Houston, we have a (concentration) problem.

"There are no solutions, only tradeoffs."

– Economist, Thomas Sowell

The common idiom, "don't put all your eggs in one basket", is said to date all the way back to the Spanish novel, Don Quixote, in the 17th century. Of course, there are multiple variations of this idiom including everything from, "don't put all your monkeys in one barrel" to "don't put all your peaches in one cobbler". Most all of us today understand the intuitive idea of diversification, though it wasn't always so intuitive. The novel concept of a diversified portfolio has origins back to the economist John Maynard Keynes in the 1920's and was further developed by the economist Harry Markowitz in the 1950's, which resulted in the latter winning a Nobel prize in 1990. One of the critical concepts to portfolio diversification is that the risk of a portfolio can be reduced below the weighted average of its constituents because of correlation (i.e. some assets zig when others zag).

The Investment Company Act of 1940 is used to formally recognize if an investment fund can be described as "diversified" per prospectus. The rule is generally referred to as the 75/5/10 Rule which states that a regulated investment company (RIC) must invest at least 75% of its assets in other issuers and cash, no more than 5% of assets in any one company and can have no more than 10% ownership in any company's voting stock. Said another way, the sum of any individual investments over 5% cannot exceed 25% of the fund. While "non

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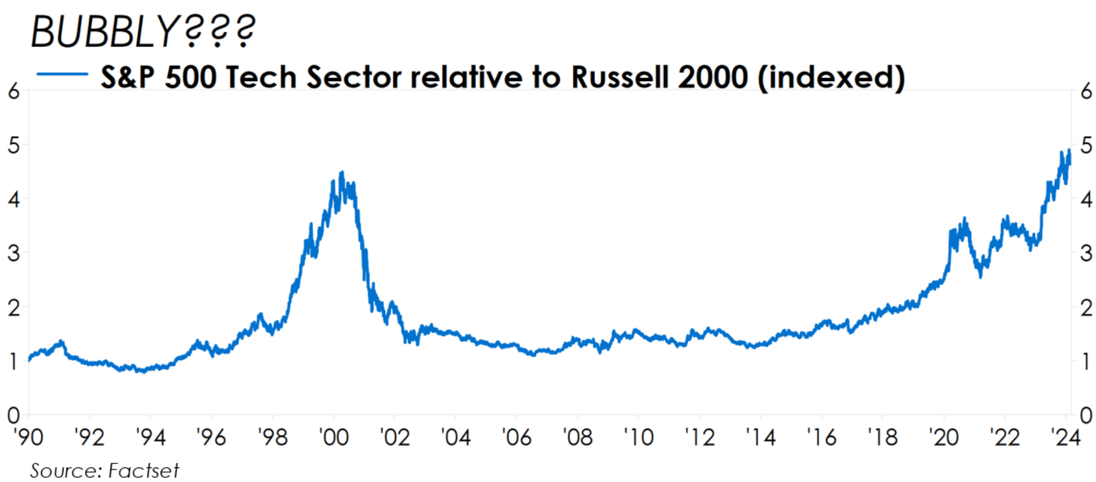
Select Heavily Concentrated Passive Equity ETF's (Min $1bn AUM)

Ticker	Name	10 Largest Weights	AUM ($MM)
XLC	Communication Services Select Sector SPDR Fund	84%	$17,362
XLE	Energy Select Sector SPDR Fund	76%	$35,673
ITA	iShares U.S. Aerospace & Defense ETF	76%	$5,999
SMH	VanEck Semiconductor ETF	73%	$16,299
IHI	iShares U.S. Medical Devices ETF	72%	$5,497
XLK	Technology Select Sector SPDR Fund	69%	$63,793
XLP	Consumer Staples Select Sector SPDR Fund	69%	$15,029
GDX	VanEck Gold Miners ETF	65%	$11,005
KWEB	KraneShares CSI China Internet ETF	62%	$5,496
EWZ	iShares MSCI Brazil ETF	60%	$5,273
IGV	iShares Expanded Tech-Software Sector ETF	59%	$7,686
VUG	Vanguard Growth ETF	57%	$116,270
XLV	Health Care Select Sector SPDR Fund	55%	$40,646
XLF	Financial Select Sector SPDR Fund	55%	$37,117
IWF	iShares Russell 1000 Growth ETF	54%	$87,875
IBB	iShares Biotechnology ETF	49%	$7,606

Source: Strategas Research Partners; Factset.

