Nordwand Capital

2024 Annual Capital Markets & Investment Outlook

Soft Landing or Bust?

January 2024

Executive Summary
Another Regime Change Coming

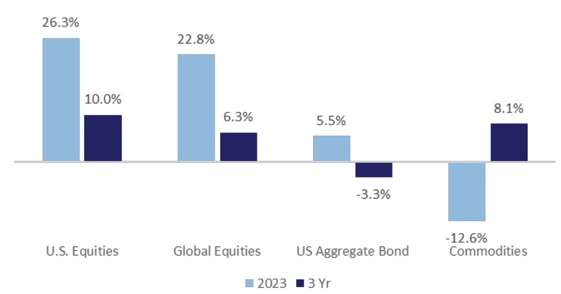
2023 is in the books.

If you slept through it and woke up for the ending, you'd be forgiven for thinking it was a simple year with a benign interest rate environment and accelerating earnings growth that was conducive to equity returns. You'd have been wrong, of course, but the wear and tear on your heart would have been considerably less than it was for those of us who were awake for the whole ride!

Looking ahead, we see a lot of changes coming. Monetary policy regime shifts, election year politicking, a concerning geopolitical landscape, and capital markets that in many ways moved much faster than policy or fundamentals would suggest will create a complicated 2024 investing environment.

In brief, we believe markets expect – and are already pricing in – no recession in the US in 2024, while also expecting accelerated rate cuts from the Fed to support asset prices. We are concerned therefore that liquid markets have already priced in outcomes that are far from certain, which suggests heightened risk awareness is critical. The following are more detailed views by asset class, and then a deeper dive into the data and story as we move from 2023 to 2024.

Figure 1: Asset Class Returns
(2023 & 3-Year)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.
Note: US equities = S&P 500, Global equities = MSCI ACWI Index, Commodities = Bloomberg Commodities Index.

Listed Equities: As we can see in Figure 1, equity markets – particularly among mega-cap US companies – exceeded expected returns in 2023. We see more room for returns in small cap stocks, emerging markets, value stocks, and segments of early-stage cyclicals in the new year. We remain selective in our equity market preferences, as we see opportunities elsewhere for similar or greater return potential with less risk and volatility.

Liquid Credit: A lot of intra-year volatility in rates produced a largely muted return year for much of liquid credit. With choppy disinflation the most likely path forward, we are less convinced that the Fed will be an aggressive rate-cutter in 2024. We therefore continue to see better value and yield in private and direct credit and expect to continue ramping up this exposure in 2024.

Private Credit: Nordwand has for some time adhered to an overweight exposure in private markets, and we continue to espouse this view in 2024. Private credit, sometimes featuring distribution yields above 10%, provides improved return potential relative to liquid credit, with the ability to create exposures that mitigate risk while preserving excess return.

Private Equity & Venture Capital: Capital markets have remained stubbornly tight, with a large pool of exit opportunities and refinancings needed to fund attractive companies. Whether through secondaries offerings with de-risked assets, or growth-stage financings in need of bridge solutions, Nordwand sees outsized opportunities in this space and plans to continue increasing our clients' exposure here in 2024 and likely beyond.

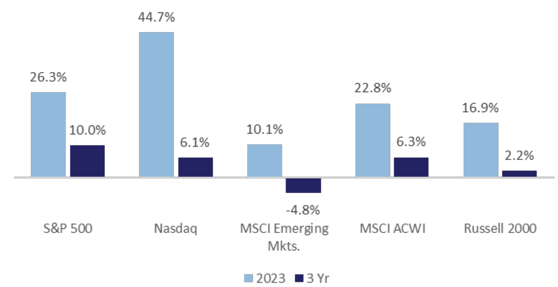
Commodities & Real Assets: The natural inflation hedge represented by commodities and real assets (real estate, infrastructure, agriculture, timber, metals, etc.) is an area that we are watching more closely in 2024 for tactical reasons. Since we think that markets have been too sanguine in assuming that ebbing inflation continues and aggressive rate cuts are on the horizon, we see segments of this area as potentially opportunistic in the event that inflation begins to return and/or economic conditions weaken.

Reviewing 2023: What Just Happened Here?

Equities 2023 Recap & Thoughts

Equity markets bounced hard off the 2022 sell-off. As we'll discuss, not all markets were equal, and breadth was limited in many respects.

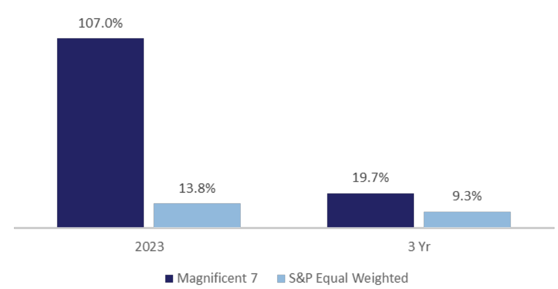
Figure 2: Equity Market Returns
(2023 & 3-Year)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

As has often been the case since the 2008 global financial crisis, monetary and fiscal intervention have helped propel US stocks higher than global peers. As everyone reading this will likely be aware, performance was concentrated in a small group of stocks that have come to be known as the Magnificent 7.

Figure 3: Concentration of Equity Returns
(2023 & 3-Year)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

These seven companies (Amazon, Apple, Google/Alphabet, Meta/Facebook, Microsoft, Nvidia, Tesla) comprising $12 trillion in market capitalization and ~29% of the entire $42 trillion index, were up 107% last year.

