APRIL 2024

MARKET UPDATE

Equity markets continued their upward trend in March, with the S&P 500 up 3.22% for the month and 10.55% so far this year, reaching several new all-time highs along the way, including after the March FOMC meeting where Federal Reserve officials decided to leave rates unchanged once again. Most of the other major asset styles had the same positive experience, with the Russell Midcap up 4.34%, and the Russell 2000 up 3.58%. International markets fared well, with the MSCI EAFE and MSCI Emerging Markets both up in March, gaining 3.29% and 2.48%, respectively.

In the March FOMC meeting, Federal Reserve officials voted unanimously to leave rates unchanged for the fifth meeting in a row while maintaining their outlook for three rate cuts later this year. Following the recent uptick in headline inflation, officials signaled that there may be fewer cuts than what was expected next year. As a result, yields on US government bonds did not change much with only single-digit basis point changes, mainly in the belly of the curve, leading to some positive performance from the bond market overall for the month, with the US Aggregate up 0.92%. The Federal Reserve's next meeting is in early May, leaving the Fed with six more meetings this year to implement the 75 basis points of rate cuts expected, where the market is anticipating June to likely be the first.

The latest economic data supports the higher-for-longer narrative with February CPI increasing just a tad from 3.1% last month to 3.2%, where it was expected to come in at 3.1%. Nonfarm payrolls came in above expectation at 275K, though a slowdown from the prior month, which was revised noticeably downwards. Meanwhile, retail sales were positive in February, but came in under expectation at 0.6%, though considerable better than January's revised 1.1% slowdown.

ADVISORS' PERSPECTIVE

The S&P 500 closed out the first quarter on a new high, posting its strongest first-quarter performance (+10.6%) since 2019. Over the last 25 years, the S&P 500 has averaged 1.2% in the first quarter. When the market is down in the first quarter, annual returns are 0.9%, on average, over the last 24 years. When first-quarter returns are positive, annual returns are 12.6%, on average, over the same period. When first-quarter returns are greater than 5%, annual returns average 21.7% over the last 24 years. First-quarter returns have been greater than 10% only three times in the last 24 years, with annual returns averaging 26.6% those years.

The Federal Reserve's continued indication of three anticipated interest rate cuts this year has further buoyed investor confidence in the second half of March. The S&P 500 has repeatedly hit record highs this year thanks to strong corporate earnings and the expected rate cuts. As of the end of March, markets are expecting rate cuts to begin following the June policy meeting, pending confirmation from upcoming data releases. The risk that markets are pricing into credit markets remains low and has steadily fallen since last summer. Both short-term implied volatility and realized volatility in the S&P 500 remain low.

Consumer spending rebounds as personal consumption expenditures inflation cools. The Fed's preferred inflation measure, the core personal consumption expenditures (PCE) price index, increased by 0.3% in February, signaling a slowdown after a robust January. Consumer spending surpassed expectations and services spending experienced its most significant increase since July 2021, led by international travel and transportation. While overall income growth moderated, wages and salaries rose by 0.8%, the most significant increase since the start of last year. The savings rate dropped to its lowest level since December 2022, indicating that some people may be using their savings to maintain spending levels.

The Federal Reserve Bank of New York created a new measure of wage growth known as “trend wage inflation” that attempts to recover the persistent “core” component of wage inflation. Wage growth may have peaked in early 2022 and has relatively stagnated since July of 2023. However, wage trends and growth are still higher than pre-COVID levels and, according to the model, it cannot be ruled out that wage growth will persist in the short term. On top of the recent reacceleration in nonfarm payrolls, CPI, and PPI inflation, wage inflation at 5% is not in accordance with the Fed’s 2% target and may lead them to keeping rates higher for longer.

Leading economic indicators across the globe versus those at home have been flipping in leadership lately. Evaluating the pace of change in the respective indices can help color which economic environment may be more favorable for companies operating there. The latest data shows that the pace of change across the globe is accelerating a bit faster than in the US, returning to a similar situation that happened across most of the second half of last year.

We remain cautiously optimistic and continue to use a quantitative investing approach. In times of uncertainty, it is more important than ever to follow the data and not make decisions based on emotions. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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