BNY MELLON
WEALTH MANAGEMENT

2024 OUTLOOK

A Healthy *Slowdown*

To our Clients and Friends,

We have had a tumultuous start to the 2020s, with historic events occurring at high speed:

- The most serious health crisis in a century, leading to the steepest economic decline since World War II
- Dramatic fiscal and monetary actions by governments and central banks that supported economies and citizens but were followed by high inflation and three of the four largest bank failures in U.S. history
- Horrific wars in Europe and the Middle East that have shattered decades of peace.

In that context, 2023 was a year that defied – and exceeded – expectations. History demonstrates a high correlation between inflation, higher interest rates, and recessions. Two years since U.S. inflation spiked, and 20 months into one of the fastest and steepest interest rate hiking cycles in Federal Reserve history, there is no recession in sight due to the extraordinary strength of two pillars of the U.S. economy: consumers and large companies. Individuals and S&P 500 companies moved quickly in 2020 and 2021 to lock in low rates and extend duration on mortgages and corporate debt, reducing their exposure to high interest rates now and for many years to come.

We head into 2024 with lower inflation, a cooling labor market, a significant decrease in the 10-year Treasury yield, and positive S&P 500 earnings growth after three quarters of declines. We've enjoyed a broad late-year rally across markets. The S&P 500 index was up over 9% in November, and investment grade and municipal bond indices delivered mid-single digit returns after two years of declines. The S&P 500 in particular is poised to deliver an exceptional year that could exceed 20% total return.

As our Outlook reports, we expect a healthy and welcome slowdown next year, which will support positive single-digit returns across most asset classes. We also expect some volatility, as half the world's population heads to the polls to vote on leaders and issues raised by the dramatic events of recent years.

This new decade has demonstrated the resilience of BNY Mellon and the commitment of our remarkable employees to you and to each other. We close the year sending appreciation and admiration to our Chief Investment Officer (CIO), Leo Grohowski, for his contribution to us all. Leo is retiring after 43 years in the industry and 16 years as our CIO. We congratulate our next CIO, Sinead Colton Grant, on her promotion, and look forward to all she will accomplish with our Head of Investment Strategy and Equity Advisory Solutions, Alicia Levine, our Head of Fixed Income, John Flahive, and our entire investment team.

We thank you for voting for BNY Mellon, and the confidence you place in us every day. We are committed to exceeding your expectations year after year.

With best wishes for a 2024 filled with good health, success and peace.

Catherine Keating
Global Head of Wealth Management

Key Highlights

01 **U.S. glides into a soft landing.** Growth slows but the economy avoids a severe recession.

02 **Inflation fades.** Central banks pivot to rate cuts as early as the spring.

03 **Bonds have their moment.** With yields at historically attractive levels, high quality bonds offer both income and capital appreciation.

04 **U.S. equities lead the way.** A resilient U.S. economy and AI technology power corporate earnings.

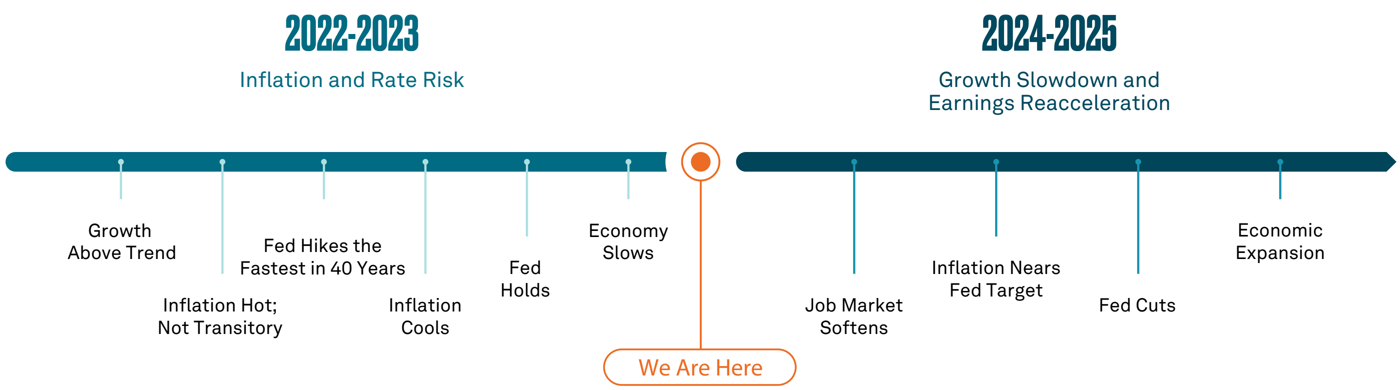
05 **A new era in private markets.** Attractive entry points across a range of private markets offer diversification, income, and non-correlated returns.

What Will 2024 Hold for Investors?

2023 proved to be a year of resilience as the U.S. economy weathered the Federal Reserve's (Fed) aggressive policy tightening and avoided a recession. With the central bank holding rates steady and monitoring economic data to ensure its goal of price stability is met, we see the next phase as a healthy slowdown followed by a more expansive business cycle in 2025.

FIGURE 1

Tightening Cycle Journey: Conclusive Phase



Source: BNY Mellon Wealth Management. For Illustrative Purposes Only. Data as of December 14, 2023.

We expect 2024 to be a year of transition to more normalized economic conditions, even as markets adjust to a world of higher interest rates. While cooling inflation and slower growth should result in modest rate cuts, short-term interest rates are likely to remain at higher levels than we've seen since the financial crisis. Even as economic growth slows, we expect corporate earnings to reaccelerate before embarking on the next phase of expansion.

