2024 Global Outlook

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The Bridge to Alternative Investments

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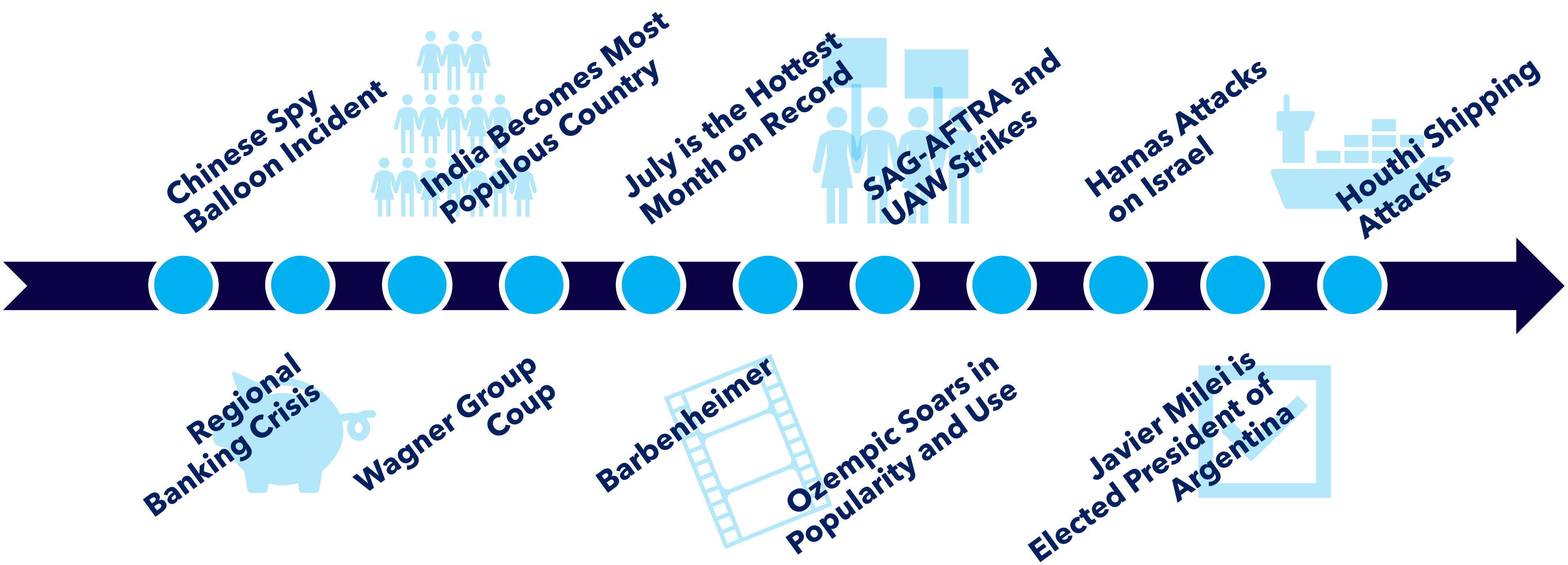
Taking Stock

The Current State of Markets + Geopolitics

Wait…that happened this year?

If you caught yourself asking the question above, you are by no means alone. 2023 was a whiplash year full of extraordinary and consequential events felt by investors and civilians around the world. We saw markets, industries, businesses, and families challenged by the unremitting hangover from COVID-19, and challenges to a world order that has been in place for much of the past 30 years.

