First Quarter Market Update

April 2024

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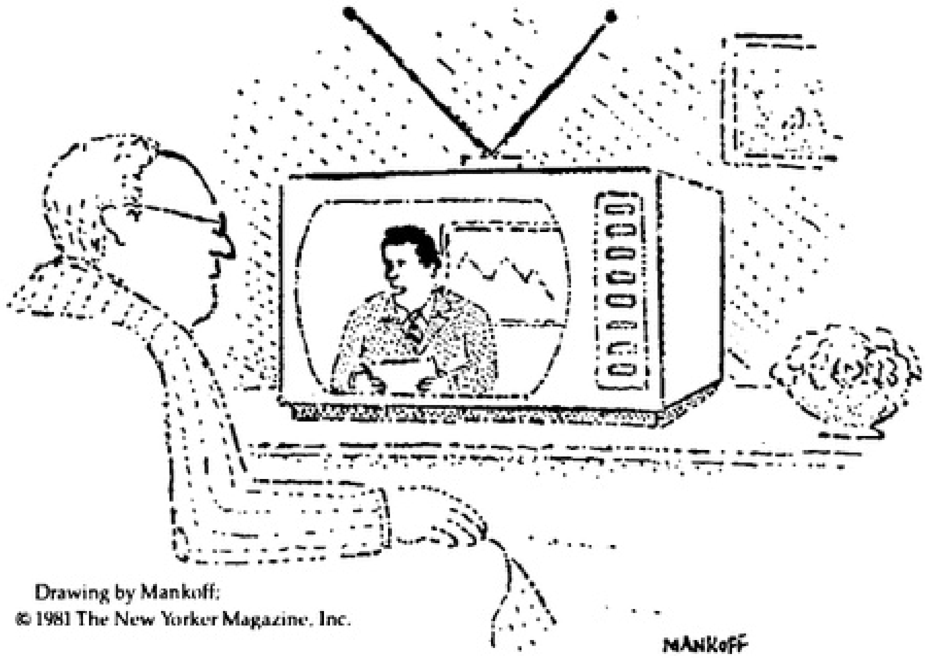


"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

There is much debate in the financial press about the timing of rate cuts at the Federal Reserve. Will they cut in June, July, or September? Will we get two cuts this year? Or will it be three?

PWM had the pleasure of recently attending a dinner, at the Commerce Club in downtown Atlanta, featuring Howard Marks, co-founder of Oaktree Capital Management. Mr. Marks is an endless source of investment wisdom, and to paraphrase his thinking on the matter, "what difference does it make"? If it's June, if it's July, or if it's September, what will you do differently? At PWM, we agree that the path for short-term interest rates is likely lower, and consider this in strategic asset allocations, but think about investing over the longer-term. We also seek to tune out financial press that over-analyzes short-term gyrations in markets, often to head-spinning effect.

Q1’24 Market Performance, Key Drivers, & Go-Forward Outlook

2024 has been off to a strong start with US stocks up 10.1% through the end of the first quarter. The United States has continued to lead the pack, with International Developed and Emerging Markets trailing behind, albeit still in positive territory, up 5.0% and 2.3%, respectively. The US Aggregate Bond Index was down 0.8%.

Figure 1. Market Performance, Total Return

	Q1'24
Equities	
US Total Market[1]	10.1%
International Developed[2]	5.0%
Emerging Markets[3]	2.3%
Fixed Income	
US Aggregate[4]	-0.8%

1. S&P Total Market Index, 2. FTSE Developed ex US Index, 3. FTSE Emerging Index, 4. Bloomberg US Aggregate

So what happened? Forecasts for the US economy improved in the quarter, and the S&P 500 saw its earnings multiple (i.e., its price relative to earnings) expand, a sign of increased optimism among investors. Earnings estimates also moved higher. Concentration among the S&P 500 remains elevated, with the top 10 stocks making up over 1/3 of the index, which we believe, from a risk management perspective, underscores the importance of selectivity and active management. International stocks lagged, with Hong Kong and China as the top detractors from performance.

