Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management

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by John Mullen and Ruth Mullen

With a strong March finish, the S&P 500 notched its 11th best start to a year since 1950. While there are indications of elevated investor expectations (always a warning sign) as the calendar turns to the seasonally weaker second quarter, history tells us to not fear the market just because it is higher. In past years that began like this one, the tendency has been for positive returns through the rest of the year, with generally modest corrections along the way. Might market leadership repeat the 2022/2023 pattern of flip-flopping changes between value and growth stocks? While growth stocks beat value for the full three months, value more than doubled growth in March. Further, on an equal weighted basis, the Technology sector (the undisputed leader for months) lagged Materials, Energy, Industrials and Financials in the quarter. While international stocks broadly trailed U.S. stocks, one standout was Japan where a continuation of their bull market finally allowed the Nikkei to hit a new high for the first time in 34 years! On the other end of the spectrum, investments in China continued to erode investors' returns as the market there was down over -2%. Domestically, small and midcap stocks had respectable showings in the quarter but still trailed their larger peers. In the more speculative corners of the market, whether it be fundamental, technical, liquidity or safe haven driven, Bitcoin roared higher, hitting its own all-time high in early March.

Data as of March 31, 2024	March 24	Qtr. 1 24	YTD 24
S&P 500	3.22%	10.56%	10.56%
MSCI AC World Index (incl. US)	3.19%	8.32%	8.32%
MSCI EAFE (Europe, Asia, Far East)	3.40%	5.93%	5.93%
MSCI EM (Emerging Markets)	2.52%	2.44%	2.44%
Russell 1000	3.21%	10.30%	10.30%
Russell 1000 Growth	1.76%	11.42%	11.42%
Russell 1000 Value	5.00%	8.98%	8.98%
Russell Midcap	4.34%	8.60%	8.60%
Russell 2000	3.58%	5.18%	5.18%
Bitcoin	16.46%	68.49%	68.49%

Data provided by Tamarac Inc.

Fixed Income Markets

Bond returns enjoyed a reprieve in the final month of the quarter, but the U.S. Aggregate Index still posted a negative -0.78% return for the quarter. Drilling down, short maturities led with the Bloomberg U.S. Credit 1-5 Years returning +0.51% while the longest-dated bonds lagged as shown by the negative return from the Bloomberg U.S. Credit Long Bond Index of -1.65%. Interestingly, the leader/laggard relationship flipped in March with the Long Index +1.91% and the 1-5 Year Index +0.65%. Continued strength from the U.S. economy has kept fears of defaults low, allowing the ICE Bank of America High Yield Index to again shine with a quarterly return of 1.49%. Perhaps due to increased supply, U.S. Treasury Indices (outside of 1-3 year) had negative returns across the board.

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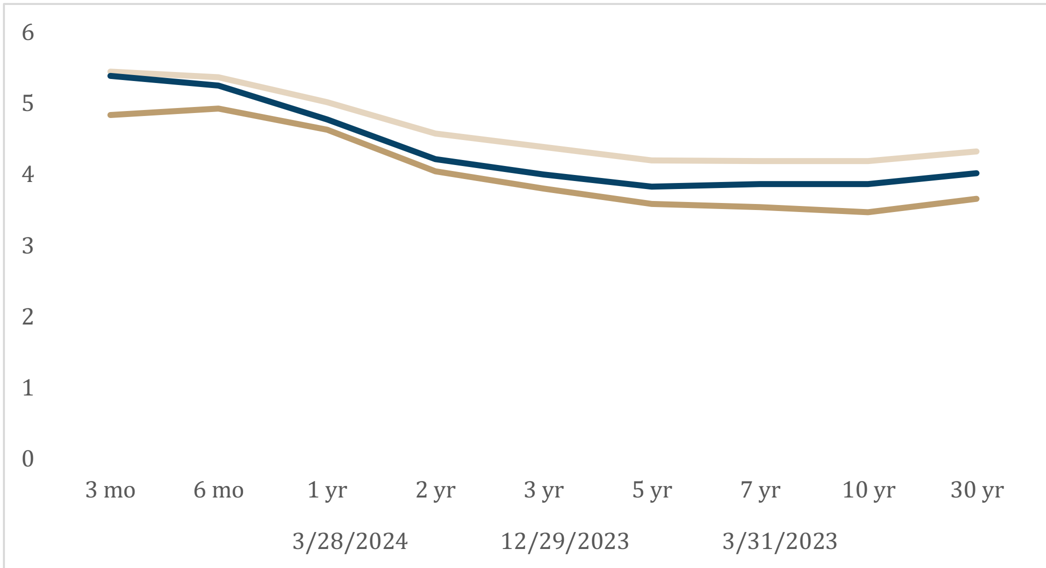
US Treasury Yields

