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Market Overview

All major stock indices experienced a first quarter rally as yields subsided, earnings came in stronger than expected, and economic growth exceeded expectations. The S&P 500 Index[1] led the fourth quarter stock gains finishing up 10.56%, with the Nasdaq Index[2] and the Dow Jones Industrial Average Index[3] trailing at 9.31% and 6.14%, respectively.

During the first quarter of 2024, communication services was the best performing sector gaining 15.8%, followed by energy at 13.7%, and technology by 12.7%. In terms of performance, the S&P 500 led the way during the first quarter as the market rally continued to broaden with participation from the financial, industrial, and material sectors.

The Federal Reserve (the "Fed") paused interest rate increases and signaled three potential rate cuts for this year from its current 5.25% to 5.50% range. It is unclear when rate cuts will occur as the Fed is still data dependent, waiting for more data to reinforce the decline in inflation which has subsided in most categories. However, service inflation remains sticky, and the rental component significantly lags actual declines in market rents. But looking forward, the catch-up in that category should put meaningful downward pressure on the Consumer Price Index (CPI), and likely affect the timing of the Fed lowering the federal funds target. Towards the end of the quarter, commodities began to rally to the upside giving the Fed another reason to keep rates higher for longer.

Bond yields (10-year) remained relatively range bound during the first quarter from 4.34% to 3.86%. In the fixed income realm, certain high yield bonds that are less sensitive to interest rate changes saw a 2.1% increase driven by continued tightening of spreads. Conversely, the overall market experienced a 0.8% decline due to a rise in yields putting pressure on bond prices.

Turning to international markets, developed market equities outperformed emerging market stocks. In advanced economies, Japan's export-oriented stock market and European equities hit unprecedented levels, buoyed by the Japanese Yen's prolonged weakness and optimism surrounding advancements in healthcare. Conversely, emerging market equities saw a modest 2.2% increase, with a strengthening dollar dampening the substantial gains witnessed in Taiwan, Korea, and India. Meanwhile, China's ongoing economic difficulties translated into underwhelming market results.

Mark L. Blom, CFP® — Brent Miller, CFA® — Kirk Masci

U.S. Equity Returns Table (Source: Tamarac)			U.S. Treasury Yield Table (Source: Treasury)				Other Indices Table (Source: Morningstar)		
Index	Q1 2024 Returns	2024 Returns		03/2024	03/2023	03/2022		Q1 2024 Returns	2024 Returns
Dow Jones	6.14%	6.14%	3 month	5.46%	4.85%	0.52%	Gold (GLD)	7.61%	7.61%
S&P 500	10.56%	10.56%	2 year	4.59%	4.06%	2.28%	Brent Oil (BNO)	16.84%	16.84%
NASDAQ	9.31%	9.31%	5 year	4.21%	3.60%	2.42%	U.S. Dollar Index (UUP)	4.72%	4.72%
Russell 2000	5.18%	5.18%	10 year	4.20%	3.48%	2.32%	Int'l Equity Markets (EFA)	5.99%	5.99%
MSCI World	4.66%	4.66%	30 year	4.34%	3.67%	2.44%	Emerging Equity Markets (EEM)	2.16%	2.16%

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Soft Landing Scenario May Continue to Drive Market Higher

The U.S. stock market surged in Q1 2024, once again led by the mega-cap dominated S&P 500 and Nasdaq 100. Both indices have paused their ascent periodically, giving market pundits just enough time to opine about the end of the bull market or, more conservatively, a material broadening of the market's current expansionary phase. These respites never seemed to last very long, however, with both indices seemingly reaching new 52-week highs every other day. Any raging bull market understandably begs the question as to where we are in the market cycle and whether a painful reversal is imminent. Any examination of this question must necessarily begin with a discussion of recent macroeconomic trends.

Those of you who follow Chairman of the Federal Reserve (the "Fed") Jerome Powell know that he is fond of discussing the Fed's "dual mandate" of promoting maximum employment and stable prices. On the topic of employment, we note that in February 2024, the unemployment rate increased by 20 basis points to 3.9%.[4] The slight increase in the unemployment rate likely signals that the labor market, while remaining resilient, has begun to show signs of slowing. In my view, this represents the preferred "goldilocks" scenario in which unemployment remains historically low while beginning to increase slightly, indicating that the labor market, and by extension the economy, is beginning to slow down. This slowing, in turn, could serve as a leading indicator of decelerating Consumer Price Inflation (CPI).

