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March 18, 2024 – Investment Commentary

Equities

The S&P 500 posted its second-straight weekly loss, with tech stocks particularly feeling the heat as inflation concerns lingered ahead of the next Federal Reserve policy meeting. The S&P 500 returned -0.1% as information technology stocks sold off and major options expiry amplified market swings while the tech-heavy Nasdaq fell -0.7% and the Russell 2000 declined by 2.1%.

Equities seemed unconcerned by two sets of inflation data that came in higher than expected and the commensurate rise in bond yields. Value outperformed growth across all market caps. Energy (+3.8%) and materials (+1.6%) were the best-performing sectors in the S&P 500; consumer discretionary (-1.2%) and healthcare (-0.7%) were the laggards.

EAFE markets returned -1.3%, with Japan (-3.7%) leading the way down. The pan-European STOXX Europe 600 Index added 0.31% in local currency terms, notching an eighth consecutive weekly gain. Encouraging corporate earnings and growing hopes that the European Central Bank (ECB) would lower borrowing costs in June stoked the advance. France's CAC 40 Index rose 1.7%, Italy's FTSE MIB gained 1.6%, and Germany's DAX added 0.7%. E.M. markets returned -0.1%, with positive returns in China (+3.2%) offset by India (-2.8%) and Korea (-1.4%).

From a valuation perspective, most markets are within ±1 standard deviation based on historical forward P/E ratios, though the S&P 500 is at +1.7 while the NASDAQ is at 1.2. For the next 12 months, EPS growth for the S&P 500 is expected to be 8.0% (vs. 7.2% annualized over the last 20 years). For the next 12 months, EPS growth for NASDAQ is expected to be 16.3% (vs. 12.7% annualized over the last 20 years). The S&P 500 (US Large Cap) and NASDAQ trade above their 20-year averages based on forward P/E ratios, as does the MSCI EM (E.M. Equities), while the Russell Midcap (US Midcap), Russell 2000 (US Small Cap) and MSCI EAFE (Non-US Developed Market Equities) all trade below.

Fixed Income

Investment-grade fixed-income sectors had negative returns as rates rose across the curve. Municipals returned -0.1%, while US AGG returned -1.2% and U.S. I.G. returned -1.0%. H.Y. bonds returned -0.2%, while bank loans rose 0.3%. E.M. debt returned -0.7% as the U.S. dollar rose 0.7%.

Rates

Rates rose across the curve as investor concerns rose after a raft of data showed inflation rising more than many expected. The recession-watch 3M-10Y spread compressed 21bps and closed the week at -111. The 2Y-10Y spread widened by 2bps and is now -42. Five-year and ten-year breakeven inflation expectations rose and now sit at 2.44% and 2.32% respectively; the 10Y real yield rose 20bps to 1.99%, as questions were raised about whether inflation has cooled enough for the Fed to cut interest rates this June. The market now expects the Fed to cut 3 times in 2024, with the first cut now coming in either June (55% probability) or July (48% probability) vs. the Fed's guidance of three cuts. At year-end 2024, the market expects the Fed Funds rate to be 4.5%.

Rates rose in other developed markets as well. The BTP-Bund spread is at 1.26%. The yield spread between German and Italian benchmark 10-year sovereign bonds narrowed significantly due to growing confidence in Italy's economic policy and increased demand for high-yield debt ahead of a likely reduction in borrowing costs later this year.

A consequence of higher for longer rates due to sticky inflation is that delinquency rates on credit card debt and auto loans are now at the highest levels in over a decade. In addition, U.S. corporate bankruptcy filing rose in 2024, closing out a year with the most filings in the last 13 years. Although many people came into 2024 expecting the Federal Reserve to cut interest rates as early as March, many are now skeptical about June, and companies may still have to contend with relatively high-interest rates and robust wage growth while waiting for Fed cuts.

Currencies/Commodities

The dollar rose 0.7%. The commodities complex rose 2.9% as energy prices increased by 4.0%. Brent prices rose to $85/bbl. U.S. natural gas fell 8.3% to its lowest level in five years, while European gas rose 1.7%.

Market monitors

Volatility fell for equities and bonds (VIX = 14, MOVE = 98); the 10-year average for each is VIX=18, MOVE=75. Market sentiment fell to 24 from 30.