Wealth Advisory Market Update

February 7, 2024

Market Update

Equities:

The S&P 500 started the year with a 1.6% increase. However, volatility surged towards the end of January following remarks by Federal Reserve Chairman Jerome Powell. The Federal Open Market Committee (FOMC) indicated in its January meeting that rate cuts were further off than market expectations, dispelling hopes for a March rate cut and shifting expectations for the first cut to later in the summer. The market's trajectory in 2024 resembles that of 2023, with a handful of stocks driving gains while market breadth diminishes.

Market leadership has become increasingly concentrated in 2024. Up to January 19th, the S&P gained $588 billion in market cap, with seven stocks contributing $463 billion of that sum. Concerns have been raised by JPMorgan's quants department regarding the heightened concentration, with the top ten stocks now accounting for 29.3% of the overall market, nearing the historical peak of 33.2% during the Dot Com bubble.

We remain committed to our disciplined approach as equity markets trade at premium valuations. For instance, the equity risk premium has reached its lowest level since the dot-com bubble. On February 2nd, the market experienced its poorest breadth since 1987, with 40% of S&P 500 companies declining despite a 1.2% rise in the index. With valuations at historical highs amid economic fragility, we maintain a defensive stance, focusing on companies with resilient cash flows, inelastic demand, and strong balance sheets.

Economic Indicators and Monetary Policy:

The US economy relies heavily on consumer spending, constituting over 70% of GDP. Recent credit card data indicates a rapid deterioration in consumer finances, with nearly 50% of cardholders carrying debt month-to-month, and 56 million cardholders in debt for over a year. This trend mirrors levels observed during the Great Recession from 2007 to 2009. Large companies, such as UPS, have announced significant layoffs, exacerbating economic headwinds.

The highly anticipated FOMC meeting at the end of the month disappointed market expectations for a March rate cut, with Powell indicating uncertainty about future rate reductions. Core inflation remains above the Fed's 2% target, and while labor market dynamics are improving, they remain tight.

Several catalysts pose risks to market stability, including the conclusion of the Bank Term Funding Program in March and potential liquidity stress in the banking system as the Federal Reserve reduces its balance sheet. Our outlook for the March FOMC meeting anticipates discussions on balance sheet runoff rather than rate cuts.

Despite market optimism for a soft landing, we maintain a cautious stance, anticipating an economic slowdown. Continued deficit spending by the Federal government and potential inflation resurgence poses further risks. The consumer's financial strain, particularly in revolving credit, suggests an impending crack in consumer resilience. As the underlying economy weakens, we prioritize defensive positioning.

Strategy:

As the likelihood of a recession increases, we emphasize defensive strategies. Historical data suggests that companies with substantial market capitalization, pricing power, and demand inelasticity perform better during economic downturns. In the fixed-income space, we remain focused on high-quality credits that offer appropriate risk compensation. While we extended our duration last year, we are now duration-neutral relative to the market due to the uncertainties surrounding growth and inflation.

As we navigate this challenging environment, we appreciate your support and the opportunity to collaborate in achieving your financial goals.

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