KRILOGY

WEEKLY MARKET RECAP | February 5, 2024

Week in Review

Equity Markets:

Market strength has continued and the S&P 500 finished the week up 1.41%, marking its 13th positive week out of the last 14. Large Cap growth led the way, ending the week up 1.99%, outpacing its Value peer which returned 0.54%[1]. The outperformance was in large part due to the positive earnings surprises from companies in the Technology and Communications Sectors, most notably Meta, which ended the week up over 20% following strong quarterly results and the announcement of its first dividend distribution.

Last week saw a slew of S&P 500 companies report quarterly earnings and the earnings picture improved as some of the largest companies in the index reported better-than-expected results. So far, 46% of S&P 500 companies have reported earnings; 72% have exceeded earnings expectations and 65% have beaten revenue estimates[2]. The earnings beat rate is slightly below the 5-year average of 77% and the 10-year average of 74%[2]. The blended earnings growth rate, which combines results already reported with estimates, sits at 1.6%, a significant improvement from the expected 1.8% decline in earnings from January 19[2].

Fixed Income Markets:

Policymakers kept the Fed Fund's Rate unchanged last week. The markets expected a more dovish tone following the meeting, but Chairman Powell did not appease market participants and all but ruled out a March rate cut. The futures market has now priced in only a 21% probability of a rate cut at the next meeting[3]. The reversal is significant considering a month ago the probability was as high as 62%[3].

Following the announcement, the bond market experienced an increase in volatility through the end of the week. The yield on the 10-year Treasury saw a low of 3.81% on Wednesday and a high of 4.05% on Thursday. The 10-year yield closed the week at 4.02%.

Economic:

The labor market reports came in mixed last week. The ADP Private Payroll Report showed that the private sector only added 107,000 workers in January, well below the 150,000 Dow Jones estimate. The leisure and hospitality sector posted the largest job growth with 28,000. Friday's Non-Farm Payrolls Report told a different story. The Department of Labor reported that 353,000 were created in January, well above the 185,000 that was expected by economists. The housing market showed continued signs of cooling. The S&P CoreLogic Case-Shiller Home Price Index fell 0.2% in November of last year. The index data does have a significant lag, but it is still a welcomed sign from a part of the economy that has been a large contributor to inflation.

Looking Ahead

Equity Markets:

The market has rallied over the past week after it struggled to get started early in January. The S&P 500 is up 4.06%, again being led by narrow breadth at the Mega-Cap level. The leadership is not only in returns but also in earnings. For the current quarter's earnings outlook, it is expected that significant growth will be driven by a handful of the S&P 500 companies while the other S&P 500 companies are expected to see earnings decline by 10.5%[4].

This narrow leadership is a cautionary sign in our view. The fundamentals are weakening in the majority of the index and the market multiple remains elevated, at 20.3x forward four-quarter earnings[5]. Quarterly earnings expectations have continued to be revised downward, and weakness keeps being pushed further out on the calendar. Q1 2024 earnings growth expectations sit at 5.8%, a decrease from 7.2% at the beginning of the quarter[5]. We believe broad diversification is proven in the current environment. The narrow leadership can lead investors to increase risk in their portfolios due to the deviation in portfolio returns and the market. There is a scenario in which the current narrow leadership could buoy the market until a broader recovery, but in our opinion, excess risk and/or concentration is not appropriate. As long-term investors, we acknowledge periods of underperformance are going to occur; while also recognizing market trends can shift very quickly. Exposure to the market leaders is necessary, but we believe attractive risk-adjusted returns can be achieved by systematic rebalancing into underappreciated areas of the market that are trading at more reasonable valuations.

Fixed Income Market

Our outlook on the fixed-income market has not changed following the policy meeting last week. We thought the market was too optimistic with a March rate cut being priced in. We see the 10-year yield being range-bound over the near term, likely in the 3.75-4.25% level.

We see this range being held until the Fed ultimately decides to lower rates, which we believe will be in the latter half of the year. If we see cuts sooner, it likely means we are seeing more severe economic weakness and will likely accompany equity market weakness. Fixed-income investors currently have the opportunity for attractive real rates of return and attractive levels to see the benefits of negative correlation to the equity markets if weakness does occur.

Economic:

This week's economic calendar will be light so corporate earnings will likely take the majority of headlines. The ISM Services PMI will be released on Monday. The Federal Reserve will release its consumer credit report on Wednesday and to close the week out, the weekly unemployment claims report on Thursday.

**** *See Important Disclosures on the following page*

Sources:

1)JP Morgan Asset Management
https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/wmr/weekly_market_recap.pdf

2) FactSet Research Systems Inc.
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_020224.pdf

3)CME Group
https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

4) FactSet Research Systems Inc.
https://insight.factset.com/are-the-magnificent-7-the-top-contributors-to-earnings-for-the-sp-500-for-q4

5) LSEG I/B/E/S
https://lipperalpha.refinitiv.com/wp-content/uploads/2024/02/TRPR_82221_733.pdf

Important Disclosures: