PERFORMA

Q1 2024

MARKET COMMENTARY

A QUARTERLY REVIEW OF THE MARKETS FEATURING MACRO AND GENERAL ASSET CLASS COMMENTARY

MACROECONOMIC OVERVIEW

The risk-on sentiment that dominated markets during the fourth quarter of 2023 was in full force during the first quarter of 2024. Credit spreads reached historically tight levels and the S&P 500 closed the quarter at an all-time high of 5,254, returning over 10%. Meanwhile, economic data remained resilient. Labor markets appear to be in good shape as evidenced by robust job creation and historically low initial jobless claims. However, we should note that some of the underlying details are looking less robust. Inflation data came in hotter than expected, which dashed market hopes for an early start to the Fed's rate cutting cycle and put upward pressure on interest rates. The most recent Fed forecast (published in March) penciled in three 25 basis point rate cuts by year end. Meanwhile, the market is now pricing in about two and a half 25 basis point moves. Lastly, high frequency data (i.e., TSA throughput, hotel occupancy and restaurant bookings) suggest a still active consumer despite some of the softness we have seen in recent retail sales data.

In our 2024 Market Outlook, we highlighted that much like 2019 (the last time the Fed pivoted) market exuberance can be slow to subside. With the S&P 500 up handsomely for the year and most cash yields north of 5%, we have decided to dial back risk within client portfolios where appropriate. To that end, we marginally decreased client exposure to equities in March with the proceeds transferred to cash or investment grade fixed income (client dependent) as we evaluate an ever-evolving financial landscape. The move will ensure that we have some dry powder to put to work when more attractive opportunities arise. Given that the fierce rally in risk assets has now completed its 5th consecutive month, we believe that protecting client capital, while realizing some gains and earning ~5% on cash/investment grade fixed income, is a prudent and logical move for our clients.

ASSET CLASS OVERVIEW

INVESTMENT GRADE BONDS: The Federal Reserve has remained patient in their inflation fight, holding the overnight borrowing rate steady since their July 2023 meeting when they raised the overnight rate for the 11th time to a 22-year high range of 5.25%-5.50%. Throughout Q1 2024, market participants finally embraced the "higher for longer" mantra and got on the same page as the Fed's dot plot, which indicates ~75 basis points (bps) of cuts by the end of 2024. Rates sold off across the curve, apart from the very front end of the Treasury bill curve, with 2-year and 5-year U.S. Treasury notes higher by 37 bps each to finish the quarter yielding 4.62% and 4.21%, respectively. Meanwhile, the 10-year U.S Treasury yield was higher by 32 bps to 4.20%. The Bloomberg U.S. Aggregate Index, a broad measure of the investment grade bond market, lost -0.78% during Q1, outperforming duration matched Treasuries by 23 bps as bond prices fell (rates higher) and option-adjusted spreads (OAS) on the Bloomberg U.S. Aggregate Index tightened 3 bps to 0.39%. Meanwhile, U.S. credit spreads tightened -8 bps to 0.85%. Sector performance was mixed with sovereign bonds (-1.20%), mortgage-backed securities (-1.04%) and U.S. Treasuries (-0.96%) detracting the most. Commercial mortgage-backed securities (0.85%), asset-backed securities (0.68%) and financial bonds (0.35%) gained the most. On a ratings basis, AAA's returned 0.02%, AA's -0.96%, A's -0.51% and BBB's -0.19%. The yield-to-worst (YTW) on the index rose 32 bps to 4.86% over the quarter, while the modified duration shortened slightly to 6.21 years.

HIGH YIELD BONDS: During the first quarter of 2024, the ICE BofA U.S. Cash Pay High Yield Index gained 1.46%. The return was comprised of -0.14% in negative price performance driven by rising rates (yields up, prices down), which outstripped the benefit of spread tightening. Income/coupon produced 1.61% of return during the period. Option-adjusted spreads (OAS) tightened -24 bps to 3.08% and the effective yield on the index widened 11 bps to 7.43% as rates rose and spreads tightened. Meanwhile, the effective duration of the index was almost unchanged, finishing the quarter at 3.28 years. Of the major sectors within the index, retail (2.86%) gained the most, followed by energy (2.68%) and health care (2.49%). The telecommunications (-2.27%) and media (-1.72%) sectors were the only major sectors that detracted from performance. As spreads tightened over the period, it was no surprise that lower rated bonds outperformed their higher rated peers. On a ratings basis, BB's gained 1.11%, B's 1.51%, CCC's 2.68% and CC's 6.75%.

U.S. EQUITIES: The S&P 500 Index, widely regarded as the best single gauge of large-cap U.S. equities, had its best first quarter in five years after gaining 10.55%, despite two of its largest constituents (Apple and Tesla) losing over 10% and 29%, respectively. All sectors were higher during the period, except for real estate, which lost -0.55%, driven lower by American Tower Corp (-8.47%), SBA Communications (-14.20%) and Crown Castle (-6.77%), which gave up some of their previous quarters gains as the 5G cycle matures and capex spending slows. Communication service stocks rose 15.83%, led by Meta (37.33%), Walt Disney (35.52%) and Netflix (24.74%). The generic WTI oil contract (CL1) gained 16.08%, sending energy stocks higher by 13.68%, with Marathon Petroleum (36.50%) and Valero Energy (32.31%) rising the most.

Mid-cap stocks, as represented by the Vanguard Mid-Cap ETF, underperformed their larger cap peers by -2.68% during Q1 after returning 7.87%. Financial stocks gained the most, rising 14.17%. Coinbase, which provides a platform to buy and sell cryptocurrencies, increased 52.4%, while electronic broker, Interactive Brokers, jumped nearly 39%. Industrial stocks produced 13.16% over the period with truck maker, Paccar Inc, up 27.19%, which contributed 20 bps to the overall return. Communication service stocks collectively lost -5.06% and were the only detractor over the period as gains by Trade Desk Inc (21.48%) Omnicom Group (12.70%) and Live Nation Entertainment (13.00%) were not enough to offset losses by Warner Brothers (-13.29%), Snap Inc (-32.19%), Roblox (-16.49%) and others.

Small-cap stocks, as represented by the Vanguard Small Cap ETF, also underperformed their larger cap peers, returning 7.52%, with the value component returning 7.12% while the growth component gained 7.99%. All sectors were higher over the quarter except for communication service stocks and real estate, which lost -4.83% and -2.10%, respectively. On the heels of rising oil prices, energy stocks led performance, rising 14.13%, followed by industrials which added 11.89%.

INTERNATIONAL EQUITIES: The iShares MSCI EAFE ETF, which tracks the MSCI EAFE Index, and has exposure to a broad range of mid and large cap companies in Europe, Australia, Asia and the Far East, gained 5.77%, underperforming U.S. stocks during a period where the U.S. dollar gained 3.11% against a basket of major world currencies. Information technology stocks returned 14.28%, led by companies tied to the semiconductor industry. Disco Corp (52.89%), Tokyo Electron (46.86), Advantest (32.50%) and chip maker ASML (28.03%) rounded out the top four. Consumer discretionary stocks rose 10.91% led by Toyota Motor Corp (36.44%) and Ferrari (29.26%). Utilities (-4.95%), consumer staples (-3.17%) and material stocks (-1.07%) combined to detract -62 bps from the overall return.