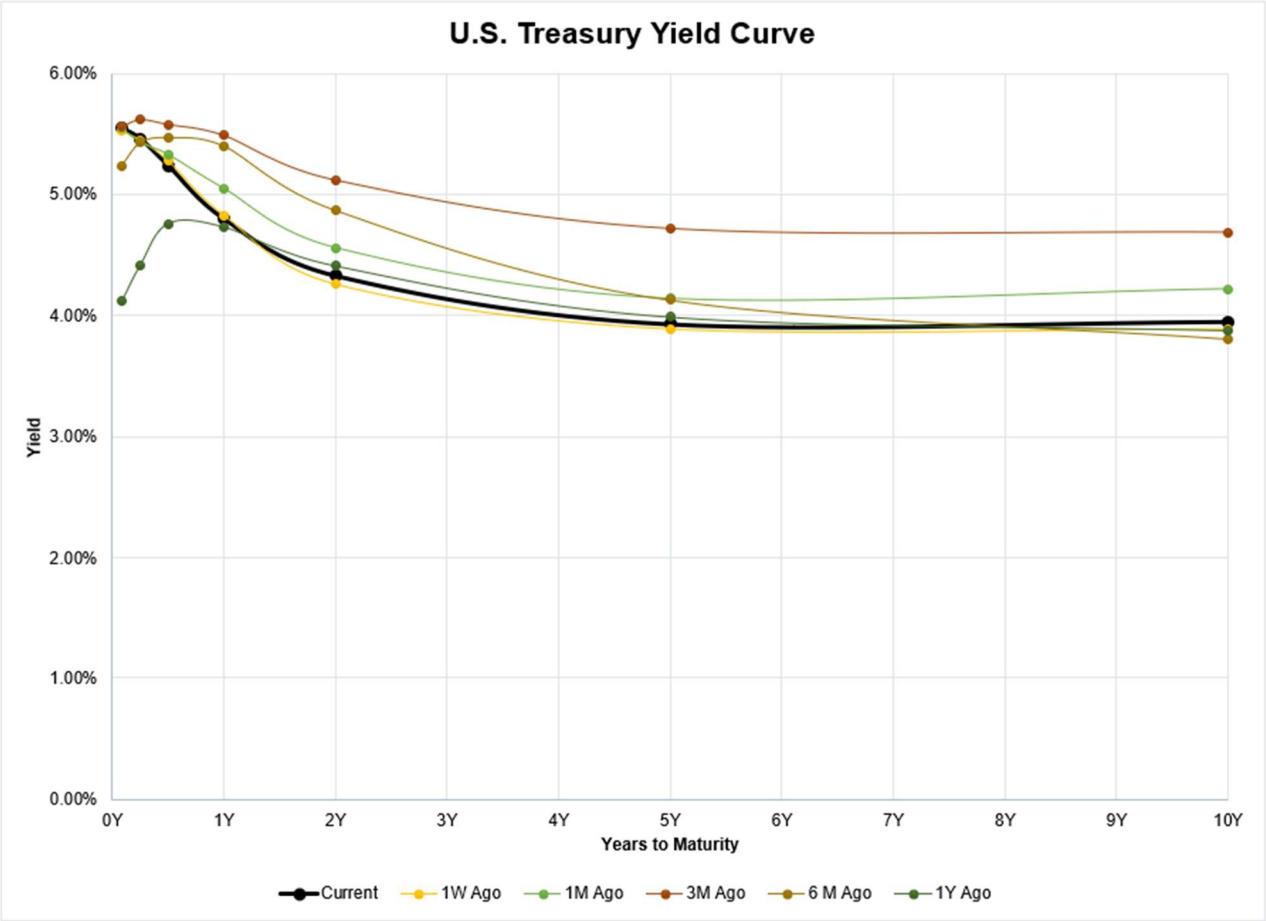


	Aggregate	MBS	ABS	CMBS	Corporate	Preferred	Floating-Rate Loans	Emerging Markets (USD)	High Yield
Max Spread Date	3/20/2020	3/19/2020	3/26/2020	3/25/2020	3/23/2020	3/23/2020	3/20/2020	3/23/2020	3/23/2020
Min Spread Date	4/14/2021	4/14/2021	6/21/2021	6/21/2021	6/30/2021	12/6/2017	4/20/2018	6/9/2014	12/28/2021
Spread on 12/31/22	51	51	76	120	130	227	645	452	479
Spread on 12/31/21	36	31	38	68	92	113	428	369	310
Spread on 12/31/20	42	39	33	81	96	71	475	352	386

