Market Review & Outlook

April 2024

The recent market rally that kicked off in late October showed few signs of cooling as it marched higher during the first quarter, with the S&P 500, Nasdaq Composite, and Dow Jones Industrial Average all hitting new all-time highs, including on the final trading day of the quarter. The S&P 500 gained a remarkable 10.56% in the first quarter, hitting 22 new all-time highs in the process. The small cap Russell 2000 remains a laggard and is still almost 14% below its all-time high set back in November 2021. On the other hand, small cap stocks have shown signs of breaking out recently, as the Russell 2000 slightly outperformed the S&P 500 in March (3.58% vs. 3.22%).

The market rally is starting to broaden out as well, as the Invesco S&P 500 Equal Weight ETF (RSP) gained 4.99% in March, besting the capitalization-weighted S&P 500's 3.22% gain. The Magnificent Seven stocks that have driven much of the market's gains since the October 2022 low have started to show some cracks with the broad market outperforming the group in March.

Index	March 204	1st Qtr. Perfo-mance	One Year Perfor-mance	Description (what the index is comprised of)
S&P 500	3.22%	10.56%	29.88%	Large Cap US Stocks
DJ Industrial Average	2.21%	6.14%	22.18%	Large Cap US Stocks
Nasdaq Composite	1.85%	9.31%	35.08%	Large & Mid-Cap US Tech Stocks
Russell 1000 Growth	1.76%	11.41%	39.00%	Large Cap US Growth Stocks
Russell 1000 Value	5.00%	8.99%	20.27%	Large Cap US Value Stocks
Russell 2000 Growth	2.80%	7.58%	20.35%	Small Cap US Growth Stocks
Russell 2000 Value	4.38%	2.90%	18.75%	Small Cap US Value Stocks
MSCI EAFE	3.29%	5.78%	15.32%	Foreign Developed Market Stocks
MSCI EM	2.48%	2.37%	8.15%	Emerging Markets Stocks
S&P US High Yield	1.20%	1.49%	10.81%	US High Yield Corporate Bonds
Bloomberg US Aggregate Bond Index	0.92%	-0.78%	1.70%	US Treasuries, mortgage-backed, investment grade corporate bonds

Indeed, Tesla (TSLA) was the worst performer in the S&P 500 during the first quarter, losing 29.25%, while Apple declined 10.81%. For now, Alphabet, Amazon, Meta, Microsoft and Nvidia continue to exhibit strength, and all are still trading near all-time highs. For a more detailed look at how various asset classes performed in recent periods, please refer to the table above.

As for bonds, they struggled during the first quarter as interest rates drifted higher, with the primary US bond benchmark declining 0.78%. Despite the Fed announcing plans to cut interest rates three times this year at the December FOMC meeting, strong economic data and sticky inflation may restrain its ability to cut. Given that we are in a presidential election year, the Fed may hesitate to cut as we get closer to November 5 as to avoid any appearance of political interference. And the upward pressure on rates will not likely fade if the economy remains strong. Just this morning, the March ISM Manufacturing PMI was released and came in at 50.3 (vs. 48.3 estimate), the first time above the 50 level (denoting expansion) since all the way back in September 2022. The yield on the 10-year Treasury Bond rose more than 12 basis points in reaction to settle at 4.32%.

Looking overseas, the diversified foreign stock indices sit at levels just below their May 2021 all-time highs. Broadly speaking, foreign stocks have dramatically underperformed US stocks since the Great Financial Crisis, and generally sport much cheaper valuations. Select markets, such as India and Japan, have enjoyed strong performance over the past year, with Japanese stocks finally surpassing their previous 1989 peak after 34 years. Various notable investors – Warren Buffett is one – are bullish on Japan based on corporate governance reforms that have taken place in recent years. China is also showing signs of emerging from its prolonged economic downturn.

Given the remarkable performance of US stocks over the past 5 months, a pause or correction wouldn't be a surprise. The forward 12-month Price/Earnings ratio for the S&P 500 of 20.9 is significantly higher than both the 5-year average (19.1) and 10-year average (17.7), so market valuations are in rich territory. The S&P 500 has closed in overbought territory (more than one standard deviation above its 50-Day Moving Average) for 50 consecutive trading days. The last time the index had a longer streak of overbought closes was more than 25 years ago in April 1998 (60). Market volatility has been unusually depressed over the past year, and

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the S&P 500 has not had a daily loss of at least 2% in 276 trading days going back to December 2022. A correction soon would arguably be healthy and welcome.