Equal weighted, the S&P 500 returned closer to 14% in 2023. Toward the latter third of the year, the "S&P 493" members began to work, which was welcome news for those looking for breadth in their market movements.

Small cap equities, represented in Figure 2 by the Russell 2000 index, also showed signs of life in 4Q'23. Small cap equities traditionally represent higher growth companies that perform well in risk-on environments. Yet this index was down 7% at the end of 3Q'23. The mighty 23% rally in small caps to close the year was likely as much investors spreading out their bets from a Magnificent 7-heavy hand earlier in the year as it was confidence in the market as we move in 2024.

As far as sector winners and losers in 2023, the song remains largely the same as it does when looking at the indices. Technology and consumer discretionary sectors soared (reminder that Tesla and Amazon are classified as consumer discretionary, and not technology stocks in the S&P's system), while defensive sectors like utilities and consumer staples fared poorly. This is logical, insofar as in periods of high interest rates investors are unlikely to buy bond-proxy substitutes like utilities, and absent evidence of an actual economic downturn owning consumer staples or healthcare companies is less likely to produce a strong short-term outcome.

Liquid Fixed Income 2023 Recap & Thoughts

Liquid fixed income markets were whip-sawed. We joked at the outset that if you'd slept through the year and woke only at the end, you would have been surprised by the path we took to journey through the year. Interest rates were the reason for that quip.

Figure 4: 10-Year Treasury Yields
(2023)

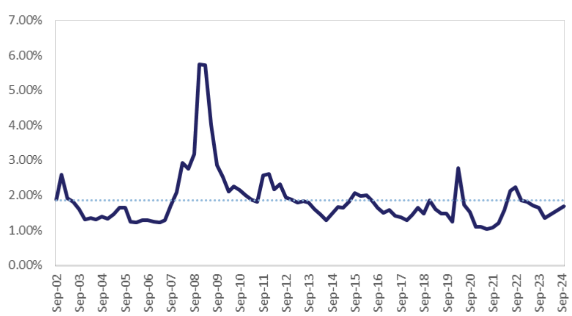
Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

Yields on the 10-year Treasury began and ended 2023 at ~3.87% but dove as low as 3.31% and as high as 4.99%. A similar pattern was evident for 2-year Treasury yields – an instrument that is even more affected by rate movements and monetary policy. In both the 2-year and the 10-year, markets witnessed some intraday and intraweek movements that were highly unusual for the world's benchmark securities.

While Treasury yields were largely unchanged from year-end 2022 to year-end 2023, the yields offered to take more credit risk by investing in corporate debt were uninspiring, in our view. Measured as a spread versus Treasuries, both investment grade and high yield bond spreads both fell over the course of 2023 (Figures 5 & 6) and are sitting at or below long-term averages.

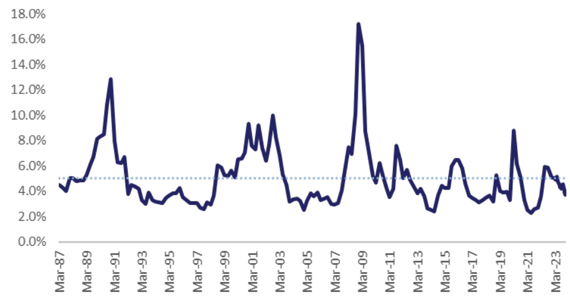
In other words, investors are not being compensated for taking additional credit risk versus investing in Treasuries at the moment. With cash yielding an attractive ~5.35% since mid-summer 2023, we found limited utility in investing in liquid credit last year.

Figure 5: Investment Grade Yield Spreads
(2002-Present)



Source: Bloomberg, Moody's, Nordwand Capital, as of Dec. 31, 2023.

Figure 6: High Yield Spreads
(1987-Present)



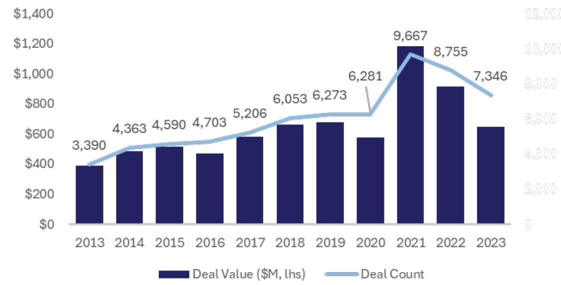
Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

The yield and price movements in liquid credit last year produced modest total returns for bond investors of roughly 0-5% across the entire year as measured by the US and Global Aggregate Bond indices (see Figure 1). As we've mentioned before, we continue to find other segments in the credit markets considerably more attractive on a risk-adjusted basis than broad liquid bond exposures.

Private Equity 2023 Recap & Thoughts

Private equity trudged through a slow year in 2023. Combined deal activity was at its lowest since 2016, with private equity selling activity its lowest in over a decade. Overall, private equity capital deployment dropped by close to 30% over the prior year as activity in the space is entering its third consecutive year of declines (Figure 7).

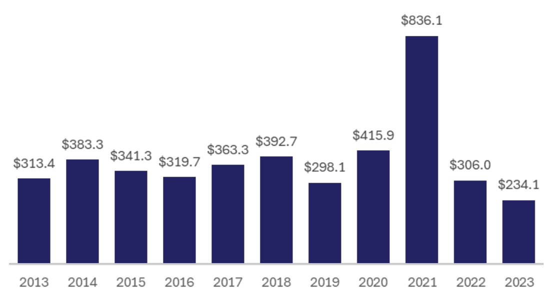
Figure 7: Private Equity Deal Activity
(2013-Present)



Source: Pitchbook, Nordwand Capital, as of Dec. 31, 2023.