Inflation continued to surprise to the upside, and expectations for the timing of rate cuts have been pushed back, which was a drag on fixed income returns, partially offset by income and tighter credit spreads (i.e., the additional yield to compensate for holding riskier bonds).

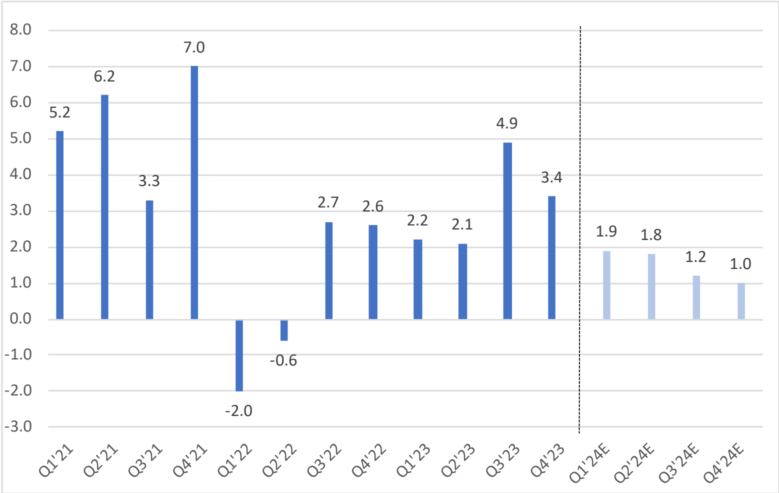
Going forward, while our economic forecasts have improved, we continue to monitor a number of risks and maintain defensive ‘tilts’ in portfolios. We view unloved parts of the market favorably, including Small and Mid Cap stocks, as well as Value stocks. These parts of the market are more cyclical, and thus, benefit from stronger economic growth, in addition to having more attractive valuations.

US Economic Trends

The economy has continued to defy predictions of recession and has surprised to the upside. Most recently, the Bureau of Labor Statistics reported that the US economy added 303k jobs in March, well above consensus expectations of 200k. The job market, and as a result, consumer spending, have been bright spots for the US economy.

After a series of upside economic surprises, investors are increasingly calling for a 'soft-landing', whereby the Fed is able to rein in inflation without creating a recession. See **Figure 2.** According to Bloomberg, consensus expectations call for continued economic growth throughout 2024, at a moderating pace.

Figure 2. Real GDP, Quarter-Over-Quarter, SAAR (%)



Source: Bureau of Economic Analysis, Bloomberg

While our economic outlook has similarly improved, a number of risks persist. First and foremost, inflation has been running higher than expected. To the extent that inflation remains too hot, the Fed may be forced to keep interest rates, which are already in restrictive territory, 'higher-for-longer'. That said, our base-case is that inflation continues to trend lower, albeit on a somewhat bumpy path, following down real-time measures of shelter and transportation.

Additionally, COVID-era household excess savings are continuing to be drained, geopolitical risks remain, and while we think that investors generally spend too much time thinking about politics, the presidential election in November may impact psychology, and thus, introduce volatility to markets. While asset allocations differ based on our clients' goals and risk/reward profiles, our portfolios generally continue to carry minor 'tilts' in defensive parts of the market.

US Stocks

In Q1’24, US Stocks generated a return of ~10%. The largest stocks continued to lead the charge, outperforming the smallest stocks by ~2x. The dominance of larger stocks, and growth stocks, has been a decade-plus trend. See **Figure 3** for year-to-date returns and 10-year annualized returns, by size and style.

