Sticking points: Removing four investor roadblocks

A MULTI-ASSET PERSPECTIVE

Executive summary

- **With the economy and market sending inconsistent and often conflicting signals,** we answer four key questions that are making investment decisions harder for market participants.
- **Precariousness relating to credit dynamics, inflation, the AI boom, and commercial real estate** has widened investors' confidence intervals around perceived risks and opportunities, but we don't see these uncertainties as reasons to stay out of the market.
- **There are always opportunities for investors,** even as macroeconomic gears shift. A look at the fundamentals can shed light on the balance between quality, yield and duration in investor portfolios.

NEW YORK LIFE INVESTMENTS

Introduction

2023 has been a year of mixed economic data, volatile market performance, and heightened uncertainty. Even the market itself is tied in knots: a year-to-date equity bull market has conflicted with bearish price action in bonds. As the confidence interval around the timing of recession widens, perceptions of risks and opportunities have varied — perhaps more so than is standard for a late cycle economy.

Tension between the fear of missing out and fear of recession lends itself to positioning in the extremes: chasing narrow rallies or sitting on the sidelines entirely. We hold to our view that a U.S. recession may start in the fourth quarter and persist into the first half of 2024, but positioning around this expectation need not be entirely "defensive" in the classic sense. There are *always* opportunities for investors, even as macroeconomic gears shift. We see late cycle allocation decisions as a matter of balancing quality (including credit risk), yield, and duration; this mix looks different for each investor.

To help investors navigate this balance, we have identified — and answered — four key questions obscuring their path. The uncertainty around these topics has made allocation decisions harder, lowered confidence, and pushed some investors into short-term thinking. Importantly, none of these uncertainties, in our view, are reasons to stay out of the market altogether.

1. **Is this time different for the credit cycle?**
2. **Is inflation really gone for good?**
3. **Did I miss the boat on Generative AI?**
4. **Is commercial real estate the next big risk?**

It is always difficult to time the market, and in this cycle's case it has been challenging to time the economy, too. But looking back across history, investors have been rewarded for finding ways to stay engaged with their long-term goals. We therefore encourage investors to focus less on if and when a recession may occur, and more on the breadth and depth of both risks and opportunities.

1

Is this time different for the credit cycle?

Macro indicators tell us credit dynamics shouldn't look this strong at this stage in the cycle. We unpack the fundamental case supporting both consumer and corporate credit.

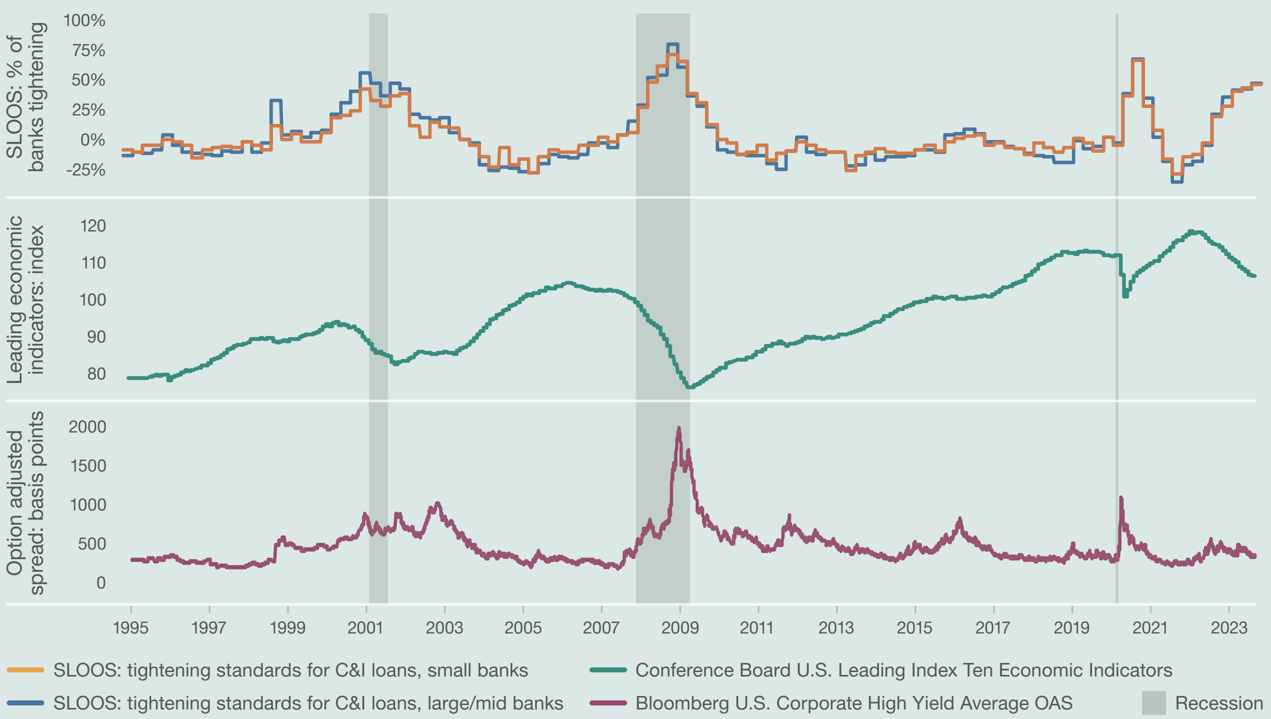
Amid ongoing calls for recession, both consumer and corporate credit have seen a story of defiance: consumer delinquencies are low and high yield credit spreads are in a moderate range. This is unusual two years into a severe credit tightening cycle. Does that mean this time is different — that credit can remain resilient, even in a recession scenario?

We track countless macro and market indicators in a credit cycle model designed to anticipate high yield default rates. According to that data, defaults should be higher than they are currently. The most significant data points here are credit conditions and leading economic indicators (which include manufacturing, housing, labor, equity, and bond market components), and their behavior is consistent with historical recessions, wider spreads, and higher defaults.

Why does credit look so resilient, and how does this widespread strength potentially benefit high yield corporate credit in particular? We see two major drivers: a strong consumer story and a digestible maturity structure.

