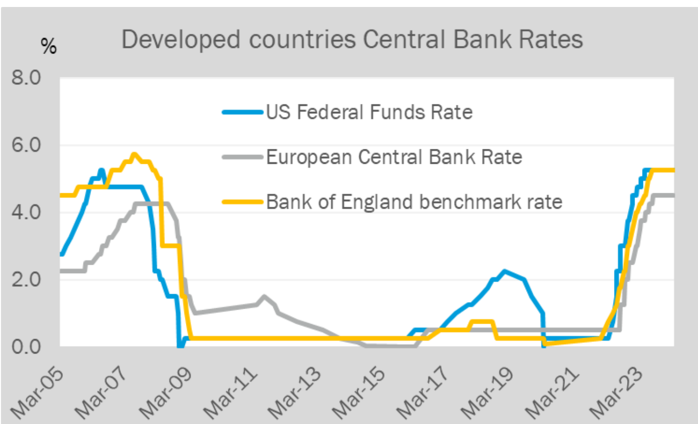
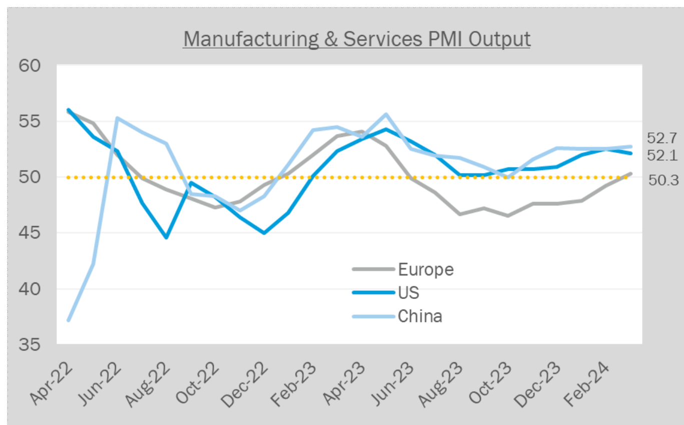
Overall

The price of risk assets continued to grind higher during the first quarter amidst positive economic data. Strong GDP growth and moderating inflation have created a "goldilocks" set of conditions that have boosted consumer confidence and spending on goods and services. Capital markets have continued their upward trend since November 2023. It seems that what has mattered more is not the timing and magnitude of Central bank rate cuts but simply the Federal Reserve's affirmation that no further hiking was needed.

In January, the U.S. Commerce Department's Bureau of Economic Analysis reported that real GDP increased 3.1% in 2023 compared to 0.7% in 2022. At the same time, inflation has moderated to 2.5% in the most recent period. GDP growth in Europe was lower at under 1%, while inflation has been more "sticky" at over 3%. Nonetheless, manufacturing and servicing output has improved since a year ago and inched up over 50 across most economic regions, indicating expansion in economic activity, even amidst higher borrowing rates. Wage growth has been modest, possibly because corporations are finding ways to deploy technology and artificial intelligence tools to improve productivity and corporate margins.



