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Market Environment Standard Report

Long Version

Fourth Quarter 2023

A business of Marsh McLennan

Market review & outlook

Stocks soar as prospect of rate cuts shift focus back to soft landing narrative

- Global equity markets performed strongly during the fourth quarter, largely driven by a sharp decrease in longer-term rates following the Fed's more dovish than expected statement in December. This led the market to price in significant rate cuts in 2024. Volatility remained subdued and declined during the quarter as asset classes rallied across the board.
- Treasury yields fell during the quarter and the yield curve remained flat to slightly inverted. The 2-year Treasury yield fell 80 bps from 5.0% to 4.2% during Q4, while the 30-year Treasury yield fell 68 bps from 4.7% to 4.0%. Credit spreads also declined during the risk-on quarter, most notably for high yield bonds.
- The Bloomberg US Aggregate Bond Index returned 6.8% in Q4, while the MSCI ACWI returned 11.0%. As a result, a traditional 60/40* portfolio returned 9.4%. For 2023, a 60/40* portfolio returned 15.4%.

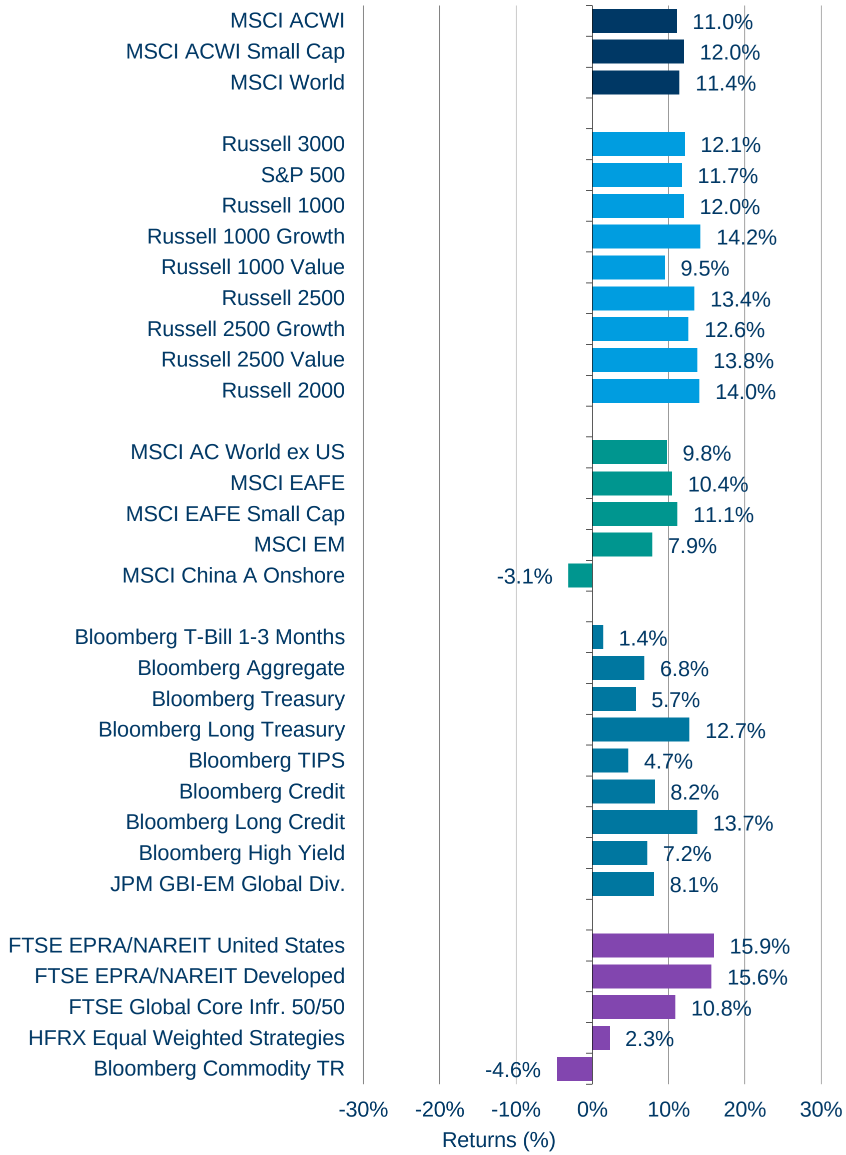
Monetary policy rhetoric raises hope for a more favorable economic environment in 2024

- US economic growth proved remarkably resilient in 2023 and investors are now hoping that easier monetary policy will continue to serve as a tailwind in in 2024, offsetting less expansionary fiscal policy and potentially lower consumer spending. We expect the US economic growth to slow in 2024, but to avoid a hard landing, especially following the Fed's latest comments. Economic activity in the UK and Eurozone remained slow in Q4. China's economy continued to struggle and entered deflation in the fourth quarter but seemed to be touching its bottom with targeted stimulus measures to support the housing market.
- US inflation has fallen significantly. Headline CPI was 3.4% year-over-year through December, while core CPI came in at 3.9%, an over two-year low. Inflation is expected to decline further as remaining inflationary components such as shelter roll over. Labor markets have shown signs of softening from tight levels, which also should help inflation fall back to target.
- With rates ending the year in restrictive territory, central banks are now openly signalling an end to the hiking cycle. Markets have priced in several rate cuts in the US for the year, starting as early as March while the Federal Reserve's own rate projections indicate lower rates by the end of 2024. Others such as the European Central and Bank of England remain more cautious while the Bank of Japan, which had kept rates near all time lows despite rising inflation, has entertained the possibility that it will not enter a hiking cycle.
- Geopolitical risks remained in the forefront as the Gaza and Ukraine conflicts continued and shipping in the Red Sea was temporarily disrupted in December due to missile attacks. While the initial market impacts have been limited, there is the risk of escalation with potential impacts on oil markets.
- Our outlook for global equities has improved from a macro and policy standpoint but high US equity valuations remain a concern after strong quarterly returns. We believe the rally in Treasuries has brought yields out of the extremely attractive territory reached in September. For the whole of 2023, US yields rose marginally.

