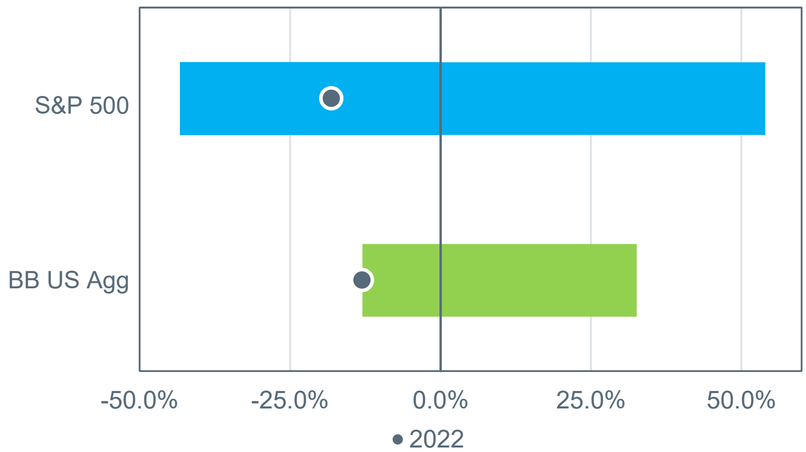
Short-Term Uncertainties, Long-Term Focus

With the yield curve still inverted, we are often asked about the potential for a recession and the magnitude of its impact on capital markets. While there is significant uncertainty about the path of capital markets over the short term, we continue to believe the best approach for strategic investors is to focus on long-term outcomes. However, having a better understanding of short-term considerations can help investors maintain a long-term perspective.

2022 was a terrible year for most assets, and in the case of bonds, the worst year since 1788.[1] This was largely due to inflation, which tends to negatively impact stocks and bonds at the same time. The last time we saw inflation at these levels (over 40 years ago), stocks and bonds had similarly poor outcomes.

Figure 1: Historical US Stock and Bond Market Index Calendar Year Returns



Source: S&P and Bloomberg.

As of the end of May 2023, financial assets in general and equities specifically have rallied. The S&P 500 is up 9.6% and the NASDAQ is up 24.1%, calendar year-to-date. This rebound has caused some to wonder if perhaps the volatility of 2022 is behind us, and a recession will be avoided altogether. While avoiding a recession is possible, with labor markets continuing to perform incredibly well, the leading economic indicators index and inverted yield curve continue to suggest otherwise **(Figures 2 & 3)**.

[1]Bloomberg. *Deutsche Bank Looks Back to 1780s for Parallel to US Bond Rout.* https://www.bloomberg.com/news/articles/2022-06-22/deutsche-bank-looks-back-three-centuries-for-parallel-to-us-rout#xj4y7vzkg

Figure 2: 10 Year-3 Month Treasury Yield Spread

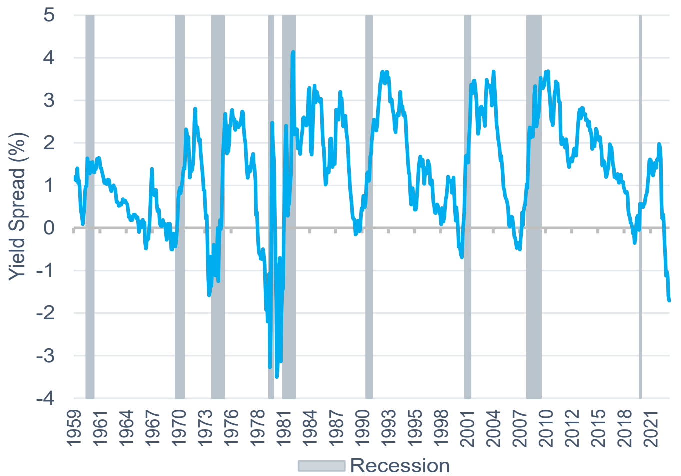
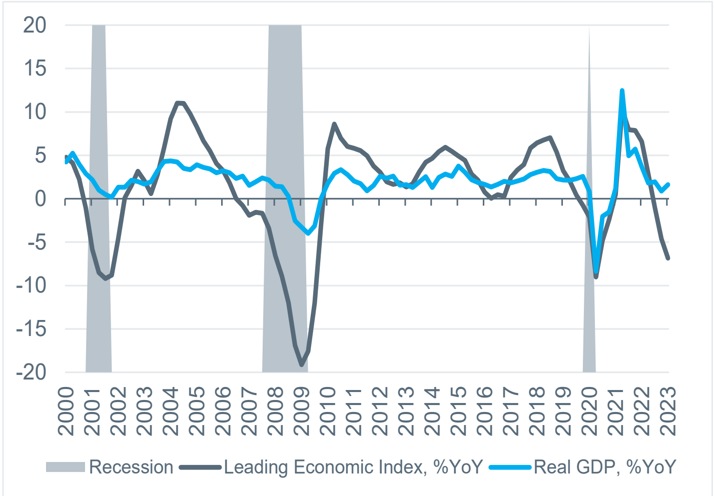


