

Outlook 2024

Investing Reconfigured

After the Rate Reset:
Five considerations for the year ahead

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Foreword

In many ways, this past year has defied expectations. The widely anticipated U.S. recession hasn't happened. Growth across many economies has proven surprisingly resilient. Inflation has retreated from its multi-decade highs. Global multi-asset portfolios have regained more than half of the ground that was lost from the market peak in late 2021 to the trough in October 2022.

At the same time, a historic rise in global bond yields has reconfigured the investing landscape. Higher rates give investors more choices in crafting their financial plans than at any time since the global financial crisis.

In our 2023 Outlook, titled "See the potential," we encouraged clients to look past the headwinds to growth and consider the prospects for stronger markets. That turned out to be pretty good advice.

To prepare for the year ahead, we rely on the experience of our Global Investment Strategy Group to help us identify both the risks and opportunities that our clients may face. In their view, higher bond yields and reasonable equity valuations mean that forward-looking returns across many asset classes seem more promising than they have been in more than a decade.

Whatever markets have in store, we rely on each other and on the relationships we have forged with you over time. We are honored to stand by your side as your financial partner.

Thank you for your continued trust and confidence in J.P. Morgan.

Sincerely,



Kristin Lemkau
CEO, J.P. Morgan Wealth Management

Highlights from the 2024 Outlook

Inflation will likely settle.

You should still hedge against it.

Equities are one option. Real assets are another.

The cash conundrum.

Yes, yields are tempting.

But we think this is as good as it gets.

Bonds are more competitive with stocks.

The rate reset has run its course. It's time

to consider locking in higher yields.

Equities seem to be on the march to new highs.

The consensus isn't wrong.

AI is a game changer.

Contained credit stress.

Investors should consider capitalizing on stressed real estate and private credit.

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An investment landscape reconfigured

After the Rate Reset: Investing Reconfigured

There haven't been this many attractive investment choices to consider in more than a decade. But how do you personalize the possibilities with a strategy that optimizes your specific financial needs and goals? We think the key to harness the dynamics of a new rate world is to understand—and further explore—five important considerations.

The big shift to a new interest rate world

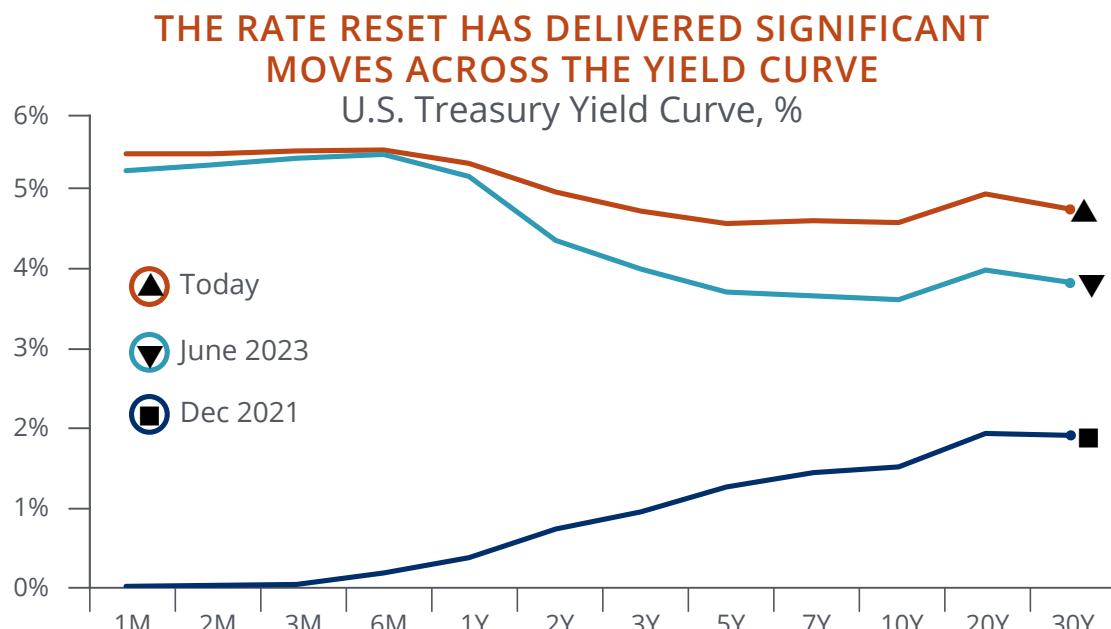
Three years ago, nearly 30% of all global government debt traded with a negative yield. It seemed the era of super-low interest rates might never end.

But it did.

Today, negative yielding debt has all but disappeared. Over half of the developed world's sovereign debt trades with a yield higher than 4%, and U.S. Treasury yields across the curve, from 3-month bills to 30-year bonds, range from ~4.5% to 5.5%.

The rise in global bond yields is not just historic—it marks the most important development in markets since the world emerged from the COVID-19 pandemic.

It has also reconfigured the investing landscape. Rates near 5% give investors more choices in crafting their goal-aligned wealth plans than at any time since the global financial crisis (GFC).
file



Source: Bloomberg Finance L.P. Data as of November 15, 2023.

Many investors have already paid a price for this newfound flexibility. Global multi-asset portfolios have managed only meager gains since stocks took off in November 2020 on the news of Pfizer's successful COVID vaccine trial. For the first time ever, investment grade debt (including sovereign securities, municipal bonds and corporate credit) is at risk of delivering negative total returns for three years in a row. Despite a strong calendar year in 2023, broad equity markets have also struggled to find direction amid wild swings by certain stocks and sectors.

As multi-asset portfolios have treaded water, cash hasn't looked as enticing in over 15 years. Not surprisingly, perhaps, our clients have added at least \$120 billion to money market funds, Treasury bills and other short-term fixed income investments to generate incremental yield with limited downside risk. This hasn't drained their

deposits—they have added at least \$18 billion more in checking, savings and certificates of deposit as well. Simply put, our clients are holding significantly more cash than they did two years ago.

Cash is understandably tempting. And at the same time, higher bond yields and reasonable equity valuations mean that forward-looking returns across many asset classes seem more promising than they have since before the GFC.

In short, it's clear the markets have entered an entirely new interest rate regime. We suggest that investors consider capitalizing sooner rather than later on what we think is a once-in-a-generation opening that may not be available a year from now. But how do you personalize the many possibilities with a strategy that optimizes your specific financial needs and goals?

We think the key to harness the new dynamics of a 5% rate world is to understand—and further explore—these five important considerations:

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Inflation will likely settle. You should still hedge against it.

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The cash conundrum: the benefits and risks of holding too much.

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Bonds are more competitive with stocks—adjust the mix according to your ambitions.

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With AI momentum, equities seem to be on the march to new highs.

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Pockets of credit stress loom, but they will likely be limited.



01

Inflation will
likely settle.
You should still
hedge against it.



It's important to mention the circumstances that caused the rate reset in order to explain our view on the course we think inflation and rates will take. In 2021 and 2022, as inflation soared globally, nearly all major central banks aggressively hiked interest rates (except the Bank of Japan and the People's Bank of China). While shorter-term interest rates quickly moved higher, longer-term yields only caught up in the late summer and early fall.

One possible reason for this move is that investors are starting to believe inflation will be higher than it was in the late 2010s and higher policy rates will be needed to help keep it in check.

