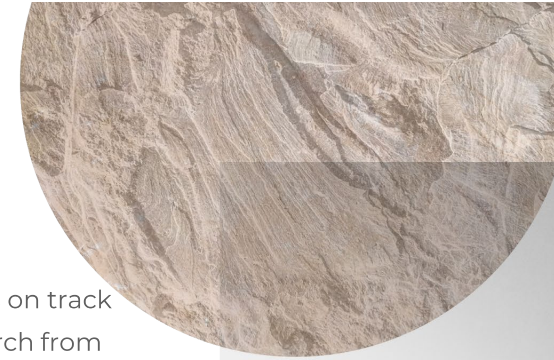
SAGE MOUNTAIN

Sage Mountain Q3 2023 Market Update

ALWAYS LOOKING AHEAD

Seasonality held true, as the broad markets across stocks and bonds sold off during Q3



In Q3 investors became increasingly confident in a "soft landing" or even a "no landing" scenario for the U.S. economy. Both a healthy job market and surprising resilience in consumer spending resulted in shifting expectations. On the other hand, the rate cuts many hoped for penciled in for 2024 are much less likely, even though the underlying inflation trend is moderating quickly.

These "higher for longer" rate expectations, combined with rising oil prices during the quarter, played into a selloff in the best performing technology groups in Q3. The "Magnificent Seven" stocks that have been powering the market in 2023 pulled back. Value stocks performed relatively better, particularly dividend payers. These stocks most likely performed better as something of a risk-off trade. Energy stocks were the best performers thanks to a rise in oil prices engineered by Saudi production cuts.

In the bond market, yields rose to their highest levels since 2007, and U.S. Treasury bonds suffered. The concern was duration (interest rate sensitivity), not credit, as floating rate loans and high yield bonds outperformed.

The broad investment grade bond market is on track for its third straight year of losses, and research from Bank of America shows that Treasury bonds are in the midst of the greatest bear market of all time.

Labor market gains had been steadily easing throughout the year before a surprise uptick in new payrolls and job openings in the most recent monthly releases. Time will tell if those were just monthly noise or the start of an upward trend. Despite the strong job gains, wage inflation continued to trend down towards levels that are consistent with the Fed's inflation target.

Looking ahead, the near-term outlook for investor portfolios appears to ride on how long interest rates stay high, as well as geopolitical worries and the progress of China's recovery. The U.S. economy is positioned to continue to grow at a moderate pace. While Bankrate's survey of economists shows that estimated odds of a recession in the next 12 months have fallen from 65% to 46% over the past year—and Goldman Sachs places the odds much lower at 15% —with expected real GDP growth in the 1-2% range the economy may be more sensitive to shocks as it continues to digest the impact of higher rates.

Market Snapshot

	QTD	YTD	2022	5 Year (Annualized)	10 Year (Annualized)
Blended Portfolio					
40% US Aggregate / 60% S&P 500	-3.3%	7.4%	-16.1%	6.4%	8.7%
Fixed Income					
Bloomberg US Aggregate	-3.2%	-1.2%	-13.0%	0.1%	1.1%
Bloomberg Municipal 1-10 Years Blend	-2.2%	-0.8%	-4.8%	1.2%	1.7%
Bloomberg Municipal Bond High Yield	-4.2%	0.0%	-13.1%	1.7%	4.0%
LSTA US Leveraged Loan Index	3.4%	10.2%	-0.8%	4.5%	4.3%
Bloomberg US Corporate High Yield	0.5%	5.9%	-11.2%	3.0%	4.2%
Equities					
S&P 500	-3.3%	13.1%	-18.1%	9.9%	11.9%
Russell 1000 Growth	-3.1%	25.0%	-29.1%	12.4%	14.5%
Russell 1000 Value	-3.2%	1.8%	-7.5%	6.2%	8.4%
Russell 2000	-5.1%	2.5%	-20.4%	2.4%	6.6%
NASDAQ 100	-2.9%	35.4%	-32.4%	15.1%	17.6%
MSCI EAFE (USD)	-4.1%	7.1%	-14.5%	3.2%	3.8%
MSCI EAFE (Local Currency)	-1.3%	10.7%	-7.0%	5.6%	6.7%
MSCI Emerging Markets	-2.9%	1.8%	-20.1%	0.6%	2.1%
MSCI All Country World	-3.3%	10.5%	-18.0%	7.0%	8.1%
Other Assets					
Cambridge Associates US Private Equity[1]	0.0%	2.5%	-3.4%	13.5%	13.4%
NCREIF NPI Returns - National[2]	0.0%	-3.8%	9.4%	5.6%	7.5%
S&P GSCI Gold	-3.3%	2.2%	-0.1%	9.3%	3.5%
Crude Oil - WTI Spot	28.5%	13.2%	6.7%	4.4%	-1.2%
S&P Goldman Sachs Commodity Index	16.0%	7.2%	26.0%	5.6%	-2.5%
US Dollar Index	3.2%	2.6%	7.9%	2.2%	2.8%
US CPI - Urban Consumers	0.6%	3.4%	6.8%	4.0%	2.7%
US CPI - All Items Less Food & Energy	0.4%	2.7%	5.3%	3.7%	2.8%
VIX Volatility Index	28.9%	-19.2%	25.8%	7.6%	0.5%

Source: Addepar; data as of 9/30/2023

[1] Returns as of 3/31/2023

[2] Returns as of 6/30/2023

Investment grade fixed income was down again in Q3 as rates rose, while high yield outperformed as credit spreads remained tight.

