CION INVESTMENTS

Q1 OUTLOOK:
THE SPACE BETWEEN SPACES

Visit cioninvestments.com for more information.

A liminal space is the boundary between two places. Liminal, from the Latin limen, or "threshold," denotes a transitory place — neither here nor there, it's the space between spaces. A liminal space is a position of potential and uncertainty; a thing neither fish nor fowl, but inevitably to become one or the other. Eventually, the box is opened and the liminality resolves.

The economy starts 2024 in a liminal space, on the threshold of a soft landing but still possibly tipping into a hard one. The main economic concerns of 2023—high inflation and a looming recession—are almost, but not quite, resolved. To confirm a soft landing will take several more months of data. Prudence would suggest that we deem no recession avoided until the yield curve normalizes, but the victory laps have already started.

What is expected is also what is priced in. Consensus doesn't move markets; it's deviations from expectations that can shake things up. After a review of markets activity, we analyze six charts and discuss what surprises investors might see across the threshold.

Q4 and FY 2023 Market Activity Summary

Markets*

	As of 12.29.2023	Q4 Return	2023 YTD
S&P 500	4,769.83 pts	11.2%	24.2%
NASDAQ	15,011.35 pts	13.6%	43.4%
The Dow	37,689.54 pts	12.5%	13.7%
Global Equities		9.9%	25.7%
Emerging Markets		6.0%	6.1%
Energy		-7.2%	-4.1%
Gas	$3.66/gal	-15.5%	-5.1%
Gold	$2,062.98/oz	11.6%	13.1%
VIX	12.45 pts	-28.9%	-42.5%
10-Yr Treasury	3.88%	-69.2 bps	0.4 bps

**See endnotes.*

Alternatives*

	Q4 Return	2023 YTD
Direct Lending	4.9%	21.8%
CLOs	4.1%	17.4%
Private Equity	20.4%	31.8%
Hedge Funds	1.5%	4.8%
Equity REITs	17.2%	6.9%
Residential REITs	8.4%	3.8%
Industrial REITs	16.2%	15.7%
Wine & Cheese	-1.3%	2.9%
Crypto Market	75.6%	139.6%
SPACs	8.5%	22.9%

**See endnotes.*

U.S. Economic Performance

- Inflation continued to ease. The Consumer Price Index (CPI) rose 0.3% in December and 3.9% over the last 12 months. The Fed's favored inflation metric, PCE, is now at 1.9% over the prior 6 months, which is below the Fed's target rate.
- Unemployment levels remain near historic lows. The unemployment rate remained unchanged at 3.7% in December.
- No signs of recession here! US GDP rose 4.9% annually in the third quarter.
- Americans spent big this holiday season, but should they have? While consumer spending increased 3.1% from Nov. 1 through Dec. 24, according to Mastercard SpendingPlus, JP Morgan reported unpaid loans on credit card balances also shot up with a 16% increase from last year.

Monetary Policy

- Is a soft landing in sight? The Fed held rates steady in Q4 with the FOMC's "dot plot" indicating 250 basis points of interest rate cuts by year end 2026, with the futures market pricing in several more.
- Higher, but for how much longer? The CME Group, the world's largest operator of financial derivatives exchanges, has predicted an 80% chance that the FOMC will pivot at its March meeting.
- The Fed's balance sheet continues to shrink. Recent Fed meetings discussed a possible end to quantitative tightening (QT). Primary dealers expect QT to be curtailed later this year.

Credit Market Performance

- Lower rates in Q4 boosted credit market returns. For the FY 2023:

Investment Grade	+8.5%
High Yield	+13.5%
Leveraged Loans	+13.3%

- As lower yielding debts roll over, defaults are expected to tick up in 2024. U.S. Speculative-grade corporate default rates may reach up to 5%, according to S&P Global.
- Private credit funds continue significant fund raising. These funds now have more than $400 billion of deployable capital. As interest in private credit increases, investors might see even more allocation into this asset class during 2024.