We agree with that assessment.

But to be clear: We believe the near-term path for inflation is lower.

Inflation has already retreated from its recent—and unexpected—highs. In the United States, inflation has collapsed from a peak of over 9% to under 3.5% today. We are especially encouraged by the recent cooling in inflation rates for services sectors such as hotels and recreation, where price increases tend to be stickier. The outlook for shelter inflation, which currently accounts for around three-quarters of all of the year-on-year change in the Consumer Price Index (CPI), gives us the most confidence that price inflation will continue to fall in the United States. The most current data on where shelter inflation is heading, including home prices and new rents, signal that shelter inflation will continue to cool to a manageable level.

Inflation is similarly decelerating outside the United States, but more slowly. In developed world economies, it has declined to 4% from a peak of ~8%. Globally, realized inflation has been coming in below economists' forecasts since April 2023, and we think price inflation in both the United States and Europe will approach central banks' 2% mandate by the end of 2024.

On the wage front, labor demand and supply are in a better balance. The gap between job openings (demand for labor) and unemployed workers (supply of labor) in the United States has shrunk from its peak of over 6 million to close to 2.5 million today. An increase in immigration has also

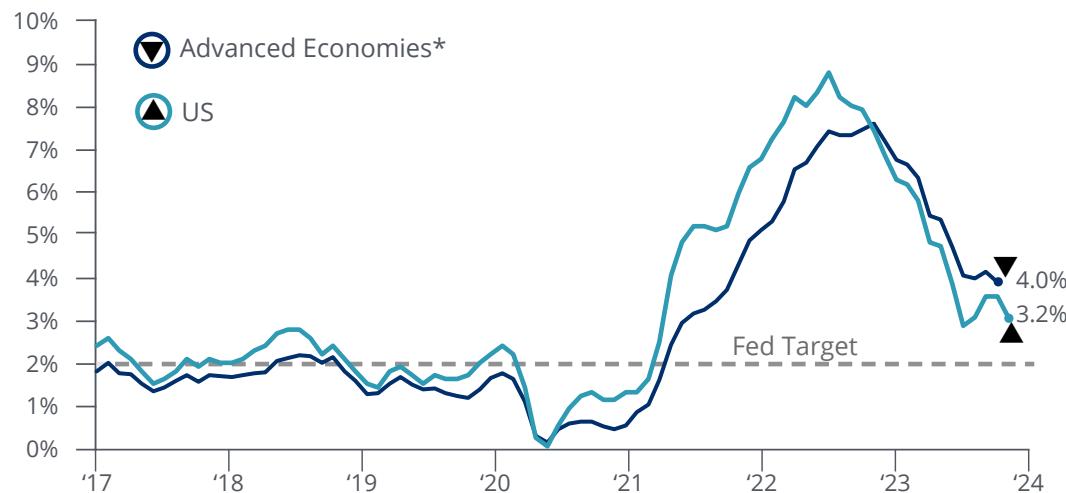
boosted the number of available workers. Year-to-date, foreign-born workers accounted for more than 40% of the 3 million-plus new jobs in the United States.

As a result, U.S. wage growth, proxied by the Employment Cost Index excluding incentive pay, has slowed from over 6% to around 4%.

Central bankers will continue to look for further moderation, but the progress is clear—and encouraging. Still, we think 2% inflation will likely represent more of a floor than a ceiling for price moves. Market-based indicators of future inflation (such as breakeven inflation rates and

INFLATION HAS ALREADY RETREATED FROM MULTI-DECADE HIGHS

CPI, YoY percentage change



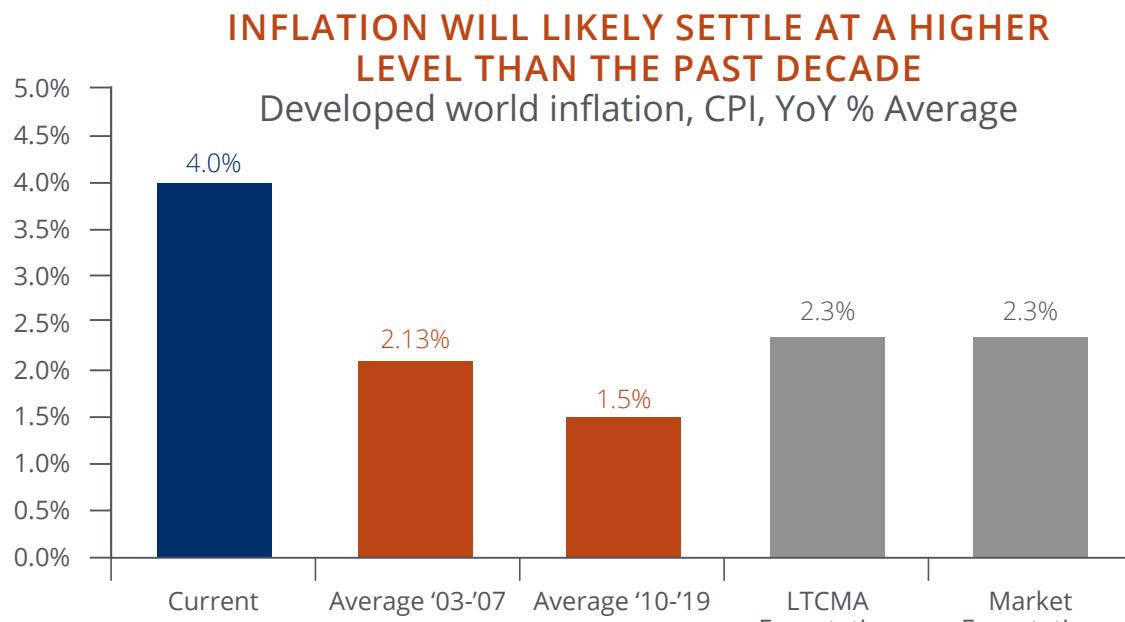
Our universe of advanced economies includes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, UK, U.S.

Sources: Bureau of Labor Statistics, Haver Analytics. Data as of October 31, 2023.

inflation swaps) suggest that investors also expect both U.S. and Euro Area inflation to run between 2.0% and 2.5% over the next 5–10 years. This would compare with the 1.5% to 2.0% range that prevailed from 2015 through 2020. We expect developed world inflation will similarly settle between 2% and 2.5%, and with more variability than existed in the 2010s.

There are, to be sure, countervailing forces that may push inflation rates higher over the medium term. Industrial policy and the energy transition could lead to higher commodity prices. In fact, at least initially, the shift to clean energy sources could lead to bouts of inflation.

Consumer and investor inflation expectations could also nudge inflation higher—becoming in effect a self-fulfilling prophecy. The process of “nearshoring” and global supply chain adjustments will also limit how much goods prices could fall. Fundamentally, it seems to us that many parts of the economy (labor markets, housing, commodities) have insufficient supply to meet demand. This should place more upward pressure on prices than occurred in the 2010s.



