The Colony Group

OUR VIEW

APRIL 2024

Equity markets typically perform well when central banks are on hold, neither raising nor cutting rates, and we believe the first quarter was evidence of that (Table 1). At the beginning of the year, it was expected that the Federal Reserve would cut rates at least six times in 2024. Those expectations are now reduced to about three rate cuts starting this summer, a signal, in our view, that inflation is higher and stickier than central bankers would like. Inflation cycles take time and are not linear. While it's likely this inflation cycle peaked in 2022 and a disinflationary trend is now well underway, it's clear that the duration of this cycle will be longer than many investors originally expected. As long as there is not a meaningful reacceleration in inflation, we think the Fed's posture is relatively benign, which in turn should be positive for equity markets.

Market Performance

	Q1 2024
U.S. Equity	10.0%
International Equity	4.7%
U.S. Bonds	-0.8%
Global Bonds	-2.1%

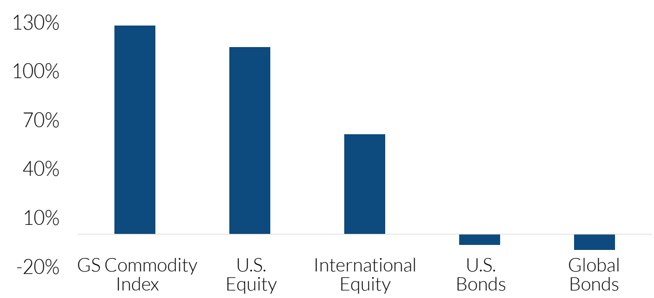
Source: Bloomberg. Total returns. Performance is gross of fees. Please see important disclosures at the end of this whitepaper.

Table 1

That Was Then

Rewind four years and the initial reaction to the pandemic was to sell equities and commodities and flee to the perceived safety of government bonds. However, one of the most impactful characteristics we observed of the pandemic was the inflation cycle that evolved, and how the financial markets adjusted materially from their initial reactions. For starters, bonds performed poorly versus equities and commodities over the ensuing four years (Chart 1). Importantly, at that time, we believed bonds provided an unattractive and asymmetric risk/reward ratio, especially bonds with duration. Instead, it was our view that the market volatility at the onset of the pandemic would provide an opportunity to add to global public equity and energy exposure.

Chart 1: Returns Since the Pandemic 3/31/20-3/31/24



Source: Bloomberg. Performance is gross of fees. Please see important disclosures at the end of this whitepaper.

This is Now

Today, we own some intermediate duration bonds, and we believe agency mortgages with their implicit government guarantee and relatively wide spreads to U.S. Treasuries are a good example of value in the bond market. In addition, we have broadened our thinking on energy markets, expanding our interest to include an investment with broader exposure to a variety of commodities including uranium, gold, copper, and other materials. The strategy is likely to benefit from an expanding global economy that is emerging from a global manufacturing trough and a growing understanding that the transition from traditional fossil fuels to alternative power sources will require massive investment. Commodity cycles can wax and wane for long periods of time and we think it is likely we are in the early stages of the current cycle (Chart 2).

Chart 2: Commodities Appear Undervalued

Source: Goehring & Rozencwajg. The chart depicts the S&P Goldman Sachs Commodity Index Total Return value relative to the Dow Jones Industrial Average Index. Please see important disclosures at the end of this whitepaper.

For public equities, the strongest argument for ownership is that we are emerging from a manufacturing trough and that earnings growth should pick up after a lull last year. U.S. large capitalization equity valuations are expensive when compared to historical averages (Table 2), but that is not the case for U.S. small- and mid-caps, nor for international equities which trade closer to historical averages.

Valuations

Index	Forward P/E	Percentile
U.S. Large-Cap	21.8x	90th
U.S. Mid-Cap	17.2x	48th
U.S. Small-Cap	22.2x	17th
International ex-U.S.	14.3x	62nd
Emerging Markets	12.5x	51st

Source: Bloomberg. Data as of 3/31/24. Table 2
S&P 500 and Russell 2000 from 1976, S&P 400 from 1991, MSCI ACWI ex-U.S. from 1987, MSCI EM from 1989. 1st percentile means the lowest valuation, 99th percentile is the highest.

We believe there is also an opportunity in private equity markets where valuations have re-rated significantly downward in the last two years as many transitory participants in the private equity market (e.g., hedge funds) retreat. This is leading to a more rational market for permanent capital sources.

Innovation, a theme we have been stressing for years, continues to thrive in the private markets. Two recent examples from current private equity managers' investments show that innovation is not strictly confined to the world of artificial intelligence:

- Eco Materials Technologies is a Warburg Pincus green cement company that has a process that reduces carbon emissions by 99% compared to standard cement production. This is a notable improvement as cement production for buildings, roads, and other infrastructure makes up roughly 8% of the world's greenhouse gas emissions. Eco Materials' pozzolanic production method is lower cost and more durable than the portland process that has been the industry standard for over 200 years.

- Eikon Therapeutics is a private investment for both Innovation Endeavors and Foresite. Eikon's Nobel

Prize-winning microscope technology is paired with machine learning to track protein target movement for drug discovery. The company's technology can distinguish molecular nanostructures smaller than 200 nanometers (a human hair is approximately 80,000 to 100,000 nanometers wide) which enables high-resolution imaging of individual proteins inside living cells, an accomplishment that was previously impossible. Eikon quantifies the imaged protein dynamics into time series data which can be analyzed with advanced machine learning techniques. The goal is to reveal novel binding mechanisms in previously undruggable targets and to optimize compounds against well-understood targets.

Going Forward

The recent death of Nobel prize winning behavioral economist Daniel Kahnemann reminds one that investing is replete with cognitive biases, decision making, and human judgment. In 2022 there was a crowding into "loss aversion" and individuals sold securities because others were selling. In 2023 there was a view that the "artificial intelligence/Magnificent 7" theme was the only thing to own; however, what Kahnemann understood, better than most, was that individuals tend to overlook the benefits of diversification because of cognitive biases such as overconfidence or narrow framing. Our point is that in today's financial markets, we believe there exists a much broader opportunity; one that is available across public and private markets and a variety of asset classes, and we think investors should widen their lens in search of those opportunities.