



WEALTH ADVISORY SERVICES

THE MARKET SHARE

INVESTMENT OUTLOOK 2024



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BUILDING AND PRESERVING WEALTH

The **1st Source Bank Wealth Advisory Services** team offers financial solutions that remain flexible, innovative and responsive to meet each client's changing needs and life milestones. Our local team of professionals is committed to delivering the highest level of personal service. With nearly 1,800 years of combined industry experience and an average of 19+ years of experience per team member, we are uniquely positioned to help you with:

- Estate and Tax Planning
- Trust and Estate Administration
- Investment Management
- Financial and Retirement Planning
- Philanthropic Services
- Florida Trust Administration

Today, Wealth Advisory Services is trusted to manage \$5 billion in client assets through nine Trust and Wealth Management locations. How can we help you?

Investment and insurance products are not insured by the FDIC or by any other government agency, are not deposits or obligations of, or guaranteed by 1st Source Bank, and may involve risk, including loss of value.



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Paul W. Gifford, Jr., CFA
Chief Investment Officer

ON SCHEDULE

To build and preserve wealth is a common goal of our clients. With that in mind, it is important to have an investment team that understands your unique situation and long-term goals and will work with you to simplify and strengthen your financial position. Partnering with the 1st Source Bank Wealth Advisory Services and Private Banking teams can help you on your path to financial security by providing services such as investment advice, financial planning, estate planning, cash flow management and obtaining credit. This partnership can help you navigate the opportunities and challenges that may lie ahead for investors in 2024.

In 2023, investors are back to building wealth. Stock market returns are positive and bond yields are near 16-year highs. Even cash now pays interest! To look ahead into 2024, we analyze many data points and advise our clients regarding the way forward. We regularly review and discuss reports on economic activity, consumer spending, inflation, corporate earnings, and Federal Reserve meetings. The flow of data is constant. Some

reports look at events that have already occurred, others forecast conditions that are likely to happen. On any given day, the investment markets may react to reports such as economic or corporate earnings releases, or news headlines about other events that may capture the attention of investors. Additionally, the financial press will analyze the importance of data or events affecting the markets.

The release of regularly scheduled data doesn't typically move the markets higher or lower until more than one report confirms a trend. Most of the time, markets move in response to unscheduled or unexpected news or events. For example, in 2023, wide-ranging discussions related to artificial intelligence helped create one of the most concentrated stock market rallies in the last 50 years. In addition, the sudden and dramatic collapse of three notable banks in the U.S. and one in Europe clearly disrupted the markets and led to changes in how bank balance sheets are analyzed.

The year 2024 will have its own unexpected events. Campaign ads and debates are already setting the presidential election cycle into full swing. And, just in case the elections aren't exciting enough, upcoming negotiations over the debt ceiling (set to expire in January 2025) are sure to spice things up. These issues will be headline news throughout 2024 and into 2025. At times, they'll seem to drive the investment markets. As we move through 2024, we'll share more information on investment trends during a presidential election year. We hope these communications will help you stay grounded in your long-term goals. The good news is that, historically, equity markets have provided positive returns during presidential election years regardless of which party wins the presidency.

In this outlook we'll cover a range of topics related to what we expect next year.

Economic Challenges: As parts of the global economy near recession, other parts are experiencing slower-than-expected growth. The U.S. economy is managing through inflation and high interest rates. Senior Fixed Income Manager Erik Clapsaddle, CFA, CFP® dives into the potential implications on page 4.

Equity Markets and Diversification: The concentrated performance of seven to 10 stocks in the S&P 500® and NASDAQ indexes skewed returns versus other equity sectors. Our Director of Research Rob Romano, CFA, will discuss possible opportunities and challenges for stocks in 2024 on page 8.

