Investment Update

April, 2024

2024 First Quarter Update

Review: Equities are off to a strong start this year, continuing the rally that began in November. The S&P 500 outperformed international equities again, benefitting from strong technology stock performance and a resilient US Dollar. Bond yields rose due to inflation data and the expectation for rate cuts to begin later than previously anticipated. This led to slightly negative returns in key bond indices.

	1Q24	4Q23	2023
S&P 500	10.6%	11.7%	26.3%
MSCI EAFE[1,2]	5.8%	10.5%	18.9%
MSCI Emerging Markets[2]	2.2%	7.9%	10.3%
Bloomberg U.S. Aggregate Bond	-0.8%	6.8%	5.5%
Bloomberg Municipal Bond	-0.4%	7.9%	6.4%

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

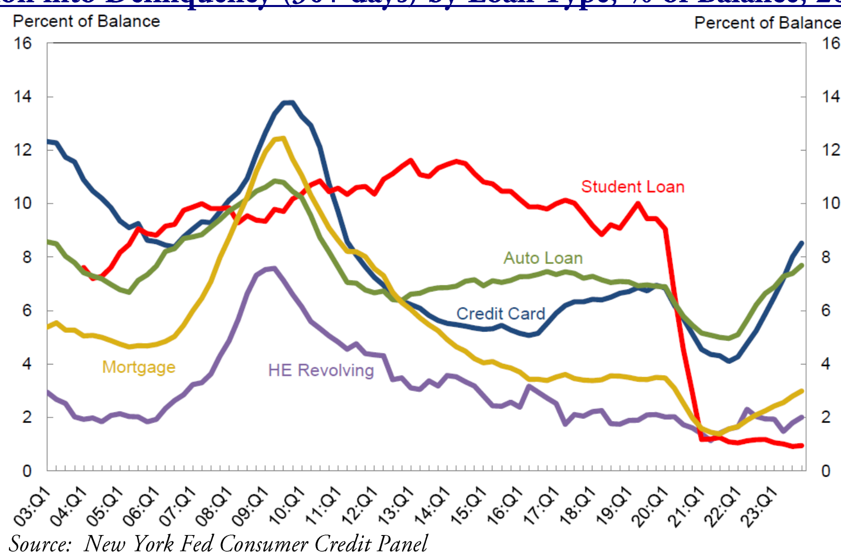
Are financial markets too complacent?

The current consensus expectation is for less than three rate cuts by year end, a significant shift from the beginning of the year, when six rate cuts were expected. This current view is similar to that of the Federal Reserve, whose median outlook for 2024 has implied three rate cuts since late last year. The shift in market expectations has been driven by stickier than expected inflation and economic conditions that have been mostly better than expected (e.g. job market). In other words, if inflation remains above the Fed's target while economic growth continues to be relatively robust, there is less incentive for the Fed to cut rates in the near term since rate cuts could result in a reacceleration of inflation.

Although the resilience of economic growth in the U.S. is positive, there are pockets of the economy where rate cuts are needed sooner rather than later. For example, consumer debt delinquency rates have been rising, particularly for credit cards and auto loans. The chart on the next page shows the delinquency trends for each major type of consumer debt. Although these delinquency rates are still below peaks seen in 2008-09 and the early 2000s, the trends clearly indicate that the seemingly solid economic growth is masking pressures felt by a number of US households.

In addition to consumers, highly leveraged companies and commercial real estate investors face pressure from the higher for longer rate outlook, which may lead to negative economic surprises this year due to potential difficulties refinancing existing debt. Office real estate, in particular, appears to be vulnerable to continued deterioration due to occupancy rates in many cities that are still well below pre-pandemic levels.

Transition into Delinquency (30+ days) by Loan Type, % of Balance, 2003-2023



Source: New York Fed Consumer Credit Panel

Outlook: Despite the undercurrents noted in the previous section, the consensus estimate for US economic growth in 2024 has increased since the beginning of the year, with the current GDP growth estimate at 2.2%, up from 1.3%. Also, the consensus estimate for corporate earnings growth for this year is currently 12%, above the historical trendline growth of roughly 7%. Continued resilience of the economy in the face of headwinds from the higher for longer rate environment is a key question. This puts an even greater importance on key economic data points such as nonfarm payrolls (monthly change in employment levels), inflation, and consumer spending in the near term as the Fed debates when to start cutting rates and as investors evaluate the extent to which potential risks are being priced into various assets.

The outlook for international growth continues to be mixed, with expectations for GDP growth in ex-US developed economies softening versus estimates at the beginning of the year. The US Dollar continues to outperform due to the relative strength of the US economy and higher for longer rate outlook, which is a headwind for some emerging economies.

Strategy: The S&P 500 forward P/E multiple is once again over 20x, which we believe underestimates the potential economic risks in a higher for longer interest rate environment. Within equities, we continue to prefer quality growth stocks at reasonable valuations and traditionally defensive sectors. Fixed income continues to offer attractive risk-reward opportunities, but this is also an area where we prefer higher quality securities, as parts of the market (e.g. high yield) appear to be underestimating potential risks. It is possible that the volatility in longer maturities continues in the near term as investors adjust expectations for rate cuts and economic growth.