Private companies and funds have lacked a clear path to monetization in public markets as required returns have risen sharply with the overall rise in interest rates over the last 2 years.

Figure 8: Private Equity Exit Activity
($bn, 2013-Present)



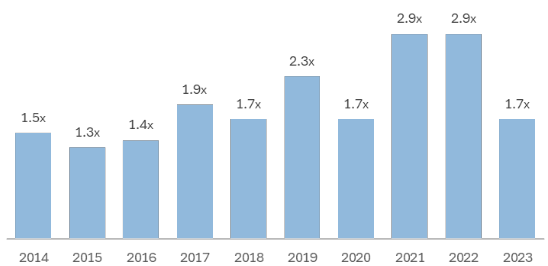
Source: Pitchbook, Nordwand Capital, as of Dec. 31, 2023.

This slowdown in IPO and exit activity (Figure 8) has increased holding times for companies within private equity funds, slowing recycling of capital and realization of gains that are necessary for future fundraising and growth for private companies and fund managers. Multiples in public markets in some cases exceed those based on private fund valuations, which may augur for a release of pent-up exit activity.

In the meantime, the dislocations that have arisen due to tighter capital markets have led to opportunities for Nordwand to provide financing and present attractive investment opportunities for our clients.

What is also notable when looking more closely at Figure 7 is that the activity levels in 2022 and 2023 were not the aberration over the last 10-12 years; 2021 was the outlier. The longer-term trendline suggests that 2023's activity was mean-reverting and might be closer to normal if we exclude 2021 from our data set.

Figure 9: US Private Equity Deal Valuations
(EV/Revenue, 2014-Present)



Source: Pitchbook, Nordwand Capital, as of Dec. 31, 2023.

Notable in Figure 9 is that elevated deal valuations in the 2021-2022 period, came back to earth in 2023. Coupled with higher structural interest rates in the next 3-5 years vs the 2013-2021 period, exit multiples could continue in this lower range. Once again, the aberration in the data was in '21-'22, when zero-bound interest rates drove much higher valuations. We'll have more to say about our expectations for forward Fed Funds terminal rates later in this piece.

2024 Outlooks
Macroeconomic & Policy Outlook

We'll begin our discussion of market and investment outlooks for this year by looking at changes in monetary and fiscal policy and how those may feed into macroeconomic conditions and outcomes.

In brief, we see four pretty typical key drivers on the macro front for 2024 that will have an impact on growth and markets:

1) **Monetary policy shift:** What will the Fed do, and how quickly will it happen?
2) **Fiscal policy direction:** Can this pace of deficit spending continue? What will happen when the Tax Cuts and Jobs Act of 2017 (TCJA) sunsets at the end of 2025?
3) **US elections:** Will we get divided government again? How challenging will the civic and market volatility become?
4) **Geopolitics:** Will the current conflicts remain confined or will they spread? What will China do?

Policy Backdrop and Context: 1980s to Now

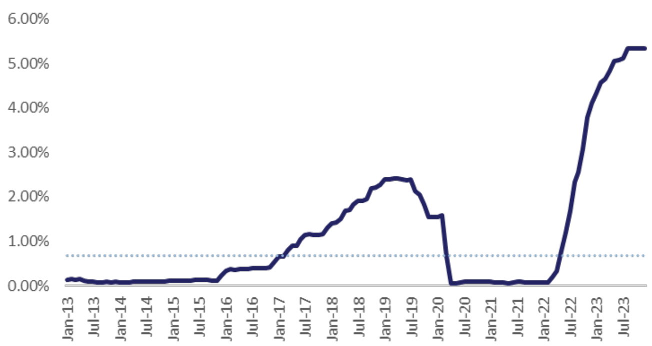
To understand the state of our monetary and fiscal questions going into 2024 – and how those are likely to impact markets and investments – it's necessary to take a quick detour into the past.

In the period from the 1980s through the 2010s, aging Western (i.e. US & Europe) demographics, technology-enabled productivity improvements, and the emergence of China and other economies as manufacturing centers combined to create deflationary pressures. This permitted the moderating of interest rates without igniting an inflationary response, thus helping to accommodate strong growth.

For the last 6-8 years, the policy stance of the US and its allies with respect to China, and the increasing awareness of the long-term effects on Western self-reliance and middle classes that these policies have wrought, has produced a probable shift in some of those long-term deflationary trends.

As we see in Figure 10, the prevailing disinflationary trend allowed the Federal Reserve to aggressively combat both the 2008 global financial crisis and the Covid pandemic's disruption of economic activity with a multi-year near-zero interest rate policy.