Based on the fundamentals, high yield spreads should look worse

Credit conditions, leading indicators, and historical spreads, including historical recessions



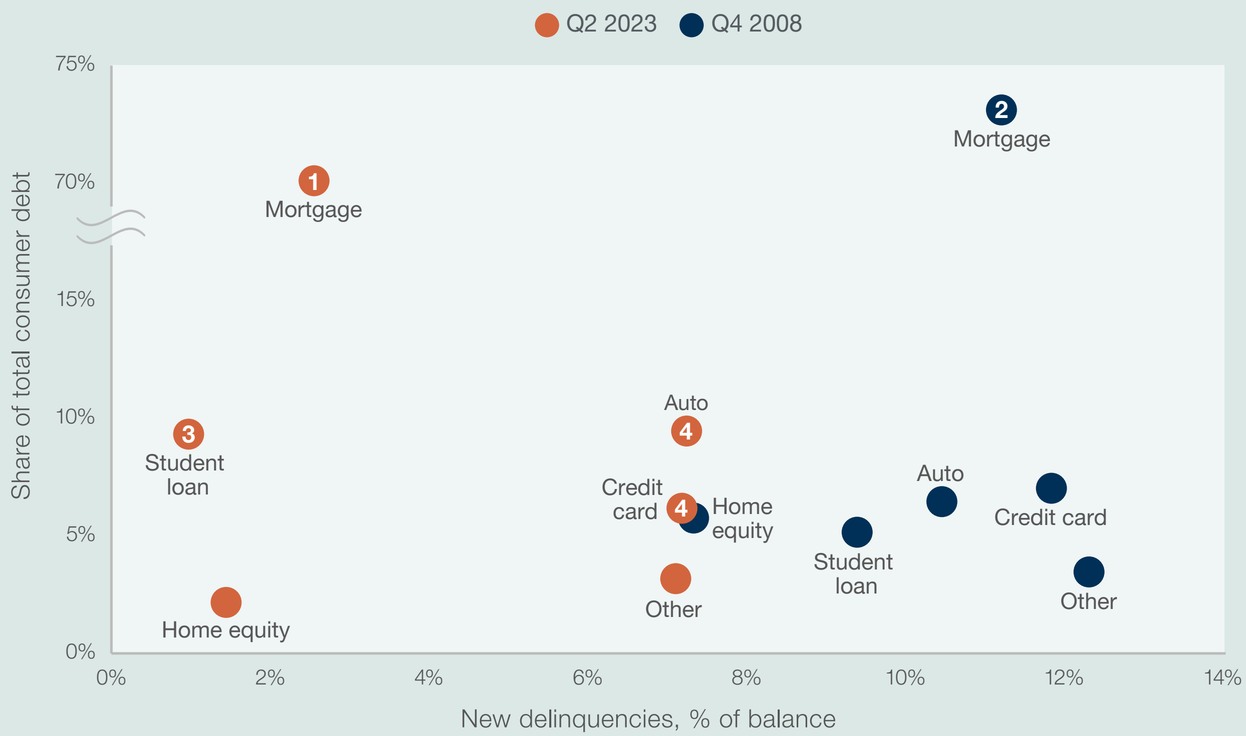
Sources: New York Life Investments Multi-Asset Solutions, Bloomberg Finance LP, Macrobond, Federal Reserve Board, Conference Board, September 2023. SLOOS: Senior Loan Officer Opinion Survey, conducted by the Federal Reserve to measure tightening or loosening credit conditions. C&I Loans: Credit and Industrial Loans made to corporations. Definitions can be found at the end of this document.

A strong and significant consumer backdrop

Though investors often consider consumer and corporate credit separately, they each affect the other — and not just on a fundamental economic basis. Stress or strength spreads easily within investable options, not least since the consumer discretionary sector comprises 27% of the major high yield corporate bond benchmark. In our Midyear Outlook, we highlighted that U.S. consumers are benefiting from ample job availability, historically strong wage growth, and nearly $800 billion in excess savings. It's also worth noting now that inflation has declined to more tolerable levels, real disposable income (adjusted for inflation) for households has improved. The result is a consumer credit picture that hardly signals a crisis.

Even after the severe interest rate adjustment of 2022, consumer credit is not sending crisis signals

New delinquencies (30+ days) vs. each credit segment's share of total U.S. consumer debt



1. Today, just 11% of mortgages are adjustable rate, sheltering many existing homeowners from the past year's hiking cycle.
2. Leading up to the Global Financial Crisis, 35% of all mortgages were adjustable rate.
3. Due to the 3-year student loan payment moratorium, the 90+ day delinquency rate on student loans fell from its 2012 – 2019 average of 11% to less than 1% in Q2 2023.
4. Auto loan and credit card delinquencies are now above pre-pandemic levels, driven almost entirely by younger and lower-income borrowers.

Sources: New York Life Investments Multi-Asset Solutions, Federal Reserve Bank of New York Center for Microeconomic Data, Quarterly Report on Household Debt and Credit, 2023: Q2, Equifax, August 2023. "Home Equity" refers to lines of credit taken out against home equity.

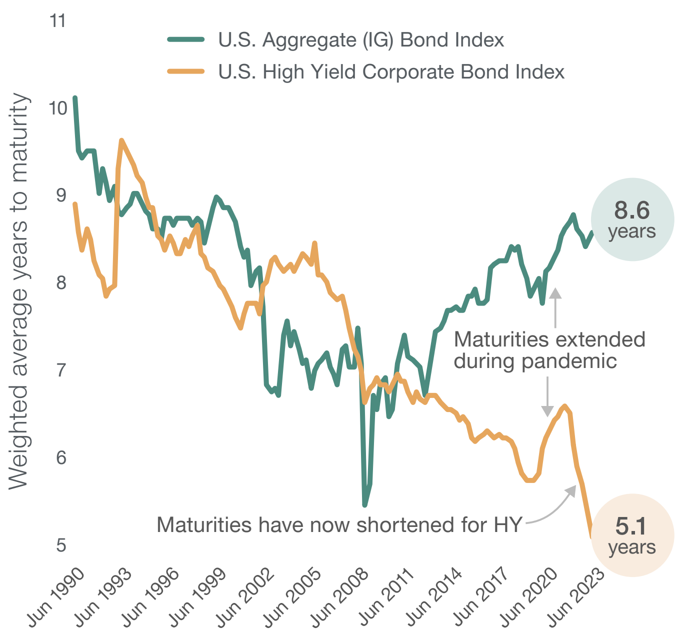
This is not to dismiss emerging pockets of consumer stress. We've known for well over a year that inflation has hit households least able to cope with it, and this stress is reflected in rising auto loan and credit card balances. 401(k) hardship withdrawals were up 36% YoY in Q2 2023, though general contributions are solid. Overall, consumer credit stress is still limited to small segments — though we are watching these closely.

Pandemic-era refinancing supports corporates

In the consumer world, fixed-rate mortgages have prevented 90% of existing homeowners from seeing rising financing costs during the Fed's latest hiking cycle. Similarly, heavy debt refinancing and increased corporate issuance during the pandemic period, when interest rates were on the floor, extended overall debt maturities for both investment grade (IG) and high yield (HY) issuers. This effect has rolled off for the high yield space and resulted in a weighted average time to maturity for the benchmark index at its lowest in 30 years. In other words — companies may soon be forced to issue new debt at now-higher borrowing costs.