With over 40% of the world economies holding national elections – including a U.S. presidential election – politics is sure to contribute to market volatility. However, history tells us that U.S. election years are often positive for equities after a sluggish first half. The growing number of active global conflicts also heightens risk. All told, while the coming year could prove volatile, it also presents attractive opportunities across asset classes for investors with a medium- to long-term time horizon.

ECONOMY

A Resilient U.S. Economy Glides into a Soft Landing

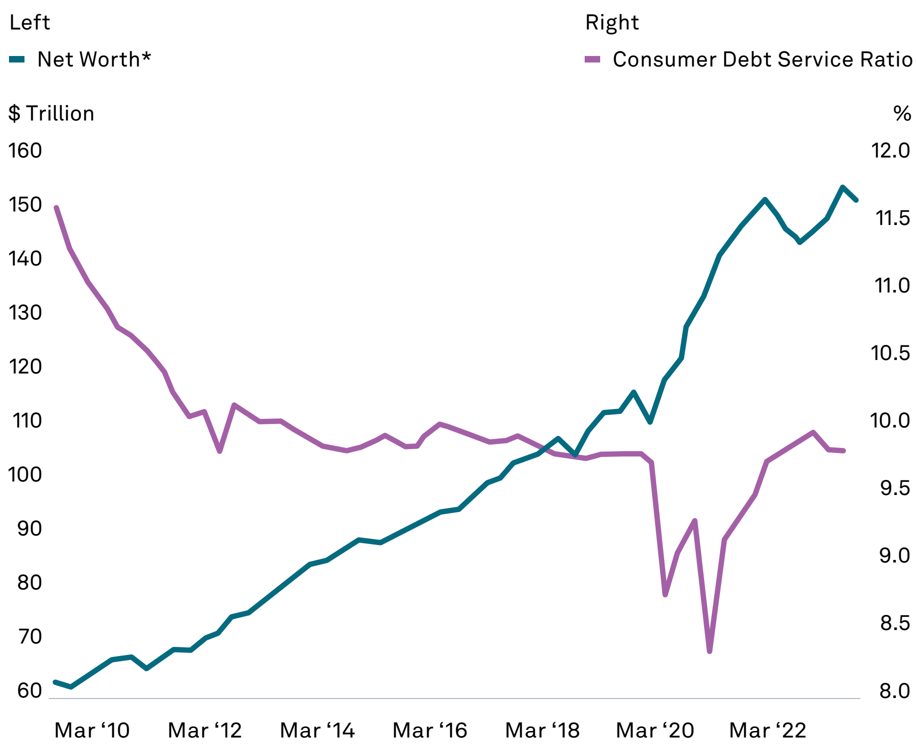
The strength of the U.S. economy has surprised economic forecasters this year, especially as the Fed raised interest rates 11 times since March 2022, the fastest sequence of hikes since the 1980s. Despite tighter money, the economy has continued to expand, and is expected to grow 2.4% in 2023, exceeding our forecast. For 2024 we expect growth of 1%-2%, slower than 2023 but, importantly, avoiding a recession. A tight employment market and resilient – although moderating – wage growth have supported consumer spending, which is vital given that consumers drive approximately two-thirds of the U.S. economy. Also, consumer balance sheets are healthy, with wealth having doubled since the financial crisis while interest expense, as a percent of disposable income, has declined from around 11.6% to less than 10%.

For 2024 we expect growth of 1%-2%, slower than 2023 but, importantly, avoiding a recession.

FIGURE 2

U.S. Consumers Remain Resilient

Wealth Rises While Interest Expenses Level Off



* Net Worth equals assets minus liabilities.
Source: Bloomberg. Data as of September 30, 2023 (latest available).

We believe the U.S. will likely avoid a recession in 2024. While the full impact of monetary tightening has yet to be felt, we are increasingly confident that still-resilient household and corporate balance sheets will help the economy avoid a severe recession.

70%

We believe there's a 70% likelihood that the U.S. avoids a recession in 2024.

Outside the U.S., the picture is weaker. Elevated interest rates in the Eurozone have slowed growth rapidly. Germany, Europe's largest economy, has stagnated in 2023 amid slowing exports to China and the energy price shock unleashed by Russia's invasion of Ukraine. In the U.K., continued high inflation and tighter monetary policy are exacerbating the pressures on cost of living, as higher interest rates impact the consumer more quickly due to the structure of the U.K. mortgage market.

Predictions of a post-Covid reopening boom in China have proven too optimistic, with continued turmoil in the property market denting consumer confidence. We expect Chinese growth to remain lackluster relative to high pre-pandemic levels, as modest government stimulus efforts may fail to offset significant growth headwinds from a weak property market and a rapidly aging population.