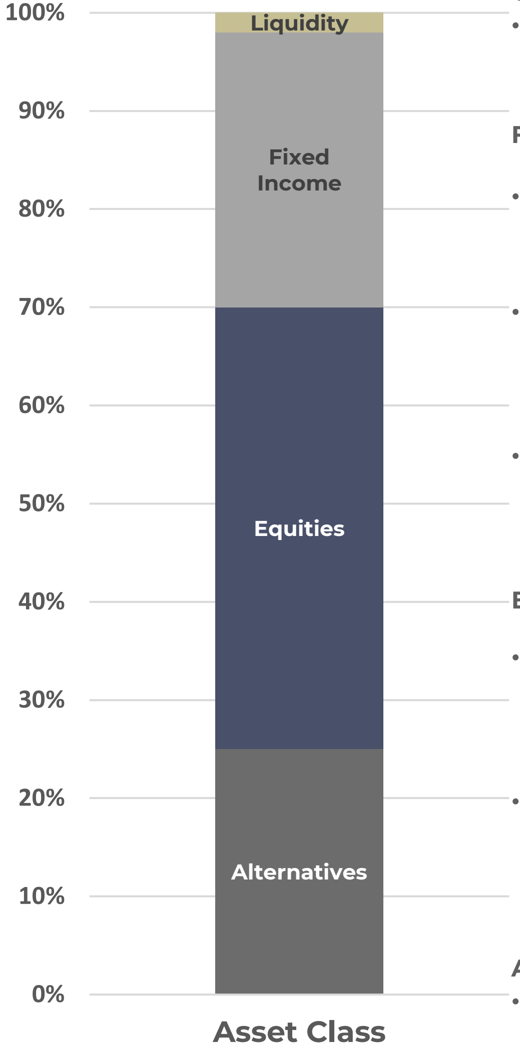
Equities reversed course in the third quarter as broad indices fell globally. The S&P 500 fell 3.3%, while international stocks shed 4.1%.

After falling for the first half of the year, oil prices rebounded 28.5% in Q3. The US Dollar bounced back, rising 3.2% in the third quarter and bringing its year-to-date return positive.

Volatility rebounded sharply in Q3 as volatility spiked leading to a 28.5% increase in the VIX index, albeit from low levels.

A 60% equity / 40% bond portfolio fell in Q3, posting a -3.3% return as both stock and bond markets fell.

Illustrative current positioning and asset class views



Cash

- Unlike recent years, holding cash remains an attractive option. With yields on money market funds near 5.00% or higher, we strategically utilize those high yielding cash instruments to earn income while ensuring we meet clients' liquidity needs.

Fixed Income

- **Government Bonds:** In the US, the Fed funds markets seem well priced for "higher for longer." However, without a stabilization in medium term inflation expectations, and with political risk looming given the leadership battle in the House that could be bearish for Treasuries, we remain reluctant to add duration now.

- **US Investment Grade:** The strengthening economy has been supportive of credit markets, both high yield and investment grade. Spreads are tight and thus may be fully valued for now. We are tactically allocated to AAA CLOs as they offer higher yields than investment grade corporate bonds and comparable yields to municipal bonds net of taxes.

- **US High Yield & Leveraged Loans:** Most analysts expect an erosion in the economy and corporate fundamentals to slightly push out spreads of higher risk credit investments. However, the economy has experienced less distress and more resiliency than expected. A continuation of that trend would likely result in tighter spreads and higher prices.

Equities

- **US*:*** Interest rates are higher and QT headwinds (central banks allowing their bond holdings to shrink) are now stronger with tightening also in Europe and Japan. Geopolitical factors have further deteriorated as well. However, earnings revisions seem to have bottomed and are moving higher, and the trend in core PCE inflation is clearly down. This brings us to a neutral stance on stocks.

- **International*:*** While valuations for international stocks remain lower than the U.S., so do their growth prospects. Europe and the U.K. remain weak, with discouraging economic data. In China, the recovery is shaping up to be weaker than expected. For various reasons, it will be more difficult for China to spur growth through infrastructure spending which is their authorities' preferred tool. We don't see a reason to suggest getting more bullish on international stocks at this point.