Figure 3. Returns and Valuations by Style

10-year annualized

	Value	Blend	Growth
Large	9.1%	13.0%	16.1%
Mid	8.7%	10.1%	11.5%
Small	7.0%	7.8%	8.1%

YTD

	Value	Blend	Growth
Large	9.0%	10.6%	11.4%
Mid	8.2%	8.6%	9.5%
Small	2.9%	5.2%	7.6%

Since market peak (February 2020)

	Value	Blend	Growth
Large	42.8%	65.8%	82.2%
Mid	42.1%	45.5%	44.3%
Small	38.3%	32.7%	23.8%

Since market low (March 2020)

	Value	Blend	Growth
Large	130.9%	150.4%	165.8%
Mid	151.2%	143.7%	124.4%
Small	143.2%	123.6%	101.2%

Current P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	16.1 / 13.7	21.0 / 15.6	27.8 / 18.9
Mid	16.0 / 14.5	18.2 / 16.4	27.8 / 20.6
Small	17.3 / 16.7	23.6 / 21.3	37.0 / 27.1

Current P/E as % of 20-year avg. PE

	Value	Blend	Growth
Large	117.4%	134.2%	146.9%
Mid	110.3%	111.4%	135.1%
Small	103.4%	110.5%	136.6%

Source: J.P. Morgan Guide to Markets

Enthusiasm for stocks continued to grow in the quarter, despite a reset in expectations regarding the timing of interest rate cuts, in part due to greater confidence the economy is headed for a ‘soft landing.” Excitement around AI also continued, but there was a greater dispersion among ‘Magnificent 7’ stocks. The gap between the best performer and worst performer within the Magnificent 7 was an enormous 112 percentage points in the quarter.

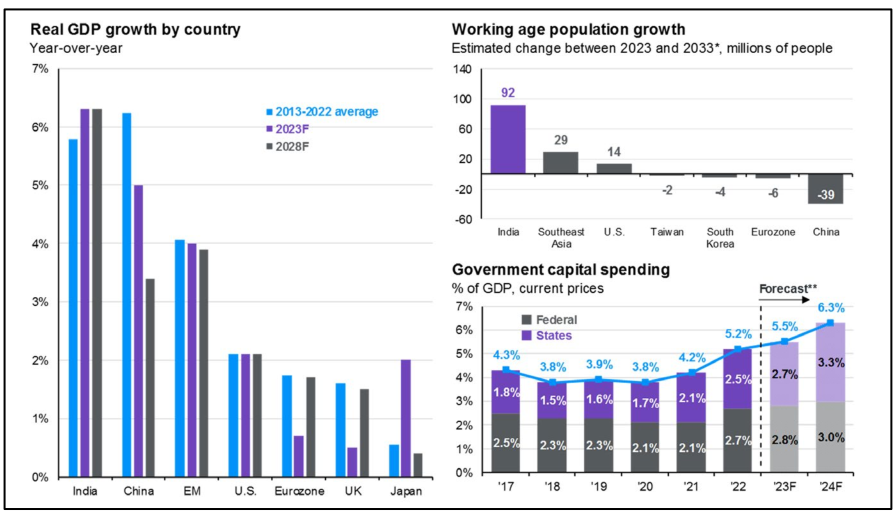
As economist Herbert Stein once stated, “If something can’t go on forever, it will stop.” We think the outperformance of mega-cap tech stocks, and more broadly, Large Cap Growth stocks, simply can’t continue forever. Should economic growth beat expectations, we think unloved segments of the market, including Small and Mid Cap stocks, as well as Value stocks, are positioned favorably, given their greater cyclicality, and more attractive valuations. At the same time, we caution that Small cap indices carry a greater number of unprofitable and highly levered companies, and believe investors benefit from being more selective and placing a greater emphasis on quality.

International Stocks

In Q1'24, International Developed Markets and Emerging Markets generated returns of 5.0% and 2.3%, respectively. International markets are far from a monolith, and there continues to be stand-out performers to the upside and the downside. Top contributors included Japan, Taiwan, and the Netherlands, while top detractors included Hong Kong, China, and Brazil.

In Japan, after a multi-decade period of fighting deflation and economic stagnation, the Bank of Japan raised short-term rates in March. This is the first time short-term rates in Japan have been positive since 2016. This was also the first time short-term rates have been raised since 2007. Actions from the Bank of Japan can be viewed as a signal that economic growth is back on track, which may set-up positively for Japanese stocks going forward. Other countries, including India and Mexico, are benefitting from 'friend-shoring', as companies seek to diversify their supply chains. India is expected to be one of the fastest growing economies going forward, supported by one of the fastest growing working age populations, favorable government reforms, and increased infrastructure spending. See **Figure 4**.

