withum WEALTH MANAGEMENT

Spring, 2024

Investment Commentary

Party Like It's 2019

Let the good times roll! The S&P 500 notched its biggest Q1 advance in half a decade, rising 10.2%. This marked the index's fifth gain in the last six quarters and a second straight double-digit quarterly percentage gain. Meanwhile, the Nasdaq narrowly missed what would have been its fourth double-digit percentage gain in the last five quarters.

It was about as close to a true "everything" rally as you can get, with all but one of the 11 S&P 500 sectors rising, though momentum and growth factors outperformed. Even gold managed to rise along with stocks, while a nearly 70% surge in the price of Bitcoin underscored the potency of the "risk on" trade.

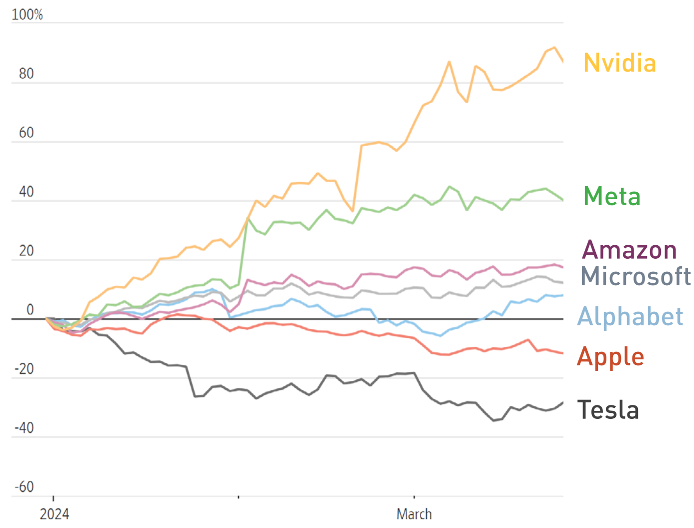
The fact that the market continued its rally despite expectations shifting towards fewer Fed rate cuts this year makes it even more remarkable. Several factors made this dynamic possible, particularly a firmer growth backdrop. The first read on Q4 GDP showed an expansion of 3.4%, far outpacing consensus of 2.0%, underpinned by strong consumer spending. With a recession nowhere in sight in the near term, the economy's soft landing seems to be behind us, and growth has reaccelerated. The market has come into alignment with the Fed's projections for just two or three rate cuts this year, and investors have taken this updated version of "higher for (even) longer" in stride. What's more, Chair Powell suggested at the Fed's March meeting that recent hotter inflation data has not changed the Fed's view on the broader disinflation trend.

Earnings and AI

Last quarter, we wrote that we were somewhat skeptical about the high bar set for corporate earnings in 2024. While we are not ready to completely abandon that sentiment, kudos must be given to companies for answering the bell in the Q4 reporting season, with earnings surprising to the upside by ~4%, with margins a bright spot. While softer Q1 guidance faced some scrutiny, Bank of America pointed out that its Corporate Sentiment Indicator has improved sequentially to near-record highs. This fits with the soft-landing messaging heard on past conference calls. Several other positive themes were evident, led by AI proliferation and margin cushion from expense control and productivity initiatives. Input costs have also come down, with inflation cooling while companies generally held prices stable. When the dust had settled, the consensus for low-double-digit S&P 500 earnings growth in 2024 remained intact, though it continues to be buoyed by outsized expectations for some of the largest companies.

The secular AI growth theme continued to drive outperformance in select high-momentum big tech names, though there was some focus on a broadening of AI beneficiaries. While market concentration in big tech has remained under scrutiny, the group's outsized earnings growth has somewhat kept valuation metrics in check. In keeping with the theme of improving breadth, The Magnificent Seven is no longer trading as a monolith, with several components (TSLA, AAPL) notably underperforming. The market's strength without the full participation of this group is a positive signal, in our view.