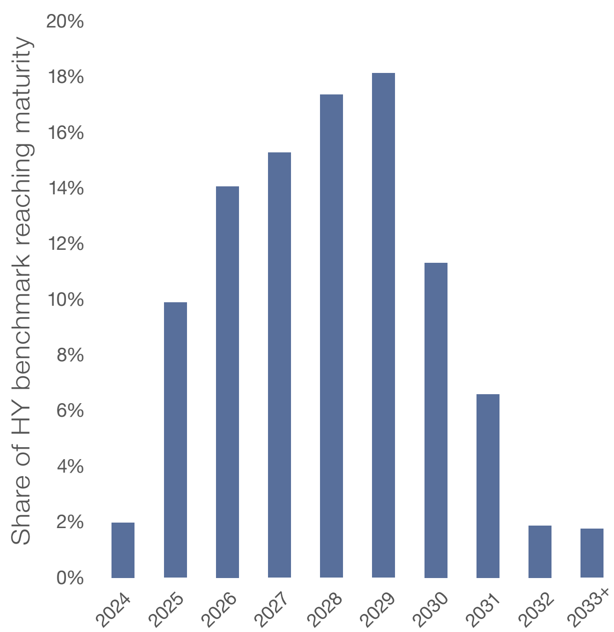
Maturity wall is more concerning for HY than IG credit, but not an imminent source of stress

Weighted average time to maturity of index constituents, IG and HY



Majority of HY loan maturities do not coincide with a 2024 recession scenario

Percent of HY benchmark index maturing over the next decade



Sources for both charts: New York Life Investments Multi-Asset Solutions, Bloomberg Finance LP, September 2023. HY: High Yield. IG: Investment Grade. Index used as benchmark is the Bloomberg U.S. Corporate High Yield Total Return Index. It is not possible to invest directly in an index. Index definitions can be found at the end of this document. Past performance is not a guarantee of future results.

However, we find concerns about an imminent "maturity wall" in high yield are overblown, considering that the overall index has an average time to maturity of over five years, and in each of those years a digestible portion of loans in the index mature. While we are not as convinced as market consensus that the Fed will be cutting rates soon, we do expect some level of policy easing over that five-year time frame, potentially allowing companies to roll over or issue debt at lower cost.

Resuming student loan payments: kind of a big deal

Due to the 3-year student loan payment moratorium, the 90+ day delinquency rate on student loans fell from its 2012 – 2019 average of 11% to less than 1% in Q2 2023. The Federal Reserve Bank of New York estimates that nearly 45 million Americans have an average monthly student loan payment of $393. If this cash would otherwise be spent, the resumption of student loan payments could mean more than a $200 billion hit to consumption spending per year. The U.S. Department of Education, on the other hand, estimates that the student loan pause saved borrowers $60 billion per year. There's a wide range in these estimated impacts, which are unlikely to be immediate; though loan payments are meant to resume in October of this year, there is a 12-month grace period for borrowers to begin repayments. Though the degree and timing of impact remain to be seen, we expect student loans to weigh on consumer spending to a meaningful degree and pressure other borrowing segments such as auto loans and credit cards.

PORTFOLIO STRATEGY:

High yield exposure doesn't imply unmitigated risk

Because of the unusual factors supporting consumers and businesses, the indicator we watch very closely to signal risk in the markets — high yield spreads — may not react as much as usual to the rising interest rate and gradually slowing economic growth environment. That doesn't mean spreads won't widen; the pace of bankruptcy filings, for example, has accelerated this year. But spread widening may be less pronounced and slower than it has been in the past, potentially reducing investor risk by giving the markets time to adjust expectations.

We believe the risks that remain are well compensated and accounted for in recent performance. The high yield asset class is printing a compelling yield of over 8.5% for the major Bloomberg benchmark, and it has experienced a drawdown consistent with the recession periods of the early 1990s and the Dot Com bust. Investors may therefore benefit from taking some of their equity-like risk in high yield, where despite some short-term pricing risk, the coupon exceeds both the earnings and dividend yields we expect from equity going forward.

We also believe high yield corporate credit can be a compelling way to manage duration, particularly with yields rising across the entirety of the Treasury curve. Barbell pairings, such as short-duration high yield paired with longer duration ideas in the municipal bond curve, can help investors keep both credit and interest rate risk in hand.

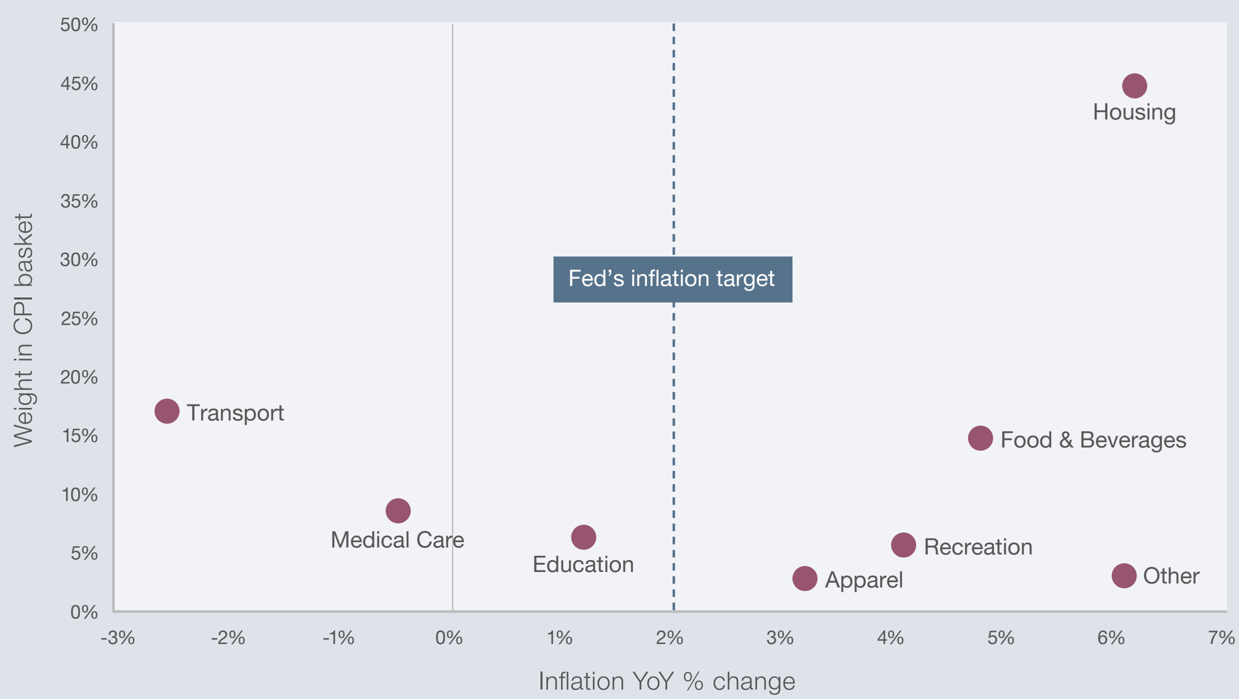
2 | Is inflation really gone for good?