Recency Bias: Portfolio Manager Pete Cahill, CFA, will look at the behavioral-finance concept of recency bias and how it can challenge an investor's long-term investment strategy on page 12. ■

ELEVATING YOUR EXPERIENCE

As part of Wealth Advisory Services, 1st Source Private Bankers work with your Trust Administrator and Portfolio Manager to build your financial stability. Our personalized approach to private banking can help ease your day-to-day financial needs. Specializing in business and personal banking, your Private Banker can provide strategic credit and depository solutions that make your financial life run smoothly. By bringing the bank to your home or office, busy professionals and high net worth individuals enjoy the 24/7 concierge service and bank on their schedule.

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Erik D. Clapsaddle, CFA, CFP®
Vice President and Senior Fixed Income Manager

THE IMPORTANCE OF RESIDENTIAL HOUSING

It is important to note the relevancy of consumers as their spending accounts for approximately 60% to 65% of U.S. economic output. In short, consumer confidence, or lack thereof, is what drives our economy. The major factors that can affect the confidence of consumers are the labor markets, inflation, and housing prices. In 2023, all three of these factors continued to be stable despite the Federal Reserve raising its target interest rate from 0% to 0.25% starting March 16, 2022, to 5.25% to 5.50%, as of their November 1 meeting.

The stability of the housing market has been the biggest surprise given that the 30-year mortgage interest rate has risen from less than 3% to around 8%. This increase in mortgage rates has sent the monthly payment on the average mortgage loan of approximately \$315,000 from \$1,330 to \$2,310 (not including escrow). It's hard to understate the importance of residential housing.

Equity in one's own home represents 28.5% of total household wealth in the United States based on the most recent data from the U.S. Census Bureau.

In the current environment, many elements point to a softening housing market. Existing home sales continue to hover around their lowest levels since 2010. New housing starts are at their lowest level since the beginning of the COVID-19 pandemic but building permits have started to recover from similar lows. Despite this data, housing prices have moved only marginally off their highs. Home prices have stayed relatively high due to a major shortage of supply and because homeowners with legacy mortgage rates of less than 4% have little incentive to move, which has resulted in lower turnover in the housing market.

There is certainly downside risk to housing prices if the economy moves into

a deeper recession than that experienced in 2022. But, given the lack of new housing starts and the decline in turnover, we could see housing prices have just a small reset. This would preserve household wealth but would continue to make ownership of a primary residence a challenge for many new home buyers.

While there will always be concerns about factors that could hamper economic growth, the consumer has always been the silver lining and driving force in the U.S. economy. We expect the output, resiliency, and entrepreneurship of consumers to continue to propel the economy forward for a long time to come.■

“My Private Banker manages my day-to-day banking needs and engages wealth advisory partners to implement my short and long-term investment strategies.

My team identifies ways to diversify my funds, manage risk, and take advantage of opportunities in the market consistent with my growth goals.”

Jim Kyle

**Investor & Business Owner
Valparaiso, Indiana**



YIELDS ARE REAL

Erik D. Clapsaddle, CFA, CFP®

While we may have thought interest rates were close to a peak at the end of 2022, we have been slightly surprised by the stubbornness of inflation throughout most of 2023. However, we have not been too surprised by the tightness of the labor markets. Federal Reserve (Fed) officials increased the federal funds target rate (target rate) by 4.25 percentage points in 2022 and increased it an additional 1.00 percentage point through November 1 in 2023. Though we have seen data showing that inflation is slowing, and the labor markets are loosening up, the Fed still feels that inflation has not been tamed. Fed members have expressed concern and have stated that they expect to keep interest rates higher for longer to bring inflation under control.