FIGURE 3

BNY Mellon Wealth Management Growth and Inflation Forecasts

	Growth		Inflation	
	2024	2025	2024	2025
U.S.	1 - 2%	1.25 - 2.25%	2.5 - 3.5%	2 - 3%
*Eurozone**	0.5%	0.6%	2.7%	2.1%
*China**	4.5%	4.5%	1.6%	1.9%

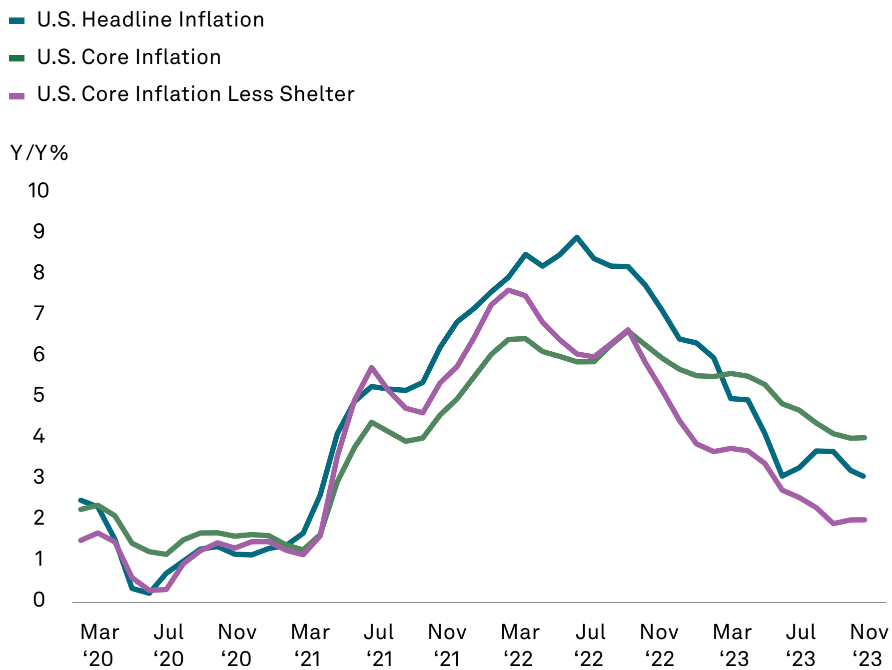
*Bloomberg Consensus Forecasts.
Source: BNY Mellon Wealth Management. Data as of December 7, 2023.

Fed Pivots to Modest Rate Cuts

The Fed has made substantial progress in bringing down inflation, which has fallen from a peak of 9% in mid-2022 to 3.1% for the year through November. While stickier components such as shelter and wages have taken longer to moderate, recent signs are encouraging. We expect U.S. inflation will continue to fall – albeit slowly – reaching a range of 2.5%-3.5% by the end of 2024, and 2%-3% by the end of 2025.

FIGURE 4

Widespread Disinflation



Source: Bloomberg. Data as of December 12, 2023.

The Fed has not raised rates since July as it waits to assess how the past 20 months of monetary tightening affect the economy. The recent cooling of price pressures has influenced the futures market, which is now forecasting a 1.5% decline in the federal funds rate by the end of 2024, with rate cuts beginning as soon as March.

However, we think the market is too optimistic about the magnitude and timing of the decline in short-term interest rates. We anticipate that the Fed will start easing monetary policy as early as the spring, if growth and inflation continue to trend towards the Fed's target. We see the federal funds rate dipping from 5.25%-5.50% at present to 4.25%-4.50% by the end of 2024.

ASSET CLASSES

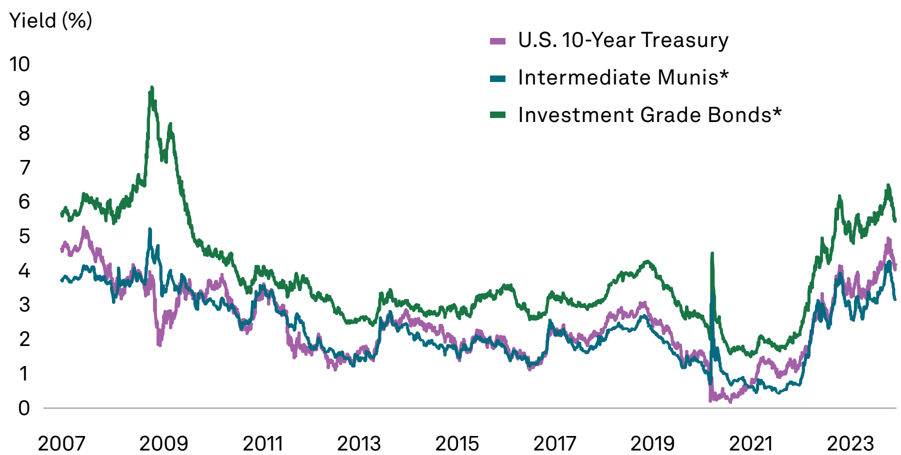
A Narrow Window to Take Advantage of Attractive Yields

Slower economic activity will influence intermediate to longer-term Treasury yields. Given the Fed's restrictive policy stance, we could see the 10-year Treasury yield fall toward 3% as the economic outlook declines and the bond market begins pricing in a policy mistake. Once the central bank begins to cut rates in the second half of the year, we expect the 10-year yield to move higher and end the year in a range of 3.75% to 4.25%, as market participants anticipate an economic boost from less restrictive policy.

Although November delivered one of the best-performing months for bonds in nearly 40 years, as the 10-year Treasury yield declined from a 16-year peak of 5.02% to 4.25%, there is still an opportunity for investors to take advantage of these attractive yields. Treasuries across the curve offer yields between 3.90% and 4.40%, which is in line with the S&P 500 earnings yield. Investment grade corporate bonds offer an average yield of 5.25%.

FIGURE 5

Bond Yields at Their Highest Levels in a Decade



*Indices used: S&P Municipal Bond Intermediate Index and Bloomberg Corporate Index.
Source: Bloomberg. Data as of December 14, 2023.