So long to an eventful 2023…



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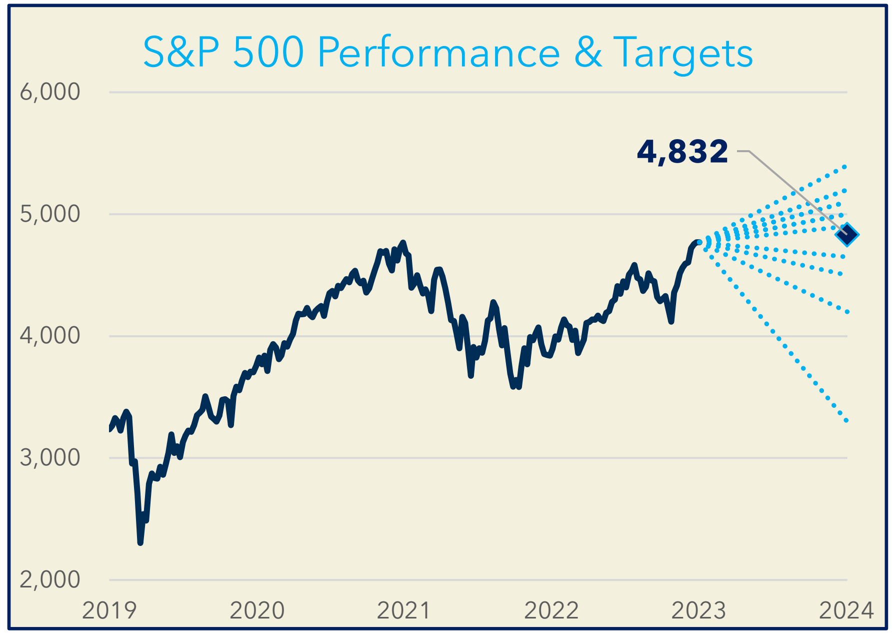
Concentrating on Concentration

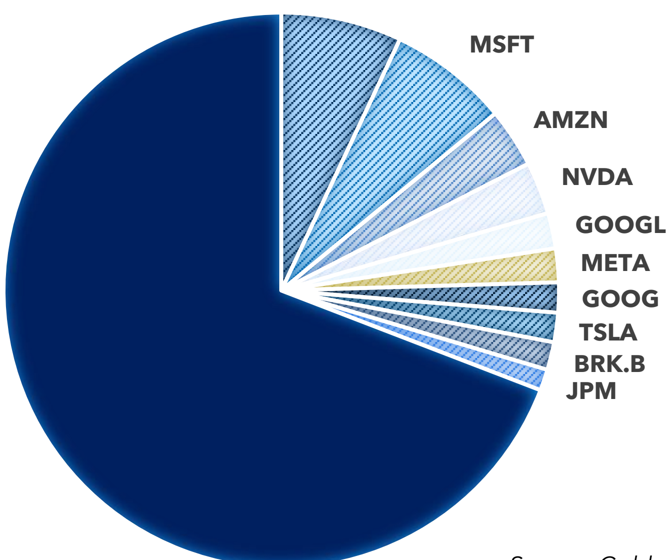
In reviewing 2023 capital markets, the Magnificent 7, without a doubt, seized the spotlight. This brigade of mega-cap stocks kept the S&P 500 afloat for most of the year until the broader market rose in the final few months. However, after the index closed the year out 25%+ higher, many analysts are now asking themselves: "Where do we go from here?"

As of year-end, the top 10 holdings of the S&P 500 comprised more than 30% of the index. This level is more than 50% higher than the 35-year average of 20%, even higher than that during the dot-com bubble.



Source: S&P Global[1]

Unprecedented Pile-up



Source: Goldman Sachs[3]

While these names delivered 63% in 2023, such concentration poses a risk considering the low likelihood of another banger year for these names.

With this in mind, Wall Street analysts predict a relatively lackluster 2024, with an average target of 4,832 from 14 institutions.[2] This implies just a ~1% price increase during the year. While large-cap equities were the clear winner last year, prudent investors may consider redeploying gains to less efficient or overlooked markets.