U.S. and Global Market Summary

- Equities had a stellar year. The S&P finished 2023 up 24.2%, while the Dow notched a 13.7% gain. The NASDAQ, led by the Magnificent 7 (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla), finished up a whopping 43.4%.
- The Morningstar Global Next Generation Artificial Intelligence Index, finished 2023 up 80.80%.
- International equities soared. The bigger gainers include:

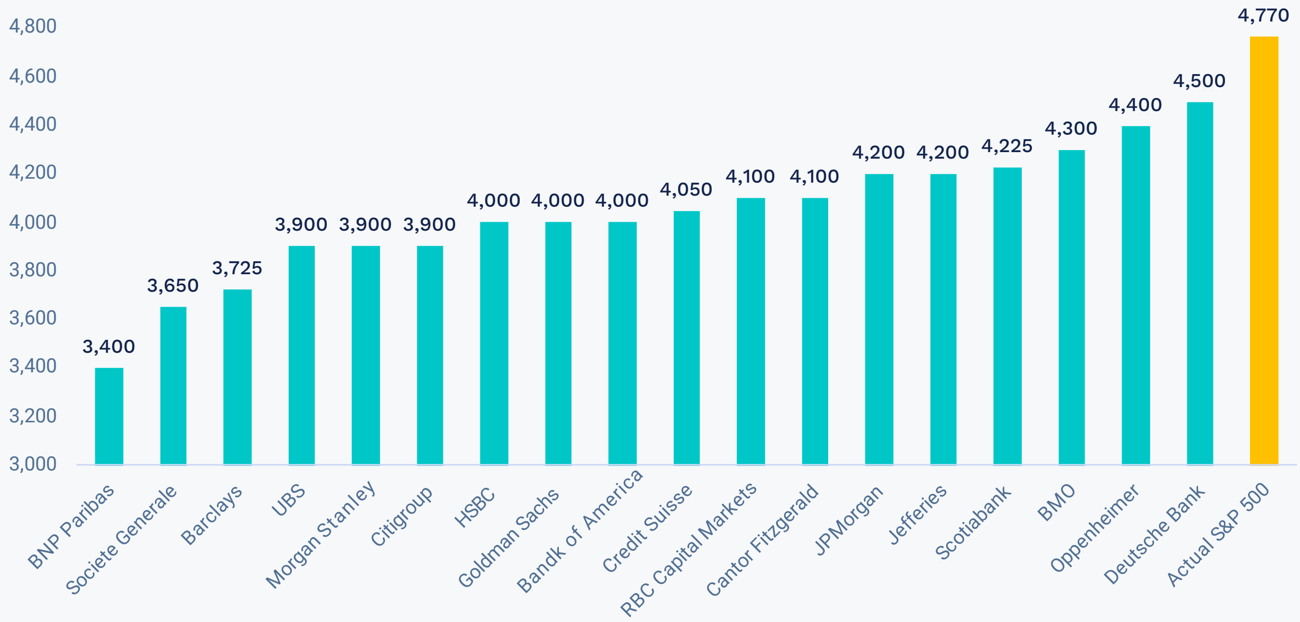
Brazil	+25%
Mexico	+37%
Spain	+26%

- Summer came early for crypto. The crypto winter ended early 2023, as Bitcoin (+159%) and Coinbase (+418%) soared. The first U.S. bitcoin ETFs began trading in early January 2024, after a landmark greenlight from the SEC.
- Gas is finally getting cheaper. Oil traded down in Q4, hitting $77 at the end of the year compared to $90 at the end of Q3. This fall in oil prices has contributed to a decrease in inflation.

2024 will be a year of change, regardless of whether inflation increases, or a recession occurs. Central banks seem to be on the cusp of cutting rates. Global disruptions—conflict, environmental, and trade related—are accumulating. This year will, unfortunately, be a global election “super-cycle.” Investing is never free of risk. Below, we look at what investors should watch out for in 2024.

Surprise #1: Consensus Will Be Incorrect

When we started 2023, supply chains were still a mess. Inflation seemed unstoppable. (Remember when egg prices were a meme?) And global central banks were raising interest rates to levels not seen in decades. Market prognosticators were pessimistic to say the least, with 85% of economists expecting a recession. For S&P predictions, even the most optimistic year-end price targets undershot actual events. The S&P 500 returned over 24% last year.