Sources: J.P Morgan Asset Management, Bloomberg Finance L.P., Haver Analytics. Data as of

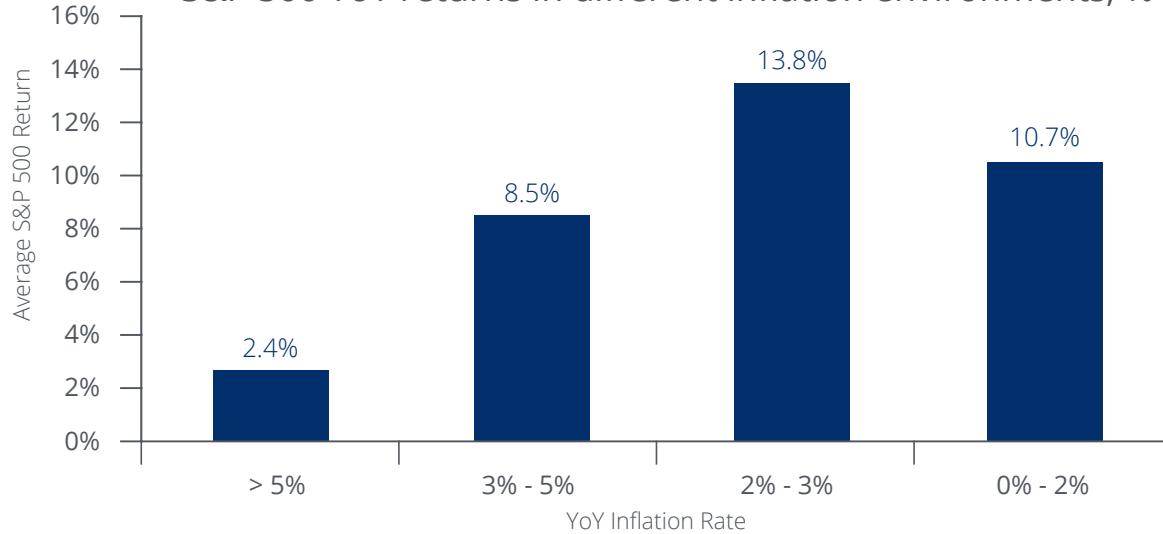
How should investors grapple with the prospect of more meaningful inflation in 2024 and beyond?

They might look first to equities. Since the end of 2019, U.S. consumer prices have risen almost 19%. S&P 500 earnings are up over 35%. Crucially, profit margins for the core of the S&P 500 have stabilized at ~12%, in line with pre-pandemic peaks and only one percentage point below the 2021 highs. We believe large public companies will be able to continue to maintain both pricing power and their margins. This is not just a U.S. phenomenon. Look no further than the European luxury goods sector, which commands pricing power while delivering robust growth.

In fact, if inflation ranges between 2% and 3%, as we think it will, it should be good for stocks. The average S&P 500 year-over-year return is nearly 14% when inflation runs in that range.

STOCKS' SWEET SPOT: EQUITIES TEND TO DO WELL WHEN INFLATION RANGES BETWEEN 2%-3%

S&P 500 YoY returns in different inflation environments, %



Source: Bloomberg Finance L.P. Data as of November 17, 2023.

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

In addition, equities may not provide the only defense against inflation. We think the current environment also argues for potential exposure to real assets such as global real estate, infrastructure, transportation, commodities and timber.

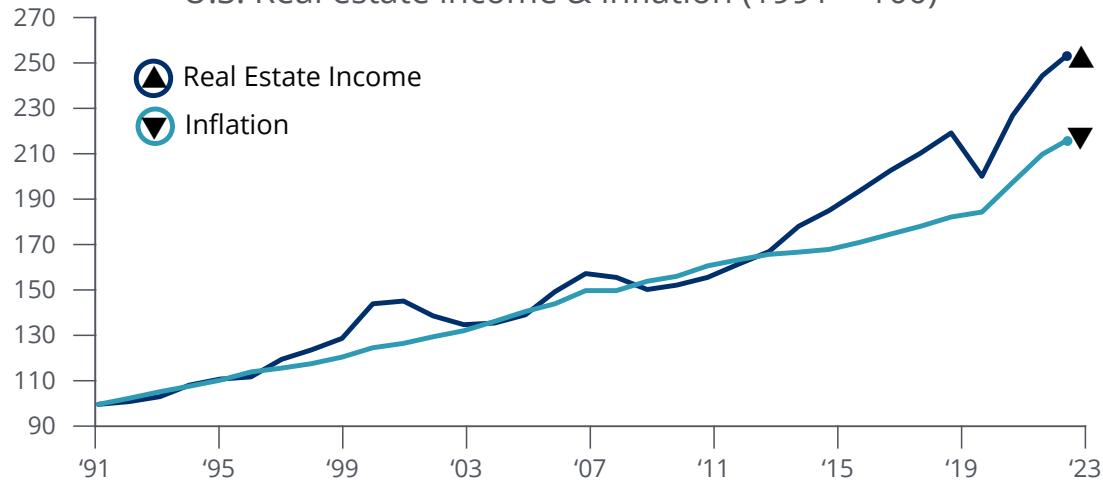
Take real estate, as an instructive example. Income growth for real estate tends to outpace inflation, and most leases in commercial properties contain inflation step-ups. What's more, as commodities (steel, say, or wood)

and labor become more costly, existing buildings tend to appreciate because it becomes more expensive to replace them. Problems in the office sector and pockets of retail and hospitality are well known, but we believe sectors such as industrial and data centers offer robust growth prospects.

In the last cycle, investors used bonds to insulate portfolios from slower growth. In the cycle now emerging, we think investors can use real assets to insulate their portfolios from higher inflation.

OVER A 30-YEAR STRETCH, REAL ESTATE INCOME HAS ALMOST ALWAYS OUTPACED INFLATION

U.S. Real estate income & inflation (1991 = 100)



Sources: J.P. Morgan Asset Management GRA Research, NCREIF, Bureau of Labor Statistics. Data as of June 30, 2023.

02

The cash conundrum: the benefits and risks of holding too much

It feels good to hold cash when rates are high and other markets are this volatile. Frankly, over the last two years, it has paid to stay in cash.

Certainly, 5% yields on cash and low volatility have been a magnet for our clients' assets. This phenomenon is global, but it is particularly powerful in the United States, where clients have over twice the allocation to short-term Treasuries and money markets as their international peers.

Could this shift into cash cause problems? In the context of your own financial planning, it may help to acknowledge that you may feel differently about cash than you do about stocks, bonds or other assets. But you should consider cash as you do any other asset—asking how it fits into your goal-aligned wealth plan, and whether the timing of an overallocation makes sense.

CASH COMFORT: OVER THE PAST TWO YEARS, IT HAS PAID TO STAY IN CASH

USD total return since December 2021, %



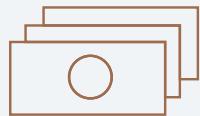
Sources: Bloomberg Finance L.P., MSCI. Data as of November 17, 2023.



Cash works best relative to stocks and bonds in periods like the one we just saw: when interest rates are rising quickly, and investors question the durability of corporate earnings growth.

Cash works less well when interest rates are falling (you are reinvesting at lower and lower yields), or when earnings growth expectations are improving and risk sentiment is recovering. We think 2024 will likely deliver a backdrop of falling rates and improving earnings, in which cash will work less well.

Our expectation of lower cash rates reflects our view that inflation has likely peaked, that central banks see their current policy positioning as restrictive, and that the labor market is cooling relatively quickly. Indeed, continuing jobless claims in the United States are 30% higher year-over-year. Historically, we have only seen that rate of increase when the economy was already in recession. Thus central banks should be willing to lower interest rates if they feel that growth is threatened. Indeed, markets think that the Federal Reserve, European Central Bank, and Bank of England could lower interest rates as soon as March 2024.



