# Economic Overview

Steve Scranton, CFA, SVP, Economist

The economy has picked up where it left off at the end of 2023, albeit at a slower pace. Although we will not receive the first official estimate of growth (GDP) until the end of April, current forecasts from economists range between 1.0% to 2.5%. The Atlanta Federal Reserve's real-time forecasting model is projecting 2.3% growth.

In looking at the components of growth in the 1st quarter, the consumer continued to exhibit the willingness to spend, even if it meant borrowing to do so. The Bureau of Economic Analysis (BEA) just released its Personal Income and Personal Spending data, and the consumer's appetite for spending continues. Real personal spending (spending adjusted for inflation) rose 0.4% in February even as real personal spending fell 0.1%. That is a rebound from the 0.2% decline in January, but slower than the December 2023 pace. Most of the spending occurred in the purchase of services versus goods. Real spending on goods rose 0.1% while spending on services rose 0.6%.

Consumers also became more confident in the economy and their personal financial situation. This can be seen in the rise in the Conference Board Consumer Confidence index and the University of Michigan Consumer Sentiment index. Both indices have risen from their lows but are still below historical levels. Examining the details of each report shows that the consumer is more confident about their current situation than their outlook for the next six months. Some of the confidence is likely related to continued solid jobs growth and wage increases. For some it may also be the rise in the value of their 401(k) retirement funds or their investment portfolios. With most global stock markets steadily rising in January and February, the value of those portfolios has risen. This may have given consumers more confidence to spend even if it meant borrowing to do so.

Small business owners are not as optimistic as the consumer. Based on the national survey from the NIFB, small business owner optimism fell in both January and February compared to December. Inflation and a lack of qualified help hurt small businesses in the 1st quarter. Earnings were lower primarily due to increased costs (labor and raw materials) and lower sales.

The 1st quarter saw the continued deadlock in Congress as both parties struggled to find consensus within their parties. Government spending came from stimulus bills that were passed in previous years but are still being distributed. Money from the Inflation Reduction Act, Chips Act and Infrastructure bill are still being distributed for projects.

One of the risks that continued to grow in the 1st quarter is the gap between the "haves" and the "have nots". Rising asset values and income benefited those who own investments and real property. Rising expenses continue to cause financial stress for those who either voluntarily or involuntarily borrowed to fund their spending or pay their bills. This will have to continue to be monitored as the year progresses since dissatisfaction can breed unrest. Throw in the noise of major national elections throughout the world and unrest could grow. Riots and other forms of physical protest do not help an economy grow.

The US economy is on solid footing right now. The key for continued economic growth this year is whether individuals and businesses can stay focused on their jobs and businesses and not get distracted or sidetracked by the noise emanating from the various media channels.

# Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

Global equities continued to rally through the 1st quarter with new record highs set. Expectations for shifts to easing monetary policies from central banks have played a part in the moves higher along with supportive economic data. This has not been without concerns from geopolitical tensions in the Middle East and Red Sea or that markets have possibly run too far.

Equity market gains accelerated within the quarter as new records were not only reached in the US, but also in Japan and Europe. For the US and Europe, inflation was still slowing while labor markets remained strong. The Federal Reserve and European Central Bank continued to signal that rate cuts are coming, although pushing further into at least the second half of the year. The Bank of Japan ignited an equity market rally for the opposite reasons, increased inflation and raising interest rates – which also ended its long-run negative interest rate policy.

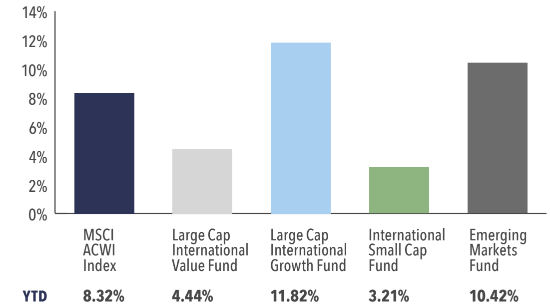
Comparing equity market returns, US equities outperformed international markets over the quarter. Market cap also mattered. Large companies led mid and small sized ones. Still the same story for emerging market equities underperforming developed markets, as Chinese markets posted negative returns, detracting from the overall gain for emerging markets in the quarter. Notably, Japan outpaced the US.

US bonds continued with the ups and downs. Yields rose slightly overall during the quarter as the 1st quarter rate cut priced in heading into the start of the year faded. Longer maturities hurt a little more than shorter dated maturities where intermediate bond prices fell, and short-term bonds gained. The risk rally provided a lift to high yield bonds despite credit spreads at some of the tightest levels in quite some time.