Source: Target Data via MarketWatch in Dec 2022.

In a year, consensus has swung from universal pessimism to now universal optimism. Bullish market sentiment has more than doubled from one year ago.

Source: Marketwatch, The New York Times

If fading consensus is the trade, then 2024 equity returns might not be as rosy as people think.

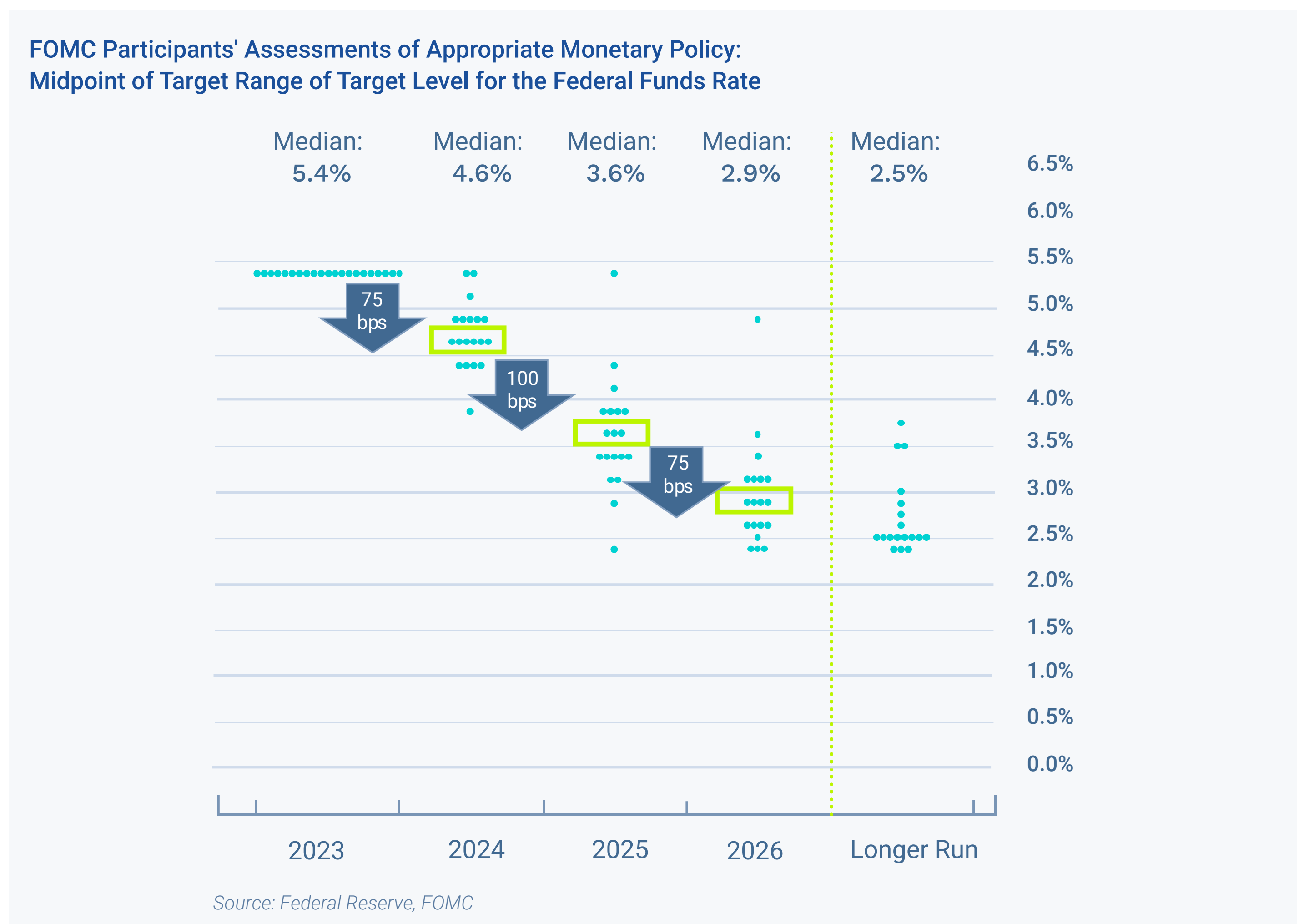
Surprise #2: Elections Will Have Financial Market Consequences