Sticky inflation makes cutting rates harder…

Rates drifted higher during the quarter in each observed timeframe in the below graph. At the start of the year, investors largely believed that inflation was a worry of the past and that the dovish comments from Chairman Powell in December would ultimately result in more cuts (six) than the Fed's dot plot projected (three). As the quarter played out, signs of inflation began to perk up and the job market remained hot, resulting in investors aligning with the Fed's outlook and pushing up interest rates across the board. With the Treasury likely to continue to finance much of the federal budget deficit by issuing bonds in the short end of the curve, thus increasing supply and potentially pushing rates higher there, longer yields may not rise as much over the next few quarters due to a better supply/demand balance.

Rates higher across the curve…



Data from U.S. Treasury

Commodities

Commodity prices up, cocoa through the stratosphere…

Commodities revved higher in the quarter, with price gains seen in most major areas. Oil's 16% advance was doubled by gasoline futures, indicating prices at the pump will be headed higher going into the summer driving season.

Copper (+3%), silver (+4%) and gold (+8%) saw more muted gains but much of the price appreciation came in the final weeks of the quarter.

The true standout in the quarter was cocoa with an Nvidia-like run of +128%.

Commodity	Qtr. 1 24	Year to Date 24
CRB (broad index)	11.49%	11.49%
Oil	16.08%	16.08%
Gold	8.04%	8.04%

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Economic Overview

The domestic economy continued to power ahead in the first quarter thanks, in large part, to a resilient job market. Confidence in their job prospects and future wage gains have consumers spending, even in the face of stubbornly high borrowing costs and inflation rates. While there have been pockets of weakness during the current economic expansion (housing, manufacturing, autos, etc.) none have been enough to derail the economy.

Job market keeps U.S. economy rolling…

It has been said repeatedly that the U.S. is unlikely to fall into a recession while the employment picture remains strong, and one must look hard to find any cracks as the first quarter ends.

- Initial weekly jobless claims sat at 210,000 to end March, largely in line with where they've been since late 2021
- March payrolls expanded by 303,000 while the unemployment rate fell 10 basis points to 3.8%
    - Of note, the workweek expanded, Average Hourly Earnings rose 4.1% year-on-year and the participation rate expanded to 62.7%
- Weak(ish) signs were seen in a lower Quits Rate and lower job openings (although this is consistent with a goal of the Fed's soft landing quest: lower openings without a rise in unemployment)

Pockets of weakness, not enough to derail the expansion…

To be sure, there have been areas of weakness where higher interest rates or exogenous shocks have clearly had an impact. Widespread strikes in the auto sector impacting production, high mortgage rates crimping housing activity and weak end-demand (especially internationally) restraining manufacturing activity have hit various parts of the economy, denting but not derailing the expansion. Until the consumer is seriously imperiled, the domestic economy is likely to continue to grow.

Federal government stepping on the fiscal gas…

Outside of the robust job market, a stimulative Federal government is also supporting the economy. The current Federal deficit would be historically more aligned with an unemployment rate of roughly 7%, compared to the current 3.8%. With a tax cut package slowly working through Congress, a resumption of payouts tied to the Employee Retention tax credit and targeted student debt relief, the domestic economic outlook is bright through the rest of the year.

