OUTLOOK 2024

AN ANNUAL PUBLICATION *of*
FERGUSON WELLMAN, OCTAVIA GROUP
and WEST BEARING

OUTLOOK 2024

IN THIS PUBLICATION

Founded in 1975, Ferguson Wellman is a privately owned registered investment adviser, established in the Pacific Northwest. As of December 31, 2023, the firm manages more than $8.4 billion for more than 990 clients that include individuals and families; Taft-Hartley and corporate retirement plans; and foundations and endowments with portfolios of $4 million or more.

West Bearing Investments, a division of Ferguson Wellman, serves clients with assets starting at $1 million.

Octavia Group provides fee-based personal financial services exclusively for Ferguson Wellman and West Bearing clients with a minimum of $10 million managed by our firm.

INVESTMENT EXCELLENCE
LIFELONG RELATIONSHIPS

STICKING THE LANDING

GEORGE HOSFIELD, CFA
Director,
Chief Investment Officer

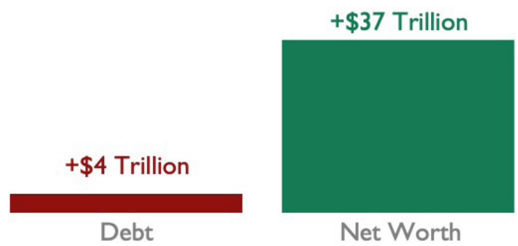
The past year not only defied predictions of a U.S. recession but also turned out surprisingly well for investors with positive bond returns and a recently broadening advance for blue-chip stocks that pushed benchmark equity returns above 20% for the year.

As the title of this piece suggests, we are now anticipating a favorable outcome to the Federal Reserve's inflation fighting campaign that has succeeded in bringing inflation to heel while not derailing corporate profits or tipping the economy into recession. Higher interest rates engineered by the Fed have so far succeeded in reducing excess job demand without causing widespread joblessness. In turn, wage gains and inflation are moderating, and with unemployment remaining near generational lows, the consumer remains gainfully employed.

Consumer debt is up notably from pre-pandemic levels, but persistently strong home prices and a resurgent stock market have boosted key sources of wealth. As the chart illustrates, post-pandemic growth in personal assets has outpaced the growth in liabilities ninefold, thus boosting consumers' propensity and ability to spend. With consumer spending making up 70% of the U.S. economy, a healthy consumer all but ensures an expanding economy.

With inflation now forecast to fall near the Fed's 2% goal in 2024, markets have begun anticipating rate cuts as soon as this spring. If the Fed ultimately achieves the "soft landing" now being discounted by stock prices, it may lower rates not because economic activity is waning, but rather to pre-emptively avoid a recession precipitated by keeping rates too high for too long.

Consumer Balance Sheets Remain Strong
Change in Personal Balance Sheets Since 2019



Source: Eikon

While optimistic about the economy avoiding a "hard landing" and lapsing into recession, we trimmed our allocation to equities last fall and recently redeployed proceeds to bonds ... which have earned a higher (now neutral) allocation in client accounts by virtue of providing the most compelling yields in more than a decade.

Now trading near 20x expected earnings, the S&P is somewhat expensive, especially in the context of current interest rate levels. However, key technology-centric earnings drivers such as cloud computing and artificial intelligence can, by our analysis, drive double-digit earnings growth that is anticipated for the S&P 500 this year. Accordingly, we retain a slight overweight to large-cap U.S. stocks. On the other hand, acknowledging later cycle dynamics, we are underweight both U.S.small-cap and international emerging market equities.

FIXED INCOME

BRAD HOULE, CFA

Principal
Fixed Income Research
and Portfolio Management

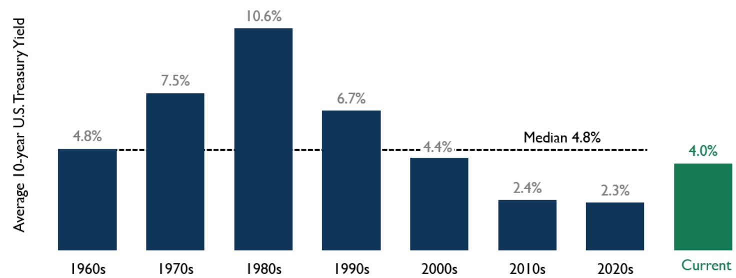
Bond market volatility has been extreme this year surpassing what we saw during the pandemic in 2020 and close to what was experienced in the great financial crisis in 2008. Earlier in 2023, with the sharp rise in long-term interest rates it looked as if the bond market was facing a third year in a row of negative returns. What changed was a cooling in the labor market, the Federal Reserve signaling that they are done increasing interest rates and inflation moving lower. We believe that the worst of the bond market is behind us. Bond yields are attractive at these interest rate levels, and we have recently added fixed income positions in client portfolios.