Figure 3: Leading Economic Index and Real GDP



Source: Federal Reserve Bank of New York (Figure 2), FactSet (Figure 3), National Bureau of Economic Research (Figures 2 & 3).

Additional headwinds for the economy include significant reductions in monetary stimulus from the Federal Reserve **(Figures 4 & 5)**.

Figure 4: Federal Reserve Balance Sheet

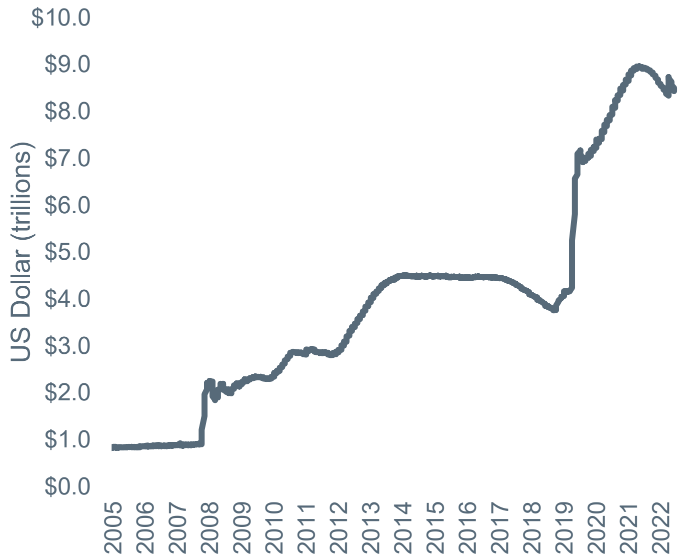
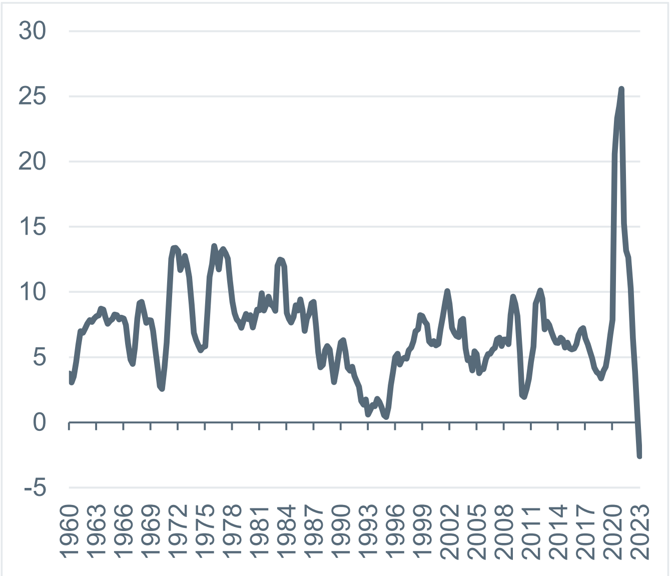


Figure 5: M2, %YoY



Source: FactSet (Figure 4), Federal Reserve Bank of St. Louis (Figure 5).

As a long-term strategic investor, we focus on the trajectory of markets over multiple cycles, meaning near-term events become less important but are certainly not unimportant. Therefore, we think a review of where capital market forecasts stand in 2023 from a long-term perspective is helpful and essential context.

After a volatile and poorly performing year such as 2022, forecasting models tend to look better as the downturn sows the seeds of the "recovery"—increased yields for bonds and better valuations for stocks. As you can see below, RVK's capital market assumptions ("CMAs") improved significantly from 2022 to 2023, especially when you consider that these are strategic long-term forecasts with a 20-year time horizon.[2]

In addition to absolute improvements in return forecasts almost across the board, there were some relative improvements worth noting, such as the improvement of bonds on a relative basis to stocks. This relative improvement suggests investors may want to re-examine allocations to capital preservation assets within the context of their long-term investment objectives and constraints.