Past performance is no guarantee of future results. It is not possible to invest directly in an index. Source: Factset and Leveraged Commentary & Data (LCD) as of 11/30/23. Spread history measures past 10 years. Data provided is for informational use only. See end of report for important additional information. All fixed-income spreads are in basis points and measure option-adjusted yield spread relative to comparable maturity U.S. Treasuries using daily data. Loan Index spread represents the three-year discounted spread over LIBOR. Aggregate represented by Bloomberg US Aggregate Index. MBS represented by Bloomberg U.S. Mortgage Backed Securities (MBS) Index. ABS represented by Bloomberg U.S. Asset Backed Securities (ABS) Index. CMBS represented by Bloomberg U.S. CMBS Investment Grade Index. Corporate represented by Bloomberg U.S. Corporate Investment Grade Index. Preferred represented by ICE BofA Fixed Rate Preferred Securities Index. Floating-Rate Loans represented by Morningstar LSTA U.S. Leveraged Loan Index. Emerging Markets(USD) represented by J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified. High Yield represented by ICE BofA US High Yield Index.

Yield Curve

In the 4th quarter, the treasury yield curve became more inverted as ultra short-term rates remained steady while intermediate to long-term rates decreased, anticipating Fed rate cuts in 2024. With the 2-10 spread hovering around 40 basis points, both rates declined together. The 10 and 30-year treasury bonds increased in price, lowering yields to 4% from previous highs of 5%. While various factors influence yield curve movements, a flattening of the curve, from inversion, often precedes recessions. This decline in yields may have marked a near-term peak for fixed product rates, like MYGAs, which have closer correlation to intermediate term rates for many products.



"Current' data as of 1/2/2024

Source yCharts

US Treasury Yield Curve Data

			Date	1/2/2024	12/26/2023	12/2/2023	10/2/2023	7/2/2023	1/2/2023
	Label	Ticker	Name	Current	1W Ago	1M Ago	3M Ago	6 M Ago	1Y Ago
Years to Maturity	0.083	I:1MTCMR	1 Month Treasury Rate	5.55%	5.53%	5.55%	5.56%	5.24%	4.12%
	0.25	I:3MTCMR	3 Month Treasury Rate	5.46%	5.45%	5.43%	5.62%	5.43%	4.42%
	0.5	I:6MTCMR	6 Month Treasury Rate	5.24%	5.28%	5.33%	5.58%	5.47%	4.76%
	1	I:1YTCMR	1 Year Treasury Rate	4.80%	4.83%	5.05%	5.49%	5.40%	4.73%
	2	I:2YTCMR	2 Year Treasury Rate	4.33%	4.26%	4.56%	5.12%	4.87%	4.41%
	5	I:5YTCMR	5 Year Treasury Rate	3.93%	3.89%	4.14%	4.72%	4.13%	3.99%
	10	I:10YTCMR	10 Year Treasury Rate	3.95%	3.89%	4.22%	4.69%	3.81%	3.88%
	30	I:30YTCMR	30 Year Treasury Rate	4.08%	4.04%	4.40%	4.81%	3.85%	3.97%
10-2 Spread				-0.38%	-0.37%	-0.34%	-0.43%	-1.06%	-0.53%

Source:yCharts

Money Market (MM) Flows

US money market funds have seen record inflows and are currently sitting near all time highs with over $6 trillion in assets. The question remains, if the Fed does start to reduce interest rates, what will happen to all this cash? Is this cash on the sideline, waiting to get back into equities, is it fixed income alternative, or is it simply American's emergency savings, as they pulled funds from traditional bank savings accounts? The answer is likely a mixture of all three. No doubt some of this cash could impact markets, but it's difficult to imagine it having large impact on a $100 trillion plus global equity market. Nonetheless, it will be interesting to see how this plays out, if the Fed does begin to cut rates, some of this money is likely to flow elsewhere, and could shorten the left-tail risk, if there are pullbacks in financial markets.