For individuals living in high-income tax states, such as New York, Massachusetts, or California, those yields are in excess of 6.25% on a tax-equivalent basis for an investor in the top tax bracket.

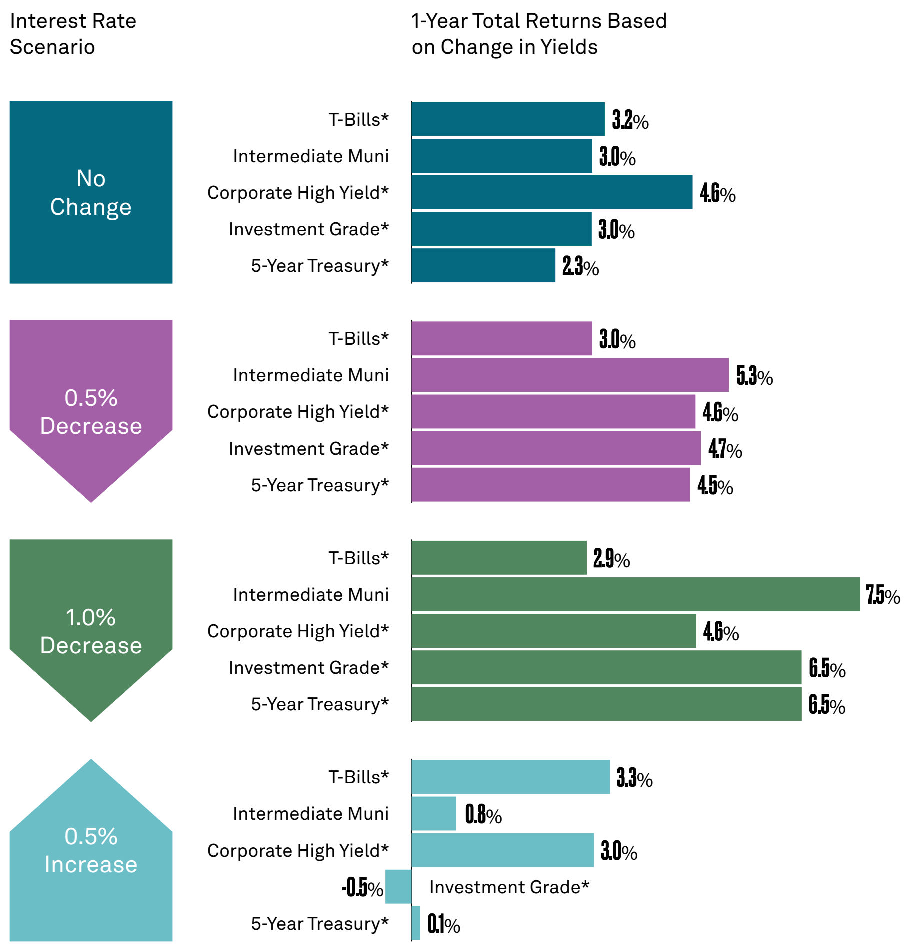
Meanwhile, yields on an actively managed, high-quality intermediate municipal bond portfolio currently range from 3.00% to 3.25%. For individuals living in high-income tax states, such as New York, Massachusetts, or California, those yields are in excess of 6.25% on a tax-equivalent basis for an investor in the top tax bracket. That's similar to a long-term expected equity market return, with much less volatility. With yields at these levels, investors may wish to explore whether they can reduce risk in their portfolios by increasing their allocations to bonds. Given the continued volatility in rates, employing an active management approach to exploit the most attractive opportunities within fixed income is more critical than ever.

Recognizing that access to credit has gotten tighter and varies greatly by institution, it is important to work with providers who have strong balance sheets.

These higher yields will also benefit investors under a variety of interest rate scenarios. As Figure 6 illustrates, if yields decline as we expect, fixed income would deliver mid-single digit returns. Even if yields were to increase, returns would remain mostly positive as higher starting yields help to offset any price depreciation. This is a much better environment than fixed income investors have experienced in the past few years.

FIGURE 6

Bond Yields at Their Highest Levels in a Decade



*After-Tax Return. Based on a 40.8% federal tax rate. T-Bills are a proxy for cash. Spread Change Assumptions: For a 1% decline in yields, spreads increase by 50 bps for Investment Grade and 100 bps for High Yield. For a 0.5% decline in yields, spreads increase by 25 bps for Investment Grade and 50 bps for High Yield.

Source: Bloomberg. Data as of December 14, 2023.

Cash Set to Underperform

With the Fed at peak rates, we have been recommending that investors get out of cash and reallocate to longer-dated bonds. Our chart illustrates that after Fed funds peaked in the last three tightening cycles, average annualized returns on short- and intermediate-term muni bonds outperformed Treasury bills, a proxy for cash, on an after-tax basis.

