MARKET REVIEW & OUTLOOK

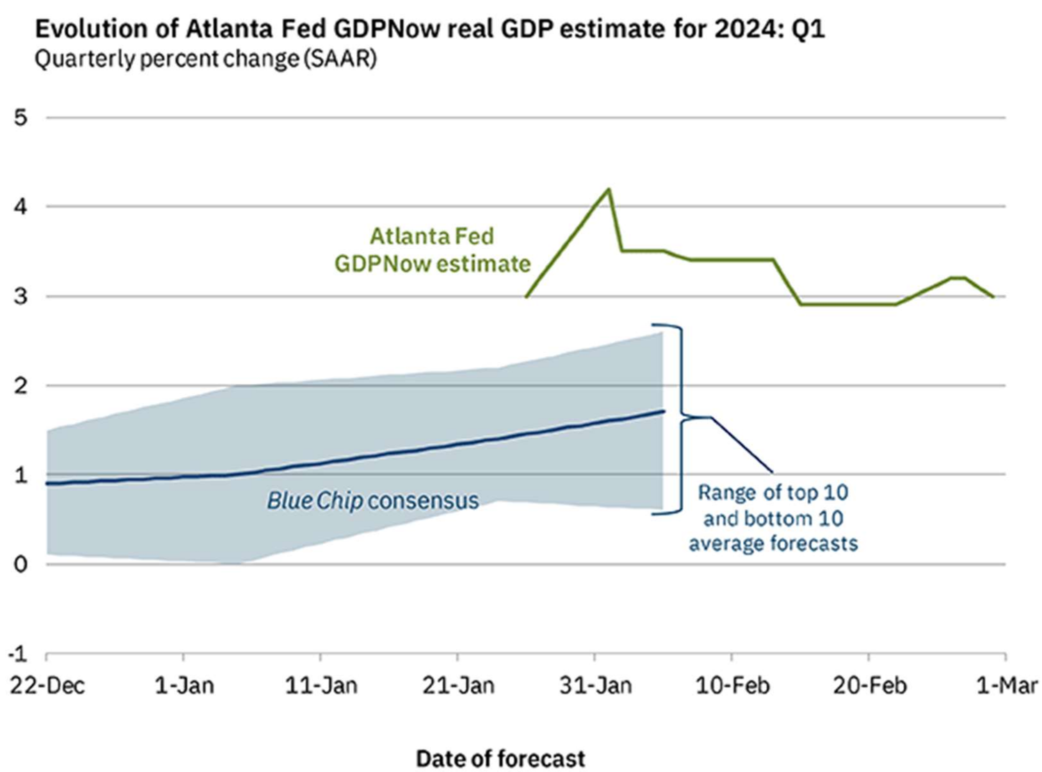
FEBRUARY 2024

KEY TAKEAWAYS

- The Fed induced dump at the end of January was just another dip to buy, which occurred a couple of times in February, leading to strong equity gains.
- The U.S. 10-year Treasury Yields rose sharply the first two weeks but stabilized around the 4.25% mark the last half of the month.
- Crude oil dipped to start off the month, but then rallied and held the upper $70's.

The U.S. Economy

The second look at 4th quarter GDP came in mildly weaker at 3.2%, below expectations of 3.3%. The core PCE, the imbedded inflation measure, rose to 2.1% from the initial report of 2.0%. Looking to the 1st quarter estimates for GDP from GDPNow is still a robust 3% and the Blue-Chip consensus forecast is moving toward 2%, as shown in the chart below. Economic activity remains solid, and the PCE deflator has moderated to the sweet spot of "2%" inflation. The data seems reasonable, and the Fed is backing away from the market's view of lower sooner, rather than higher for longer.



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

The U.S. 10-year Treasury yield fell the last week of January and into the first day of February. However, that ended with the barn burner employment report, discussed below, that led to a persistent two-week rally in yields. Yields stalled out in the low 4.30's for the balance of the month. The Fed heads continued to talk about higher for longer and that while rate cuts may be appropriate later this year, March was too early and 6 was too many. The chart below shows that rate cut expectations have pulled back through most of this year. However, the equity markets continued not to care what they said and continued to hold hope that someday rate cuts will start so continue partying like it is 1999, thanks Prince. 😉 The chart below also shows how the Mega Cap Tech index, the NASDAQ 100, has completely decoupled from future rate cut projections. If they were still trading in sync, either 8 rate cuts are in the future or the NASDAQ is ahead of itself by 2,000 points, not sure which is more right, but the divide is huge! The sharp rise in yields created a strong headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF dropped -1.41% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.25%, up meaningfully from January's close of 3.97%.