Share-Price Performance



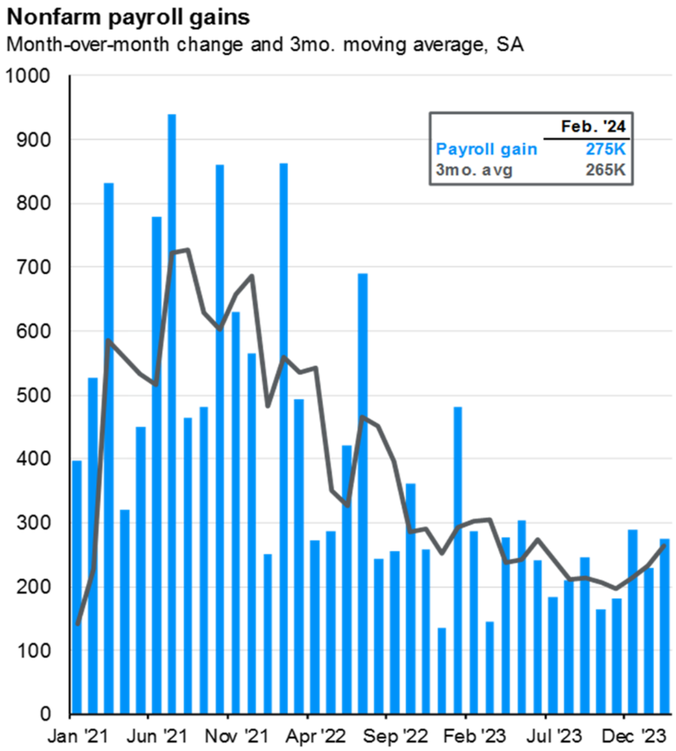
Source: FactSet

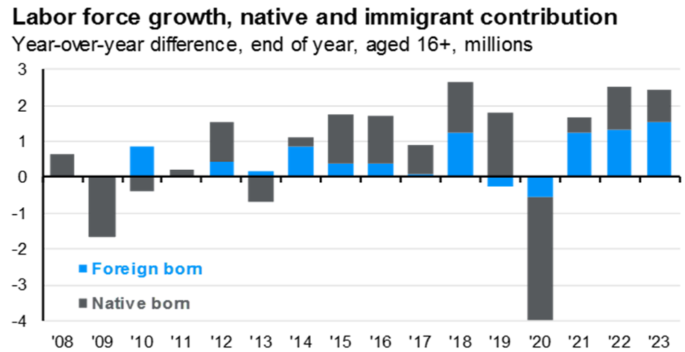
Labor Labyrinth

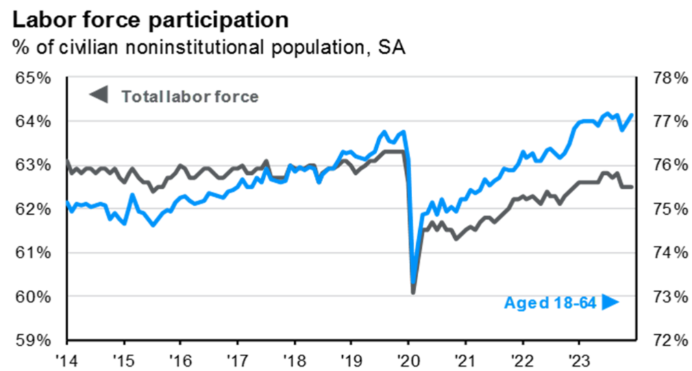
We mentioned earlier that consumer spending has continued to be resilient and played a key role in the Q4 GDP beat. With excess pandemic savings dwindling and delinquencies continuing to rise, just how much longer can we expect the consumer to carry the economy's water? Part of the answer can likely be found in a recent utterance from Dr. David Kelly of J.P. Morgan: "We've learned that the US consumer does not stop at the limits of prudence; they stop at the limits of credit." But if the strength of the US consumer buttresses the economy, surely the labor market – that is, labor supply and demand and their manifestations in the unemployment rate and wage growth – ultimately underpins consumer health.

At first blush, the fact that we are in the longest sub-4% unemployment streak since the 1960s seems objectively positive. A closer look at the current state of the labor market instead reveals a more muddled picture.

Labor Supply







Source: BLS, FactSet, J.P. Morgan Asset Management

First, consider the supply side, where nonfarm payroll gains are regularly over 200K a month—how? Where are all the workers coming from? There are two answers: first, the labor force participation rate is rising, with the best participation from the prime-age 18-64 year-old cohort since 2009. Second is immigration—a rather astonishing 60% of employment growth in the last 3 years is from people not born in this country. The vast majority of these are filling jobs at the lower-income end of the spectrum, which is in many ways healthy for the economy but holds down overall wage growth, which the Fed carefully observes as an inflation indicator because it is indicative of how much money consumers can spend.

What about the demand side? Through the first quarter of this year, layoff announcements are down 5% from a year ago. However, people are quitting their jobs at the slowest rate since 2009, and higher quit rates typically correlate to higher wage and price inflation pressures. Many companies appear to be adopting a "do more with less" approach, and the strong corporate margins we discussed earlier suggest such productivity measures are working for employers, and thus likely to continue. Job creation has also skewed towards part-time positions. An alternative jobless measure that includes discouraged workers and those holding part-time jobs for economic reasons (sometimes called the "real" unemployment rate) rose slightly in February to 7.3%.

Are there any firm conclusions that can be drawn from this jumble of conflicting data points? That's a task likely best left to the Nobel laureate economists. As investment advisors, we'll merely surmise that there's a lot of uncertainty right now around the strength and direction of the labor market and, by extension, the consumer. Given the importance of the labor market to the Fed's calculus, we'll continue to monitor and update our view.

