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MARKET REVIEW
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RCB BANK
Trust & Wealth Management

JAPAN STOCKS RETURN TO PROMINENCE

– Japan is one of the world's top performing stock markets this year with the Nikkei 225 up 28.33% in local currency terms.

– Strong stock performance was driven by corporate governance reform to better align capital decisions with shareholders' interests.

– Japanese stocks were also supported by a stronger economy and return to sustained inflation after decades of battling deflation.

Japan's Nikkei 225 stock index, which includes the country's top 225 blue chip stocks, reached its highest level since 1990 this summer. Japan is one of the world's top performing stock markets this year with the Nikkei 225 up 28.33% in local currency terms, outpacing the S&P 500's 20.80% return. Reform efforts for more shareholder-friendly corporate governance and a stronger economy in the first half of this year led to foreign investor assets flowing into Japanese equities in volumes not seen in over a decade.

Japanese stocks have been a persistently under owned asset class over the last few decades amid the country's often sluggish economy, lower corporate earnings growth and profitability, and company executives' poor reputation for not prioritizing shareholder interests. Japanese stocks had a more prominent role in global markets in the 1980s when the country had the world's biggest stock market which, at its peak in the late 1980s, accounted for around 40% of the MSCI All Country World Index (ACWI). Currently, it has less than a 6% weight in the index. In the late 1980s, some economists projected Japan's economy would surpass the size of the U.S. economy after Japan averaged a blistering 6.44% annual economic growth from 1956 to 1989. However, Japan's economic growth slowed rapidly after the country's real estate and stock market bubbles burst in 1990. The Nikkei 225 index lost over 60% of its value between 1990 and 1992 and struggled to regain traction amid the country's disappointing economic growth during the "lost decade" in the 1990s. Japan's annual economic growth averaged a meager 0.65% from 1991 through last year. The lack of healthy economic growth translated into weaker corporate sales and earnings growth. The MSCI Japan index's sales growth averaged 1.3% over the last 20 years, compared to 3.4% average sales growth for the MSCI World developed market index.

Renewed optimism in Japanese stocks this year was largely propelled by corporate governance reform to better align capital decisions with shareholders' interests. According to Nomura's chief equity strategist, Yunosuke Ikeda, "until very recently, the problem was although there has been a rise in healthy corporate activism, companies and managers were still not so proactive listening to shareholder proposals." In an effort to increase pressure on companies to focus on shareholder interests, the Tokyo Stock Exchange (TSE) issued a notice this year requesting companies with market valuations below book value provide capital improvement plans to increase their valuation toward at least 1x price-to-book (P/B) value and boost return on equity (ROE) to at least match their cost of equity. A P/B ratio below 1 indicates investors value the company less than its assets are worth. According to Bloomberg, around one-third of the members of Japan's Topix 100 index, which includes the 100 largest companies, have a P/B ratio below 1, compared to only 3% of S&P 500 members. The TSE's penalty for not complying with their enhanced listing criteria includes the prospect of having their shares delisted. Nomura's Ikeda said delisting is probably unlikely to occur and peer pressure is likely to be an effective enforcement mechanism because "if rival companies are doing great improvements in corporate governance, others will tend to follow that move."