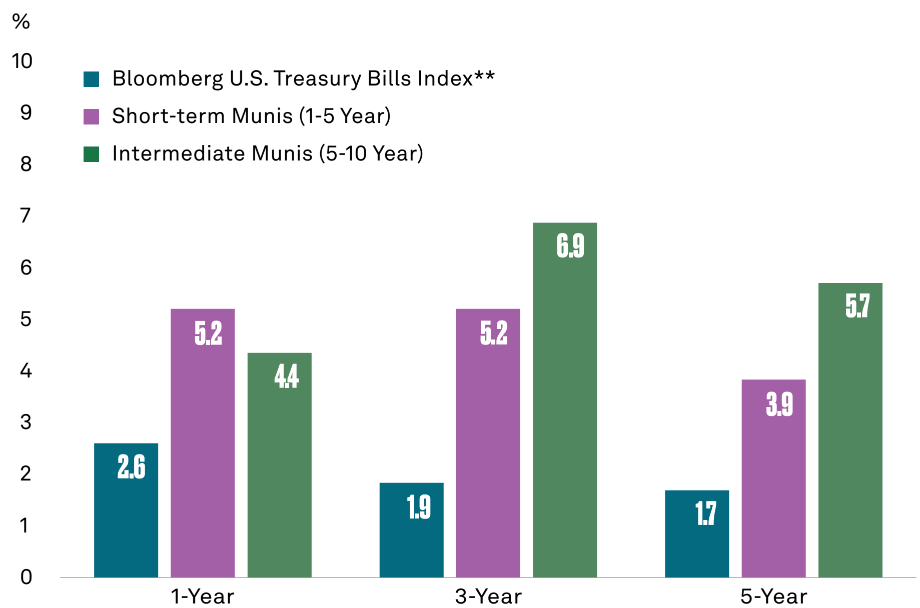
Staying in cash implies significant reinvestment risk, at a time when short-term yields are likely to trend lower. The longer an investor stays in cash, the greater the risk of missing out on today's higher bond yields. Over a three- and five-year period, intermediate muni bonds deliver three times as much return as cash, making this an ideal time to consider extending maturities.

The longer an investor stays in cash, the greater the risk of missing out on today's higher bond yields.

FIGURE 7

Peak Fed Funds Favor Bonds

Average After-Tax Returns* Post Peak Fed Funds



*3-and-5-year returns annualized. Last three tightening cycles used to calculate average excluding current.
**Assumes a 40% federal tax rate.
Source: Bloomberg.

Earnings Growth Will Power Equities Higher

2023 has turned out to be a good year for the S&P 500 despite periods of volatility, with the index up 20% year-to-date through November 30. A handful of stocks – the Magnificent Seven – account for 75% of the gains. While the S&P 500 trades at a 12-month forward price-to-earnings (P/E) ratio of 18.7x, the market trades at a more reasonable valuation of 16.5x without these seven stocks, which is in line with the index's historical average. In our view, the Magnificent Seven's valuations are not overextended given their strong cash balances and competitive positioning for AI advancements. And we also think that there is room for the market rally to broaden.

The earnings recession is over. After three consecutive quarters of negative corporate earnings, the S&P 500 delivered surprisingly resilient earnings growth of 4.3% year over year for the third quarter. Consensus estimates for fourth quarter earnings growth is 2.8%.

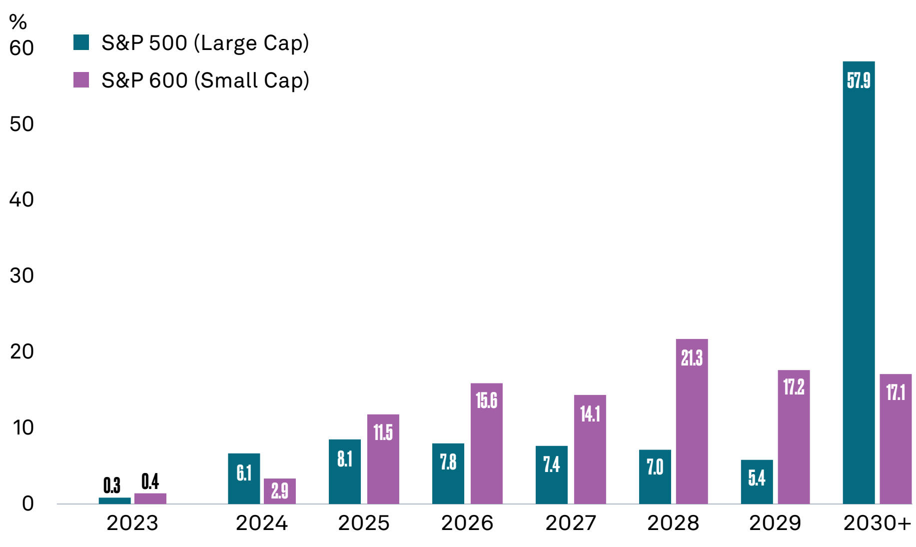
We believe earnings growth will drive the stock market in 2024. We see S&P 500 earnings growth of 8% in 2024, followed by a further 7% increase in 2025. With the S&P 500 currently at 4,600, that suggests more muted returns than 2023, though positive for next year.

S&P 500 companies have healthier balance sheets, having locked in low interest rates with 60% of debt maturing in 2030 or later.

FIGURE 8

Large Companies Have Healthier Balance Sheets

Debt Maturity Schedule Ex. Financials



Source: Strategas. Data as of November 30, 2023.

$9.8T

Market capitalization of U.S. listed IT companies vs. $1.14 trillion and $1.29 trillion in EAFE and EM.

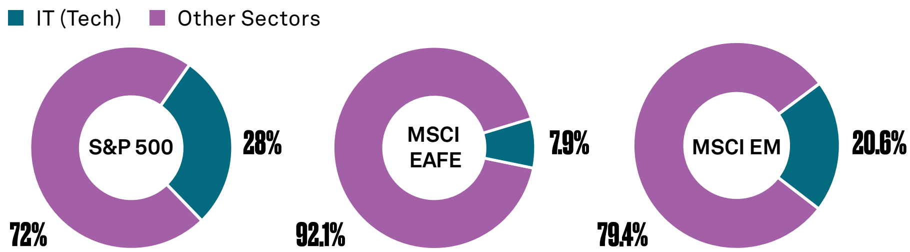
Historically, our portfolios benefited from an overweight to U.S. equities. We continue to favor U.S. equities, and large caps in particular, for the following reasons.