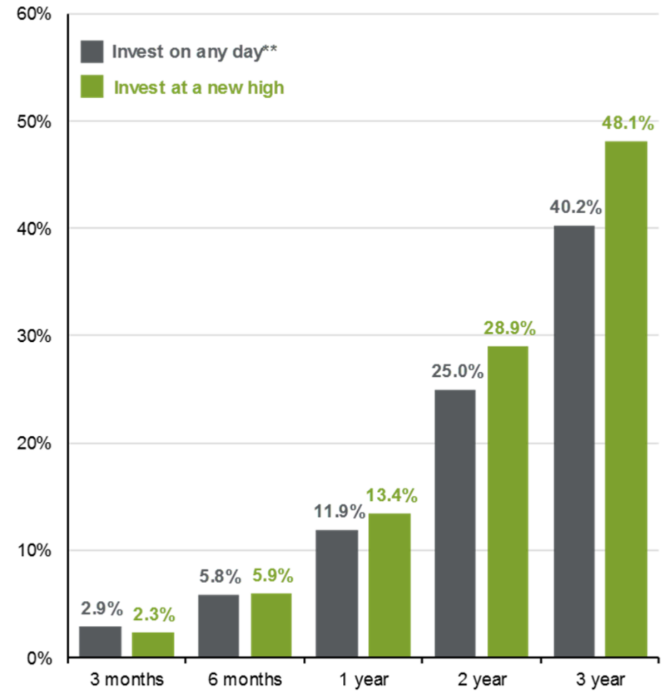
All-Time Highs

Perhaps you've noticed that we often conclude these quarterly commentaries with a similar message encouraging our clients to take the long view – look past near-term volatility and stay invested so you don't miss out on the market's long-term average annual returns of 8-10% a year. No matter how many times we've said it, the temptation to doubt this wisdom constantly gnaws at investors of all stripes. For many, this psychological test of conviction becomes even more difficult when the market is consistently making new all-time highs, as it has done quite often recently. But counterintuitively, new highs are a bullish signal most of the time.

The adjacent chart is worth putting words to: if you invested in the S&P 500 on any given trading day since 1988, your average total return a year later would have been just shy of 12%. However, if you invested on days when the S&P 500 made a new all-time high, your average return would have been well over 13%. The comparative advantage of putting money to work at market highs only grows over longer time horizons—increase the holding period to three years, and the average total return is nearly 8% higher.

Average Cumulative S&P 500 Total Returns

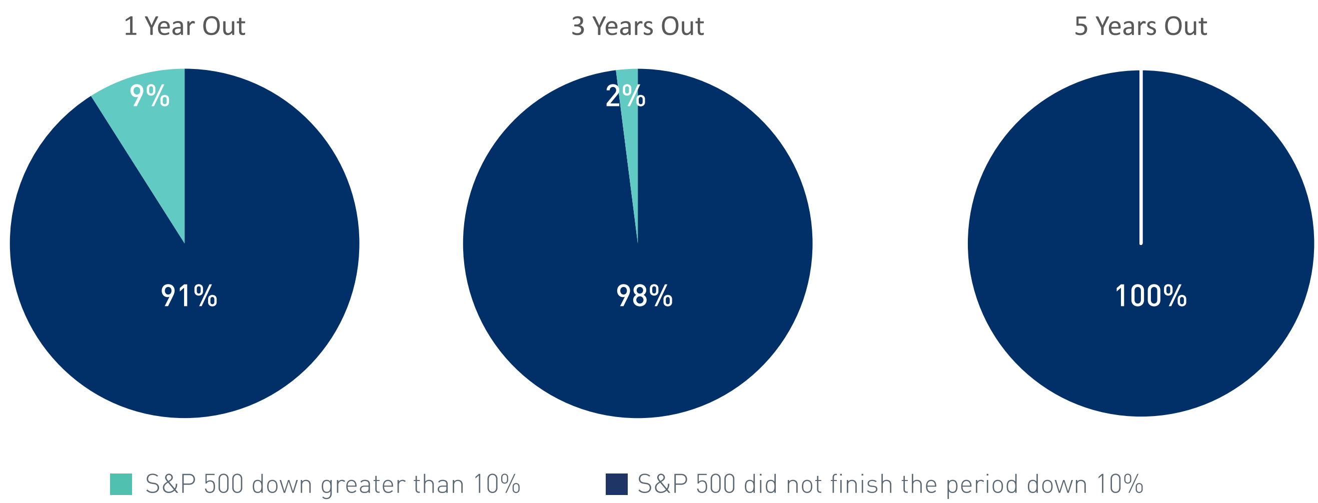
Jan. 1, 1988 - Dec. 31, 2023



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

This is surprising and counterintuitive. Human behavioral biases, as brilliantly elucidated by Daniel Kahneman (the recently departed godfather of behavioral economics) and his colleagues, go a long way in explaining these remarkable results. Investors anchor to recent results, move in herds when trends become evident, and suffer from confirmation bias. There's also the simple truth that the stock market goes up most of the time, as the graphic below bears out.

How Frequent Are Market Corrections Following All-Time Highs?



Source: Bloomberg, RBC GAM. Data as of January 1, 1950 to March 2024, in U.S. dollars

Closing Thoughts

With the usual platitudes about "staying the course" having received special treatment above, what is left to say here? As we've written previously, we know from our conversations with clients that November's election and its implications for the market remain top of mind. While we won't discuss the election here, rest assured that we have plenty of election-specific content in the pipeline, including a podcast with a guest political expert this summer. Until then, be sure to catch our quarterly Market Update webcast in late April.

Have a wonderful spring and early summer!

withum

WEALTH MANAGEMENT

Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management team with any questions or concerns:

T (732) 450 0147
infowwm@withumwealth.com
withumwealth.com