ASSET MANAGEMENT SOLUTIONS

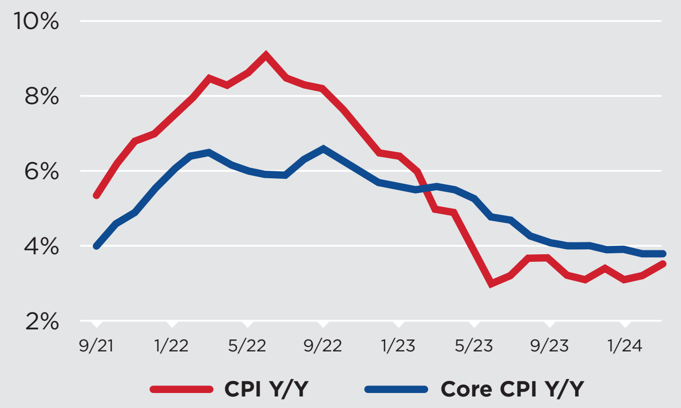
Q1 2024 Commentary

APRIL 2024

KEY UPDATES

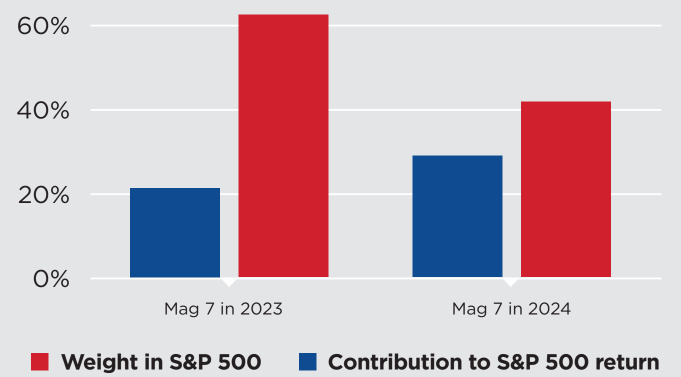
- Global stocks started the year on a positive note, with U.S. markets once again outpacing their international counterparts.
- Bond prices, on the other hand, were down slightly as interest rates remained elevated on stubborn inflation and hawkish central bank rhetoric.
- After a few quarters of significant improvement, inflation progress stalled due to pressure from energy, shelter, and sticky wages (figure 1).
- At the same time, the U.S. economy grew faster than expected, as a strong labor market and resilient consumers overcame persistent price pressure.
- Due to the upside surprises in both economic growth and inflation, the Federal Reserve left policy rates unchanged and reduced the number of expected rate cuts in 2024.
- Geopolitical turmoil continued, as the conflicts in Gaza, the Red Sea, and Ukraine saw marked increases in intensity and international attention.

Figure 1: Slight Uptick in Headline Inflation



Source: U.S. Bureau of Labor Statistics

Figure 2: A Broader Stock Market



Source: S&P Global, FactSet, and First Command.

MARKET HIGHLIGHTS

2024 opened with a bang, as major stock indices hit fresh all-time highs on the back of an improving economic outlook and strong corporate earnings. More importantly, positive performance continued to spread beyond the big tech names that dominated markets in 2023, which is typically viewed as a sign of health for any market advance (figure 2).

And like 2023, the first calendar quarter of 2024 served as lesson on why it's so important to block out "noise," as stocks advanced despite no shortage of potential disruptors. For example, not only did Congress once again take the government to the brink of a shutdown, but inflation's deceleration stalled, global interest rates stayed elevated, the conflicts in Gaza and Ukraine worsened, and global shipping continued to languish in the Red Sea and the Panama Canal (due to low water levels). Through it all, however, investor sentiment remained bolstered by a potential end of the global monetary tightening cycle.

International stocks, in both developed and emerging markets, were positive as well despite generally being more exposed to these disruptive events than the U.S. This occurred even as the Eurozone continued to struggle, with its largest economy (Germany) slipping into recession. Alternatively, Japan's long-awaited exit from negative interest rate territory and the prospect of even more economic stimulus from the Chinese government were enough to keep international markets afloat.