The recent disinflation trend has been encouraging, but we're concerned that market expectations for sustained interest rate cuts in 2024 will be disappointed.

Inflation is cooling and, for some investors, is no longer a major macro risk or key determinant of asset allocation. We are not so sanguine. On the surface inflation has become more docile, but less so when looking under the hood. A number of inflation components are still running hot, especially core services inflation, and some developments such as rising food and energy prices threaten to reignite price growth.

Most inflation categories are still too hot, particularly the heaviest portions of the basket

Year-over-year change (%) in inflation components vs. weight in CPI basket



Sources: New York Life Investments Multi-Asset Solutions, Bureau of Labor Statistics, Macrobond, September 2023. Index definitions can be found at the end of this document.

We don't mean to be inflation scaremongers — disinflation is often a wavy process, and it is common, after a large spike in inflation like we saw in the U.S. last year, for another wave to follow. A *modest* uptick in inflation this fall may therefore not be a major risk. If investors expect this pattern, then markets may take the data in stride.

However, investors should be aware of developments that could break the existing trend and deliver a steep rise to a second peak of inflation. We're tracking several factors to signal whether an inflation resurgence is becoming more likely. Food and energy prices are rising, which could filter their way into core inflation. Historically tight employment conditions suggest that wage-price spiral pressures are still in play. Geopolitical, health, or weather events could cause a return of supply chain pressures. Or, a sustained easing in financial conditions, whether from favorable broad market conditions or premature Fed cuts, could allow inflation to re-accelerate. Finally, though not in our central assumptions, an unexpected positive fiscal impulse could also present an upside risk.

A double peak in inflation akin to the 1970s and 1980s is possible; but a double peak is more than just a modest uptick

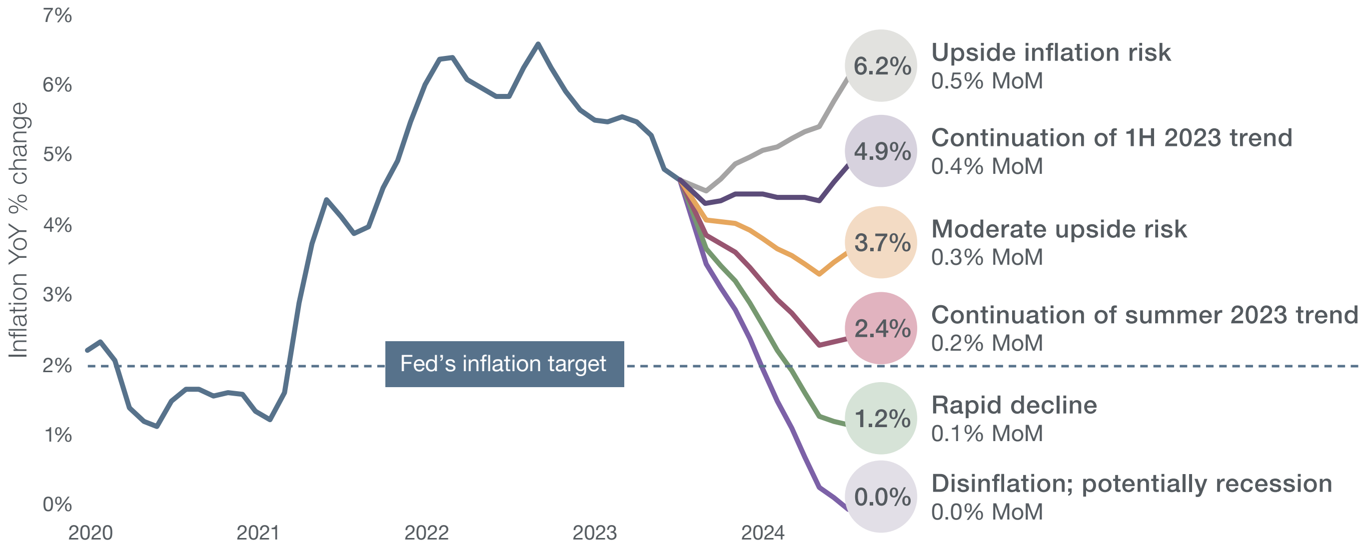
Year-over-year changes in the consumer price index, current cycle vs. 1972-1982

Sources: New York Life Investments Multi-Asset Solutions, U.S. Bureau of Labor Statistics (BLS), Macrobond, September 2023. Index definitions can be found at the end of this document.

The primary cause of the 1970s double peak in inflation was the Fed cutting interest rates before underlying price pressures were truly under control, a decision complicated by two oil crises during this period. And while today's inflation trend is encouraging, it doesn't yet demand cuts from the Fed next year. As the scenarios on the next page illustrate, if core inflation continues to rise at just 0.2% month-over-month, it would still be above target at 2.4% next July.

Even with moderate increases, core inflation could remain above target into 2024

12-month ahead core CPI evolution based on month-over-month scenarios



Sources: New York Life Investments Multi-Asset Solutions, U.S. Bureau of Labor Statistics (BLS), Macrobond, September 2023. YoY and MoM refer to year-over-year and month-over-month changes, in %. Index definitions can be found at the end of this document.

Current bond market pricing suggests we could see four rate cuts (100 bps total) next year. To us, this seems aggressive considering the current trend of inflation and labor market tightness. In our view, more than just a continuation of the 2023 status quo would have to happen — an economic slowdown and labor market deterioration — for this timing and pace of rate cuts to hold. Given this outlook, we think the market may be vulnerable to inflation risks, and any upside inflation surprises have the potential to change market expectations. This particularly holds for the equity market given its runup in price performance and valuations. Bond markets have adjusted more readily to a higher interest rate scenario, but could still be at risk of a larger upward inflation surprise as we saw in 2022. At the same time, other asset classes could relatively benefit from higher inflation environments, including commodities and real assets.

If the inflation target is the problem, why not just move it?

Rather than cause a recession to bring inflation back down to target, can't the Fed raise the target? We don't believe this will happen for the foreseeable future. A sudden change in the inflation target could erode the Fed's inflation-fighting credibility, leading to doubts about its commitment to its objectives. Additionally, an unexpected change in the target could alter expectations, potentially destabilizing financial markets, spending decisions, and wage negotiations. Making such a decision in the middle of a cycle would also appear hasty and might increase the risk of policy errors.