Source: U.S. Federal Reserve, ECB



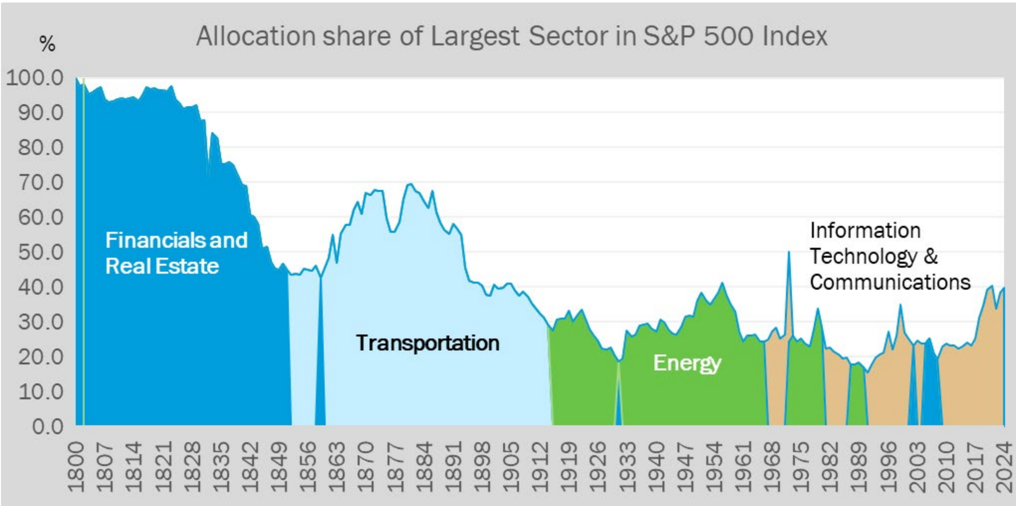
Source: www.tradingeconomics.com

We cannot predict the probability or timing of the next economic slowdown, nor can we opine on the need to reduce rates from current levels. At this time, though, the broadening of positive fundamentals supports higher valuations amidst markets anticipating further easing monetary conditions from here. Analysts forecast S&P 500 earnings to grow a healthy 11% in 2024 and possibly another 13% in 2025. Barring some significant circumstances, the European central banks have managed their short-term borrowing rates in lockstep with the U.S. Federal Funds Rate over the years and will likely cut in line with the Federal Reserve.

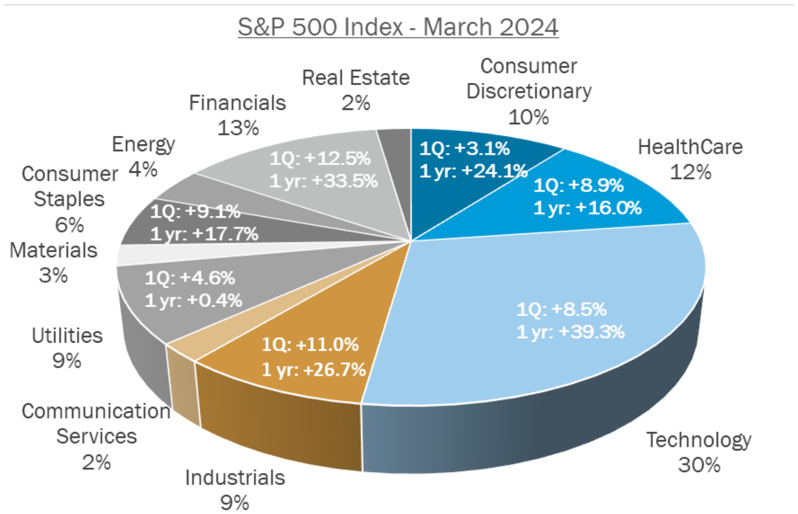
Equities

U.S. equity markets were up 10% for the first quarter, and the index's performance was fairly broad-based. Every economic sector was up for the quarter, with the exception of Real Estate, which was down marginally (-0.6%).

In the U.S., the Technology sector, which makes up 30% of the S&P 500 index, was up 8.5%, lagging the broad index. Financials (+12.5%), Energy (+13.6%), and Industrials (+11%) outperformed other sectors. The larger holdings that have received so much attention as the "magnificent seven," given their outsized contribution to index performance in the prior 12 months, actually saw more dispersion across their performance, with NVIDIA up over 83% in the first quarter while TESLA was down 32%.