Figure 6: 2022 vs. 2023 Capital Market Assumptions

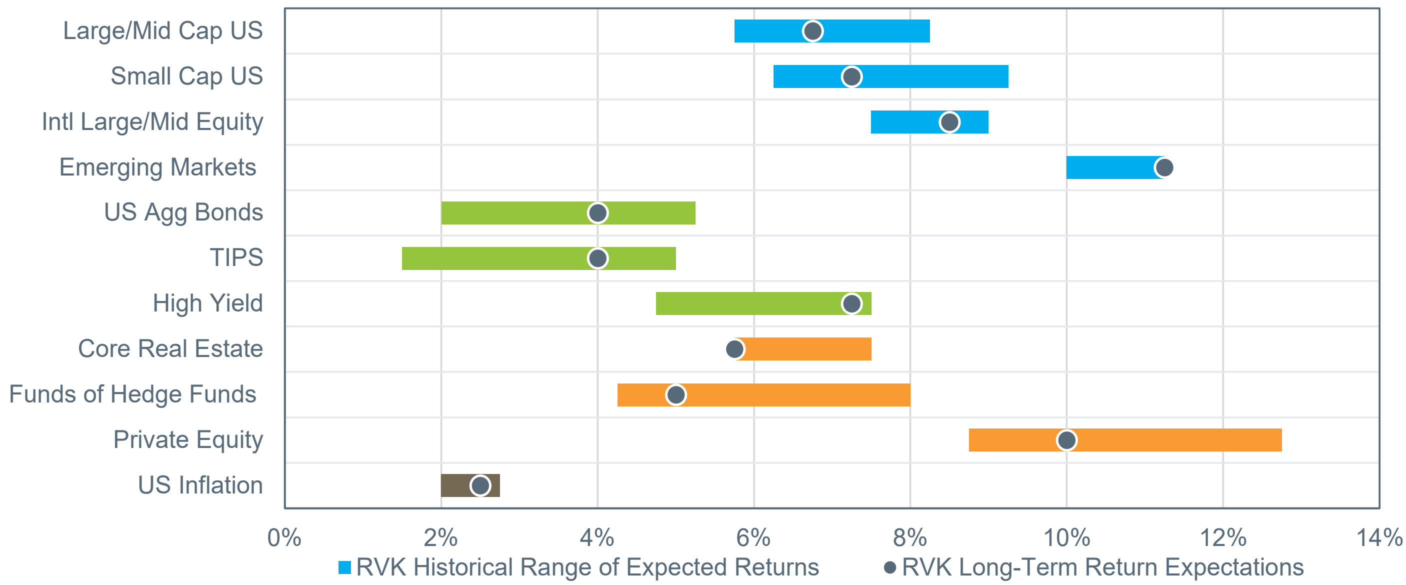
Asset Class	2022		2023		Change (2023 - 2022)	
	Nominal Return	Risk (St. Dev.)	Nominal Return	Risk (St. Dev.)	Nominal Return	Risk (St. Dev.)
Large/Mid Cap US	5.75%	16.00%	6.75%	16.00%	1.00%	0.00%
Small Cap US	6.25%	19.00%	7.25%	19.00%	1.00%	0.00%
Intl Large/Mid Equity	7.50%	17.00%	8.50%	17.00%	1.00%	0.00%
Intl Dev'd Small Cap	8.00%	20.00%	9.25%	20.00%	1.25%	0.00%
Emerging Markets	10.25%	25.00%	11.25%	25.00%	1.00%	0.00%
US Agg Bonds	2.50%	5.00%	4.00%	5.00%	1.50%	0.00%
Emerging Debt-Hard	6.00%	10.00%	7.50%	10.00%	1.50%	0.00%
Emerging Debt-Local	5.75%	11.50%	6.50%	11.50%	0.75%	0.00%
TIPS	2.00%	5.50%	4.00%	5.50%	2.00%	0.00%
High Yield	5.50%	10.00%	7.25%	10.50%	1.75%	0.50%
Bank Loans	5.00%	8.00%	6.50%	8.50%	1.50%	0.50%
Core Real Estate	6.00%	12.50%	5.75%	12.50%	-0.25%	0.00%
Global REITs	6.50%	21.00%	7.75%	21.00%	1.25%	0.00%
Funds of Hedge Funds	4.25%	9.50%	5.00%	9.50%	0.75%	0.00%
GTAA	5.00%	9.00%	6.00%	9.00%	1.00%	0.00%
Private Credit	7.25%	13.00%	8.00%	13.00%	0.75%	0.00%
Private Equity	9.00%	22.00%	10.00%	22.00%	1.00%	0.00%
Commodities	5.50%	17.50%	6.00%	17.50%	0.50%	0.00%
US Inflation	2.50%	2.50%	2.50%	2.50%	0.00%	0.00%

Increased CMAs do not necessarily indicate short-term gains are forthcoming, but rather that the long-term picture has improved. It is also worth noting that while CMAs significantly improved year-over-year (as shown above), RVK CMAs remain well below historical averages (as shown on the following page).

