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Q1 Market Review

Follow The Earnings

As I'm sure you're aware, a geopolitical event has - once again - occurred while we were preparing to publish our quarterly review. Iran recently attacked Israel with a barrage of drones and missiles that, fortunately, were intercepted by the Israeli military. As the world braces for Israel's retaliation, our biggest concern as investors is what type of impact these events will have on capital markets. According to historical data provided by Ruchir Sharma, CEO of Rockefeller Capital Management's International Business and columnist for the Financial Times, "The stock market reaction to 25 of the most significant geopolitical crises since World War II - the S&P 500 dropped on average by around 4%, reaching bottom in 15 days, but fully recovering in 33 days." It is important to keep this data in mind as we will likely experience further financial market volatility stemming from ongoing geopolitical concerns and events. It also supports our conviction that staying invested in high-quality, leading companies will generate the best long-term total returns versus trying to time getting into and out of the stock market.

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The stock market carried its momentum from 2023 into the first quarter of 2024. After posting modest gains in January, stocks dipped in February on the news that the Fed would keep rates unchanged for the near-term. But the markets rallied in March as positive economic data – including decelerating inflation, steady unemployment, and modest GDP growth – drove stocks higher. During the Fed's March meeting, Chairman Powell stated that "inflation is not far from where it needs to be for the central bank to start cutting interest rates," and signaled his inclination to cut interest rates three times this year. This news led to a market rally and the S&P 500's best first quarter performance in over 5 years. As we head into the second quarter, we see several factors that will influence the stock market's

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performance including continued economic momentum, the uncertainty surrounding the recent uptick in inflation, the Fed's timing and number of rate cuts, U.S. consumer confidence, the broadening of more industry participation in equity market returns, upcoming corporate quarterly earnings and forward guidance, and if the U.S. stock market has risen too far, too fast.

Economic Momentum

The American economy continues to defy odds. According to the Bureau of Economic Analysis, Gross Domestic Product and personal income increased in all fifty states during the fourth quarter of 2023 with growth in the manufacturing and retail sectors leading the way. Wages have also continued to rise. The Bureau of Labor Statistics reported that average hourly earnings have increased by 4.1% in the past year. At the same time, the U.S. Department of Commerce reported that 300,000 new jobs were added in the month of March while unemployment remained under 4%. "Over 15 million jobs have been created since President Biden took office and we continue to see economic growth in all 50 states and the District of Columbia," said Secretary Gina Raimondo. The unprecedented pace in hiring reflects the economy's ability to withstand the high borrowing costs that resulted from the Fed's interest rate hikes. If the country's consumers continue to spend, employers will be forced to hire more workers to meet steadily growing demand.

Inflation Uncertainty

According to the U.S. Bureau of Labor Statistics, CPI data for March showed that inflation ran hotter than expected. Overall, the index rose 0.4% - higher than analysts had projected – and the 12-month CPI inflation rate increased to 3.5% from 3.2% in February. The annual core CPI inflation rate – an important data point that reflects the relationship between the price of goods and services and the level of consumer income – held steady at 3.8%. The primary contributors to the overall increase in core prices included higher gas, transportation, auto repair, and auto insurance prices. So, what does this mean for investors? The most recent CPI data may cause Chairman Powell and the Fed to rethink its near-term rate cut strategy. The upcoming CPI statistics and other economic data reported over the next several months will likely influence the actions and timing of the Fed's decisions.

Steady Confidence

Consumer confidence remained unchanged throughout the first quarter of 2024. According to the University of Michigan's sentiment survey, consumers feel that inflation will continue to soften and that high prices and pressure on living standards will ease as a result. Per *Figure 1*, the March numbers reflect significantly more optimism from Q1 2023 as Consumer Sentiment (+28.1%), Economic Conditions (+24.4%), and Consumer Expectations (+30.7%) all jumped by more than 24 percent. According to the survey's director, Joanne Hsu, "this stability reflects a perception among consumers that the economy has been holding steady in its current state."

Figure 1

Consumer Sentiment Survey – University of Michigan

Final Results for March 2024

	Mar 2024	Mar 2023	Y-Y Change
Index of Consumer Sentiment	**79.4**	62.0	+28.1%
Current Economic Conditions	**82.5**	66.3	+24.4%
Index of Consumer Expectations	**77.4**	59.2	+30.7%

Source: University of Michigan, Consumer Sentiment Survey-March 2024

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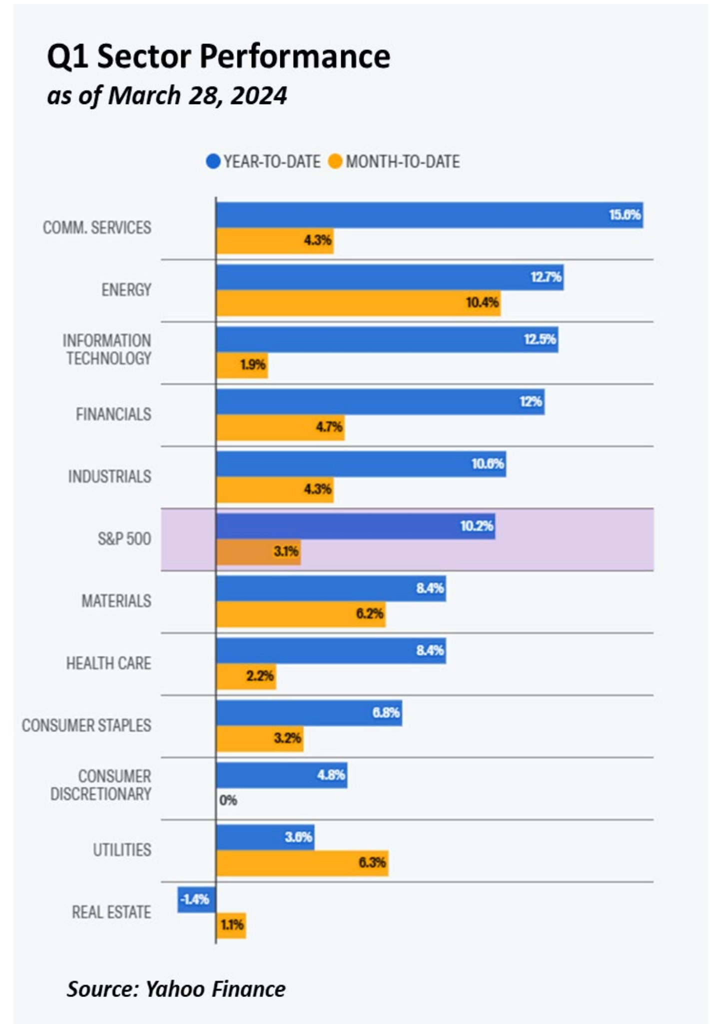
Broadening Participation

