Market commentary notes

Monthly call notes
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Wealth Management

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Key issues last month and this month:

The Fed published their March 1 Monetary Policy Report—The Fed published their comprehensive assessment of policy, monetary and economic conditions in the US. For those of us who care about Fed policy and what it means for the markets (all of us!), it was pretty enlightening.

I think the most important conclusions from the report were:

1. The Fed is committed to a 2% inflation rate target. "The FOMC is strongly committed to returning inflation to its 2 percent objective.... The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent." That means they will be slow to bring down rates.

2. They are going to continue to reduce their balance sheet. That means continued restrictive monetary policy. The impact should be to raise the 10-year rate, currently around 4.25%, by another 25 bp or so this year.

3. They don't see a recession this year or next year. They expect real GDP to grow 1.4% this year and 1.8% next year. By the way, their 2023 estimate was 0.5% below the actual 3.1% rate. I think they are being conservative. They also think consumer spending is generally healthy, though obviously the housing market and car loans are weak.

4. The Fed's favorite inflation gauge, PCE core index, came in at 2.8% for the last 12 months. Another Fed index came in at 3.3%. The upshot is that the inflation picture is improving, but so far not enough to motivate the Fed to reduce rates.

[Board of Governors of the FRS, Monetary Policy Report, 1 Mar. 2024, https://www.federalreserve.gov/publications/files/20240301_mprfullreport.pdf]

Employment — The Fed also noted that employment remains robust although new jobs stats are declining somewhat. In 2022, new jobs averaged 375,000 per month. In the first half of 2023, this dropped to 290,000. In the second half of 2023 it was 239,000. The Fed sees this as a slowdown, though still very healthy. I could interpret it as meaning that we're running out of employable people not currently in the labor force. I say that because the unemployment rate hasn't increased materially despite this slowdown in hiring.

Another indicator that is worth looking at is the layoff rate. The press has made much of this recently, especially where the tech industry and banks are concerned. However, if you look broadly at the economy, in December, there were 1.6 million nonfarm layoffs. In December 2022, it was 1.47 million. Pre-pandemic the numbers ranged from 1.7 to 1.9 million per month. Post-pandemic, it's been as low as 1.3 million and as high as 2.1 million per month. In other words, nothing unusual appears to be happening with layoffs. [https://fred.stlouisfed.org/series/JTSLDL, 2 Mar. 2024]

Inflation — The 12-month core PCE price index (excludes food and energy) was up 2.8% in January. The full index was up 2.4%. That was in line with market expectations, but probably not at a level that would incline the Fed to reduce rates in March. [https://www.bea.gov/data/personal-consumption-expenditures-price-index-excluding-food-and-energy, Mar. 2, 2024]

Earnings — Before 4Q 23 earnings reports began, the expectation was for a flat quarter. Maybe even down a little. Now that financial reports are in, the reality is that earnings YoY were up a stellar 9.8% and revenues were up 3.7%. Earnings were up the most in communications services, consumer discretionary and utilities. They were down in health care, materials and energy. Revenues were down in utilities (also energy and materials) but were up nicely in communications services, technology and financials.

Overall, this was a good start to the year and consistent with my hypothesis that what happened was costs rose for corporations, then they increased prices and margins normalized. Meantime, employment and wages were up so spending (i.e. revenues) were up. Under normal circumstances, revenues translate into earnings of about 3X, and that's pretty close to what we experienced. [https://lipperalpha.refinitiv.com/2024/03/sp-500-earnings-dashboard-23q4-march-1-2024/, Mar. 3, 2024]

February — Continued improvements — Following the uptick in the stock market at the end of 2023, it wouldn't have been a surprise if the markets took a pause at the beginning of this year. They didn't. Why? First, much of the strong 2023 was just a recovery from the weak 2022. Second, the Fed showed signs that maybe it would be reducing rates in 2024 and the markets—stocks and bonds like that, as long as there isn't a recession. Third, is that recession talk has pretty much gone away given the strong economic growth of the last six months, and apparently at the start of 2024 as well. Finally, earnings are up more than expected. This is the situation from the last couple of months, but I think the positive vibe will probably hold in the markets for at least a few more months. I'm optimistic.

In February, U.S. large caps were up 5.3%. Midcaps were up even more at 5.9%, and small caps a bit less at + 3.3%. International indexes were a bit weaker, but still came in positive.