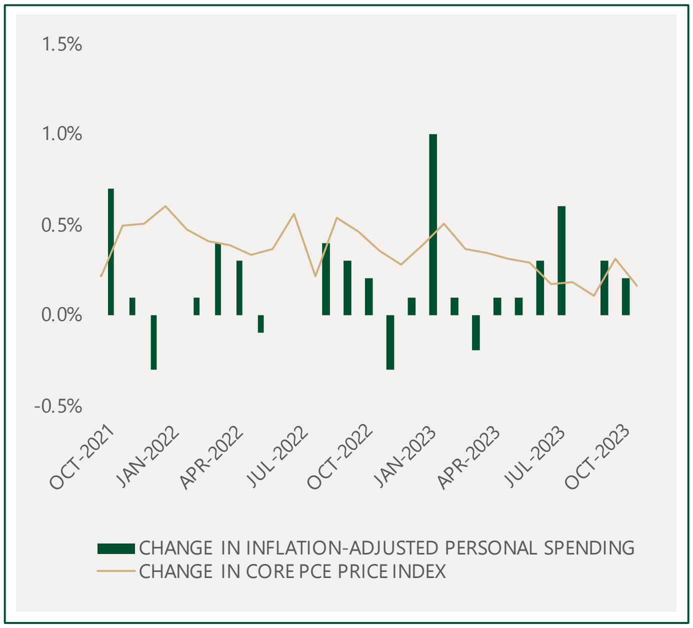
The TSE's notice suggested implementing steps including "investment in R&D (research & development) and human capital that leads to the creation of intellectual property and intangible assets that contribute to sustainable growth, investment in equipment and facilities, and business portfolio restructuring." Additional measures could include increasing cash distributions to shareholders through dividends or share buybacks. Japanese companies are in an advantageous position to increase the amount of cash reinvested in their businesses or distributed to shareholders given their historical preference to accumulate cash rather than engage in shareholder proposals for excess cash. According to asset manager Schroders, around half of Japanese companies have a net cash position (cash balance is greater than their liabilities) compared to less than 20% of U.S. and European companies.

> "AROUND ONE-THIRD OF THE MEMBERS OF JAPAN'S TOPIX 100 INDEX, WHICH INCLUDES THE 100 LARGEST COMPANIES, HAVE A P/B RATIO BELOW 1"

There are encouraging signs that the TSE's reform effort is already showing some results with companies announcing new business plans that include more aggressive dividend pay outs and share buybacks. Over 30% of TSE Prime Market companies have announced initiatives they plan to implement. According to Morgan Stanley, Japanese companies' dividends and share buybacks are expected to reach a record $210 billion this year.

The TSE's reform effort was not the only factor supporting Japan's stocks this year. The country's delayed COVID reopening in late 2022 boosted growth in the first half of this year. Japan's economy grew 5.0% and 3.6% quarter over quarter annualized in the first and second quarters, respectively. Additionally, a return to sustained inflation after stretches of deflation over the last few decades has enabled Japan to see healthy wage growth and given companies the confidence to raise prices to boost sales and margins.

A COOLING ECONOMY MIGHT LEAD TO A FED PIVOT
SLOWING INFLATION AND CONSUMER SPENDING



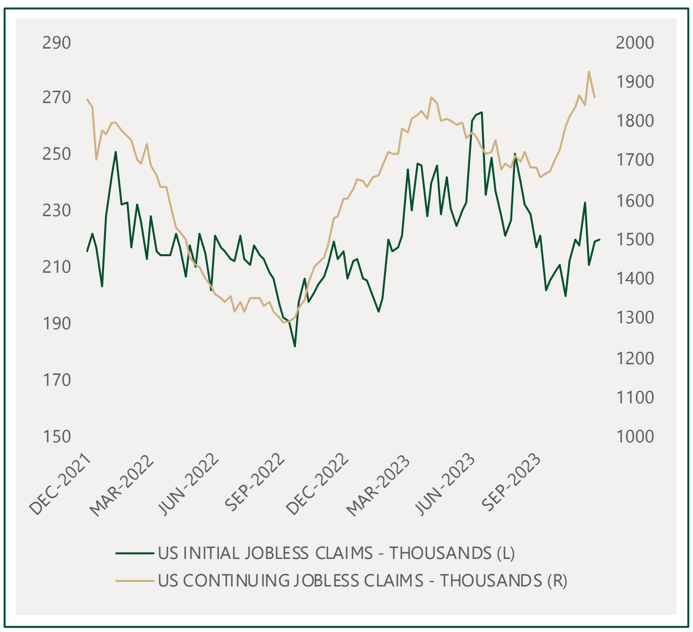
Source: Bloomberg. Past performance does not guarantee future results.

Signs of cooling in U.S. consumer spending, inflation, and the labor market led the Federal Reserve to hold rates unchanged in their last two meetings and fueled expectations of a dovish pivot with their monetary stance in 2024 as key components of slowing the economy. According to an economist survey compiled by Bloomberg, fourth quarter economic growth is estimated to slow to an annualized pace of 1.1% compared to the blistering 5.2% growth in the third quarter.