We think 2024 will likely deliver a backdrop of falling rates and improving earnings, in which cash will work less well.

From a planning perspective, holding more cash today than you did in 2021 or 2017 is probably fine. Cash yields after inflation are at some of their highest levels of the last 20 years. But holding relatively more cash probably isn't the best use of your overall portfolio.

Here's why. You can commit less capital to a goal today if you are willing to invest it in a way that increases the expected return. It's a simple but profound principle of investing.

Look at it this way. Based on J.P. Morgan Asset Management's Long-Term Capital Market Assumptions (LTCMAs), we think a person could keep all their assets in cash and still spend 3% of their wealth per year for 30 years and not run out of money.

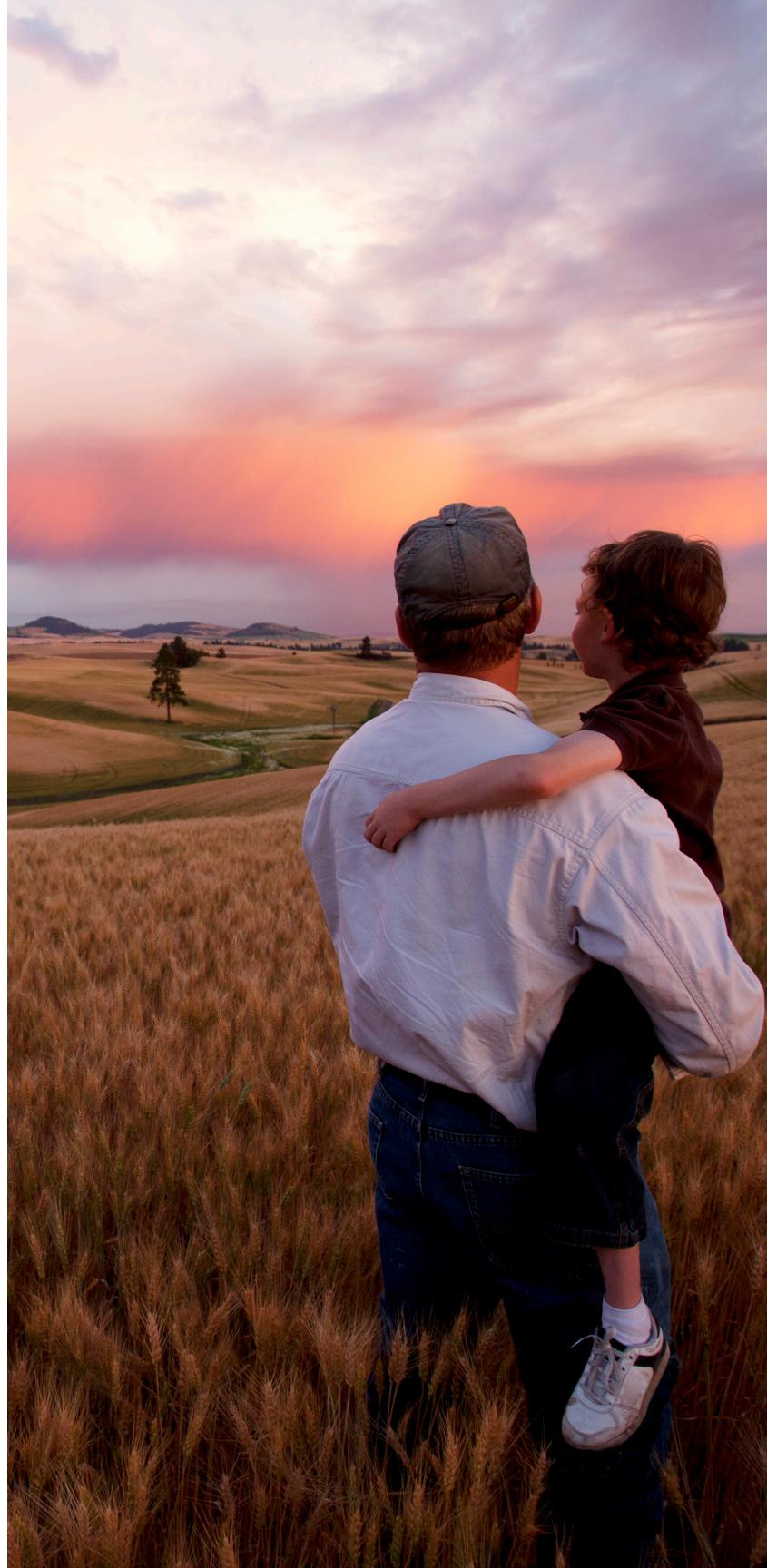
That's not a terrible scenario. But it leaves no room for error if an unexpected setback occurs, or if other priorities (such as legacy planning, philanthropic giving or health spending) become more important. In this particular all-cash scenario, your wealth can support your spending—but nothing more.

Now let's think about the alternate approach. Allocating assets outside of cash reduces the amount of capital that is required today to fund a goal with a high degree of confidence. It could also allow your wealth to fund more goals than you could with an all-cash approach.

As a first step, if you design a portfolio of only core, investment grade bonds, you could need just ~85% of the all-cash portfolio to maintain the same rate of spending.¹ The other 15% is unencumbered, and could be earmarked for anything: buying the next home, giving to charity, funding your grandchildren's education. Indeed, adding more assets to the mix (including equities, high yield bonds and alternatives) could further reduce the initial capital required, or could increase the rate of spending that the portfolio can support.

Holding more cash in the near term may not be a poor decision, but it likely isn't the best one either. Cash may offer a viable path to achieve some of your goals—but probably not many.

¹J.P. Morgan Asset Management's LTCMAs are the product of a deep, proprietary research process that pools the quantitative and qualitative insights of more than 60 investment professionals.



03

Bonds are more competitive with stocks—adjust the mix according to your ambitions.



4 out of 5

Clients have not materially increased their allocation to fixed income.

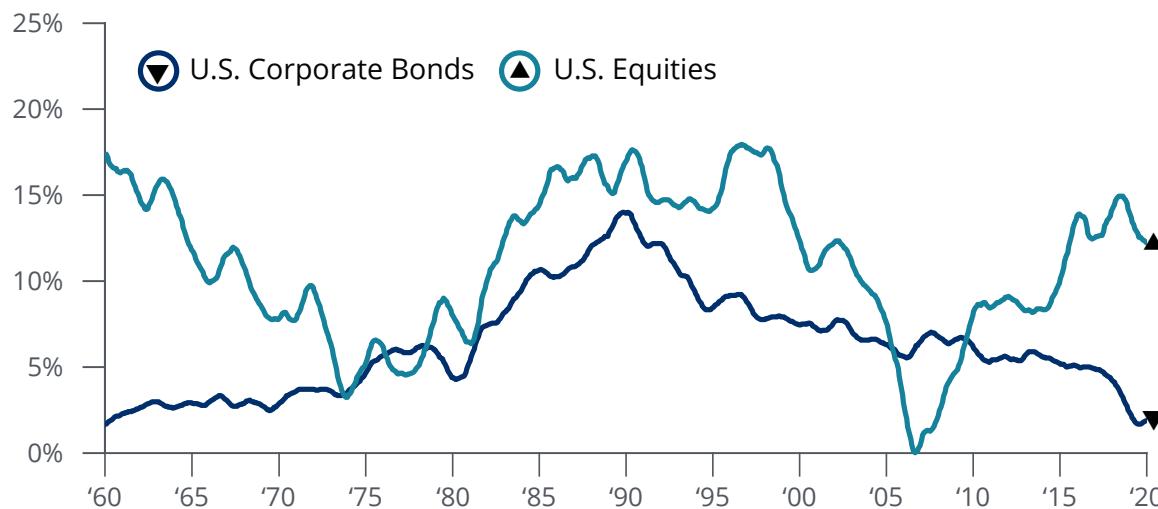
Higher rates mean that bonds are as competitive with stocks as they have been since before the GFC. Yet four out of every five of our clients have not materially increased their allocations to fixed income over the last two years. The first question to ask is, do bonds deserve a larger share of your portfolio?