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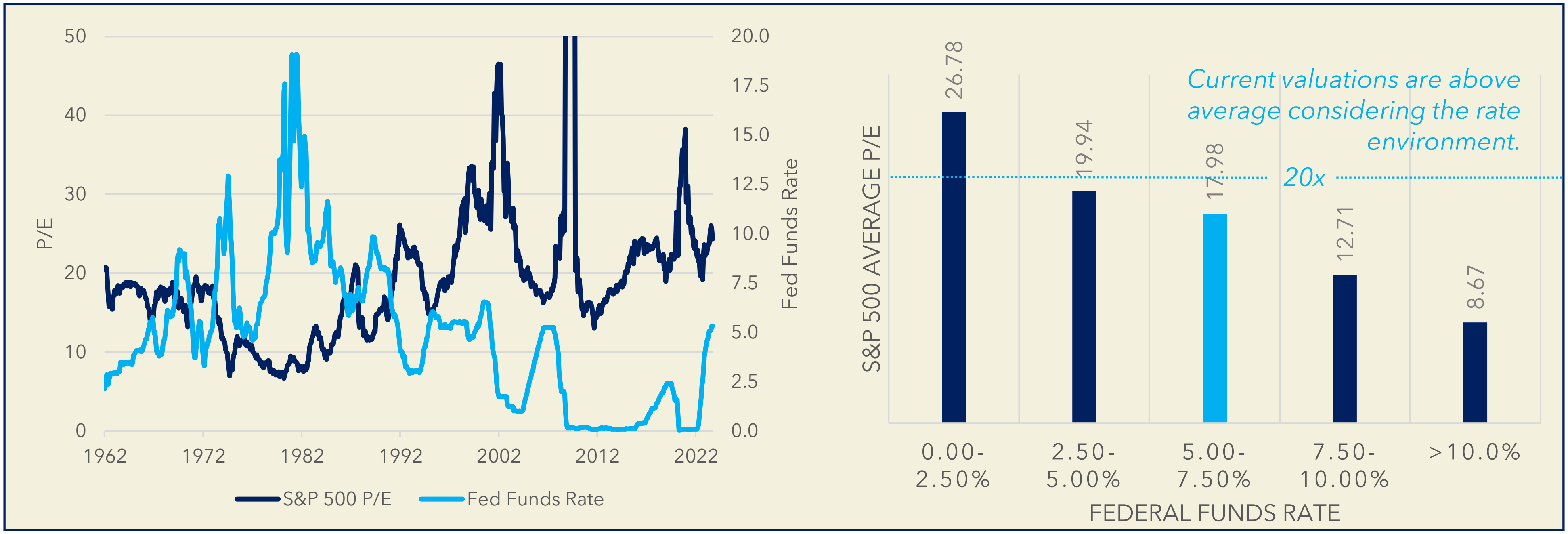
Is the Price Right?

Few would have anticipated that in the same year, the Federal Reserve would set borrowing rates to the highest level in twenty years *and* the S&P 500 would approach its all-time high. Historically, interest rates and valuations have an inverse relationship, as highlighted below. However, as equity markets pushed and pulled, battling over indications of an impending recession and "inevitable" rate cuts, the index's valuation has crept higher.

Based on analyst earnings estimates for 2024, the S&P 500 trades at an approximately 20x multiple. While not an exorbitant valuation, this is above the historic average considering the current Fed Funds Rate. If the Federal Reserve begins to cut rates in 2024, we anticipate it will be done methodically at a moderate pace, leaving little room for multiple expansion.

Guidelines, Not Rules



Source: Federal Reserve Bank of St. Louis[4], Macrotrends[5]

Booked Solid

While 2023 may have been an eventful year, we expect 2024 to be just as momentous, if not more so. We anticipate a similarly choppy environment for capital markets, as the global economy strives for growth while taming inflation and geopolitical tensions heighten.

What we'll be paying attention to in 2024:

Global Elections – More than 50 countries will hold elections this year, with more than four billion people eligible to participate. These elections will lay the groundwork for international relations for the next several years, even decades. Voters will go to the polls in the US, UK, India, Taiwan, South Africa, and Mexico among many others.

Inflation + Fed Policy – While equity markets may be screaming the end of inflation, Federal Reserve comments and recent data make us slightly hesitant to celebrate just yet. A robust jobs market, a shockingly reticent real estate market, improving consumer confidence, and rising risks to international supply chains are opposing factors, to name a few.