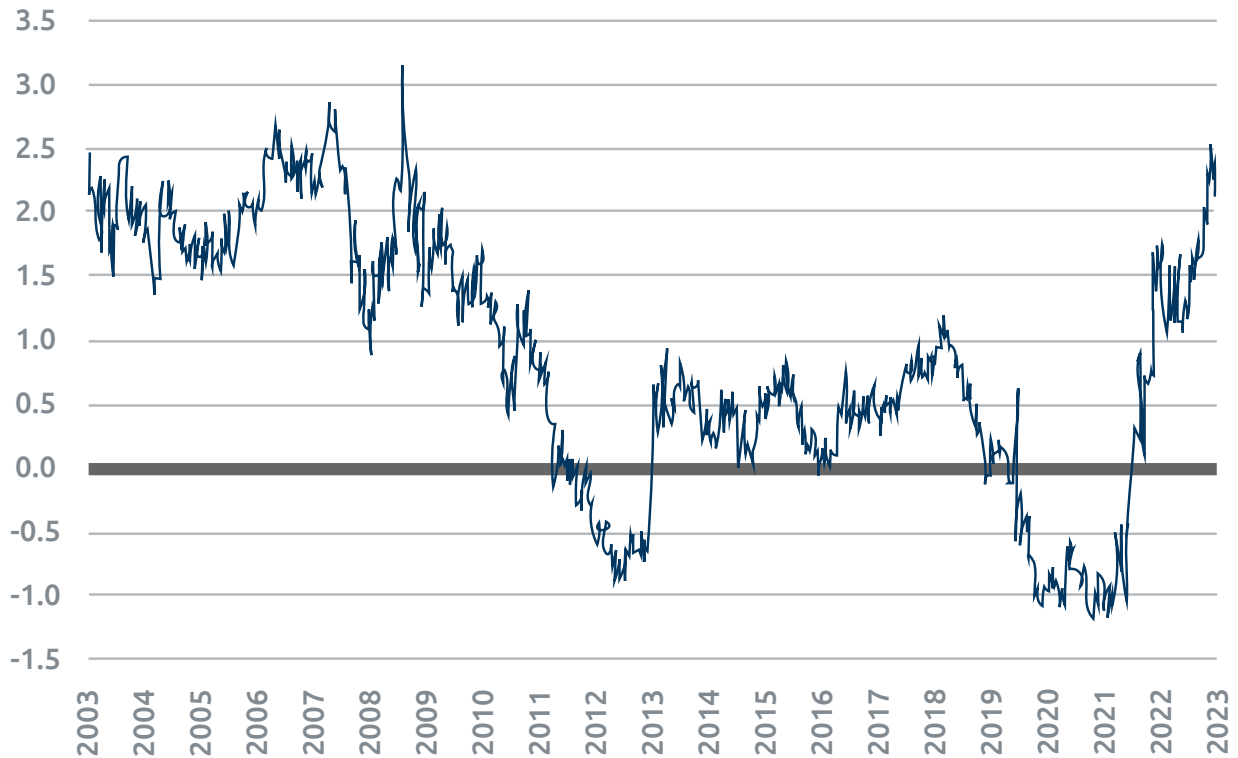
The Fed's "dot plot" chart records each Fed official's quarterly projection for the appropriate midpoint of the federal-funds rate (the central bank's key short-term interest rate) at the end of a calendar year. The current dot plot shows that Fed officials expect the target rate to remain higher for longer. In December 2022, the Fed forecasted the target rate would be at 4.125% by the end of 2024. Today, it expects the target rate to be 5.125% by year-end 2024. As previously mentioned, the Fed continues to be concerned with inflationary pressures, especially those that tend to be stickier such as housing and services.

Given recent dot plot projections, our outlook for fixed-income securities has become even more positive. Now,

not only do bonds look more attractive from an absolute perspective, but they look most attractive from a real yield perspective. The real yield is a bond's yield to maturity minus inflation. The starting point for real yields typically utilizes the yield on the 10-year U.S. Treasury note (10-year) and subtracts the year-over-year change in the Consumer Price Index (CPI). The CPI is the primary measure of inflation as it's a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

As you can see in the chart on page 7, the real yield on the 10-year is at its highest level since December 2008. This is important for savers, investors, pension plans and others as a high real yield allows fixed-income investments to easily outpace inflation with far less volatility than equity investments. Real yields moving up to a more normal level reconfirms the importance and credibility of the traditional investment portfolio mix of 60% equities and 40% fixed-income assets. ■

REAL YIELD



MORE THAN INVESTMENTS

The Wealth Advisory Services team brings value to our client relationships by:

- Organizing and facilitating **FAMILY MEETINGS** to provide the next generation with a solid foundation to continue your legacy.
- Using our **WEALTH PRIORITIES** process to determine the issues most important to you and provide the framework for a solid financial plan.
- Offering a **DOCUMENT REVIEW** by our trust and estate professionals to ensure your wishes are reflected in your estate plan based on current laws and financial conditions.