[2]Data not intended to convey any guarantees as to the future performance of investment products, asset classes, or capital markets.

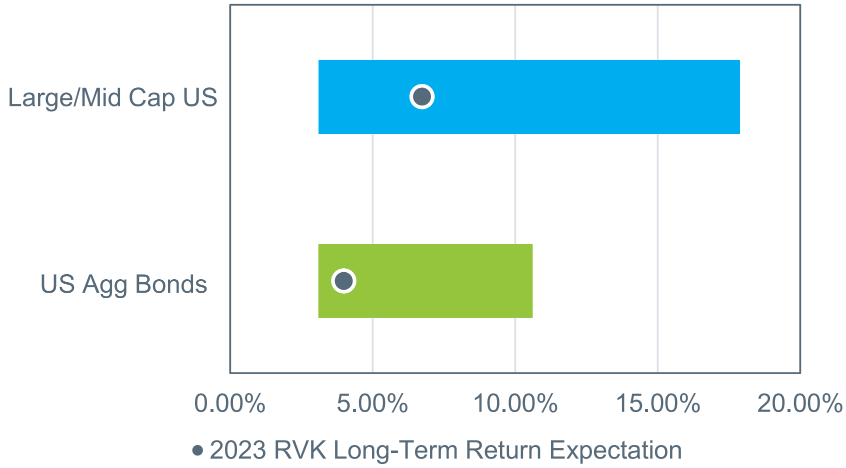
Is a recession coming? Nobody knows, but a variety of economic indicators do suggest headwinds for economic growth. With this as our current backdrop, we continue to recommend strategic investors maintain their long-term perspective and adhere to the strategic asset allocation and rebalancing guidelines within their investment policies.

Figure 7: RVK Historical Range of Expected Returns



Historical range of expected returns include 2006 through 2023 Capital Market Assumptions for selected asset classes.

Figure 8: Historical Range of 20-Year Return Outcomes



Source: S&P and Bloomberg. Large/Mid Cap US is represented by the S&P 500 Index. US Agg Bonds is represented by the Bloomberg US Aggregate Index. 20-year return outcomes are measured every December 31.

Disclaimer of Warranties and Limitation of Liability

This document was prepared by RVK, Inc. (RVK) and may include information and data from third party sources. While RVK has taken reasonable care to ensure the accuracy of the information or data, we make no warranties and disclaim responsibility for the inaccuracy or incompleteness of information or data provided or for methodologies that are employed by any external source.

It is impossible to guarantee returns on investments that have market risk because performance depends in part on future market forces. Additionally, return projections can raise unrealistic expectations of future performance. RVK Capital Market Assumptions are forward-looking, and do not reflect actual performance. Past performance is actual historical performance information, but does not predict how an investment strategy will perform in the future. This document is not intended to convey any guarantees as to the future performance of investment products, asset classes, or capital markets.

About RVK

RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm is headquartered in Portland, Oregon, with regional offices in Boise, Chicago, and New York City. RVK is one of the five largest consulting firms in the world, as reported by *Pensions & Investments' 2022 Special Report–Consultants*. Additionally, in April 2023, RVK received a notable award as a *Coalition Greenwich Quality Leader* among large US investment consultants, based on Greenwich's 2022 study. Coalition Greenwich is an industry-recognized third-party firm which asks plan sponsors to rank their consultants on a series of key metrics. Notably, RVK is the only firm among large US consultants to receive an award for a sixth consecutive year. Coalition Greenwich issued the award on April 25, 2023 based on their February through November 2022 study. No direct or indirect compensation has been paid by RVK in connection with obtaining or using this award. To read more about the Greenwich award, please refer to the following URL: https://www.rvkinc.com/about/about.php. RVK's diversified client base of nearly 200 clients spans 30 states, and covers endowments, foundations, corporate and public defined benefit and contribution plans, Taft-Hartley plans, and high-net-worth individuals and families. The firm is independent, employee-owned, and derives 100% of its revenue from clients for investment consulting services.