Source: Goldman Sachs



Source: S&P Dow Jones

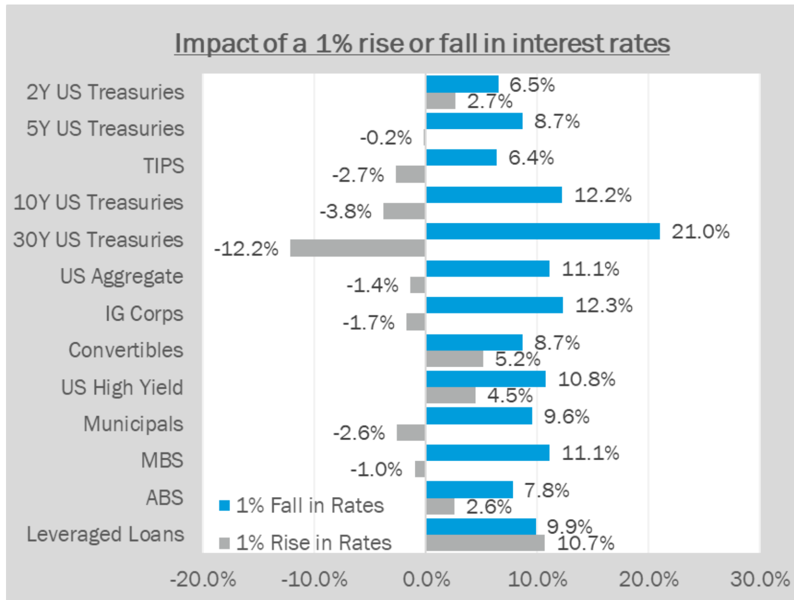
No one month, quarter, or year performance is indicative of a long-term trend. Over half (52%) of the S&P 500 index is allocated to "growth" sectors such as Technology, Healthcare, and Consumer Discretionary. In particular, the technology sector has outperformed most other sectors over the last 15 years and has grown to be the largest sector in the index. However, we have had similar dominance of other sectors in the index's history, and regardless of how compelling the importance of the sector's prominence at the time, circumstances do evolve over time for the sector. The Energy sector, for example, was over 30% of the index at one time. Today, it is 4% of the index. Putting aside the outsized idiosyncratic risks of a small group of businesses, we are cautious not to be too complacent with the momentum of any one sector's performance, either in the negative or positive.

We take a passive approach for over 50% of the U.S. equities to maintain a market-level exposure to the broad sectors but also have exposure to active managers across the large and small cap to take advantage of inefficiencies in individual securities to add incremental returns.

In the area of non-U.S. equities, we see the opportunity set as much broader than what is represented by the benchmarks and feel that there is potential for active managers to add value net of fees relative to the market benchmarks. For the quarter, the MSCI ex-USWI ex U.S. index was up 10% when measured in local currency but up 6% in U.S. Dollar terms, given the strengthening of the U.S. Dollar.

Fixed Income

Positive news on economic growth has caused upward pressure on yields and a downward pressure on bond prices over the last few quarters. At the same time, spreads have continued to compress amidst growing demand for credit across the quality spectrum. The Barclays U.S. Aggregate bond was down -0.78% for the quarter. Credit issues, in particular, high yield bonds, continued to make positive contribution. The U.S. High Yield bond index was up 1.5% for the quarter and 11.5% for the 1 year ending March 2024.



Source: JP Morgan

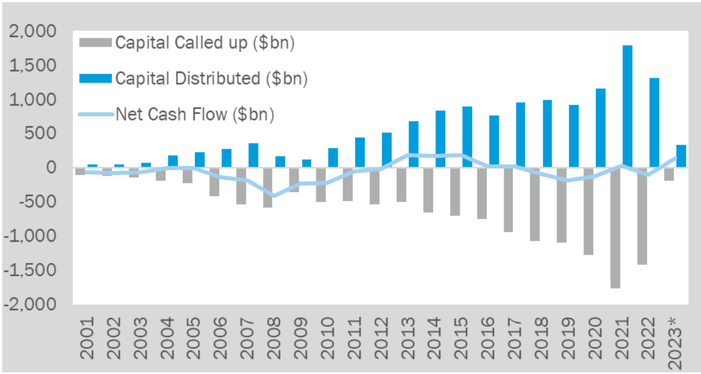
We have been cautious of high-yield credit, particularly as a prolonged period of high rates has made certain weak businesses vulnerable to refinancing risk once their current low-rate debt matures. Certain retail and transportation sectors have seen more business stress and are potential candidates for default.