Rob Romano, CFA
Vice President and Director of Research

EARNINGS VERSUS YIELDS

The resiliency of the U.S. economy and equity markets in 2023 has been nothing short of impressive as they have been able to withstand headwinds throughout the year, including three of the four largest bank failures in U.S. history, concerns over the debt ceiling fight in Congress, narrow market leadership among stocks, and elevated valuations of S&P 500 companies.

U.S. equity markets surprised to the upside in 2023 led by technology stocks. The NASDAQ recorded its best-ever first half of a year up a strong 32%. Investor returns outside of technology stocks were more muted. The S&P 500 gained 17% and the equal weighted S&P 500 was up 2% as of November 14, 2023. Small cap stocks have been unable to find any momentum, and will be more impacted by higher interest rates versus large caps, as a higher percentage of small company debt is in floating-rate instruments.

Developed international markets lagged U.S. markets, and emerging markets struggled due to a weaker-than-expected economic recovery in China after the country exited COVID lockdowns. As we transition into a new year, we expect

equity market investors to stay focused on the higher-for-longer stance of Fed officials and the effect of higher interest rates on the U.S. economy and corporate earnings.

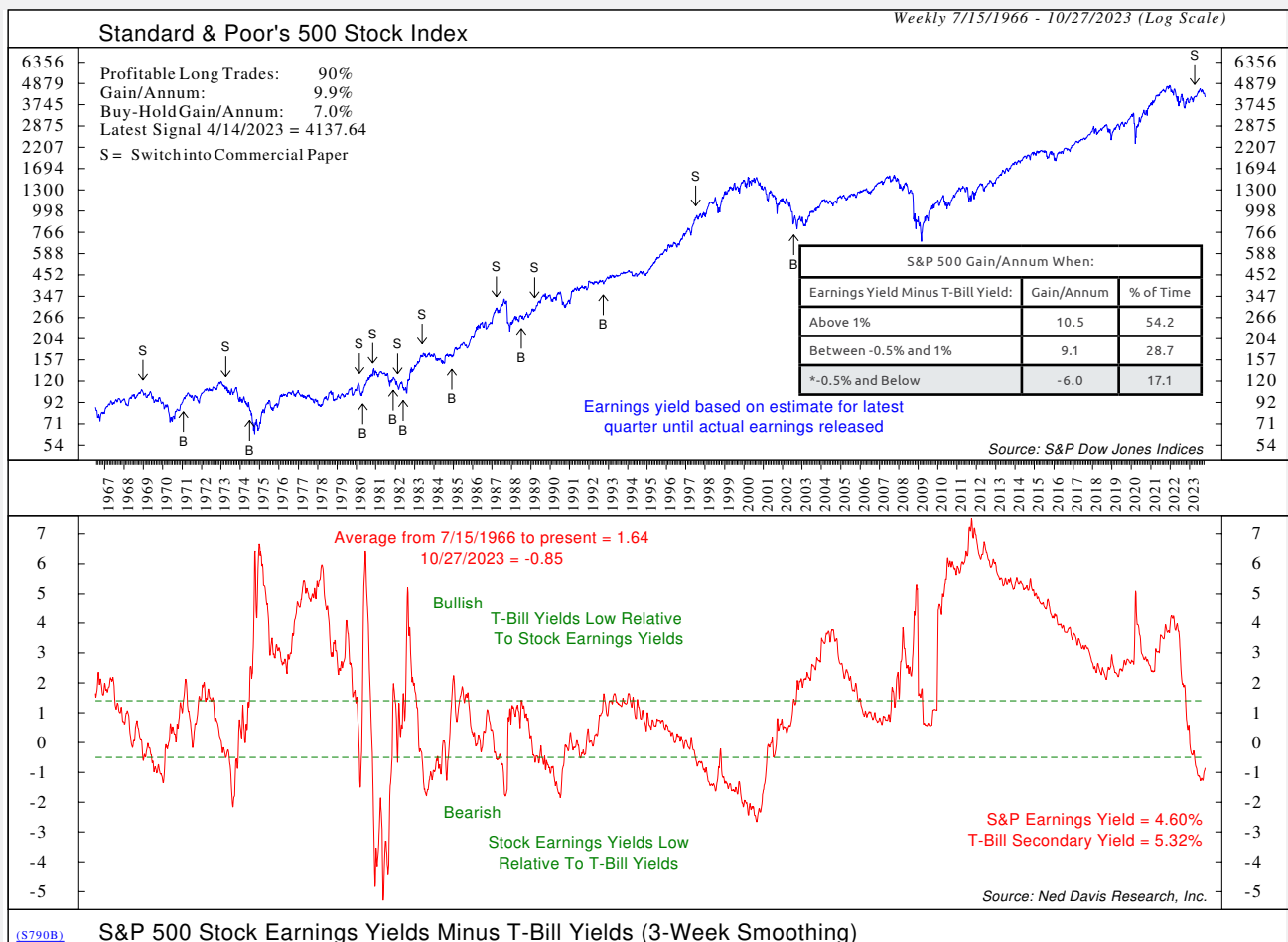
At 1st Source, our investment philosophy is based on the belief that Fed actions and corporate earnings drive the performance of the equity markets. In this respect, third quarter 2023 was the first quarter of positive year-over-year earnings growth since third quarter of 2022. The improvement in earnings was the result of corporate America reducing expenses and rightsizing their business to a slower economic environment in 2024. Looking forward, we believe operating margins will trend to more normal levels as corporate America's ability to pass along further price hikes has become limited given that consumers' savings have continued to move significantly lower. Also, many restaurants and retailers have noted that consumers are trading down to private label and lower priced goods. We view it as unlikely that operating margins will re-accelerate in 2024. If pricing power continues to decline faster than operating costs, we expect margins to continue to