*60% MSCWI ACWI, 40% Bloomberg US Aggregate

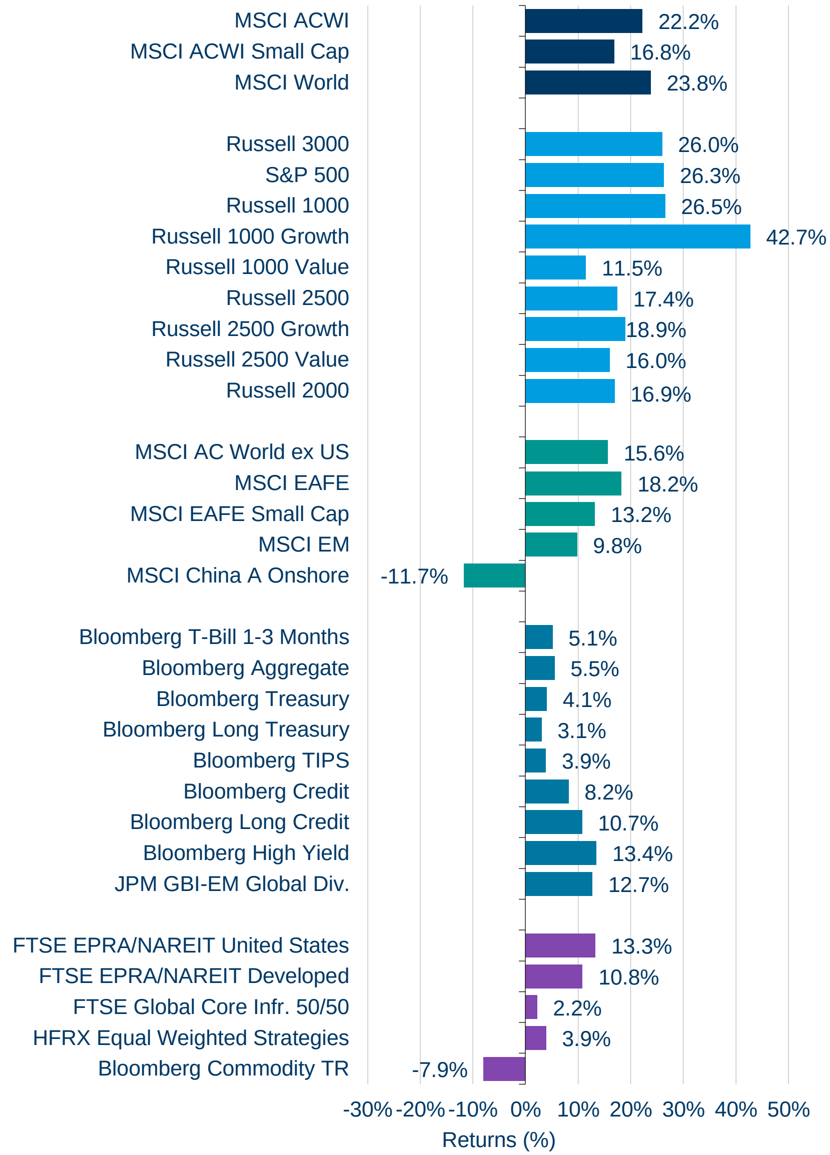
Performance summary

Market Performance
Fourth Quarter 2023



Source: Standard & Poor's, Russell, MSCI Barra, NAREIT, Bloomberg; as of 12/31/23

Market Performance
2023



Source: Standard & Poor's, Russell, MSCI Barra, NAREIT, Bloomberg; as of 12/31/23