Bonds Have Earned Their Way Back Into Portfolios

Source: Bloomberg

Higher interest rates are good and bad. As bond investors, higher interest rates allow investors to earn greater returns. The downside of higher interest rates is the higher debt servicing cost for borrowers. Perhaps no borrower is more adversely impacted than the U.S. government. The U.S. national debt has ballooned to $33 trillion dollars. Put in context, the cost to fund the national debt has gone up $800 billion dollars in the *last two years alone* due to more debt and higher interest costs. Said differently, this sum is nearly equivalent to what the U.S. spends on the military in one year. While still affordable, higher interest costs have a crowding-out effect. Money spent on interest cannot be otherwise spent on programs such as infrastructure that are an engine for economic growth. Further, this situation is more challenging due to the fact that more than half of the debt will become due in the next three years. Higher interest costs are a headwind to economic growth and the tough choices of cutting spending or raising taxes will have to be made.

Rates Return to "Normal"



Source: Bloomberg

We believe interest rates have reverted to a more normal environment. The near-zero interest rates that followed the great financial crisis for nearly two decades was not normal. Capital has a cost and current interest rates are actually below the long-term average.

We view the current interest rate environment as both sustainable as well as workable for a functioning economy. For the past 10 years the average yield on the broad bond market has been 2.6%, whereby it is now 4.5%. In addition to returns, bonds should again offer "insurance" for declines in risk assets. Historically, bonds and stocks are inversely correlated, meaning when stocks decline, bonds often increase in value. Our belief is that this inverse correlation of returns or insurance provided by bonds is not broken and bonds will provide protection for the next time stocks enter a bear market.

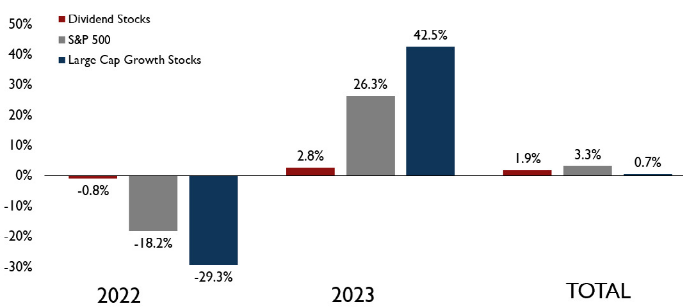
DIVIDEND VALUE

JASON NORRIS, CFA

Principal
Equity Research and
Portfolio Management

After a relatively healthy year for dividend stocks in 2022, those same strategies lagged the S&P 500 meaningfully in 2023. This occurrence was due to equity returns being driven by a small number of large technology stocks, also known as "the Magnificent Seven."

Total Return Comparison



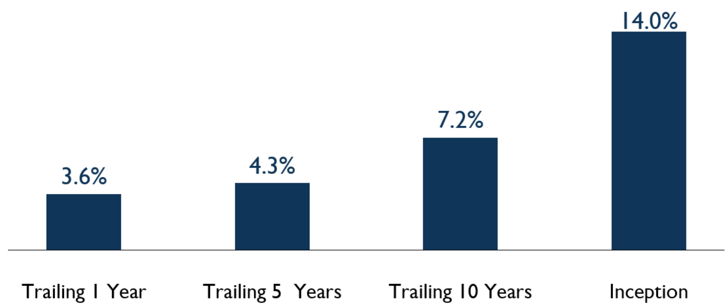
Source: Morningstar

**Select Dividend ETF (DVY), SPDR S&P Dividend ETF (SDY) and Schwab US Dividend Equity ETF (SCHD) used for "Dividend Stocks." Russell 1000 Index used for "Large Cap Growth Stocks." Investors cannot invest directly into an index.*

The strength in large cap stocks in 2023, specifically technology and growth stocks, amounted to little more than recovering their losses in 2022. Unfortunately, while large companies have recouped the majority of their losses, small company stocks have not been as fortunate. Over the last two years, large cap investors have ended up in roughly the same place where dividend and large growth stocks are concerned. Because the engine of equity markets in 2023 was centered in big cap technology, the smaller indices are still in a hole. The main driver we saw in 2023 was artificial intelligence (AI). While most companies with high exposure to AI pay a minimal or no dividend, investors can gain exposure to some high-quality AI names that also pay an attractive dividend. For example, dividend strategies may not own AI company Nvidia, however, they may own Broadcom, a company with considerable AI exposure, which has a dividend yield of 2%.