Board of Governors of the Federal Reserve System (US), Money Market Funds; Total Financial Assets, Level [MMMFFAQ027S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MMMFFAQ027S, December 27, 2023.

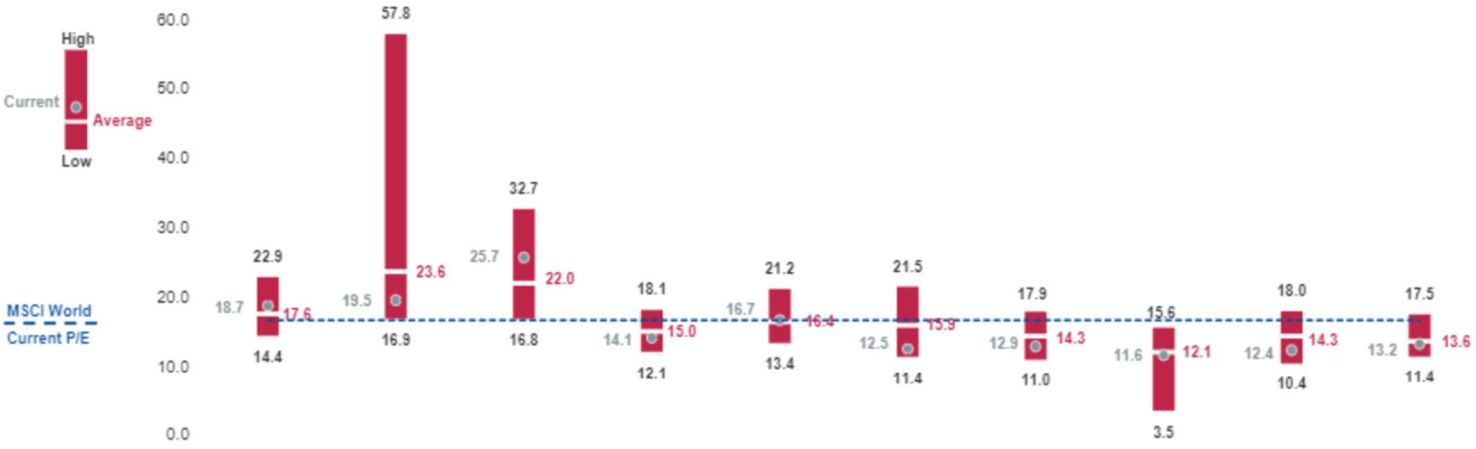
Equities

Valuations & Earnings

Market dynamics and earnings have been favorable, but there has been a distinct divergence in asset class returns and valuations, namely between US Value & Growth. The below chart provides a 10 year lookback on relative asset class valuations. Nearly all equity asset classes are in line, or cheaper than their 10 year historical averages, except US Growth stocks, which have taken up a larger share of the S&P 500, pushing the S&P 500 above it's 10 year historical P/E ratio. Worth noting, our Foundational Equity model carries a slight value bias to offset some of this expansion of growth overweight in the S&P 500. Longer term, we believe factor evidence indicating that growth and value will pull closer to parity.