ECONOMIC OUTLOOK

Soft Landing Still Possible: Recession fears have mostly faded into the background, as the U.S. labor market, a bellwether indicator for our economy, continues to hold up remarkably well. This has allowed the core of the U.S. economic machine, the consumer, to keep spending despite the Fed's ongoing efforts to battle inflation. However, escalating geopolitical conflict has the potential to stress supply chains, which could result in a resurgence of goods inflation and may have an outsized impact on spending if wage growth slows. Additionally, this type of supply-side inflation increases the risk of a Fed policy error, as the need to maintain credibility in the fight against inflation may force them to keep policy tighter than otherwise appropriate.

Inflation Warms Up: Reversing the disinflationary trend of the last few quarters, both headline and core CPI came in hotter than expected in recent months. The primary culprits were once again stale shelter data and wages, and while the former should simply work its way out with time (as measurement catches up to real activity), wage growth has proven more stubborn than expected. And while high wages sound like a net positive, the issue is that they are driving levels of consumption that are inherently inflationary, meaning that in order for the Fed to achieve it's 2% target, wage growth needs to slow.

Elsewhere on the inflation front, we saw an uptick in energy prices due to looming OPEC+ production cuts, lowered estimates for U.S. oil production, and feared supply disruptions due to ongoing conflict in Russia and the Middle East. However, global demand for energy is likely to weaken given poor growth expectations outside of the U.S., implying that higher energy costs may prove short-lived. Similarly, shipping disruptions in the Red Sea and the Panama Canal have the potential to lead to higher goods costs, but fortunately have minimally impacted U.S. companies and consumers thus far.

Gaza Turmoil Escalates: International pressure continues to mount for a ceasefire in Gaza, but fighting in the area, and its rippling effects on the Middle East, has only worsened. Israel now finds itself actively fighting not only Hamas, but Hezbollah militants in Lebanon and Syria as well, while the Houthi terrorism of the Rea Sea is escalating despite a U.S. led naval coalition to protect the waterway. The biggest news, however, was the recent escalation by Iran, involving a massive drone and missile attack on Israeli targets. While ultimately resulting in little damage, the involvement of a state actor and potential Israeli retaliation further complicate an already tumultuous situation. While Israeli PM Netanyahu remains adamant that the only acceptable outcome can be the elimination of Hamas, drastically increasing pressure from the U.S. may put Israel in the position of either coming to the negotiating table or potentially losing more support from D.C.

Fed on Standby: As inflation progress slows, the Fed finds itself in the difficult position of balancing market expectations for rate cuts with the real risk of allowing inflation to reignite if it relaxes policy too soon. While policy makers still officially project multiple rate cuts by year end, their confidence appears to be wavering, as seen in diverging public remarks from Fed members. Chair Powell claims the Fed will not overreact to a few bad months of data and that progress is still on track, but what was once a near-certain rate cut by June is now a coin-flip at best. Of course, the looming presidential election only complicates the situation, as the closer we are to November, any action (or inaction) could be easily misconstrued as partisan, a perception that the Fed will feel the need to fight. This could add to the aforementioned risk of a policy misstep.

D.C. Watch: Primary season brought no surprises and barring no major legal hurdles for either candidate, the stage is set for a 2020 rematch. Luckily, dealing with known entities means it's much easier to anticipate potential policy shifts that may occur. But as we discussed in longer form here, the parties ultimately do not differ on most things that truly matter for the economy or markets. Meanwhile, Congress narrowly avoided yet another government shutdown, passing – just six months late – a $1.2 trillion spending bill to keep the lights on until September. And just like last time, discontent within the ranks of the Republican party over concessions made to pass the bill is threatening House leadership, potentially adding even more fuel to an already volatile election year.