We rely on bonds to help provide stability in a multi-asset portfolio. Coupon payments generate income, and bond prices tend to rise when economic growth slows.

Given the recent increase in yields, we think bonds are now well positioned to deliver on both fronts. What's more, they could also hold up much better against equities than they have over the past decade. Consider that for the 10 years ended in Q3 2023, bonds have posted annual returns of just ~1% versus nearly 15% for equities.

**STOCKS TYPICALLY OUTPERFORM BONDS,
BUT THE MAGNITUDE VARIES WIDELY**

10-year rolling total return, % annualized



Source: Bloomberg Finance L.P. Data as of October 31, 2023.

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Across many sectors, yields have reached highs not seen since 2007. The yield on a 5-year Treasury bond is 300 basis points (bps) above the dividend yield on the S&P 500. Tax-equivalent yields on benchmark AAA-rated 15-year municipal bonds are over 6%. Junk bond yields are over 8%, and private credit yields are in the low teens. The only negative yielding debt left in the world is in Japan.

Those higher yields—and thus lower bond prices—depressed core bond returns in 2022 and 2023. In fact, the current drawdown for the Barclays Aggregate Bond Index from its prior high is -14%. That's better than the recent trough of -17%, but still lower than at any other point in the index's history. Despite the drawdown, our clients' allocations to fixed income are flat relative to the end of 2021. In 2024, we think they should consider continuing to add to the asset class.

We make this case with conviction because we believe the new rate regime represents a generational reset in bond market pricing. The rate reset means that core bonds may now be poised to deliver strong forward-looking returns.

Over a 10-to-15-year investment horizon, J.P. Morgan Asset Management's LTCMAs project that core bonds, as proxied by the Global Aggregate and U.S. Aggregate Bond Indices, will deliver 5% plus annual returns.

We think strong performance will begin in 2024—with modest price appreciation as rates fall, combining with an attractive starting yield. In our view, those returns will reflect a favorable economic backdrop for bonds in the coming year: Economic growth should slow, inflation will continue to cool, and central banks could start to reverse their rate-hiking cycles.

What's more, higher starting yields mean that a decline in interest rates would provide a gain that is proportionately larger than the loss created by a similarly sized rate increase. To illustrate, an investment in a U.S. 10-year Treasury bond would lose approximately 2% if yields rose one percentage point over the next year. If rates fall 1% over the next year, an investment in a 10-year Treasury bond would gain over 12%.

Globally, we are focused on tax efficiency in fixed income allocations. In the United States, the municipal bond market is the clear expression. Municipals have an extremely low historical default rate (0.1% cumulatively over 10-year periods since 1970 versus 2.2% for corporate bonds). In addition, state and local debt loads have not expanded relative to GDP since 2000, in stark contrast to the federal debt.

Each jurisdiction globally has its own nuances, and we recommend exploring this with your local advisor.

Across global markets, the rate reset offers the potential to lock in strong returns in many parts of the yield curve. We believe bonds within the 3-10 year maturity range offer attractive yield, and they are less exposed to longer-term risks regarding government deficits.

It has been a brutal stretch for bond investors, no doubt about it. But we think the end of central bank tightening cycles and cooling inflation will offer more than a reprieve—they'll bring stability back to the asset class.

In short: The rate reset has run its course, and we think it is time to lock in yields. In light of this, the second question to ask is, should you own more fixed income relative to equity?

We don't think investors should see this moment as a choice between stocks or bonds. We think they should personalize the possibilities by designing a portfolio of stocks and bonds suited to their particular goals and risk tolerances. The

rate reset also means that investors should assess existing holdings to make sure their current allocations still make sense.

Imagine for a moment that you're evaluating your current assets. Top of mind is likely the concern you've had with market volatility over the last two years. Even though a balanced portfolio has underperformed our expectations, you may now have an opportunity to reduce equity risk, add more fixed income exposure, and still reach your financial goals.

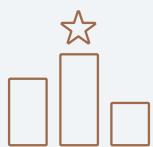
If you've got new funds to invest, your perspective may be slightly different. One sign of fixed income's new appeal: J.P. Morgan Asset Management's long-term return assumptions for bonds today are higher than our equity market return assumptions were at the end of 2021. The rate reset gives investors the opportunity to add fixed income to portfolios, reduce the range of possible outcomes, and sacrifice relatively little potential return to do so.

But remember that fixed income comes with its own risks as well. A concentrated allocation to bonds could depress portfolio returns if inflation is more persistent than expected.

Ultimately, the thing to keep in mind is that the higher-rate regime gives you more options in crafting your goals-based financial plans. If you aim to limit the potential downside for your wealth, and reduce the range of possible outcomes, it could make sense to swap equity exposure for bond exposure. But if you aim to capture a significant degree of potential upside, you'll likely want to hold on to your equities, both public and private. In the end, the right move for most may be to keep their strategic asset allocations and look forward to the stronger forward-looking returns that we expect.

04

With AI momentum,
equities seem to
be on the march
to new highs



Equities offer the potential for meaningful gains in 2024.

We rely on equities to help provide long-term capital appreciation in portfolios. Though more volatile than bonds, equities have outperformed bonds 85% of the time on a 10-year basis since 1950. Over the long term, we think equities can continue to outperform bonds and generate capital appreciation for investors.

In 2024, equities offer the potential for meaningful gains. Even as economic growth slows amid higher rates, we think large-cap equity earnings growth should accelerate, and that could propel stock markets higher over the next year.