Valuation Analysis

Regions/Styles: Current NTM P/E vs. 10-Year High, Low, Average



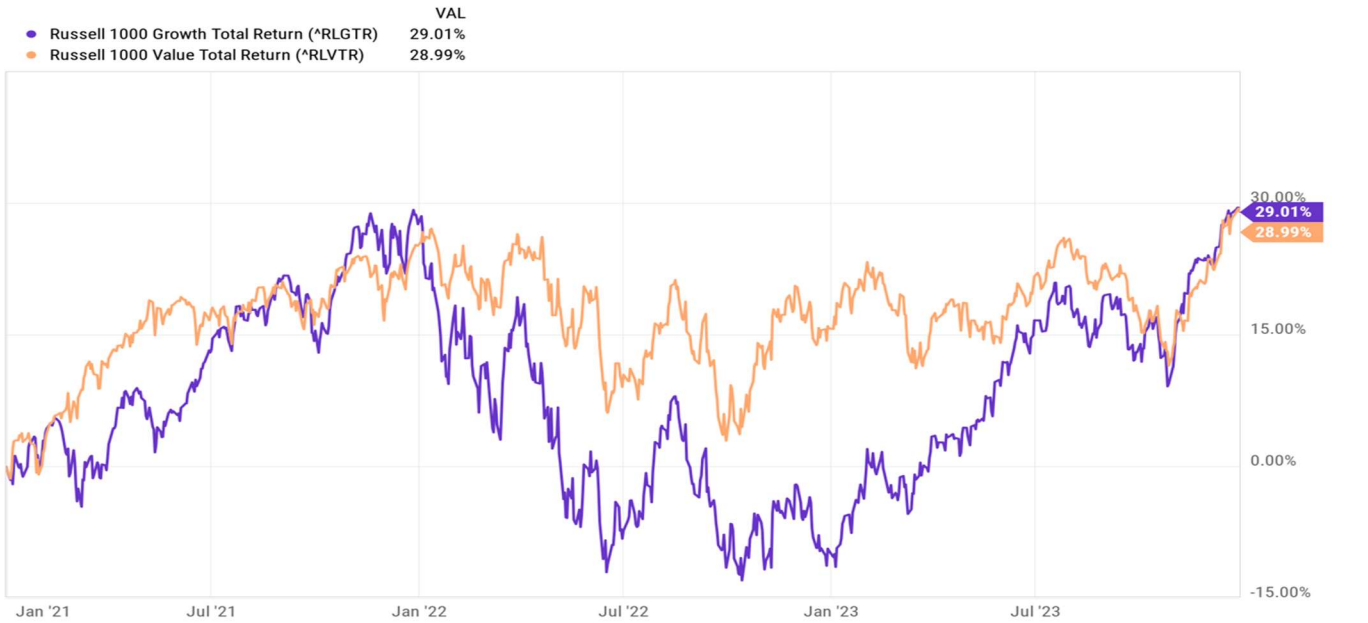
	S&P 500	Russell 2000	Russell 1000 Growth	Russell 1000 Value	MSCI World	MSCI World ex USA Small Cap	MSCI EAFE	MSCI EM	MSCI Europe	MSCI AC Asia Pac
High Date	8/20	6/20	8/20	3/21	8/20	8/20	8/20	1/21	6/20	1/21
Low Date	12/18	9/22	2/16	9/22	12/18	9/22	9/22	1/14	9/22	12/18

Source: FactSet as of 11/30/23. NTM P/E is market price per share divided by expected earnings per share over the next twelve months. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Date Range: 12/30/2022 - 12/29/2023

Jan 05 2024, 12:45PM EST. Powered by YCHARTS

Despite the outsized performance from growth stocks in 2023, our premise is that you can't tell the story of 2023 without looking at 2022. The below chart shows that growth and value are within spitting distance of each other over a two-year period. The performance in growth stocks is yet another example of how the best returns usually come off the heels of drawdowns, which is why it's imperative to guide investors towards appropriate risk tolerances and establish a regular rebalancing cadence to stay in line with their long term investing goals.