Inflation-adjusted consumer spending slowed to a gain of 0.2% in October from a revised lower 0.3% gain the prior month. Consumer spending is projected to moderate to 1.5% growth in the fourth quarter after the brisk 3.6% growth in the third quarter.

The Federal Reserve's preferred inflation measure, the Core Personal Consumption Expenditures (PCE) index which strips out volatile food and energy components, slowed to a 0.2% monthly gain in October from a 0.3% gain the prior month. From a year ago, the Core PCE index was up 3.5%, the smallest increase since April of 2021.

JOBS BECOMING HARDER TO FIND
CONTINUING JOBLESS CLAIMS NEAR 2-YEAR HIGH



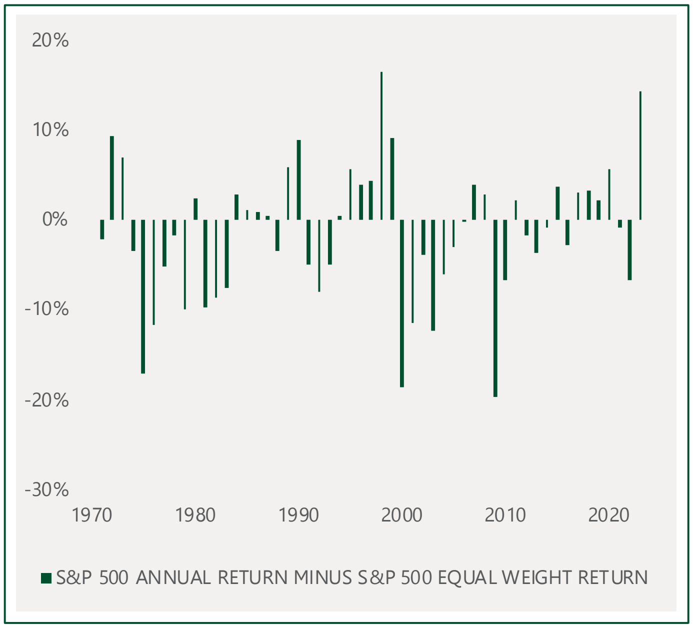
Source: Bloomberg. Past performance does not guarantee future results.

Slowing the strong labor market has been part of the Fed's focus on curbing inflation. The chart on the left shows signs of labor market softening are starting to develop. Nevertheless, the overall labor market remains relatively strong despite the aggressive Fed tightening over the last two years.

Continuing jobless claims, a proxy for how difficult it is for laid off workers to find a new job, fell slightly to 1.861 million in the week ended November 25. This marked only the second weekly drop since September. Continuing claims fell 64,000 from the previous week which was the highest level since November 2021. Higher continuing claims suggest unemployed workers are having a harder time finding new jobs.

Initial jobless claims have remained relatively range bound over the last two years. The latest reading increased to 220,000 for the week ending December 2, a 3,000 increase from the prior week. A strong labor market has driven the stronger-than-expected economic growth during the third quarter; however, slowing job growth and rising jobless claims could bring slower growth over the winter months.