Asia in Focus: All eyes are currently on Japan and China, as both are going through dramatic policy and growth shifts that could have major impacts on the broader global economy. After struggling with low growth and subsequent deflation for decades, Japan's economy was finally deemed strong enough to abandon its negative interest rate policy stance, a step that policy makers hope will encourage greater investment in the country. China, however, is sliding in the opposite direction, as years of poor government investment, corporate heavy-handedness, and a focus on philosophical abstractions over economic reality have reversed many of the advancements made over the past few decades. And while the CCP continues to bolster the languishing economy through government stimulus, these efforts may be undercut due to quickly worsening trade relations between China and the West, with both the U.S. and U.K. recently announcing new rounds of sanctions.

COMPOSITE PERFORMANCE (%) AS OF 3/31/24

	Quarter	Year-To-Date	1 Year	3 Years	5 Years	10 Years	Since Composite Inception*
SIP Aggressive Growth (Gross)	7.73	7.73	21.29	5.41	10.77	8.54	10.06
SIP Aggressive Growth (Net)	7.48	7.48	20.11	4.38	9.68	7.48	8.99
Morningstar Allocation Category (85%+ Equity)[1]	7.31	7.31	20.14	4.23	8.63	7.36	9.14

The SIP Aggressive Growth Strategy has a Strategic Asset Allocation Equity/Stock target of 98%.

[1]Funds in this category (Morningstar Aggressive Allocation) seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These aggressive strategies typically allocate at least 10% to equities of foreign companies and prioritize capital appreciation over preservation. They typically expect volatility similar to a strategic equity exposure of more than 85%.

SIP High Growth (Gross)	6.39	6.39	18.44	4.41	9.19	7.07	8.44
SIP High Growth (Net)	6.14	6.14	17.27	3.37	8.09	6.00	7.36
Morningstar Allocation Category (70% to 85% Equity)[2]	6.77	6.77	17.75	4.87	8.11	6.65	7.98

The SIP High Growth Strategy has a Strategic Asset Allocation Equity/Stock target of 85%.

[2]Funds in this category (Morningstar Moderately Aggressive Allocation) seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderately aggressive strategies prioritize capital appreciation over preservation. They typically expect volatility similar to a strategic equity exposure between 70% and 85%.

SIP Wealth Building (Gross)	5.24	5.24	15.75	3.46	8.02	6.36	7.51
SIP Wealth Building (Net)	4.98	4.98	14.57	2.41	6.92	5.28	6.42
Morningstar Allocation Category (50% to 70% Equity)[3]	5.30	5.30	15.15	4.04	7.37	6.14	7.25

The SIP Wealth Building Strategy has a Strategic Asset Allocation Equity/Stock target of 65%.

[3]Funds in this category (Morningstar Moderate Allocation) seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderate strategies seek to balance preservation of capital with appreciation. They typically expect volatility similar to a strategic equity exposure between 50% and 70%.

SIP Balanced (Gross)	4.00	4.00	13.04	2.34	6.36	5.26	6.19
SIP Balanced Growth (Net)	3.74	3.74	11.85	1.27	5.25	4.18	5.10
Morningstar Allocation Category (30% to 70% Equity)[4]	4.27	4.27	12.65	2.84	5.86	5.08	5.97

The SIP Balanced Strategy has a Strategic Asset Allocation Equity/Stock target of 50%.

[4]This category is a custom blend of two Morningstar categories referenced in this document: the Morningstar Moderate Allocation[3] and the Morningstar Moderately Conservative Allocation[5] categories. These benchmark returns are based on an equally weighted composite of the two categories, which is rebalanced monthly.

SIP Moderately Conservative (Gross)	2.85	2.85	10.68	1.69	5.06	4.15	4.76
SIP Moderately Conservative (Net)	2.59	2.59	9.52	0.63	3.96	3.09	3.70
Morningstar Allocation Category (30% to 50% Equity)[5]	3.22	3.22	10.23	1.72	4.45	3.96	4.62

The SIP Moderately Conservative Strategy has a Strategic Asset Allocation Equity/Stock target of 35%.

[5]Funds in this category (Morningstar Moderately Conservative Allocation) seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderately conservative strategies prioritize preservation of capital over appreciation. They typically expect volatility similar to a strategic equity exposure between 30% and 50%.