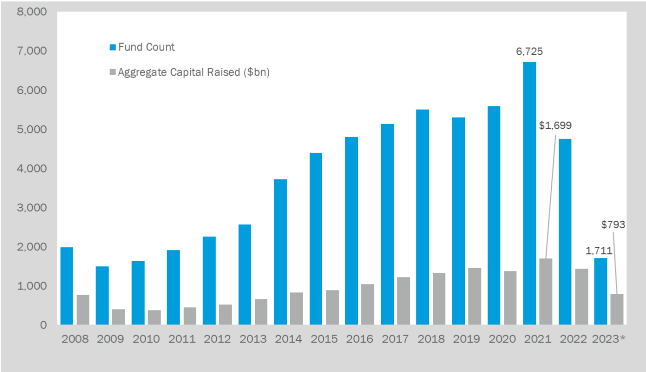
We have tilted the fixed income segment towards U.S. Core bonds, partly to reposition the fixed income as the anchor of the portfolio against equity risk but also in recognition that despite the short-term volatility in fixed income, each sector is positioned for more upside benefit when interest rates do move lower. Given the current absolute level of yields and the duration of core fixed income, which is around six years, we see more upside potential than downside from current levels. As the graph shows, the potential loss from a 1% rate increase is less than the potential gain from a similar decline in rates.

Private Equity

The pace of private equity activity has slowed for the last year, which has come through in the data we receive from various databases. Public markets have a ripple effect on private markets, with a lag of a few quarters. The decline in equity markets in 2022 caused transactions in the private markets to stall as buyers also looked for lower valuations. As many private and public companies had refinanced before 2022 at low rates, they could push out any impending transaction in search of improved pricing. Private equity funds holding a lot of "dry powder" in their existing active funds could deploy that capital to work opportunistically.

The low levels of activity and cash flow can be seen in the overall decline in fund distributions, capital calls, and fundraising.

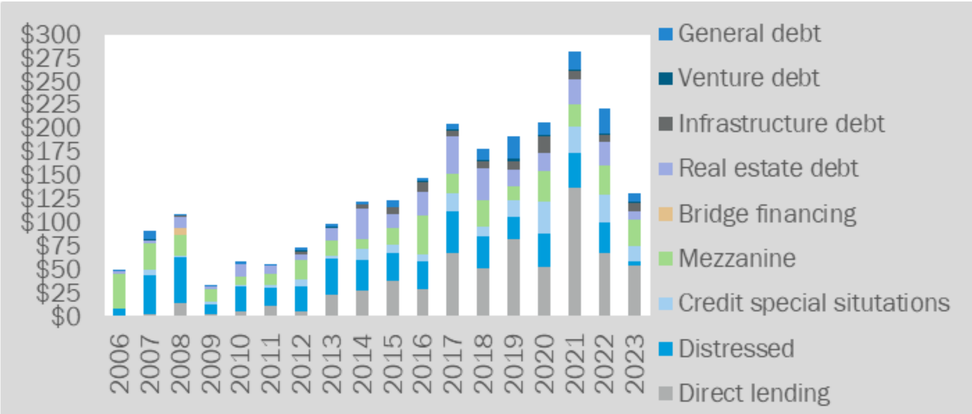




Source: Pitchbook

The slower pace of activity and fund deployment has impacted the pacing of commitments to private funds for clients ramping their exposure to private equity towards their targets. At the same time, the pullback has provided a healthy reassessment of the valuation and activity in the marketplace.

This slowdown in activity in buyout and other areas or private equity has also had an impact on private credit funds. Much of the loan activity done by direct loan funds are to companies sponsored by private equity firms. With rates up substantially compared to two years ago, lending activity has fallen across all the categories of private debt.



Source: Pitchbook

Any economic or business environment stress will likely affect below investment grade bonds sooner than other areas. The lack of transactions is one sign of less liquidity, but so long as there is no forced selling, prices are not forced to readjust. A prolonged period of high-interest rates can eventually impact companies that are faced with the need to refinance their debt and may not have the financial ability to pay higher rates. Even a slowdown in business activity that affects a company's revenues and financial health, such as its ability to cover interest rate payments, can cause the company to fail certain bond covenants, which may require the private fund manager that holds the loan to write the value of the loan down.