Figure 10: Fed Funds Rate
(2013-Present)

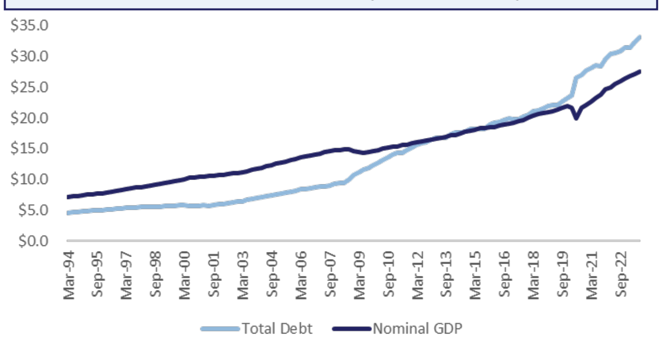


Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

On the fiscal side, deficit spending has been rampant for a long-time in the US, but it is notweworthy that recent trends arising from both of these "recent" crises have accelerated deficit spending and created a level of debt accumulation that are different in degree than in the past.

Since 2013-2014, total US Federal debt outstanding has exceeded annual nominal GDP (Figure 11). The difference was negligible until 2020, at which point the gap widened considerably. To bring the level of debt relative to GDP back closer to 100% would require balancing the budget, removing more than $1 trillion per year from the US economy in the process. Though the scale of that figure and its implications are daunting, looked at another way the concern for macro stability is somehow even more concerning.

Figure 11: US Total Debt & Nominal GDP
($ in trillions, 1994-Present)

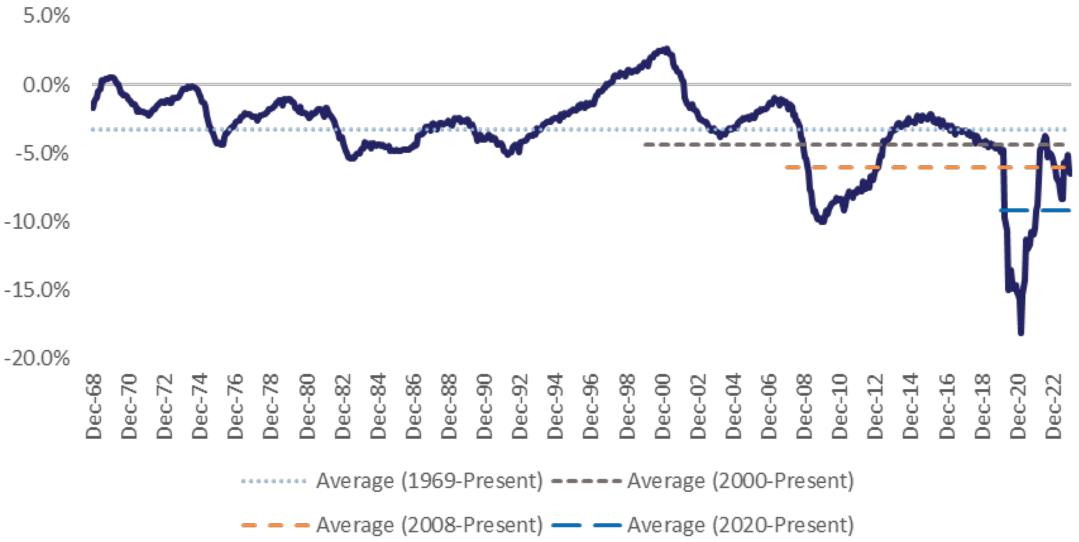


Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

Figure 12 highlights our annual budget deficit expressed as a percentage of nominal annual GDP. In addition to noting the deficit trend over time – we currently are running a 6.5% deficit, which is historically large for any period outside of a crisis or war – we also included deficit spending averages since 1969, 2000, 2008, and 2020.

The trend is obvious just by looking at the last 20 years in Figure 12. We've gone from running ~3% deficits on average for the 1969-2023 period to 6% since 2008 and 9% since 2020. These are obviously unsustainable figures, and call attention – again – to the issues regarding debt funding costs and macroeconomic impact should the US Federal Government step back from its recently oversized role in supporting GDP. It would be difficult to imagine avoiding a recession were the Federal Government to reduce spending by this amount. The short-term political fallout is unlikely to be an outcome either political party would be willing to experience.

Figure 12: US Federal Deficit as % of GDP
(1969-Present, Nominal)

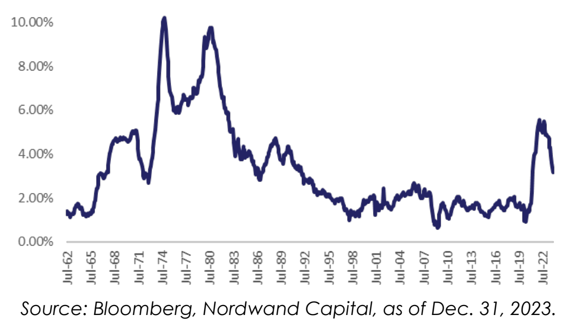


Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

Monetary Policy: Whither Interest Rates, and When?

Back to the present, inflation – which was nurtured at least in part by stimulus-fed excess demand meeting the supply constraints coming out of Covid – remains higher than policy makers at the Fed would like to see, revealing another variable in this equation.

Figure 13: Core PCE Inflation (YoY)
(1962-Present)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

Inflation has been waning since late 2022 (Figure 13), but components, like wages, remain sticky and elevated on the services side of the economy – which continue to grow at a yearly pace of over 4%. If the Fed really wants to bring inflation down to 2%, while balancing the employment picture and staying mostly clear of election-year politics in the US, it has its work cut out for it.

Herein lies a large problem for the markets and for investors. The Fed has indicated it expects to cut rates by 75 basis points (i.e. 0.75%) in 2024. The market currently expects 175 basis points of cuts, at the time of this writing – or fully an additional four 25bp cuts than the Fed forecast. On top of that, if the Fed doesn't want to be seen as influencing political outcomes, it may seek to avoid any action at its September meeting. This leaves only four meetings (March, May, June, and July) at which the Fed could cut rates and be clear of the elections in the fall.