The S&P 500 index has more exposure to technology than global indices and boasts many of the world's Artificial Intelligence (AI) players. We believe that AI has the power to drive significant productivity gains over the next decade. Beyond the technology sector, American businesses have historically been more adept at adopting new technologies while growing margins than their global competitors.

FIGURE 9

Higher Tech Sector Exposure in the U.S.

Sector Breakdown by Index



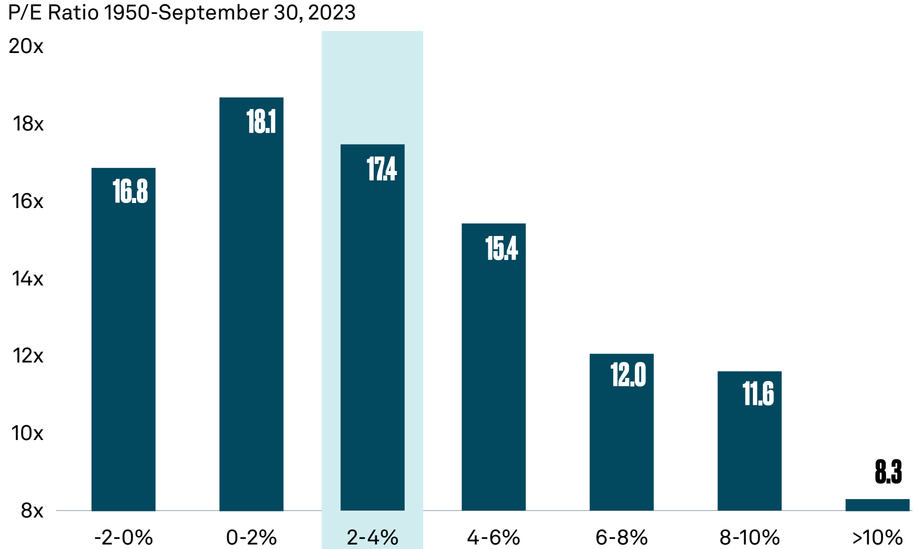
Source: FactSet. Data as of December 6, 2023.

Inflation has moderated to a range where stocks historically performed well. Inflation in a range of 2-4% is supportive of higher multiples.

FIGURE 10

Impact of Inflation on Earnings Multiples

P/E Ratio 1950-September 30, 2023

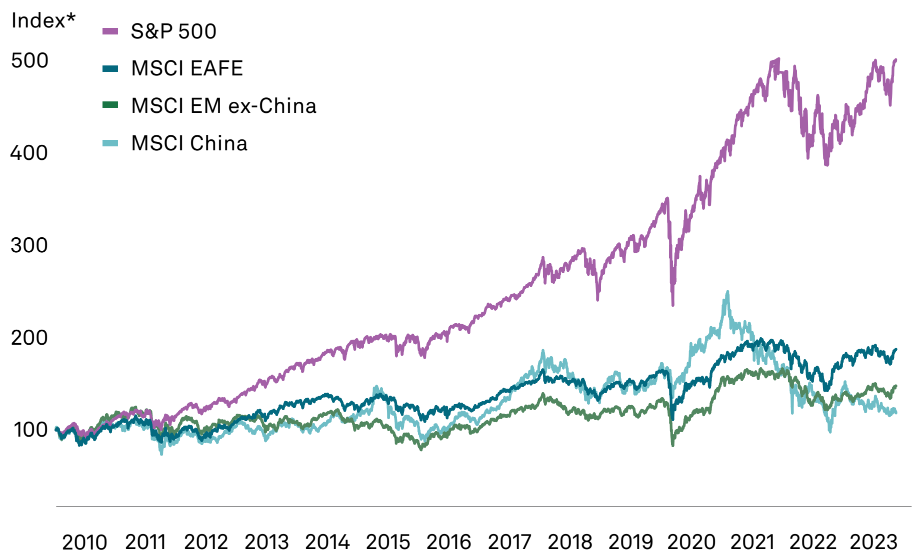


Source: Strategas. Data as of September 30, 2023.

Large companies also have better profit margins than their small cap counterparts (17.4% vs. 10.3%)[1]. With expected continued advancement in AI leading to improved productivity, we believe large cap companies are best positioned for this trend and continued improvement in margins.

FIGURE 11

U.S. Outperformance to Persist



*Indexed to 100 on January 1, 2010.
Source: Bloomberg. Data as of November 30, 2023.

[1] Data as of November 30, 2023, per FactSet.

Seize Opportunities in Private Markets

Investing in private markets has become an increasingly important component of investor portfolios over the last couple of decades. The additional compensation an investor receives for foregoing liquidity – the illiquidity premium – accessed through private equity and private credit can be meaningful. In private equity, the illiquidity premium is typically in the region of 3%-5% annually, and while the history is shorter, evidence suggests the illiquidity premium for private credit is in the range of 1% or more. Accessing these premia meaningfully boosts portfolio returns over time.