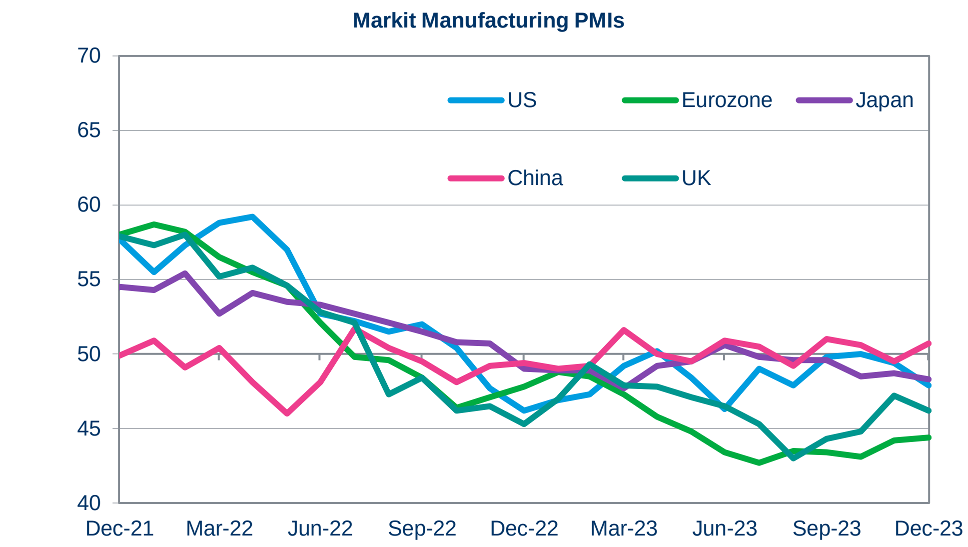
Mercer

Past performance is no guarantee of future results

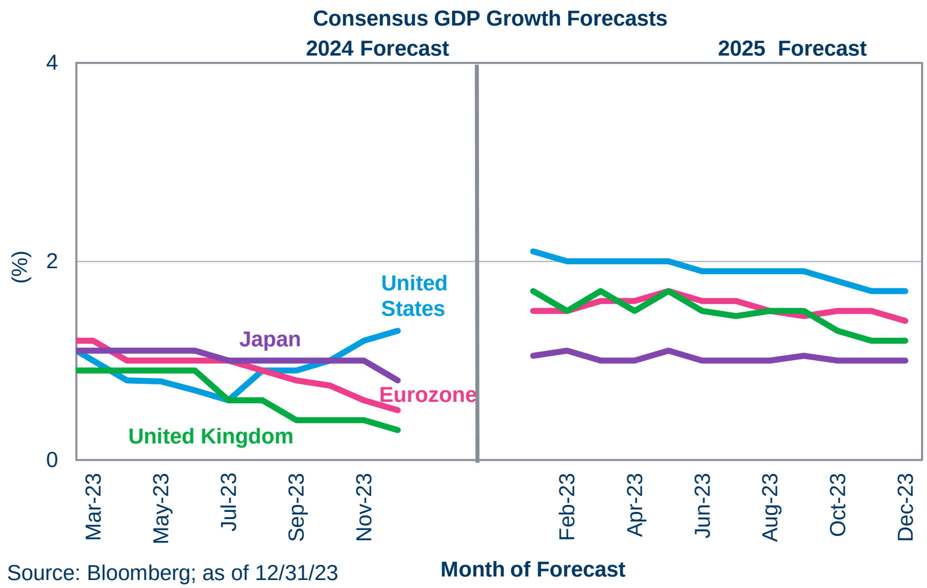
Economic fundamentals

US economic growth remains resilient, driven by strength in service sectors

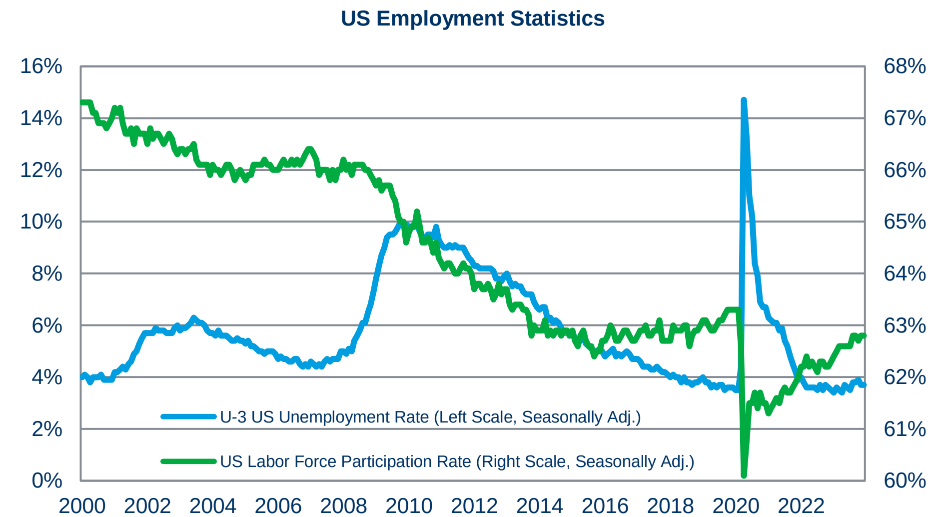
- US economic growth continued at a solid pace during the fourth quarter, while growth in the Eurozone and UK lagged. Consensus growth forecasts for 2024 improved for the United States but fell for other regions, while forecasts for 2025 remained unchanged.
- Manufacturing PMIs remained at contractionary levels for most major regions. Service PMIs remain stronger.
- The US labor market remains tight. The unemployment rate (U-3)[1] ended the quarter at 3.7%, and the labor force participation rate remained at 62.8%, just below its pre-Covid trend. However, wage growth appears to be moderating.



Source: Bloomberg; as of 12/31/23



Source: Bloomberg; as of 12/31/23



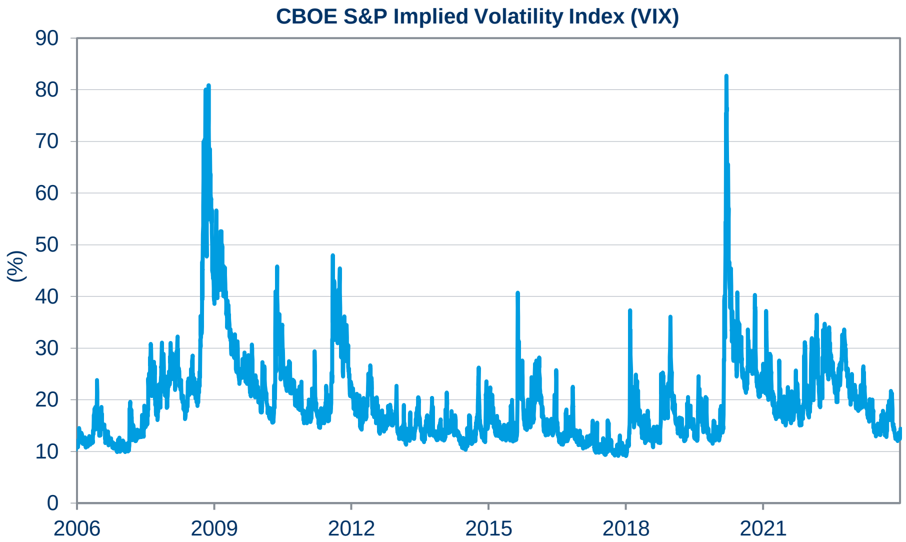
Source: Bureau of Labor Statistics; as of 12/31/23

[1] The U-3 unemployment rate represents the percentage of the civilian labor force that is jobless and actively seeking employment.

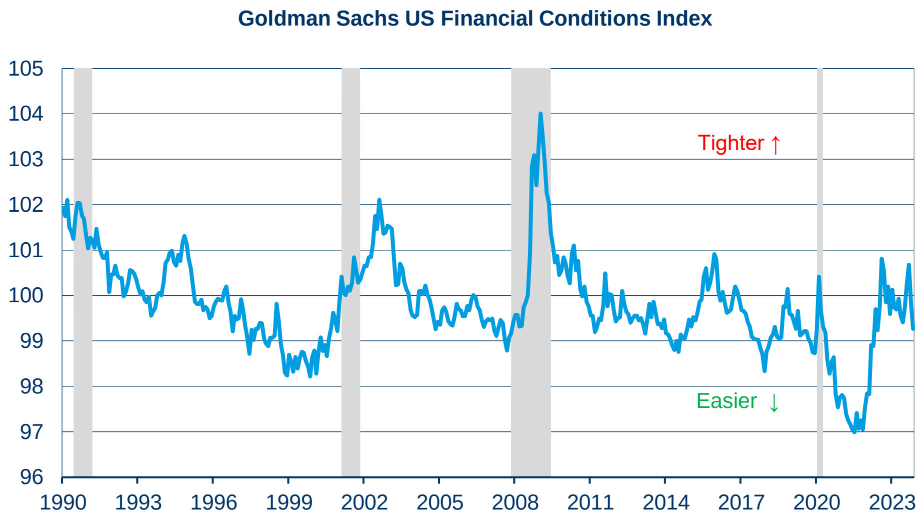
Risk factors

Long-term interest rates decline, financial conditions ease

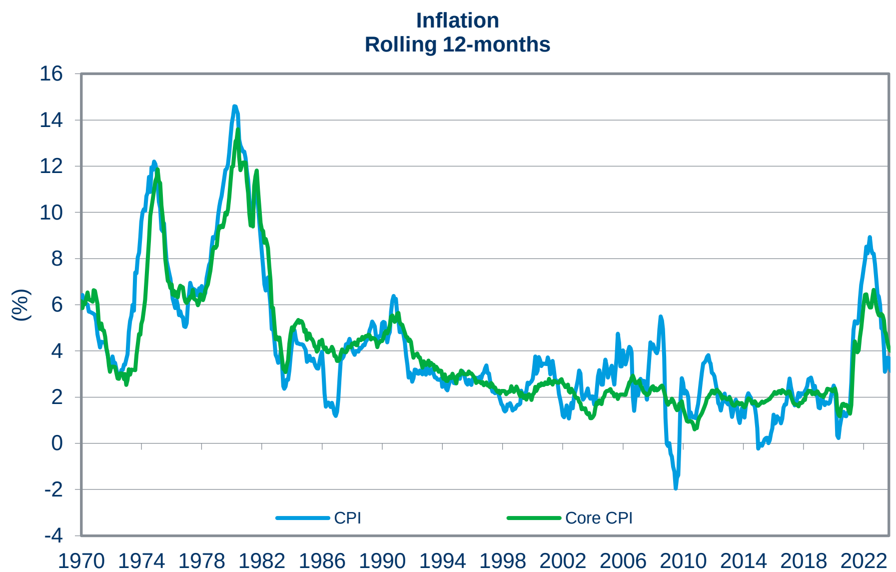
- The decline in long-term rates last quarter provided a welcome relief to the economy, especially the most rate sensitive sectors.
- Geopolitical risks remained elevated with numerous conflicts across the Middle East and Eastern Europe. The risk of further escalation has the potential to impact the oil markets.
- US headline inflation came in at 3.4% in December, while core CPI declined to 3.9%.
- The CBOE Volatility Index (VIX) volatility index moved lower during the quarter, falling from 18 to 12, a level not seen since 2019.[1]
- The Goldman Sachs US Financial Conditions Index fell during the quarter, to levels below March 2022 as long-term rates declined dramatically.



