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April 15, 2024 – Investment Commentary

Equities

The major equity benchmarks retreated for the week amid heightened fears of conflict in the Middle East and some signs of persistent inflation pressures that pushed long-term Treasury yields higher. Large caps held up better than small caps, with the Russell 2000 Index suffering its biggest daily decline in almost two months on Wednesday and falling back into negative territory for the year to date. Growth stocks also fared better than value shares, which were weighed down by interest rate-sensitive sectors, such as real estate investment trusts (REITs), regional banks, housing, and utilities. The primary factor weighing on sentiment appeared to be last Wednesday morning's release of the Labor Department's consumer price index (CPI) data.
The S&P 500 returned -1.5% for the week. No sectors in the S&P 500 had positive returns; financials (-3.6%) were the laggards. EAFE markets returned -1.1%, with positive returns in the U.K. (+1.3%) and Japan (+1.1%) offset by negative returns in Europe (-1.8%) and Australia (-1.5%). E.M. markets returned -0.3%, dragged down by Korea (-2.7%) and Brazil (-2.2%).

From a valuation perspective, most markets are within ±1 standard deviation based on historical forward P/E ratios, though the S&P 500 is at +1.7. For the next 12 months, EPS growth for the S&P 500 is expected to be 8.4% (vs. 7.2% annualized over the last 20 years). For the next 12 months, EPS growth for NASDAQ is expected to be 21.9% (vs. 12.7% annualized over the last 20 years). The S&P 500 (US Large Cap) and NASDAQ trade above their 20-year averages based on forward P/E ratios, as does the MSCI EM (E.M. Equities), while the Russell Midcap (US Midcap), Russell 2000 (US Small Cap) and MSCI EAFE (Non-US Developed Market Equities) all trade below.

Fixed Income

The consumer inflation data helped drive the yield on the benchmark 10-year U.S. Treasury note to its highest intraday level since November before Treasuries rallied on Friday as investors sought U.S. dollar-based assets. (Bond prices and yields move in opposite directions.) The U.S. Aggregate Bond index price dipped below $90 again, hitting $88.76 to close last week. Over the last three years, support has been around $85-$84. The yield-to-maturity on the U.S. Aggregate has surpassed 5% again to 5.15%. If spreads remain constant over a 12-month window, the 10-year. yield would need to surpass 5.50% to have a negative total return. While this cycle has taught us anything is possible, we see the 10 yr. yield in a wide trading range of mid-3% to 5%, and higher high-quality bond yields represent opportunities.

Investment grade fixed income sectors had negative returns as rates rose across the curve. Municipals returned -0.2%, while US AGG returned -0.7% and U.S. I.G. returned -0.7%. H.Y. bonds returned -0.6% while bank loans rose 0.1%. E.M. debt returned -0.8% as the U.S. dollar rose 1.7%.

Rates

Rates rose across the curve as a hot CPI report pushed out expectations for the timing of the first rate cut. The recession-watch 3M-10Y spread compressed 10bps and closed the week at -88. The 2Y-10Y spread widened by 3bps and is now -38. Rates rose in the U.K. and Japan but fell in the Eurozone. The BTP-Bund spread is at 1.40%. 5-year and 10-year breakeven inflation expectations rose and now sit at 2.53% and 2.40%, respectively; the 10Y real yield rose 10bps to 2.13%. The market now expects the Fed to cut one to two times in 2024, with the first cut now pushed out to September (45% probability, though July still prices a 38% probability) vs the Fed's guidance of three cuts. At year-end 2024, the market expects the Fed Funds rate to be 4.875%.

Currencies/Commodities

The dollar rose 1.7%. The commodities complex fell 0.5% as energy prices fell 0.9% for the week despite the move in Brent prices, which were higher on Friday. Brent prices were flat at $90/bbl. U.S. natural gas fell 0.8%, still near its lowest levels in 5 years, while European gas rose 13.5% amid Middle East tensions.

Market monitors

Volatility was higher for both equities and bonds (VIX = 17, MOVE = 113); the 10-year average for each is VIX =18, MOVE = 76. Market sentiment dropped slightly to 19 from 25 but remained bullish.