Making Sense of Finance

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First Quarter 2024 Review

STOCK MARKET

Stocks in the U.S. in the first quarter continued where they left off at the end of 2023 with all the major indexes reporting gains. The S&P 500 index hit all-time highs 22 times during the last three months and ended the last quarter at an all-time high with a quarterly increase of over 10%. The tech heavy Nasdaq Composite realized a slightly smaller gain, yet significant, of over 9%. However, the Dow Jones Industrial Average lagged but still posted a positive return of nearly 6%. Equity market returns are broadening as compared to most of 2023. Over the past five months, the equal weighted S&P 500 index's (also hitting a record high) gain mirrored the traditional S&P 500 (market capitalization weighted) index gain and even surpassed it for the month of March. The midcap S&P 400 index also hit a record high last quarter. The first quarter of 2024 was the second consecutive quarter of double-digit percentage increases for the S&P 500. This was only the ninth time since 1940 this has happened. All the previous eight times were followed by positive total returns over the next twelve months with a median gain of 13%. The S&P 500 price/earnings (P/E) ratio for the next twelve months' earnings is now approximately 21. Compared to the average P/E ratio since 1995 of 17 this may seem high. However, relative to bond yields at some other times when the P/E was hovering around 21, stocks look more attractive. Although the forecast of six Fed Fund rate cuts for 2024 coming into this year has now dropped to about three rate cuts, the consensus is we are still at peak interest rates for this business cycle which is lending support to the stock market. This notion coupled with expected increases in the S&P 500 earnings of 12% for this year may be enough to keep this rally going - not to say that there won't be some market pullbacks.

Stock sector rotation was evidenced by the fact that the best performing sector in the fourth quarter of 2023, REIT (real estate investment trust), was the only sector that showed a loss in the first quarter of 2024. The reality of a postponement of rate cuts resulted in a pullback of this highly interest rate sensitive group. On the flip side, the negative sentiment in energy stocks in the fourth quarter of 2023 reverted to a positive outlook in the first quarter of this year. Energy stocks, second best

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Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

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performing sector last quarter, got their boost from a 16% jump in oil prices. Communication services stocks were the top performing category with a gain of 15%. Technology stocks, as they have done for the past year, also outperformed the overall market in the first quarter, rising 12%. Utilities, although posting a slight gain, were amongst the laggards for a similar reason that REITs were out of favor – a delay in the highly anticipated cut in the Fed Fund rate. The spread between the worst performing sector and the best performing sector narrowed as market breadth broadened.

Foreign stock markets lagged the US when measured in US dollar terms. The MSCI EAFE Index of developed country stock markets increased 5% last quarter. Gains in the first quarter were global, as 34 of the 36 developed markets tracked by MSCI had positive returns. The strength in the US dollar in the first quarter constrained the gains somewhat when translated into US dollars. The Japanese market stood out as the Nikkei 225 index posted double digit gains and finally surpassed its all-time high set in 1989! European markets did well in the last quarter on a local currency basis. Emerging Markets did not fare as well as developed markets, in particular China was a drag on performance amongst this group.

BOND MARKET

Bonds did not continue their end of year rally, as the stock market did, into the first quarter of 2024. The Bloomberg Barclays US Aggregate Bond Index declined almost 1% last quarter. As mentioned previously, the hope of Fed Fund rate cuts diminished as the quarter went on due to stickier than expected inflation. With reported inflation above the Federal Reserve target of 2%, and continuing strength in the economy as witnessed by a resilient labor market, the Fed does not want to rush into cutting the target rate at this time. At their most recent meeting in March, the Fed left the target rate at 5.25-5.50%. Yields were higher (bond prices lower) across most of the curve, and there is still an inverted yield curve (shorter term bonds have a higher yield than longer term bonds). While often an indication of a pending recession, the 2-10 Year Treasury has had an inverted yield curve for quite some time now. It has been inverted for longer than any time since 1978.

Short-term bonds fared better than longer term bonds last quarter although short term bonds still posted losses. Only the lower quality, high yield bonds, had positive returns in the first quarter as the spread between high quality and lower quality bonds tightened to historically low levels due to better-than-expected default rates.

OUTLOOK

While most financial pundits suggested that rate cuts would come sooner than later, we remained realistic and were proven correct. Very few things increase or decrease in a straight line, as the inflation rate has shown us year to date. The Fed has now suggested that interest rates will not get cut without continued declines in inflation. As we mentioned in previous newsletters, the 2% target inflation rate by 2025 seems a bit optimistic. The general market commentary has it wrong; backwards even, in our opinion. We should not be eager for a weaker economy that would prompt a rate cut. Should the U.S. economy continue to expand at a healthy rate, current interest rates might be healthier for all, in our view. The expectation of "free money" (historically low interest rates), can lead to a lot of excess and bubbles in many markets.

A one-year Treasury bill now yields about 5% and actually an investor can now expect a real return after inflation. We are now a big proponent of short-term treasuries which provide a rare combination of a real return and safety. REITs continue to make us nervous, particularly in the commercial space, namely Hotels and Office, although demand in the Residential sector remains strong. We should mention that gold has been a big winner the past year, up 20% in the last 12 months, likely due to inflationary fears and due to the Ukraine/ Russian and Israel/ Palestinian conflict and has matched the S&P 500's performance the past 5 years. Over long periods of time, stocks, in general, have greatly outperformed gold. Finally, we must remind ourselves that our investment process is more bottoms up, versus top down. Predicting short-term economic swings remains difficult for anyone and our portfolios tend to be based on long-term goals, rather than year-to-year assumptions.