trend lower. Many companies over-hired and over-spent during the pandemic and have labeled 2023 the “year of efficiency” as they streamlined their operations to become more profitable. Companies like Amazon and Meta (Facebook) are seeking to rightsize their businesses to slower revenue growth and are reducing costs to preserve margins.

Looking ahead to 2024, the expectations of market participants are for a resumption in S&P 500 earnings growth to around 10%. This may be optimistic as it is predicated on the Fed guiding the U.S. economy to a soft landing and growth re-accelerating in the second half of 2024.

In our view, the fastest Fed tightening campaign of the past several decades has

presented investors with a competitive alternative to equities, one which we have not seen for several years. Fixed income interest rates are up materially across the maturity curve. As the graph below shows, the yield on U.S. Treasury bills (T-Bill yield) is currently higher than the S&P 500 earnings yield. The earnings yield is the inverse of the price-to-earnings (P/E) ratio and can be particularly valuable when comparing returns across different asset classes. As the graph illustrates, as of October 27, 2023, the T-Bill yield of 5.30% was much higher than the S&P 500 earnings yield of 4.60%. A T-Bill yield greater than the S&P 500 earnings yield has been a rare occurrence. Historically, the equity markets underperformed when the earnings yield minus the T-Bill yield was 0.5% or lower. ■