The other headwind for dividend stocks in 2023 was competition from bonds. As interest rates increased, the perceived relative attractiveness of high dividend-paying stocks was reduced. However, the one thing that bonds do not give investors is a rising income stream. Ferguson Wellman's *Dividend Value Strategy* has delivered mid-single digit income growth for the last 20 years, which has resulted in a yield-to-cost of 14% since inception.

Ferguson Wellman Dividend Value Strategy



Source: Ferguson Wellman

If a client invested $1m in *Dividend Value* 20 years ago, they would have experienced competitive appreciation, as well as healthy income growth. Today, the income they are receiving from that initial $1m is approximately $140,000.

Investors must remain patient with the typical stable dividend-paying stocks. While there may be periods when dividend stocks lag broad market upswings, historically, dividend stocks have cushioned investors in down markets. Also, with the focus on dividend growth, during volatile markets, investors can continue to receive their growing income stream. As interest rates stabilize, and even trend down due to lower inflation and slower economic growth, dividend-paying stocks may have their day. The focus on high-quality companies that generate healthy cashflows has resulted in healthy income growth, as well as strong, long-term capital appreciation.

INTERNATIONAL EQUITIES

SHAWN NARANCICH, CFA

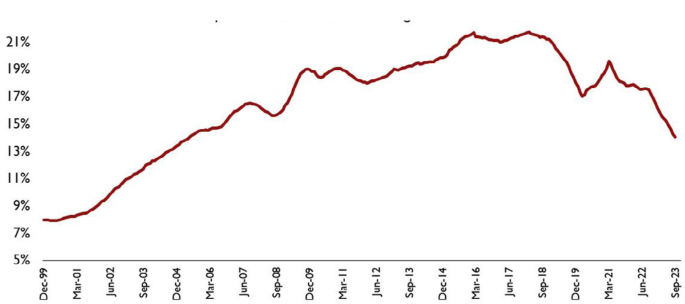
Executive Vice President
Equity Research and
Portfolio Management

REGLOBALIZING

For international investors, 2023 began with hope for an economic boom in China after the country lifted COVID-19 restrictions and reopened its border to foreigners. In contrast to expectations, China's rebound has been tepid, the economy is struggling to meet policymakers' 5% growth objective, and its stock market has disappointed, with key country indexes down over 15% last year.

Several factors are responsible for China's malaise, including stagnant home prices, stifling government regulation of key industries such as technology and finance, geopolitical division with the West and a population that is now shrinking. For Chinese consumers, recent declines in home value and stock prices create a negative wealth effect weighing on consumption and contributing to outright deflation in consumer prices. Meanwhile, sanctions on Chinese investment are causing multinational companies to rework supply chains, with emerging market economies like Vietnam, India and Mexico benefitting from new investment at China's expense.

U.S. Imports from China as Percentage of Total U.S. Goods



Source: Strategas

In the most recently reported month of November, foreign direct investment in China fell by 10%, its worst showing since the pandemic-impacted spring of 2020. As the chart depicts, China is becoming a smaller source of U.S. imports and was recently supplanted by Mexico as America's top trading partner.

Recognizing headwinds in China yet seeking the growth of emerging market countries, we added emerging markets ex-China exposure through an exchange traded fund (ETF) investment last year. With evidence of Chinese underperformance accumulating last fall, we further reduced client exposure by selling a China-centric fund. Our China exposure is now just 5% of the strategy and below the benchmark weighting.

We have increased our investment allocation to Japan and are receptive to new investments there as stock specific opportunities arise. Japanese companies are gaining investment appeal as they embark upon actions being promoted by Japanese regulators seeking to enhance corporate governance and shareholder returns. Key initiatives include simplifying conglomerate structures by spinning off or selling non-core operations and returning more capital to shareholders through additional dividends and share repurchase. These actions also boost companies' return on equity, supporting better stock market valuation for Japanese companies.