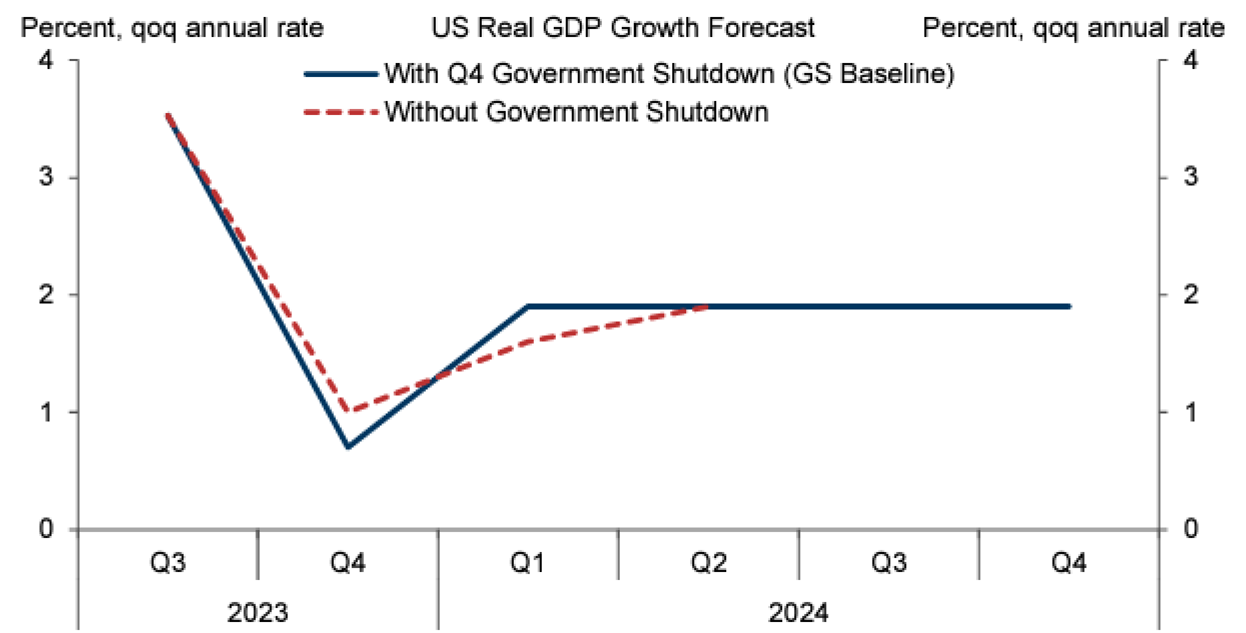
Alternatives

- Alternative lenders may benefit from stress at regional banks. We expect more borrowers to turn to private credit as it becomes relatively better priced and given the certainty of execution and long-term partnership. We are leaning into private real estate debt which may benefit from a similar dynamic, while becoming much more cautious on new real estate equity commitments which will need to overcome borrowing costs that have increased more than cap rates. The slowdown in venture capital fundraising and deals may make this upcoming cycle a good time to participate in the sector. We also believe secondaries funds across strategies are well positioned to capitalize on the current environment.

The U.S. economy should slow in Q4, but underlying strength will likely remain.

We expect US GDP growth to slow in Q4. There are a handful of reasons for this. First, the end of the student loan moratorium will take some spending out of the economy. Second, labor unrest, particularly the UAW strike, should slow production and spending. Third, the recent increase in oil prices, possibly exacerbated by the horrific events in Israel, will also serve as a drag. Lastly, the apparent slowdown in consumer spending seems likely to worsen. Goldman Sachs estimates that real GDP growth will slow from 3.5% in Q3 to 0.7% in Q4.

Exhibit 1: A Temporary Growth Pothole in Q4, Even if a Shutdown Is Ultimately Averted



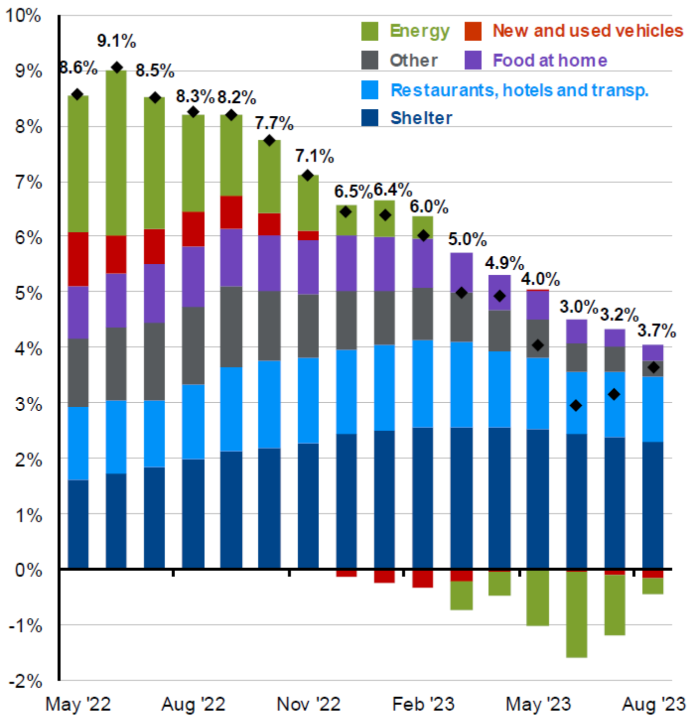
Source: Goldman Sachs Global Investment Research

Inflation continues to fall; will it stay manageable?

Following two years of raging inflation, we seem to have a steady downtrend in CPI inflation. After peaking at 9.1% in June of 2022, **CPI inflation has fallen to 3.7%** in August of 2023. Additionaly, core inflation has continued to decline after peaking close to a year ago. The headline disinflation has been driven by reversals in energy costs since 2022 along with other major causes such as vehicle sales and shelter costs. While inflation is above the 2% Fed target, the sustained decrease is an encouraging, but cautious, sign.