Figure 4. India vs. Select Countries/Regions: Real GDP, Population & Govt Spending



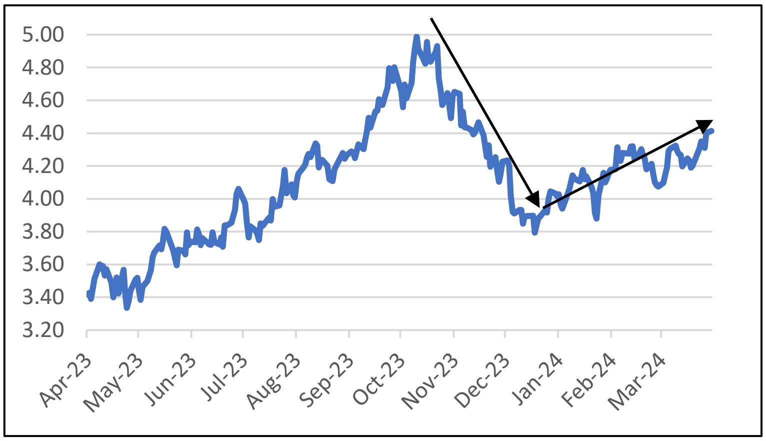
Source: J.P. Morgan Guide to Markets, (Left) International Monetary Fund, World Economic Outlook, (Top Right) Oxford Economics, (Bottom Right) Ministry of Finance, India

From a risk perspective, we continue to believe that owning international stocks is an important part of a well-diversified portfolio, and opportunities exist for better performance going forward, particularly if international growth and domestic growth begin to converge. We also think that a more normalized interest rate environment should be beneficial to Europe, where banking is a particularly important sector. Importantly, International Developed and Emerging Markets also continue to be cheaper than the United States on an absolute basis, and relative to each markets' own history.

Fixed Income

The US 10-Year Treasury Yield declined precipitously last fall, driven in part by hopes that the Fed would soon 'pivot' to rate cuts. Recall that when yields decline, bond prices go up, and vice versa. As a result, with yields declining, the end of last year saw a meaningful bond rally. Q1'24 saw yields retrace somewhat, as investors again adjusted their expectations due to stronger-than-expected economic data and hotter inflation prints. See **Figure 5.**

Figure 5. US 10-Year Treasury Yield



Source: Bloomberg

The US Aggregate Bond Index in Q1'24 produced a total return of -0.8%, impacted by higher rates, partially offset by income generated and tighter credit spreads (i.e., the additional yield offered to hold riskier bonds), reflecting stronger economic growth prospects.

We continue to be more excited about fixed income than in years past. With yields having increased meaningfully from 'near-zero' levels, fixed income once again offers opportunities for income and diversification. As a reminder, fixed income can act as a ballast in portfolios, since high-quality bonds typically appreciate in a recession, while stocks sell off. While the path may be bumpy, we believe that inflation will continue to trend lower, such that the Fed can cut short-term rates, which should have a positive impact on the bond market more broadly. Last quarter, in our Q4'23 Market Update, we noted the market was calling for six rate cuts, while the Fed was calling for three rate cuts, which we thought set-up for disappointment. Fed messaging and market expectations are now much more well-aligned. At a higher-level, we think the Fed will continue to be data dependent. A stronger economy will lead to more delayed, and fewer, rate cuts. Conversely, a weaker economy will lead to quicker, and more, rate cuts. We think this sets up positively, particularly for well-balanced portfolios with exposure to both equities and fixed income. It's also the essence of diversification.

As always, we continue to monitor financial markets and invest on your behalf, with a long-term orientation, consistent with the PWM investment philosophy. We continue to emphasize financial planning, and take a holistic approach to helping you manage your wealth. We consider it a privilege to help our clients reach their financial goals.

Thank you for your continued trust, and as always, we remain available to address any questions or concerns.

Sincerely,

Power Wealth Management