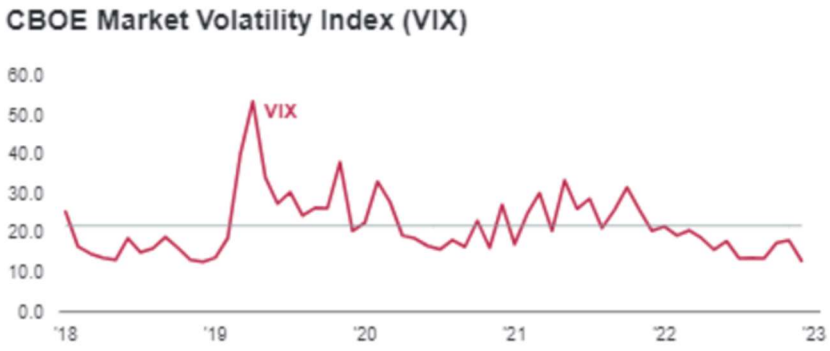


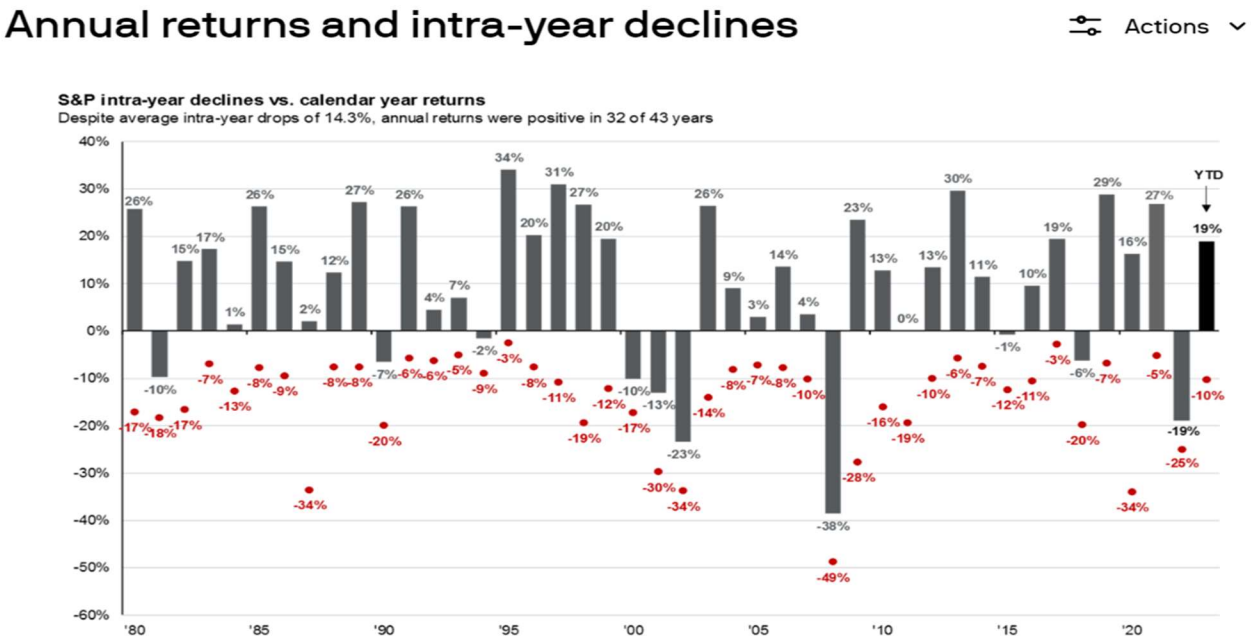
Date Range: 12/31/2020 - 12/29/2023

Jan 05 2024, 12:47PM EST. Powered by YCHARTS

Strong Year End Run

The S&P 500, Dow and Nasdaq closed 2023 on a 9-week winning streak. This might create a recency bias in investors' minds, suggesting that this has been an easy year for investing and that this trend will continue into 2024. Reflecting on the past year, we did observe a below-average level of volatility for equities, even if it just recently felt that way. Nevertheless, it's important to remember the intra-year decline of 10% in the S&P 500, a dip considered to be within correction territory. While this has been a relatively strong market year for equities, much of the gains are rebounding from the poor performance in the 2022 calendar year, bringing us back near all-time highs. Expectations for equities in 2024 remain mixed, but we have seen positive revisions, following the strong recent run. One certainty is the current VIX position, near a multi-year low. If history serves as an indicator, investors should prepare for potential shifts in market dynamics. Thus, it is essential to approach investment decisions with a balanced perspective, focusing on long-term strategies rather than short-term fluctuations, to navigate the uncertain terrain that lies ahead.





Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. *Guide to the Markets – U.S. Data are as of November 30, 2023.* Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2022, over which time period the average annual return was 8.7%.

International

Currencies and US Dollar Headwinds

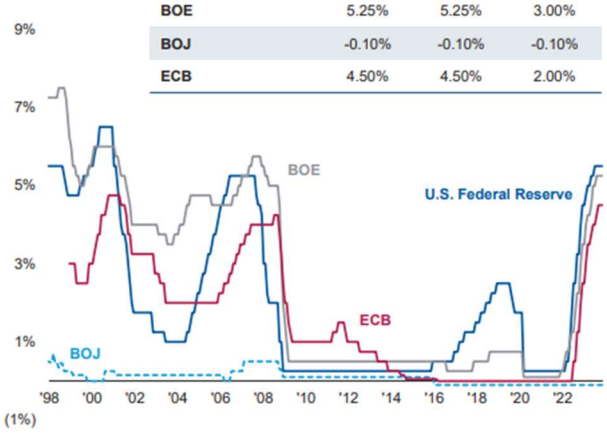
The U.S. dollar's period of strength is facing potential headwinds, accentuated by tightening interest rate differentials and shifting global growth patterns. International equities have demonstrated potential outperformance during periods of dollar weakness, presenting investment opportunities in diversified international sectors.

The Fed has largely led the global interest rate hiking cycle, outside of a few emerging market central banks. Most of the developed world, outside of Japan, followed their lead and increased interest rates. If the US begins rate cuts in 2024, some foreign central banks will certainly follow suit, however the narrative from other central banks, may not be the same. The European Central Bank does not have a dual mandate, like the Fed, and thus does not focus on employment, instead focusing primarily on inflation. On December 14th, 2023 Christine Lagarde, the European Central Bank (ECB) President, was quoted after their last meeting as saying policymakers, "Did not discuss rate cuts, at all."[3] If other leading economies around the globe continue to focus on inflation, and keep rates higher for longer, this could create significant interest rate differentials. If sustained, it could lead to investment flows out of USD denominated assets, into foreign assets and place downward pressure on the US dollar. Large currency moves were seen after commentary was released from recent Fed & ECB meetings, in mid-December.

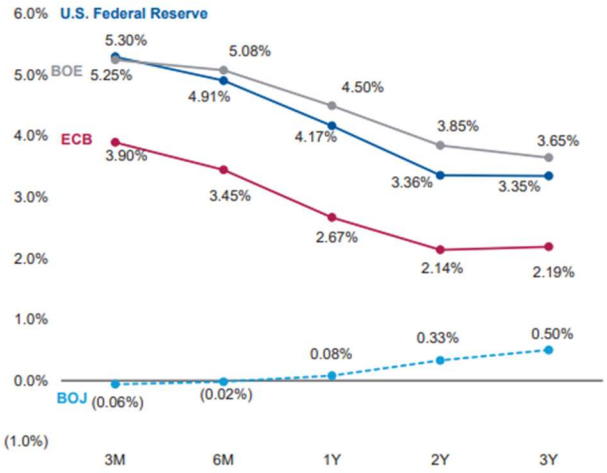
Monetary Policy

Central Bank Policy Rates

	Current	1-Mo. Ago	12-Mo. Ago
U.S. Federal Reserve	5.50%	5.50%	4.00%
BOE	5.25%	5.25%	3.00%
BOJ	-0.10%	-0.10%	-0.10%
ECB	4.50%	4.50%	2.00%



Market Expectations for Future Central Bank Rates



Source: Bloomberg, Factset as of 11/30/23. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

[3] https://www.reuters.com/markets/europe/ecb-has-tough-job-fight-rate-cut-bets-inflation-falls-2023-12-13/

Portfolio Changes:

During the fourth quarter of 2023, we made several portfolio revisions. We continue to focus on near term liquidity, priotizing short term debt instruments, and implementing hedged equity alternatives, such as structured products, to review with clients in certain risk profiles.

