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Market Commentary Q1 2024

In the first quarter of 2024, the global financial markets experienced a mix of positive and negative trends, while stock markets showed resilience despite ongoing geopolitical tensions and concerns about rising inflation. Investors recognized that the U.S. economy has thus far weathered the most aggressive interest rate hiking cycle since the 1980's without the anticipated repercussions of high unemployment or a recession. The riskiest market segments have generated remarkable returns since late October, and certain sectors of the credit markets have acted as if the easy money era never ended.

Major indices, such as the S&P 500 and the Dow Jones, reached new highs, driven by corporate earnings and economic recovery optimism. The S&P 500 enters the second quarter with a 12-month percentage change just about in the top decile historically. The S&P 500 was up 10.2% and is now up almost 28% since the October 2023 lows.[1] Recession fears continue to subside, and the focus of investors is predominantly on the Federal Reserve ("Fed") and when the first rate-cut will happen.

Leading US Indices (Total Return)	3Q'22	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23	1Q'24 (sorted)	TTM
S&P/Citigroup Growth	-3.9%	1.4%	9.6%	10.6%	-2.6%	10.1%	12.8%	33.7%
S&P 100 Mega-Cap	-5.4%	5.6%	10.1%	11.1%	-2.8%	11.7%	11.2%	34.2%
S&P 500 Total Return	**-4.9%**	**7.6%**	**7.5%**	**8.7%**	**-3.3%**	**11.7%**	**10.6%**	**29.9%**
S&P 400 Mid-Cap	-2.5%	10.8%	3.8%	4.9%	-4.2%	11.7%	10.0%	23.3%
Nasdaq	-3.9%	-0.8%	17.0%	13.1%	-3.9%	13.8%	9.3%	35.1%
S&P/Citigroup Value	-5.8%	13.6%	5.2%	6.6%	-4.1%	13.6%	8.1%	25.6%
Russell 2000	-2.2%	6.2%	2.7%	5.2%	-5.1%	14.0%	5.2%	19.7%
S&P 600 Small-Cap	-5.2%	9.2%	2.6%	3.4%	-4.9%	15.1%	2.5%	15.9%

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Although we did see some modest broadening out of leadership, the main themes that outperformed last year in 2023 continued to be top performers in 2024 (large > small, growth > value, quality> risk, etc.). Within large caps, technology and communication services (the biggest winners in 2023) outperformed again in the first quarter. Energy also had a strong quarter. Defensive sectors such as utilities and staples continued their string of underperformance.

The technology sector faced challenges, including regulatory scrutiny and supply chain disruptions. Despite these challenges, tech stocks generally performed well, benefiting from increased artificial intelligence and digitalization trends.

S&P 500 Sectors (Total Return)	3Q'22	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23	1Q'24 (sorted)	TTM
Communication Services	-12.7%	-1.4%	20.5%	13.1%	3.1%	11.0%	15.8%	49.8%
Energy	2.3%	22.8%	-4.7%	-0.9%	12.2%	-6.9%	13.7%	17.7%
Technology	-6.2%	4.7%	21.8%	17.2%	-5.6%	17.2%	12.7%	46.0%
Financials	-3.1%	13.6%	-5.6%	5.3%	-1.1%	14.0%	12.5%	33.5%
Industrials	-4.7%	19.2%	3.5%	6.5%	-5.2%	13.1%	11.0%	26.7%
S&P 500 Total Return	**-4.9%**	**7.6%**	**7.5%**	**8.7%**	**-3.3%**	**11.7%**	**10.6%**	**29.9%**
Materials	-7.1%	15.0%	4.3%	3.3%	-4.8%	9.7%	8.9%	17.6%
Health Care	-5.2%	12.8%	-4.3%	3.0%	-2.7%	6.4%	8.8%	16.1%
Staples	-6.6%	12.7%	0.8%	0.5%	-6.0%	5.5%	7.5%	7.2%
Discretionary	4.4%	-10.2%	16.1%	14.6%	-4.8%	12.4%	5.0%	28.7%
Utilities	-6.0%	8.6%	-3.2%	-2.5%	-9.2%	8.6%	4.6%	0.4%
Real Estate	-11.0%	3.8%	1.9%	1.8%	-8.9%	18.8%	-0.5%	9.6%

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The S&P's +10% gain in the first quarter is good for the 11th best start to a year since 1950![1] Among similar historical examples, corrections that followed in the seasonally weaker second quarter were generally modest while rest of year performance skewed positive.[1] The immediate risk we see is sentiment (i.e., the bar of expectations is high), but so far fatigue in the market's most pronounced momentum corners has been met with strength elsewhere. Interestingly enough, in equally-weighted terms, energy, industrials, financials, and materials actually all outperformed tech at quarter end (you could probably win a bar bet with that fact).

