amb wealth

Wealth Advisory Market Update

April 5, 2024

Equities:

The market, measured by the S&P 500, rose 3.1% in March. This marks the fifth straight positive month for all three major indexes. The first quarter return of 10.2% was the best start to the year since 2019. Interest rates, macroeconomic data, and inflation data continue to be at odds with the market. The futures market is now pricing in only three rate cuts for 2024, down from six coming into the year. We have not seen a market repricing as of yet. The equity markets, though, are not the economy. Meaning returns can deviate from the underlying fundamentals on both the upside and the downside. In our opinion, the equity markets remain detached from economic realities.

Multiple expansion continues to be the main driver of equity performance, meaning earnings growth is not driving equity markets higher. The S&P 500 is trading above its five-year and ten-year forward earnings average, at 21.17x. The market is expensive when comparing 99% of metrics to historical norms, although energy and utility stocks are trading below their respective averages. In light of this, as well as our view of a weakening economy, we have increased our exposure to utilities and continue to remain overweight in energy due to the supply/demand dynamic.

Earnings season for the fourth quarter saw about 75% of companies beat expectations. It is important to note that much of Wall Street's estimates have been lowered beforehand. Even with these reduced forecasts, the percentage of companies exceeding earnings and revenue estimates are below their five-year averages.
Our main focus is always on forward guidance and it was disappointing to say the least. As of the beginning of the month, of the 101 companies that issued guidance for the first quarter, 71 came in lower than expectations. Of the 263 that gave full year guidance nearly half came in below Street forecasts.

Market concentration continues to be a major risk for equity markets. The percentage weight of the top ten stocks is at levels not seen since 1929. Weak economic data, increased geopolitical risk, as well as an inflation picture that appears to be embedded in the economy, cause us to believe that a more defensive approach is warranted when it comes to the equity picture. In this market environment, companies with a robust balance sheet, inelastic demand, pricing power, and significant market share are particularly well-suited.

Geopolitical risks continue to be heightened as the fighting continues in both the Middle East and Ukraine. As a result, the price of oil has risen to six-month highs and the price of gasoline continues to rise causing more financial stress for an already beaten down consumer. The recent attack on the Iranian consulate in Syria, as well as attacks on Russian oil refineries have only driven the price of oil higher. Couple this with sticky inflation readings and the Fed is going to have to reassess the expected June rate cut.

Economic Indicators and Monetary Policy:

Economic data over the last six weeks has been converging. The personal savings rate decreased from 4.1% to 3.6%, furthering our thought of a weakening consumer. This is well below the average for the past decade, and represents a headwind for the consumer. Spending over the past few years has been fueled by government stimulus and cannot be sustained. Consumers have also begun tapping into their retirement plans to help their debt spending. Vanguard Group has seen 3.6% of workers participating in employer-sponsored 401k plans make hardship withdrawals. This is well above the pre-pandemic average of 2% and the highest level since

Vanguard began tracking this data in 2004. This is not a sign of a healthy consumer, as inflation has caused severe financial hardship for many Americans.

The Federal Open Market Committee (FOMC) met in the month of March. Coming into the year, a rate hike was priced in for the meeting. Inflation and Jobs data reset the entire Futures curve however. The Fed released their Summary of Economic Projections (SEP) which was last released in December. These projections showed the members do expect three rate cuts for 2024 but were hawkish in that 2025 and 2026 had fewer rate cuts than previously thought in December. Overall, the dot plot was hawkish in our opinion.

The FOMC GDP forecast was raised to 2.1%, up noticeably from forecasts of 1.4% in December. Core Personal Consumption Expenditures (PCE) is forecasted to be at 2.6% at the end of 2024 when it was previously expected to be 2.4%. We have to keep in mind these are just projections and the Fed is wrong more than it is right.

While the release of the Fed's Summary of Economic Projections (SEP) was initially hawkish, it was the press conference in which Fed Chairman Jerome Powell's comments were viewed as dovish, sending the markets higher. When asked about the past few months of hotter-than-expected inflation data, Powell dismissed it as the result of seasonal adjustments, even though the data is already seasonally adjusted. The Chairman said this has not changed the overall story and that it is a bumpy road to get to their 2% target. He also discussed the current economic data, which he seemed pleased with. He said that the economy is performing well, the Fed has made good progress on inflation, and the risk of achieving inflation goals has moved into better balance. Another area we have been watching closely is the Fed's balance sheet. Powell said that they have discussed slowing the pace of the runoff but have not made any changes yet.

A reduction in the amount of quantitative tightening is what we expect as a precursor to a rate cut. We have mentioned this multiple times over the last year. A way for the Fed to ease financial conditions without resorting to rate cuts is to slow the runoff of its balance sheet. Unfortunately for the Fed, financial conditions are easier now than when they started their rate hike cycle. This happens when you run stealth QE through a bank bailout facility while the Federal government runs trillion-dollar deficits. We are also keeping our eye on the repo markets. A 2019 redux would not be out of the question and would be an ominous sign for markets.

Strategy:

In our opinion, the current economic landscape indicates that the chances of a soft landing are low. Given this perspective, we emphasize the importance of adopting a defensive strategy. Historical evidence signals that companies that have significant market capitalization, pricing leverage, and stable demand tend to weather economic downturns better. In the fixed income sector, our preference remains for high quality credits and Mortgage-Backed Securities (MBS) due to their appealing spreads and favorable risk-return balance. As rates have risen back to November highs, we are once again extending the duration of our portfolios without taking on undue credit risk.

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

Matthew J. Roach, CFA®
Chief Investment Strategist

Mike Servetas
Assistant Portfolio Manager