Source: Bloomberg; as of 12/31/23



Source: Bloomberg; as of 12/31/23



Source: Bloomberg; through 12/31/23

Mercer

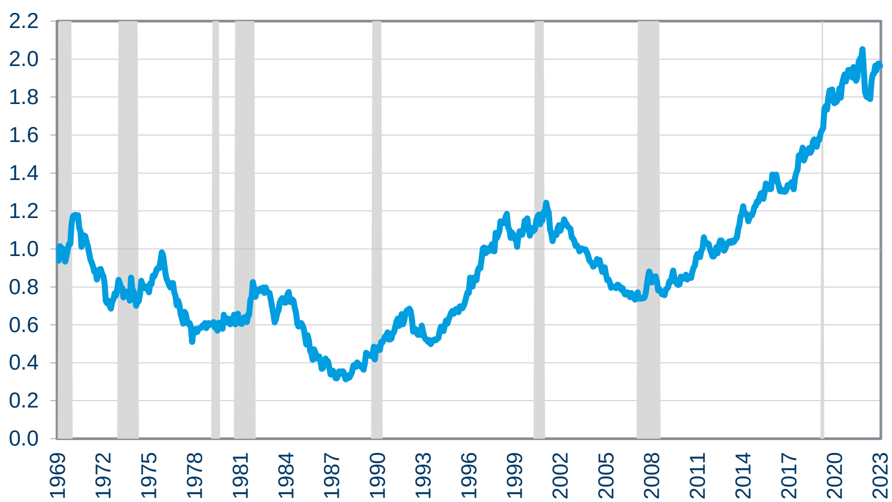
[1] Source: Bloomberg; as of 12/31/23

Regional equity returns

Global equities rally as the narrative pivots back to soft landing

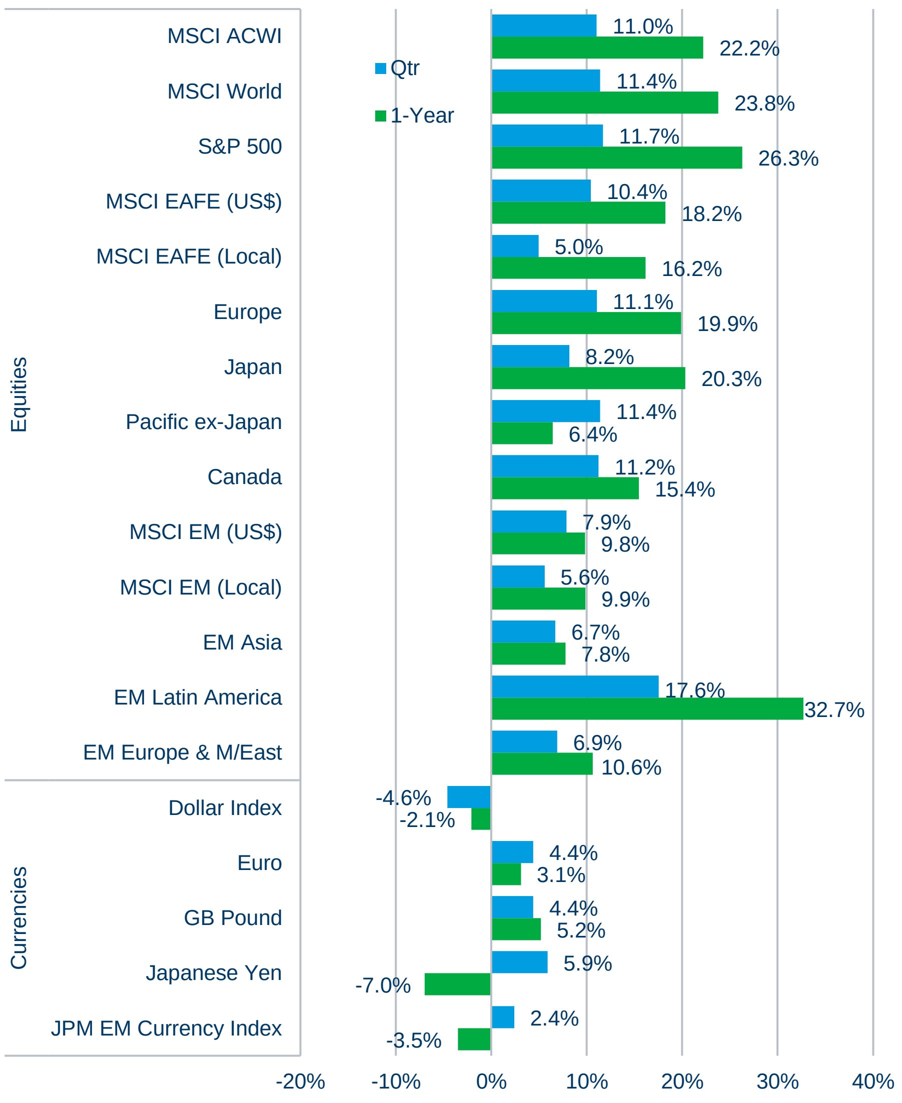
- After a soft period during Q3, global equities rebounded sharply in Q4, with the MSCI ACWI returning 11.0%. The Index gained 22.2% for 2023.
- The S&P 500 rallied strongly during the quarter lead by the Magnificent 7, but the rally broadened as well.
- International developed stocks returned 10.4% in Q4, bringing their 2023 gains to 18.2%. A weaker dollar added 540 bps to US$ returns during the quarter.
- Emerging market equities returned 7.9% in Q4 and gained 9.8% in 2023. Latin America was the best performing emerging market equity region last year offsetting negative returns from China.

Ratio of MSCI US to MSCI EAFE (Relative Performance)



Source: Bloomberg; as of 12/31/23

Global Performance



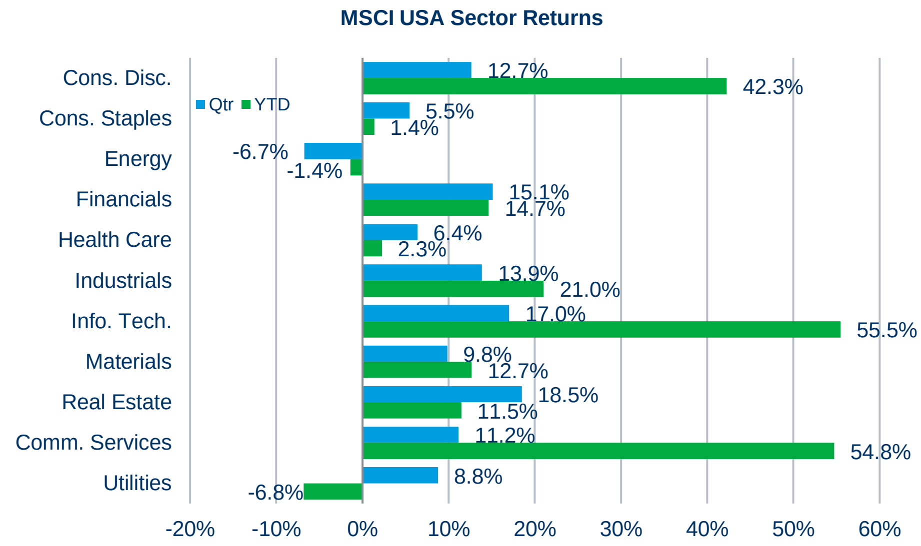
Source: Bloomberg, Refinitiv; as of 12/31/23

