Mosaic represents Madison's global multi-asset product suite spanning the risk spectrum with distinct portfolios across ETF/Mutual Fund and ETF mandates. Madison's Multi-Asset Solutions team has deep experience monitoring worldwide macroeconomic trends and their associated investment implications. Risk management and a commitment to consistency are key components of our philosophy and process. We believe that efficient asset allocation and downside volatility mitigation should lead to increased long-term client investment success.

REVIEW – FIRST QUARTER 2024

The U.S. stock market held the course set by the explosive rally to end 2023 over the first three months of the year. The S&P 500 jumped out of the gate with a 10.6% return, marking the index's best first quarter advance since 2019. That year the index went on to gain 31.5%! Also analogous to today's market expectations, the Federal Reserve (Fed) pivoted to cutting rates three times in 2019, matching the current Fed and market expectations for three cuts in 2024. So, while the early results have been undeniably favorable, time will tell if we have another blockbuster year in stocks. What has been striking over the past several months is that the cornerstone of the rally has been seriously eroded to the widespread indifference of the market. The current rally was born out of the belief that the Fed would be cutting interest rates by March 2024, with market rate cut expectations peaking around +/-7 cuts for 2024. Over the course of the quarter those expectations were halved to possibly three cuts, with June now being the anticipated start date.

Inflation has remained a sticking point, which is behind the pricing out of rate cuts and the resetting of the benchmark 10-year U.S. Treasury yield from below 4% to 4.2% by the end of the quarter. So, while bonds enjoyed the decline in rates into the end of 2023, the resetting of rate cut expectations has taken the broad bond market down -0.8% year-to-date (Bloomberg U.S. Aggregate Bond Index).

Overseas markets' returns were strong, yet still lagged the U.S., led by the developed markets, particularly the continued resurgence of Japanese equities and a surprisingly strong Eurozone advance despite the region's economic headwinds. China, on the other hand, continued to wallow and watered down the MSCI Emerging Markets Index's +2.4% gain versus the Japan/Eurozone led developed world's MSCI EAFE Index return of 5.8%.

Encouragingly, the U.S. stock market broadened out beyond the Magnificent Seven (which has now become the Fab Four as Apple and Tesla declined, and Alphabet underperformed), as cyclical stocks, led by the energy sector, surged in March. That said, from a size standpoint, large caps remained the place to be with mid (Russell Mid Cap Index +8.6%) and small (Russell 2000 Index +5.2%) caps lagging.

PERFORMANCE

Admittedly, we were caught off guard late last year by the market's (and Fed's) quick pivot from believing that rates needed to be higher for longer, to 150 bps of cuts starting in March. Even more surprising was the Fed's nonchalance and indifference by not pushing back given the speed and magnitude in which financial conditions eased. To us it was clear that the war on inflation was far from over, and the Fed was playing with fire by relaxing too soon. To that end, we maintained our relatively defensive posture on equity risk, which was the biggest headwind to performance for the quarter. Despite the risk-on market, a few key asset allocation decisions contributed to relative performance for the quarter. Our strategies once again benefited from our long-standing preference for domestic over international stocks. Within the international allocation, an overweight to Japanese equities was a sizeable performance contributor. Inside the U.S. stock allocation, portfolios benefited from an overweight to the outperforming energy sector, whereas small cap exposure weighed on returns. Turning to fixed income, duration and curve positioning were generally additive, which was offset by our overweight to underperforming mortgage-backed securities and our small exposure to longer-term U.S. Treasuries.