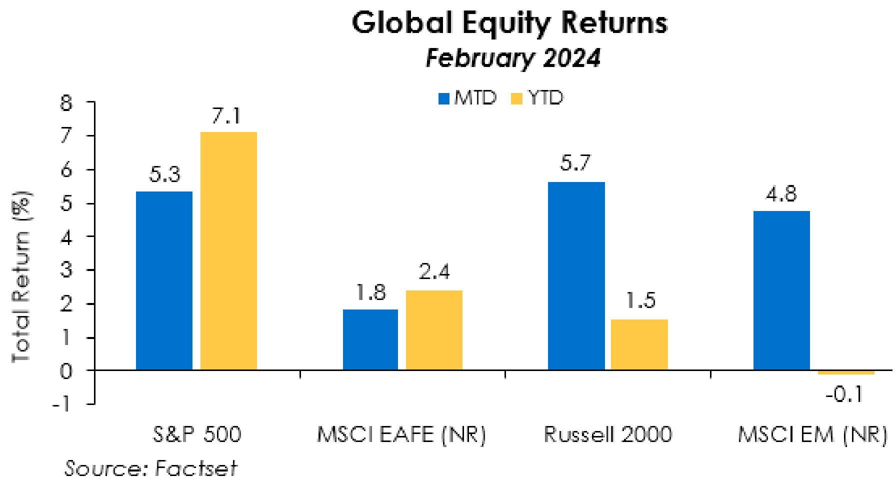
diversified" investments have typically been associated with very specific niche sector or industry associated funds, today it applies to some generally considered standard benchmarks. As can be seen in the table on the prior page, among the list of select heavily concentrated passive ETF's are now some traditional US Large Cap Growth indices. In the case of both the Vanguard Growth ETF (VUG) and the iShares Russell 1000 Growth ETF (IWF), the sum of the constituents exceeding 5% is a whopping 45% and 41%, respectively. Neither meet the "diversified" definition per the Investment Company Act of 1940 given that the concentration of individual issues above 5% well exceeds the 25% threshold. Today, just three sectors make up between 70-80% of each US Large Cap Growth index with the Tech sector alone representing 40-50% of the total exposure. As can be seen in the chart below, the degree of outperformance in the S&P 500 Tech sector relative to the Russell 2000 US Small Cap index can be considered even more extreme than what was witnessed during the Tech bubble in the late '90's. Quite simply, the top of the market has been much more favored than the bottom of the market.



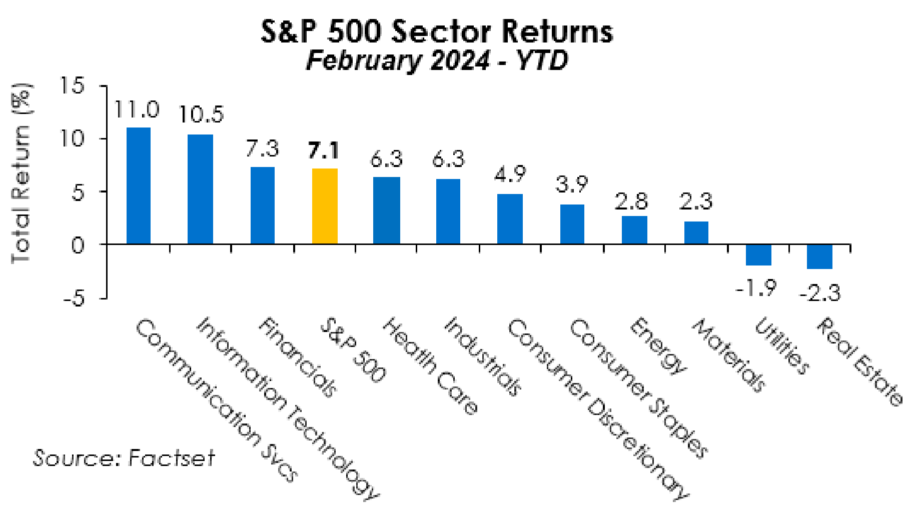
As a result, the concentrations now represented in the Growth index are a function of the outperformance attributed to that select part of the market for more than a decade, but turbocharged post COVID. Most of these mega cap growth companies are in similar industries (with higher correlations to each other) making portfolio risk, in an absolute sense, even more extreme. But the conversation in investor circles is becoming much less focused on the absolute risk represented in these indices and much more focused on the relative risk of being left behind. The opportunity cost of being up – but not as much as the benchmark – is seen, by some, as the bigger risk. Those decisions are often influenced by the current state of markets which can often be backward looking. Performance based measures mean that there's risk no matter what you do. Relative risk is most associated with the opportunity cost being more important while absolute risk is most associated with diversification being top of mind. Decisions made might often require investors having to choose which risk is more important to them. In such a way, we're reminded of the quote, "there are no solutions, only tradeoffs". Often times, such is the case not only in life but in economics and in markets as well.