Past performance is no guarantee of future results

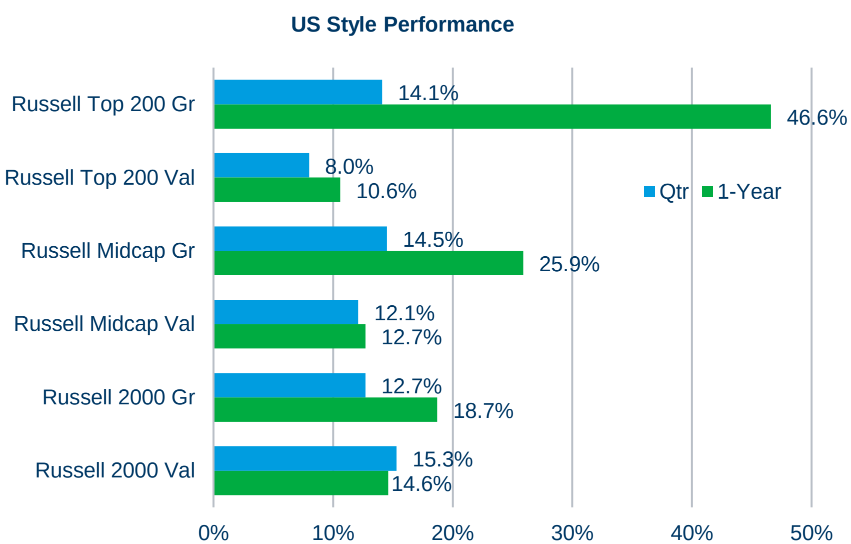
US equity factor and sector returns

Small-caps and large/mid growth stocks outperformed in Q4

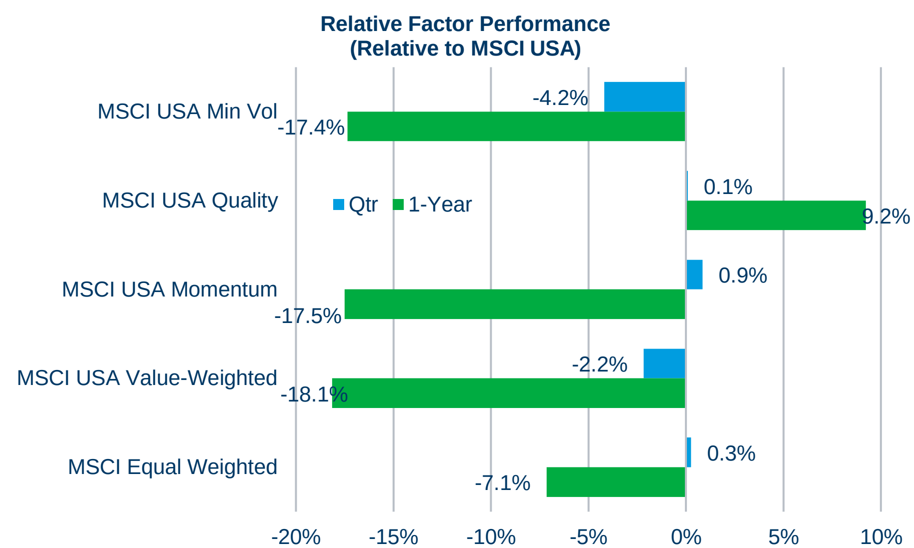
- Small-caps outperformed large-caps during Q4 but lagged by a wide margin in 2023 (as measured by Russell 2000 vs 1000). Growth stocks outperformed value stocks during the quarter for large and mid-cap. Large-cap growth was the best performing style segment in 2023.
- Relative to the MSCI USA, the momentum factor produced the strongest results during the quarter, while minimum volatility was weakest. Quality was the best performing factor in 2023 relative to the MSCI USA while the other factors underperformed the broader index.
- Energy was the only sector with negative returns during Q4. For 2023, communication services, information technology and consumer discretionary were the best performing sectors, while utilities and energy were weakest.