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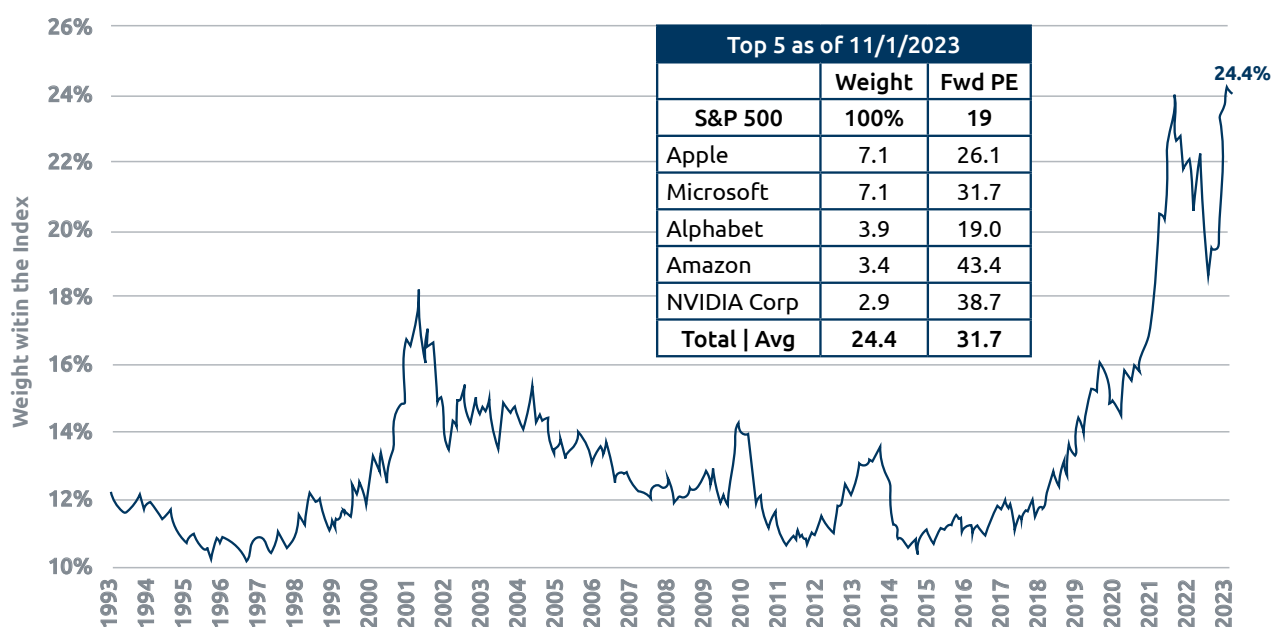
EQUITY DIVERSIFICATION

Rob Romano, CFA

At 1st Source Bank, we emphasize risk management and advise rebalancing when equity allocations drift above a client's target range. We've been proactively rebalancing equity allocations back to their targets after strong equity returns in 2023. Our focus on risk management also extends to the valuation of assets. We believe you can buy a great company at the wrong price and have it turn into a bad investment. As of November 1, 2023, the S&P 500 was trading at a forward P/E of 19, which is at the higher end of the historical range. As mentioned above, we believe the equity markets are currently pricing in a soft

landing for the economy. Much of the S&P 500's higher valuation is due to the five companies shown below. These five stocks collectively trade at a forward P/E of 31.7. Also, the combined weight of these five companies in the S&P 500 is 24.4%, which is equal to the prior high in late 2021. The remaining 495 S&P 500 companies trade at a more reasonable forward P/E of 15. While these five companies are leaders in their industries and their management teams execute very well, we believe there are other opportunities that offer much better risk versus reward potential. ■

HISTORICAL WEIGHTS OF THE 5 LARGEST STOCKS IN THE S&P 500



Source: Bloomberg and Amundi Research as of November 1, 2023. There is no guarantee that forecasts discussed will be realized. Past performance is no guarantee of future results.

OUR INVESTMENT PHILOSOPHY

Our investment philosophy is focused on the needs and objectives of our clients.

We place a high value on long-term consistent investment returns.

To grow assets and preserve wealth within each client's investment portfolio, we believe in broad diversification as a way to manage risk.

Economic and financial markets are cyclical. Therefore, we believe value can be added through tactical adjustments to a portfolio's asset allocation.