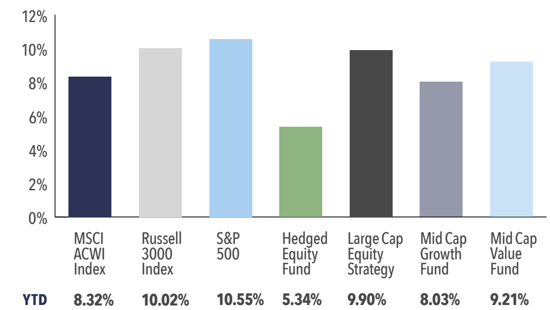
Commodity prices saw prices increase overall with the broad index gaining a little over 2% over the quarter. Headlines have captured the rise in gold prices to record levels over $2,200 per ounce. Oil prices also gained from around $70 per barrel in January to a little over $80 per barrel by quarter end. Offsetting this increase was a decline in natural gas prices. What may not have been noticed by all is cocoa prices nearly tripled during the quarter, driven by changes in weather patterns which have hurt crops, thus reducing supply. Not so sweet for the sweet tooths!

With the end of another strong quarter and spring in the air, investors are feeling pretty good at the moment. Concerns may persist about the economy and monetary policy, but it is unknowable what exactly will happen and when. For that reason, a more balanced approach can help to participate in the market ups while helping to protect some should there be a change.

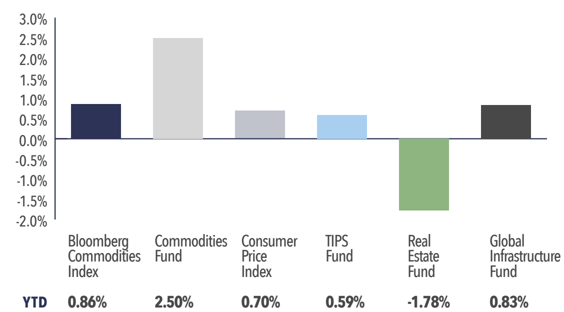
**INTERNATIONAL DIVERSIFICATION**
YEAR-TO-DATE PERFORMANCE



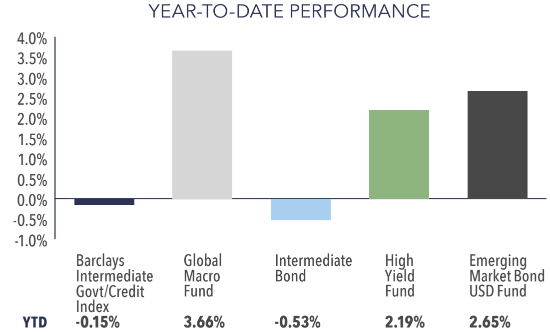

**DOMESTIC DIVERSIFICATION**
YEAR-TO-DATE PERFORMANCE




**REAL RETURN (INFLATION PROTECTION) DIVERSIFICATION**
YEAR-TO-DATE PERFORMANCE




**INCOME DIVERSIFICATION**
YEAR-TO-DATE PERFORMANCE



# Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

Last year's impressive market performance was a tough act to follow. Going into this year, investor sentiment was upbeat. However, the gains achieved in 2023 left the market's valuation elevated relative to historic levels and fueled speculation that a correction might be around the corner. Stocks certainly quashed that notion by putting up a great 1st quarter and keeping the bull market chugging forward. The Dow Jones Industrial Average (Dow) gained 6.1%, the S&P 500 rose 10.5%, the Nasdaq Composite shot up by an impressive 9.3%, and the Russell 2000 tacked on 5.2%. In addition, the S&P 500 reached a new all-time high and delivered its best 1st quarter since 2019.

In 2023, spectacular gains from the Magnificent Seven group of stocks (Apple, Alphabet, Amazon.com, Microsoft, Meta Platforms, NVIDIA, and Tesla) resulted in narrow market performance leadership. During the 1st quarter of 2024, five of these seven continued to deliver strong performance, and contributed a little over 50% of the S&P 500's gains. Performance contribution has broadened out to a moderately wider swath of companies versus last year, but 1st quarter performance for the equal weighted S&P 500 (+7%) continued to lag the cap weighted S&P 500 (+10.5%).

At the sector level, leadership came from communications services, up 15.8%, and information technology, up 12.7%. The laggards were utilities, up 4.6% and real estate, down 1.1%. Notably, real estate was the only sector that delivered negative performance during the quarter. From a style perspective, growth stocks were the leader, up 12.9% compared with value stocks, up 7.6%.

Gains during the quarter were fueled by better-than-expected 4th quarter earnings results and a continued expansion in the market multiple. The price/earnings (P/E) multiple expanded from 19.2x to 20.9x during the quarter. In addition, upbeat investor psychology aided upward momentum. Anticipation remained high that the Federal Reserve (Fed) could start cutting interest rates. During the quarter, expectations about the timing and magnitude of cuts worked their way lower, amidst solid economic data and some sticky inflation reports. However, the market remains hopeful that inflation will continue to moderate, the Fed will begin cutting rates this year, and that the possibility of a recession is now quite low. Besides expectations around earnings growth, these macro topics are focal points for the equities market.

