A new year, a new quarter and the same old conversation: when will the Fed begin to cut interest rates? Pundits and market participants have been asking some version of this question and speculating on its answer seemingly since the Fed began their hiking cycle back in Q1 of 2022. Nonetheless, the US consumer and by extension, the economy, remain remarkably resilient, stubbornly resistant to changing prices and showing little regard for the Fed's attempts at bringing inflation fully down to their 2% target. Similarly resistant has been the US equity market, which shrugged off much of the so-so news in the quarter and continued its march higher, with the S&P 500 notching a 10.56% gain.

One theme we touched on last quarter was the narrow breadth of the market and the expectation for a widening of the dispersion of returns to occur, a prediction which will likely take a little longer to crystallize. The Bloomberg Magnificent 7 Index returned 17.14% for the quarter, though a deeper dive reveals something even more shocking: one stock, Nvidia, accounted for 65.75% of that return and a whopping 41.46% of the entire return for the S&P 500 in Q1. On a relative value basis, the spread between the forward P/E of the S&P 500 market cap-weighted index and the S&P 500 equal-weighted index, as well as the S&P 500 growth vs value indices, has never been higher. Interestingly however, while the forward P/E on the broader S&P index sits about three points higher than its ten-year median level, both the Mag 7 and equal-weight indices are right at their medians over the same time frame. Growth certainly comes at a premium, as the projected 12-month EPS growth for the Mag 7 is 26.11%, compared to the S&P at 9.24% and the equal-weight index at 6.09%.

The additional premium that the market was pricing in for much of Q1 was the prospect of Fed rate cuts on the horizon, as the disinflation trend that began in late 2022 seemed firmly intact. However, as the quarter wore on, that narrative began to shift; stronger than expected CPI prints in January and March, coupled with a firm labor market and a healthy February retail sales report served to push rates higher across the curve. At the beginning of 2024, the implied Fed Funds rate for year-end was 3.82%, or about 6 rate cuts; currently the year-end forecast is 4.89%, or less than 2 cuts, as market participants readjust to the changing macroeconomic picture and the higher-for-longer narrative stays stickier than expected.

In fixed income, the volatility in rates created a bifurcated market of sorts. The reversal in rates meant losses for the aggregate index (-0.78% for the quarter), especially for longer duration instruments (investment grade credit -0.40% and Agency mortgage-backed securities -1.05%), but lower-quality credit instruments experienced positive returns (high yield +1.47% and collateralized loan obligations +4.27%), as the stronger than expected economic numbers buoyed those more sensitive sectors. The flipside to increasing risk-free rates is the higher starting yields on new investments. As the 10-year US Treasury now sits north of 4.5%, yields on corporate bonds and other spread-related products are now approaching levels last seen in Q3 of last year.

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A copy of Form ADV, our registration statement with the Securities and Exchange Commission, is available at the FINRA website.

We fully expect to continue our allocation to attractively yielding investments, maximizing our held-to-maturity total return and enhancing the overall portfolio yield.

Looking ahead, we are resolved to remain vigilant amidst ongoing macroeconomic shifts, geopolitical risks, and policy uncertainties. Monitoring inflation trends, central bank actions, and geopolitical developments will be critical for navigating market volatility and identifying investment opportunities. Diversification across asset classes, active risk management, and a long-term investment perspective remain paramount in achieving our investment objectives amidst ever-evolving market dynamics. Challenges certainly persist and valuations are not cheap historically, but, in our view, patience and fortitude are historically rewarded.

If you have any further questions or concerns, please feel free to reach out. We're here to provide you with the support and guidance needed to navigate the markets with confidence. As always, thank you for your continued trust in our services.

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