To us, this suggests two contradictory things at the same time: 1) either a very aggressive rate-cutting schedule in the spring even with above-trend inflation while there is scant evidence of tight financial conditions or a crisis to justify it; or 2) a slower-moving Fed that cuts much less than 175bps, therefore disappointing a market where interest rates and equity valuations are banking on a more dovish Fed.

"The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function." -F. Scott Fitzgerald

While we are fans of both Fitzgerald and the markets, we expect that the market's "ability to function" in light of this emerging dissonance between probable reality and hopeful expectation may lead to some breakdown of the market's proper functioning – or in this case, an increase in volatility and re-pricing of assets that appear priced for the perfect outcome of a no-recession future.

Fiscal Policy: Potential Tax Policy Changes & Impact on Estate Planning

The Tax Cuts & Jobs Act of 2017 (TCJA) included provisions that expire, or sunset, at the end of 2025. This means a mix of effects depending on where someone lands on the income spectrum, whether they were likely to be standard deduction-users or itemizers, whether they lived in higher tax or lower tax states, etc.

For Nordwand's clients, particular note should be focused on the lifetime exemption provision. This is the amount a person can pass to anyone other than a spouse or charity at death completely tax-free. This figure effectively doubled under passage of the TCJA, and including inflation adjustments now sits at approximately $13.6 million per person, or $27 million per married couple. Going into 2026, those figures will ratchet higher, with many expecting the exemption to sit at $15 million and $30 million for single persons and married couples, respectively.

We will continue to watch these things develop throughout 2024. We don't expect any legislative activity before the elections, and in fact don't think we will see serious movement until close to the end of 2025. In the meantime, we include this information in our 2024 outlook piece because we think it should be highly relevant to many clients' estate plans in 2024 and 2025.

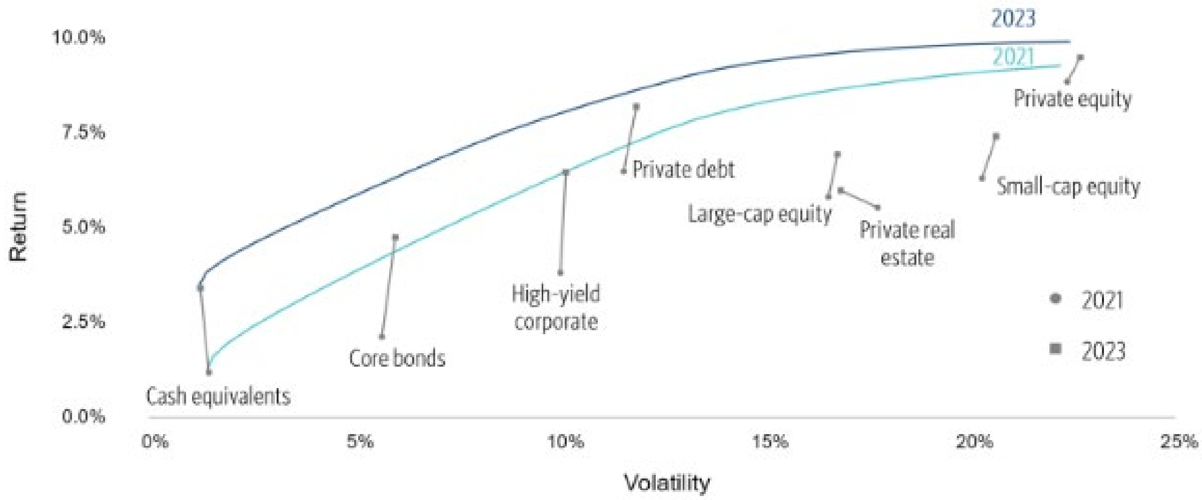
US Elections & Geopolitics

Addressing the last two of our macro influences together, we would remind investors and clients that historically the 4th year of a presidential cycle has been good to markets. That said, we think the equity markets outperformed in 2023, and remain cautious that some of the accelerated returns will make for a weaker than normal 4th year market in 2024.

Further, in the US many of us remain worried about the civic mood over the last few election cycles, and at the very least expect heightened volatility going into the fall this year. Merging this politically-inspired concern with our comment above about the path of Fed rate cutting and its intersection with timing and politics, it may well be prudent to be more tactical than normal and harvest some gains and reduce risk if the first one-third to one-half of the year produce solid winners.

Globally, we are collecting more concerns on this front each year. In 2022, the Russia-Ukraine conflict arose; in 2023, the Middle East has seen troubling regional conflict, beginning in Israel and now spreading to the Red Sea. Through the last several years the China-Taiwan situation continues to merit close monitoring. While our hope for 2024 is that none of these issues worsens, as always we are watching client investments for exposure to these areas.

Figure 14: 10-Year Expected Asset Class Risk & Reward
(10 Years)



Source: Pitchbook, Nordwand Capital, as of Dec. 31, 2023.

Asset Class & Investment Outlook

Looking back to last year's outlook, we expressed the view that the rapid sell-off in liquid markets made for some attractive entry points that could lead to a rewarding 3-5 year return profile. In private markets, we were more circumspect given the slower marking-to-market for valuations, arguing for caution in finding value.