Source: Bloomberg

Source: https://www.zerohedge.com/markets/leap-faith-feb-favored-bitcoin-bulls-bond-bears-anti-obesity-advocates

The Dow Jones Industrial Average rose +2.22%, the S&P 500 rallied +5.17%, and the small cap iShares Russell 2000 ETF jumped +5.64%. The international markets traded similarly with the U.S. markets. The MSCI EAFE iShares Core International Developed Markets ETF Index climbed +2.74%, and the MSCI Emerging Markets iShares Core ETF Index popped +4.48%.

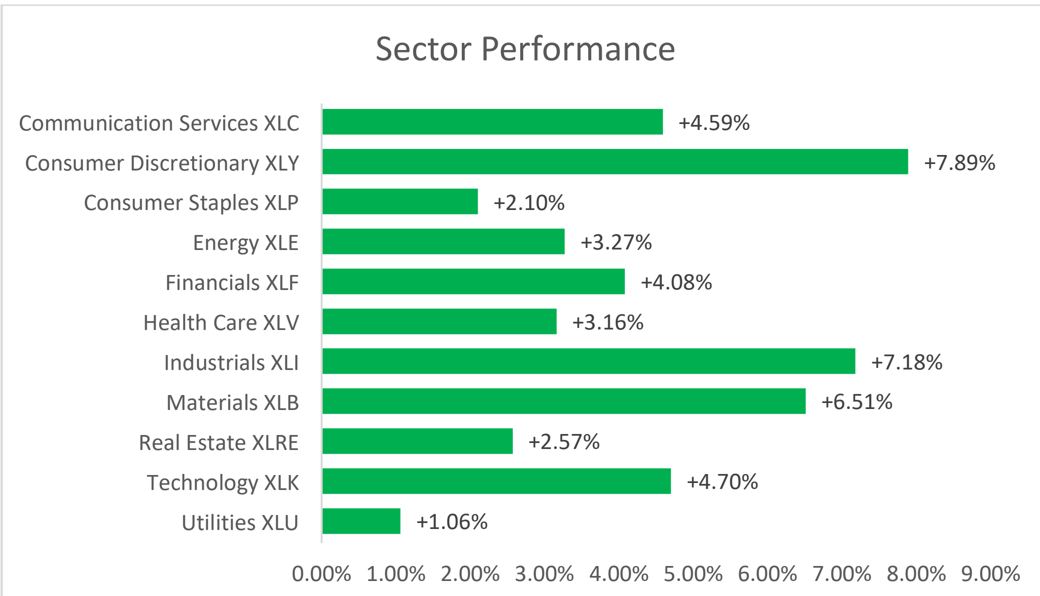
February's performance was green and very green!

The best performers were…

- Consumer Discretionary: +7.89%
- Industrials: +7.18%
- Materials: +6.51%

The "worst" relative performers were…

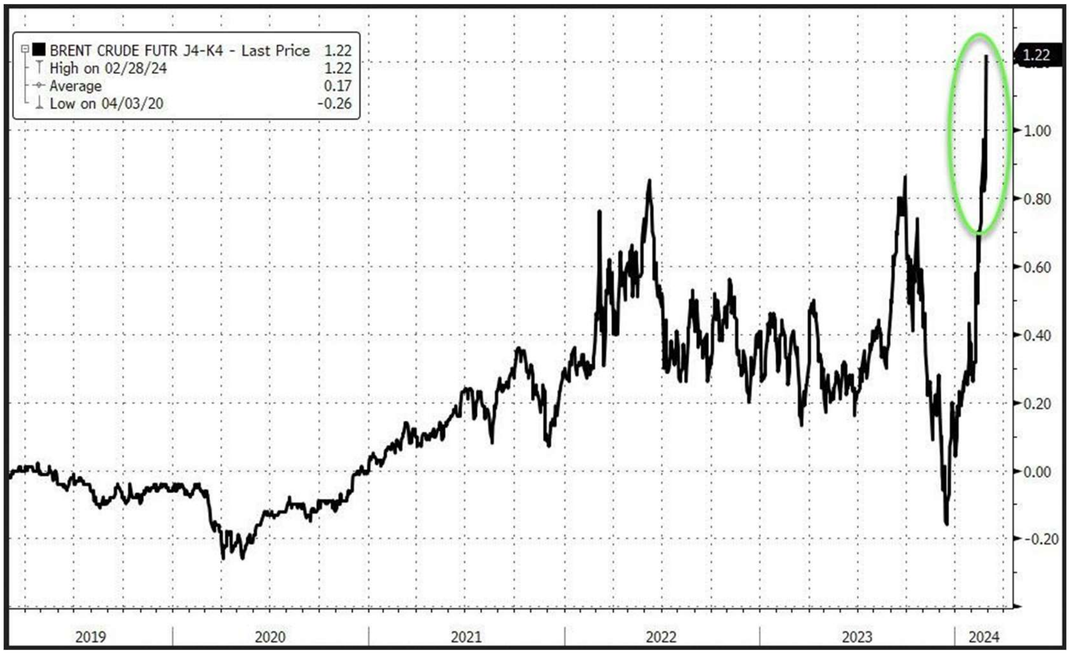
- Utilities: +1.06%
- Consumer Stables: +2.10%
- Real Estate: +2.57%