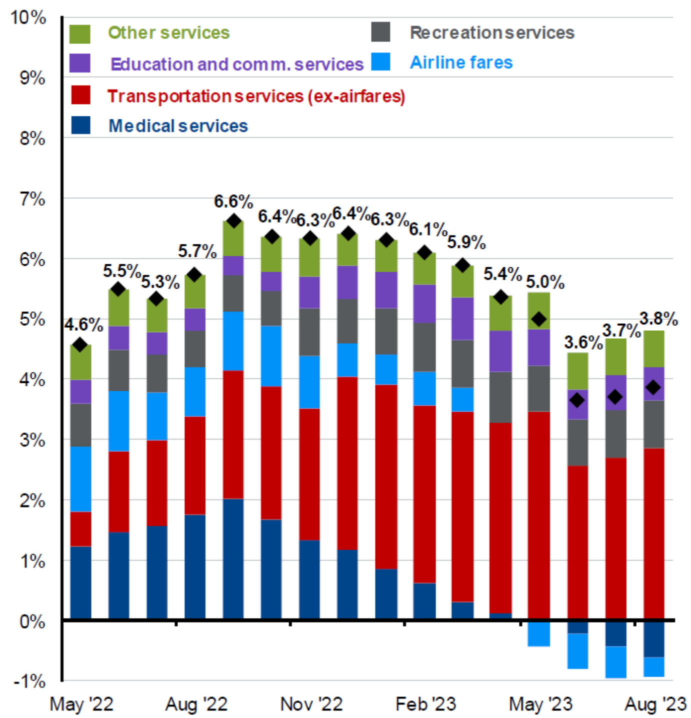
Contributors to headline CPI inflation

Contribution to y/y % change in CPI, non-seasonally adjusted



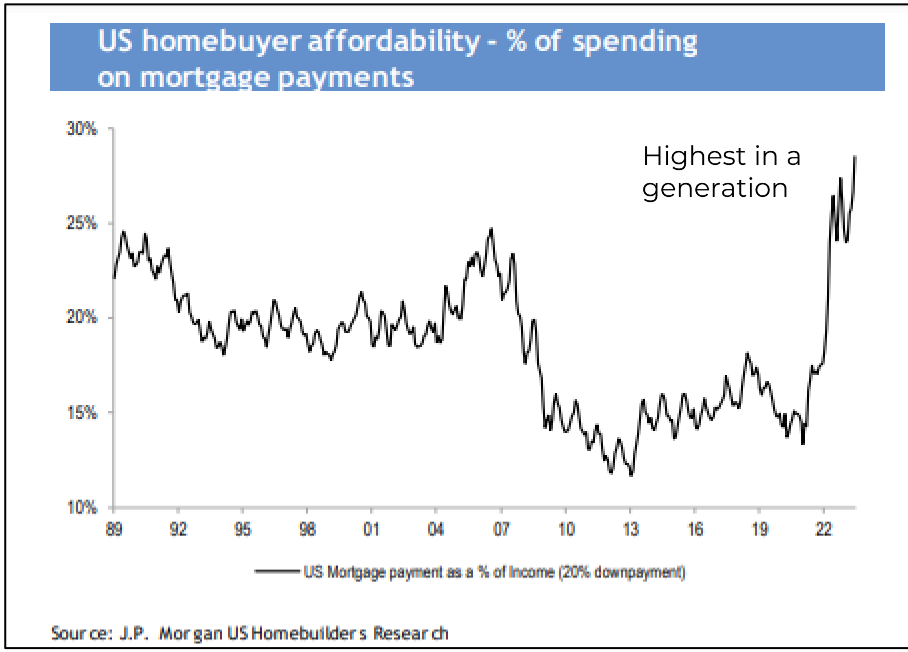
Contributors to core services ex-shelter CPI inflation*

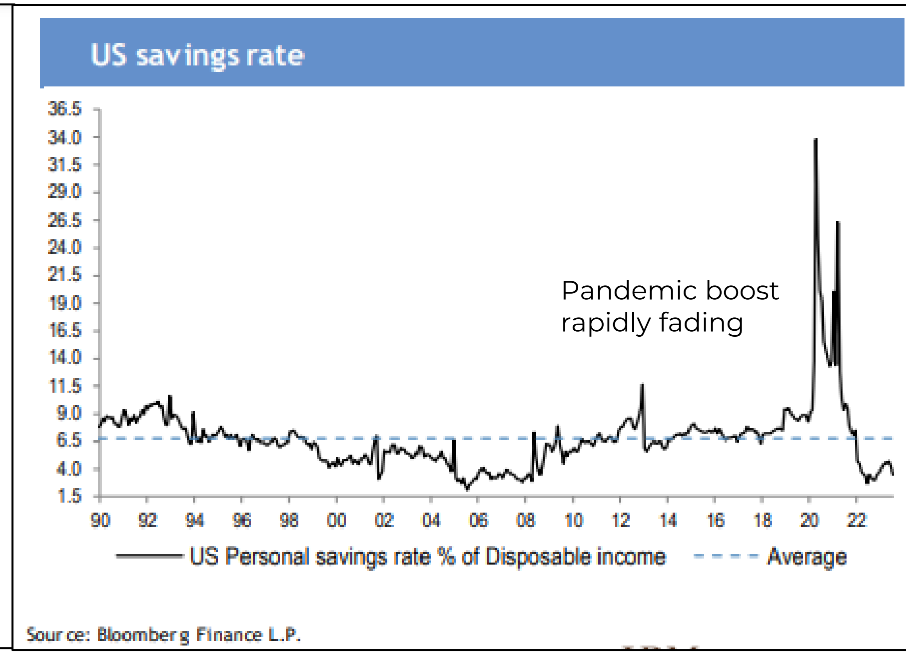
Contribution to y/y % change in custom CPI index, non-seasonally adj.



Source: BLS, FactSet, J.P. Morgan Asset Management

Depleted savings and housing unaffordability will likely crimp consumer spending





The charts above highlight two possible reasons for a slowing in GDP in the near future. For equities, this could be good or neutral because of less pressure on interest rates. The chart on the left shows that housing affordability is low (costs are high), which should slow demand. The chart on the right shows the savings rate, which was massively boosted by COVID stimulus payments. It has now returned to more normal levels.