Source: Bloomberg; as of 12/31/23



Source: Refinitiv; as of 12/31/23

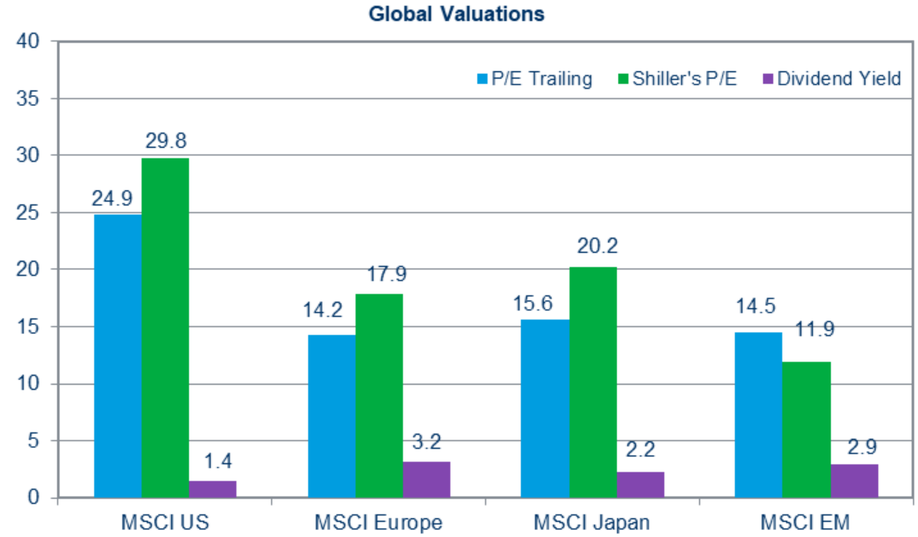


Source: MSCI; as of 12/31/23

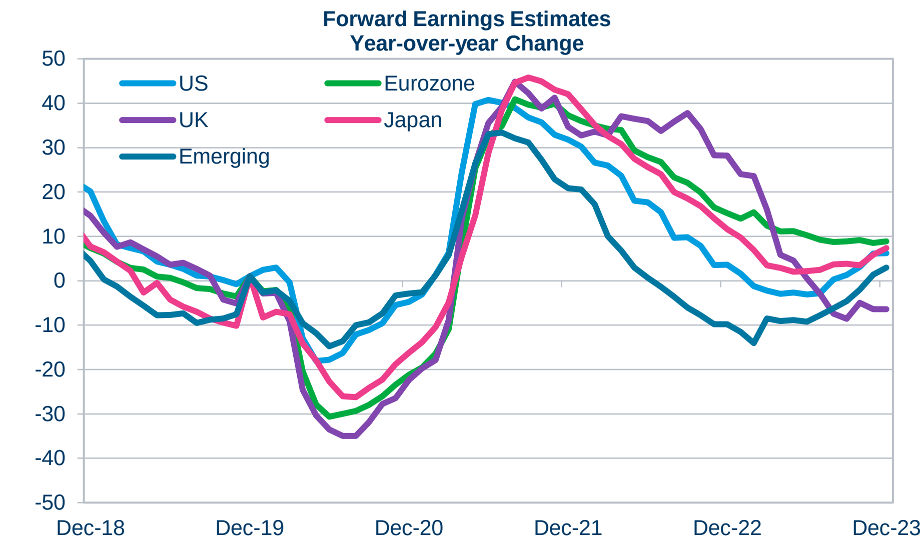
Equity fundamentals

Valuations deteriorated amid strong equity returns

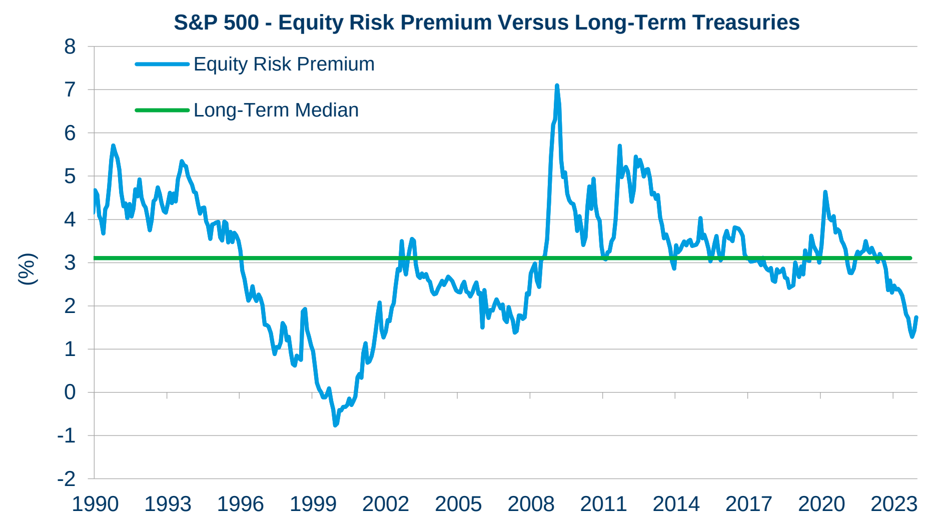
- Valuations increased during the quarter due to the general increase in equity prices. The trailing P/E ratio on the MSCI US Index rose from 22.9 to 24.9[1]. We estimate that the equity risk premium over long-term treasuries increased roughly 28 bps[2].
- International developed stocks appear more reasonably valued than US stocks due to higher US growth expectations but are likely to experience slower economic and earnings growth.
- Emerging market valuations continue to appear more attractive than developed markets. However, ongoing weakness in the Chinese economy remains a drag on emerging markets.



Source: Bloomberg, Datastream, Mercer; as of 12/31/23



Source: Refinitiv; as of 12/31/23



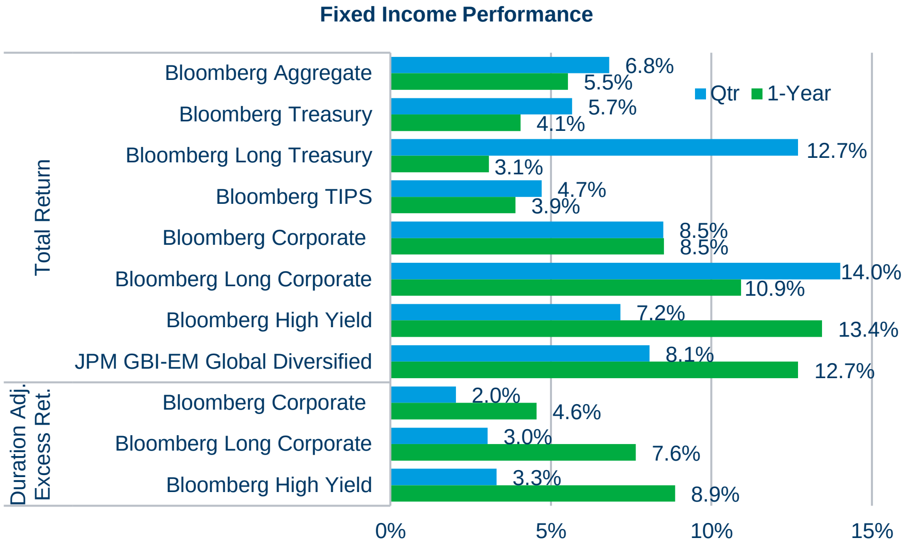
Source: Bloomberg, Datastream, Mercer, as of 12/31/23

[1] Source: Refinitiv; as of 12/31/23
[2] Source: MSCI, Refinitiv, Mercer; as of 12/31/23

Interest rates and fixed income

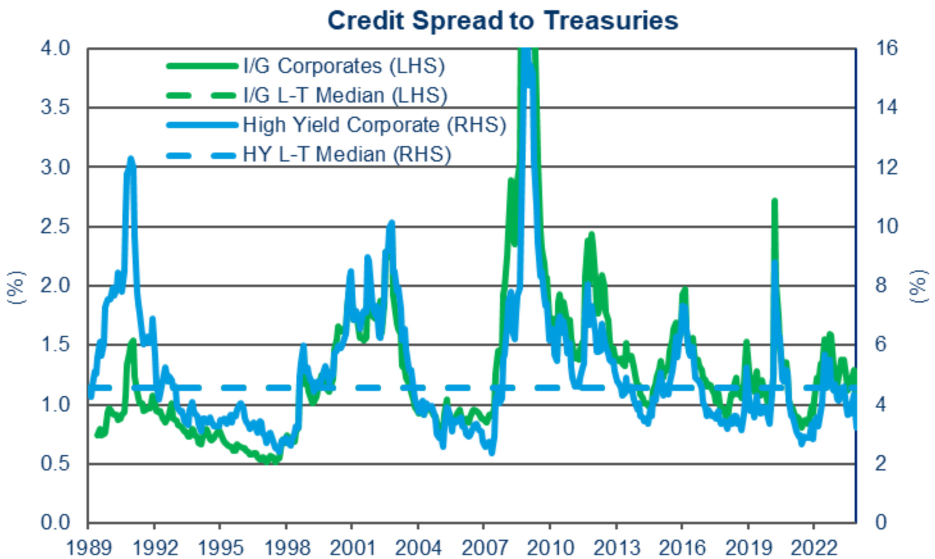
Yields and credit spreads decline sharply

- The Bloomberg US Aggregate Index returned 6.8% during the quarter. Treasuries returned 5.7% and corporates returned 8.5%. The yield curve shifted lower during the quarter. The 2-year yield fell 80 bps, while the 30-year yield fell 68 bps[1].
- Spreads on US investment-grade credit fell to 0.93%, which is now below the long-term median level[2].
- US high yield bonds returned 7.2% during the quarter, bringing the 2023 return to 13.4%. High yield spreads fell 71 bps to 3.2%. US high yield spreads are 140 bps below the long-term median level of 4.6%[2]. Local currency EMD returned 8.1% during Q4.



