Week in Review

Equity Markets:

The S&P 500 finally breached the 5,000-point level and finished its 14th positive week out of the last 15. The S&P 500 finished the week up 1.4%. Performance broadened but the Large Cap Growth still came out ahead. The Russell 1000 Growth finished the week up 2.58% relative to their Value peer up a modest 0.14%[1]. The year-to-date spread continues to widen and growth has a 7.69% average. Small-cap companies picked up steam last week, the Russell 2000 finished up 2.44% but remains down 0.76% for the year[1].

Earnings results have continued to improve. So far, 67% of S&P 500 companies have reported earnings. 75% have beaten earnings expectations and 65% have surprised on revenue numbers[2]. The percentage of companies beating earnings expectations is below the 5-year average of 77% but following a string of positive results is better than the 10-year average of 74%[2]. The blended earnings growth rate, which takes actual results and the forecasts for companies that have yet to report, for the quarter has improved to 2.9%[2].

Fixed Income Markets:

The 10-year Treasury Yield climbed 14 basis points last week, closing at 4.17%. The recent labor market strength has put upward pressure on rates and the market has lowered its expectation for rate cuts in 2024. The Fed Fund's Futures market is currently pricing in five rate cuts for the year, a reduction from the 7 potential cuts priced in at the beginning of the year[3]. The market has also significantly reduced the odds of a cut at the Fed's next meeting in March. The futures market is pricing in an 84% probability that policymakers hold rates where they are which is a drastic change from the 19% probability a month ago[3].

The yield curve saw little movement last week as the broader market sold off. The current 2's/10's spread sits at -0.31%, a 0.02% increase from the previous week's close of -0.33%.

Economic:

The ISM Services PMI rose to 53.4, up from the 50.5 reading in December and ahead of economists' forecast of 52. A reading above 50 indicates growth in the sector. The New York Federal Reserve released its household debt report last week. Household debt rose to a record of $17.5 Trillion. The increase was led by a $50B increase in credit card balances. The report also showed a surge in delinquencies. Credit card delinquencies rose 59% in 2023[4]. Another report last week showed the labor market remains on solid footing. Unemployment claims saw a slight drop from the prior week, with 218,000 initial claims. Continuing claims also decreased by 23,000 to 1.871 million.

Looking Ahead

Equity Markets:

Last week we saw a broadening of the market with small-caps picking up steam. We believe this will need to continue; along with continued earnings surprises to see a sustainable rally. We believe the market is pricing a very positive future outcome at current valuations. The forward four-quarter P/E current sits at 20.6x[5]. Although, not extreme, the current valuation coupled with excessive sentiment, and low VIX could lead to a pick-up in volatility and equity market drawdowns in the near term. Investors should be aware of their current risk exposures given the concentration in returns so far this year. We believe revisiting strategic allocation targets during market highs is just as important as revisiting during market lows. Diversification can be psychologically challenging in environments like we are currently in, but concentration in specific sectors, market capitalization, and/or names could lead to overexposure to risks if the markets experience weakness.

As long-term investors, we believe portfolio construction begins with a thoughtfully developed strategic asset allocation that aligns with your risk tolerance. A proper asset allocation can help alleviate the stress during market drawdowns, and most importantly, it helps investors by not making short-term decisions that could negatively impact the potential for achieving their desired multi-year compounded returns.

Fixed Income Market

The recent labor market reports have put pressure on yields and we believe brought market expectations back to reality. Comments from policymakers have remained consistent and have not indicated cutting rates anytime soon is a possibility. The current policy rate has had little effect on the labor market which can be seen in the recent reports, and economic growth, while slowing, remains positive.

We see the fixed income market staying range bound, in the 3.75%-4.5%, through the end of the year. A large move outside of this range would likely be due to drastic measures taken by the Fed, such as quick cuts due to economic weakness or the unlikely scenario, in our opinion, of another hike due to an unexpected surge in inflation. We still have a positive long-term outlook for fixed-income investors at current yield levels. Investors can obtain suitable income return and have the dual benefit of potential negative correlation if equity market weakness occurs.

Economic:

Following a slow week on the economic calendar, the market interest will increase this week. We will get another round of inflation reports. Starting on Tuesday, the CPI will be released and to close the week will be the PPI. Other relevant reports include Thursday's retail sales, business inventories, and the NAHB's Housing Market Index. The University of Michigan will release February's preliminary Consumer Sentiment Index on Friday as well.

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

Sources:

1)JP Morgan Asset Management
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4) CNBC
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