PORTFOLIO STRATEGY:

The risks of cash

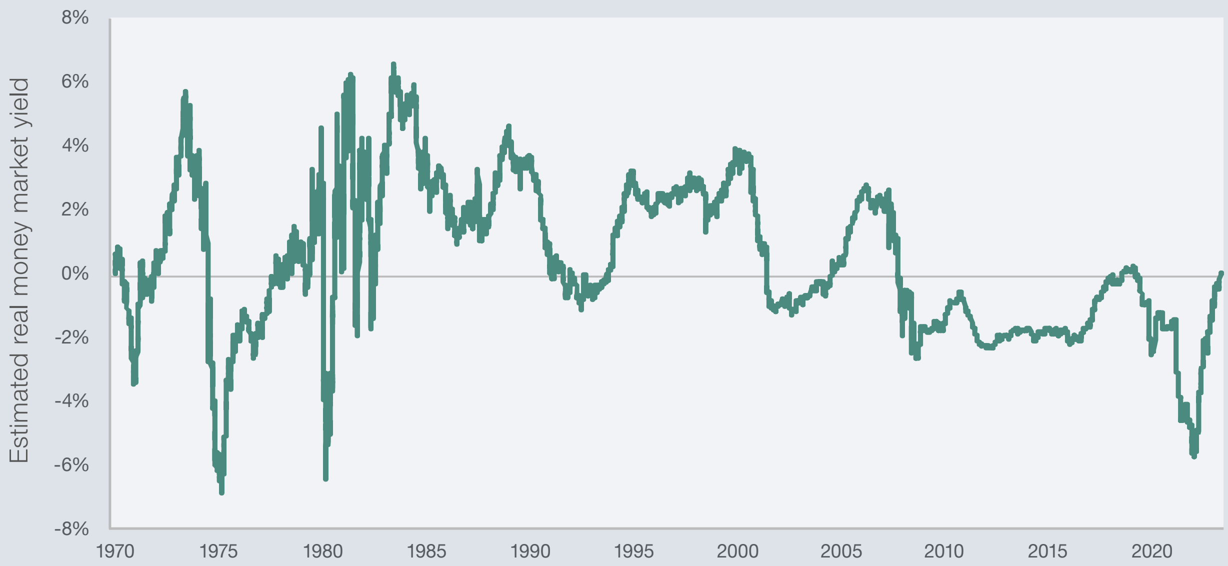
With the money market delivering nominal yields of 4%, 5%, or even higher, many investors have opted out of market volatility in favor of the shelter and relatively strong yield of the money market. But sitting in cash carries three risks:

1. **Mistiming the recovery:** By sitting on the sidelines, investors are more likely to miss out on the market recovery, which historically happens well in advance of the real economic recovery.
2. **Purchasing power erosion:** The money market is barely protecting purchasing power when adjusted for inflation. On a historical basis, the real money market return actually destroyed value — was negative when adjusted for inflation — for the better part of the last 20 years.
3. **Cash paralysis:** When out of the market, investors miss out on buying and rebalancing opportunities in which they can incorporate both cyclical and structural trends.

The takeaway for investors is that it's important to stay invested and diversified as market leadership across asset classes and sectors looks different whether inflation deflates or reignites.

The money market is often considered a safe haven, but has destroyed value when adjusted for inflation over 20 years

Estimated real money market yield: 3-month Treasury yield less core CPI



Sources: New York Life Investments Multi-Asset Solutions, Macrobond, Bloomberg Finance LP, September 2023. The estimated real money market yield is defined as the 3-month Treasury yield (lagged 3 months) less the annual change in U.S. Core CPI. Index definitions can be found at the end of this document.

3 Did I miss the boat on Generative AI?

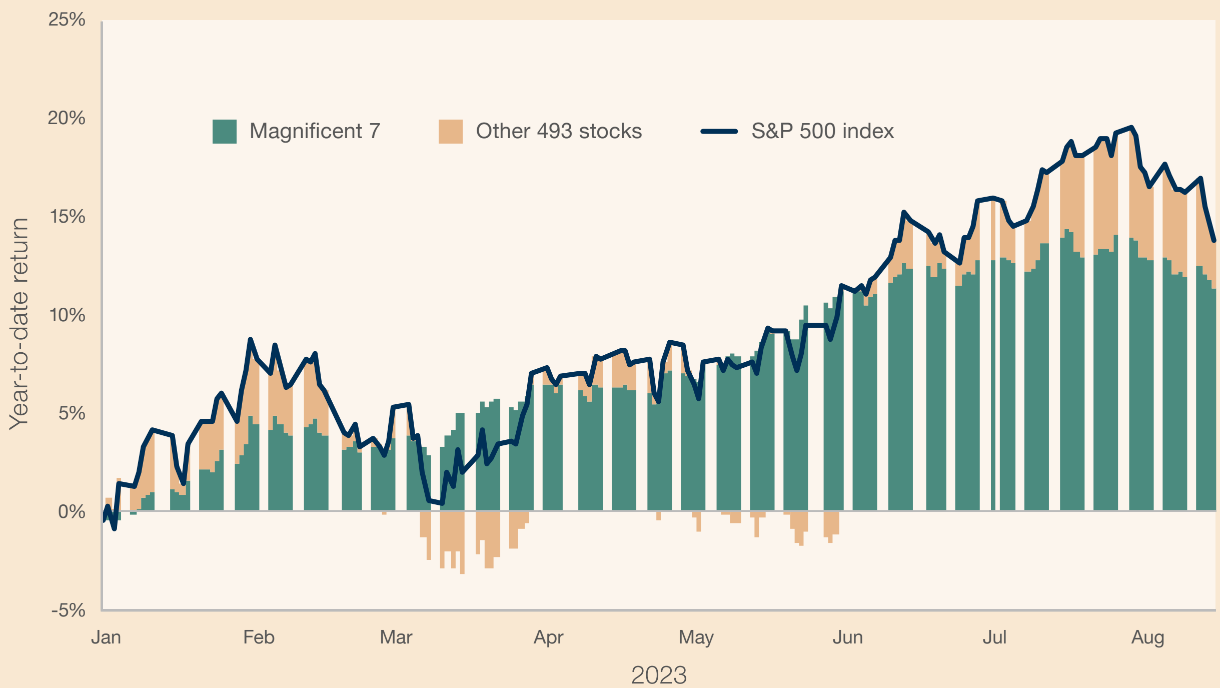
Investing in Generative AI is about more than chasing a few leaders. We believe new winners emerging from the applications of AI will provide investors time and entry points to participate.

ChatGPT, the generative artificial intelligence-powered (GenAI) chatbot, was the fastest-growing app in history, surpassing 100 million users in just two months. And perhaps more important than the chatbot itself is the ecosystem of unearthed potential it offers: opportunities for improved processes, productivity, and systems integration have excited data scientists and business leaders alike.

Investors have taken note, and as they scramble to gain a foothold in this emerging trend, the stock market has responded favorably. But a closer look at AI's meteoric rise tells a story of narrow growth. A cluster of dominant tech giants, often labeled the "Magnificent 7", have monopolized the majority of year-to-date gains. Recency bias, or the fear of missing out, has driven investors to continue chasing these stocks even as they have become more expensive. Despite recent breakthroughs in GenAI, we find it hard to justify mega-cap valuations at these levels. However, we see opportunity for companies of any size to participate in AI expansion.