Year-to-date, Equity markets posted strong returns while Fixed Income and Commodities generally traded lower. In February, Stocks broadened out (led by Small Caps, Large Caps & EM) as expectations for solid growth and Artificial Intelligence (AI) related enthusiasm aided the move higher. Bonds were held back by the hotter than expected inflation data which likely further delayed the start and number of interest rate cuts expected from the Federal Reserve. Meanwhile, REITs rebounded from January's declines but still lagged Equities year-to-date.

Stocks

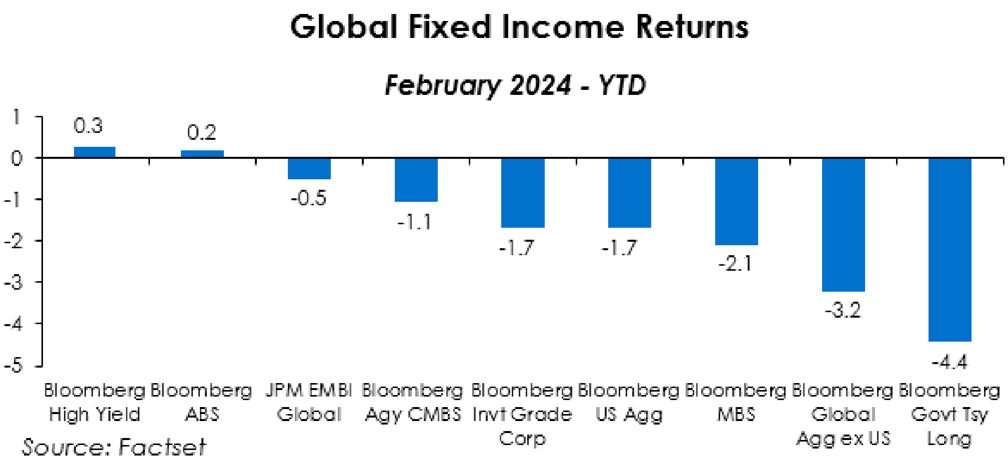


February's equity returns broadened with US Small Caps (Russell 2000) leading the way on the improving growth outlook. Year-to-date, US Large Caps continue to outpace other areas with the S&P 500 delivering its 13th best start to the year since 1950 on the strength of AI related Mega Caps in the Technology and Communications sectors. Overseas, equity performance in International Developed Markets (MSCI EAFE) was up solidly but lagged due to weak economic data in Europe and Japan. Meanwhile, Emerging Markets (MSCI EM) rebounded as Chinese equity markets rallied off of oversold conditions exiting January. As mentioned above, US Large Cap sector performance favored the higher priced cyclical growth sectors (Technology and Communication Services) while Financials also outperformed. Meanwhile, most all other sectors lagged.