We track measures of investor sentiment to look for indicators which help us make prudent investment decisions on behalf of our clients.



Peter Cahill, CFA
Vice President and Portfolio Manager

RECENCY BIAS: FOCUSING ON THE LONG RUN

One of the central tenets of our investment philosophy at 1st Source is that we place high value on long-term consistent returns. While this sounds rather straightforward, in practice, staying focused on the long run is often a significant challenge. That's because human beings tend to focus more on recent events and information and thus discount older events or information. In behavioral finance, this tendency is commonly referred to as recency bias.

Following are four reasons why recency bias may keep investors from properly focusing on the long term:

1. Human brains are wired to pay attention to what's new. This is a survival mechanism that helped our ancestors avoid danger and find food. However, it can also lead us to overreact to recent events, even if they are unlikely to have much impact on the long term.
2. Recent events are more salient in our minds. This means that they are more likely to come to mind when we are making decisions. This can result in failure to consider recent events in their proper long-term context. Asking questions can help maintain focus on long-term financial objectives. It can also help to discuss concerns with a trusted financial partner. "Am I considering all of the relevant information or am I focusing too much on the latest news and headlines?"
3. The media often focuses on recent events. This can give investors the impression that recent events are more important than they are.
4. Investors may feel pressure to buy or sell assets based on recent market performance. This is especially true if they see friends and family buying and selling.

RECENCY BIAS CAN LEAD TO INVESTMENT MISTAKES

Buying high and selling low: Recency bias can lead investors to buy investments that are popular and have been performing well recently. However, these investments may be overvalued and could be poised to decline in price. Conversely, recency bias can also lead investors to sell investments that have been performing poorly recently. However, these investments may be undervalued and could be ready for a rebound.

Chasing trends: Recency bias can lead investors to chase market trends, which can be risky. Trends often reverse themselves, and investors who chase them can end up buying at the top and selling at the bottom.

Overweighting certain asset classes or sectors: Recency bias can lead investors to overweight certain asset classes or sectors that have been performing well recently. However, this can lead to a portfolio that is not well diversified and is therefore riskier.

To avoid recency bias, investors should focus on the long term and stick to their investment plan. They should also be aware of the media's tendency to focus on recent events and not let current news influence their investment decisions. See tips to avoid recency bias on page 14.



TIPS FOR AVOIDING RECENCY BIAS

- **Have a long-term investment plan.** Before you start investing, decide what your financial goals are and how long you have to reach them. This will help you stay focused on the long term and avoid making decisions based on short-term market volatility or the news of the day.
- **Educate yourself about the markets.** The more you know about the markets, the less likely you are to be swayed by recent events. Read books and articles about investing and follow market experts on social media.
- **Diversify your portfolio.** Don't put all your eggs in one basket. Spread your money across different asset classes and sectors. Over the long term, this will reduce your risk and help you weather market downturns.
- **Rebalance your portfolio regularly.** Over time, your portfolio may become unbalanced due to the performance of different investments. Rebalancing your portfolio will help you maintain your desired asset allocation.
- **Don't panic-sell.** When the market takes a downturn, it's important to stay calm and avoid selling your investments in a panic. Remember that the market is cyclical. Throughout its history, it eventually recovered from downturns.

At 1st Source, we work with our clients to develop a long-term investment plan that suits their needs and is designed to help them achieve financial stability. We want to foster a working relationship that will help you as you strive to achieve your long-term goals.■



IN CLOSING

As in past years, you should receive this investment outlook publication during the holiday season. Although right on schedule, you probably won't be focused on the investment markets and that's okay. Enjoy your holidays, spend time with friends and family and let us worry about the markets.

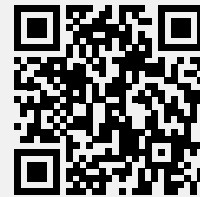
Throughout the new year, we will convey important news and information by collaborating with you in-person, via phone or video conferences and through our Market Share emails and videos. Your 1st Source team of wealth advisory and private banking experts will be by your side every step of the way, offering insights, strategies and personalized guidance to help you achieve your financial goals.

