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SoundView Wealth Management
Quarterly Market Recap – Q1 2024

To Our Clients,

The 2023 rally continued in the first quarter of 2024 as a positive combination of stable economic growth, falling inflation, impending Fed rate cuts and ever-growing enthusiasm towards artificial intelligence (AI) propelled stocks higher.

Q1 Review

The year began with a modest uptick in volatility, as traders and investors initially booked profits following the strong 2023 gains. However, those initially small declines intensified shortly after the start of the year when the December Consumer Price Index, an important inflation indicator, declined less than expected. That reading challenged the idea that inflation was quickly falling towards the Fed's 2.0% target and caused investors to delay the expected date of the first Fed rate cut, as expectations for that first cut moved from March to June. Then, in late January, the Federal Reserve clearly signaled that rate hikes were over and strongly hinted that rate cuts would occur in the coming months.

The rally continued and accelerated in February as fears of a potential rebound in inflation subsided. Inflation metrics released in February largely met expectations and importantly did not imply that inflation was reaccelerating. As such, investor expectations for a June rate cut were strengthened and that helped stocks extend the year-to-date gains. Those results further fueled investors' AI enthusiasm and large-cap tech stocks powered the S&P 500 higher into month-end as the index hit a new record high above 5,000.

The final month of the quarter saw even more gains, aided by familiar factors such as solid economic growth, generally as-expected inflation data, AI enthusiasm and bullish Fed guidance. Broadly speaking, economic and inflation data largely met expectations in March and continued to point towards stable growth and (slowly) falling inflation. Then, in mid-March, updated Federal Reserve interest rate projections still pointed towards three rate cuts in 2024, further reinforcing investor expectations for a June rate cut. Those positive factors combined with additional strong AI-related earnings pushed markets broadly higher ending March with strong gains.

In sum, the 2023 rally continued and accelerated in the first quarter of 2024 thanks to positive news flow that implied stable growth (no recession), still falling inflation, looming Fed rate cuts and continued AI enthusiasm and those factors propelled the S&P 500 to new all-time highs.

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Q2 Market Outlook

We begin the second quarter in the midst of a positive macroeconomic environment as growth appears stable, inflation is still falling, the Fed is likely going to deliver the first rate cut in four years and AI enthusiasm keeps earnings estimates high. But while this is undoubtedly a favorable set up, the strong rally of the last six months has left the S&P 500 at previously historically unsustainable valuations while investor and analyst sentiment is very bullish and, potentially, complacent. So, while the outlook is currently positive, it's essential we continue to monitor the macroeconomic horizon for risks because at current stretched valuations and with sentiment very bullish, the market is vulnerable to a negative surprise.

Specifically, while it's true that economic growth has remained resilient in the face of higher rates, some data is pointing to a loss of momentum. Retail sales missed expectations in January and February while the unemployment rate jumped to the highest level since 2022 during the first quarter. Neither number warrants concern about the economy right now, but both serve as a reminder to watch data closely as a continued economic expansion is not guaranteed.

The scourge of Inflation, meanwhile, is still retreating but the pace of that decline has slowed meaningfully. Core CPI, one of the Fed's preferred measures of inflation, has barely declined over the past several months as it sat at 4.0% y/y in October and in February was just 3.8% y/y. Meanwhile, other anecdotal indicators of inflation have hinted at a rebound in prices. If inflation bounces back that will reduce the number of Fed rate cuts in 2024 and that disappointment could pressure stocks and bonds.

To that point, markets fully expect a June rate cut from the Fed and three rate cuts in 2024 and that assumption was central to the first-quarter rally. However, those rates cuts are not guaranteed and if the Fed does not cut as aggressively as markets expect, that will result in disappointment and a potential decline in stocks and bonds.

Finally, investor enthusiasm towards the potential for artificial intelligence remains a critical part of the bull market and strong earnings furthered investors' hopes that AI integration will lead to a profitability and earnings boom, not just for tech companies, but for the entire market. However, that's also not guaranteed and so far, AI integration has produced a lot of flashy headlines but not a lot of profit maximization for non-tech industries. If AI fails to broadly boost profits and demand declines, that will be a significant negative for this market.

Bottom line, this historic rally is currently supported by positive fundamentals. But we cannot let the currently positive set up blind us to risks and that's why, while we are pleased with the market performance, we are also focused on managing both reward and risk in portfolios, because despite the strong performance this market remains vulnerable to negative news.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

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