Inflation remains a key concern for investors, with central banks closely monitoring the situation. Rising commodity prices, supply chain disruptions, and labor shortages contributed to inflationary pressures.

That said, central banks maintain accommodative monetary policies, although some started to signal potential tightening measures in response to inflation. The Fed, for example, indicated a willingness to raise interest rates to combat inflation if need be. Yet Fed Chair Powell said late last week that they can wait to see if inflation comes down further before cutting rates.

U.S. Core Personal Consumption Expenditure ("PCE"), the Fed's preferred inflation gauge, rose 0.3% in February after a 0.5% gain in January, which marked the sharpest two-month increase in a year.[1] The year-over-year gain matched estimates at 2.8%, remaining above the Fed's 2% target.

In Europe, we contend that two economic headwinds are now turning into tailwinds: bank lending is picking up, as is real wage growth. These are likely to continue to improve, meaning a reacceleration in eurozone growth now looks probable in the second half of 2024.

By contrast, China's economic story continues to be largely uninspiring. The People's Bank of China had been defending the renminbi's devaluation to the US dollar, even as it continues to weaken further. While China's equity indexes have gone nowhere when you look out over the long-term, its total market capitalization has expanded significantly to keep pace with GDP.

Chinese onshore equities have bounced from their February lows, prompting mounting speculation about whether a sustained rally may finally be in the offing. There are reasons for both optimism and skepticism: stock buybacks, for instance, have surged this year and helped to lift share prices, but dropped back to more normal levels in the past two weeks. Even if a rally materializes, regulators have turned back to interventionist tactics that they had seemed to be moving away from, such as limiting new listings, cracking down on short-selling and issuing instructions to large institutional investors. The end goal of a truly mature and sophisticated Chinese equity market has slipped further into the distance.

The bond market's fourth quarter 2023 performance proved to be a tough act to follow. The Morningstar US Core Bond Index, a proxy for the US-dollar-denominated investment-grade bond market, soared 6.6% in last year's final frame, but lost momentum in 2024's first quarter and fell 0.8%.[1]

Interest-rate volatility persisted as strong economic data and reduced rate-cut expectations lifted yields higher over the quarter. Investors who accepted more duration risk, or sensitivity to shifting yields, felt the most pain, something we have avoided. The typical long government Morningstar Category fund, which invests in long-dated Treasury bonds and carries a duration of 16.9 years, plummeted 3.1% during the year's first three months.[1]

US Yields	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23	1Q'24	Q/Q Chg (bps)	Y/Y Chg (bps)
Fed Funds Target Rate	4.5	5.0	5.3	5.5	5.5	5.5	0	50
3-Month T-Bill	4.4	4.9	5.4	5.6	5.4	5.5	6	61
2-Year Note	4.4	4.1	4.9	5.0	4.3	4.6	37	56
5-Year Note	4.0	3.6	4.1	4.6	3.8	4.2	37	62
10-Year Note	3.9	3.5	3.8	4.6	3.9	4.2	32	67
30-Year Bond	3.9	3.7	3.9	4.7	4.0	4.3	30	66

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The broad municipal bond index is almost flat for the year, but it's outperforming the Bloomberg US Aggregate Bond Index, Treasuries, and investment-grade corporate bonds.[1] In recent years when the broad index was down, it was mostly attributable to rising rates dragging down the prices of the longer-term bonds in the index, but that's not the case so far this year. This year's performance is largely due to higher-rated issuers underperforming lower-rated issuers.

Like most other fixed income investments, municipal bond yields have risen significantly since late 2021 and are now at levels that largely haven't been reached during the past decade. Although yields are down from their recent highs, we still think they're an attractive option for investors in higher tax brackets looking for more conservative income options. The yield-to-worst on the Bloomberg Municipal Bond Index, is roughly 3.4%.[1] For an investor in the top tax bracket who's in a high-tax state like New York, to achieve that same 3.4%, they would need a yield of close to 7% with a fully taxable bond!

Commodities experienced mixed performance, with prices of oil and metals fluctuating. Supply constraints and demand dynamics influenced commodity prices, impacting sectors such as energy and manufacturing. After being one of the worst-performing asset classes in 2023, commodity prices broadly rose in the quarter. Of note, WTI oil was up nearly 16% and closed the quarter at $83.[1] Gold prices rose to all-time highs this quarter hitting $2,229/oz (a quarterly gain of 8%).[1]

A host of other drivers have helped push up the metal by around 14% since the middle of February, including elevated tensions in the Middle East and Ukraine and strong buying by central banks, particularly in China.[1]

Cryptocurrency markets continued to be volatile, with Bitcoin and other major cryptocurrencies experiencing significant price swings. Regulatory developments and market speculation influenced prices.

