Market review: March, 2024

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Asset class recap for March

March was a good month for all of the asset classes we track below, as each of them had positive returns. The quarter was very good for stocks, but negative for long term and intermediate term bonds. The three market trends that impacted security returns most significantly for Q1 were

1) Intermediate and long term interest rates increased
2) The artificial intelligence bubble continued to expand
3) Oil prices increased

The S&P 500 returned 10.6% during the first quarter, which is roughly the historical average return for a full calendar year. Growth stocks outperformed value stocks, as A.I. stock momentum propelled growth stocks even higher. Higher oil prices helped push energy related stock prices up. U.S. stocks outperformed international stocks, with a strengthening U.S. Dollar providing a majority of the relative outperformance.

Bond yields for all but the very shortest duration bonds rose during Q1, which drove bond prices lower. High yield and short term bonds overcame price headwinds, thanks to the higher coupon payments for risky high yield bonds and the lower interest rate sensitivity of short term bonds.

Returns as of 3/31/2024						Annualized			
Asset class	**Mar 2024**	**Q1 2024**	**2023**	**2022**	**2021**	**3 yr**	**10 yr**	**30 yr**	Representative Index
U.S. Stocks	3.2	10.6	26.3	-18.1	28.7	11.5	13.0	10.7	S&P 500
U.S. Growth Stocks	1.8	11.4	42.7	-29.1	27.6	12.5	16.0	11.2	Russell 1000 Growth
U.S. Value Stocks	5.0	9.0	11.5	-7.5	25.2	8.1	9.0	9.7	Russell 1000 Value
U.S. Mid Cap Stocks	4.3	8.6	17.2	-17.3	22.6	6.1	9.9	11.0	Russell Mid Cap
U.S. Small Cap Stocks	3.6	5.2	16.9	-20.4	14.8	-0.1	7.6	8.8	Russell 2000
International Stocks	3.3	5.8	18.2	-14.5	11.3	4.8	4.8	5.3	MSCI EAFE
Emerging Market Stocks	2.5	2.4	9.8	-20.1	-2.5	-5.1	2.9	*	MSCI Emerging Market Equity
High Yield Bonds	1.2	1.5	13.4	-11.2	5.3	2.2	4.4	6.8	Bloomberg US Corp High Yield
Long Term Bonds	1.6	-2.4	7.1	-27.1	-2.5	-6.0	2.3	6.0	Bloomberg US Gov/Cred Lng Term
Intermediate Bonds	0.9	-0.8	5.5	-13.0	-1.5	-2.5	1.5	4.5	Bloomberg US Agg Bond
Short Term Bonds	0.4	0.4	4.6	-3.7	-0.5	0.2	1.3	3.4	Bloomberg US Govt/Credit 1-3 Yr
3-Month T-Bills (Cash)	0.4	1.3	5.0	1.5	0.0	2.6	1.4	2.5	ICE BofA US 3M Treasury Bill

** The Emerging Markets Equity index has not been in existence for 30 years yet. Source: Morningstar*

Investors, advisors, portfolio managers and the Fed all continue to grapple with uncertainty about where interest rates and inflation might be in the next 3 months, 1 year, 3 years, and beyond. Interest rates are a major factor in the prices of all investment securities, and in my 30 years of working with investments, I cannot remember a time when markets were so uncertain about what the yield curve might look like a year from today.

At the start of the year, the average economist was forecasting that the Fed would cut overnight interest rates 6 times during 2024, from the current 5.375% midpoint to 3.875%. Those expectations have been drastically reduced, as many economists are now forecasting only 3 cuts. Interest rates in the intermediate and longer ends of the yield curve are highly correlated to expectations for the Fed's overnight interest rate and have subsequently gone up. The 10 year treasury yield started the quarter with a yield of 3.87% and ended the quarter at 4.21%, an increase of 34 basis points. Predictably, the increase in yields was bad for securities that are sensitive to interest rates during Q1; Real estate sector stocks returned -0.5%, intermediate bonds returned -0.8%, and long term bonds returned -2.4%.

Very often, increasing interest rates drive equities to have negative returns as a result of higher debt servicing costs, higher discount rates, and crowding out because bonds have more attractive yields, however, during Q1 there was such enthusiasm for A.I. stocks that equity prices overcame the headwind of higher interest rates and had a terrific quarter. There were seven days during the quarter when the S&P 500 rose more than 1%, most of which were the direct result of one or more tech companies reporting good earnings. For example, the largest one day return during the quarter was a 2.1% jump in the S&P 500 the day after Nvidia reported Q4 earnings that beat analyst expectations. A couple weeks later, Oracle beat earnings expectations and the market jumped ahead another 1.1% in one day.