2023 MEGA-CAP STOCK MARKET LEADERSHIP
S&P 500 OUTPERFORMANCE VS S&P 500 EQUAL WEIGHT



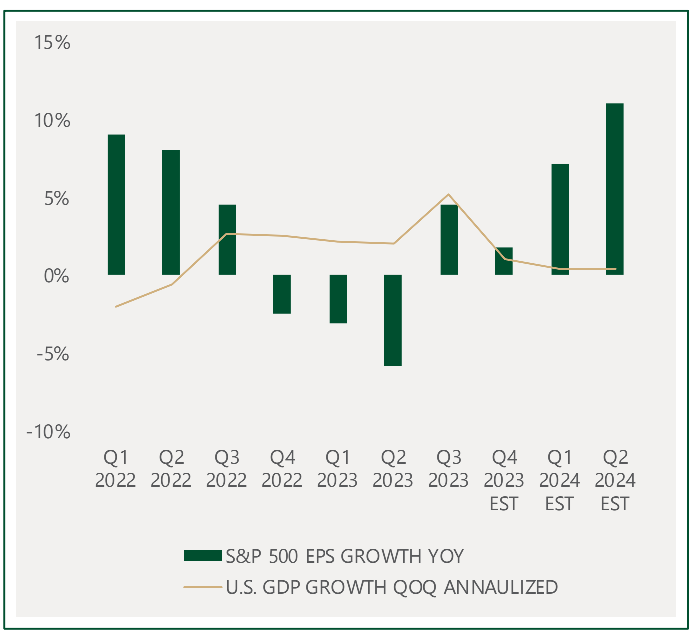
Source: Morningstar. Past performance does not guarantee future results.

Global equities broke a three-month losing streak in November with the best monthly performance in over a year. The S&P 500 index surged 9.13% in the month, the strongest month since last July. November's rally erased stocks' drawdown over the three prior months which was driven by bond yields rising to multi-year highs and concerns the Fed could keep interest rates higher for longer. Stocks' November advance was supported by the continued slowdown in inflation, lower bond yields, and growing expectations for Fed interest rate cuts in the first half of next year.

A few stock market technical indicators, including the 14-day Relative Strength Index (RSI) and percent of index members trading above their 200-day moving average, suggest stocks may have been oversold in late October and were poised for a rally under the right conditions.

The 10.83% and 11.68% monthly gains in the Nasdaq and Bloomberg Magnificent Seven indexes underscored the shift back to market leadership in mega-cap technology stocks. This year's elevated concentration in mega-cap outperformance is driving the largest annual return difference between the S&P 500 and S&P 500 Equal Weight indexes since the technology bubble in the late 1990s.

EARNINGS AND GDP GROWTH PROJECTIONS DIVERGE
EARNINGS EXPECTED TO ACCELERATE AS GDP SLOWS



Source: Bloomberg. Past performance does not guarantee future results.

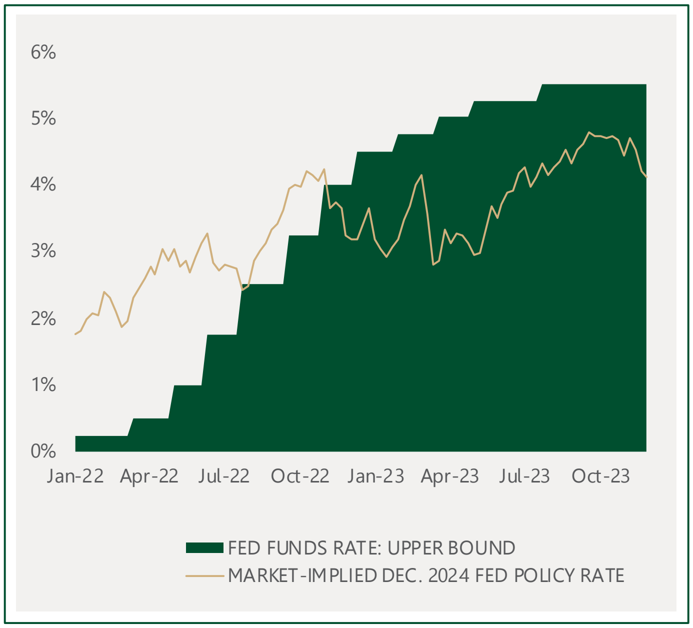
Estimates for stronger U.S. corporate earnings and sales growth are defying expectations for weaker economic growth. Equity analysts project S&P 500 earnings growth will accelerate in the first half of next year to 7.20% and 11.00% in the first and second quarters, respectively. Meanwhile, economists forecast economic growth will slow to a near standstill over the same time period.

The divergence in earnings and economic growth estimates suggests expectations might be too optimistic for earnings or too pessimistic for the economy. A downward revision in earnings would likely be a headwind for equities, while a revision higher for economic growth might support equities if disinflation continues. Optimistic earnings expectations likely have little room for error given the S&P 500's elevated valuation, sharp rebound in technical indicators toward overbought levels, and seemingly complacent equity options data as the CBOE Volatility Index (VIX) and put/call ratio are around the lowest levels since the pandemic started.