More broadly, our stock selection internationally emphasizes companies in healthcare, utilities and materials. While international stocks failed to keep pace with their domestic counterparts last year, our strategy produced strong absolute and relative returns.

ESG INVESTING: TRIPLE HEADWINDS

PETER JONES, CFA

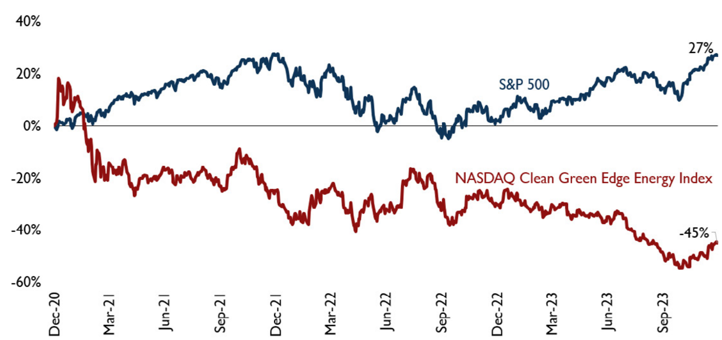
Senior Vice President
Equity Research and Portfolio Management

Environmental, Social and Governance (ESG) strategies have had a challenging couple of years, both in relative returns and from the perspective of investor demand. For broader ESG investors, returns have lagged traditional benchmarks largely because of the outsized returns generated in commodity sectors. Commodities, in particular fossil fuel companies, have enjoyed tremendous returns in the post-pandemic era due to generationally elevated inflation and geopolitical supply issues resulting from war in Eastern Europe. Since 2021, the return figures for fossil fuel companies have been staggering. Over the period, the S&P 500 energy sector has gained 155% versus the overall S&P 500, up 31%. ESG-focused strategies tend to allocate de minimis capital to the energy sector because of the goal to commit funds to companies that are working towards a more environmentally-friendly future.

Underperformance, of course, has driven a moderation in demand for ESG strategies among both institutional and retail investors. However, we believe the larger contribution has come from questionable credibility in the discipline itself. In the last couple of years, a number of major financial institutions have received hefty fines from the SEC for the practice of "greenwashing" where fund managers market their strategies as having an ESG focus but a closer inspection reveals these funds lack material differentiation from non-ESG investments. These headlines have caused investors to be more selective in their search for ESG funds that align with their values. In addition, ESG has become politicized. Several red states have banned the use of ESG mandates for public pension funds and continue to argue that ESG is nothing more than a measure of alignment with leftist ideology. While most money managers disagree, investors are always cautious when it comes to investing in areas that make political headlines. The combination of weaker performance, "greenwashing" penalties and political headlines have clearly driven a pullback in investors appetite for ESG funds. In fact, after years of consistent inflows, ESG funds saw outflows in every quarter of 2023.

A major distinction between our GSI approach and that of clean energy funds is tracking error. Our GSI Strategy is broadly diversified across economic sectors and geographical regions. In addition, we apply the same fundamental analytical rigor, focusing on valuation and cash flows just as our other strategies. As such, since we launched in 2018, GSI has maintained a similar risk-return profile to that of traditional equity strategies. Conversely, clean energy funds tend to be over-concentrated and own highly-volatile, speculative companies that often have yet to generate profits. This approach has yielded dramatic losses for investors in recent years. We continue to take pride in our GSI strategy as an option for clients to better align their values with their investments, without sacrificing the financial integrity of their portfolio.

Change Since December 31, 2020



Source: FactSet

REAL ESTATE

JOE HERRLE, CFA
Vice President
Alternative Assets

The defining force of 2023 was the Federal Reserve's aggressive interest rate hikes aimed at curbing inflation. This sent shockwaves through the commercial real estate landscape, pushing borrowing costs higher and dampening investor appetite. Acquisition volumes plummeted, particularly in the second half of the year as capital costs climbed. Existing owners felt the pinch as well, with increased debt service obligations eating into cashflow.

While interest rates cast a chill, rent growth painted a less uniform picture. Industrial and multifamily segments, bolstered by robust demand and limited new supply, witnessed continued rent hikes. Industrial landlords, fueled by burgeoning e-commerce activity, enjoyed some of the highest rental increases in the market. Multifamily, too, remained a bright spot, as rising home prices kept many potential buyers renting, pushing occupancy rates and rents upwards.

However, not all asset classes fared as well. The office sector, grappling with the hybrid work paradigm, saw the weakest rent growth. Downtown centers, once bustling hubs, faced vacancy challenges as companies embraced flexible work arrangements.

These dynamics translated into a stark divergence in performance across different real estate types. Industrial and multifamily emerged as the clear winners, delivering stable returns and attracting significant investor interest. Data centers, benefiting from the insatiable demand for cloud computing, also continued to see strong performance.

Conversely, office and retail faced significant challenges. While some prime office assets in high-demand locations weathered the storm, secondary assets and suburban offices struggled with vacancies and declining rents. Retail, too, saw a bifurcation, with essential space such as grocery stores performing well, while discretionary retail faced headwinds from inflation and online competition.

As we step into 2024, the commercial real estate outlook is somewhat cloudy. Despite the uncertainty, several trends show promise for specific asset classes. The industrial sector is likely to maintain its momentum driven by its inherent resilience and underlying demand. Data centers, too, are expected to continue their upward trajectory, fueled by digital innovation. Housing assets, while rents are expected to moderate in the short term, have a massive supply and demand imbalance. Investor capital, scared off by the subprime mortgage crisis circa 2007-08, led to developers underbuilding new homes in the U.S. The shortage, calculated as new households formed versus new homes built, is estimated to be over 6.5 million homes. Such a strong demand driver can't be ignored.

However, the office sector's future hinges on the evolution of hybrid work models. Prime assets in major cities may see a gradual uptick as companies seek out collaborative spaces for in-person interaction. Secondary and suburban offices face an uphill battle, requiring creative redevelopment strategies to adapt to the new normal.

In the new year investors will see that caution and selectivity will be paramount. Adopting a long-term perspective and focusing on assets with inherent demand and strong underlying fundamentals will be crucial for weathering potential market volatility. To that end, we remain confident in our allocations within real estate to asset types experiencing tailwinds from the housing shortage (housing and apartments), the proliferation of artificial intelligence (AI) and increased data needs (data centers and cell towers), and the growth of ecommerce (industrial warehouses).

MUNICIPAL BONDS

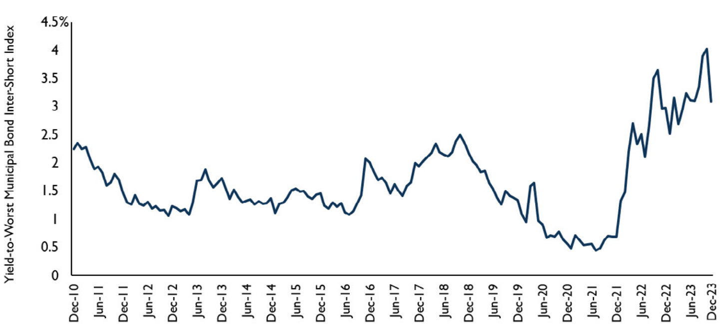
JOE BROOKS

Vice President
Tax-Exempt Trading and
Portfolio Management

Municipal bond yields remained elevated in 2023, reaching their highest point in over a decade. With interest rate cuts likely coming in 2024 and continued strong demand, we expect municipal bond yields to come down during the coming year. Municipal bond demand tends to increase when yields start to fall (prices rise), which can spur heightened demand and push yields lower. We don't foresee a big year for new issuance and expect elevated demand against a backdrop of tight supply.

Nationally, aggregate municipal bonds continued their multi-year improvement in quality in 2023. Specifically, over 71% of municipal bonds in the Bloomberg Municipal Bond Index carry one of the two highest ratings (AAA or AA). Pre-pandemic, the highest rated bonds only accounted for roughly 67% of the index. Tax revenues are the biggest funding source for municipal bonds with property tax revenue supplying the most significant source of funds. Last year, revenue collection was strong which played a significant role in allowing states to increase their budget reserves, but some headwinds may be on the horizon.

Municipal Bonds Are Attractive



Source: Bloomberg

State tax revenues had significant growth during the pandemic which, along with federal stimulus, helped to bolster state coffers and shore up budgets. However, we expect tax revenues to slow as the economy softens in 2024. That said, we do not see this becoming a credit quality issue for the municipalities we invest in.

