MARCH 2024

MARKET UPDATE

Equity markets resumed their strong uptrend in February, with the S&P 500 returning 5.34% and bringing its year-to-date and 1-year total returns to 7.11% and 31.05%, respectively. This time the rally was fairly uniform across US markets, with the Russell Midcap gaining 5.58% and the Russell 2000 gaining 5.65%. A blockbuster earnings report from NVIDIA helped continue the momentum in the latter parts of the month and pushed the Bloomberg Magnificent 7 Index to a 14.11% year-to-date return through February. Internationally developed markets lagged the rest of the world, with the MSCI EAFE gaining 1.83% for the month while the MSCI Emerging Markets gained 4.76%

As the Federal Reserve approaches their March meeting, expectations continued to shift on the timing and potential magnitude of rate cuts this year. Where there appeared to be some level of conviction in a multitude of rate cuts has shifted to where the market is expecting the first rate cut to happen following the Fed's mid-June meeting, and two additional cuts throughout the rest of the year. The market will be particularly focus on the language the Federal Reserve uses over the next few months, along with the continued focus on inflation, jobs, and wage data that has been the case for some time.

The latest economic data showed a slightly different picture for the consumer than what has been happening over the past several months. Retail sales and personal spending both showed substantial slowdowns in January compared to December, though inflation was more stubborn than many economists surveyed by Bloomberg had expected. As with last month, expectations continued to change around the Federal Reserve's policy path for the year and will likely continue to be a major topic among investors through at least the first half of the year. Focus will turn to the Fed's statement coming out of their next policy meeting on March 20th.

ADVISORS' PERSPECTIVE

The second half of the fourth quarter's earnings season was dramatically better than the first half, with earnings up 7.75% across the S&P 500, with most companies reporting as of the end of February. The results were over 7% better than estimates compiled by Bloomberg. While NVIDIA deservedly got the most press, earnings were notably up in other sectors as well with Consumer Discretionary growing over 28% and Communications up nearly 49%. While they should be taken with a grain of salt, year-end analyst EPS targets imply a 5.5% earnings growth rate over the course of this year.

Overnight reverse repurchases, known as reverse repos, enable large financial institutions to earn interest by briefly swapping extra cash on hand for high-quality securities on the central bank's balance sheet. In recent years, the Fed program has been heavily used, surpassing $2.5 trillion at one point, but has steadily shrunk to near $500 billion. When banks have excess reserves, reverse repo balances increase and vice versa. If the repurchases continue to fall, there could be less support for T-bills, duration, credit markets, and more stress in money markets.

On March 20th, eyes will turn to the comments coming out of the next FOMC meeting. Rates will likely be unchanged, but Powell's statements following the meeting will be critical in further shaping market expectations. The most recent CPI inflation reports have helped fuel and support these changing expectations (as well as Federal Reserve Governor's speeches and talks). The most recent report showed slowing and stalling improvement in the inflation picture and began side chatter of a possibility the Fed may have to tighten further before finally getting core inflation back under the 2% target.

The National Bureau of Economic Research (The NBER) evaluates key components such as Real Personal Income, Nonfarm Payrolls, Retail Sales etc… when assessing if we are in a recession or not. For January, headline nonfarm payrolls increased by 353K, higher than the consensus estimate of 185K and an increase from the upwardly revised December figure of 333K, adding pressure on the Fed. Incomes were strong, but spending was weak in January. Real personal income increased 0.3% while consumption fell 0.1%, compared to an upwardly revised 0.6% for December. Retail sales for January were expected to fall 0.2%, but actually fell 0.8%, the biggest drop in almost a year. This is following December's holiday gain of 0.6%, which was revised down to 0.4%.

Monetary policy expectations continue to shift, particularly on the back of a worse-than-expected inflation report and significant job gains. The delicate balance the economy finds itself in will likely reignite debate on how successful the Federal Reserve may be in bringing inflation finally below its target rate without doing damage to the jobs market as well as overall economic growth. As with last month, cautious optimism in a potential soft landing may still be the predominant story, though the next inflation report and jobs report will be important ahead of the Federal Reserve's next meeting on March 20th.

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.