5x

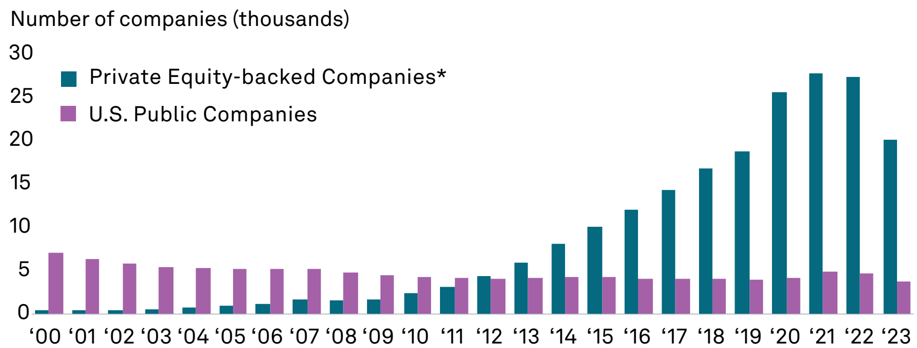
As many U.S. private equity-backed companies than publicly listed companies.

Private equity investing today captures growth opportunities that were previously accessible through public markets. The number of publicly listed companies has dropped by 50% since the late 1990s, from 8,000 to less than 4,000 today. In fact, there are now more than five times the number of private equity-backed firms than public companies. Private companies are also taking longer to go public, experiencing their ultra-high growth phase while still privately owned. As a result of these structural equity market changes, an allocation to private equity is desired to complement public equity exposures.

FIGURE 12

Equity Market Structure is Changing

Number of U.S. Private Equity-backed Companies Has Surpassed Public Companies



*Private Equity-backed data consists of both Private Equity and Venture Capital-backed companies.
Source: World Federation of Exchanges, Center for Research in Security Prices and Pitchbook. Data as of June 30, 2023.

Debt markets have evolved significantly due to changes to bank regulation in the wake of the Global Financial Crisis. As banks pulled away from lending to middle market companies, private credit has flourished. It has grown fivefold since 2010 to $1.4 trillion. While the size of the private credit market has not yet surpassed the high yield or leveraged loan market as approximately 25% of that $1.4 trillion is "dry powder" (assets that have been committed but not yet invested or deployed), it is closing in fast. The bespoke nature of private loans results in improved lender protections, stronger financial covenants, plus historically lower default rates and higher recovery rates than in the leveraged and high yield markets, all of which make private credit an attractive portfolio allocation.

INVESTOR IMPLICATIONS

What Does it Mean for Investors?

Given our expectations for a healthy slowdown and positive returns across many asset classes, there are three tenets we believe are important for investors in navigating investment markets in 2024.

1. Stay Invested but Not Static
2. Look Through Election Headlines
3. Update Your Plan

1. Stay Invested but not Static

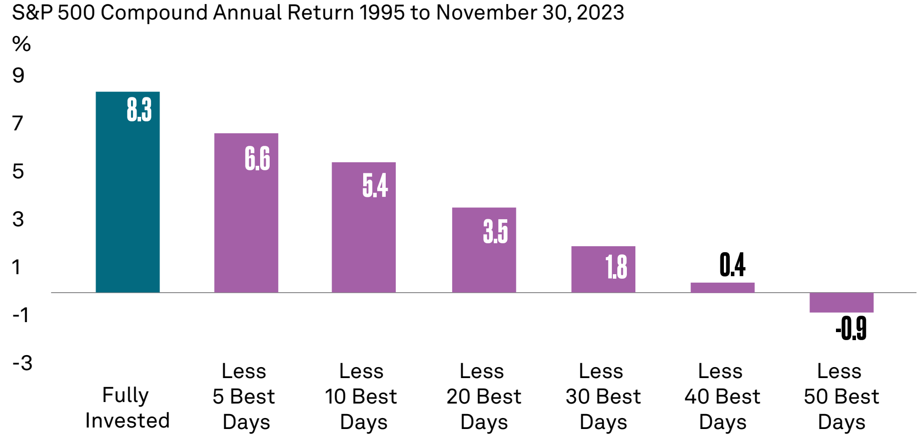
At a 5% yield for much of the past year, it is not surprising that investors hold over $5.9 trillion in money market funds. That's an increase of over 20% in 2023. While cash has a role in your overall wealth plan, holding too much cash can put long-term goals at risk. This is especially true in the environment we see ahead. 2023 provided an example of how challenging it is to time the markets. Investors who chose cash over other investments missed out on strong equity gains as the S&P 500 rose nearly 20%. It's a reminder why investors should remain focused on their investment plans to meet their long-term goals.

Since 1995, the annualized return of the S&P 500 if an investor missed the ten best days over those 28 years would have been reduced by one third. And that gap widens to over half when missing the best 20 days. Those highest performing days often occur during periods of higher volatility.

FIGURE 13

Stay Invested – Timing the Market is Challenging

S&P 500 Compound Annual Return 1995 to November 30, 2023



Source: Bloomberg. Data as of November 30, 2023.

Staying invested does not mean having a static portfolio. As your investment team, we continually look to identify dislocations and market opportunities over a 12–18 month horizon. These opportunities result in tactical shifts around your strategic asset allocation designed to further protect portfolios and enhance long-term results. For our full asset class investment positioning, please see Figure 15 in the appendix.

2. Look Past Election Headlines

Headlines during an election year can evoke great emotion, but history tells us that the U.S. presidential election years typically deliver positive returns, particularly when an incumbent is running for re-election. The first half of an election year tends to be muted, with the market gaining momentum leading into the election before finishing higher.