The majority of year-to-date S&P 500 gains have been made by just seven companies

Magnificent 7 price performance vs. S&P 500 YTD



Sources: New York Life Investments Multi-Asset Solutions, S&P Global, Macrobond, September 2023. The Magnificent 7 are Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla. Index definitions can be found at the end of this document. Past performance is not a guarantee of future results.

Investors can think about GenAI architecture in terms of the physical layer, the foundational model layer, and the application layer. In the context of AI, the physical layer connects and enables both the foundational and application layers, representing the semiconductors and related equipment powering the foundational layer, as well as the digital infrastructure required to reach the end user. The foundational model layer refers to the underlying algorithms, data structures, and mathematical models that enable machine learning and AI capabilities. The application layer leverages the foundational AI models to perform specific tasks for end users, including voice assistants, recommendation systems, image recognition software, etc.

The full spectrum of AI investing suggests there are still opportunities to participate

Location in AI landscape	Physical layer	Foundational layer	Application layer
Types of companies	**Enablers:** Companies making semiconductors and related equipment Digital infrastructure	**Hyper-scalers:** Enterprise businesses leveraging their large-scale infrastructures, especially in cloud, to commercialize the foundational layer	**Beneficiaries:** Companies leveraging AI tech to turbocharge their businesses Software
Investment opportunity set	**Infrastructure equities and bonds**	**Mega-cap tech**	**Small and mid-sized growth companies**

Opinions of the New York Life Investments Multi-Asset Solutions, September 2023. For illustrative and educational purposes only.

Mega-cap tech companies dominate the foundational model layer because of their scale. Given their size and early adoption, it will be difficult for new entrants to disrupt their position, particularly in the near term. Many GenAI applications will be powered by foundational models developed by the top players, and the deployment of these new tools will likely require rapid growth in corporate spending on cloud computing services — a business area in which the mega-cap tech companies also have a strong presence. The application layer, in contrast, is wide open for innovation and likely will provide investors the time and entry points to participate. Companies of any size investing in AI capabilities could find success with the new technology, but the winners will be hard to predict. As with the internet, mobile, and cloud, some winners surfaced immediately, while others a decade later.

Investors' choice of where to access the AI trend may impact investment volatility

We find the application and physical layers of AI to be critical parts of the investment thesis because the question of how, how quickly, and to what end companies will use AI capabilities remains largely unknown. The answer to this question could impact the volatility of AI investing. If businesses are able to adopt new GenAI tools faster, helped by access to physical support such as chips and infrastructure, this could improve productivity for these companies and, depending on the scale of the business, a higher potential for more consistent returns. Rapid consumer adoption, on the other hand, can lead to exponential growth but with higher volatility — as we've already seen in booms and busts in software adoption related to the pandemic. For this reason, we encourage investors to see across the whole of the AI investment landscape, beyond the seven current leaders.

PORTFOLIO STRATEGY:

How to participate in the AI boom with an eye on concentration risk

To participate in AI advancements, investors can focus on affordable growth opportunities. An analysis of the AI sector points to an opportunity set of potential winners of mega-cap tech, infrastructure, and small and mid-sized growth companies. We believe mega-cap tech is especially expensive at its current levels, while infrastructure (both equity and bonds) and small and mid-sized growth companies may offer a better risk/reward entry point for, and access to, AI development via the application or even the physical layers.

Another potential benefit of these investment avenues is that they may offer investors secular upside opportunity. In order to scale up the processing capacity to run AI and large language models, mega-cap tech companies are surely going to need to expand their digital infrastructure capacity. Investors can look to capture that spend by investing in infrastructure solutions with exposure to technology and digital infrastructure.

4

Is U.S. commercial real estate the next big risk?

While we see potential pain points in the asset class in line with our recession view, this risk is likely already baked into listed investment opportunities.

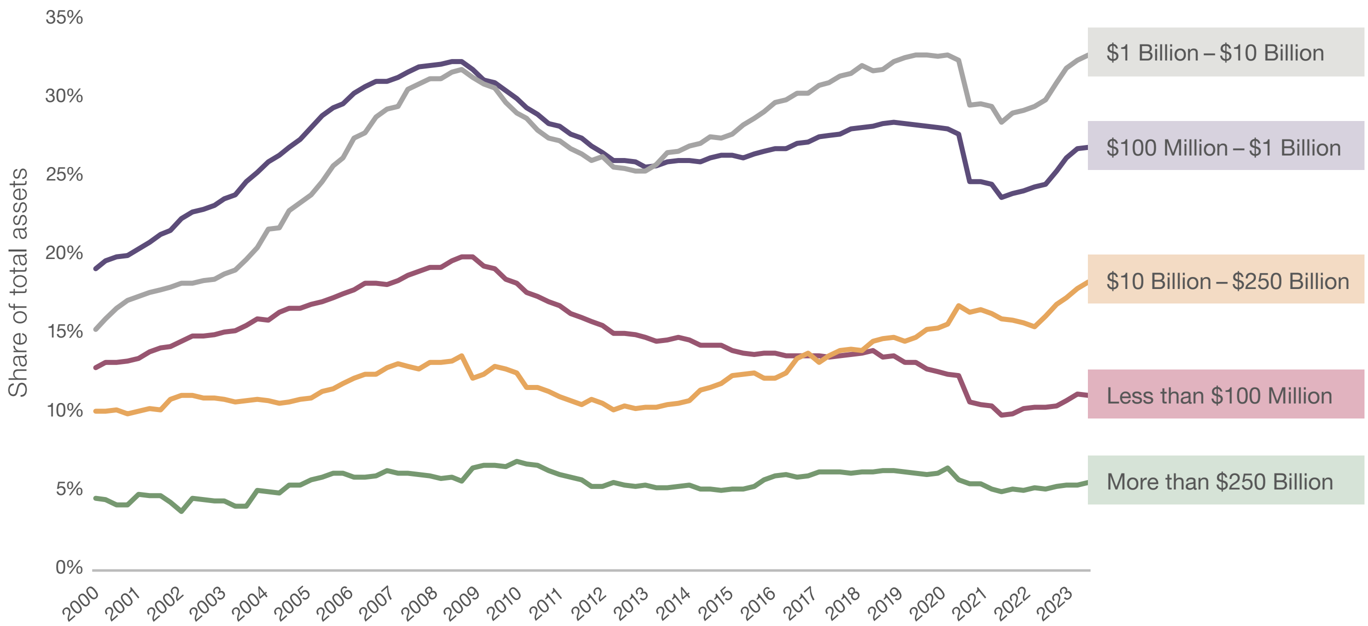
Authors' Note: We focus on listed, or liquid, publicly traded real estate in this piece due to its wide investor accessibility. However, many of the trends we have identified here — including the diversity of property type and geographic opportunities; the importance of quality; the potential attractiveness of today's yield; and the structural or regulatory changes underway — may extend to illiquid real estate opportunities as well, especially in senior debt.