These predictions proved generally correct, in that the sharp rebound in equities markets from the 2022 sell-off yielded nice gains, although liquid credit was more challenging given the path of interest rates and spreads during the year. Private equity did indeed have a slow year again, owing to the capital markets issues we noted earlier in this year's piece.

Looking into 2024's version of this same crystal ball we think much of the easy returns in public/liquid markets have been harvested. Equities generally worked in both developed and emerging markets, and rates rose and then came back down, creating a more uncertain path in 2024. We find value in pockets of private markets and continue to find value in a burgeoning private credit market relative to liquid credit options. Ahead are our thoughts on each of these segments.

Figure 14 highlights some of these same thoughts in visual form. Even in a rate-cutting environment, cash and credit bring more to a portfolio than they have in years. The return of yield should allow increased potential to balance risk, return, and liquidity, which is constructive.

In a world with inflation at 2-3%, rather than 1-2% as in the last decade, earning a suitable real return (i.e. return above the rate of inflation) takes on more complexity, but as Figure 14 illustrates, investors are requiring higher returns to account for this, with cash and credit showing the most improved prospects.

Listed Equities Outlook

If last year's story was one of uncovered value after the 2022 fall, this year's story is about being more picky and finding the right spots.

Figure 15: S&P 500 1-Yr Forward P/E (10 Years)

Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

The S&P 500 is no longer inexpensive relative to its own trading history. While this outcome is heavily influenced by the performance of the "Magnificent 7" that we noted earlier, the reality still remains that the index broadly is trading at ~20x forward earnings versus an historical median of ~16-17x. We see better value in other areas for incremental investment in the near-term.

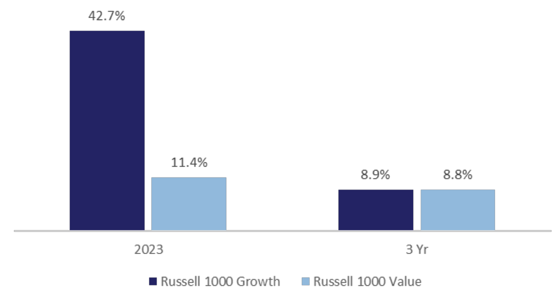
Figure 16: Russell 1000 Value vs. Growth 1-Yr Forward P/E (10 Years)

Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

For instance, we continue to find better opportunities within large cap value stocks more so than growth stocks.

This is true not only because value stocks have tended to outperform growth stocks at this point in prior economic cycles, but also due to their being relatively less expensive than the growth counterparts (Figures 16 & 17).

Figure 17: Russell 1000 Value vs. Growth Total Returns (2023 & 3 Years)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

We also see opportunities in small cap stocks. In spite of posting similar expected earnings growth profiles and historically trading at higher valuations than their large cap peers, small cap stocks have returned only a very modest ~2% per year over the last three years (See Figure 2, Russell 2000) as capital has concentrated in larger-cap alternatives.

While we find aspects of international developed markets attractive due to their generally lower valuations, we remain more excited by emerging markets, just as we did in 2023. Emerging markets lagged developed markets meaningfully in 2023, with the MSCI EM Index up 10.1% for the year while the S&P 500 was up 26.3% and the MSCI ACWI (global developed market index) posted +22.8% returns.

EM is notably shaky in periods where a US recession is expected given many emerging markets' exposure to the US dollar and exports to the US. If we are in fact going to skirt a recession in 2024 and the Fed and other central banks begin to cut interest rates, growth acceleration may begin to be discounted in EM next year. If tensions with China subside, this case would be even stronger – although that last item is not our base case.

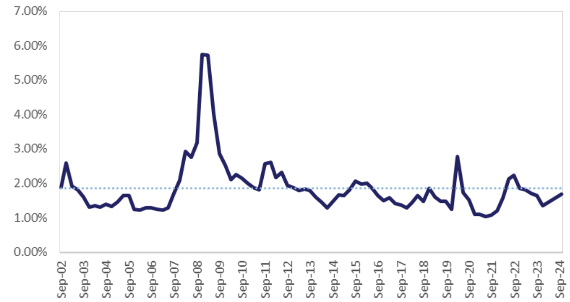
Our biggest ongoing concern for equities, and one that we highlighted in our 2023 Outlook as well, is that typically equity markets bottom in the months *following* a Fed rate cut, and we've yet not had the first of those. Typically, this is due to the reasons requiring a rate cut: weakening economic conditions, deteriorating employment, a financial crisis – these are all the ordinary events that precipitate the Fed wanting to ease financial conditions. None of these has shown up meaningfully in this cycle yet.

We have historically been loud proclaimers of the warning that believing "this time it's different" is the road to financial ruin, so we will continue to watch these developments closely. But in the meantime, as we make incremental changes to portfolios and find pockets of value and risk-adjusted return for clients, our focus within equities is likely to be much more squarely on the areas we highlighted above: value stocks, emerging markets, and small caps over large caps.

Liquid Credit & Fixed Income Outlook

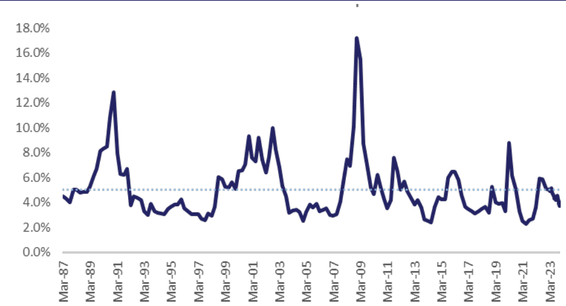
Modest returns in liquid credit last year broke a two-year losing streak for investment grade and high yield credit. As we look at 2024, cash is still highly attractive ahead of any Fed rate cuts, while the picture for corporate credit is more nuanced.