Turning to the economy, it's starting to look like a "soft landing" or even "no-landing" scenario will be the most likely way this cycle unfolds, as the number of economists forecasting a recession this year continues to dwindle. Real annualized GDP growth for the 4th quarter was revised higher to 3.4%, and the Atlanta Fed's GDPNow model is currently forecasting 2.8% for the 1st quarter, a number that was revised higher from 2.3% on March 29, in part based on this morning's stronger than expected Manufacturing report.

This is a remarkable turnaround from the beginning of last year, when ~85% of professional economists were predicting a 2023 recession. Week before last, the Conference Board released its Index of Leading Economic Indicators (LEI) for February, when the index rose 0.1%, breaking a streak of 23 consecutive months of being in negative territory. Over the duration of this decline, the index dropped 13.4%, and it was the first decline of that magnitude in history without the economy falling into recession.

However, another historical recession indicator, an inverted yield curve is still flashing caution. A normal yield curve, sloping upwards, suggests healthy economic conditions, with investors expecting higher returns for longer-term loans. An inverted curve, when long-term rates dip below short-term, has preceded every modern recession, with a notable false positive in 1966-67 when the curve inverted, and no recession followed. Since 1976, there have been six times when the yield curve has inverted for more than 30 days. Each time a recession followed, with the only exception being the 1982 inversion when the economy was already in recession. Currently, the U.S. yield curve has been inverted for a record 635 days as of April 1. Notably, the current inversion is the first one since the Fed changed the way it influences interest rates by switching to an abundant reserve monetary policy after the Great Financial Crisis.

Due to this significant monetary shift, the dependability of this indicator and its correlation with economic activity may have broken down. Nonetheless, several prominent economists, including David Rosenberg, Steve Hanke, and Brian Wesbury, among others, still anticipate a recession later this year. Economic forecasting is challenging, leaving room for unexpected developments, such as military conflict. However, barring some exogenous shock, it's difficult to envision the economy slipping into contraction territory this year. This is supported by a variety of economic indicators showing gradual improvement, and growth has surprised to the upside. Consequently, in the last six months, many economists have abandoned their predictions of an impending recession.

All of this is good news, as is the consumer price index (CPI) declining from its 9.3% peak in July 2022 to 3.2% in February. The continued strength in stocks is even more remarkable given the increasingly hawkish tone from the Fed. Was it premature for Fed Chair Powell to announce three cuts in December? You could make the case. Back then, the market immediately priced in seven rate cuts, which felt like wishful thinking. It wasn't long before Fed officials were trying to walk back the dovish comments. The reality is the Fed still has some work to do to get inflation down to its 2% target. Headwinds to this objective include oil prices that have risen 22% since mid-December, and ongoing shipping disruptions in the Red Sea due to Houthi rebel attacks. Regarding potential rate cuts, last Friday Fed Chair Powell said, "The economy is strong: We see very strong growth. There's no reason to think that the economy is in a recession or is at the edge of one. That means that we don't need to be in a hurry to cut."

Consequently, market expectations of rate cuts have faded, which could introduce some volatility into the market. A 5-10% correction would not be out of the ordinary given the strong advance stocks have experienced. Current market sentiment is off the charts, with the bull share in the Investors Intelligence survey now up to 60.6% compared to the bear camp at 15.2%. Generally, any spread of 40 percentage points or more is considered extreme, and enough to make a contrarian nervous. Of course, the AI craze has many drawing comparisons to the dot.com bubble of the late 1990s. There are similarities, but stock valuations have a way to go before they hit the nosebleed levels of that previous era. During much of period, the S&P 500 forward P/E ratio exceeded 30 or even 40 at times, compared to 20.9 now. There's also the presidential election later this year. It is true that historically, the market has tended to do well during election years, no doubt highly correlated to Washington, D.C. pulling every lever possible to keep the populace happy. By no means is this a foolproof indicator, after all, 2008, when the S&P 500 fell 37%, was an election year.

Investing involves the risk of loss that clients should be prepared to bear. If you have a general administrative question about your account, please contact our customer service at 800-535-4253 option 1. If you would like to set up an investment consultation, please contact our customer service line or send us an email at advisors@wespac.net. We would be happy to schedule a call or Zoom meeting to discuss your portfolio.