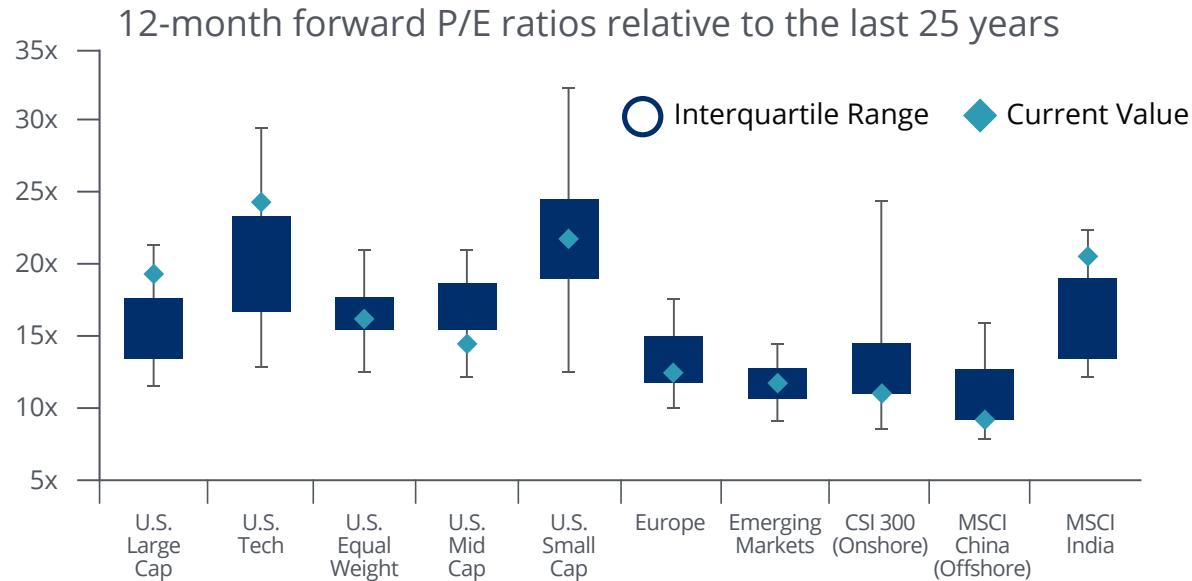
Why do we anticipate improving corporate earnings? It's partly because we believe the U.S. large-cap corporate sector has gone through an earnings recession already (nine of the 11 major sectors in the S&P 500 reported negative earnings growth for three consecutive quarters in 2022–2023). They have emerged with leaner cost structures, which should help them face a still resilient (if slowing) demand environment in 2024. Indeed, since 1950, earnings per share has been accelerating about 25% of the time when GDP growth has been decelerating.

Higher rates may also make you skeptical of valuations. But we think they appear reasonable in the United States and inexpensive elsewhere. The S&P 500 trades at above-average valuations on a price-to-earnings basis, while U.S. mid-cap and small-cap stocks (and European, emerging market and Chinese stocks) all trade at a substantial discount. Indian stocks, meanwhile, trade with fair valuations, but we are optimistic about their low leverage and high growth rates.

While we prefer the U.S. stock market in 2024, low valuations elsewhere suggest that prices already anticipate bad news for corporate profits, limiting the downside for stock performance. By the same token, better-than-expected news could spur greater-than-expected gains.

Some investors argue that U.S. stock valuations need to correct further to account for higher interest rates. But today's 18x–20x forward P/E multiples appear reasonable to us, given that the index currently has wider margins (free cash flow margins are 30% higher than they were 10 years ago) and healthy interest coverage (11x EBITDA to interest expense). We also see prospects for better corporate revenue growth over the medium term, given the tailwinds from fiscal spending and productivity gains from artificial intelligence. In the end, an outlook for slightly higher inflation and better growth means that an equity risk premium (proxied in this case by the difference between 10-year Treasury yields and the earnings yield of the S&P 500) between 0% and 2% makes more sense than the post-GFC environment of 3%–5%.500) between 0% and 2% makes more sense than the post-GFC environment of 3%–5%.

DESPITE HIGHER INTEREST RATES, VALUATIONS SEEM REASONABLE ACROSS GLOBAL MARKETS



Source: Bloomberg Finance L.P. Data as of November 17, 2023.

Past performance is no guarantee of future results. It is not possible to invest directly in an index.



Finally, we see several trends in public and private equities that we think could generate long-term outperformance.

The promise of artificial intelligence (AI) is hardly a secret. But we do think it could have profound implications for corporate productivity and profitability.

AI has already seemingly started a new technology research and development cycle. In fact, the R&D budgets for the top-five tech companies alone have eclipsed \$200 billion per year and are rapidly approaching the U.S. government's own R&D spending (~\$250 billion). The use cases are also broadening. For example, a recent study suggested that an AI model can outperform expert radiologists at spotting malignant pancreatic cancers, and AI has helped reduce airline contrails that contribute to global warming.

At JPMorgan Chase, we expect that incorporating AI and machine learning into our processes could deliver more than \$1 billion in impact this year. As investors, we are focused on accessing AI's potential through both the software and hardware leaders that are set to benefit. On the private side, consider looking to growth equity managers to identify new AI-connected businesses that could prove to be effective disruptors.

GLP-1 weight-loss drugs could continue to drive divergences within and outside the healthcare sector. We believe that around 2 million people in the United States are currently taking GLP-1 drugs for weight management. Nearly 100 million obese Americans could potentially benefit from the drug, but cost is a real hurdle. For example, the list price for Mounjaro is over \$1,000 per month, which is higher than the \$650 per month cost of shelter per capita for the top 20% of earners. Nonetheless, sales for these types of drugs could reach \$100 billion by 2030 (up from \$6 billion today), using relatively conservative assumptions regarding total market penetration.

From an investor's perspective, we see potential upside in the stocks of drug makers with a growing share of the weight-loss market.

At the same time, we think some consumer staples and medical device company stocks have been unduly punished by investors exclusively focused on the impact of GLP-1s. We see selective opportunities here.

Finally, companies across sectors should benefit from a renewed focus on infrastructure, construction and defense spending. Real private spending on manufacturing structures has doubled since 2021, largely driven by semiconductor factories. Earnings estimates have doubled for companies whose businesses are tied to electrification.

How can you best evaluate these different stock scenarios?



Bear in mind that you're investing in a higher rate environment, which could be useful if you want to structure your equity holdings to limit downside exposure, extract yield or increase potential upside based on our expectations for next year.

In private markets, we continue to see opportunity in secondary private equity funds, as the lack of distributions (the lowest since 2009) creates a catalyst for institutional investors to monetize their current holdings. Further, we are focusing on offsetting higher cost of debt by concentrating on buyout managers who operate in higher-growth sectors such as technology, healthcare and security.

We expect the equity market rally of 2023 to carry on into 2024. And when it comes to capital appreciation, a critical element of any financial plan, stocks can continue to provide long-term compound growth to investment portfolios.



We see opportunity
in secondary private
equity funds.



05

Pockets of credit
stress loom, but they
will likely be limited



We expect the coming year to see more stress in certain sectors of the credit complex.



An inescapable fact of the business cycle is that higher interest rates make credit harder to come by. Of course, companies and households can still borrow money when credit is tight, but not as easily, and not in the ways they are used to.

Not surprisingly, we expect the coming year to see more stress in certain sectors of the credit complex. Vulnerable sectors include: commercial real estate loans, leveraged loans, and some areas of consumer credit (e.g., autos and credit card) and high yield corporate credit. Small-cap equities may be similarly affected by higher rates, given the levels of debt on their balance sheets.

But we think these stresses of higher rates will be manageable—and more importantly—not enough to cause a recession in 2024.

Indeed, some sectors of the economy have fared better than some might have expected in the face of rising rates.

For example, U.S. residential home values have accommodated the recent and substantial jump in mortgage rates. Even though financing activity has collapsed (J.P. Morgan Private Bank and Wealth Management is on pace to underwrite just one-third of the mortgages that we did in 2021), home prices have been supported by the lowest supply on record.

Corporate credit has also held up well across a number of global markets, as U.S. and European corporates (both investment grade and high yield) took advantage of the low interest rates of prior years to “term out” (extend the maturities) of their debts. It is also notable that to take advantage of higher rates in their own fixed income portfolios, companies increased their holdings of shorter-duration cash equivalents, which are now yielding higher coupon payments.² All of this means that non-financial corporate interest payments as a share of after-tax profits are at their lowest levels since 1980.

