LINSCOMB Wealth

QUARTER 1 | 2024

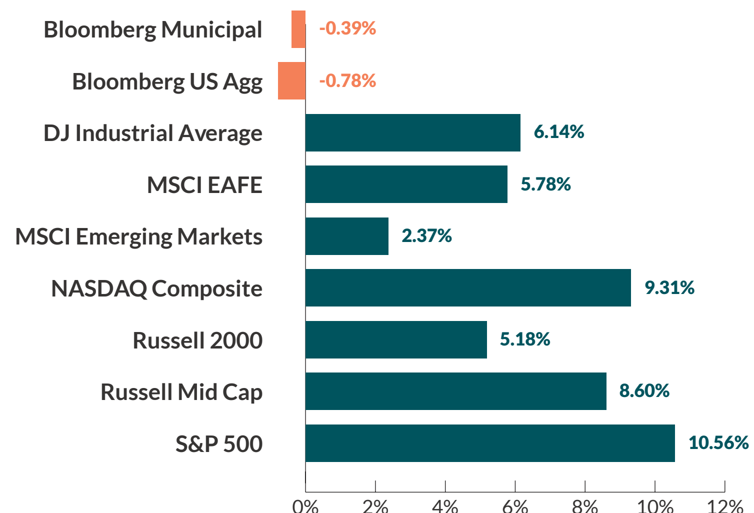
Market Commentary

Welcome to Linscomb Wealth's Quarterly Market Commentary, where we dive deep into the latest trends, opportunities, and challenges shaping the financial landscape. Whether you're a seasoned investor or exploring new opportunities, we're here to equip you with the knowledge and perspectives needed to make informed decisions and help achieve your financial goals.

The Economy

At this time one year ago, investor sentiment was decidedly negative. We were coming off a year, 2022, in which both stock and bond markets performed poorly, the global economy flirted with recession, and inflation was at levels not seen in decades. And then in March of 2023, Silicon Valley Bank, then the 16th largest bank in the U.S., failed following a run on its deposits. It's not the stuff you'd think sustainable market rallies are made of.

But here we are at the end of the first quarter of 2024 and financial assets have continued to perform well. We think the resilience of the global economy, and the U.S. in particular, is a primary reason for that. Here in the states, fourth quarter GDP growth came in at 3.4%, and projections for the recently completed first quarter range from 2 – 3%. Consumer spending, the largest component of GDP, remains strong despite the depletion of pandemic stimulus. This spending has been supported by a labor market that is in good shape in our opinion. At 3.9%, the unemployment rate has been at or below 4% for 27 straight months, a level most economists consider to be full employment. Other indicators we track, including initial jobless claims and job openings, also indicate a strong demand for labor. Wage growth is between 4 – 5% providing another spending tailwind in addition to new job gains.



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That 4 – 5% wage growth is all the more important given that it is now outpacing inflation, which is up between 2.5% - 3.5% depending on the measure used. Headline wage numbers have looked good on an absolute basis since 2022 but were actually trailing aggregate price increases for much

of that period. That relationship has flipped in recent months thanks to falling inflation rates, leading to an improvement in real purchasing power. One caveat regarding commonly cited inflation figures is that they don't do a great job of capturing increased financing costs resulting from the higher interest rate environment. So, for example, even though the price of a car or house may not have changed much over the past year, or even declined in the case of used cars, the total cost of those purchases may still feel more expensive due to the higher cost of taking out a loan.

Overseas, Europe's economy is growing but has been sluggish compared to the U.S. It is more manufacturing-oriented, a sector which has been in a mild downturn over the past year. Recently though, both business and consumer confidence has picked up, which bodes well for a better 2024. Japan's economy continues to perform well, and it remains the one major developed economy without an inflation problem. It's also a leader in robotics and automation, and we think going forward the country could have a bigger role to play in semiconductor design and manufacturing as well as more general applications of artificial intelligence.

Emerging markets are a large and diverse group, so member countries are often in different stages of the business cycle and respond to unique external factors. One clear, wide-ranging theme though is the migration of supply chains away from China to other parts of Asia or in some cases Latin America or developing Europe. We believe this will be a long-term transition but want to be careful not to overstate the benefits or drawbacks for the countries involved too soon, as there are still many moving parts.

Central Banks

Trends in inflation continue to be the focus for not just the Federal Reserve (Fed), but central banks globally. In the U.S., depending on the data set used, core inflation (excludes food and energy), which is the Fed's preferred metric, is up between 2.8% - 3.8% over the past year. That's down from a peak of above 9% in 2022. That clear move lower is a key reason why the Fed is discussing lowering short-term interest rates later this year. However, we don't think there is any rush. Inflation is still above the stated 2% target and as we mentioned earlier the labor market is still robust. We think that Fed Chair Jerome Powell and the rest of the Federal Open Market Committee want to be sure inflation won't reaccelerate before taking any action.