U.S. commercial real estate (CRE) has experienced a one-two punch in the past several years. First came the pandemic, which pushed many white-collar jobs to work at home for a time, a trend that has been sticky in the U.S. Then came the interest rate hiking cycle of 2022–2023. While the extent of now-empty office space gets much of the attention, these shocks also affected earnings and valuations across real estate. The residential sector saw a once-in-a-generation shift in where and how people live and work. The industrial sector coped with a period of meaningful supply chain disruption. Retail space continues to digest the long-standing ecommerce trend.

The risk of recession now also looms, but standard cyclical pressures are not the central risk investors fear in the asset class. Instead, there are questions about whether write-downs in CRE valuations could prompt a new wave of banking losses, given the outsized exposure of small and mid-cap (SMID) banks to CRE loans. These concerns are in many ways well-founded: Moody's downgraded 10 SMID banks in Q3 2023 in part due to their CRE exposure. There are also signs of pain points beyond what default rates show: the share of securitized CRE loans being transferred to special servicers — which handle defaults, expected defaults, loan restructurings, and changes to capital structures — is rising.

CRE accounts for about a third of small and mid-sized U.S. banks' assets, potentially exposing these institutions to defaults and property value write-downs

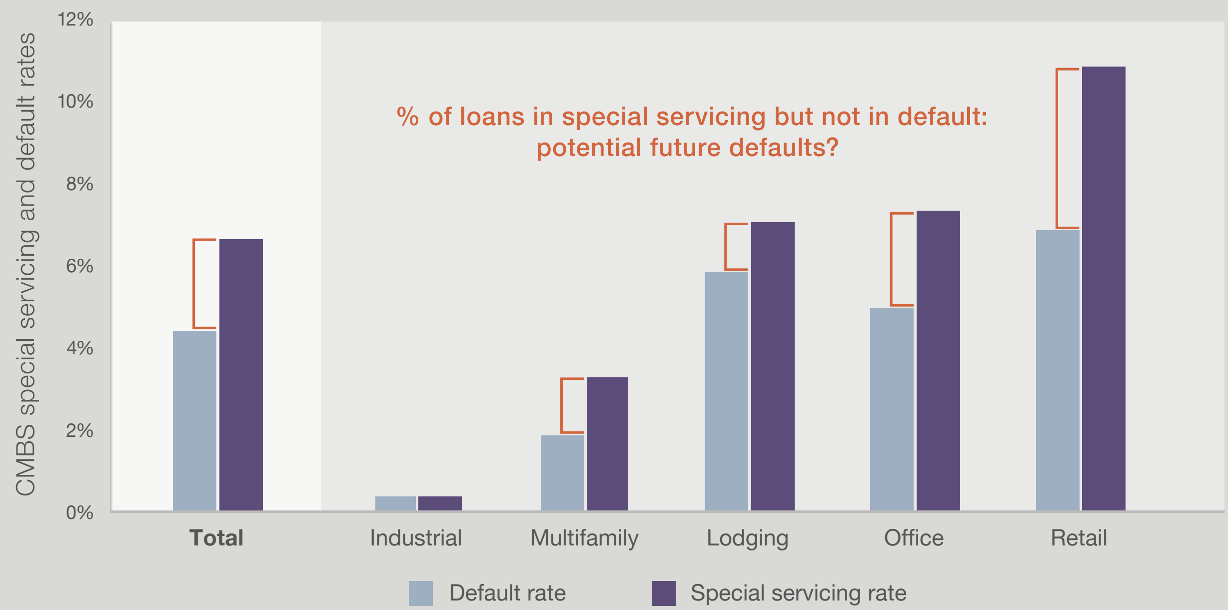
Commercial real estate loans as percent of total assets, by bank's total asset size



Sources: New York Life Investments Multi-Asset Solutions, Federal Deposit Insurance Corporation, Macrobond, September 2023.

Default rates alone may underestimate pockets of potential stress in CRE

Trepp special servicing and default rates of loans under CMBS structures, July 2023



Sources: New York Life Investments Multi-Asset Solutions, Trepp CMBS Research, September 2023. CMBS: Commercial Mortgage-Backed Securities. Past performance is not a guarantee of future results.

We certainly have concerns about real estate in a slowing economic cycle, but we also see pockets of resilience and opportunity.

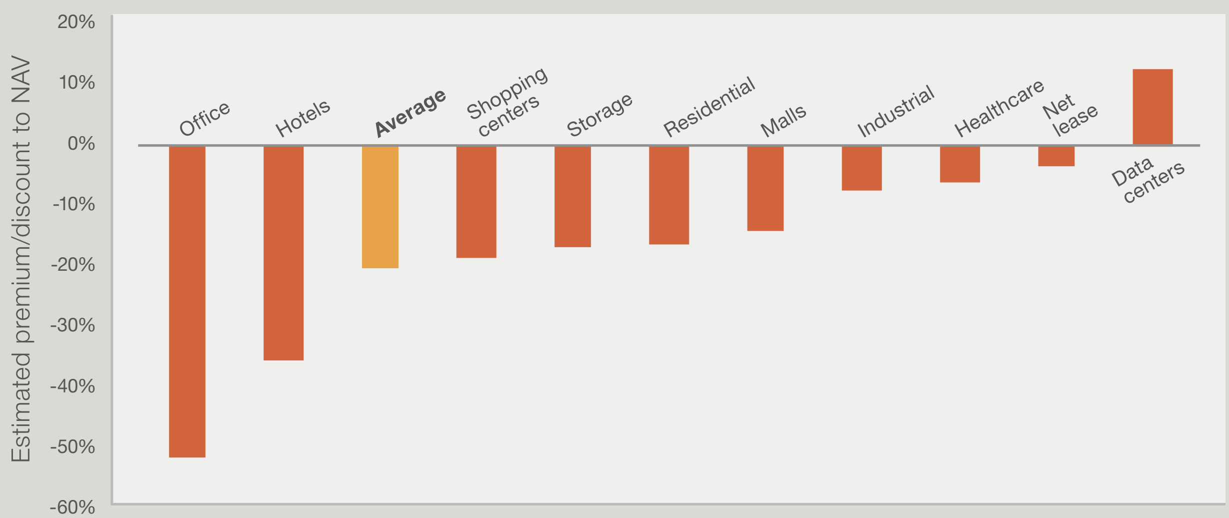
First, there are many structural shifts in play that extend beyond our 6- and 12-month views for valuation and earnings. Shifts in residential demand and potential new uses of office space, both pandemic-era hangovers, have yet to settle out.

A second source of resilience we see is the diversity inherent in listed (publicly traded) real estate assets, through both property type and geography. Though office is rightfully considered a problem for U.S. REITs, it comprises just 5% of a major listed real estate benchmark, down from 13% in 2009, and some investment approaches avoid it entirely. Geography has been both a source of risk and opportunity this year, per Moody's Analytics, with San Francisco leading vacancy rates and facing a harsher maturity wall — most notably in office space — than other major cities. On the flip side, residential areas in Texas, North Carolina, and Florida have seen incredible strength.