Still, we believe higher interest rates are limiting the flow of credit. U.S. corporate and household borrowing is

ALL CLEANED UP: CORPORATE BALANCE SHEETS SHOW INTEREST BURDENS AT HISTORIC LOWS

Net interest payments as a share of after-tax profits



Sources: Haver Analytics, U.S Department of Commerce. Data as of June 30, 2023.

² According to the Flow of Funds data, the share of assets in the nonfinancial corporate sector that are cash equivalents (checkable deposits + savings deposits + money market fund shares) is currently around 5.5%, which is up from 4% in the 2010s and 2-3.5% in the 1990s and 2000s.

roughly comparable to most of the 2010s, a time when the economy was still deleveraging from the GFC. In the Euro Area, bank lending both to households and corporates is barely growing, and at the slowest pace since 2015. Indeed, higher interest rates look to be much more onerous for the European economy than the American economy.

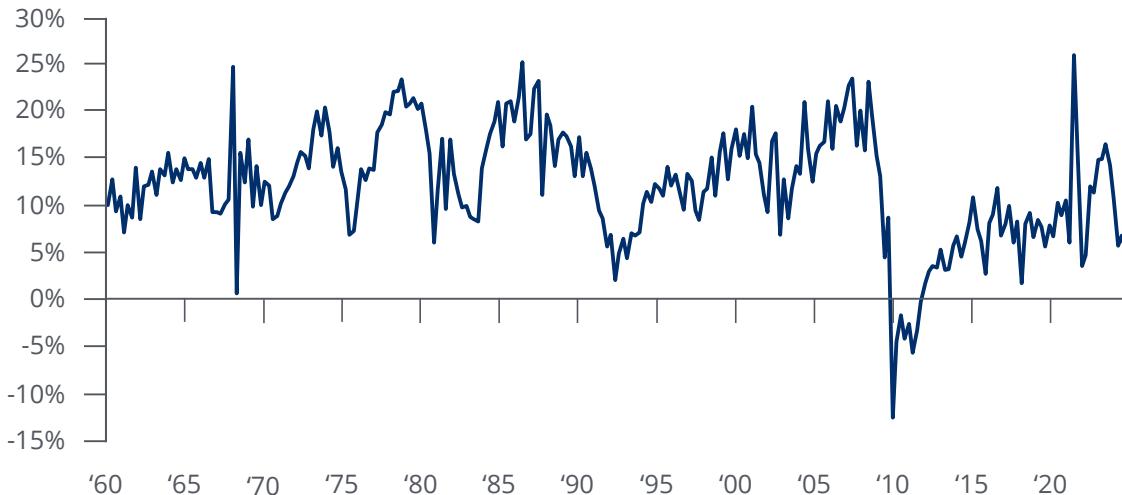
We are also starting to see cracks in pockets of the credit complex, specifically those that are either most exposed to floating interest rates or facing near-term maturities. Over 50% of commercial real estate loans are at a floating rate, and nearly \$2 trillion of commercial real estate debt

matures by 2025. Indeed, BBB-rated commercial mortgage-backed securities spreads are nearing 1,000 bps (which is higher than their COVID crisis peaks), while high yield spreads remain well anchored.

In corporate credit, the healthcare sector is under particular stress, accounting for more than a quarter of all corporate credit defaults YTD. The sector faces regulatory headwinds, labor inflation (which crimps margins) and liability payments (e.g., from opioid lawsuits).³ The longer that interest rates stay elevated, the faster interest coverage metrics will deteriorate, especially for smaller companies.

TODAY'S CREDIT GROWTH RECALLS THE 2010S, A DECADE OF POST FINANCIAL CRISIS DELEVERAGING

Nonfinancial corporate and household new borrowing as a % of GVA



Source: Haver Analytics. Data as of April 2023.

³ Nelson Jantzen & Tony Linares, "Default Monitor: High Yield and Leveraged Loan Research," J.P.Morgan Corporate Investment Bank Global Research, October 2, 2023.

U.S. leveraged loan markets have already felt the sting of higher rates. As a result, default rates are now higher than they are for high yield bonds (a historical anomaly). And, of course, many U.S. regional banks are under the strain of earning low rates on old loans while having to pay higher and higher rates on cash to attract deposits. Commercial real estate debt on regional bank balance sheets only exacerbates those strains.

OVERLEVERAGED SECTORS ALREADY SHOW SIGNS OF STRESS

Commercial mortgage-backed security & high-yield spreads, %



Sources: Haver Analytics, Bloomberg Finance L.P. Data as of November 19, 2023.

Ultimately, though, we think these problems will be contained. We do not see tighter credit conditions leading to a full-blown credit crunch

For investors, stresses in the credit complex can create a wide range of investment opportunities.

We think relative value strategies, with a focus on fund managers who can identify stress and dislocations at the sector, or even subsector, level, are positioned to take advantage of the coming credit cycle.

Moreover, U.S. private credit funds could continue to take market share from high yield and leveraged loan markets. Currently, direct loans by private lenders are yielding upwards of 12%, even though risk metrics, such as net debt to EBITDA for borrowers, have improved. In addition, covenants for lenders are stronger than they are in leveraged loan markets. In our view, private credit is competitive with private equity for a place in investors' portfolios.

Finally, stress in commercial real estate markets could create opportunities for investors who have the capital to provide as regional banks look to offload loans, or existing borrowers may need to bring in partners to help refinance.