Inflation, however, has proven to be a stubborn opponent in recent months. The Fed's preferred measure of inflation, the Personal Consumption Expenditures (PCE) Price Index, increased 0.3% in February and was up 2.5% on a 12-month basis.[5] While both numbers were in line with consensus estimates, the 12-month figure represented a modest *increase* from the 2.4% number reported in January. The Federal Reserve's stated inflation target is 2.0% and it will likely want to see several months of persistent progress towards this goal before it initiates the rate cutting process.

Meanwhile, the U.S. consumer remains healthy, and the economy continues to hum along. Q4 2023 GDP growth was recently revised up to 3.4% from the initial estimate of 3.3%, the latter of which easily beat the consensus estimate of 2.0%.[6] While the initial estimate for Q1 2024 GDP will not be released until April 25th, the Federal Reserve Bank of Atlanta's GDPNow forecasting model[7] is predicting growth of 2.8%, which is consistent with a cooling but still growing economy.[8] In addition, personal consumption expenditures, a key consumer health indicator, increased 0.8% in February, eclipsing the consensus expectation of 0.5%.[9]

Putting all of these data points together provides us with a picture of a strong but slowing economy, a relatively healthy consumer, and lower but somewhat persistent consumer price inflation. Reading the tea leaves, I believe these indicators point to interest rates staying higher for longer. While the most recent Federal Open Market Committee's projections for rate cuts imply three 25 basis point rate cuts by the end of 2024, I believe two 25 basis point cuts, with both cuts likely occurring in the back half of the year, are more likely for two reasons.

First, with the economy still growing, a healthy consumer, and unemployment remaining relatively low, I see no reason for the Fed to rush into the rate cutting process. Second, with the "last mile" of the inflation battle proving to be relatively challenging, the worst mistake the Fed could possibly make in my view would be to declare a premature victory by cutting rates too soon, reigniting inflation in the process.

Circling back around to the stock market, what does all of this mean for equities? If the Fed is able to keep rates higher for the first half of 2024 without triggering a recession, i.e. the "soft landing" scenario, I believe there is more room for the market to run. This does not mean that the Q1 2024 pace set by large cap growth stocks will prove to be sustainable, as it almost certainly will not. While I believe large cap tech stocks with generative AI exposure will maintain market leadership, the ride will likely prove to be a bit bumpier than its purely upward sloping move in the first quarter of the year.

I also believe market breadth will continue to expand as large cap stocks outside of the NVIDIA (NVDA), Meta Platforms Inc. (META), Amazon.com, Inc. (AMZN), Microsoft Corporation (MSFT), and Alphabet Inc. (GOOG) basket begin to narrow the performance gap.[10] In addition, small cap stocks, after taking a breather for much of Q1 2024, may begin to finally take off as the path to lower interest rates becomes clearer.[11]

In sum, while I see the rest of the year being a bit choppier from a performance perspective, I believe a modest rate cutting environment in the absence of recessionary economic signals and/or resurgent inflation should propel the market higher, driven by a larger basket of stocks than 2023 or Q1 2024. In addition, while the market in aggregate appears to be priced at a premium, I believe it there are pockets of the market that still appear attractive from a valuation perspective, and within these undervalued market segments, it is possible to find stocks that trade at a material discount relative to their near and long-term earnings power.

Brent Miller, CFA® – Senior Portfolio Manager

Grace’s Corner

Summary from the March 9, 2024 Client Appreciation Luncheon

Welcome to our annual client appreciation luncheon. The event has been held for 25 years. This is one way for us to show our appreciation to you. We have over 120 clients, family, and friends in attendance. You represent 56 households out of an estimate of 200. Thank you!

