Market Outlook
First Quarter 2024

MARKET SNAPSHOT

The U.S. economy, labor market, and stock markets continued to show strength in the first quarter, despite short-term interest rates sitting at 20-year highs.

A number of inflationary data came in hotter than expected, which caused interest rates to rise across the curve and bond prices to fall.

While we don't expect a spike in inflation, we do think the path from 3.5% to 2.0% will be difficult and bumpy for the Fed.

While recession is not our base case, the risk is certainly not off the table either. If we were to see a contraction in the economy, it could come later in the year.

We entered 2024 with a fairly bullish setup, however, we think now is a time for prudence as opposed to excessive risk-taking, as the "soft-landing" scenario is still very much in question.

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Market Recap

In the first three months of 2024, the U.S. economy remained resilient despite short-term interest rates sitting near 20-year highs. Noteworthy in the quarter were continuing robustness in the labor market, stronger-than-anticipated corporate earnings, and a convergence of market participants' aggressive forecast of rate cuts with the Fed's own projections. Retail sales pulled back, but the trend remains positive.

These factors provided a supportive backdrop for stocks. The S&P 500 Index continued to reach new highs throughout the quarter, gaining 10.6% in the three-month period. Large-cap U.S. stocks (S&P 500 Index) outperformed small-cap U.S. stocks (Russell 2000 Index), and growth stocks (Russell 1000 Growth) again beat value stocks (Russell 1000 Value).

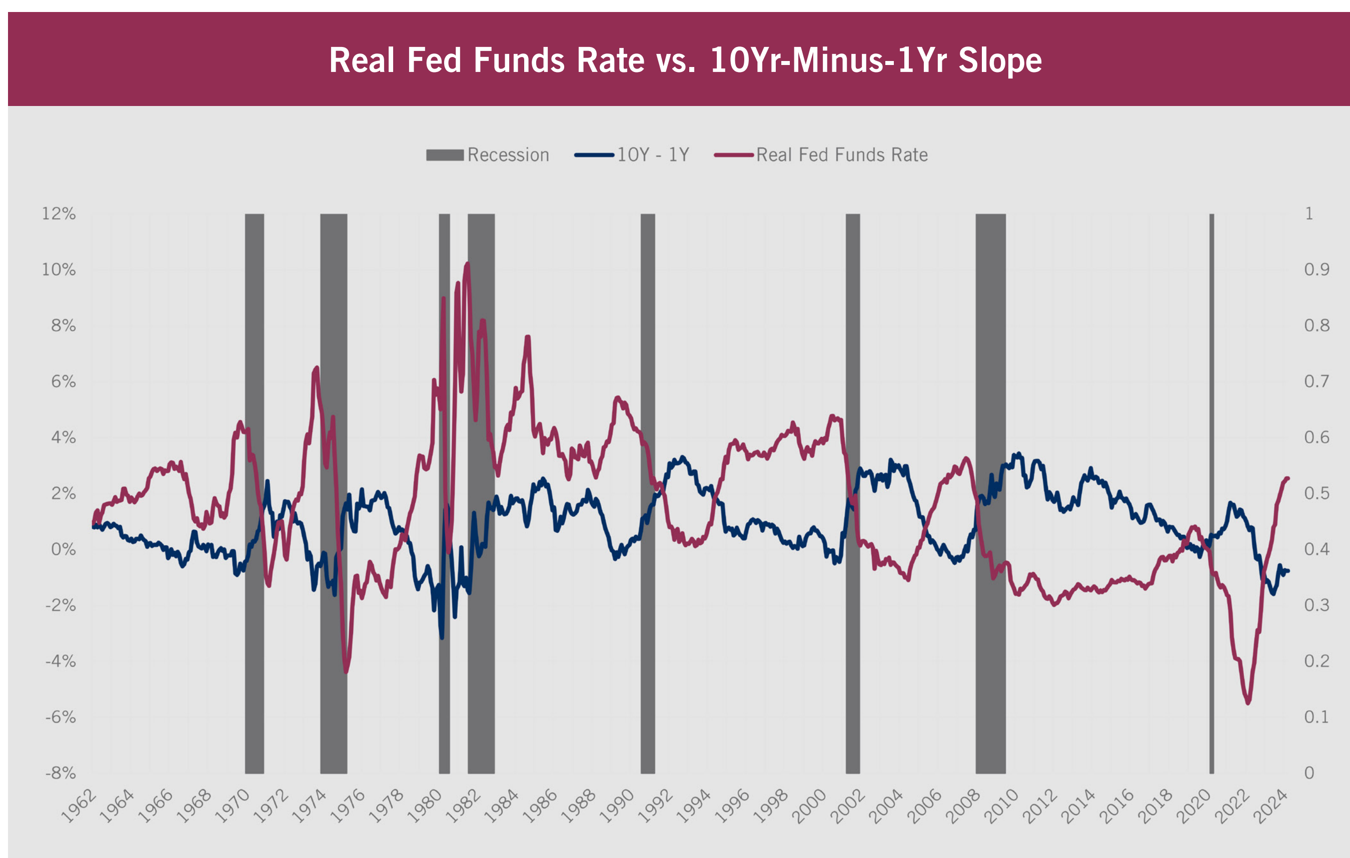
Developed international and emerging-market stocks also posted gains, but they did not keep pace with the U.S. market. Developed international stocks (MSCI EAFE) gained 5.8%, while emerging-market stocks (MSCI EM Index) posted a 2.4% return.

