FRONTIER
ASSET MANAGEMENT

Capital Markets Perspective

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A SOLID START

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Coming off a year-end rally for both stocks and bonds, markets were a bit more subdued and investors increasingly discerning about where to put money to work in January. Particularly given that optimism over March rate cuts was already fading by month end when Fed chair Powell all but guaranteed that such hopes would be dashed. At a press conference, Mr. Powell said, "I don't think it's likely the committee will reach a level of confidence by the time of the March meeting to identify March as the time to do that…We know that reducing policy restraint too soon or too much could result in a reversal of the progress we have seen on inflation."

The final nail in the coffin for March rate cuts came soon after month's end when the Labor Department reported that employers added about 353,000 jobs in January, almost twice as many as expected. In addition, December's payroll gains were revised upward from 216,000 to 333,000, the unemployment rate remained at 3.7%, and wages advanced by 4.5% year-over-year, well ahead of December's 3.4% inflation print. Even before the release of these figures, the International Monetary Fund published an upgraded forecast for the global economy, indicating that economic activity would again reach 3.1%, as it did in 2023. The I.M.F. noted that it anticipates the United States will experience growth of 2.1% this year, up from its prior estimate of 1.5%, and that it sees improvement in many of the world's larger economies, including China and India.

It's not just economists who are viewing conditions in an increasingly positive light, every component of the University of Michigan's consumer sentiment index jumped during the month, from the general level of expected future financial conditions, to the adequacy of retirement income, to home values, to buying conditions for vehicles and durable goods. The 29% increase in the sentiment reading over November's level marks the biggest two-month increase since 1991. Further, consumers lowered their inflation expectations, and in a separate report, the Bureau of Labor Statistics stated that labor productivity came in at a healthy 3.2% quarter-over-quarter, which is not only helpful on the inflation front but also to corporate earnings. Overall, geopolitical tensions and risks aside, 2024 is off to a splendid start.

What happened in the markets in January?

EQUITIES: ASIAN SEPARATION

Japanese equities jumped out of the gates, gaining 8.5% in local currency terms, and a more modest, but still healthy 4.6% in U.S. dollars. Meanwhile, ever-increasing concerns about China's real estate troubles contributed to

a more than 10% decline in Chinese equities. While pessimism about China's economy and markets may be peaking, according to the BofA Global Fund Manager Survey, shorting Chinese equities is the second most crowded trade, after, you guessed it, being long the Magnificent Seven. But another reminder that this love affair with big tech stocks is much more reasonable than in the late '90s comes from Goldman Sachs and FactSet, which suggest that margins for the Mag 7 could continue to increase over the next three years, from about 20% currently to 22.6% in 2026, while margins for the remaining S&P stocks should hover around 10%.

Large caps generally had a decent month, advancing by 1.7%, while small-cap stocks struggled mightily, retreating by about 4% after their torrid fourth-quarter performance. Small value did even worse on concerns about the health of regional banks, given the troubles at New York Community Bancorp, which saw its stock plunge on the final day of the month. Large growth stocks were in positive territory and outperformed value both at home and abroad, while the reverse was true for international small caps which were down 1.7% and where value stocks held up a bit better. International large caps outpaced the S&P 500®, gaining 2.6% in local currency terms, but a strengthening dollar meant that the return to U.S. investors was only 0.6%

With about 76% of S&P 500 companies reporting fourth-quarter earnings thus far, operating earnings are estimated to be down 0.5% and GAAP earnings are looking to be 3.4% lower than in the third quarter. Margins are being projected at 10.7%, according to S&P Global.

BONDS: TIPS ON TOP

The yield on the 10-year Treasury increased for much of the month before backing off and ending at 3.99%, 11 basis points (bps) higher than where it started. The yield curve became less inverted on both a 10-year minus 2-year and 10-year minus 3-month basis and long-term Treasuries fell by 1.8%. The bond market as a whole was down 0.2%, with investment grade corporates flat, and high-yield bonds eking out a 5 bps gain. Leveraged loans advanced by 0.3% and TIPS came out on top, gaining 0.4% as investors took advantage of attractive real yields. Spreads on investment grade corporates were essentially unchanged, while high yield spreads widened by 20 bps.

