1Q 2024
Market Commentary

The markets in the first quarter of 2024 continued the strong upward momentum of 2023 but with a broadening of the overall stock market gains beyond technology and media stocks that so dominated last year. This good news is reflected in the nearly equal total returns, roughly 9%, for the NASDAQ and the Russell 1000 Value benchmarks. The S&P 500 exceeded both of these, gaining 10.6% for the quarter. It seems that the *Magnificent Seven* has become the *Fab Four* as total returns for Tesla (-29%), Apple (-11%), and Alphabet (+8%) in the quarter fell short of the overall market gains. Yet the "king" of Artificial Intelligence (A.I.), Nvidia, led the Fab Four charge with another magnificent gain of 83%!

At the same time, the good news on the A.I. front has created such enormous optimism that valuations seem to reflect much if not most of the good news regarding future earnings growth. Whether or not earnings disappointments might result in 2024, some of these stocks may soon run out of new passive buyers.

Overall statistics suggest the economy remains stronger than expected and the risk of recession remains elusive. The Federal Reserve Board lowered the market's expectations of the number of cuts likely to occur in 2024 from six to two or maybe three (statements by Chairman Powell and other Board members). The failure of recent price inflation readings to confirm evidence that the Fed's 2% target will be reached this year has provided Powell with confidence that the Fed Funds Rate should be held flat in the 5.25-5.50% range for longer. This is consistent with our skepticism about the Fed's dovish pivot expressed in the client newsletter of a couple of months ago, *That Dove Won't Fly!* It appears likely to us that downward pressure on price/earnings ratios could persist for most of 2024.

In line with this perspective, our view remains that stagflation (subpar economic growth combined with stubbornly high price inflation) is the most likely economic environment we will experience this year. Consumer spending momentum appears to be waning, but massive government spending supports the investment side of the economy. Consistent with this backdrop, Treasury yields rose 30 basis points or more for most maturities from 1-year all the way out to 30-year Treasury bonds, producing negative returns for intermediate to long-maturity bonds during the quarter. The relative strength of energy, financial, and industrial stocks appear to be benefiting from this outlook.

At the same time, the world is a mess! U.S. and NATO defense spending will need to be boosted to successfully counter current and growing threats from existing conflicts from Ukraine to the Middle East as well as to deter an increasingly aggressive China. Commercial real estate markets remain in turmoil. The U.S. is unlikely to go back to working five days a week in the office any time soon, but what is still missing from the picture is the full downward mark-to-market adjustments in real estate valuations at commercial banks and pension funds. The U.S. struggles with its illegal immigration crisis and the disruptions to normal life in border states and beyond, including the costs

of supporting such a population surge. Reshoring production back to the U.S., primarily from China, adds costs and price inflation pressures, it does not diminish them. Add to this the massive growth in the federal deficit with debt issuance that has nearly doubled since the beginning of the COVID pandemic, and we have a potential recipe for pandemonium.

With all of this uncertainty, perhaps it is not so surprising that the stock and bond markets appear to be looking past the upcoming 2024 presidential election. The race for President appears deadlocked. Neither candidate is popular, with FiveThirtyEight polling highlighting a 55% disapproval rating for President Biden and 53% for former President Trump. National polls on popular voting also appear to be a tossup at 43% and 44%, respectively. If Biden wins, expect a continued rise in the burden of federal regulations. If Trump wins, tariff wars could damage world trade flows. Yet the real impacts are just as likely to result from the likely flip in the House to Democrat control and the Senate to Republican control. This means divided government in Congress may continue regardless of whether Biden or Trump is reelected. The greatest impact on the economy, therefore, would come from a massive tax and tax rate increase in 2026 as the 2017 Trump tax cuts expire and tax rates move higher and tax brackets lower to return to 2016 levels. President Biden has clearly indicated he would let them expire and that he would increase the corporate tax rate if he can get the Congressional votes for this (not likely for the latter). A reelected Trump would want to extend his 2017 tax cuts but most likely would be unable to get the votes in Congress to do so. A split-party Congress makes it difficult to either party's presidential candidate from pursuing that party's legislative agenda.

We remain cautious about the outlook for financial markets and continue to believe there is both more downside protection and upside opportunity in implementing a thoughtful value-based approach to investing.

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