Source: https://www.morningstar.com

Oil Report

The oil market continues firming as the pressures in the Red Sea are starting to impact supplies. The oil market is still being stymied by the $80 level, but from a technical perspective a sustained break above $80, heading into the traditional strength of spring and summer driving season, looks poised for a significant rally in oil prices and continued/renewed inflationary pressures. The current NYMEX WTI Crude Oil futures settled at $78.26 posting a gain of over 3% from the prior month's close of $75.85 a barrel. The tight supplies are really starting to show up in RBOB gasoline, which finished with a gain of almost 16% vs. January's close. The chart on the next page shows that prices for current oil is higher than for the forward month contract, which pre-Covid was unusual. To start the year, the oil market temporarily normalized, but this year we are seeing relatively very high prices for current oil, suggesting tight supplies, which is a large driver of higher gas prices. Stock up, it looks like oil and gas could get pretty expensive this summer.



Source: https://www.zerohedge.com/energy/wti-retraces-gains-after-crude-build-spreads-signal-physical-market-tightening

The Rest of the Data

The January ISM Manufacturing Index increased to 49.1 from December's reading of 47.4. The ISM Services Index jumped to 53.4 in January, from December's print of 50.6. The prices paid component for Services jumped up to elevated levels and Manufacturing prices jumped back to neutral levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence dropped to 106.7 in February, which compares to a sharp downwardly revised figure of 110.9 in January. The unemployment rate remained at 3.7%, while the economy added a massive 353,000 jobs in January, crushing expectations of 185,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.3% in January, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate of increase moderated to +3.1% on a non-seasonally adjusted basis. The CPI ex Food and Energy remained at 3.9% over the last year. Same news, the economic data remains solid, employment reports are good/strong, and inflationary pressures are flattening out, and still higher than the Fed target of 2%. The only sign of slight weakness remains in the Manufacturing sector. The market has backed off expectations for a March rate cut, now pushed to June and taken rate cuts down to 3 from 6 previously for 2024 as shown earlier. However, given the continued robustness/strengthening of the economic data and initial signs of inflation firming, it seems hard to see rate cuts happening soon without an exogenous event. Potential catalysts in March, the end of the banking support mechanism and the near depletion of the Reverse Repo Reserves. However, clearly the equity market is dismissing those as concerns at the moment. We will continue to monitor economic activity along with inflation reports.

Summary

The equity markets just continue to be happy go lucky. As the sector analysis above shows, the early cyclical industries led the charge. Are the comparisons that this is the start of a massive bull market like the early ‘80’s or 1995 accurate? The bond market is repricing something, less rate cuts alone, more inflation or an economic boom? The deficit spending is helping GDP at the cost of increasing the national debt, and higher rates will be a drag. Additionally, if oil prices really make the run higher they seem poised for, inflation will start running hotter again, which won’t help with rate cuts. The bond market and oil market are trying to tell a story, not a 100% sure what they are saying and only time will reveal what they are saying. Equities are acting like children with fingers in their ears shouting lalala ignoring risk as prices continue to ramp higher.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients’ portfolio in concert with the clients’ risk tolerance and long-term goals. The markets will always face different “worries”, today it is inflation/war vs. growth and growing debt, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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