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First Quarter 2024 Commentary

An Oxford Harriman & Company Market Commentary

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Stocks continued to provide positive returns during the first quarter. The S&P 500 returned more than 10% for the quarter, setting multiple new all-time highs. As we have discussed in prior commentaries, the first quarter saw a significant shift in sentiment, as investors now only expect three interest rate cuts this year as compared to six at the start of the year.

This change in expectations came as inflation progress slowed and the U.S. economy continued to expand despite higher interest rates, both of which signal a need for fewer rate cuts. We were skeptical of the need for six rate cuts entering 2024 and we want to once again reiterate that investors should not necessarily expect multiple rate cuts during 2024.

Equities Have a Strong Quarter

As mentioned above, the stock market is off to a strong start this year, with the S&P 500 Index gaining 10.16% in the first quarter. Shortly after the January 2022 all-time high in the S&P 500, the Federal Reserve started its campaign of aggressive interest rate hikes as inflation spiked to a 40-year high. As we painfully remember, there was a stock market selloff in 2022 as investors feared that higher interest rates would slow the economy.

The January 2022 all-time closing high held throughout all of 2022 and 2023, but it's already been eclipsed multiple times in 2024. After trading below its prior all-time high for over two years, the S&P 500 Index has set 22 new all-time closing highs this year.

Decline in Inflation Slowed in the First Quarter

Inflation was on a steady downward trajectory at the beginning of this year, and the market expected it to continue to move lower. However, recent data is causing investors to rethink this position. While inflation continues to decline, it's not falling as quickly as investors, or the Federal Reserve anticipated. Getting back to the Fed's 2% inflation target is not occurring as quickly as expected. Inflation readings have been uneven, and we believe the disinflation process may not be a straight line. The latest risk is rising oil prices, which has resulted in gasoline prices jumping by over 20% during the first quarter. Falling energy prices helped to ease inflation pressures during the past two years, but there is now concern about whether that trend can continue.

Investors Expect Fewer Interest Rate Cuts This Year

One of the big debates heading into 2024 was how many times the Federal Reserve would cut interest rates. Looking back to the start of the fourth quarter of last year, the market expected the Federal Reserve to cut interest rates by 0.75% this year. By the end of December, the market's rate cut forecast for the entirety of 2024 had risen to 1.50%. Based on a typical rate cut increment of 0.25%, investors came into this year expecting six interest rate cuts (i.e., 1.50% in total cuts). In contrast, the Federal Reserve indicated an expectation of only three interest rate cuts, or half the market's estimate.

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There was a debate over whose interest rate cut forecast was more accurate and concern about how the stock market would respond if fewer rate cuts were expected. As of the end of the first quarter, the central bank's forecast appears more accurate. Investors now only expect three interest rate cuts this year, which is in line with the Fed's initial forecast.

One potential reason for the fewer cut scenario is that inflation progress is slowing. Another reason is that the U.S. economy remains resilient despite higher rates. For example, new home construction activity is at levels not seen since before the 2008 financial crisis, despite the average 30-year fixed-rate mortgage sitting near a 15-year high of 7%. Also, consumer sentiment rose to a 2.5-year high in March after setting a record low in June 2022.

Other factors contributing to the improved sentiment include a tight labor market, rising stock prices and home values, expectations for a continued decline in inflation, and a solid overall economy.

Equity Market Posts a Second Consecutive Quarter of Strong Gains

Following impressive gains during the fourth quarter of last year, the S&P 500 gained 10.16% during the first quarter. Small cap stocks underperformed during the first quarter, as the Russell 2000 Index gained 5.18%. Ten of the eleven S&P 500 sectors posted gains, with cyclical sectors outperforming their defensive counterparts.

As mentioned earlier the stock market had a strong start to 2024. Following impressive gains during the fourth quarter of last year, the S&P 500 gained 10.16% during the first quarter. Small cap stocks underperformed during the first quarter, as the Russell 2000 Index gained 5.18%. Ten of the eleven S&P 500 sectors posted gains, with cyclical sectors outperforming their defensive counterparts. The Energy, Communication Services, Financials, and Industrials sectors each outperformed the broader S&P 500 Index, while the Real Estate, Consumer Discretionary and Utilities sectors were notable underperformers.

International stocks underperformed U.S. stocks for a fourth consecutive quarter during the first quarter. A few reasons may explain why international stocks continue to underperform. First, international stock market indices lack exposure to leading artificial intelligence companies. Second, as discussed above, the U.S. economy continues to expand despite higher interest rates. Conversely, some countries and regions outside the U.S. are already feeling the impact of higher interest rates and are in, or are just recovering from, a recession.

Bonds Trade Lower After a Strong Fourth Quarter

While stocks started the year off with strong gains, bonds traded lower during the first quarter. The losses came as investors realized that the continued resilience of the U.S. economy meant the Federal Reserve may not need to cut interest rates as much, which caused Treasury yields to rise. The Bloomberg U.S. Bond Aggregate Index, which tracks a broad index of investment-grade bonds, posted a decline of 0.7% for the first quarter. This represents a sharp reversal from last year's fourth quarter when the index gained 6.7%, the largest quarterly gain since 1989.

Second Quarter Outlook – Themes to Watch

The major investment themes were mostly unchanged during the first quarter. Stocks continued to trade higher, and the U.S. economy continued to expand. While the market now expects fewer interest rate cuts this year, the primary reason is that investors and the Fed believe the U.S. economy can handle higher interest rates.

The major investment themes were mostly unchanged during the first quarter. Stocks continued to trade higher, and the U.S. economy continued to expand. While the market now expects fewer interest rate cuts this year, the primary reason is that investors and the Fed believe the U.S. economy can handle higher interest rates.

Economic theory suggests that higher interest rates should slow economic activity as the cost of capital increases, but the data tells a different story this cycle. Home construction activity is the strongest since before 2008, consumer sentiment recently hit a 2.5-year high, and unemployment remains below 4%.

It's difficult to overstate the uniqueness of this economic cycle. There was unprecedented monetary and fiscal stimulus in 2020 and 2021, followed by a rapid rise in interest rates in 2022 and 2023 as inflation reached levels not seen since the 1970s. In the housing market, many homeowners locked-in low mortgage rates during the past few years, which has effectively limited the impact of rising interest rates.

The labor market remains relatively tight after five million workers left the labor force during the pandemic and didn't return; an event which has not been seen before. These themes won't reverse quickly and will have long-lasting impacts, which both the Federal Reserve and markets must navigate.

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Thus far, the stock market has successfully navigated a reduction in anticipated interest rate increases, but geopolitical risks remain, and the U.S. will have a presidential election in the second half of the year. Historically, election years tend to deliver favorable stock market results, but past performance certainly is no guarantee of future results.

We will continue to monitor financial markets and the economy, provide timely updates to you, and adjust portfolios accordingly.

Sources:

CNBC
The Wall Street Journal
Bloomberg

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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value. The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The NASDAQ 100 Index is an unmanaged group of the 100 biggest companies listed on the NASDAQ Composite Index. The list is updated quarterly and companies on this Index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology and retail/wholesale trade. The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The MSCI Emerging Markets Index is designed to represent the performance of large- and mid-cap securities in 24 Emerging Markets. Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Additional information is available upon request. PM-10122025-6548883.1.1