Tale of two economic paths…

For the rest of the world, the economic picture since the Covid pandemic has been much less robust. While governments across the globe worked to stimulate their economies to get through the worst of the Covid lockdowns, few acted as aggressively as the U.S. With growth abroad less resilient in recent years, many foreign economies are now considering monetary easing. For example, an improving inflation outlook allowed the Swiss National Bank to recently cut its official rate, and the ECB is increasingly indicating that their own inflation picture may allow for rate cuts in the near future.

Finally, in China, targeted support looks to be reviving that country's manufacturing sector, with the Caixin Manufacturing PMI coming in at a better-than-expected 51.1 in March. Consumers remain constrained due to a problematic property market.

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Investment Implications

Change in macro facts not enough to disrupt the markets advance…

The impressive gains in equity markets witnessed last year carried over to the first quarter of 2024 as investors continue to bet on the Fed engineering a soft landing for the economy. A key part of that outlook was that ebbing inflation would allow the Fed to cut rates up to six times throughout the year. A slew of hotter-than-expected inflation readings late in the first quarter, regardless of which preferred gauge one used, threw cold water on the aggressive rate cut outlook. Notably, the dramatic shift in the investing outlook barely registered as a blip for market performance as evidenced by the particularly strong start to the year as discussed at the beginning of *Perspectives*. If anything, the market ended the quarter looking much healthier than when it began the year.

Leadership broadening out, still skewed to the larger names…

A common criticism of the current bull run has been that leadership has been overly concentrated in the largest names. By the end of March, however, 85% of stocks in the S&P500 traded above their 200-day moving average - the best reading in three years and a solid indication of performance broadening out (at least among the large companies that comprise the S&P 500). More sectors participated: Energy, Financials, Industrials, Technology and Communication Services all outperformed the index for the quarter. To be sure it still paid to hew large, as the S&P500 easily beat the Russell Midcap and 2000 indices, but a broadening participation profile is a welcome change.

History tells us that a strong first quarter typically leads to better-than-average returns throughout the remainder of the year. Coupled with that, presidential election years tend to be good ones for stocks as well (though there is notable relative weakness in the second quarter of these years). Beyond historical trends, there remain multiple pillars of support for the stock market.

Earnings starting to perk up…

The 10-year Treasury ended March at 4.2%, well below the 5% number which helped to trigger an equity sell-off last year. Market earnings, after advancing only 1% in 2023, are perking up with a gain of 7.5% in the fourth quarter of last year and expectations for a 5% advance in the first quarter once all companies report. At the same time, the Federal government looks to be doing all it can to stimulate the economy going into the election, again typical for a presidential election year and supportive for the market.

While the near-term outlook for stocks remains positive, clouds are gathering on the horizon. The foundation for the primary world order in which investors have operated for 40 years is showing some cracks. Beginning in the early 1980s, investors could largely count on tame inflation, falling interest rates, increasing globalization and (relative) geopolitical stability - all of which aided in margin expansion and higher price-to-earnings multiples.

A shifting macro outlook…

In 2024 de-globalization and a re/friend-shoring of supply chains is taking effect. While this is likely to help certain economies and provide some insulation to supply chain disruptions, it is also likely to bias inflation higher in the long run. The peace dividend enjoyed since the fall of the Berlin Wall also seems to have run its course as major geopolitical conflicts are leading nations to ramp up defense spending. Aging demographics (in both developed and emerging countries) will strain safety nets and the available labor pool. Rising costs from all of these issues increasingly strains federal budgets and widens deficits.

Adding to these macroeconomic forces, stock valuations aren't cheap. Rising earnings will help modulate this, but if interest rates do continue to rise, that will be a headwind. All of these factors lead us not to pronounce doom and gloom, but rather to expect something less than double digit returns in the next few years, again primarily due to the resilience of the U.S. economy. The good news is that a balanced portfolio can once again include bonds as a contributor to returns, allowing investors to lower their risk profiles and rely on income as a meaningful part of their total return.

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