Figure 18: Investment Grade Bond Yields Less 10-Year Treasury Yields



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.
Note: Investment grade = Moody's Baa Index.

Figure 19: High Yield Bond Yields Less 10-Year Treasury Yields



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.
Note: High yield = Barclays Capital Corporate HY.

Figures 18 & 19 highlight the state of investment grade (IG) and high yield (HY) corporate bond yields in the US. Typically, these bonds price their yields for investors as a function of a spread to US Treasuries to compensate investors for the higher credit risk of lending money to an entity other than the US government.

As we can see in these Figs. 18 & 19, those spreads currently are 1.34% and 3.71% respectively for IG and HY, equating to ~5.3% and 7.7% yields for investors in these instruments. IG spreads are close to their 20-

year average, while HY spreads are ~60bps below their long-term average.

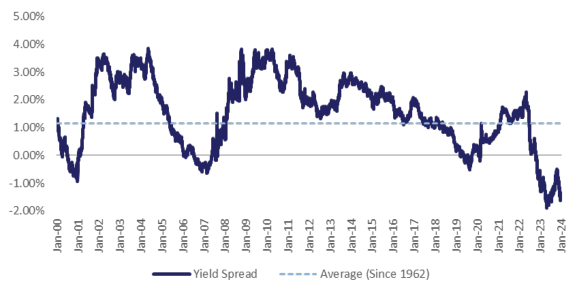
Since cash is currently yielding 5.35% with effectively no duration or credit risk, we don't find much value in taking additional credit risk – particularly at below-average credit spreads – for HY corporate debt. IG credit and agencies show modestly better relative value and could present a nice portfolio addition as Fed rate cuts begin to reduce the absolute return prospects for cash as we move into 2Q and 3Q 2024.

If credit risk is one axis for assessing relative attractiveness for credit, the other is duration. The duration argument is very lively at the moment, with many positing that a reduction in short-term Fed Funds rates will drag the whole curve lower and therefore reveal greater value for those investors willing to buy longer-term debt.

We find obvious merit to that argument but find more immediate value in the 0-7 year parts of the yield curve. First, we believe the Fed will cut rates this year, even if we doubt it will do so 6-7 times. This leads to a lower-risk return potential for shorter-term debt and cash. Second, long-term yields retrenched so strongly in 2H23 that much of the easy value has been extracted, in our view. Third, we expect that 2024 may be the year that the yield curve un-inverts (Figure 20), meaning that short-term yields will drop below long-term yields, again leading to positive returns for shorter-term bond investors. Fourth, absolute yields are higher given the yield curve inversion we noted in point #3 above – creating higher immediate income potential as well.

As a separate but vital part of this analysis, we are conscious of the risk at the long end of the curve from either an unexpected recession or re-emergence of strengthening inflation.

Figure 20: Yield Curve (3-Mo Less 10-Yr)
(2000-Present)



Source: Bloomberg, Nordwand Capital, as of Dec. 31, 2023.

A recession – which we believe markets and economists are not expecting at this time – could be either supply or demand led. Examples of inflation-oriented supply disruptions have been omnipresent since Covid, and we highlighted some potential geopolitical causes above. Demand-side inflationary issues could arise from the Fed cutting interest rates, financial conditions easing, and the resulting economic growth drives higher wages and boosts demand.

Since we view a recession / hard-landing or re-acceleration of inflation as being out of consensus, we are inclined to be particularly sensitive to the risks that arise in these cases. That also pushes us toward finding attractive liquid credit exposure on the shorter end of the curve – in other words, cash (for now) or debt with less than 5-7 years of duration.

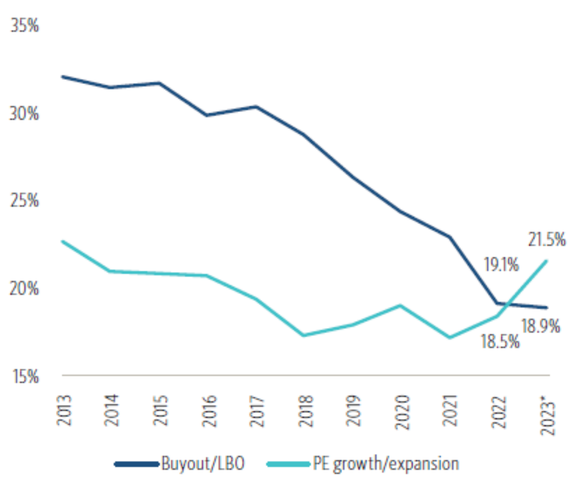
Private & Venture Capital Outlook

While 2023 represented a continuation of the multi-year struggles in private markets for deal flow, a few trends emerged that may influence 2024 positively, although we remain cautious while capital costs stay elevated and risk appetite diminished.

First, the pent-up exit deal flow we discussed in Figure 8 above is creating enormous pressure for refinancing and public listing offerings. While problematic for bigger funds and players requiring sufficient market depth and liquidity to execute, the smaller-sized deals in which Nordwand finds value and opportunities become tactically more available and interesting.

