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FROM THE CIO'S DESK
MARKET COMMENTARY

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Quarterly Market Perspective

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A positive and constructive mood propelled stocks higher during the quarter. The S&P 500 appreciated by +10.6% as the equity market demonstrated signs of a modest broadening in returns. During 2023, equity results were driven by an incredibly narrow group of stocks, with the so-called 'magnificent seven' stocks (Apple, Amazon, Alphabet, Microsoft, Meta, Tesla, and NVIDIA) serving as the dominant source of overall return. During the quarter, five of the eleven sectors composing the S&P 500 performed better than the index. Even among the magnificent seven stocks, only four outpaced the market average. We view this as a positive sign of less market concentration and expect a continued broadening out of the market as 2024 progresses.

The pace of stock gains during the quarter was remarkably steady. Of the thirteen weeks during the quarter, only four experienced a decline, the worst being a modest retracement of 1.5% during the first week of the year. The steady move higher led to low levels of equity volatility, as measured by the CBOE VIX index. This is emblematic of risk in general being priced low across the market. Concerns were negligible among investors given that economic readings were generally positive, fiscal and monetary policies were not disruptive, and geopolitical concerns were contained. By the quarter's end, equity prices seemed to reflect a continuation of favorable economic, geopolitical, and business conditions. Any reverberation in these risk factors is likely to present a downside risk to share prices.

Valuations have become more dispersed across parts of the equity market. Large-cap U.S. equities are the only major segment where stock valuations are well ahead of their long-term average. This may be justified given the stronger growth in earnings coming from large U.S. corporations along with improving levels of profitability. Within the U.S., elevated valuations held by large growth-oriented stocks appear stretched relative to other segments of the market such as economically sensitive businesses or small and mid-size companies. Over time we'd expect valuations across both the U.S. and international markets to gradually compress. As such, diversifying portfolio exposures beyond the magnificent seven and large growth pockets of the market is a prudent approach in our view.

Within the bond market, prices did not follow the same path as stocks as a rise in bond yields led to a modest drop in prices. The bond market barometer, the Bloomberg U.S. Aggregate Index, lost a modest -0.8% during the quarter. Bonds were pressured as inflation readings released during the quarter indicated that the pace of improvement in price gains has begun to level off. As such, intra-quarter investors quickly shifted away from expectations of as many as seven interest rate cuts by the Federal Reserve in 2024 to a mere three. We view the reset in bond yields to be representative or more likely expectations on the direction of future Federal Reserve actions. As a result, by quarter end, we viewed Treasury bonds as offering yields that were more in line with our long-term expectations. While volatility in Treasury yields is likely to remain as market participates parse through incremental data points, we believe investors can take comfort in the 5% yield offered within the broader market and wade through the noise associated with the short-term movement in yields.[1]

Any near-term variability is likely to stem from the inability of the U.S. economy to eradicate the last mile of excess inflation that remains. After peaking at a 9% inflation rate in June 2022, the Consumer Price Index's (CPI) annual rate of inflation

[1] Source: Bloomberg, as of 3/29/24. Based on yield-to-worst of the Bloomberg U.S. Aggregate index.

experienced a strong descent to 3% by June 2023. Since then, the CPI has been stuck in a range between 3-3.7% and has been unable to achieve any sustainable gains in moving lower. This presents the risk that policymakers will need to hold interest rates higher for a more protracted period. The longer rates remain at present levels, the greater the risk of added funding pressures for borrowers such as real estate investors, homeowners, and corporations. We would expect any stress stemming from borrowing pressures to be asset-specific rather than systematic challenges. Our bias in this environment is to lean toward quality assets that have stable and predictable cash flows and have below-average amounts of leverage.

On the economic front, the surprising strength of the economy has come from elevated levels of consumer and government spending. We don't believe recent levels of consumer spending are sustainable. Eventually, savings rates, which presently sit at roughly half of normalized levels, will need to return toward long-term averages and spending patterns will have to reset. However, we expect a more gradual shift in behavior as low unemployment rates and the structural undersupply of labor are supportive of consumer confidence. As such, an eventual reset in consumer spending is likely to lead to a moderation in the pace of economic growth, although we project that the U.S. economy to continue to expand at a reasonable pace.

Continued economic growth is supportive of equities. However, given strong gains year-to-date and the low level of volatility, a moderate pullback at some point during 2024 is not unreasonable. As the year progresses, we expect returns to broaden out and see improving relative results out of segments of the market that did not keep up with 2023's narrow market rally.

In the bond market, our focus is on avoiding unnecessary risks given that investors are compensated with a level of yield that is near the highest it's been over the past twenty years. While short-term rates are positioned to fall once the Fed gets toward an easier policy, we view intermediate and long-term rates are reasonable. Among the sectors composing the bond market, we have become more cautious about corporate bonds given the below-average yield afforded to investors for accepting credit risk. Emphasizing predictability and being patient waiting for more attractive pricing within riskier segments of the bond market seems to be the best way to navigate the present climate.

Markets move as expectations shift along the spectrum of worry to euphoria. In the present climate, markets lean toward a more euphoric state. This is for good reason as the economy is not only strong but has stable underpinnings to it. Political concerns have yet to rear their head and higher borrowing costs have not had the magnitude of impact many feared. However, at Miracle Mile, we know the world doesn't work in a linear fashion and thus we believe in preparing for a range of scenarios. As market conditions have changed, we've evolved portfolios to manage risk and also take advantage of emerging opportunities. As 2024 continues to play out, we know we'll face some expected and unexpected conditions and we'll be with you every mile.