

## March 2024 Market Commentary

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**Fast start out of the gates on the potential for rate cuts.** All three major US equity market indices hit new highs in March, posting gains for the 5<sup>th</sup> consecutive month. The S&P 500 gained 3.2%, the Dow advanced 2.2% and the NASDAQ rose 1.9%. After stumbling to start the month stocks found their footing as Fed Chairman Powell signaled interest rate cuts were still likely this year despite still elevated inflation readings and economic data remained resilient. The rally continued to broaden beyond technology-related stocks and Energy was the best-performing sector for the month (+10.5%), followed by Utilities (+6.6%) and Materials (+6.5%). Energy stocks benefited from higher crude prices, which climbed due to intensifying geopolitical concerns, better global industrial activity, and limited supply growth. The first quarter of 2024 ended with the S&P 500 posting a total return of 10.6%, the best start to a year since 2019 and only the fourth time since 2000 that the index has registered a first-quarter double-digit gain. At the sector level, Energy, Financials, Communication Services, Industrials, and Technology all posted double-digit percentage gains, while Real Estate was the only sector in the red with a modest decline of 0.65%.

**But about those rate cuts...** Following hotter inflation numbers in January and February, the March CPI report released last week also came in higher than expected. The inflation measure rose 0.4% for the month and 3.5% on an annual basis. Gasoline and shelter accounted for more than half of the increase. The core CPI reading, which strips out food and energy, also came in above expectations rising 3.8% year-over-year. On top of the higher-than-target CPI readings, the latest labor market figures remained robust, making interest rate cuts less likely in the near term. Nonfarm payrolls rose by 303k in March versus 214k expected. While the headline labor numbers remain healthy, there are continuing signs of moderation. Wages grew at an annual pace of 4.1% in March, down from the previous month and the lowest increase since June 2021. The rate of employees quitting their jobs is also falling, indicating workers have less confidence in finding new jobs or better-paying jobs. This bodes well for a continued easing of wage growth and inflation. Still, given plateauing inflation and a strong labor market, it is likely the Fed will delay and possibly reduce the number of expected interest rate cuts this year.

**Interest rate intermission.** Post the latest round of economic data, the market is now pricing in 2 interest rate cuts this year, down from 6 just a few months ago, and expectations are coalescing around the first cut coming in the fall. Accordingly, the odds of Fed-induced equity selloffs seem less likely with this latest recalibration of expectations, and we believe stocks can continue to move higher from here, as the interest rate outlook takes a welcomed backseat to

corporate fundamentals as the first quarter earnings season gets underway. We remain constructive, given that the labor market is healthy, manufacturing activity is showing signs of turning up after 16 months of contraction, infrastructure and reshoring projects are ramping, green shoots are emerging in China, and AI-related spending remains robust. The current boom in AI infrastructure spending may begin to usher in a new wave of productivity. Earlier this year, the “buy now pay later” company Klarna, noted that its AI assistant can handle a range of tasks on par with or better than a human, has had 2.3 million customer conversations over the past year representing 2/3 of its customer service inquiries, and is doing the work of 700 full-time agents, saving the company more than \$40 million per year ([Klarna](#)). Investment banks are also beginning to employ AI programs to perform routine tasks, such as assembling PowerPoint presentations, which may allow them to reduce their analyst program hiring by two-thirds and reduce pay packages, given less demanding schedules ([Wall Street](#)). Moreover, valuations remain reasonable for the average stock outside of the AI darlings. A recent Bloomberg article noted roughly 70% of S&P 500 members “carry forward-price-to-earnings multiples beneath the index level, with roughly half below their average before Covid”. Smaller cap companies are even more attractively priced, particularly after selling off on the latest interest rate move, as we have noted in previous letters.

Yet, there are still risks from the Fed maintaining interest rates at what is likely to be peak rate cycle levels for an extended time. CarMax recently reported lackluster earnings results and said it might not meet its long-term sales goal. The company cited inflationary pressure, high interest rates, tougher lending standards, and sagging consumer confidence for the disappointing sales results. With both credit card debt (\$1.3 trillion) and average credit card interest rates (~28%) at record levels, it would not surprise us to see more pronouncements of slowing consumer demand. We are also mindful of the potential for growing distress in commercial real estate. According to Bloomberg, \$929 billion in real estate debt will mature this year and office vacancy rates are on the rise in a wide swath of cities. Refinancing buildings generating lower cash flow at higher interest rates will be problematic in many cases. Accordingly, we continue to be selective in the consumer and financial sectors. The other major risks we see are related to increasing geopolitical tensions and the potential for inflation to meaningfully reaccelerate. To account for these, we are maintaining our exposure to commodity and defense-related companies with an inclination to add to these positions on any pullbacks. We particularly like copper, which has started to move higher, given growing AI-related power demand ([Southern Company raised their 2030 demand forecast by 17X](#)), necessary electrical grid improvements, the potential for a turn in the Chinese economy, and limited supply growth in the intermediate term (note, it can take up to 20 years to bring on a new copper mine).



**Strong starts bode well for the remainder of the year.** In election years, it is rare to see a down equity market after a strong first quarter. However, we are due for a pullback, especially considering the currently high level of bullish sentiment. Nonetheless, we believe that any pullbacks could present opportunities to add to our favorite positions.

As always, we would enjoy hearing from you. Please reach out with any comments or questions.

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