The main bond index, on the other hand, dipped; probably because the market was finally accepting the idea that the Fed may reduce rates this year, but it won't be right away, and it probably won't be by a lot. As I've been saying for a few months. Commodities are up nine-tenths of a percent.

Global stock indexes

Total Index	February %	YTD %	1 yr %	2023 Est PE Trailing/ Projected
S&P 500	5.34	7.11	30.45	23.27/21.76
S&P Mid Cap	5.94	4.13	13.05	18.25/16.49
S&P Small Cap	3.33	-0.75	6.50	26.69/16.44
FTSE All REIT	1.93	-3.03	4.29	
MSCI All Country xU.S.	2.53	1.51	12.51	
MSCI Emerg Mkt	4.76	-0.11	8.73	

Source: Morningstar as of February 29, 2024. Estimated PEs are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 29, 2023. Projected PEs are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	February %	YTD %	1 yr %
Bloom Agg Intermed	-1.19	-1.19	3.69
ICE BofA U.S. Convertibles	1.28	0.06	8.60
S&P GSCI	0.87	5.38	4.99
Bloom U.S. Corp HY	0.29	0.29	11.03

Source: Morningstar as of February 29, 2024.

Sector performance — In February, the best performing sectors were communications discretionary, industrials and materials. That's a big change from 2023, when it always seemed to be IT, communications and consumer discretionary. The bottom three were real estate, consumer staples and utilities. It's interesting to me that materials was at the bottom of the list in terms of earnings growth and utilities were at the top of the list. It shows that, in the short run, performance doesn't always neatly follow fundamentals. [https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, Mar. 3, 2024] [https://digital.fidelity.com/prgw/digital/research/sector, Mar. 3, 2024]

Commodities

Commodity and food price changes, current month and YoY.

Total Index	December %	YoY %
Copper	0.9%	-5.5%
Lumber	2.1%	25.0%
Cotton	12.0%	17.8%
Sugar	-11.7%	3.8%
Coffee	0.0%	4.4%
Wheat	-6.9%	-21.7%
Corn	-7.1%	-35.1%
Oil	10.6%	2.1%
NatGas	-12.1%	-36.7%

Source: https://tradingeconomics.com/commodities, Mar. 3, 2024

Four of these nine major commodities saw prices decline in February. It was six last month. For these nine, the average one-year price change was a decline of 9.3%. Two things jumped out at me when I looked at the price change numbers. First, oil and natural gas moved in opposite directions: Oil prices were up 10.6% for the month and +2.1% over twelve months. Meanwhile natural gas was down 12.1% for the month and down 36.7% over twelve months. That's unusual since they are co-produced for the most part in the U.S. Second, the four food categories—sugar, coffee, corn and wheat—were all flat or negative for the month. Of the four, two were up over 12 months—sugar and coffee were each up about 4%. Meanwhile, grains were down 22% and 35%. That suggests that consumer food and energy pricing are likely to continue to moderate.

Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 29 of the 48 saw price declines in February, compared to 22 in January and 20 in September. Thirty-three saw lower prices than a year ago. That suggests to me that price declines are still happening, which should continue to filter through to the consumer end over time. That's good for our inflation numbers, and arguably less good for emerging markets and production economies.

US Economy

The U.S. economy keeps growing...

GDP Estimates: [https://www.bea.gov/data/gdp/gross-domestic-product, Mar. 3, 2024] [https://www.atlantafed.org/cqer/research/gdpnow, Mar.3, 2024] The economy continues to surprise with positive growth numbers. The second estimate for GDP real growth in the 4th quarter was +3.1% (annualized), which is a very positive reading.

The Atlanta Fed's GDPNow model to estimate 1Q GDP growth is now estimating a 2.1% real growth rate for the current quarter. That's down from 4.2% estimated a month ago. The steep decline is due mainly to new data suggesting weaker consumer spending and weaker private business investment. My guess is that this will rise a little in March. [https://www.atlantafed.org/cqer/research/gdpnow, Mar. 3, 2024] [https://www.census.gov/econ/indicators/advance_report.pdf, Mar. 3, 2024]