COMMODITIES: OIL REBOUNDS

Winter storms, slowing production, and strong economic data helped oil move higher. WTI futures gained 6.1% and Brent crude futures advanced by 5.4%, but the energy complex only moved higher by 2.8% thanks to a 9.3% decline for natural gas (futures contracts have plummeted by almost 40% over the past three months). Agriculture, precious metals, and industrial metals were all down, losing 1%, 1.3%, and 1.9%, respectively.

How are Frontier strategies positioned?

ALLOCATION CHANGES

Due to the complexities of attempting to generalize about allocation changes across our Core, ETF, Specialty, Tax-Managed, Multi-Asset Income, and Faith-Based Strategies, and the additional difficulties of properly conveying how those asset allocation changes flow through to trade level activity, we are instead directing clients to our monthly trade summaries, which describe in detail what trade activity occurred by strategy, and why.

Focusing on our Core Strategies, relative to their long-term asset allocations, which serve as policy portfolios guiding our dynamic allocation decisions, we favor U.S. and international small caps, emerging market equities, managed futures, floating rate loans, and cash/short-term bonds. We are generally underweight U.S. and international large cap stocks, REITs, commodities, and both high-yield and high-quality bonds at the asset allocation level, but differences between the asset allocations and actual exposure at the fund level can and will occur. At the beginning of January, our asset allocation models modestly increased cash and short-duration fixed income at the expense of minor reductions across several asset classes, given the strong performance of equities and bonds in December.

Return expectations for emerging market equities and international small caps continue to remain near the tops of their respective 20-year ranges. Expectations for TIPS, managed futures, and T-bills are likewise high relative to history. U.S. large caps remain near their 20-year lows, as do REITs, and leveraged loan return expectations while still attractive, have moved lower from a year ago.

PERFORMANCE ATTRIBUTION

Overweight to global small caps and emerging markets hurt relative and absolute performance for the month, as did the underweights to U.S. large caps. Due to the negative currency impact on international large caps, our underweights were not as much of a headwind as they otherwise would have been. Our underweights to REITS were beneficial, as were our exposures to leveraged loans in our more conservatively oriented strategies. Managed futures funds as a group were down, but less so than long-term Treasuries, which are the other primary hedging tool that we utilize in our portfolio construction process.

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FRONTIER ASSET MANAGEMENT

Inflation is the decline of purchasing power of a given currency over time. A quantitative estimate of the rate at which the decline in purchasing power occurs can be reflected in the increase of an average price level of a basket of selected goods and services in an economy over some period of time. The rise in the general level of prices often expressed as a percentage, means that a unit of currency effectively buys less than it did in prior periods.

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ASSET CLASS	**INDEX**	**INDEX DESCRIPTION**
U.S. Large Cap Equity	S&P 500	Represents US large company stocks.
U.S. Small Cap Equity	Russell 2000	A small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.
International Small Cap Equity	MSCI EAFE Small Cap	An equity index which captures small cap representation across Developed Markets countries around the world, excluding the US and Canada
International Developed Equity	MSCI EAFE	An equity index which captures small-cap representation across 21 Developed Markets countries around the world, excluding the U.S. and Canada.
Emerging Market Equity	MSCI Emerging Markets	Captures large and mid cap representation across 24 Emerging Markets (EM) countries.
Investment Grade Corporates	Morningstar US Corporate Bond	Measures the performance of fixed-rate, investment-grade USD-denominated corporate bonds with maturities over one year.
High Yield Bonds	Morningstar U.S. High Yield Bonds	Measures the performance of USD-denominated high-yield corporate debt. It is market-capitalization weighted.
TIPS	Morningstar US TIPS	Represents inflation-protected securities issued by the U.S. Treasury.
Leveraged Loans	S&P / LSTA U.S. Leveraged Loan 100	Designed to reflect the performance of the largest facilities in the leveraged loan market.
Long-Term Treasuries	Morningstar US 10+ Yr Treasury Bond	Measures the performance of fixed-rate, investment-grade USD-denominated Treasury bonds with maturities greater than ten years.
REITS	FTSE NAREIT Equity REIT	A free-float adjusted, market capitalization-weighted index of U.S. equity REITs.
Commodities	Bloomberg Commodity	Broadly diversified index that allows investors to track commodity futures through a single, simple measure. The DJ-UBSCISM is composed of futures contracts on physical commodities.

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