Bond returns were mixed as the benchmark 10-year Treasury yield rose from 3.88% to 4.20%, with market expectations for rate cuts tempered in terms of timing and magnitude. In this rising-yield environment, the more interest-rate-sensitive Bloomberg U.S. Aggregate Bond Index declined 0.8%. Credit performed relatively well in the quarter, as high-yield bonds (ICE BofA High Yield Index) were up nearly 1.5%.

Investment Outlook

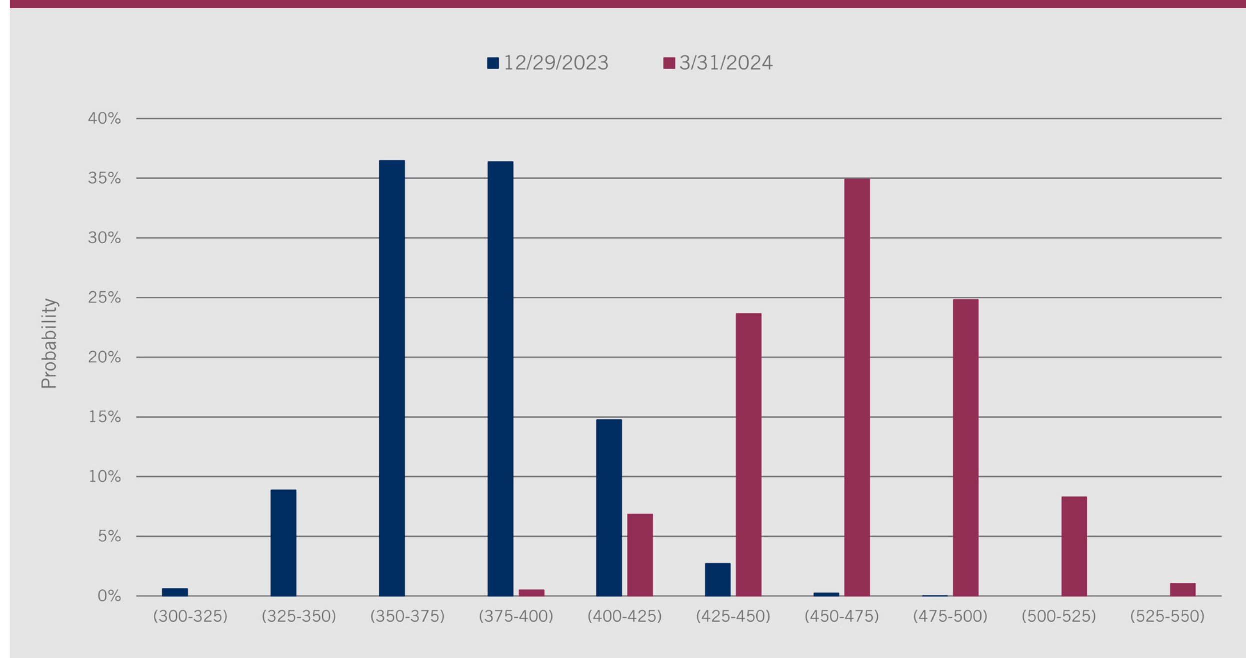
The U.S. economy has continued to prove resilient despite the Fed maintaining a higher level of interest rates for longer than most expected. A main driver of this better-than-expected economic growth has been the continued strength of the U.S. consumer. The combination of robust job gains and steady real income growth has allowed consumers to continue spending despite higher rates. The strong consumer has also benefited corporate earnings. And after a decade of near-zero interest rates, companies are generally well positioned financially, with balance sheets that are healthier than they have been in past tightening cycles.

