WATERFRONT | BALANCED

WATERFRONT | ASSET MANAGEMENT

1Q 2024 COMMENTARY

Executive Summary

The equity market continued its advance in the first quarter with the S&P 500 hitting an all-time high in March. The global economy has been surprisingly resilient in the face of stiff headwinds emanating from higher interest rates, tightening credit and a contracting manufacturing sector. Stubbornly persistent inflation and exceptionally strong employment data caused markets to push out expectations for short-term interest rate cuts. With that backdrop, stocks posted strong returns while bonds declined modestly. The S&P 500 Index rose 10.6% in the first quarter and the Bloomberg U.S. Agg Gov't/Credit Index declined 0.7%. The Waterfront Balanced Composite rose 4.8%, lagging the blended benchmark which posted a 6.0% increase as well as peers in the Morningstar Moderate Allocation category.

The Bureau of Labor Statistics posted the 'seismic' March Employment Report on 4/5/2024 about an hour prior to an actual earthquake in the NE United States. The number of jobs added in the Survey smashed expectations (303,000 vs. 214,000 expected) with 'tremors' reverberating across asset classes. Yields on fixed income securities hit their highs for 2024 as expectations of interest rate cuts from the Federal Reserve were both reduced in size and pushed further into the future. Equity markets also 'wobbled' after posting strong performance in the first quarter as strong employment and sticky inflation readings caused some nervousness as the second quarter commences. Given stiff headwinds from higher rates; weak economic leading indicators; tightening credit conditions; recessionary data in the Euro area and the UK; as well as numerous ongoing geopolitical risks; the prevailing consensus of a 'soft landing' for the U.S. economy seems a bit naïve. To date, domestic economic growth has been sustained by the resilience of consumer spending and corporate profit margins. However, consumer finances are increasingly strained with the savings rate well below the pre-pandemic average and credit card delinquencies at the highest levels since 2012. Corporate profit margins have recently benefited from rising productivity without a reduction in headcount; a goldilocks scenario that supports consumer confidence and spending. Going forward, the ability of corporations to maintain profitability in the face of elevated costs and a shrinking pool of available workers could determine the next 'tectonic' shift for assets.

	Q1 2024 Total Return
Waterfront Balanced Composite (net)	**4.8%**
60% S&P 500 / 40% BBG U.S. Agg Gov't/Credit (benchmark)	**6.0%**
Morningstar Moderate Allocation category (median return)	**5.3%**
S&P 500 Index	**10.6%**
Bloomberg U.S. Agg Gov't/Credit Index	**<0.7%>**

The Waterfront Balanced strategy advanced 4.8% in the first quarter, underperforming the funds benchmark (blended benchmark consisting of 60% S&P 500 & 40% Bloomberg U.S. Aggregate Govt/Credit) as well as peers in the Morningstar Moderate Allocation category. During the quarter and relative to the benchmark, performance was negatively impacted by a conservative asset allocation and defensive risk posture in the equity sleeve of the portfolio. At quarter end, the strategy's allocation to equity was 54%; fixed income represented 41%; with the balance in cash.

The equity sleeve advanced 9.6% during the quarter, underperforming the benchmark as poor stock selection in the Technology and Consumer Staples sectors hurt relative performance. Strong stock selection in the Consumer Discretionary sector was helpful to relative performance but insufficient.

The fixed income sleeve declined 0.2% during the quarter, outperforming the benchmark. The Treasury curve inversion was relatively unchanged with the 2yr/10yr curve ending the quarter inverted by <39bps>. Investment Grade credit spreads narrowed 11 basis point to 93 bps, well below the 25yr average of ~157bps. Performance benefited from the duration and credit extension that took place in 2023. The strategy is overweight credit with ~48% of the fixed income sleeve in U.S. government-guaranteed Treasuries and Agency bonds and ~52% in corporate debt (predominately Investment-grade rated).

The quarter's top contributors to performance were concentrated in the Technology and Communication Services sectors. Microsoft and Netflix are secular growers with strong competitive moats and unique growth drivers in 2024. Microsoft has durable growth in its Cloud segment and a burgeoning opportunity in AI across its product suite. Netflix has deepened its competitive moat over the last several years and is increasingly monetizing its subscriber base through membership pricing and advertising. Amazon benefited from strong growth in its AWS segment and growing profitability in its consumer-facing segments. Micron is seeing booming demand for its memory chips as corporations race to build out the datacenters necessary to enable artificial intelligence capabilities. In each case, the fundamental outlook is strong, supporting my continued conviction.

TOP CONTRIBUTORS	AVG. WEIGHT	RETURN	CONTRI-BUTION
Microsoft (MSFT)	4.4%	12.1%	0.51%
Micron Technology Inc. (MU)	1.4%	38.3%	0.44%
Netflix Inc. (NFLX)	1.7%	24.7%	0.43%
Amazon.com, Inc. (AMZN)	2.2%	18.7%	0.38%
Progressive Corp. (PGR)	1.2%	30.5%	0.32%

Infineon Technologies, Apple and IPG Photonics were negatively impacted by softer consumer demand for smartphones and automobiles. Infineon and IPG Photonics also have significant exposure to the global economy which has posted slower growth and in some cases seen recessionary conditions. Apple is struggling to bring innovation to the smartphone market that will spark consumer demand. As interest rates rose during the quarter, United States Treasuries with longer duration were negatively impacted. I continue to believe interest rates are near an intermediate peak and likely to decline over the medium term. Finally, UnitedHealth Group had a cyber-security event in its most profitable segment which will likely meaningfully slow its growth in the near term. In addition, the rate the U.S. government will pay insurers for the Medicare population came in below expectations which will pressure margins in that business in 2024. For each of the equities, I continue to believe in the long-term growth and profitability of the franchise and expect patience to prove rewarding.

TOP DETRACTORS	AVG. WEIGHT	RETURN	CONTRI-BUTION
Infineon Technologies ADR (IFNNY)	1.3%	<17.9%>	<0.28%>
Apple Inc. (AAPL)	0.9%	<10.8%>	<0.10%>
IPG Photonics Corp. (IPGP)	0.5%	<16.5%>	<0.08%>
UST 4.125% due 8/15/2053	1.5%	<4.2%>	<0.07%>
UnitedHealth Group, Inc. (UNH)	0.9%	<5.7%>	<0.05%>

As I look forward, the backdrop for risk assets continues to be uncertain. On the positive side of the ledger, the inflation outlook is clearly improving. And yet, while I am encouraged by the consensus view that inflation rates will cool further in the months ahead, the pace of moderation is slowing and the underlying trends are sending conflicting signals. While goods inflation has clearly rolled over, the level of inflation in services has remained elevated. Over the medium and longer term, de-globalization, geopolitical tensions and global demographic trends impacting labor availability and healthcare costs suggest that the inflation backdrop may have structurally changed. If that proves true, interest rate increases by global central banks, which have been extreme, are unlikely to be entirely reversed. And as mentioned in many prior commentaries, the impacts of tighter monetary policy occur with a lag and will likely drive a continued reset in consumer and corporate spending and investment in the months ahead. While the consensus anticipates a series of interest rate cuts in 2024, the previously discussed structural drivers of inflation seem underappreciated which suggests there will likely be some disappointment. Finally, the valuations of equity and fixed income instruments imply a meaningful amount of confidence in a positive outcome for earnings growth and the durability of cash flows for publicly traded corporations. While a 'tip of the cap' is due to those who anticipated a benign economic environment, the risks haven't dissolved and the growth backdrop for 2024 continues to look uncertain. As a result, your account is conservatively positioned in terms of asset allocation, sector weights and credit exposure. As we saw in 2023, there will be attractive investment opportunities in the midst of uncertainty. Volatility creates opportunity for active investors and your account is positioned to respond quickly to capitalize on them when they come.

While the outlook is uncertain, my focus is unchanged. Across economic cycles and irrespective of market moods, I seek to maintain an emphasis on finding high quality, growing companies whose securities are trading at a reasonable valuation with visible catalysts to drive relative performance over the next twelve months. This approach has served investors well over time, and my confidence in it has not waned.

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