SIP Conservative (Gross)	1.76	1.76	8.07	0.97	3.57	3.28	3.65
SIP Conservative (Net)	1.51	1.51	6.96	-0.15	2.44	2.20	2.58
Morningstar Allocation Category (15% to 30% Equity)[6]	1.97	1.97	7.15	0.81	2.86	2.75	3.31

Source: Morningstar Direct

IMPORTANT DISCLOSURES

*Performance inception date is September 1, 2011 for all strategies listed along with their blended benchmarks. While some strategies were available prior to this date, September 1, 2011 is the first date available for which composite returns were calculated. See the Important Disclosures section for more details.

This report was created by First Command Advisory Services, Inc. an investment advisor.

The performance figures are based on month end account value data provided by Pershing LLC, custodian of assets in the AMS program. The monthly return figures from Pershing LLC are linked together to create time weighted trailing composite returns. Compounded annualized rates of return are computed by geometrically linking monthly rates of return and then appropriately adjusting the cumulative total to reflect the number of years in the annualized calculation.

Returns for the strategy composites are shown on a gross and net basis. Gross returns are presented before the deduction of investment adviser fees and other expenses. The net returns are based on the gross returns and are reduced by the actual fees at the individual account level (prior to asset weighting each period's returns). The net returns reflect the deduction of investment adviser fees and all other fees and charges clients have paid. These fees and charges reduce the returns and are described in our Investment Management Agreement and Wrap Fee Brochure. Investment adviser fees are deducted quarterly in arrears from each client's account, which produces a compounding effect on the total rate of return net of investment management fees.

The performance figures include: (a) realized and unrealized gains, (b) cash and cash equivalent returns, and (c) the reinvestment of dividends and other earnings.

All client accounts managed in accordance with the stated strategy (which includes being rebalanced, as appropriate) are included in the individual composite. On March 1, 2018, First Command consolidated its AMS Select Investor Program and its AMS Core Investment Program. Prior to such consolidation, investments purchased under the AMS Select Investor Program and AMS Core Investment Program were different. For purposes of the performance figures provided herein, all calculations use the historical information of the AMS Core Investment Program for holdings prior to March 1, 2018. Prior to 2022, accounts were included in a strategy composite on the date of the historical monthly composite file data pull, which was typically around the 10th business day of the following month. Beginning in 2022, client accounts are included in a composite the month after they are added to such composite and accounts that change strategy intra-month are dropped from the applicable composite (and not included in the monthly performance for such composite).

The value of an account managed in accordance with each strategy may be volatile and you may lose money. Past performance is not a guarantee of, or necessarily indicative of, future results and there can be no assurance that having your account managed in accordance with each strategy will achieve similar returns in the future or that client investment objectives will be achieved. Having your account managed in accordance with any specific strategy may not be suitable for your goals, objectives or risk tolerance. We encourage you to consult your advisor before deciding to have your account managed in accordance with any strategy listed.

AMS portfolios are reviewed on a monthly basis to determine if rebalancing the account is necessary. Asset allocation, diversification and rebalancing do not ensure a profit or guarantee against loss.

The performance figures contained herein are unaudited. The summation of dollar values and percentages reported may not equal the total values due to rounding discrepancies. All information is shown in US dollars.

The information contained herein does not represent a recommendation to buy or sell securities. Nor does this information constitute an offer to sell or a solicitation of an offer to buy any security. Nothing in this presentation should be construed as providing specific investment, tax or legal advice.

Rebalancing is a taxable event that may result in a taxable gain or loss; thus, rebalancing in non-tax advantaged accounts will result in involve higher taxes.

Each strategy composite is compared against the most comparable category of asset allocation funds based on overall equity exposure, provided by Morningstar. These categories cannot be purchased. The holdings, return, and volatility characteristics of the categories are also different from the accounts comprising each strategy composite, as further described below. Investors should keep these differences in mind when comparing the performance of any strategy to the performance of the corresponding category.

All information is believed to be from reliable resources; however, First Command makes no representation as to its completeness or accuracy.

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