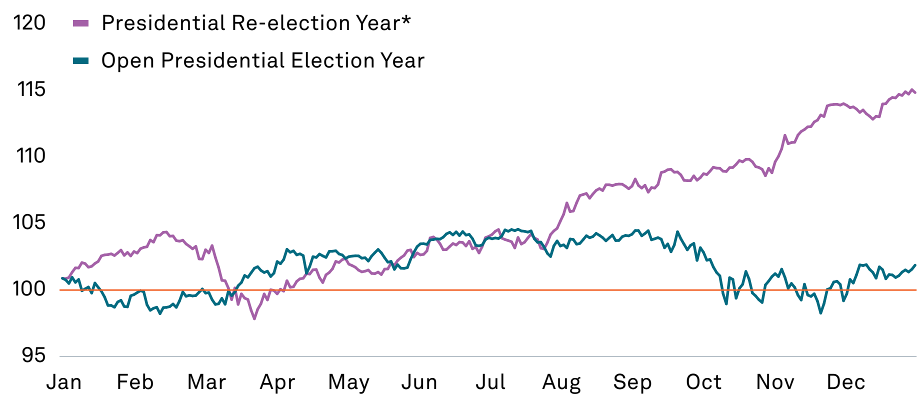
There is also a distinct pattern of stock market performance throughout a presidential cycle, with markets generally weaker in the first two years, only to strengthen in the latter two years as the incumbent attempts to spur economic growth in order to win re-election.

FIGURE 14

Presidential Election Years are Generally Positive

S&P 500 Average Performance: Presidential Election Years - Open Vs. Re-election Year

1960 - 2020



*1964 & 1976 are treated as open elections.
Source: Strategas.

Whoever wins the presidential election, taxes are likely to rise in the years ahead. U.S. public finances are stretched, with debt exceeding 120% of GDP. Higher interest rates and Treasury yields have raised the government's net interest cost as a percentage of tax revenue to 13.6%, the highest since 1997. Historically, such conditions have been associated with fiscal austerity as administrations realize they must either raise revenue by increasing taxes and/or reduce spending.

3. Update Your Plan

We know from our centuries of helping families to sustain their wealth that success over market cycles and generations goes beyond investing. As our retiring Chief Investment Officer, Leo Grohowski, shared in a recent podcast entitled, 4 Lessons from 4 Decades of Investing, it's important to "Use all the tools in the toolkit," including four other practices: manage, spend, borrow and protect. Based on our outlook for the year ahead, we believe that investors should evaluate actions across all of these areas including:

It's important to "Use all the tools in the toolkit."

Execute on Three Investment Priorities

Extend duration: Take advantage of a once-in-a-decade opportunity to modestly extend duration and lock in attractive yields across a variety of types of bonds.

Focus on U.S. equities' potential: U.S. companies, relative to their non-U.S. peers, have better earnings growth prospects, better margins, and stand to benefit from the technological advancements associated with AI.

Consider opportunities in private markets: Given the growth in private markets over the last couple of decades investors who can accept the illiquid nature of these investments can earn higher returns and diversified sources of income.

Manage for After-Tax Returns

Managing taxes is vital in all market environments. As inflation remains higher than in previous decades, after-tax returns become increasingly important for taxable investors. We have honed our expertise in delivering after-tax investment returns since 1997.

Plan Spending

Inflation erodes purchasing power, and although we expect inflation to cool from here, it may settle at a higher level than a decade ago. It is important to review the impact of higher prices on your desired spending levels. For investors who have current spending needs such as retirees, trust beneficiaries and non-profits, having a spending strategy can help ensure that current expenses do not erode funds that will be needed for the future.

Evaluate Borrowing

Strategic borrowing can be a valuable tool for long-term investors. With short-term borrowing rates heading lower and bonds expected to earn equity-like returns for the first time in decades, it will be prudent to evaluate your strategic use – and source – of credit. While interest rates have fallen, the availability of credit has also fallen across the bank sector, as many banks address idiosyncratic balance sheet issues. BNY Mellon has a strong and resilient balance sheet to support our clients through the business cycle.

Leave a Legacy

The goal of creating sustainable, multigenerational wealth is to leave behind a legacy that supports what matters most, such as family, values and charitable causes. Make sure that you've utilized your lifetime exemption before the current level of $12.92 million per individual or $25.84 million per couple expires at the end of 2025.

It is easier to forecast the path of markets over many years than it is for a single year. Time is an investor's greatest ally, as markets rise over longer periods. Investors who stay invested should be rewarded over time.

Appendix

FIGURE 15

Asset Class Positioning

Investment Strategy Committee Recommendations

	Underweight	Small Underweight	Neutral	Small Overweight	Overweight
EQUITY			◆		
Large Cap				◆	
Mid Cap			◆		
Small Cap			◆		
International Developed		◆			
Emerging Markets		◆			
FIXED INCOME			◆		
Treasuries			◆		
Investment Grade Corporate			◆		
Tax-exempt			◆		
High Yield			◆		
Emerging Market Debt	◆				
DIVERSIFIERS			◆		
Long/Short Hedge			◆		
Absolute Return Hedge				◆	
Real Assets			◆		
Private Equity				◆	

Source: BNY Mellon Wealth Management. Reflects portfolio positioning within the Fully Diversified Balanced Model for taxable clients. Data as of December 7, 2023.

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