We prefer value and dividend paying stocks as valuation remains fundamental:

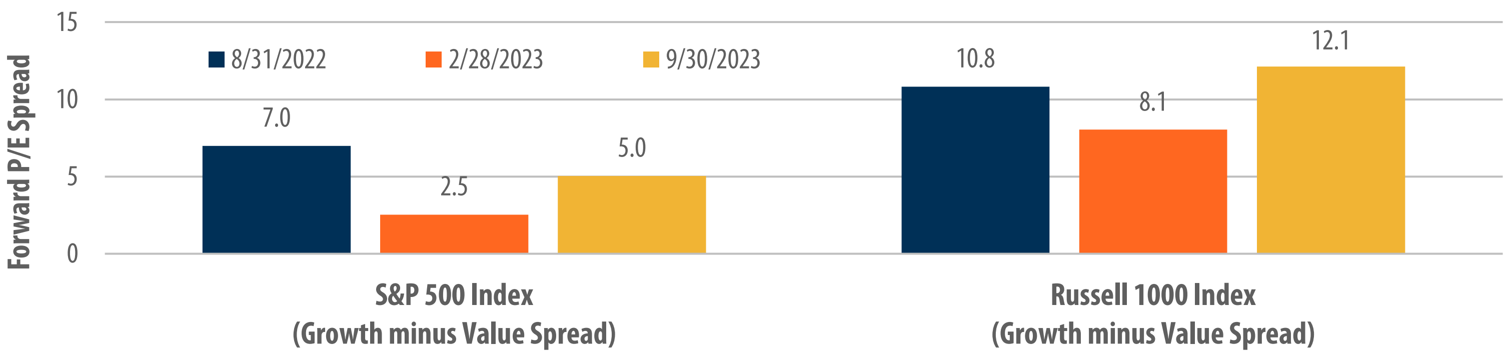
As of the end of August 2022, there existed a notably large valuation spread between growth and value stocks (Chart 1), and we expected that rising rates needed to combat inflation would narrow the valuation spread between "long duration" growth equities and value stocks.

- From September 2022 through the end of February 2023, the Federal Reserve ("Fed") raised rates 225 basis points (bps), and the spread between growth and value narrowed significantly as of 2/28/23 (Chart 1).
- Since then, the spread between growth and value has widened again as firstly, Tech+ was favored in March as a shelter from the banking crisis, and secondly, in May, Tech+ began to rocket higher as NVIDIA announced a massive increase in future revenue estimates due to surging demand for its specialized AI chips.
- As of 9/30/23, the valuation spread is once again significant despite the 10-year Treasury yield reaching 4.6%. We believe that fundamentals still matter, and that the valuation spread is too wide between growth and value currently.

The third quarter of this year witnessed a 70 bps increase in the 10-year U.S. Treasury yield overall, which had a disparate impact on yield-rich sectors of the equity market such as utilities and real estate (Chart 2). We believe this adds evidence to the case that now is an attractive entry point into dividend paying stocks as we come closer to eventual economic slowdown.

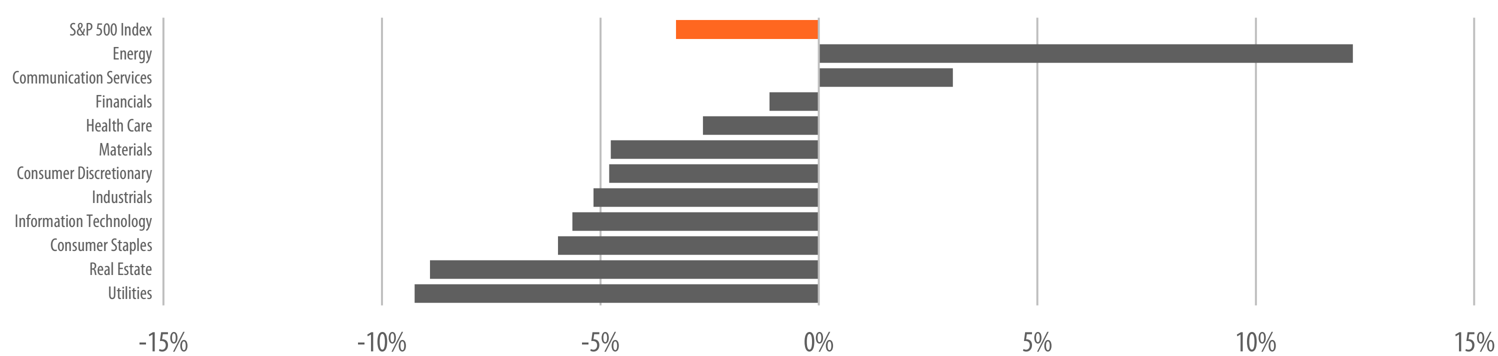
Meanwhile, the energy sector was the top performer in the third quarter of 2023. Oil producers continue to benefit from tight supply and strong cash flow, and geopolitical uncertainty is increasing as well.