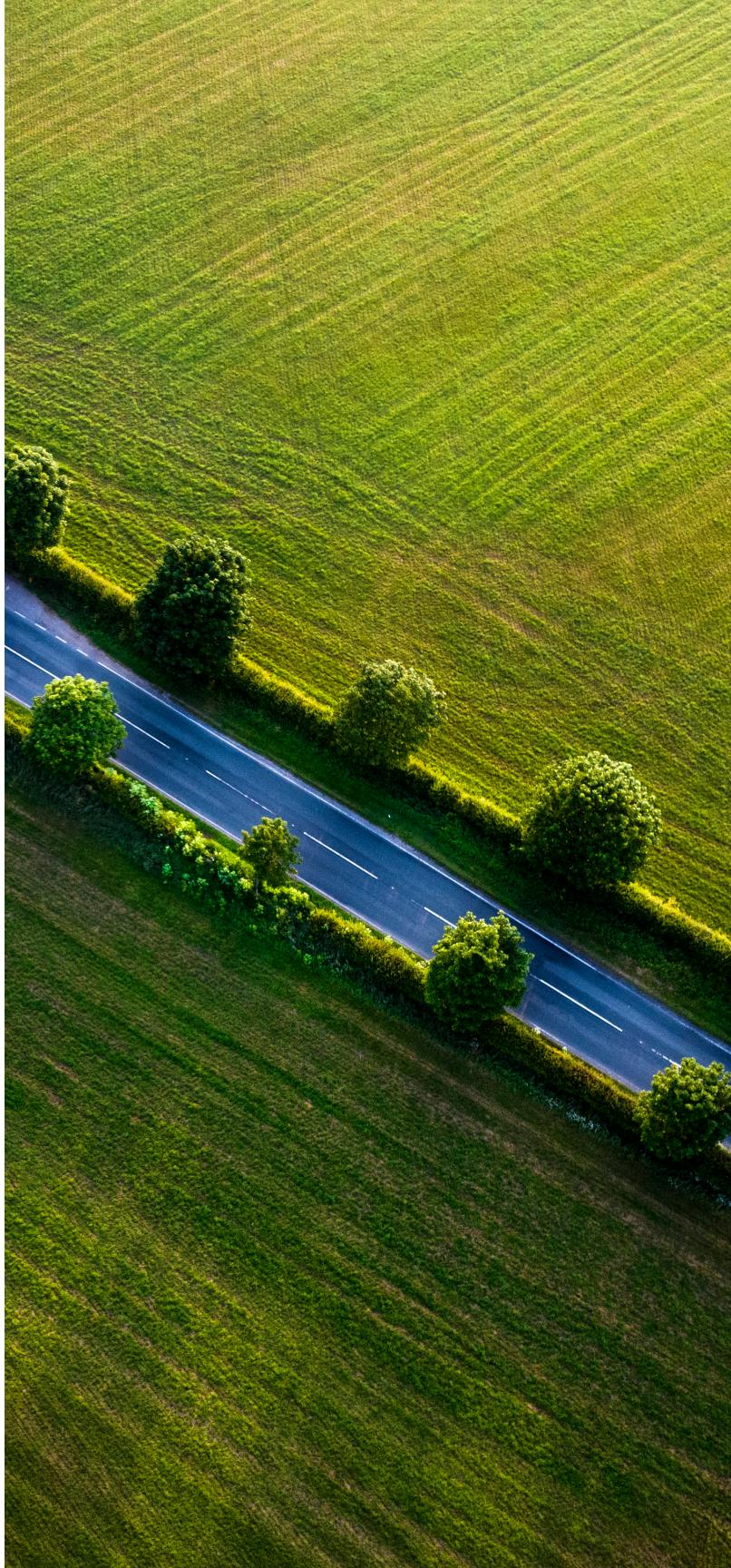
Conclusion

An investment
landscape
reconfigured

As we head into 2024, investors find more options for their portfolios than at any time since before the GFC. Bond yields are high. Equity valuations are fair. Private markets continue to offer premiums over their public counterparts, while also becoming more accessible to investors. Even cash doesn't look so bad.

Almost certainly, new or resurgent risks will emerge. A presidential election cycle looms in the United States. Growth in Europe appears to be quickly succumbing to higher interest rates. China may continue to balance the competing interests of alleviating leverage in the property sector while supporting domestic consumption. War in Ukraine and the conflict in Israel and Gaza are ongoing, and new geopolitical flashpoints may well appear.

Consider those risks as you weigh your investment options. Evaluate the implications, for 2024 and beyond. Personalize the possibilities. And finally, harness the power of markets to help realize your long-term financial goals.



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ABBREVIATIONS

- Bps**—Basis points
COVID-19—Coronavirus disease 2019
CPI—Consumer Price Index
DM—Developed Markets
EM—Emerging Markets
EMEA—Europe, Middle East and Africa
EUR—Euro
Fed—Federal Reserve
GDP—Gross Domestic Product
GFC—Global Financial Crisis
LATAM—Latin America
U.K.—United Kingdom
U.S.—United States
USD—U.S. dollar
YOY—Year-over-year
YTD—Year-to-date

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INDEX DEFINITIONS

Note: Indices are for illustrative purposes only, are not investment products, and may not be considered for direct investment. Indices are an inherently weak predictive or comparative tool. All indices denominated in U.S. dollars unless noted otherwise.

The **Bloomberg Barclays Global Aggregate Bond Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the U.S. Aggregate (USD 300mn), the Pan-European Aggregate (EUR 300mn), and the Asian-Pacific Aggregate Index (JPY 35bn). In addition to securities from these three benchmarks (94.1% of the overall Global Aggregate market value as of December 31, 2009), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300mn), Euro-Yen (JPY 25bn), Canadian (USD 300mn equivalent), and Investment Grade 144A (USD 300mn) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized subindices by liquidity constraint, sector, quality, and maturity. A component of the Multiverse Index, the Global Aggregate Index was created in 1999, with index history backfilled to January 1, 1990. All indices are denominated in U.S. dollars.

The **Bloomberg U.S. Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

NCREIF Real Estate is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors—the great majority being pension funds. As such, all properties are held in a fiduciary environment.

The **MSCI China Index** captures large- and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs).

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The **NASDAQ-100 Index** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No security can have more than a 24% weighting. Prior to December 21, 1998 the Nasdaq 100 was a cap-weighted index.

Standard and Poor's Midcap 400 Index is a capitalization-weighted index that measures the performance of the mid-range sector of the U.S. stock market.

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The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region.

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The **CSI 300 Index** is a free-float weighted index that consists of 300 A-share stocks listed on the Shanghai or Shenzhen Stock Exchanges.

The **MSCI India Index** is designed to measure the performance of the large- and mid-cap segments of the Indian market.

The **MSCI World Index** is a free-float adjusted SPX market capitalization-weighted index that is designed to measure the equity market performance of developed markets. The index consists of 23 Developed Market country indexes.

The **STOXX Europe 600 Index (SXXP Index)**: An index tracking 600 publicly traded companies based in one of 18 EU countries. The index includes small-cap, medium-cap and large-cap companies. The countries represented in the index are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Holland, Iceland, Ireland, Italy, Luxembourg, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The **IBOV Index** is a gross total return index weighted by free float market cap and is composed of the most liquid stocks traded on the São Paulo Stock Exchange.

The **Hang Seng Index** is a free-float capitalization-weighted index of a selection of companies from the Stock Exchange of Hong Kong. The components of the index are divided into four subindices: Commerce and Industry, Finance, Utilities, and Properties.

The **S&P BSE Sensex Index** is a cap-weighted index. The index members have been selected on the basis of liquidity, depth, and floating-stock-adjustment depth and industry representation.

The **Jakarta Stock Price Index** is a modified capitalization-weighted index of all stocks listed on the regular board of the Indonesia Stock Exchange.

The **FTSE Bursa Malaysia KLCI Index** comprises the largest 30 companies by full market capitalization on Bursa Malaysia's Main Board.

The **S&P/BMV IPC** seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. The index is designed to provide a broad, representative, yet easily replicable index covering the Mexican equities market. The constituents are weighted by modified market cap subject to diversification requirements.

The **Straits Times Index (STI)**, maintained and calculated by FTSE, is the most globally recognized benchmark index and market barometer for Singapore. Dating back to 1966, it tracks the performance of the top 30 largest and most liquid companies listed on the Singapore Exchange.

The **FTSE/JSE Top 40 Index** is a capitalization-weighted index. Companies included in this index are the 40 largest companies by market capitalization included in the FTSE/JSE All Shares Index.

The **KOSPI Index** is a capitalization-weighted index of all common shares on the KRX main board.

The **TWSE, or TAIEX, Index** is capitalization-weighted index of all listed common shares traded on the Taiwan Stock Exchange.

The **MSCI Taiwan Index** is designed to measure the performance of the large- and mid-cap segments of the Taiwan market.

The **MSCI Korea Index** is designed to measure the performance of the large- and mid-cap segments of the South Korean market.

The **MSCI Brazil Index** is designed to measure the performance of the large- and mid-cap segments of the Brazilian market.

The **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.

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