First Quarter 2024 Letter

Figure 1 – S&P 500

Figure 2 – U.S. 10-Year Treasury Yield

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Market Recap

Markets moved higher in the first quarter of 2024, supported by solid economic news and improving corporate earnings. The large cap S&P 500 (**Figure 1**) gained 10.6%, continuing its leadership of equity indices. Gains were broad-based. The S&P MidCap 400 rose 10.0%, while the Russell 2000 Small Cap added 5.2%. Broad European and Japanese exchanges rose 5.8%, shrugging off concerns of recession in Germany. Emerging markets lagged, gaining 2.4%, weighed down by ongoing challenges for businesses in China. After a robust 4th quarter rally, U.S. bonds pulled back. The Bloomberg U.S. Aggregate Bond index fell as intermediate term interest rates rose finishing the quarter with a -0.8% return.

The quarter's stock rally was practically uninterrupted, marked by unusually low volatility. The technology sector again posted strong gains, continuing 2023's market action. However, market leadership broadened to include energy, financials and industrials. All S&P 500 sectors gained except for real estate. The Federal Reserve reiterated its intention to cut interest rates three times this year, and this undoubtedly helped stocks. But investor sentiment also appeared to improve with economic news.

Corporate earnings in the fourth quarter of 2023 rose 6.4% and revenue inched 3.4% higher. These results were much stronger than the 1.1% growth expected before the last earnings season and helped propel stocks higher. 73% of S&P 500 companies topped expectations, lower than the 5-year average. The information technology sector continued to post strong results. Consumer discretionary, finance and industrial companies also posted double-digit growth, while energy and materials again had the steepest declines. 2024 Q1 earnings are expected to increase +2.2% from the same period last year on +3.5% higher revenues. Following last quarter's surprising improvements, investors are likely to expect significantly more from first quarter reports. Companies that don't raise their outlook for the rest of the year are likely to suffer.

Economic Perspective

U.S. economic growth moderated in in the 4th quarter of 2023, growing at an annual rate of 3.4% after Q3's very strong 4.9% expansion. Consumer spending, business investment and residential construction all contributed. Continued government spending, especially at the state and local levels, also boosted the economy. Housing starts jumped in February to meet demand for new homes. Purchasing manager surveys for the services sector slowed towards the end of the quarter, as consumers appeared to exercise more discretion in their spending. However, the manufacturing sector surprised with the first expansionary reading since 2022. This may be a very good sign for the coming months. Historically, when the manufacturing sector emerges from contraction, it tends to signal further prolonged economic growth.

Employers continued to add jobs through the first quarter while the unemployment rate rose slightly to 3.8%. The labor force participation rate rose to 62.7%, the 2nd highest reading since the pandemic, as more potential employees entered the workforce. Average hourly earnings continued to rise at an annual rate of 4.1%, helping workers keep pace with inflation. The strong job market has supported consumer spending, the largest sector of the U.S. economy. Higher interest rates may be weighing on consumer budgets, particularly for big ticket items including cars and trucks. However, consumer balance sheets remain strong. Moodys estimates that less than 20% of consumer debt has variable interest rates; many across the country locked in low mortgage rates before the increase that began in 2022. In addition, almost 40% of homeowners are now mortgage-free. Overall, consumer spending appears likely to remain at levels that will support the economy.

U.S. inflation remains a concern for the Federal Reserve and investors. While price increases have slowed, the consumer price index (CPI) has stayed above 3% and made no progress towards the Fed's target of 2% in the past quarter. Inflation may remain stubbornly high for the foreseeable future. The U.S. economy is growing strongly, increasing demand for commodities including oil. Also, demand for workers has been robust, and supply has been constrained by our declining birth rate and limits on immigration. This may keep inflation higher than the Federal Reserve would like, pushing out this year's promised interest rate cuts. However, as we noted last quarter, stock investors may continue to gain if rate increases are pushed out because of a strong economy.

Looking Ahead

The technology sector (**Figure 3**) has delivered leading earnings growth and stock returns since the beginning of 2023. While we would not bet against these companies, we note that some of last year's leaders, including Apple and Tesla, have lagged the market this year. With the economy surprising to the upside, traditional cyclical sectors, including financials (**Figure 4**), industrials and energy, have led U.S. markets so far this year. These companies are more sensitive to change in economic growth than technology companies, and generally pay higher dividends.

The 10-year Treasury rate of 4.4% (**Figure 2**) remains well below the Federal Funds effective rate of 5.3%. As the Federal Reserve delays rate cuts, Treasury buyers may focus on interest rate risk and demand higher yields to hold longer-term bonds. For many investors, it may be more prudent to stay with shorter-term bonds, which are less sensitive to interest rate changes and, in many cases, offer higher yields than their longer-dated counterparts.

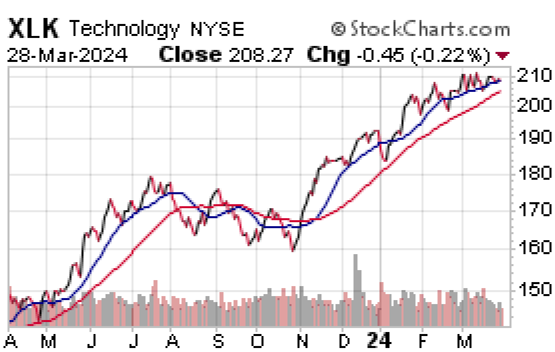

Figure 3 – Technology Sector SPDR Fund

Figure 4 – Financial Services iShares

After the year's strong start, markets may pause and stumble as traders take profits and sentiment turns negative. Unfortunately, we're never far from a noticeable correction. In our experience, it's very difficult to predict these declines. Investors who stay the course are likely to enjoy recovery and solid growth through compounded returns.

Index returns taken from Morningstar.com

We wish you a beautiful spring and encourage you to call us with any questions.

Best regards,

Kenneth M. Bernard, CFA

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