Cold War II – The next few years will present the most significant challenge to U.S. hegemony since the end of the Cold War. The deepening alliances between authoritarian regimes pose a threat to Western democracies and the global economy. We anticipate "friend-shoring" and increased government expenditures will be critical themes through much of the 2020s.

Where to Look

As we look back on a year of volatility and innovation, strife and progress, investors can catch a glimpse of the future from events and trends that took hold in 2023. Last year's performance was a gift and should not be wasted – one can only reap what has been sowed. We see opportunities abound for investors to diversify their holdings and build redoubtable portfolios.

2024 Themes

- **Modern Critical Infrastructure + Defense**
- **Automation + AI**
- **Residential Housing**
- **European Assets**
- **Corporate Credit**
- **Alternative Income**

The Way Forward

Opportunities for 2024 + Beyond

The Way Forward

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Modern Critical Infrastructure + Defense

A major issue to take center stage for many Americans and policymakers in 2024 will undoubtedly be national security. Increased military activity from rivals of NATO, namely China, Russia, and Iran, has led to bipartisan calls to replenish munition stores and upgrade and increase the size of the military, particularly the US Navy.

Over the past several decades of the Fourth Industrial Revolution, the scope and meaning of defense and broadened greatly. Beyond the more traditional forms of defense, improving our modern critical infrastructure and investing in cybersecurity will be crucial. "Reshoring" and "friend-shoring" of important supply chains, particularly semiconductors, has been a major effort of the last several administrations as well as the private sector, with hundreds of billions of dollars being allocated for investment.

Such demand along with this inflow of capital will generate significant opportunities for allocators investing in communications, semiconductors, cybersecurity, and aerospace and defense.

Department of Defense FY2024 Budget

Research, Development, Test, & Evaluations

$145B Total

- **$17.8B** – *Science & Tech*
- **$1.8B** – *Artificial Intelligence*
- **$1.4B** – *Joint All Domain Command & Control (High-Speed Communications)*

$280B CHIPS and Science Act

~8,000 satellites in orbit

17 states impacted by Colonial Pipeline cyberattack

Navy Battle Force Goal of 381 Ships vs. actual fleet of 299

Source: Department of Defense[6]

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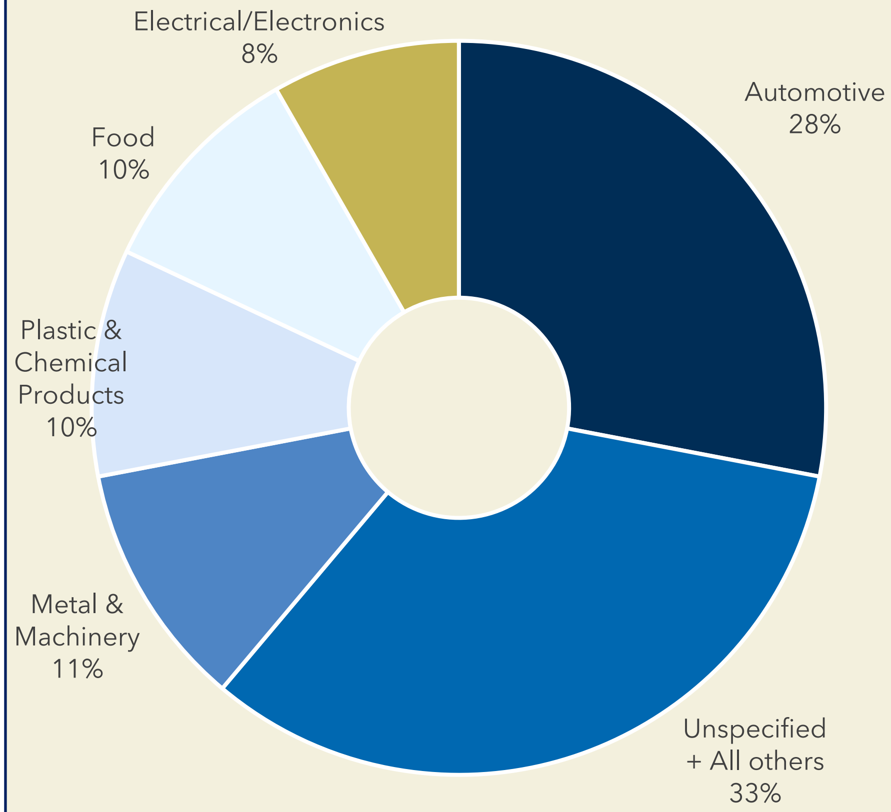
Automation + Artificial Intelligence