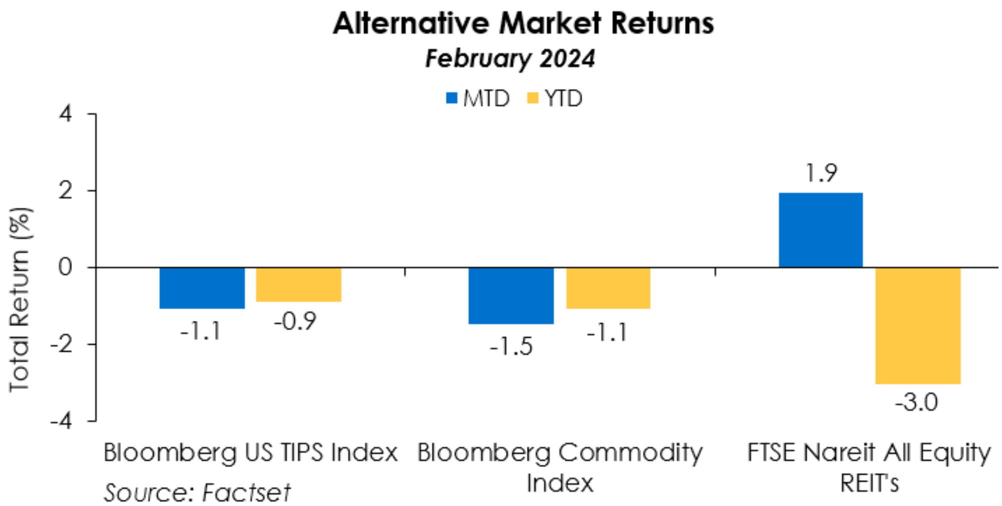
Bonds

Following aggressive moves by the Fed (Fed Funds at 5.25-5.50%) amid ongoing balance sheet reduction – policymakers have now indicated a "wait and see" approach with rates unchanged in the last four meetings. The market dialed back more aggressive rate cut expectations following the most recent Fed meeting and a strong January jobs report. Rates backed up due to hotter than expected inflation data reported during the month. Meanwhile, the yield curve remains inverted but has steepened off the lows. Bond returns were generally negative year-to-date with longer duration assets (Govt Tsy Long) down the most as interest rates have increased on the inflation data. Conversely, shorter duration assets (ABS & HY) were marginally positive while EM Debt (JPM EMBI) outperformed as well.



Alternatives

Commodities traded lower year-to-date with negative returns in Agriculture and in Metals more than offsetting positive returns in Energy. Meanwhile, publicly traded Real Estate (REIT's) rebounded in February though remained negative year-to-date. Finally, Treasury inflation protected securities (TIPs) were down on the rate move but outperformed nominal Treasuries as inflation expectations rose.



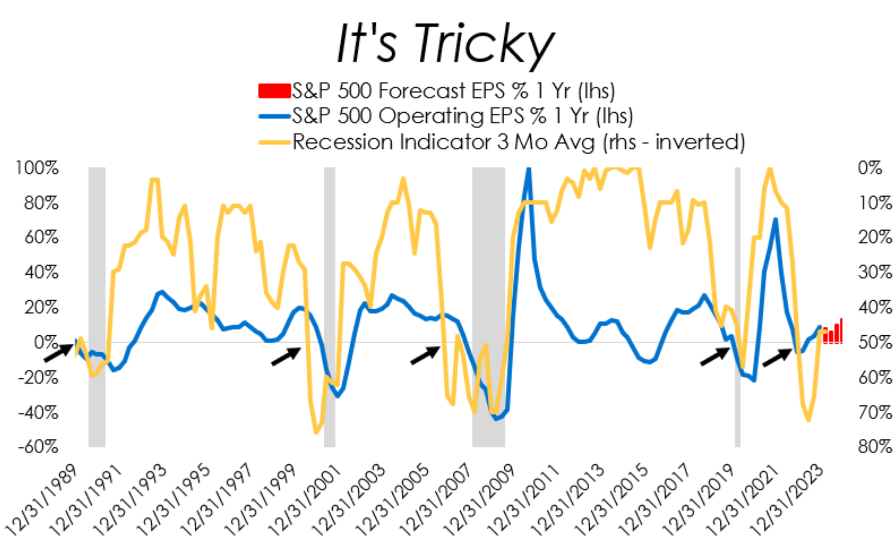
Market Outlook

"It's Tricky to rock a rhyme, to rock a rhyme that's right on time. It's Tricky."
– Run DMC, *It's Tricky* (1986)

We continue to believe that it's important to maintain two frameworks for managing portfolios – the cyclical (shorter-term) and the secular (longer-term). The cyclical perspective is an attempt to assess where we are in this particular business cycle while the secular perspective evaluates where the structural tendencies might be over multiple business cycles.