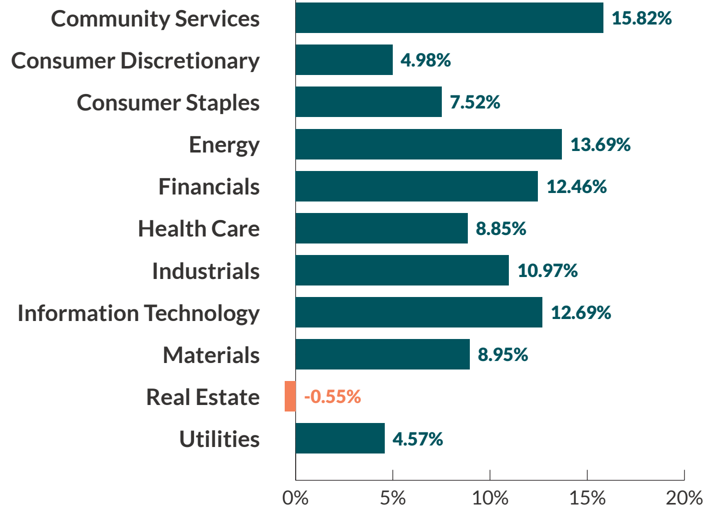
In Europe, inflation measures have consistently been at 3% or lower, so we believe the European Central Bank (ECB) may be closer to cutting interest rates. The European economy in aggregate hasn't performed as well as the U.S. either, giving the ECB further incentive to do so.

Bonds

Bonds suffered modest losses to start the year, with the Bloomberg U.S. Aggregate Bond Index – an index representing the investment grade bond market – falling 0.78%. Credit quality looks strong to us, and default rates remain low, so the rise in interest rates is likely most responsible for the decline in price. The 10-year U.S. Treasury yield for example ended the quarter at 4.20%, up from 3.88% at the end of 2023. Municipal bonds fell slightly less but were still down 0.39% over the first quarter.

Higher interest rates and price declines may trigger memories of 2022 which was one of the worst calendar years on record for fixed income securities. However, starting yields are much higher today which provides more cushion should rates continue to drift higher, making an environment like 2022 much less likely in our opinion.

Stocks



The rally following last October's correction continued through the first quarter of the year. The S&P 500 tacked on another 10.56% this quarter following an 11.69% gain in the final three months of 2023. This type of momentum is a phenomenon we often see in stock markets. Double-digit returns quarter after quarter are of course not the long-term expectation, but strength tends to beget further strength over shorter time frames. It was an interesting collection of sectors that led the way to start the year, with technology and communications – generally comprised of growth stocks – along with energy and financials – classic value stocks – all outperforming. We're glad to see the market broaden out so to speak, with additional industry groups performing well. If we looked at the sector breakdown last year, it was technology and communications at the top of the charts with the other 9 sectors meaningfully behind the overall market. Small cap shares did trail their large cap peers but still turned in respectable performance. The Russell 2000 rose 5.18% in the first quarter.

Overseas, international markets also delivered gains. The MSCI EAFE index of developed markets and the MSCI Emerging Market index were up 5.78% and 2.37%, respectively. Taiwan and Japan were standouts with both up more than 10%.

From a valuation perspective, U.S. large cap stocks do look elevated relative to history, trading at roughly 21 times expected earnings. That valuation level creates a higher bar for companies to clear to deliver acceptable performance. Outside of U.S. large cap though, many other equity asset classes have valuations that are in-line with historical averages, if not outright cheap.

Outlook

As we mentioned earlier, a year ago investors were in poor spirits. Today though, sentiment is much more positive regarding financial markets and the global economy, and the strong performance in financial assets reflects that optimism. It certainly can be true that too much optimism can set investors up for disappointment, but there are reasons the constructive outlook can be justified.

In the U.S., the economy is on solid footing currently, and we don't see immediate reason for concern. The U.S. has a large, relatively stable economy, and it typically avoids significant swings to and from growth. As long as the consumer is in good shape, the outlook here seems to be steady as she goes for the time being. After muddling through in 2023, we think Europe is on its way to a better 2024. Compared to the U.S., inflation in Europe has been stable at lower levels which should allow the ECB to cut rates sooner rather than later. The global recovery in manufacturing ought to help as well.

Emerging markets are also likely to continue to grow, though the biggest one, China, is unlikely to accelerate meaningfully this year. Issues in the property market are poised to linger for some time to come.

As far as what could upset the apple cart, we wouldn't consider inflation in the U.S. to be a solved problem just yet. Both services and energy prices have moved higher recently, which could delay the Fed's plans to lower interest rates. It's also an election year, and while the potential results are just one of many factors we consider, presidential election years have tended to have more volatility than others. And finally, we'll reiterate a prior point regarding the higher-than-average valuations for certain segments of the U.S. market. There's a lot of positive news already built into those prices in our opinion.

In summary, the global economy appears poised for continued growth, which is typically a supportive environment for asset prices. We do think it's more important than ever to maintain a well-diversified portfolio and stick to your long-term strategy, especially given the potential risks to the outlook mentioned above. As always, we will continue monitoring the market environment and position portfolios accordingly in response.

Interested in learning more or want to speak with an advisor?

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The S&P 500 Index is considered generally representative of the U.S. equity market and its market cap is weighted. The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark of the U.S. investment grade and global investment grade bond market. They include Treasury, government related, corporate and securitized fixed-rate bonds. The Bloomberg Municipal Bond Index is a benchmark of U.S. long-term tax-exempt bond covering four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. The MSCI Emerging Markets Index is a measure of the performance of emerging market equities. The MSCI EAFE Index is a measure of large and mid-cap equity performance across 21 developed countries, ex U.S. and Canada. The Russell 2000 Index is a measure of U.S. small cap performance. The Russell Midcap Index is a measure of U.S. mid-cap performance. The DJ Industrial Average is a price-weighted measure of 30 U.S. blue-chip companies covering all industries except transportation and utilities. The NASDAQ Composite is a broad based, market cap weighted index of more than 3,700 stocks listed on the Nasdaq stock exchange.

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