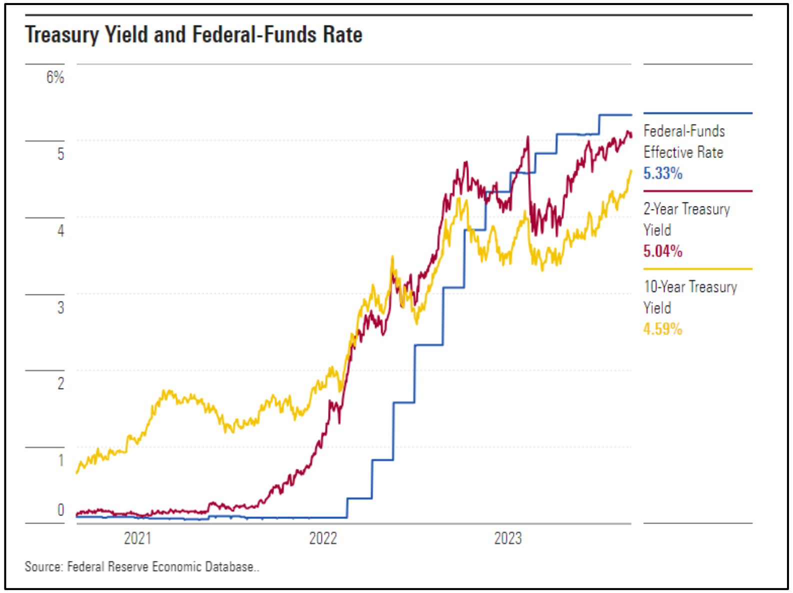
Financial markets are focused on interest rates, now more than ever

During the quarter, the bond market largely came around to the Fed's point of view that it would be taking a tough line against inflation via hiking rates and holding them high.

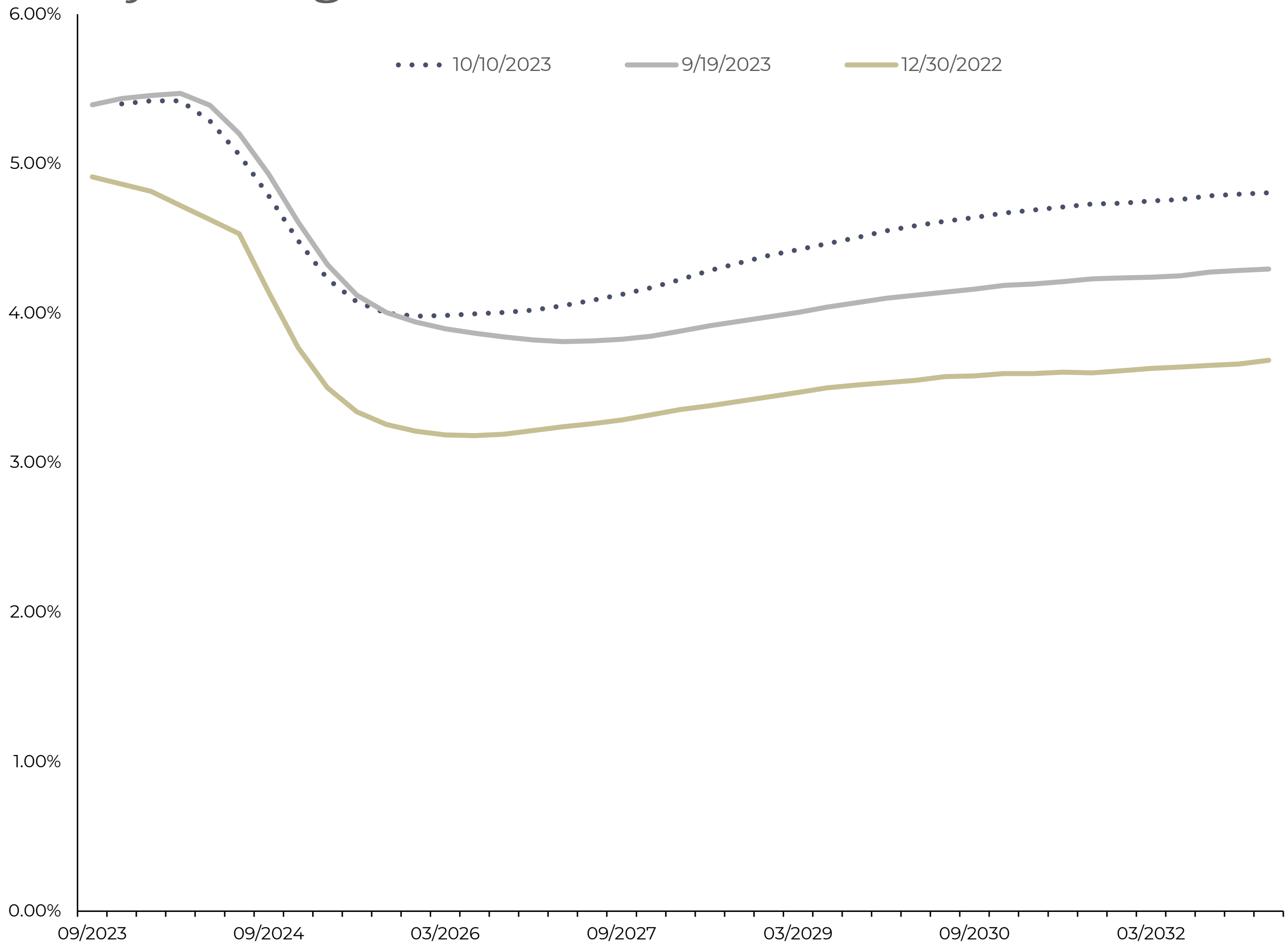
The Fed raised its benchmark Federal Funds rate an additional 0.25% in July to a target range of 5.25%-5.50% then held rates steady at their September meeting. The Fed has raised rates by 1% so far this year, a much slower pace relative to the 4.25% increase in 2022.