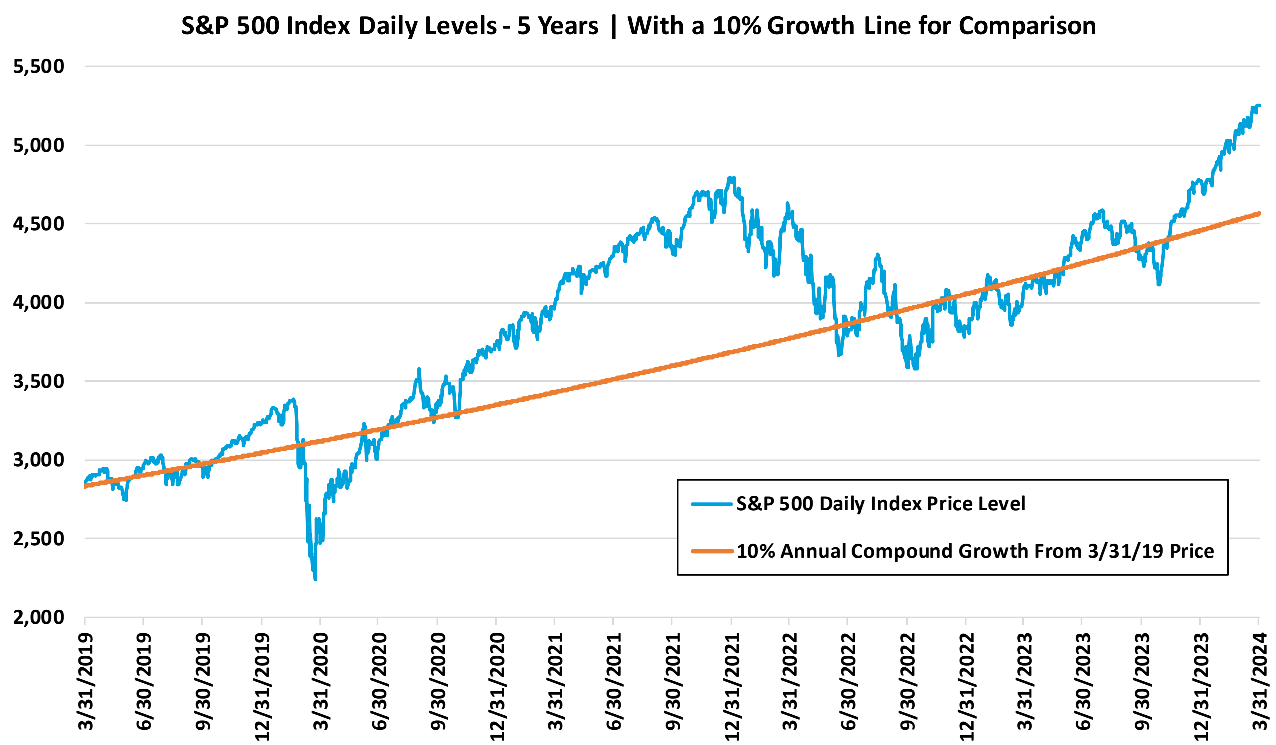
Oil prices for WTI crude rose from $71.65 per barrel at the start of the quarter to $83.17 at the end of the quarter, a 16% increase. Energy stock prices rose in parallel, with the S&P 500 Energy Sector Index returning 13.7% during Q1. Reasons cited for the increase include OPEC production cuts and strong demand.

Real estate was the worst S&P 500 sector this quarter. In previous commentaries, we have written about our concerns about the real estate sector, due to high interest rates and the impact on commercial real estate from the work-at-home trend. Studies have reported that there may be an oversupply of apartment buildings that were started a few years ago when interest rates were near zero, which could have a negative impact on occupancy rates.

Looking Forward

One of the most simple tests I like to start with to evaluate whether the market may be over or undervalued is a comparison of the S&P 500 index to a simple compound price growth line. History teaches us, market cycle after market cycle, that stock prices always revert to fair values over the long run. History is much less helpful in signaling us on *when* this reversion might happen, but it always happens eventually. Underweighting equities when you believe prices are too high is a very risky move, because you can't be certain whether you will be able to identify the right day to get back in, before the market pushes up and leaves you with a permanent loss of capital because prices never return back down to your selling level. Overweighting equities when they are undervalued is much less risky because if you are wrong and prices drop, you always know that the market will eventually return up to the level where you bought in.