# Fixed Income

Callen Young, VP, Portfolio Manager

After a sharp decline in yields during the 4th quarter of 2023, bond yields rose during the first quarter of 2024 as a reemergence of the "higher-for-longer" theme made a comeback.

It only took a few hotter-than-expected inflation reports to pare market-based rate cut expectations from six 25-basis-point rate cuts to less than three. With headline CPI being reported at 3.4%, 3.1% and 3.2% for December, January, and February, respectively, the bond market found itself sufficiently spooked and significantly over its skis in its exuberance for easier Fed policy in 2024. Treasury yields rose in response and are nearly 50 basis points off their lows set prior to CPI being reported in January. The 2- and 3-year Treasuries had the widest trading range during the quarter, rising 48 basis points each between mid-January and late March.

Elsewhere, the tax-free municipal bond market continued to put on a show during the first quarter. Coming into the new year, muni/treasury ratios looked expensive, with 5-year AA municipals trading at approximately 60% of a similar maturity Treasury. They ended the quarter at a 59% ratio, which is even more impressive when you consider that supply has been running at about 28% greater than the first quarter of 2023. The counter to the higher supply has been an insatiable demand, with many new issue deals being 6-8x oversubscribed. We continue to think that municipal bonds look expensive and remain opportunistic with our purchases.

Despite the end-2023 excitement not yet coming to fruition, there is still reason for optimism as the Fed has displayed a steady willingness to cut rates later this year. At their policy meeting in March, officials affirmed their expectation of three rate cuts in 2024 but forecast a slightly shallower path of rate cuts in the future, including the first increase to the Fed's long-term rate forecast since 2019, from 2.5% to 2.6%. Market-based expectations have come into alignment and now expect three rate cuts this year, with the first to occur in July.

The rate volatility exhibited during the first quarter led to a mixed bag of returns. Longer-term bonds offered the worst performance during the quarter, will losses of nearly 2.50% while shorter-term bonds provided positive returns greater than 1.00% in certain sectors. As we move into the 2nd quarter, we will keep a close eye on economic indicators, particularly inflation. Our long-term outlook continues to be lower rates, with an expectation that the Fed will begin cutting rates later this year.

# International

Matthew Clarke, CIMA®, VP, Senior Client Portfolio Manager

Despite a persistent message from the Federal Reserve (Fed) that rates would likely remain higher for longer, global stocks continued to push higher on a continuation of strength within technology stocks – especially artificial intelligence (AI) – easing inflationary pressures, lessening concerns about the potential of recession in the US, and rising expectations of early summer rate cuts from both the Bank of England (BoE) and the European Central Bank (ECB).

Like last quarter, **developed international outpaced emerging markets.** The MSCI EAFE (developed international), finished the quarter higher by 5.94%, helped along by strength in growth stocks, which returned 7.11%. It's worth noting that despite the gains in the developed international space, several developed international economies weakened further or slightly contracted within the 1st quarter (Germany, UK, Japan, and the Netherlands). On that note, Japan's economy slowed for the second quarter in a row while stocks continued to push higher. In fact, **Japan was one of the best performing international markets** in the developed space. The Japanese Nikkei 225 index returned an impressive 21.43% despite the Bank of Japan's (BoJ) shift to end negative interest rate policy, yield curve control, and purchases of equity exchange traded funds (ETFs) and Real Estate Investment Trusts (REITs). Japan serves as a solid reminder that **the markets are not the economy** as stocks there continue to soar along with corporate profits while wage growth stagnates, and the economy slows.

At the same time, the MSCI emerging markets index added only 2.41%, weighed down by weakness in China largely due to a mixed bag of economic data and not enough economic stimulus. There were, however, significant pockets of strength to be found in the emerging markets space. The three top performers were Peru, Columbia, and Turkey. Taiwan was a notable winner as well, helped along by advances in AI. The Taiwan MSCI total return index gained 12.51%, fueled by significant gains in Taiwan Semiconductor Manufacturing (TSM), which happens to be its largest index weighted holding.

In terms of fixed income, global bonds struggled a little as stronger-than-expected US economic data pushed expectations for a rate cut in March all the way out into June. The Bloomberg Global Aggregate (measure of global investment grade debt) finished the quarter lower by -2.08%. As one might expect, the changes in interest rate expectations negatively impacted longer duration bonds more than shorter duration bonds.

As we look ahead, we are still "cautiously optimistic" about the remainder of the year. If inflationary pressures continue to move in a favorable direction, central banks will be in a better position to gradually lift their foot off the economic brake pedal. Of course, unwanted volatility could be found in a number of places, including unforeseen geopolitical risks as well as central bank policy errors.

*Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.*

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