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Economic & Market Summary
April 2024

Equity markets are off to a solid start. The S&P 500 and Dow Jones Industrial Average are up 10% and 6% respectively through the first quarter including dividends. Earnings estimates for the S&P haven't changed much year-to-date, so the gain is a function of a higher valuation placed on those future earnings. The price-to-earnings ratio grew from 19x in January to about 21x currently. This is well above the ten-year average of 17.7x implying the S&P is richly valued. Performance remains driven by technology firms particularly those heavily exposed to AI. However, the gains have broadened out to other areas of the market which we find encouraging. Longer-term interest rates have risen with the 10-year Treasury yield climbing from 3.9% to 4.2% since the start of the year. This rise likely reflects an uptick in inflation and reduced expectations for interest rate cuts from the Federal Reserve.

Inflation reaccelerated in January and February. Market expectations for rate cuts have fallen and are now better aligned with what the Fed signaled in December and reiterated in March. Fed Chair Powell has emphasized the need for greater confidence that inflation is moving down to the 2% target before cutting rates. We think this is prudent. The Fed needs to be just as careful cutting rates as they were raising them. Cut too much too quickly and inflation will reaccelerate like it did in the 1970s. If the two strong months of inflation are a blip and the downward trend resumes, we would expect the first rate cut at the June or July meeting. Given how sticky certain inflationary elements have been, we wouldn't be surprised if the Fed cut only once or twice this year out of caution. The one issue that could cause the Fed to cut more aggressively would be trouble in the labor market.

At a high level, the labor market looks quite strong. Job gains have surpassed consensus forecasts for the last several months and year-over-year wage growth remains above inflation. There are early signs that supply and demand for workers are coming back into balance which helps with inflation and is good for employers. The gap between job openings and job seekers has narrowed since its peak in 2022. Workers are quitting their jobs in fewer numbers, which suggests companies are more easily retaining people. Helped by an encouraging rebound in productivity, economic growth has remained surprisingly healthy. Real GDP grew 3.1% in 2023. The consensus forecast for Q1 economic growth is about 2% annualized, which we would consider normal. However, there are some signs of weakness to monitor. The robust job gains have been concentrated in a few industries. Others have shown much weaker or negative growth over the last twelve months. Also, delinquencies on credit card and auto loans are still rising, particularly for younger and lower income demographics.

Many critical issues will be highlighted this election year, but we believe our country's debt load needs more attention. Federal debt held by the public as a percentage of the economy, is approaching levels last seen in World War II. Having such large debt levels during a peacetime economy speaks to the government's propensity to spend. For now, the US still has willing creditors and attractive borrowing costs. However, a dysfunctional government that lacks fiscal discipline threatens not only our creditworthiness but our standing in the world. Furthermore, we are very concerned that both parties are pivoting away from free market principles which helped make the US so prosperous. Stocks usually rise in a presidential election year. However, given the S&P 500's high valuation and the unique circumstances of this election, we could see elevated market volatility. Pullbacks are normal in a bull market and often provide buying opportunities for patient, long-term investors.

Mark J. Sprtel, CFA

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.