This comparison to a simple price growth line is very simplistic for many reasons, including; 5 years is not very far back in historical terms, the 10% line is a bit generous as it is about 2% higher than the S&P's roughly 8% historical price return, the starting point of 3/31/2019 may have been a point at which stocks were overvalued or undervalued, and this analysis ignores changes in the interest rate environment. Even with its simplicity, I find this chart does a great job of helping us understand where we might be in the market cycle. As of today, stocks look a bit overvalued, but not so overvalued that we feel compelled to become defensive. If stock prices gap up much higher though, we will start to look for attractive opportunities to get defensive.



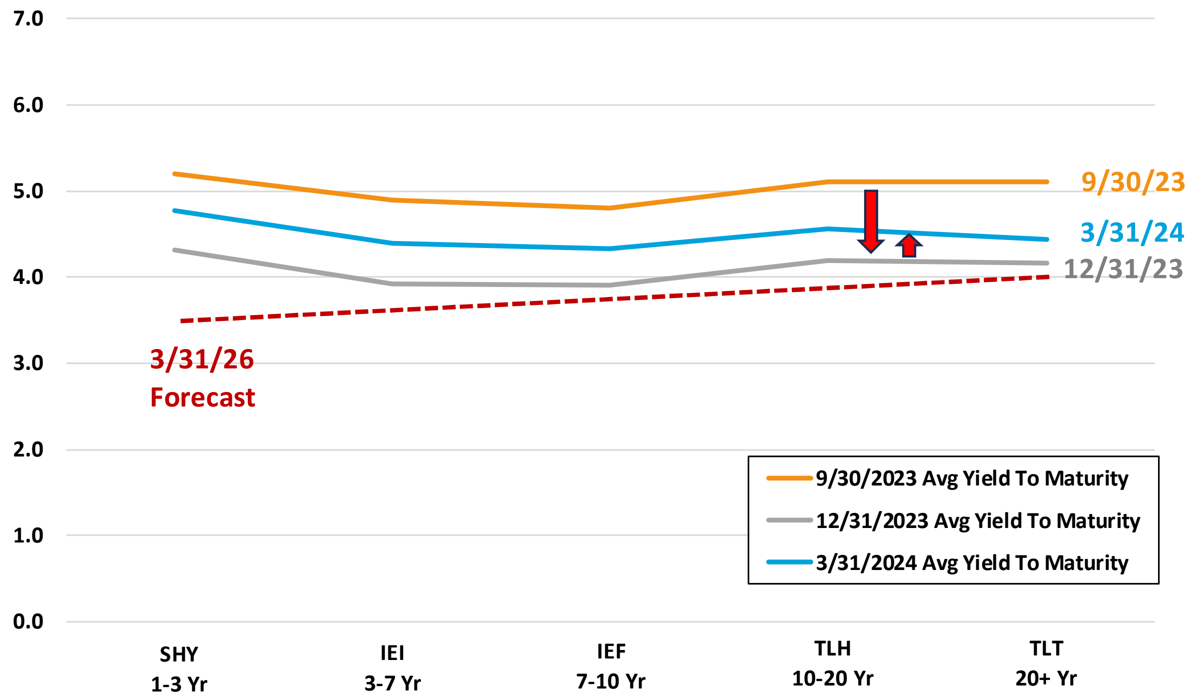
Source: S&P Dow Jones Indexes

Our tru Investment portfolios have been underweight to long term bonds for many years, which has been a good portfolio tilt and boosted our relative returns. We have been watching for the right time to get back into long term bonds, because in markets when interest rates are not rising, they have proven to be a good source of portfolio return and diversification. In our 9/30/23 market commentary, we included a table with yields to maturity for various iShares ETFs that help us clearly see the differential in potential coupon payments across the yield curve for easy to understand ETFs. We have reproduced that table below with a column for 3/31/2024 yields,

				Returns as of 3/31/2024		
ETF Name	**Ticker**	**Yield To Maturity at 3/31/24***	**Yield To Maturity at 9/30/23***	**Q1 2024**	**1 Year**	**3 Year Not Annualized**
iShares 20+ Year Treasury Bond ETF	TLT	4.4	5.1	-3.6	-7.7	-24.6
iShares 10-20 Year Treasury Bond ETF	TLH	4.6	5.1	-2.3	-4.3	-18.6
iShares 7-10 Year Treasury Bond ETF	IEF	4.3	4.8	-1.3	-1.6	-11.1
iShares 3-7 Year Treasury Bond ETF	IEI	4.4	4.9	-0.6	1.0	-6.5
iShares 1-3 Year Treasury Bond ETF	SHY	4.8	5.2	0.2	2.8	-0.3

**Yield To Maturity (YTM) is the average of the fund's individual bond holding yields and does not include fees*
Source: iShares and Morningstar

In Q4 of 2023, yields dropped significantly with a parallel shift down, but bounced partially back up during Q1 of 2024. We expect to see more downward adjustment during the next two years.



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