Source: Bloomberg, Refinitiv; as of 12/31/23

Source: Bloomberg, Federal Reserve; as of 12/31/23



Source: Bloomberg; as of 12/31/23

[1] Source: Federal Reserve, Refinitiv; as of 12/31/23
[2] Source: Bloomberg, Refinitiv Mercer; as of 12/31/23

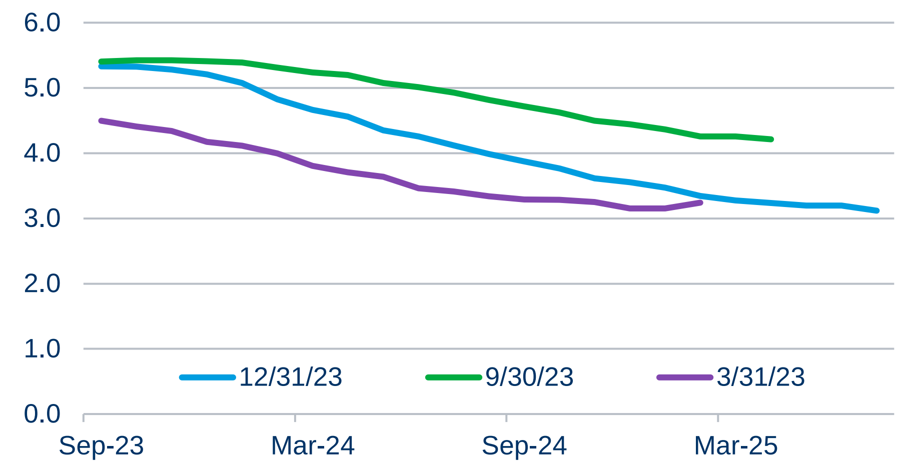
Past performance is no guarantee of future results

Monetary policy

Fed pivot fuels Santa Rally

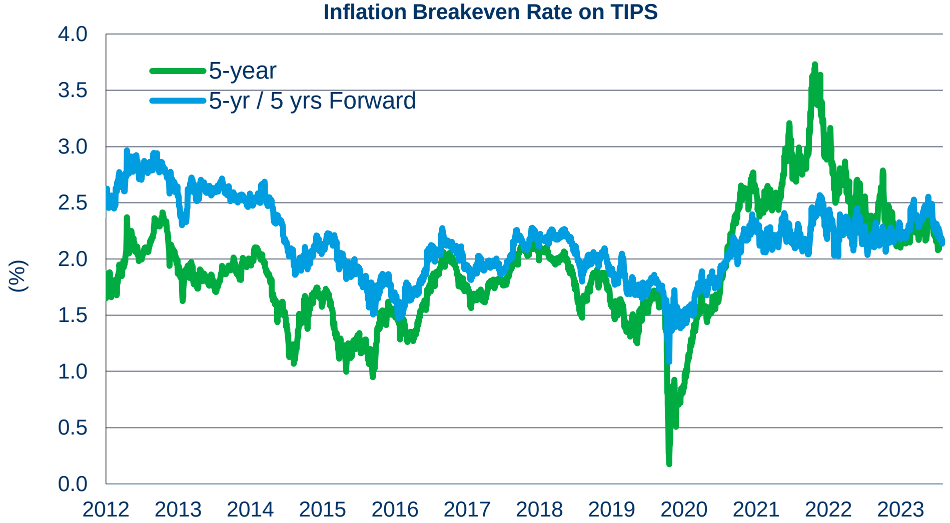
- The Federal Reserve left rates unchanged in December. The Fed's commentary following the December meeting was unexpectedly dovish, which led to a substantial decline in long term rates. The market is now optimistically pricing numerous rate cuts in 2024.
- US inflation breakeven rates saw modest decreases during the quarter, with 10-year inflation breakeven rate falling 18 bps to 2.12%, below the Fed's target of 2% PCE (roughly equivalent to 2.5% CPI)[1].
- Overseas, the ECB and BOE left rates unchanged in December. The BOJ made no changes during the quarter, while China continued to loosen monetary policy at the margin.

Market Implied US Overnight Lending Rate (Based on Fed Funds Futures)



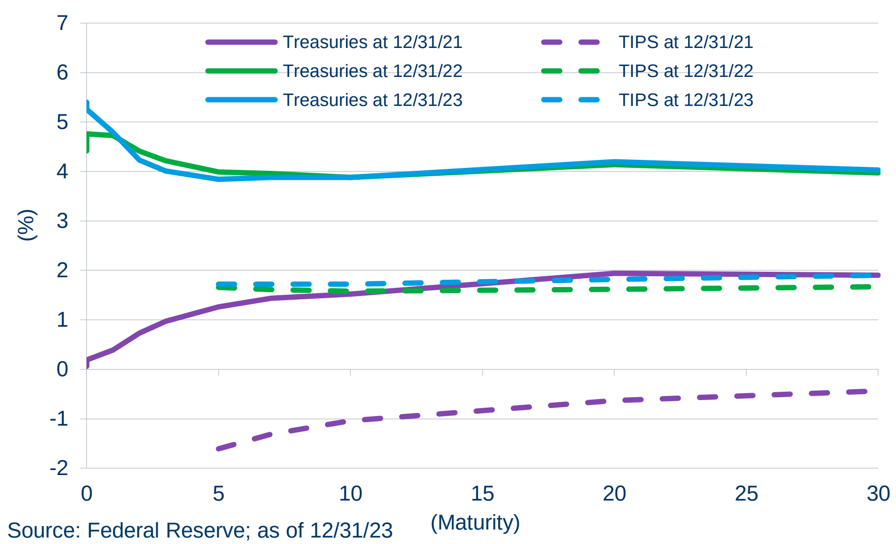
Source: Bloomberg; as of 12/31/2023

Inflation Breakeven Rate on TIPS



Source: Bloomberg, Mercer as of 12/31/23

Treasury Yield Curve



Source: Federal Reserve; as of 12/31/23

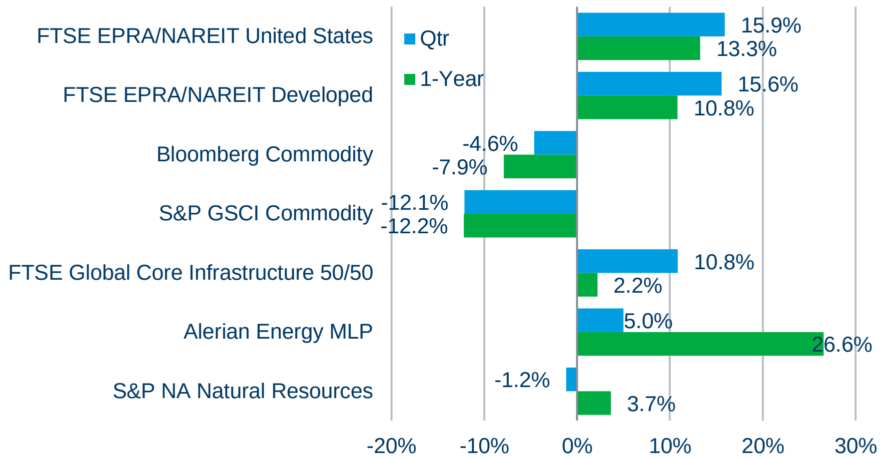
[1] Source: St. Louis Fed; as of 12/31/23