If there was one theme that stood out amongst the rest in 2023, it was AI and automation. ChatGPT and its competitors exploded in popularity, with hundreds of millions of people experiencing the future *now*. While we know automation and AI will have a lasting impact on the economy, not unlike that of the internet, we are not sure exactly *how* it will. Having diversified exposure to innovative businesses, particularly in private markets, will be important for long-term success in a new industry filled with such fervor.

Opportunity by the Numbers...

18x	**Increase of Investment in AI from 2013-2023**
$3.3B	**2022 Federal Government AI Contracts**
3.5mm	**Global Operational Stock of Industrial Robots in 2021**
14.6%	**Global Increase in Operational Robots from 2020-2021**

The Future is Now



While we are very much in the early days of robotics, we are seeing in real-time what sectors are adopting it fastest. As one might expect, heavy industries like automotive and machinery, as well as agriculture, have deployed thousands of robots in just the last few years.

Source: Stanford University[7]

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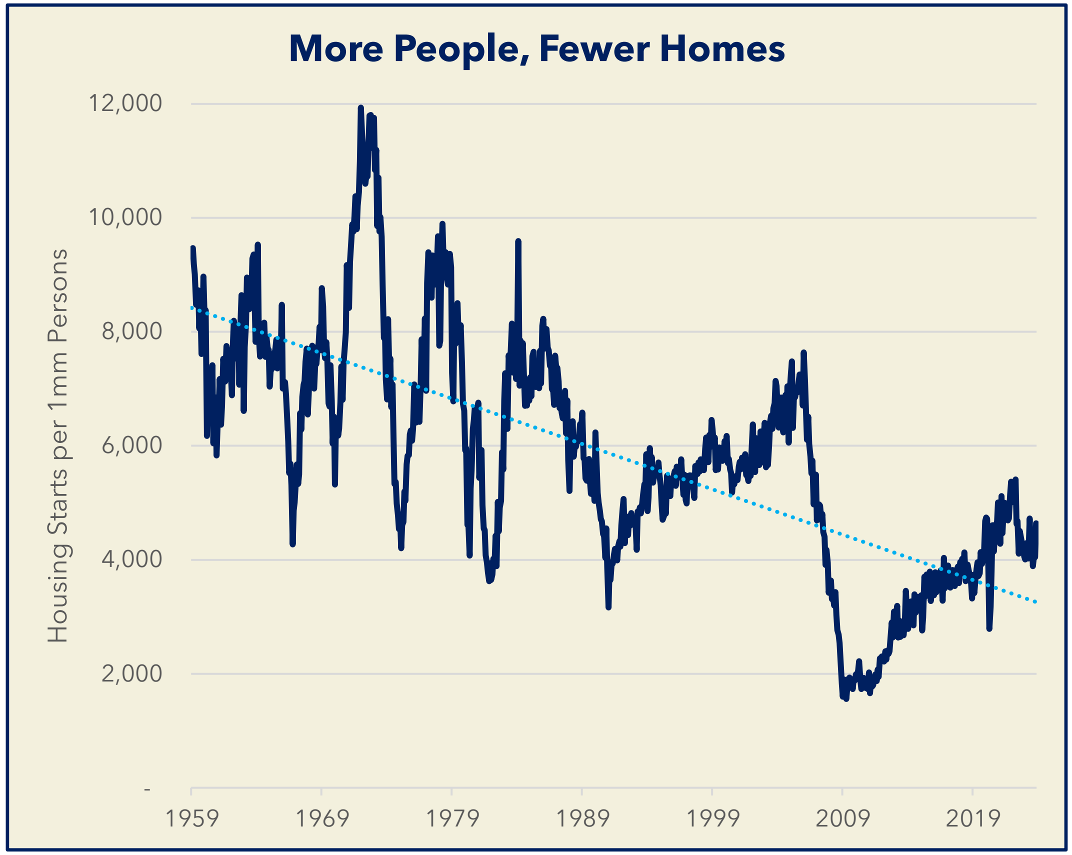
Residential Housing