Geopolitical tensions, including the conflict in Ukraine and other global issues, impacted market sentiment. Investors closely monitored these developments for potential impacts on global stability and economic growth.

As we move into the second quarter, there are several noteworthy economic matters we are keeping note of. The tailwinds include continued easy financial conditions and incremental fiscal support, while capex could get a lift from federal CHIPS Act and IRA infrastructure spending along with private sector AI boom. Questions remain around Fed easing, private credit growth and a potential China reacceleration.

On the headwinds front, it's all about employment, where we are witnessing some cracks such as downward non-farm payroll revisions, stagnant household employment, stalled cyclical employment, and declines in temporary employment. The Sahm Rule has been triggered in 20 states at the time of this piece, representing a large percentage of GDP in states such as California, New Jersey, New York, and Illinois.[3] The Sahm Rule shows that an economy has entered a recession if the three-month average of the unemployment rate has risen 0.5% or more from the previous 12-month low. In addition, the low-end consumer confidence is in recession territory and there are signs of weakness in the sector. Real Incomes have stalled, and credit card and auto loan delinquencies are increasing.[1]

A key question that remains is how low is the Fed Funds rate going to go (i.e. where is neutral?). And if the Fed does cut rates, will it be a meaningful endeavor as it relates to the economy? We believe a ~1% real (inflation-adjusted) rate should still be a good longer-term target.

We are exercising more caution and patience with equities headed into the second quarter. The S&P 500 has not had any pullback exceeding 2% during its five-month 28% rise from its October low.[1] While impressive, it is unrealistic for it to continue. Our breadth measures have started to improve; however, we need more confirmation this was not just a result of quarter-end "window-dressing" and fear of missing out!

Several commodities such as gold, oil, and cocoa have surged in price in recent weeks, which could cause inflation to reaccelerate, potentially forcing the Fed to remain on pause. With the Fed seemingly reluctant to cut interest rates given sticky inflation and a strong labor market, investors are finally scaling back their expectations for rate reductions in 2024.

Inflation remains a risk. Based on history, inflation has tended to come in waves. This result has been robust across different countries and time periods for the last century. An inflation wave has typically ended when economic slack has opened up (i.e., there's a recession). There are countries where there now looks to be some slack (e.g., China). But this time has been different (so far) in the U.S.

In today's hyper-connected world, economic reports seem increasingly tinted by the lens of the beholder. The Fed continues to walk a tightrope to fulfill its twin goals of maintaining price stability while retaining maximum employment. Though investors seem transfixed by rate cuts, the Fed appears more attuned to unemployment, especially given this being an election year.

Chairman Powell seems petrified by the prospect of a policy error. Consequently, the Fed is likely to remain extremely cautious to avoid acting prematurely, potentially leading to re-inflation. The longer the Fed delays its pivot, the more volatile the markets may become. Said another way, the longer you hold your breath under water, the more dangerous it becomes. If history is any indication, the catalyst for lowering the Fed Funds rate has not been that it was high enough to cause a recession, but rather an active financial crisis.

The financial markets appear to be entering a new phase where optimism is giving way to realism.

Though the probability of a recession is diminishing, the prospect of this goldilocks economy shifting to an era of stagflation may create greater market volatility and uncertainty in the second half of the year.

In other news, after the first round of the NCAA Men's basketball tournament, ESPN reported there were no remaining perfect brackets on its site, out of the 22,114,647 entries.[4] The NCAA says there are no unblemished brackets remaining in its own game, CBS' or Yahoo's. 8 double-digit seeds advanced to the second round of the tournament – probably the main reason everyone's brackets have been busted!

We continue to maintain long-term diversified portfolios that are built to withstand market volatility.

As always, we appreciate and highly value the trust you have placed in us. Please feel free to reach out with any questions.

To discuss this commentary further, please contact us at 914-825-8630.

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[1] Y-Charts – 04/02/2024
[2] Strategas Securities, LLC – 04/02/2024
[3] https://finance.yahoo.com/news/why-unemployment-rising-in-states-like-california-and-new-jersey-isnt-a-problem-for-the-us-economy-090513132.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAMtqPNyHOkhL1ib0D9rtnNBFq54EkUGantffwe1WbL1Mv6YW1Z6pTCSJbo-BgVgcq_KRkH8PIpgsbFDMklLkPBc7vJb1i1VTVgUgWShRucPdStwqSWxiXnJcjaPECrlQ61B_YnRcUMzQui5EjvYOP5Hs6KxFrGezUiAVmsgMcEF5 – Accessed 04/02/2024
[4] https://www.usatoday.com/story/sports/ncaab/2024/03/22/march-madness-perfect-brackets-remaining/73073364007/. – Accessed 04/02/2024