Signs of progress on inflation, the move up in longer term rates potentially doing some of the Fed's work for them, and recent statements from several Fed members have largely convinced the market that Fed is done raising rates for this cycle. Current odds indicate less than a 10% chance of a hike in November and less than 30% in December.

We expect that the debate will now shift to the timing and pace of rate cuts which are now expected to begin in 2H 2024. However, a significant growth scare or "financial accident" in the markets could accelerate the Fed's response.



Expected short term interest rates have stabilized and are now expected to remain "higher for longer"



Source: Bloomberg; data as of 10/10/2023

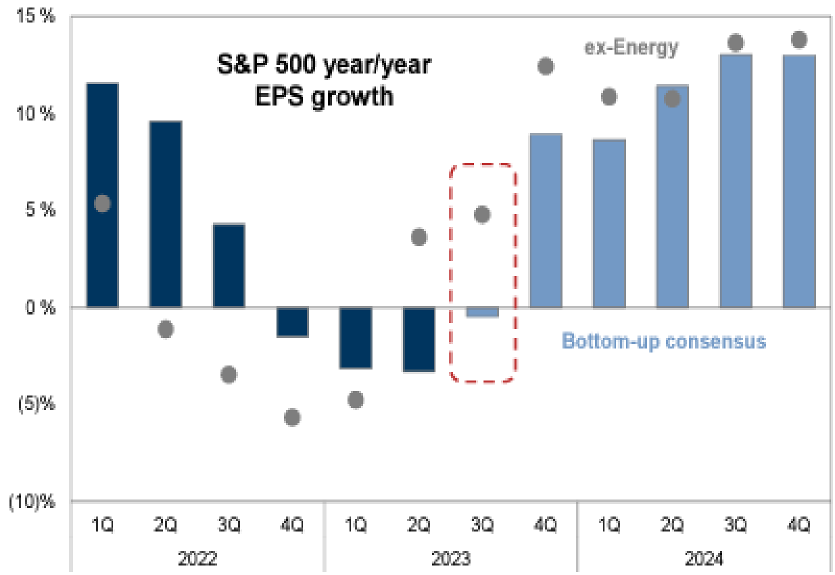
The chart shows market-implied yields for 3-month SOFR futures, a proxy for the Fed Funds Rate.

The "higher for longer" theme continues to gain traction as evidenced by the further steepening of the forward curve after the Sept. 20 Fed meeting.

Surprising some, the earnings outlook has strengthened...

Exhibit 1: Consensus expects S&P 500 EPS growth troughed in 2Q

as of October 5, 2023



Source: FactSet, Goldman Sachs Global Investment Research

As noted on the left chart, consensus expectations are for earnings to have troughed in the second quarter, with a return to positive territory in Q4.