Inflation (CPI) has declined meaningfully over the past year, falling from 6% to just over 3%, though still above the Fed's long-term target of 2%. Our expectation is that the Fed will ultimately achieve their goal in getting inflation back to 2%. However, it could take longer and be a bumpier road, particularly as inflation seems to have stalled out between 3% and 3.5%.



Source: Bloomberg L.P. Data as of 3/31/2024.

As inflation has declined over the past 12-18 months, we believe Fed policy has crept into borderline restrictive territory. The chart above shows the yield curve (10-year minus 1-year maturities, blue line), alongside the real fed funds rate (i.e., fed funds rate net of inflation, red line). Going back to 1960, an inverted curve combined with a sharply higher real fed funds rate has preceded a recession (gray bar). In the most recent cycle, however, we can see that while the yield curve has been inverted since July 2022, Fed policy has been very accommodative for most of that time (i.e., the real fed funds rates were sharply negative when the curve first inverted). It's only more recently that Fed policy has started to move toward restrictive levels due to the combination of a higher fed funds rate and falling inflation. Simply put, to the extent that inflation continues to fall and the Fed keeps rates unchanged, monetary policy will become proportionately more restrictive and could reach a level that slows the economy.

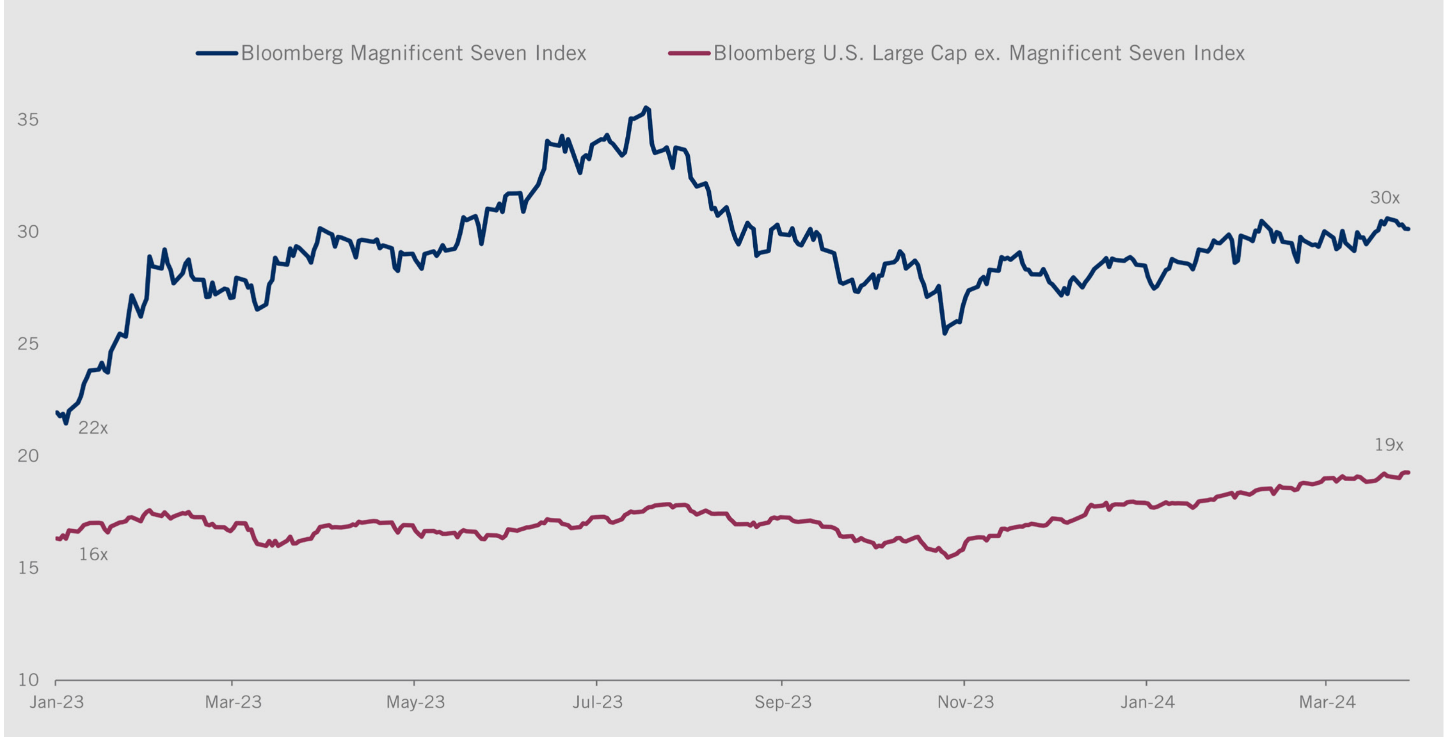


Source: CME Group. Data as of 3/31/2024.

Economic growth in and of itself does not cause inflation, and ongoing modest economic growth is not a reason for the Fed to avoid cutting rates. However, persistent growth of around 2% does make it difficult to foresee aggressive rate cuts, and we've seen this reflected in the market's expectations for the fed funds rate during the quarter. In the chart above, we see that at the beginning of the year, the market was anticipating six to seven rate cuts (shown in blue). But as of the end of March, the market's expectations (shown in red) have tempered, and the consensus is for three rate cuts bringing the top end of the fed funds range to 4.75% at the end of 2024.

With inflation still running slightly hot, the Fed has to balance cutting too early and potentially causing a second wave of inflation vs. waiting too long and putting pressure on consumers and the economy. What the Fed ultimately decides will depend on the economic data that unfolds. As we write this (the data can change quickly), we feel the bigger question around rate cuts in 2024 is not "when" the Fed will cut, but "if" the Fed will cut. Between the November elections and recent data around inflation, we feel the Fed is likely to cut at most twice this year, with a real possibility that they do not cut at all.