Discovery Stock Changes:

November 22nd. Sold NRG Energy Inc (NRG). Purchased Evergy Inc (EVRG).

Sell NRG Energy Inc (NRG)

NRG has been one of the highest performing utility stocks through 2023. The firm's strong performance tends to be cyclical, and has aligned with some recent success surrounding mergers & acquisitions. NRG has met or exceeded most of its price targets, and the firm has higher debt metrics, than many peers. Utilities were the worst performing S&P 500 sector in 2023, so we decided to reposition this part of the Discovery portfolio, to a firm that carries an attractive valuation & dividend yield, with a history of consistency, taking from NRGs outperformance.

Buy Evergy Inc (EVRG)

Evergy is a regulated electric utility firm that engages in the generation, transmission, distribution, and sale of electricity in Missouri & Kansas. Missouri and Kansas do not have retail choice for electric providers, giving Evergy a regulated monopoly status in its service territories. Evergy serves roughly 1,650,000 customers across its Kansas and Missouri service territories. Evergy expects 60% of its 2023 retail revenues to derive from Kansas service territories, while it expects Missouri to account for the other 40%.

Evergy has a consistently healthy balance sheet, paired with strong cash flow metrics. They operate in a favorable regulatory environment and an economically healthy region. Analyst believe environmental & climate risk to be low. The firm also pays a consistent & favorable dividend, compared to others within the sector. [4]

Terrapin Fixed Income Changes:

November 6thnd. Increased weight towards mortgages, via Morgan Stanely Mortgage Securities (MTGDX). Reduced weight toward US governement bonds.

Rationale: Agency mortgage bonds carry attractive valuations, increasing portfolio yield to maturity, above treasury yields. The strength of the Average American household remains strong, with many locked in at sub 3.5% rates, reducing mortgage refinance risk. This move also added a slight increase towards duration, which helped as rates softened in November.

[4] Rich, D. CFA (2023). Evergy, Inc. CFRA.

Asset Class Positioning

	Short View	Long View	Trend	Fund
Domestic Equity				
Large Blend			Neutral	FXAIX
Large Value			Neutral	VTV
Mid-Cap Blend			Neutral	FSMDX
Small Blend			Neutral	JDSCX
Small Value			Neutral	FSSNX
Real Estate			Positive	CSRIX
International Equity				
Foreign Large Blend			Up	FSPSX
Foreign Small/Mid Growth			Up	FIXIX
Diversified Emerging Mkts			Up	ABEMX
Short Term Bonds				
Short Government			Neutral	EILDX VGSH
Short-Term Corp			Neutral	LUBYX
Core Bonds				
Intermediate Government			Neutral	SCHR
Inflation-Protected Bond			Up	STIP
Long Government			Down	VLGSX
Investment Grade Corp			Neutral	FGBPX AGG
Securitized			Neutral	MTGDX
High Yield Bond				
Bank Loan			Neutral	EIBLX
High Yield Bond			Neutral	BGHIX
Preferred Stock			Neutral	CPXIX

Disclosures

We believe the sources to be reliable, however, the accuracy and completeness of the information is not guaranteed.

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Indices mentioned are unmanaged and cannot be invested into directly. The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. The Bloomberg U.S. Aggregate Bond Index is an unmanaged index comprised of U.S. Investment grade, fixed rate bond market securities, including government agency, corporate and mortgage-backed securities. The Russell 1000® Value Index measures the performance of those Russell 1000 Companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000 Companies with higher price-to-book ratios and higher forecasted growth values. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The Nasdaq 100 Index is a basket of the 100 largest, most actively traded U.S. companies listed on the Nasdaq stock exchange. The index includes companies from various industries except for the financial industry, like commercial and investment banks.