Figure 2



Economic sector participation continued to broaden during the Q1 market rally. Per *Figure 2*, top performers as of March 28, 2024 were Communications Services (+15.6%), Energy (+12.7), Information Technology (12.5%), Financials (+12.0), Industrials (+10.6), Materials (+8.4%), and Healthcare (+8.4). "We think the Mag Seven is going to become the Lag Seven," said Piper Sandler's Chief Market Technician, Craig Johnson. This expansion in the market represents something that we haven't seen for many quarters. Several leading Investment Strategists, including Bank of America's Savita Subramanian, think it is just the beginning. In mid-February, Subramanian's research projected that the other 493 companies in the S&P 500 will grow their quarterly earnings faster than the Magnificent Seven starting in the fourth quarter of this year. Several other positive signs surfaced in Q1 that indicate the stock market is becoming less dependent on the Magnificent Seven. According to the Wall Street journal, the S&P 500 equal-weight index is near all-time highs, 106 stocks in the S&P 500 recently hit new 52-week intraday highs (the most since May 2021), and more than 40% of the cyclical stocks in the S&P 500's industrial sector traded at their highest levels over the past year. This broadening out is reflective of a healthier overall stock market, and it is certainly refreshing for investors that are well diversified beyond the "Mag Seven."

Earnings Optimism

Investor optimism is high as we head into earnings season. According to recent S&P 500 earnings estimates published by Forbes (*Figure 3 on the next page*), analysts are predicting growth of 3.5% for the quarter and 10.8% for the year. While topline sales are expected to grow modestly at 3.5% for the quarter and 5.1% for the year. Jonathan Golub, Head of U.S. Equity Strategy for Credit Suisse, believes there is considerable upside to this year's consensus S&P 500 earnings estimates for several reasons:

- Early reporting companies are topping estimates by 13.5%, more than double the historical average.
- Q1 24 revisions have been much stronger than normal, a sign that analysts underestimate earnings power.
- Economic data is accelerating, including 1Q GDP expectations (from 2.2% to 3.0% since January) and ISM (from 47.1 to 50.3 over the past three months).

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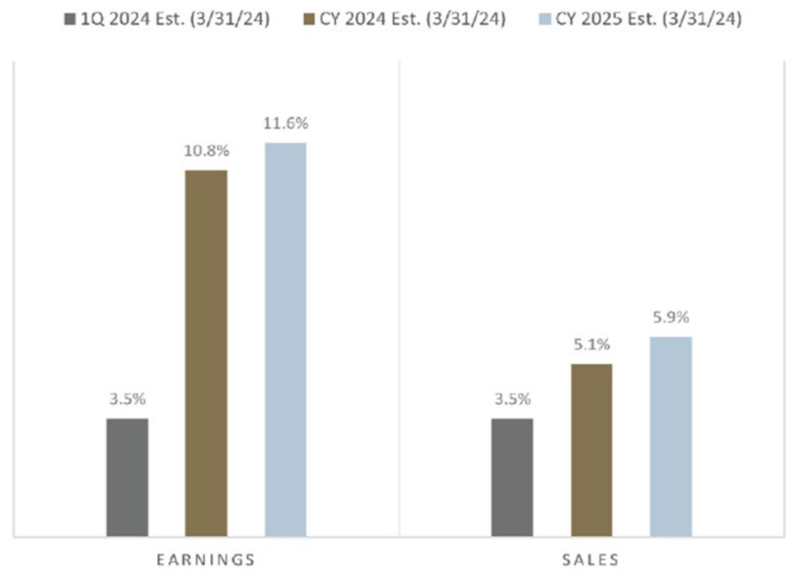
As is true in most earnings seasons, there is the possibility of both positive and negative surprises. Consensus right now, however, seems biased towards positive surprises.

Figure 3

S&P 500 Earnings Estimates



Source: Forbes, FactSet

Too Far, Too Fast

The equity market's anticipation of several Fed interest rate cuts during 2024 was one of the factors that caused the S&P 500 to produce its best first quarter performance in over 5 years. However, it's possible the S&P 500 got ahead of itself and rose too far, too fast as the U.S. economy continued to chug along with no imminent signs of a recession. The resilient economy and recent uptick in domestic inflation have given investors pause as the Fed may decide to make fewer rate cuts and make them later in the year. Regardless of the Fed's decision, it will not be as important a driver of the U.S. stock market as corporate earnings. We would focus on the S&P 500 consensus 12% earnings growth to a record $244 per share this year as we believe it provides a solid underpinning for the stock market to move higher through the rest of 2024. In other words, follow the earnings.

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*GIPS Composite Data and Verification Information Available Upon Request

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