As the largest sector within the largest real estate market in the world, it's fair to say that the US housing market receives a lot of attention. Particularly since the onset of COVID, we have seen a generation shift towards homeownership and suburban living. This, coupled with lower market inventory, has pushed the average home price to record levels. However, considering the severe lack of construction for many years, we believe the housing market has room to grow and will benefit from secular tailwinds.

For the past six decades, the US has seen a dramatic fall in real housing starts – that being the number of new starts relative to the population. The Great Financial Crisis greatly exacerbated this decline, with an ~80% drop in starts.

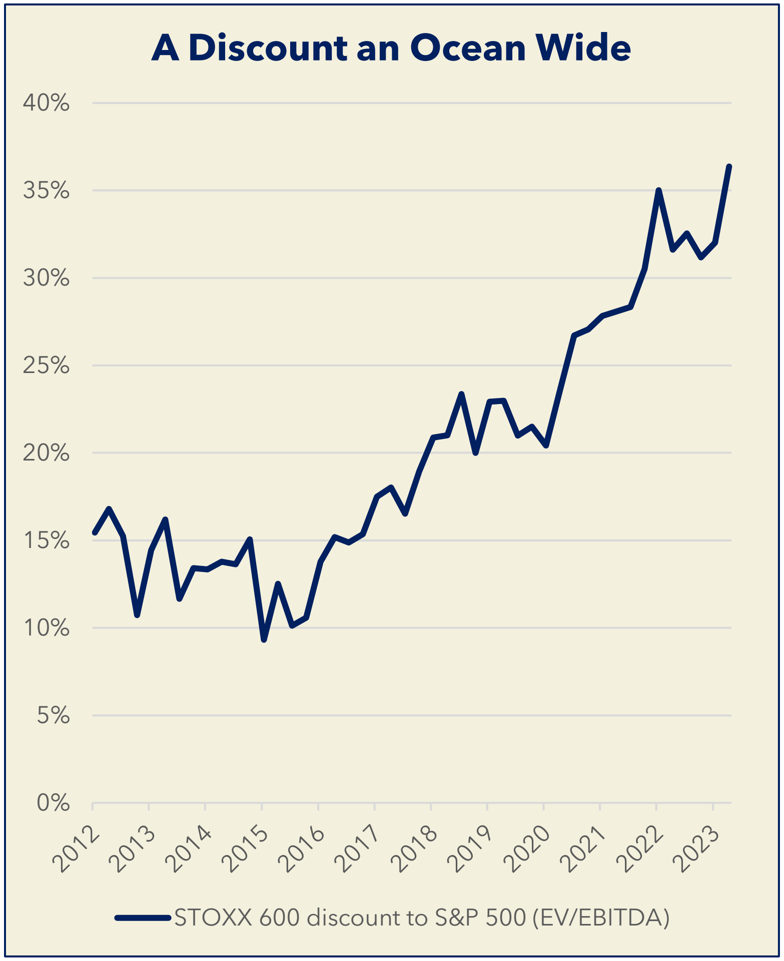


Source: Federal Reserve Bank of St. Louis[8]

While there has been a significant shock to housing prices in the past three years, long-term prices are likely to be sticky as demand remains robust with not nearly enough supply coming online. Investors looking to minimize exposure to real estate cycles might consider workforce and affordable housing, property types with relatively stable tenant bases.