From a secular lens, we remain sympathetic to the notion that the paradigm is changing to one that ushers in the potential for more persistent and volatile inflation. Such a backdrop might set the stage for a higher cost of capital environment acting as a weight on stock valuations along with changes in market leadership. We find historical parallels today to the higher and more volatile inflation regime that existed back in the '60's-80's and we think the Fed is re-learning the painful lesson of falling behind inflation – one that it hopes not to repeat any time soon. Additionally, we believe there are structural considerations that exist today that might also support this changing paradigm including changes to both aggregate demand (money supply) and supply (de-globalization, labor markets, energy complex).

Currently, there's no doubt that inflation is moderating with CPI now well below its peak of 9.1% back in June 2022 – suggesting the first wave of inflation is over. However, according to Strategas Research Partners, historical bouts of meaningful inflation evidence multiple waves more often than not. As we move toward the trough of this inflationary wave, much will depend on how the Fed reacts. By our estimates, the money supply is still sitting meaningfully above its long-term trend so if policymakers ease

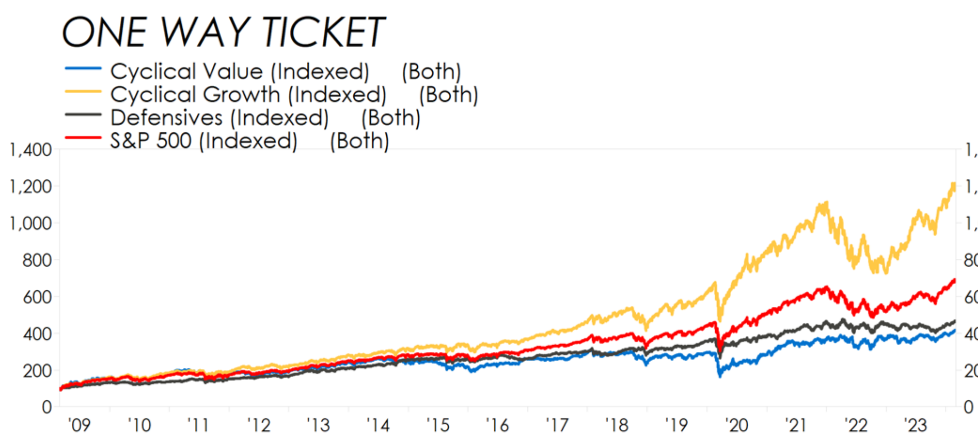


Source: Factset; S&P Dow Jones Indices with EPS defined on a trailing twelve month basis. Yellow Cardinal Research; the Recession Indicator is a proprietary dashboard of financial conditions that historically have provided some lead time on recessionary events. When more than half of the weighted average signals were triggered, this often precluded a recession. The Recessionary Indicator is a weekly signal with the 13 week moving average smoothing the volatility.

agressively, we wonder if a second wave of inflation takes shape. If so, this might have implications for a company's cost of capital, a stock's valuation multiple and changes in market leadership. As a result, we've referred to this secular mantra as "Doing the Opposite".

Meanwhile, the cyclical perspective has, admittedly, gotten more "Tricky" of late. Part of this tricky backdrop is related to: (1) being late in the business cycle but early in the profit cycle and (2) the disparity among valuations which has been driven by the increased concentration of the market.