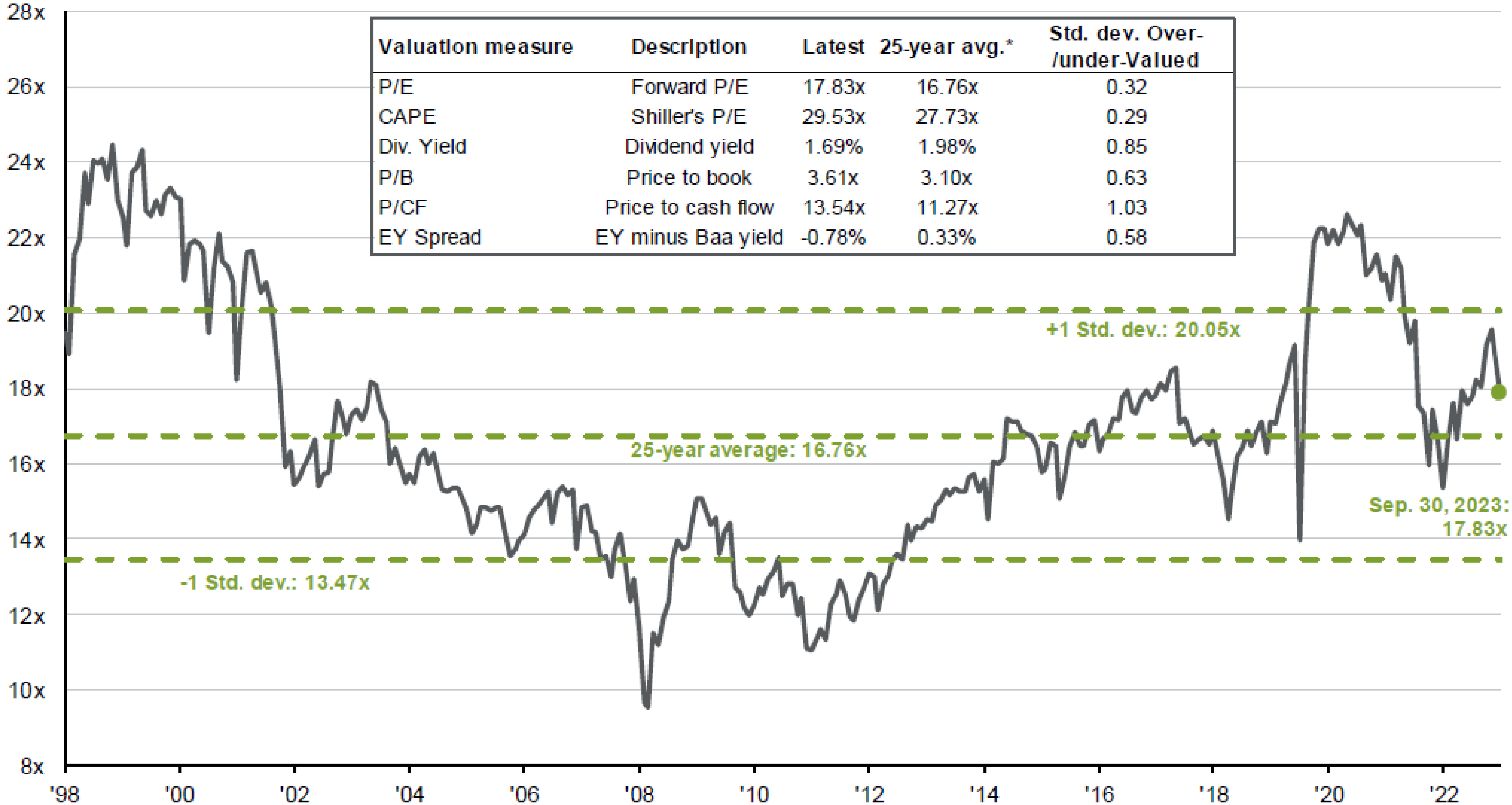
S&P 500 earnings and valuation

	Goldman Sachs Portfolio Strategy		Consensus Bottom-Up	
	2023E	**2024E**	**2023E**	**2024E**
EPS	**$224**	**$237**	**$221**	**$247**
Growth	***1 %***	***5 %***	***(0)%***	***12 %***
	NTM	**2023E**	**NTM**	**2023E**
P/E	**18.2x**	**18.0x**	**17.9x**	**19.2x**

Source: I/B/E/S, FirstCall, Goldman Sachs Investment Research

…in this context valuations are above average but not unreasonable.

S&P 500 Index: Forward P/E ratio



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	17.83x	16.76x	0.32
CAPE	Shiller's P/E	29.53x	27.73x	0.29
Div. Yield	Dividend yield	1.69%	1.98%	0.85
P/B	Price to book	3.61x	3.10x	0.63
P/CF	Price to cash flow	13.54x	11.27x	1.03
EY Spread	EY minus Baa yield	-0.78%	0.33%	0.58