European Assets

While many investors spent months preparing for the 2023 US Recession that never was, conditions across the pond may be ripe for opportunistic investors. European economies were hit hard by inflation and now are faced with low to no growth. While investors must be cautious of value traps, discount hunters may be able to discover great deals across asset classes.



Source: Preqin Pro[9]

Euro Equities: a Public + Private Matter

While the broader economic environment in Europe may not look as bright as that of the US, the discount applied to European businesses has been increasing steadily over the past decade, arguably beyond reason. European equities now trade at a bottom-quintile valuation based on the last 20 years. While some of these companies deserve to trade at low valuations, just as many US Value stocks deserve their own, active investors may be able to find diamonds in the abandoned European coal mine.

Allocators can look to Berkshire Hathaway's investment in Japanese trading companies for inspiration. BRK recognized high-quality, durable businesses in a systemically cheap market. As the late Charlie Munger put it: "It was awfully easy money."

Though a different market and environment altogether, investors can still find pockets of value via global hedge funds and private equity strategies that have a depth of regional knowledge.

European Assets Continued

Opportunistic Euro Real Estate: Right Time, Wrong Place

Analysts and journalists have long been discussing the impending commercial real estate collapse in the US. However, European deals have already collapsed in value and volume. In the first three quarters of 2023, the aggregate deal value was just $12 billion, less than 10% of 2018's aggregate. Significant and sticky inflation led the ECB and BOE to implement aggressive monetary policy that has essentially brought the real estate market to a halt.

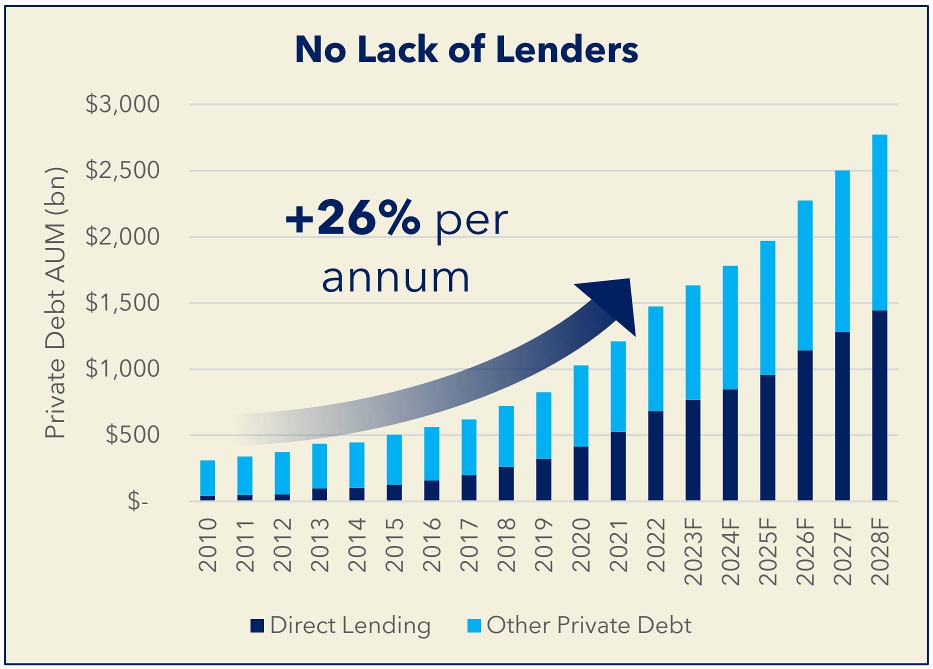
As inflation in Europe falls back to earth and the economy constricts, analysts anticipate rate cuts to come in the next few quarters. Valuations are therefore likely to bottom in 2024 with renewed deal volume. Opportunistic investors can take advantage of the current stressed market environment before capital inflows return, boosting valuations.