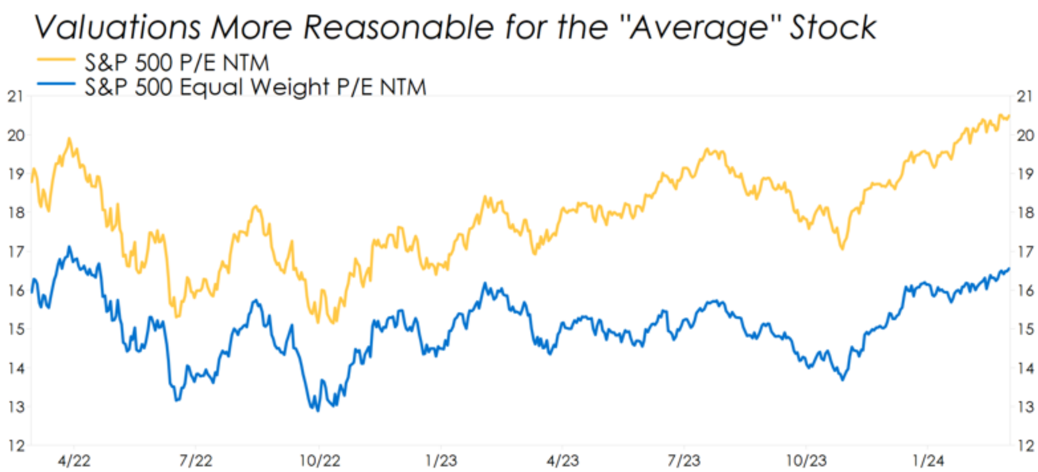
With regards to the first point, an extended inversion of the yield curve and limited incremental economic capacity suggets that we remain closer to the end than the beginning of the business cycle. However, the earnings recession that occurred last year is now resolving with an upturn in profit growth expected for this year. The chart on the prior page evidences both of these conditions. Our recession indicator remains at comparable late cycle levels while the forecast for S&P 500 earnings growth is for a re-acceleration. We believe this setup requires investors to keep their proverbial "head on a swivel" in recognizing the cyclical earnings improvement while also understanding that its sustainability remains up for debate.



Source: Factset; Cyclical Growth is represented by an equal weight of the S&P 500 sectors including Technology, Consumer Discretionary and Communication Services . Cyclical Value is represented by an equal weight of the S&P 500 sectors including Financials, Industrials, Energy and Materials. Defensives are represented by an equal weight of the S&P 500 sectors including Consumer Staples, Health Care and Utilities.

With regards to the second point, the gap between what's been working and everything else is quite wide. As can be seen in the chart at right, the three sectors that make up the Cyclical Growth defined basket (Technology, Discretionary and Communication Services) have materially outperformed everything else for an extended period. As a result, valuation multiples have expanded in these areas faster than elsewhere. Because these sectors are dominated by the largest constituents of the market, the valuations of the cap weighted S&P 500 index have expanded materially relative to the "Average" stock or the equal cap weighted S&P 500. The end result can be seen in the chart on the next page. While valuations are extended at the top of the market, more reasonable valuations are represented under the hood of the market. The cap weighted S&P 500 is trading at 20-21X forward earnings while the equal weighted S&P 500 is trading at 16-17X forward earnings.

A key takeaway for us is that this kind of market action has conditioned investors to become accustom to succeeding with much less diversifcation than in the past – regardless of valuation risk.



Source: Factset

As we look ahead, we think investors might have to think differently or "Open the Aperture" from both a cyclical and secular lens. Alternative scenarios to the existing leadership trends might be beneficial to consider. Given the narrowing set of market conditions, expanding one's investment field of view might lead to the realization that the future opportunity is now in the diversity of the investment universe rather than in the concentrated focus of a few select investments.

So what are the implications and key takeaways for portfolios?

From a portfolio positioning perspective, consistent with the above view, we continue to emphasize balance across asset classes and market segments while remaining UW to the most expensive and concentrated areas. We also continue to believe that it's important to be cognizant of the potential changing paradigm (i.e. Secular) while also recognizing the recent improving profit cycle setup – albeit within a late-cycle frame (i.e. Cyclical).

Within equities, in acknowledging the increased evidence of a bottoming in the Fundamental data, we recently adjusted our positioning to incorporate more balance geographically and within our US Large Cap exposure. In the latter, our bias has generally been to have more exposure to less expensive areas (broader vs top) while maintaining a bit more balance of late by adding to late cycle cyclicals at the expense of defensives. As such, we've moved to a greater OW in Cyclical Value relative to Defensives combined with a smaller cap bias. We remain UW the most concentrated and expensive Cyclical Growth areas.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – which remains our biggest OW in portfolios for diversification purposes. Our US Core Bond managers are slightly OW corporate bonds, though we've previously moved up in credit quality by adding some Treasuries and lengthening duration (along with the adjustment from a barbell to belly approach). Our bias towards this higher quality segment means that we remain UW the most cyclical parts of the bond market where spreads have tightened considerably (High Yield and Emerging Market Debt).

Within alternatives, we're slightly OW and remain fairly balanced by recently reducing our UW to Real Estate and our OW to Diversified Alternatives as we think valuations in the former have come down to reflect the challenges of this interest rate senstive area.