Thank you for entrusting us with the opportunity to serve you and your family. ■

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Jason Cooper; Matt Noll, CFA; Marie Alvarez; John Ross Haley; Paul Gifford, CFA; Cody Petrowsky; Chris Davis, AIF; Erik Clapsaddle, CFA, CFP®; Rob Romano, CFA; Peter Cahill, CFA; Noreen Kazi.

Our Investment Management team brings over 200 years of combined professional experience to our clients. A local decision-making team with accessible portfolio managers sets 1st Source apart from other investment advisors. Our team continues their pursuit of learning and achieving elevated distinctions to add value to client relationships. Five of our investment staff members hold the Chartered Financial Analyst designation, three have earned MBA degrees and one is a CERTIFIED FINANCIAL PLANNER™ professional. By working directly with clients, they can tailor portfolios to meet the individual needs of their clients. ■

Marie Alvarez
Investment Coordinator

Marie has over 35 years of banking and investment experience. She currently serves as our investment coordinator responsible for client presentation material, report writing and assisting with trades and execution.

Jason W. Cooper, MBA
Vice President and Portfolio Manager

Jason joined 1st Source in 1999 as a member of the Corporate Training Program. He was promoted to Investment Analyst in 2000 and to Portfolio Manager in 2002. He serves as portfolio manager for individually managed accounts and assists with the analysis of stocks.

John Ross Haley
Investment Analyst

J.R. joined 1st Source in May 2022 and is responsible for the execution of equity and fixed income securities and assists Portfolio Managers by gathering client reports and providing investment market research.

Noreen A. Kazi, MBA
Vice President and Portfolio Manager

Noreen joined 1st Source investments in January 2014, with experience working in Personal Trust, Funds Management and with the Office of Financial Planning & Analysis. She currently serves as Portfolio Manager for individually managed accounts and assists with the analysis of stocks.

Peter Cahill, CFA
Vice President and Portfolio Manager

Pete joined 1st Source in January 2022 bringing nearly 30 year of investment experience, predominately managing equity portfolios. He shares his insights into the investment markets and assists the investment team with providing outstanding client service.

Chris Davis, MBA
Vice President and Portfolio Manager

Chris joined 1st Source in March 2015 with over 25 years of diverse portfolio management experience. He has developed and implemented tailored portfolio asset allocation strategies for a wide array of clients with a large range of financial instruments.

Cody Petrowsky
Investment Analyst

Cody joined 1st Source in October 2022 bringing 6 years of banking experience working both in a banking center and loan operations department. Cody executes trades and provides research assistance for the investment team.

Rob Romano, CFA
Director of Research, Vice President and Portfolio Manager

Rob joined 1st Source in August 2010 and has spent nearly 30 years in the investment management profession. He manages both fixed income and equity portfolios, providing due diligence and equity analysis for the research team. Rob earned the right to use the Chartered Financial Analyst designation in 1999.

Erik Clapsaddle, CFA, CFP®
Vice President and Senior Fixed Income Portfolio Manager

Erik joined 1st Source in April 2015 and brings nearly 20 years of investment experience to the team. His work has focused on credit analytics, valuation, interest rate strategies, and macro-strategy. He develops portfolio asset allocation focused on fixed income for a wide array of clients. Read Erik's perspective in each edition *The Market Share* e-newsletter.

Paul W. Gifford, Jr., CFA
Senior Vice President and Chief Investment Officer

Paul joined 1st Source in 2000 and leads the investment team's strategy, construction, and implementation of client portfolios. Since beginning his investment career in 1989, Paul has gained the portfolio management experience needed to align the team with our investment philosophy.

Matt Noll, CFA
Vice President and Portfolio Manager

Matt joined 1st Source in October 2022 bringing 16 years of investment experience to the team. Matt is a holder of the Chartered Financial Analyst designation. He is responsible for asset allocation, equity and fixed income selection and trading.



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