Source: Preqin Pro[9]

Navigating the "Golden Age of Private Credit"

Once a negligible fraction of private credit assets, direct lending has evolved into the default private credit strategy. Since 2010, direct lending has grown its assets under management at an astounding 26% annualized rate. However, this growth did not come without a need, as bank lending standards tightened significantly after the Great Financial Crisis. Private direct lending funds have since been able to deliver relatively competitive returns considering the senior secured position of the loans.

In what has been dubbed the "Golden Age of Private Credit," there are a few considerations investors should keep in mind. First, what is the true quality of the underlying portfolio company? (i.e., why is there not a bank lender?) Is the loan realistically fully recoverable through collateral sales? Does this manager have experience in corporate workouts and restructuring should the worst happen?



Source: Preqin Pro[9]

Further, it's important to not underestimate the power of supply and demand. We are currently seeing the impact on loan terms as the supply of capital has grown exponentially for well over a decade. As more and more lenders come to market, competition for deals will continue to grow, forcing terms to loosen. Bank lending is, in practice, a commodity, and so too are its substitutes.

With all this in mind, private credit and direct lending will remain important components of any diversified portfolio. However, manager selection is key, and selecting those with flexible mandates to invest across the capital stack is a benefit in choppy and evolving markets.

The Way Forward

True Alternative Income

As always, a top priority for private wealth advisors and clients in 2024 is to build and maintain a well-diversified portfolio. However, that goal is becoming more and more difficult to achieve solely through traditional investments. Over the past several years, stocks and bonds have become increasingly correlated, leaving few places to hide in down markets. In 2022, the Aggregate Bond index total return was down double digits as the S&P 500 lost approximately 20% of its value.

Private markets, on the other hand, provide investors with thousands of unique strategies and uncorrelated assets that add significant value to a portfolio, particularly in times of wider market stress. Below are just a handful of strategies that may provide balance in difficult market environments.

Conclusion

Takeaways for the New Year

Conclusion

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Ask yourself…

#1 How am I diversifying my allocation to innovative tech?

#2 How will my portfolio be impacted by major macro events?

#3 How are my current managers positioned to take advantage of market dislocations?

Takeaways for the New Year

In 2024 and beyond, we see immense opportunities for investors. Once again, our world is on the cusp of a technological revolution. Automation and artificial intelligence will have an undoubtedly seismic impact on our economy with a healthy dose of disruption. These technologies hold the potential to change our economy and world, not unlike railroads, electrification, and the internet.

Further, investors can find true value hidden in markets that have been beaten down or forgotten in recent years – true alpha can only be found where no one else is looking. At the same time, today's environment is highly fluid, and allocators should remain flexible to take advantage of changing dynamics and special situations.

It will not be a year without risks. Geopolitical tensions are at a yearslong high, as hot wars rage on in Europe and the Middle East and a new cold war seems to get frostier by the day. Protecting a portfolio through traditional investments may prove difficult should any of these situations escalate. Alternative investments from global hedge funds and private equity to cash-flowing real estate all will play a role in protecting a portfolio and driving long-term returns for investors.

Your connection to alternative investing

Make your whiteboard priorities happen

As you think about the focus areas of your business this year, it's important to align your investment program with your clients' goals. Common themes among the private wealth community include:

- ☑ **Providing uncorrelated income**
- ☑ **Taking gains and diversifying**
- ☑ **Incorporating tax efficient strategies**
- ☑ **Business growth and appreciation**

Scale your business in ways you may not have considered

Many of our RIA partners express concerns of maintaining the scale they need to manage alternative investments. Our team is here to understand your priorities and challenges to find ways to help you accomplish your business objectives. That means gaining the full potential out of your business.

- Differentiate your practice with the support of peer ideas
- Drive revenue and boost AUM growth through unique fund structures
- Relieve complex operational tasks associated with private funds

We can help. **Contact us** **484.278.4017** **advrel@ppbadvisors.com**

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