Pundits are calling it the "election super-cycle." Several 3, 4, and 5 year election cycles will collide this year. More than 40 national elections will be decided in 2024, sending more than half the world's population to the polls. We won't see this number of global elections again until 2048.

Politics will dominate the news for much of the year. Financial markets could be impacted if elections turn contentious. If anything brings a sense of liminality to financial markets, it is uncertainty related to elections. Investors hate uncertainty. Expect ramped up volatility until this super-cycle of elections is complete.

Surprise #3: Rate Cuts Might Not Be a Good Thing

Consensus now is that rate cuts are coming, with an average estimate of 125 bps cut in 2024. Futures markets are currently pricing in six cuts.



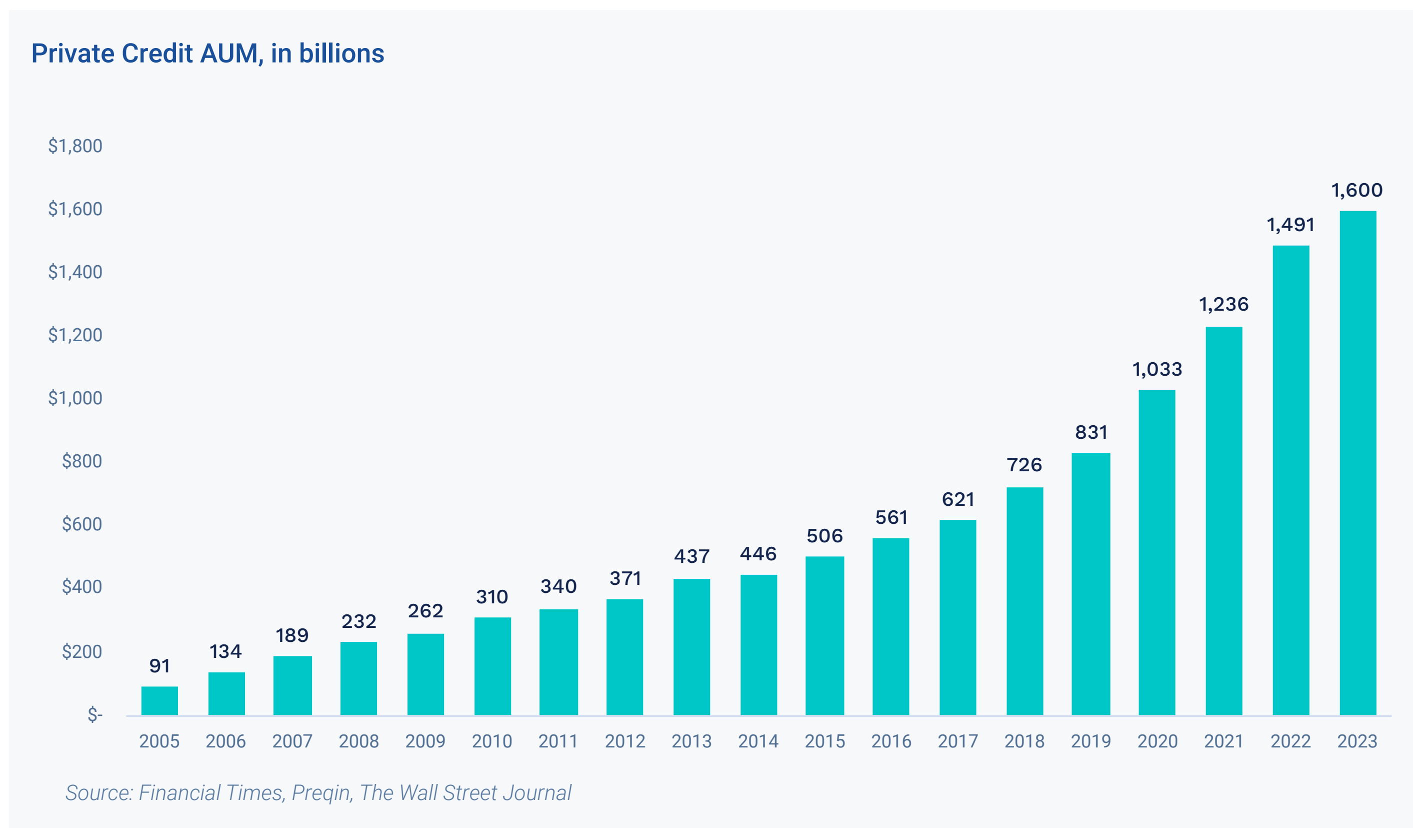
Source: Federal Reserve, FOMC

The futures market is currently more optimistic than the Fed about the pace of rate cuts. The Fed has taken a hard line about not cutting prematurely to prevent an inflation flare up. Powell could maintain higher rates past March or longer if inflation data goes up. If so, the financial market would be disappointed. With the market expecting cuts sooner, this deviation from expectations could negatively impact equity