Second, debt is becoming scarcer in many deals. Leverage ratios have dropped dramatically according to Pitchbook, reflecting both the higher cost of debt and liquidity and risk constraints being felt by lenders. The higher level of equity is resulting in smaller financing rounds to reduce dilution, which again presents financing opportunities.

Figure 21: Platform LBO & Growth Equity as % of All Private Equity Deals

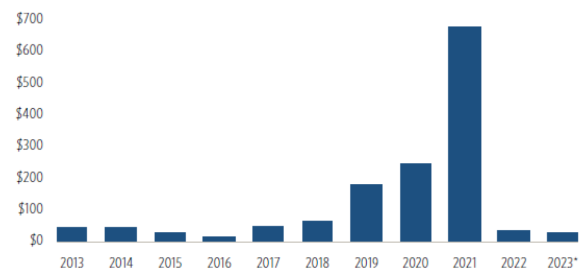


*Source: Pitchbook, Nordwand Capital, *as of Dec. 31, 2023.*

Third, with debt becoming more pricey and larger LBO-style deals struggling to find risk-takers and liquidity, smaller growth-stage companies have become a bigger piece of the private market. Many of these companies have a financial and operational profile that will not support debt, leaving small equity raises as the only option. Illustrating this trend, Figure 21 highlights that 2023 was the first year that growth equity deals outnumbered platform LBOs.

While deal activity stays muted, we think level-setting is necessary for investors' psychological well-being. The challenge, as we've mentioned before in this piece, is less that activity has dropped and more that activity rose to such unsustainable levels in 2019-2021.

Figure 22: Venture Capital Public Listing Value ($ in billions)



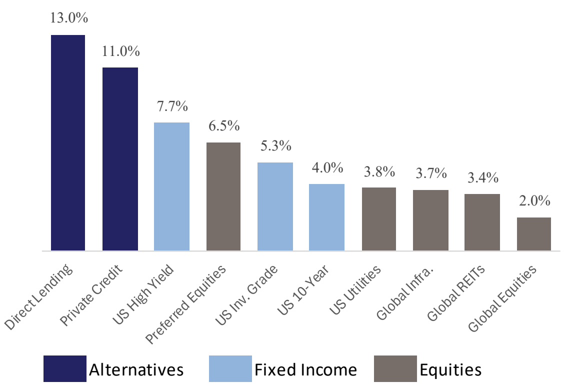
*Source: Pitchbook, Nordwand Capital, *as of Nov. 16, 2023.*

Looking at Figure 22 in the context of Figures 7, 8, and 9 is illuminating. It's difficult not to look at these trends – rapidly expanding levels of activity and heightened valuations – as the late-stage effects of a decade of artificially low interest rates that drove unrealistic expectations and outcomes. The same story is true of interest rates and broad market expectations.

The only question is whether the market and investors' need for these rates will force fiscal and monetary policymakers to respond accommodatively, or instead to offer tough love as we move to the "new old normal."

In private credit, the market opportunity continues to intrigue. Once again, multiple trends are converging to create a favorable investing landscape.

Figure 23: Estimated Investor Yield Alternatives



Source: Bloomberg, Nordwand Capital estimates, as of Dec. 31, 2023.

Risk-adjusted returns being the guiding star for strategic and tactical asset allocations, we point to relatively unattractive valuations across large cap equities (Figure 15), 10-year Treasury yields at 4%, spreads for investment grade and high yield that are at or below long-term averages (Figures 18 & 19) as evidence that return potentials are modest for many traditional asset classes at these prices and at this point in the economic and market cycle.

Figure 23 illustrates multiple yield options across equities, fixed income, and alternatives. We think income production will be increasingly important over the next few years, whether we are primed to enter a recession or whether we skirt one and instead produce positive but uninspired growth. Private and direct lending are poised to be key contributors to portfolio return given their attributes – senior debt, often secured or asset-based, in cash flow-generating companies spread across sectors. Overall, we view private credit's return potential as similar to equities over the last 10 years, but generally with a considerably better risk profile.

Summary

As we look back at 2023 and apply any lessons learned to our 2024 outlook, a few things stand out.

First, the macro and policy backdrop will loom large in the US. We do not expect a quiet election season and therefore expect some increase in volatility. We also expect the Fed has been backed into a corner. Its posture indicates several rate cuts may be possible, while its explicit language suggests otherwise. Combined with the political optics of aggressive easing just before an election, we think the market will find itself disappointed by the Fed, which may take some air out of risk assets (e.g. equities).

Second, almost irrespective of the Fed's choices, the US economy seems poised either for a below-trend growth year or a mild recession. In either event, growth and risky assets may suffer, and more durable earnings and cash flows may be rewarded.

Third, and related to our above points, large-cap US equities likely outperformed last year, making this year more complicated. Better risk-adjusted returns are available among small caps, international developed and emerging market equities, and in value versus growth stocks, in our view.

Fourth, yields across various parts of the credit landscape look compelling to us. We have been strongly in favor of private credit as the de-banking of America continues and see pairing that exposure with cash (if the Fed stays more moderate in its moves), agency debt with more attractive yields than Treasuries, and higher-yielding instruments that take advantage of structuring to produce increased income.

On balance, we think good returns are quite achievable in 2024, and expect that a higher degree of flexibility in timing will be prudent this year. In terms of risk-adjusted returns, we think credit trumps equity, and private beats public. We look forward to discussing these views with many of you in person during the year.

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