Presidential election years tend to create some volatility in the capital markets. With municipal bonds, it usually centers around taxation at the individual level and in recent years (with the passage of the Tax Cuts and Jobs Act in 2017), how municipalities are able to issue taxable versus tax-exempt debt. The Tax Cut and Jobs Act, which will sunset in 2025, is likely to be a hot political topic of discussion this year. Any changes in the tax tables can increase, or decrease, demand for tax-exempt municipal debt, especially in high tax states like California, New York and Oregon. Should demand increase, the yield for tax-exempt bonds will move lower and municipals would become more expensive relative to taxable instruments like corporate and Treasury bonds.

We believe that municipal bonds will enjoy a positive return in 2024. While there may be some volatility, our allocation to high-quality municipal bonds will continue to provide diversification and offer downside protection. Owning a diversified municipal bond portfolio is an effective way to hedge against the volatility of the equity markets and provide stable long-term value and income.

ALTERNATIVES

JOE HERRLE, CFA

Vice President
Alternative Assets

Last year, we dubbed 2022 "the year of alternative assets," and rightly so. In a market where both stocks and bonds had losses in the double digits, our core alternative strategy, the Absolute Return Income Strategy, provided positive returns. As the public markets declined last year, many predicted a large repricing awaited alternatives in 2023. As the year unfolded, the large anticipated losses in alternatives did not transpire, although our core alternatives lagged other asset classes in investor portfolios.

When comparing the relative underperformance of alternatives this year, it is important to maintain a longer-term perspective. When looking at the last two years, we can see that our core alternatives strategy performed well in relative terms. The strategy produced positive total returns, while bonds performed negatively over the same period. So, while performance in 2023 was middling, in the long run it has done just what it was designed to do: serve as a steady source of returns in all market conditions.

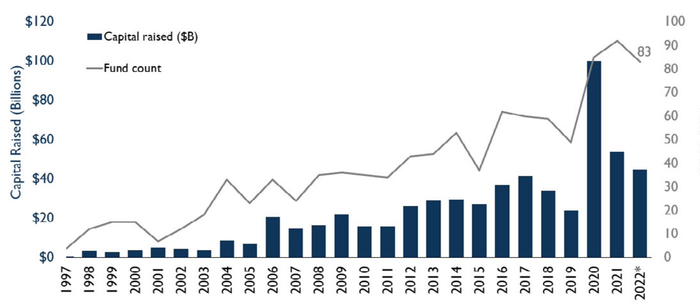
The positive return driver for the alternatives sector in 2023 was private credit, which enjoyed strong returns spurred by higher interest rates. Unlike traditional fixed income, private credit investments receive interest payments that fluctuate month-to-month based on prevailing market rates. So, when we see interest rates rise in the public markets, private credit investments will receive larger interest payments, thus higher returns.

The major detractor for alternatives sector-wide this year was real estate. Higher interest rates impact the asset class negatively across the board despite strong rent growth and demand for the sectors we allocate to most: industrial warehouses, data centers, and apartments. Unsurprisingly, office real estate is the hardest hit; however, our small allocation in the space is to newer, high-end offices that maintain high occupancy levels. Pressure on the market should subside next year as rates are expected to decline. However, office space will likely remain challenged as remote work continues to affect rent growth and valuations.

As we enter 2024, two promising opportunities are emerging within alternatives: private credit and private equity secondaries. Private credit thrives even as interest rates inch up. Banks, hobbled by regulations, retreat, leaving space for private lenders offering customized loans, higher returns, and strong protections. Consequently, private credit assets under management have doubled over the last decade.

Private equity secondaries offer another compelling avenue. Investors can buy existing stakes in funds at discounts, gaining swift liquidity for sellers and attractive entry points for buyers. Average discounts, right now about 16%[1], sweeten the deal, and buyers know exactly what they're getting. Add diversification and faster liquidity, and it's a potent package.

Growing Appetite for Secondaries



Source: Prequin

Alternative investments will continue to support the outcomes investors seek in portfolios. Some of the most pressing issues for 2024 will likely be diversification, inflation hedging and alpha. Our balanced approach to alternatives is designed to address those concerns, and we remain confident it can achieve its goals in 2024 as a core allocation within portfolios.

1 Jeffries Group H1 2023 Global Secondary Market Review