Easing inflation pressures and cost cutting throughout the year appear to be helping corporate margins stabilize. The S&P 500's operating margin is projected to rise year over year in next year's first quarter for the first time since the second quarter of 2022.

FIXED INCOME

MARKET BEGINS TO QUESTION "HIGHER FOR LONGER"
FED FUNDS RATE AND YEAR-END 2024 MARKET EXPECTATIONS



Source: Bloomberg. Past performance does not guarantee future results

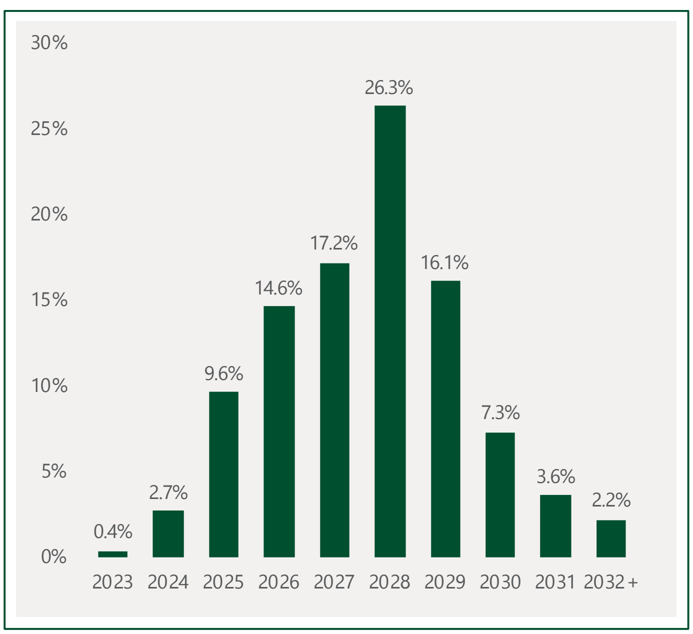
One of the biggest stories across the fixed income landscape in November was a shift in market expectations for a larger amount of Fed rate cuts in 2024 and a quicker timeline to the initial cut.

The perception of a dovish tone from Fed Chair Powell at his November 1 post-FOMC press conference seemed to be confirmed by signaling from many Fed officials in subsequent weeks that monetary policy had probably been sufficiently tightened to continue driving core inflation toward the 2% target.

Softer-than-expected consumer price index (CPI) and producer price index (PPI) data for October released during the week of November 13-17 amplified the building consensus that the Fed's "higher for longer" policy rate mantra likely had a short shelf life.

As seen in the accompanying chart, market expectations for the federal funds rate level at the end of 2024 rose substantially from April through September of this year as the Fed lifted its policy rate by an additional 75 bps after the March 10 failure of Silicon Valley Bank.

U.S. HIGH YIELD DEBT MATURITY SCHEDULE
2023 THROUGH 2032



Source: Clearbridge Investments, Franklin Templeton, ICE BofA U.S. High Yield Index. Past performance does not guarantee future results.

The surprising strength of the U.S. economy has helped prevent high yield credit spreads from significantly widening despite a pickup in issuance in the first three months of 2023 compared to the same period a year ago.

Still-low default levels across the high yield universe have been gradually increasing in recent months but not by enough for credit spreads to signal an elevated risk of a recession. To the contrary, most market observers would probably say the current level of spreads suggests the broad credit market has priced in an economic "soft landing" after an aggressive Fed hiking cycle.

As depicted by the accompanying chart, U.S. corporate issues with below investment grade credit ratings took advantage of the ultra-low rate environment in 2020 and 2021 to extend, or "term out" their debt profile. There is not much refinancing or rollover risk at the high yield index level until 2025.

We would expect issuance to pick up in the second half of next year and into 2025 based on high yield-rated grade borrowers' historical preference to refinance 18 to 24 months ahead of sizable debt maturities.