When I joined Benefit Financial Services Group (BFSG) in the beginning of 2017 the Phoenix office had about $200 million assets under management. That was seven years ago. At the end of December 2023, we were at $420 million. This is not only because of the market appreciation. This is because you all trust us with your hard-earned dollars and stayed with us through good and bad markets. You also brought your family and friends, so we have an opportunity to work with them too. This is also because of the hard work of my team, their professionalism, their knowledge, and how much they care about all of you. Whenever a new team member joins this office, they always comment on how long clients have been with us and how easy it is to manage their portfolios and the relationships. They seemed pleasantly surprised. Isn’t that something all financial advisors strive for?

Among our guests today, some of you have been with us for two decades and a few may be attending this event for the first time. Welcome to everyone!

It is also important for me to point out the full footprint of BFSG. There are 25 professionals working as analysts, financial planners, portfolio managers, relationship/client service managers and an operations manager in our Irvine office. They support us in technology, cyber-security, compliance, and trading as well as providing intellectual capital in investments and financial planning. The Irvine office manages about $700 million in assets under management and $16 billion in institutional assets under consultation as of December 31, 2023.[12] Our clients benefit from the knowledge of our Irvine colleagues, increasing the breadth and depth of our offerings. They are professionals with the same philosophy as we have when it comes to putting clients first. We work together as a team.

Last year at this event one of you asked when I plan to retire. I answered that there is no plan to step away although I may want to work less. It is too hard to leave and not have you in my life anymore.

Today I have an answer for you about the future of the BFSG office in Phoenix. Mark Blom has been promoted to Managing Director of BFSG Arizona’s office, the first one with that title in the company. He will help me manage the office so I will have more leisure time. Mark has been with the firm for seven years and started his eighth year last month. Many of you know Mark very well. He has over 25 years’ experience in wealth management, he is a Certified Financial Planner™ professional, and has been working in the role of Senior Wealth Manager in this office.

We also have two senior professionals that joined this office in the last four months. Brent Miller, CFA®, and Scott Sollars, CFP®. Brent is our Senior Portfolio Manager and leads our research efforts. I am sure you have been enjoying his writing. Scott is a Senior Wealth Manager and has responsibilities in relationship management, financial planning, and new business development. Both come with years of experience in our industry, and I feel very fortunate to have them on our team.

As always please call anytime. We are here to serve you.

Grace Lau, CFA® - Managing Principal

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Disclosures

Sources:

1. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The Nasdaq Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock market and is heavily weighted towards companies in the information technology sector.
3. The Dow Jones Industrial Average (DJIA), Dow Jones, or simply the Dow, is a stock market index of 30 prominent companies listed on stock exchanges in the U.S. The DJIA is one of the oldest and most commonly followed equity indexes.
4. https://www.bls.gov/news.release/pdf/empsit.pdf
5. https://www.bea.gov/news/2024/personal-income-and-outlays-february-2024
6. https://www.bea.gov/data/gdp/gross-domestic-product
7. The GDPNow model forecasts GDP growth by aggregating 13 subcomponents that make up GDP with the chain-weighting methodology used by the U.S. Bureau of Economic Analysis
8. https://www.atlantafed.org/cqer/research/gdpnow
9. https://www.bea.gov/news/2024/personal-income-and-outlays-february-2024
10. These stocks, along with Apple Inc. (AAPL) and Tesla, Inc. (TSLA) were formerly known as the Magnificent Seven due to their material outperformance versus the rest of the S&P 500 in 2023. With AAPL and TSLA badly lagging the index performance YTD, the outperforming basket now consists of the five stocks mentioned above.
11. Small cap companies tend to carry higher relative levels of variable rate debt and tend to underperform large cap stocks in high interest rate environments due to their higher carrying costs of debt.
12. As of December 31, 2023, BFSG's assets under management are $1,148,705,835 managed on a discretionary basis and $381,356 managed on a non-discretionary basis and our assets under consultation are $16,003,674,151. Assets under consultation are assets for which we provide ongoing recommendations based upon the needs of the retirement plan sponsor client, as to which specific securities or other investments to make available to its plan participants, as well as other services set forth in the Consulting Agreement. Reference our disclosure brochure.

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Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/ comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your BFSG account holdings correspond directly to any comparative indices or categories. **Please Also Note**: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your BFSG accounts; and, (3) a description of each comparative benchmark/index is available upon request.