Chart 1: Growth Minus Value Index Forward P/E Spread



Source: Bloomberg.

Chart 2: S&P 500 Economic Sectors Total Return



Source: Bloomberg. Data from 6/30/23 - 9/30/23.

Past performance is no guarantee of future results.

Sector Views

Communication Services

- Digital advertising spending starting to recover but would be impacted in event of recession.
- After taking steps to rationalize costs earlier this year, internet and streaming firms are investing in Artificial Intelligence (AI) to increase monetization and improve efficiency.
- Risk of increasing regulation.
- Focus on quality within sector.

Consumer Discretionary

- Low unemployment, strong wages are positives for consumption, but dwindling excess savings, higher interest rates and higher than normal inflation are key risks to sector.
- Services industries, such as travel and dining, may be more attractive than goods producers.
- Valuation levels not particularly attractive.

Consumer Staples

- Defensive sector but offers what we see as relatively meager growth.
- Consumer staples retailers and grocers face risk of reduced pricing power as inflation slows.

Energy

- Continue to see strong free cash flow generation as exploration & production companies have maintained capex discipline.
- Lack of investment in production in recent years limits supply growth, supporting oil market fundamentals.
- OPEC has signaled a willingness to expend determined effort to curtail production and support oil prices.
- Geopolitical risks to oil supply are re-emerging.

Financials

- Loan growth is mixed, as tightening lending standards and higher interest rates have resulted in less commercial lending and mortgage borrowing, while consumers are increasing credit card utilization.
- Net interest margin on loans gradually compressing as deposit rates increase.
- Credit quality remains reasonable, and banks are increasing reserve provisioning for potential future loan losses.
- Investment banking and trading revenue sluggish in volatile, high interest rate environment.
- While near term risk remains in the sector, current valuations are quite attractive, providing a compelling long-horizon opportunity.

Healthcare

- Provides opportunity to invest in sector with growth potential that is less correlated to business cycle.
- Popularity of GLP-1 weight loss drugs has impacted sentiment towards medical device companies.
- Elective procedures and office visits continue to rebound post-COVID.
- Biotechnology stands to benefit from secular innovation, and potentially increasing merger activity as cash rich Big Pharma motivated to replenish their pipelines.
- Relatively weak performance year-to-date offers valuation opportunity.

Industrials

- Demand for capex is a secular driver than benefits sector, as firms are motivated to reshore supply chains and increase productivity in a tight labor market.
- Sector benefits from fiscal spending on infrastructure as well as national defense.
- ISM Manufacturing PMI index continues to indicate a cyclical contraction in industrial activity, as firms reduce precautionary inventories built up during supply chain difficulties.
- Weak international macroeconomic growth may be a risk to exports.
- Defense industry names may benefit from increasing geopolitical risk.
- We believe valuation in sector is reasonable.

Information Technology

- Key innovations such as artificial intelligence and process automation may offer substantial secular growth opportunities.
- Slowing overall IT corporate spending and the risk of recession are cyclical challenges for the sector. Additionally, technology stocks are still too expensive relative to value stocks.
- Prefer quality within the sector, particularly firms with strong corporate balance sheets and reasonable valuation.
- High multiple, unprofitable cloud software names are currently risky as higher interest rates constrain risk capital.
- We see cyclical risk to semiconductors overall, and we expect semiconductor capital equipment growth to slow. That said, key semi end markets such as artificial intelligence (AI) and vehicle electrification benefit from secular tailwinds. Valuation is a risk for some well-known semis benefiting from investor enthusiasm towards AI. Due to geopolitical tensions with China, increased export restrictions are a risk to the industry.