OUTLOOK & POSITIONING

What might be in store after a +10.6% start to the year and a near 30% gain since late October 2023? As alluded to in our market recap, with rates backing up, bonds seem to have picked up on the fact that the Fed isn't going to be as easy as everyone thought entering 2024, yet stocks are glued to Chair Powell's "damn the torpedoes" attitude to reaccelerating inflation. The man at the helm tells us that the battle is being won and that inflation (core PCE) is safely on the path to 2%. Never mind that the Fed's own statement of economic projections (SEP) doesn't see that happening before 2026, and that the most recent Consumer Price Index (CPI) data showed that year-over-year core CPI was stuck at 3.8%, 3-month annualized hit 4.2%, and 6-month annualized shot up to 3.9%, all double the Fed's 2% target. Despite the strength of the U.S. Dollar on the back of higher rates, the price of gold, oil, and other commodities shot higher through the end of the quarter. Combine this with the outperformance of cyclical value stocks over growthy technology and consumer stocks in March, and it's starting to look like the market is coming to the conclusion that the Fed might be falling behind the curve.

Turning to valuation, broad U.S. stocks (S&P 500 Index) appear at best fully valued given the 21x forward price-to-earnings multiple at quarter end. The "E" in that ratio also remains quite optimistic as consensus is looking for over 10% earnings growth for 2024. Market participants are wildly bullish, as noted by CNN's Fear & Greed Index settling just a touch under "extreme greed" to end March. Elevated valuations, optimistic earnings assumptions, and investor euphoria are often cues to prepare for a more challenging market environment ahead.

Putting it all together, we remain in a highly uncertain economic environment that has been greatly influenced by the heavy hand of government, both fiscally and monetarily, coupled with elevated equity valuations and euphoric sentiment. Inflation is smoldering and the wind appears to be picking up. The need for interest rates to be higher for longer has crept back into the market, without any serious repercussions, so far. Unfortunately, we believe that stress points will eventually appear and that it's unlikely we can get inflation truly under control without any real economic or market pain. And so, while we continue to enjoy the run we're on, our risk-minded approach has our guard up, favoring the safety of high quality stocks and bonds with a mix of inflation hedges to navigate the risks and vulnerabilities we see in today's market environment.

We truly appreciate your confidence and partnership.

Patrick Ryan, CFA *Stuart Dybdahl, CFA, CAIA*

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Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

The S&P 500® is an unmanaged index of large companies and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

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The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index.

The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000® Index, which represent approximately 35% of the total market capitalization of the Russell 1000® Index. As of the latest reconstitution, the average market capitalization was approximately $3.7 billion; the median market capitalization was approximately $2.9 billion. The largest company in the index had an approximate market capitalization of $10.3 billion.

The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries.

Bloomberg U.S. Aggregate Bond Index is an unmanaged index of U.S. fixed income securities. The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS sectors.

Consumer Price Index (CPI) measures changes in the price level of a weighted average market basket of consumer goods and services purchased by households.

The CNN Fear & Greed Index is a compilation of seven different indicators that measure some aspect of stock market behavior. They are market momentum, stock price strength, stock price breadth, put and call options, junk bond demand, market volatility, and safe haven demand. The index tracks how much these individual indicators deviate from their averages compared to how much they normally diverge.

The Magnificent Seven stocks are a group of high-performing and influential companies in the U.S. stock market: Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla.

Yield Curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward sloping curve), inverted (downward sloping curve) and flat.

Duration is a measure of interest rate sensitivity. For example, a portfolio with a duration of three years would be expected to rise 3% if interest rates were to fall 1%. It is measured in years because it can also be used to measure the time it takes to recover one's original investment taking all cash flows into account.

Please consult with your financial advisor to determine your risk tolerance and investment objectives. While Madison constructs portfolios for various risk tolerances, its Asset Allocation Team does not determine individual client's risk tolerance or investment objectives.

All investing involves risks including the possible loss of principal. There can be no assurance the asset allocation portfolios will achieve their investment objectives. The portfolios may invest in equities which are subject to market volatility. In addition to the general risk of investing, the portfolio is subject to additional risks including investing in bond and debt securities, which includes credit risk, prepayment risk and interest rate risk. When interest rates rise, bond prices generally fall. Securities rated below investment grade are more sensitive to economic, political and adverse development changes. International equities involve risks of economic and political instability, market liquidity, currency volatility and differences in accounting standards.

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