prices. Cuts that come past June would offer almost no boost to a market that has priced in earlier, and more significant cuts. Not all cuts are created equal—too little or too late will disappoint investors and be unlikely to provide a boost to asset prices.

Surprise #4: Alts and Private Credit Assets Allocations Will Grow Even Faster

Alternative assets will have another blockbuster year. Alternative investments—or "alts"—encompass private equity, private credit, infrastructure, hedge funds, real estate, and even more exotic investments like art, whisky, and watches. Many investors are upping their allocation to alts as the traditional 60/40 allocation (60% stocks, 40% bonds) gets displaced by a 40/30/30 allocation: 40% stocks, 30% bonds, 30% alternatives.

The current MVP of alts is Private Credit. This asset class has grown 23% annually since 2020. Expansion of this $1.6 trillion segment will likely continue, as individual investors are now able to access private credit through innovative structures, such as interval funds.



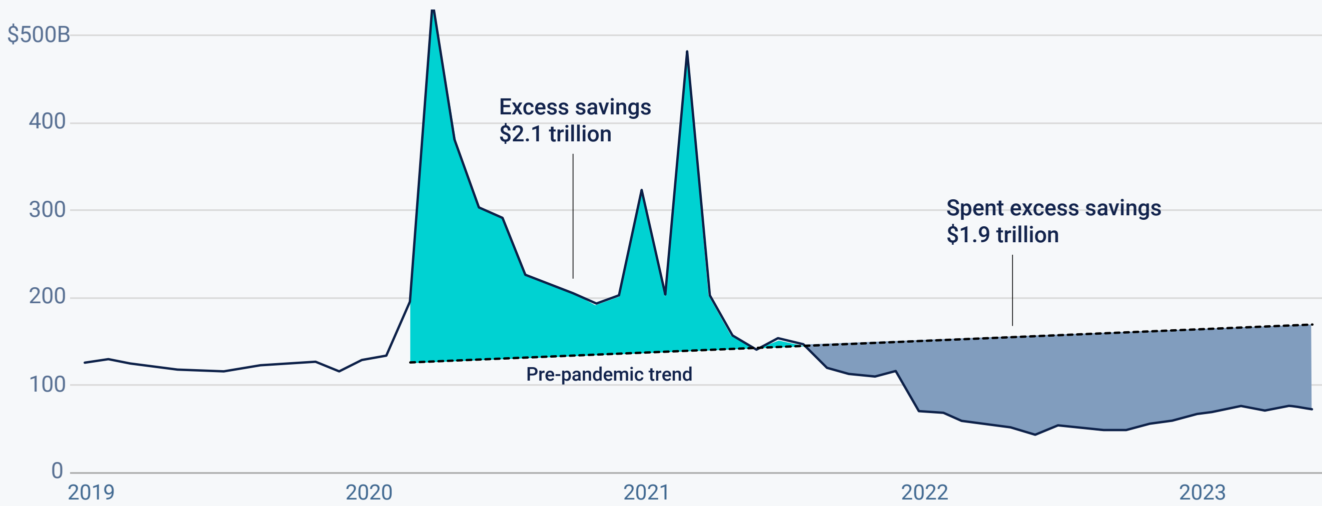
Source: Financial Times, Preqin, The Wall Street Journal

The uncertainty of the liminal market space can be mitigated with alts, which generally have lower correlation to public markets and may offer investors downside protections.