Materials

- Materials sector poised to benefit from any recovery in Chinese fixed asset investment spending from policy stimulus, but prolonged slowdown in Chinese real estate construction would negatively impact demand outlook.
- Incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive.

Utilities

- Low growth sector but defensive, dividend paying nature more attractive in times of macroeconomic uncertainty.
- Interest rate sensitivity less of a concern as Fed nears end of tightening cycle

Real Estate Investment Trusts (REITs)

- Higher yielding sector and has been sensitive to rising interest rates.
- Data center REITs may provide strong secular opportunity, but there is risk of a cyclical IT spending slowdown.
- Office REIT fundamentals remain challenged as shift to work from home has impacted occupancy, although utilization of office space may improve over time.

DEVELOPED MARKETS

Europe

- Inexpensive valuation in comparison to U.S. stocks, but no clear near-term catalyst.
- Uneven industrial activity and weak retail sales point to risk of recession.
- After a recent rate increase, the European Central Bank is expected to remain data dependent as economic activity slows.
- Any re-acceleration of growth in China potentially stimulates demand for Europe's exports, but Chinese growth has been disappointing in recent months.
- Geopolitical risk from Russia's war on Ukraine.

United Kingdom

- Labor market is robust, but still elevated inflation and higher rates impacting disposable incomes.
- Bank of England expected to end tightening cycle soon, as both manufacturing and services PMI surveys point to economic weakness.
- Fiscal policy becoming less supportive in 2023.
- Downturn in U.K. housing market a risk to broader economy.
- Inexpensive valuation in comparison to US stocks.

Japan

- Robust wage growth improving near term domestic demand prospects, driving inflation and corporate pricing power.
- Japan domestic economy in cyclical recovery, with later re-opening than U.S., resulting in more services demand, such as inbound tourism.
- Rising wages and core inflation raise possibility that the Bank of Japan may revise its "yield curve control" policy, potentially lifting Yen.
- Industrial-heavy Japan exposed to global appetite for capital equipment, which implies risk if developed economies pull back on investment.
- Structurally low return on equity, although some corporate governance reforms have been recently implemented by the Tokyo Stock Exchange.
- Challenging demographics limit long-run potential economic growth.

Australia

- Commodity exporter which benefits from higher commodity prices.
- Exports of raw materials to China key driver of economic growth.

Canada

- Energy and metals exporter which benefits from commodity inflation and would suffer from a U.S. recession.

EMERGING MARKETS

Emerging Asia

- It remains to be seen if monetary easing and fiscal stimulus have been sufficient to re-accelerate Chinese economic growth, as recent economic data has been underwhelming, particularly in the property market, which is a source of downside risk.
- Geopolitical tensions with U.S. reduce possibility of tariff reductions, and complicate U.S. firms' decisions to invest in China.

Latin America

- Mexican economy benefits from exports to U.S. but would be negatively impacted by U.S. recession. Over time, supply chain diversification away from China may be a structural tailwind to exports.
- Brazil and Latin America overall are sensitive to demand for commodity exports, and commodity price inflation.
- Brazil's socialist president Lula da Silva may propose policies that undermine the country's fiscal credibility, potentially resulting in a weaker currency and weighing on sentiment.
- The Brazilian Central Bank has begun easing policy amid cooling inflation but indicates that monetary policy may be impacted by how well the government abides by its fiscal targets.

Definitions

The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The Russell 1000 Index represents the top 1,000 companies by market capitalization in the United States. Investors cannot invest directly in an index. Forward Price-to-Earnings (P/E) is the price of a stock divided by estimated forward earnings. Technology Plus (Tech+) is a combination of the technology sector, interactive home entertainment, interactive media & services, internet & direct marketing, Tesla Inc., and Netflix Inc.

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