Alternative investment performance

REITs & infrastructure outperform broader equities, hedge funds underperform, negative commodity returns

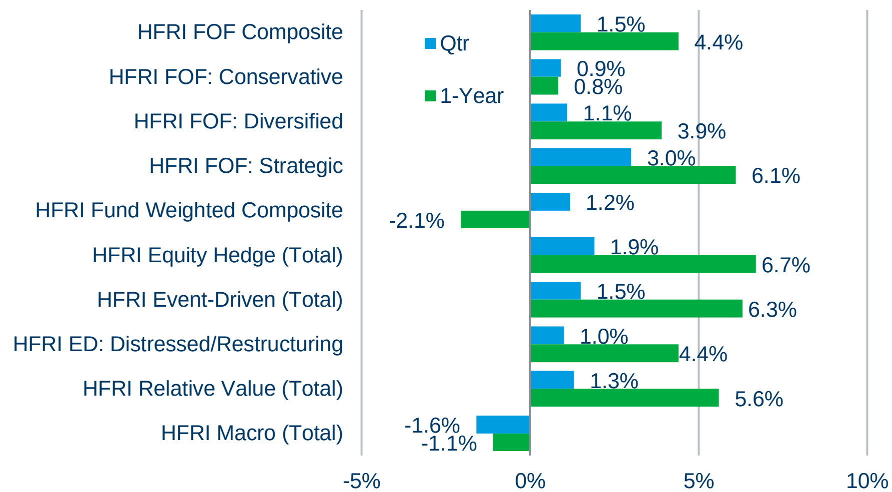
- Global developed REITs returned 15.6% during Q4, outperforming broader equity markets. Core infrastructure stocks returned 10.8% during the quarter.
- Commodities generally decreased during the quarter along with natural resources while MLPs held up. The price of WTI crude oil fell by 21% and ended the quarter at around $72.
- The HFRI FOF Composite Index returned 1.5% in Q4, leaving it with a 4.4% gain year-to-date[1].
- Global private equity outperformed global developed stocks over the most recent longer-term trailing periods[2].

Real Asset Performance



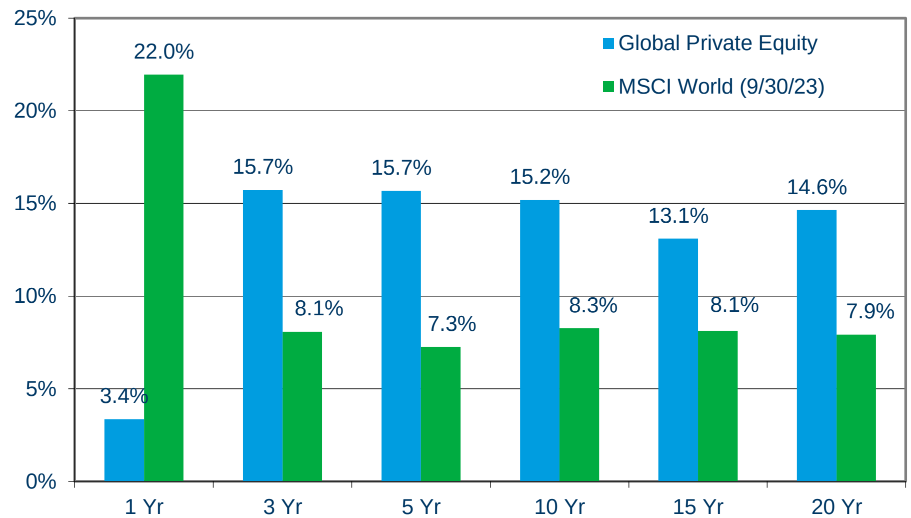
Source: Bloomberg, Refinitiv; as of 12/31/23

Hedge Fund Performance



Source: Hedge Fund Research; as of 12/31/23

Global Private Equity vs. Global Public Equities



Source: Burgiss, Bloomberg; as of 9/30/23

[1] Source: Hedge Fund Research; as of 12/31/23
[2] Source: Burgiss, Bloomberg; as of 9/30/23
Past performance is no guarantee of future results

Valuations and yields

Ending December 31, 2023

Valuations

MSCI USA	12/31/2023	9/30/2023	6/30/2023	3/31/2023
Index Level	21453.4	19163.7	19770.6	18184.1
P/E Ratio (Trailing)	24.9	22.9	23.6	21.9
CAPE Ratio	29.8	27.3	28.8	27.1
Dividend Yield	1.4	1.6	1.5	1.6
P/B	4.5	4.1	4.3	4.0
P/CF	16.4	15.3	15.4	14.4
MSCI EAFE	**12/31/2023**	**9/30/2023**	**6/30/2023**	**3/31/2023**
Index Level	7784.0	7049.3	7351.5	7140.7
P/E Ratio (Trailing)	14.7	14.4	15.4	15.1
CAPE Ratio	15.6	15.4	15.1	15.3
Dividend Yield	3.0	3.2	3.1	3.1
P/B	1.8	1.7	1.8	1.7
P/CF	9.5	9.3	8.7	8.2
MSCI EM	**12/31/2023**	**9/30/2023**	**6/30/2023**	**3/31/2023**
Index Level	533.8	494.9	509.8	505.3
P/E Ratio (Trailing)	14.5	14.1	13.6	12.4
CAPE Ratio	11.9	10.9	11.3	11.4
Dividend Yield	2.9	3.1	3.3	3.3
P/B	1.6	1.6	1.6	1.6
P/CF	8.3	8.3	8.3	7.5

Source: Bloomberg, Refinitiv

Past performance is no guarantee of future results

Yields

Global Bonds	12/31/2023	9/30/2023	6/30/2023	3/31/2023
Germany – 10Y	2.02	2.84	2.39	2.29
France – 10Y	2.56	3.40	2.93	2.79
UK – 10Y	3.54	4.44	4.39	3.49
Switzerland – 10Y	0.70	1.10	0.96	1.25
Italy – 10Y	3.70	4.78	4.07	4.10
Spain – 10Y	2.99	3.93	3.39	3.30
Japan – 10Y	0.61	0.77	0.40	0.35
Euro Corporate	3.56	4.52	4.44	4.22
Euro High Yield	7.35	8.43	8.29	8.18
EMD ($)	7.43	9.03	8.36	8.50
EMD (LCL)	6.19	6.76	6.32	6.59
US Bonds	**12/31/2023**	**9/30/2023**	**6/30/2023**	**3/31/2023**
3-Month T-Bill	5.40	5.55	5.43	4.85
10Y Treasury	3.88	4.59	3.81	3.48
30Y Treasury	4.03	4.73	3.85	3.67
10Y TIPS	1.72	2.24	1.61	1.16
30Y TIPS	1.90	2.33	1.62	1.44
US Aggregate	4.53	5.39	4.81	4.40
US Treasury	4.08	4.85	4.37	3.83
US Corporate	5.06	6.04	5.48	5.17
US Corporate High Yield	7.59	8.88	8.50	8.52

Source: Bloomberg, Refinitiv

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