Surprise #5: U.S. Consumers Finally Tap Out

U.S. consumers have been bulletproof. Despite years of a pandemic, spiking inflation, and geopolitical uncertainty, spending has not slowed down. With housing costs continuing to increase and the excess pandemic cash now exhausted, will 2024 be a year of retrenchment for the indominable consumer? If so, expect a pull back on spending to pay for higher housing costs and eliminate debt.

Personal Savings from 2019 to 2023, in billions



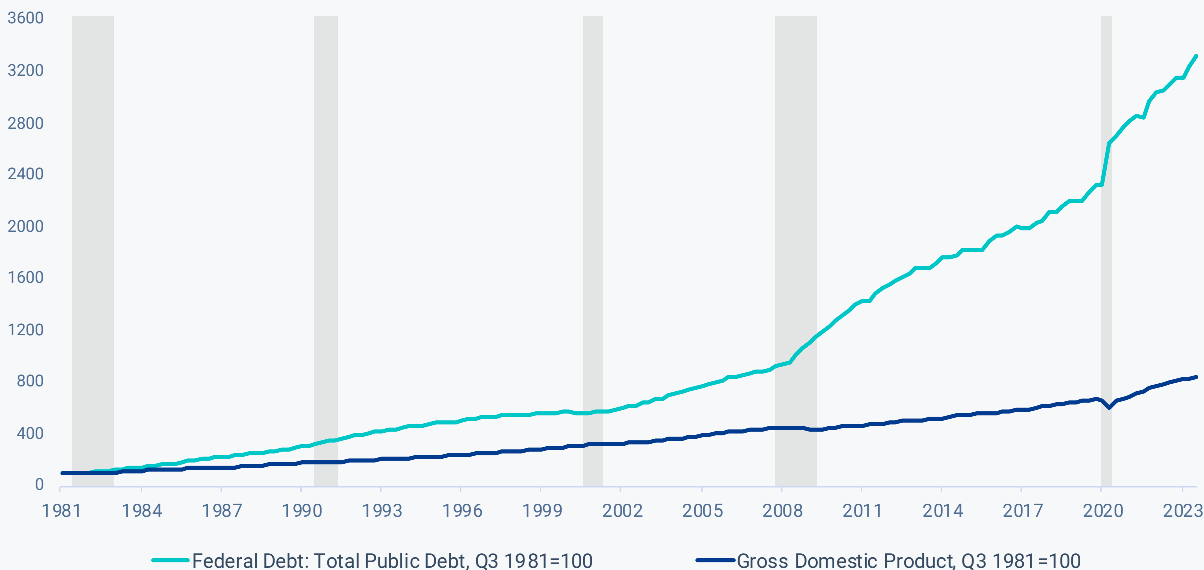
Source: Federal Reserve Bank of San Francisco
Graphic: Christopher Hickey, CNN

Surprise #6: Debt Will Finally Start to Matter

Forty years ago, on October 23, 1981, U.S. debt crossed $1 trillion for the first time. It was a shock to the nation. Crossing the threshold forced a national conversation on fiscal policy. Then nine months in office, President Reagan thundered, "If we as a nation needed a warning, let that be it." The warnings went unheeded and national debt has continued to increase since.

Now the U.S. is set to spend over $1 trillion annually on interest alone. National debt recently passed $34 trillion and shows now sign of slowing. Debt has grown significantly faster than GDP since 2008. With low-rate debt rolling over, interest expenses are projected to consume more of the federal budget than defense spending within a few years.