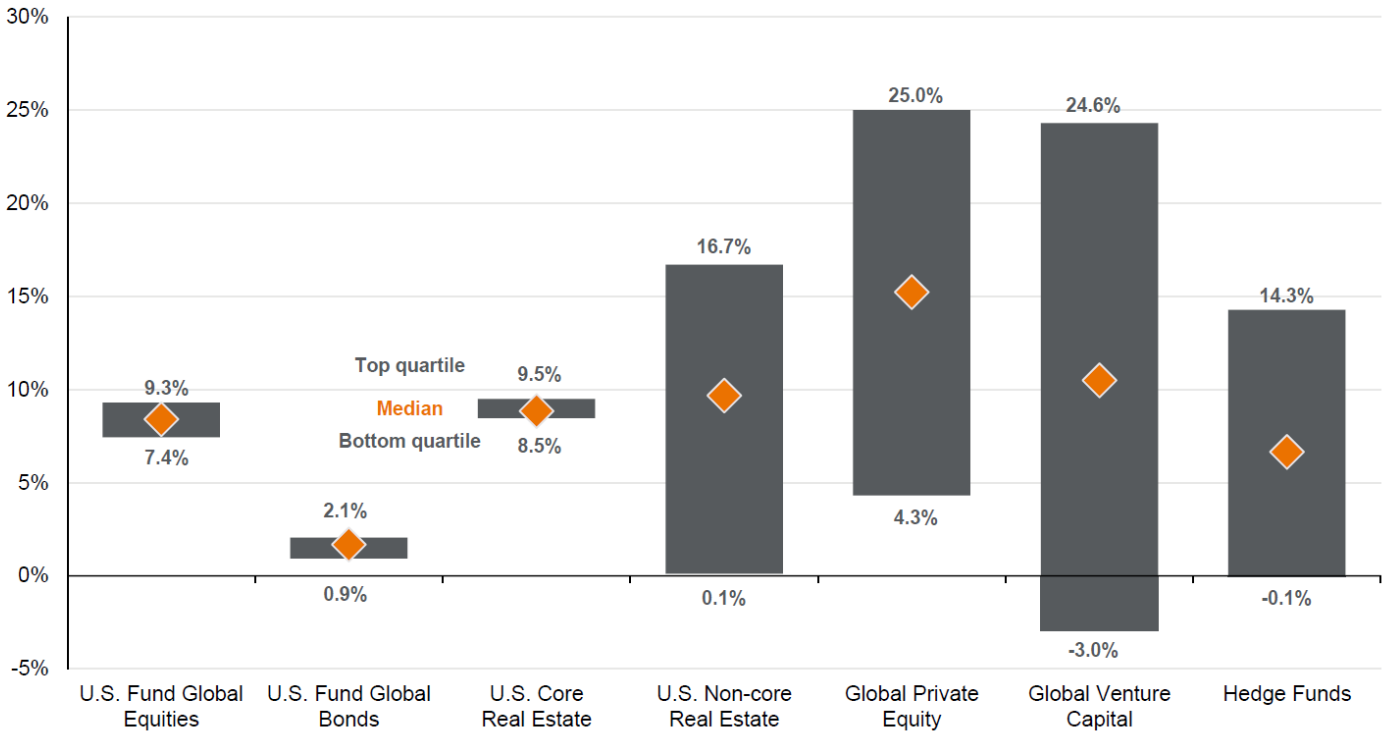
Source: JP Morgan

Manager selection continues to be paramount…especially in private markets.

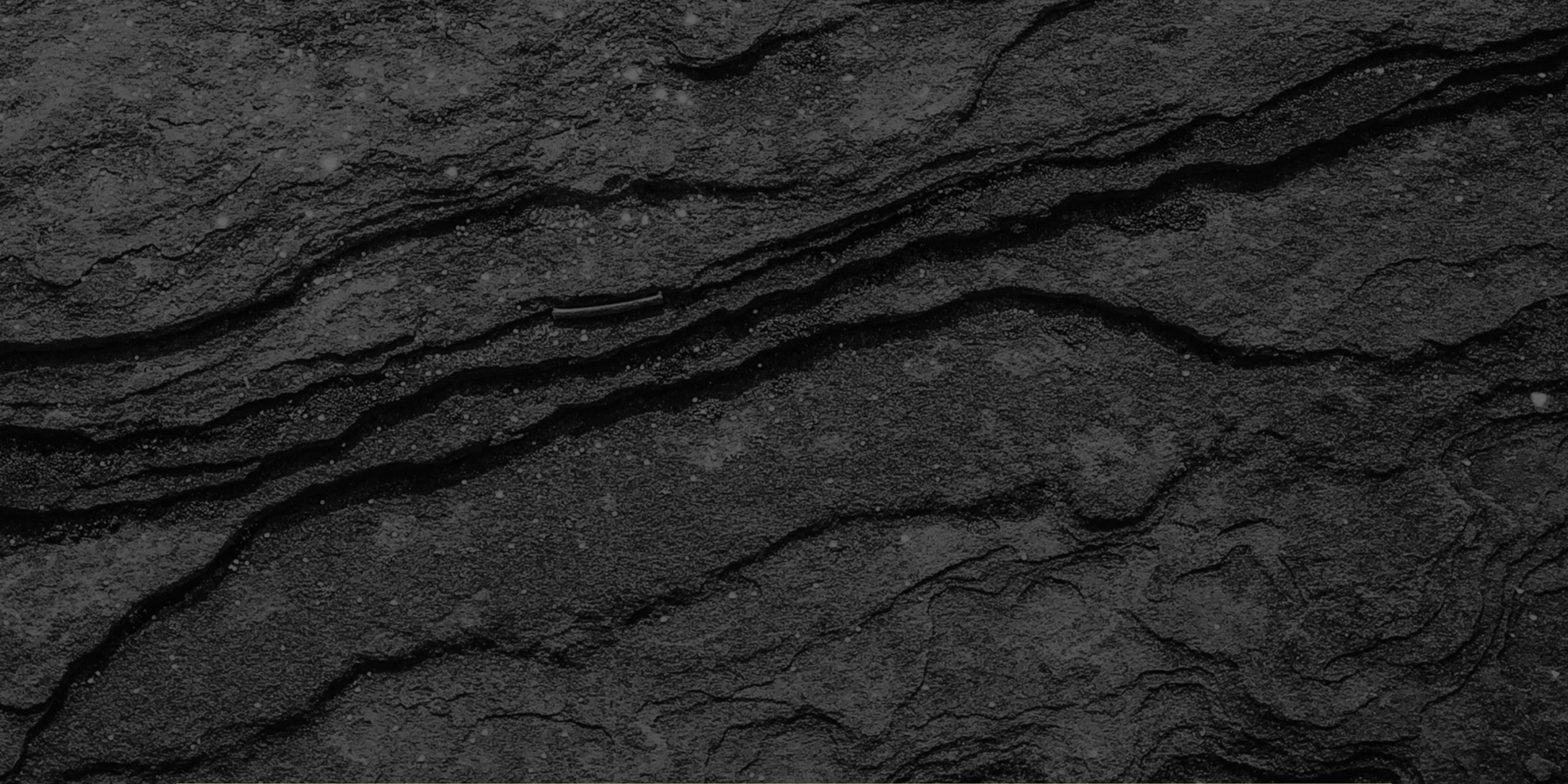
Manager selection in public markets is always important, but it is crucial in private markets. This drives our philosophy to invest mostly passively within our public market allocations while focusing more on sourcing and analyzing opportunities in the private markets.

The return dispersion, as illustrated below, between the top and bottom quartile private fund managers over the last 10-years is vastly larger versus public markets. Given the illiquid nature, lack of public information, and longer time horizon, private markets require strict and through due diligence to select best in class managers for investments.

Public and private manager dispersion
Based on returns over a 10-year window*



Source: Burgiss, Morningstar, NCREIF, PivotalPath, J.P. Morgan Asset Management



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