Finally, in areas of concentrated risk, we see hefty and potentially attractive discounts that tell us the scope, though not the timing, of opportunities in the listed space. As seen in the chart below, the average discount to estimated NAV across U.S. CRE sectors is about 20%. Seeing as the broad U.S. REIT market's 20-year historical discount to NAV is less than 5%, we expect some degree of mean reversion to support overall listed real estate valuations over the course of this cycle.

We believe valuations of many U.S. CRE sectors have already adjusted to cyclical and structural concerns

CBRE Investment Management's estimates of U.S. CRE sector valuations relative to NAV



Sources: New York Life Investments Multi-Asset Solutions, CBRE Investment Management as of 06/30/2023. Estimated net asset value (NAV) is calculated based on individual REIT-only stocks followed by the firm's research team and are considered as investible. Sector NAV premium discounts are calculated using simple average with CBRE Investment Management's proprietary models. Information is the opinion of CBRE Investment Management as of 06/30/2023, is subject to change, and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. Forecasts and any factors discussed are not indicative of future investment performance.

Why don't we see an imminent CRE threat to banking stability?

Though we do expect to see pressure in portions of the CRE market, we see this as a symptom in line with broad economic pressure, rather than a trigger of recession through the likes of a major banking crisis.

This view has four prongs. First, the CRE holdings of SMID U.S. banks — those outside of the 25 largest — are less concentrated than feared. SMID banks hold roughly a third of domestic CRE debt, less than the commonly believed 70%. Second, other key CRE holders, including life insurance companies and government-sponsored entities, may have enhanced risk management thanks to their equity capabilities, meaning they can potentially step in as subordinate capital providers where necessary. Third, there is still dry powder in institutional portfolios to be put to work — about $280 billion, according to New York Life Real Estate Investors' internal estimates. Fourth, ongoing strength in consumer credit could potentially offset any liquidity strain on the CRE side, particularly for smaller, regional banks that have relatively small individual CRE loan balances relative to consumer credit.

PORTFOLIO STRATEGY:

The structural role of a real estate allocation

We are confident in our view that there is a structural role for real estate in portfolio allocation. For this cycle, we're vigilant about the balance of risks and mitigants.

- **On the risks side:** the real estate earnings outlook is troubling, particularly in a recession scenario.
- **Risk mitigation:** we find pain points in real estate to be more concentrated, and potentially narrower, than investors currently appreciate. In addition, real estate investments can potentially help mitigate or even benefit from other risks, including inflationary surprises.
- **Looking to opportunities:** consider emerging long-term drivers from climate adaptation to the enablement of a new technology boom. The listed real estate space can provide a diversified option to participate in these trends (new builds, repurposed assets, valuations, and earnings adjustments), possibly even before new "winner" companies access public equity and bond markets.

Conclusion

There is no way around it: there are always risks to investing. And although recession risk has increased more slowly than anticipated, we do still expect a hard landing. In such an environment, it can be tempting to sit out both the uncertainty and the expected accompanying increase in market volatility. Certainly, macroeconomic headwinds make investment *selectivity* more important, but it's just as important to acknowledge that there are opportunistic selections to be made.

Sticking points: removing four investor roadblocks

	Investor question	Our take	Investment approach
1	**Is this time different for the credit cycle?**	While the economic cycle isn't different this time (we believe a hard landing is inevitable), the credit cycle may be. Strong consumer and corporate fundamentals, alongside pandemic-era supports and smart issuance, may mean that high yield spreads do not widen as much as is typical when macro risks rise.	Consider high yield corporate bonds, potentially taking from an equity sleeve, to capture equity-like risk and higher coupon. We prefer short duration in our corporate credit exposure, balanced by longer duration in municipal credit.
2	**Is inflation really gone for good?**	The recent disinflation trend has been encouraging, but risks remain. Rate cuts are highly unlikely without a major slowdown in economic activity or labor market strength.	Cash has not kept up with inflation, and is not riskless if inflation reaccelerates. We believe diversified allocation includes an allocation to beneficiaries of an inflation surprise, including real assets.
3	**Did I miss the boat on Generative AI?**	Investing in Generative AI is about more than chasing a few leaders. We believe new winners emerging from the applications of AI will provide investors time and entry points to participate.	Digital infrastructure and small and mid-sized growth companies may offer a better risk/reward entry point for the broad range of AI opportunities.
4	**Is U.S. commercial real estate the next big risk?**	While we see potential pain points in the asset class in line with our recession view, this risk is likely already baked into listed investment opportunities.	We maintain a structural allocation to real estate, with listed options offering attractive pricing in our view.

Definitions

Breakeven inflation rates are derived from the difference in yields between nominal bonds and inflation-linked bonds of the same maturity. It serves as a market-based indicator of inflation expectations over a specific time horizon.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

Core Consumer Price Index (Core CPI) is the Consumer Price Index excluding the more volatile prices of food and energy.

Earnings per share (EPS) is the monetary value of earnings per outstanding share of common stock for a company.

A **maturity wall** refers to the total amount of debt that will mature in a defined time period for a single issuer or for the weighted average of the constituents in an index.

The **National Bureau of Economic Research (NBER)** traditionally defines recession as a significant decline in economic activity that is spread across the economy and that lasts more than a few months.

Net asset value, or **NAV**, in a Real Estate Investment Trust (REIT) represents the fair market value of real estate assets minus any outstanding debt, expenses, and capital expenditures and is the preferred valuation approach for REITs.

The **nominal 10-year Treasury yield** represents the interest received from a U.S. 10-year government bond without adjusting for inflation. It is the yield expressed in current dollars. The **real 10-year Treasury yield** represents the yield adjusted for changes in the purchasing power of money.

An **option-adjusted spread (OAS)** measures the difference in yield between a bond with an embedded option, with the yield on Treasuries. The **average option-adjusted spread** measures the average of this difference over a defined time period.

Real gross domestic product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy.

The **Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS)** is a quarterly survey conducted by the Federal Reserve on the standards and terms of the banks' lending and the state of business and household demand for loans.

Index Definitions

The **Bloomberg U.S. Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The Index includes Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate pass-throughs), asset-backed securities and commercial mortgage-backed securities (agency and non-agency).

The **Bloomberg U.S. Corporate High Yield Total Return Index** measures the return of the high yield, U.S. dollar-denominated, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P are Ba1/BB+/BB+ or below respectively.

FTSE Nareit U.S. Real Estate Index is a broad-based index consisting of real estate investment trusts (REITs). This excludes any equity REITs that are designated as Timber REITs.

The **S&P 500 Index** is an unmanaged index that is widely regarded as the standard for measuring large-cap U.S. stock market performance.

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