Total Public Debt vs. GDP (1981- 3Q 2023)



Source: Treasury; BEA; St Louis Federal Reserve, FRED
Shaded areas indicate U.S. recessions.

So far, the accumulated debt has not negatively impacted the economy. With no checks on spending, and increasing interest expenses, 2024 might be the year that U.S. debt starts to matter.

Conclusion

Economic data is positive for now. GDP is growing, unemployment is low, and the equity market recently hit new all-time highs. The Fed has all but declared victory over inflation. The "dot plot" shows lower rates on the horizon, which the equity market has already priced in. Treasury Secretary Yellen says that pessimism about the economy "has proven unwarranted." A soft-landing is now the base case.

Betwixt and between normalized and runaway inflation is an uncomfortable spot to be in. This is a liminal space in which no one wants to linger. Soft or hard, a landing is coming this year. We are starting our descent, tray tables are up, seatbelts are buckled, now we just have to see if the Fed can pull it off. The year 2024 will determine if Chairman Powell's legacy is a Burns or a Volcker.

Investors, as always, should think long term and allocate in a way that allows them to sleep at night. Time in the market always beats timing the market. No matter what surprises occur, investors should prepare for the unexpected and look for stability on the other side of the liminal space.

Endnotes

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material or guarantee the accuracy or completeness of any information herein, nor does Bloomberg make any warranty, express or implied, as to the results to be obtained therefrom, and, to the maximum extent allowed by law, Bloomberg shall not have any liability or responsibility for injury or damages arising in connection therewith.

"Crypto Market" represented by the Bloomberg Galaxy Crypto Index. "NASDAQ 100" represented by the NASDAQ 100 Index. "S&P 500" represented by the S&P 500 index. "Private Equity" represented by the Invesco Global Listed Private Equity ETF. "Direct Lending" represented by the DLX Direct Lending Index. "US Residential REITs" represented by the MSCI US Residential REIT Index. "CLOs" represented by the Palmer Square CLO Debt Index. "Leveraged Loans" represented by the S&P/LSTA Leveraged Loan Total Return Index. "High Yield Bonds" represented by the Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged. "Gold" represented by the SPDR Gold Shares. "Emerging Markets" represented by the iShares MSCI Emerging markets ETF. "Investment Grade Bonds" represented by the Bloomberg US Corporate Bond Index. "Hedge Funds" represented by the Bloomberg All Hedge Fund Index. "Equity REITs" represented by the MSCI World Equity REIT Index "Financials" represented by the Financial Select Sector SPDR Fund. "Telecom" represented by the iShares US Telecommunications ETF. "Utilities" represented by the Utilities Select Sector SPDR Fund. "Commodities" represented by the Invesco DB Commodity Index Tracking Fund. "Oil" represented by the United States Oil Fund LP. "VIX" represented by the Chicago Board Options Exchange's CBOE Volatility Index. "Natural Gas" represented by the United States Natural Gas Fund LP.

The information contained within is for educational and information purposes ONLY. It is not intended nor should be considered an invitation, inducement to buy or sell any security or a solicitation to buy or sell any security. The information is not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from us or any of our subsidiaries to participate in any of the transactions mentioned herein. Any commentary provided is the sole opinion of the author and should not be considered a personal recommendation. This is also not intended to be a forecast of future events nor is this a guarantee of any future result. Both past performance and yields are not reliable indicators of current and future results. Information contained herein was obtained from third party sources we believe to be reliable; however, this is not to be construed as a guarantee to their accuracy or completeness. Observations and views contained in this report may change at any time without notice and with no obligation to update. All investments carry a certain degree of risk, including possible loss of principal and there is no assurance that an investment will provide positive performance over any period of time. There are specific risks associated with investing in various types of financial assets and in different countries. The information contained within should not be a person's sole basis for making an investment decision. One should consult a financial professional before making any investment decision. Investors should ensure that they obtain all available relevant information before making any investment. Financial professionals should consider the suitability of the manager, strategy, and program for their clients on an initial and ongoing basis.