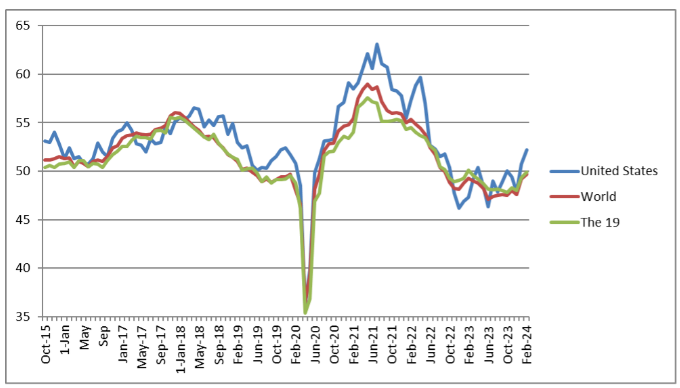
US PMI statistics — The U.S. Manufacturing PMI for February increased significantly to 52.2 from 50.7. A moderately positive number but, more importantly, the best reading we've had since July 2022. The U.S. Services PMI—80% of our economy—is well into positive territory at 51.3, which is down from January's 52.9. [Trading Economics, PMI statistics Mar. 3, 2024.]. [Trading Economics, https://tradingeconomics.com/country-list/services-pmi Mar. 3, 2024].

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. In February, our count of expanding manufacturing economies rose by two to 19 out of 38. That's up from 12 at the end of 2023 and suggests an acceleration of global economies. China stayed in the modest growth category at 50.9 and the EU was stable at 46.5, mostly because Germany dipped a little while the rest of EU expanded. EU's Services PMI rose some more to 50, with Germany up to 48.2. Overall, our weighted world manufacturing index rose a little more to 49.7, while the index for the 19 major economies rose to 49.9. [https://tradingeconomics.com/country-list/services-pmi, Mar. 3, 2024].

Here's our updated graph of Manufacturing PMI's:



Source: Author's calculations based on published PMI statistics, as of Mar. 3, 2024.

Table summary

Region	Manu PMI	Last Month	12 mo. Ago
U.S.	52.2	50.7	47.3
19 majors	49.9	49.3	50.1
38 world	49.7	49.2	49.3
EU	46.5	46.6	48.5
China	50.9	50.8	51.6

Source: Author's calculations based on published PMI statistics, Mar. 3, 2024

Investment strategy

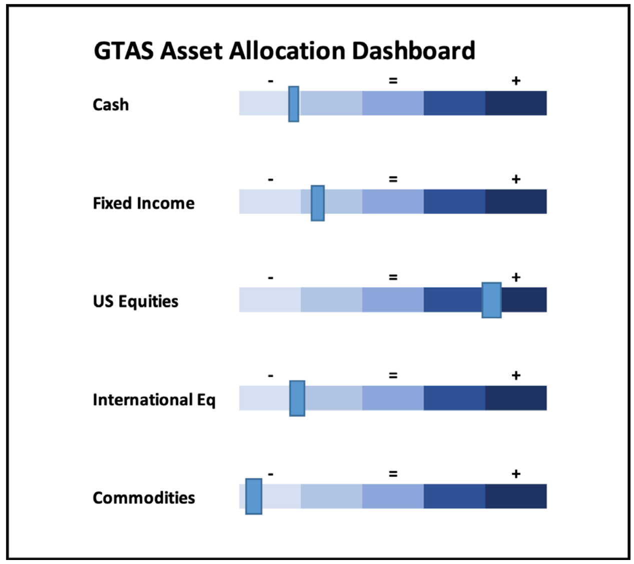
Stocks have appreciated nicely so far in 2024. Nonetheless, I think there's a little more upside in U.S. stocks, assuming no major negative political events around the world. The election is too far away to be much of a factor for a few more months. Maybe after July/August.

Internationally, I think Europe is slowly, haltingly coming out of its doldrums. In the first half of 2023, international developed stock indexes did as well or a little better than U.S. indexes. That advantage dissipated after October, however.

Where fixed income is concerned, my sense is that short term rates will come down slower and later than many seem to hope. That means that intermediate rates may sell off a little more. I'd expect 10-year treasuries to lose another 2% in principal, meaning a total return of about +1-2% of the year. Lower quality credits may do a little better as I don't see a recession on the horizon.

I'm a little surprised by the uptick in oil prices. I don't believe it can be sustained, especially with spring and summer around the corner.

GTAS Allocation Chart



(+/=/-) represents our group's views over a 6 to 18 month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed — Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY — Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT — FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles — ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade, and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. — MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt — MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

S&P 500 — S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI — S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap — S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap — S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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