March 8, 2024

Dear Friends and Clients,

As spring approaches, the weather is starting to warm up. For the stock market, the temperature has been rising for a while now. In fact, since December 2023, the S&P 500 has not experienced a pullback of even 2%. Strong starts to years tend to signal more gains ahead, so this calm market may not precede a storm. In fact, when the S&P 500 has been up in January and February, it has gained an average of 11% over the rest of the year and has been higher in 26 out of 28 cases.

Here's some more good news. The market's process of adjusting to fewer interest rate cuts from the Federal Reserve (Fed) could be mostly over, with the Fed and the bond market generally aligned on the path of rates. Some upward pressure on yields is possible as this debate evolves and some components of inflation remain sticky, but with rate cuts forthcoming, there is a limit to how much higher rates will go. Stable interest rates can help support lofty stock valuations and reverse early-year losses in the bond market.

An excellent fourth quarter earnings season provides additional support for stock valuations. The mega cap technology companies were the stars of the show, as the biggest six technology companies drove more than nine points of S&P 500 earnings per share growth in the quarter *by themselves* – turning a 4.5% decline into a nearly 5% earnings increase. That's doing some heavy lifting. Prospects for high-single-digit earnings growth for the S&P 500 in the year ahead have brightened, though gains will be dependent on the U.S. economy achieving a soft landing. In the absence of recession, stocks have a strong track record of gains.

Against the odds, the Fed may have threaded the needle. Government spending has helped, enabling the economy to sustain itself late in its cycle. We'll be watching the economic data, credit markets, and various measures of investor sentiment for signs of deterioration. A broadening out to the "S&P 493" would be welcomed. Pairing technical analysis with fundamentals will be especially important.

History does suggest volatility may pick up after such a strong and steady advance. Although the S&P 500 has returned over 11% annualized since 1980, on average, the index typically experiences one 10% correction per year and three 5% to 10% pullbacks. A divisive presidential election now just eight months away could bring more volatility, as could geopolitical tensions or weakness in the mega-cap technology stocks.

Here's hoping for a warm — but not too hot — spring for the economy and markets, keeping Fed rate cuts in play while providing a solid foundation for corporate America to grow earnings.

As always, please reach out to me with questions.

Best regards,

Victor

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All data is provided as of March 6, 2024.

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All index data from FactSet.

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