For now, U.S. economic data seems supportive of growth, not contraction. If the Fed is able to engineer a "soft landing" of the U.S. economy with inflation converging to 2% and growth continuing, they can incrementally lower rates and ensure that policy does not become too restrictive. If a recession does occur later this year, the Fed will have the ability to swiftly and meaningfully cut rates given current levels.



Source: Bloomberg L.P. Data based on next 12 months earnings. Data as of 3/31/2024. "Magnificent Seven" stocks: Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, Tesla.

Closing Thoughts

The U.S. economy currently appears to be in decent shape. The stock market continues to hit new highs as economic growth continues. There remains a high level of concentration in the "Magnificent Seven" stocks, which comprise about a quarter of the value of the S&P 500. In our view, this creates relative opportunity in the remaining 493 stocks in the S&P 500, which have not seen valuations so stretched. The possibility of a recession isn't off the table by any means, but if it does happen the timing is likely pushed back until late this year or 2025.

As we look ahead, we anticipate there will be pockets of choppiness given headline risks related to Fed policy, geopolitical events such as the ongoing wars in Europe and the Middle East, and the upcoming U.S. presidential election (election years have historically been more volatile for the equity markets). In anticipation, we are prepared to be opportunistic and take advantage of any attractive risk/reward opportunities that arise.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors

Market Indicators
First Quarter 2024

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THE FUTURE IS BETTER THAN YOU THINK

S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	8.51	8.51	39.26	24.39
S&P Financial Select Sector TR USD	12.46	12.46	33.55	12.76
S&P Consumer Disc Select Sector TR USD	3.14	3.14	24.13	11.21
S&P Health Care Select Sector TR USD	8.85	8.85	16.09	12.05
S&P Industrial Select Sector TR USD	10.97	10.97	26.70	12.96
S&P Cons Staples Select Sector TR USD	6.89	6.89	5.28	9.37
S&P Energy Select Sector TR USD	13.55	13.55	18.03	13.02
S&P Utilities Select Sector TR USD	4.57	4.57	0.42	5.87
S&P Real Estate Select Sector TR USD	-0.55	-0.55	9.60	5.34
S&P Materials Select Sector TR USD	9.05	9.05	17.68	13.24
S&P Telecom Select Industry TR USD	-6.87	-6.87	-7.35	2.21

Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	10.56	10.56	29.88	15.04	12.96
Russell Mid Cap	8.60	8.60	22.35	11.09	9.95
Russell 2000	5.18	5.18	19.71	8.10	7.58
MSCI EAFE	5.78	5.78	15.32	7.32	4.80
MSCI Emerging Markets	2.37	2.37	8.15	2.22	2.95
BBgBarc U.S. Agg Bond	-0.78	-0.78	1.70	0.36	1.54
High Yield	1.47	1.47	11.15	4.21	4.44

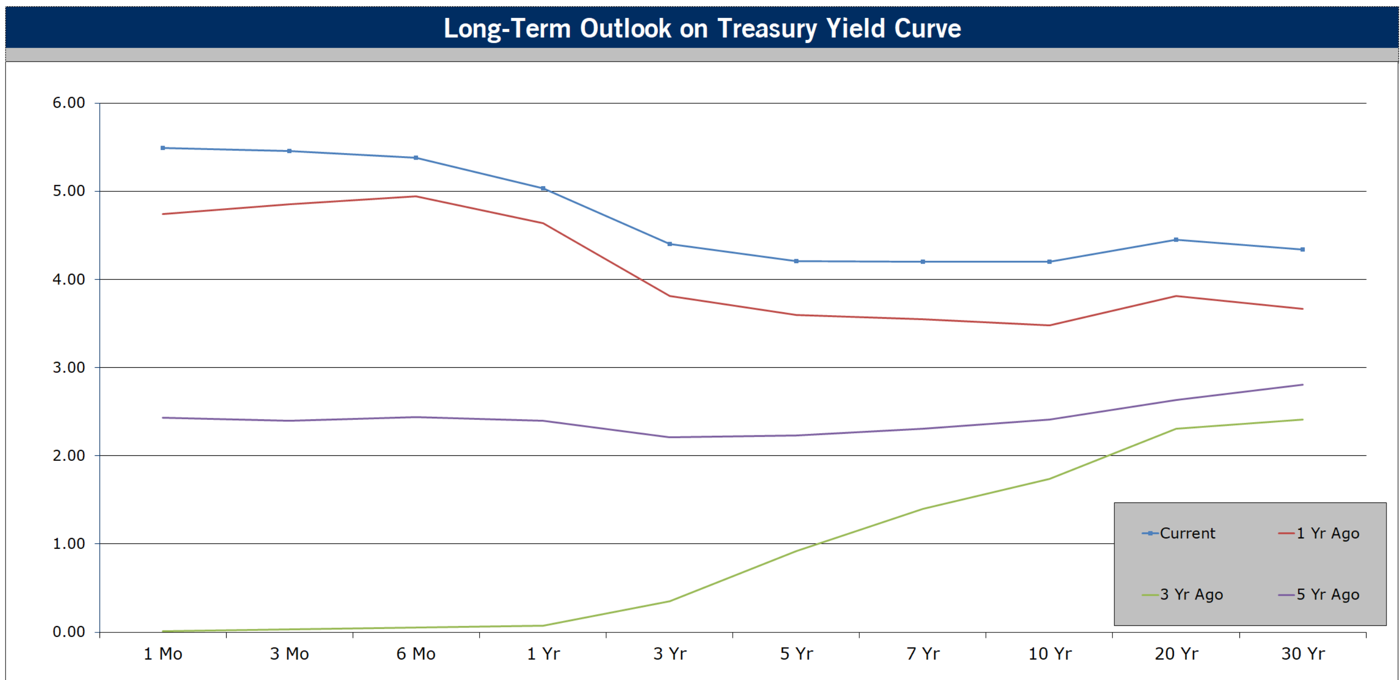
Value / Growth Returns

	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	8.05	4.12	-0.45	22.23	15.39	12.30
Growth	12.75	15.60	4.77	30.03	17.49	17.10

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	25.56	21.04	1.28	4.75%
Russell Mid Cap	20.73	18.01	1.27	5.55%
Russell 2000	16.22	15.09	1.23	6.63%
MSCI EAFE	15.76	13.79	2.81	7.25%
MSCI Emerging Markets	14.02	12.49	2.57	8.01%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

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