We are cautious of these dynamics, which can quickly take a turn and create a domino effect for both borrowers and lenders in the private credit space. Some of the hesitation shown by private fund managers may also be in anticipation of the potential for stress or distress to occur in certain more vulnerable segments of the economy, which can create investment opportunities at more attractive prices.

And what about Inflation?

Since the first Quantitative Easing program in 2009, after the Global Financial Crisis, investors have been somewhat fearful of the potential for high inflation and the threat it poses to financial assets. Like many investors, we were cautious and carved out a portion of our investment portfolio to hedge against bouts of unexpected inflation.

After the decade of general deflationary trends in the 2010s and a pandemic-induced supply shock in the 2020-2022 period with a positive inflation spike, we have been humbled by how difficult it has been to anticipate and effectively hedge inflationary pressures in an investment portfolio. Each form of hard asset, be it oil, real estate, master structure limited partnerships (MLPs), hard and soft materials, or infrastructure, has been equally affected by the idiosyncratic challenges faced by their respective industries and markets.

Our investment in a liquid diversified real asset bucket served its purpose in contributing to the overall portfolio return over the years, but it made us realize the difficulty of directly fighting inflation, given its complex dynamics. The portfolio's exposure to equities provides a natural hedge to inflation, just as higher interest rates, resulting from a prevailing rate of higher inflation, provide an income return that supports fixed-income investments.

We continue to look for interesting opportunities in hard assets that would allow us to underwrite an investment that can add incremental value to a portfolio of financial assets. We will add them where they provide a good fit to a client's broad investment objectives.

Overall

We find ourselves in a state of delicate balance at this time; where we are cautious about the gains we have made to date, given that valuations are above average and spreads are somewhat tight. Our clients have long-term objectives, so it is important to stay invested. At the same time, we are always vigilant of market dynamics and portfolio liquidity so that when an opportunity does present itself that can be added incrementally on the margin, we can take advantage of it promptly.

Above all, we are always attentive to our client's circumstances and needs and remain grateful for your trust in us.

Sincerely,

Poorvi, R. Parekh, CFA
Director of Outsourced Investments

Ms. Parekh is a member of the Board of Directors, a shareholder of Canterbury, and directs the Canterbury Outsourced CIO platform, which caters to institutions and private clients seeking to outsource the day-to-day management of their portfolios. In this role, Ms. Parekh is the chair of the Canterbury Outsourced CIO Committee and a member of each of the firm's five Manager Research Committees. Joining Canterbury in 1996 as the manager of analytics, she directed the firm's account analysts and client services group, securing many of the asset allocation modeling and research software tools we use today. In 2001, she became the director of manager research — overseeing all manager, fund, and product research; maintaining Canterbury's proprietary research database; and chairing the Investment Manager Research Committee. Ms. Parekh graduated from the University of Hong Kong with a Bachelor of Arts in economics and completed her Master of Business Administration at Shenandoah University.

About Canterbury

Canterbury Consulting is an independent investment advisory firm based in Newport Beach, CA. Canterbury provides consulting services to tax-exempt organizations, including community foundations, educational endowments, religious organizations, arts and cultural foundations, and health care organizations, as well as family offices. Founded in 1988, the firm designs and manages custom investment programs aligned with each client's goals. Canterbury acts as the investment office for its diverse clients and provides objective investment advice, asset allocation, manager selection, risk management, implementation, and performance measurement. Named one of the Best Places to Work in Money Management by Pensions & Investments in 2023, 2022, 2021, and 2020 as well as one of the Best Places to Work in Orange County by the Orange County Business Journal in 2023, 2022, 2021, 2020, and 2015. Canterbury Consulting strives to deliver performance and service that exceeds the needs and expectations of its clients. Learn more about Canterbury at www.canterburyconsulting.com.