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Quarterly Market Update

April 3, 2024

Stocks at All-Time Highs as Recession Fears Fade

Stocks continued their upward trajectory in early 2024. The S&P 500 returned more than 10% for a second consecutive quarter, setting multiple new all-time highs along the way. Notably, this 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.

S&P 500 Sets 22 New All-Time Highs in Q1

The stock market is off to a strong start this year, with the S&P 500 Index gaining +10.4% in the first quarter. Figure 1 graphs the price of the S&P 500 Index since the end of 2021. The yellow dots mark new all-time closing highs. On the far-left side of the chart, the single yellow dot marks the previous all-time closing high set on January 3rd, 2022. Shortly after the January 2022 all-time high, the Federal Reserve started its campaign of aggressive interest rate hikes as inflation spiked to a 40-year high. The chart shows the 2022 stock market selloff as investors feared that higher interest rates would slow the economy.

FIGURE 1 – S&P 500 Index Sets Multiple New Highs in Q1



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. The yellow dots on the far-right side of the chart mark these new highs and show the S&P 500's steady climb higher in early 2024.

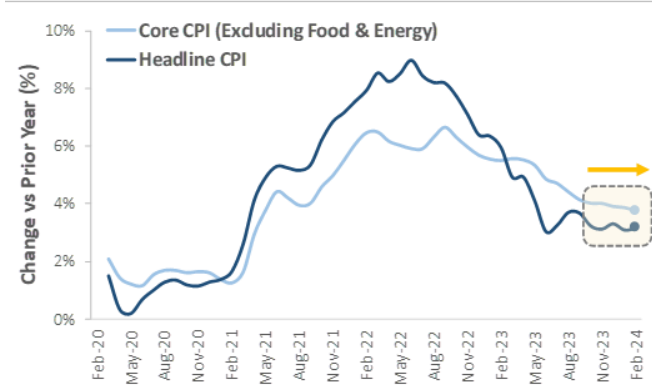
Source: MarketDesk. Latest available data as of 3/31/2024.

Higher Inflation Persists

Inflation was on a steady downward trend heading into this year, and the market expected it to continue moving lower. However, recent data is causing investors to rethink that assumption. Figure 2 graphs the year-over-year change in the Consumer Price Index, which measures the change in price for a basket of consumer goods. The chart shows the inflation spike in 2021 and early 2022, followed by a period of easing inflation during the past two years. However, the yellow box shows that the pace of inflation progress has slowed recently. While inflation is still drifting lower, it's not falling as quickly as investors, or the Federal Reserve want.

The question is whether the slowing progress is the start of a new trend or a temporary break in the current trend. Seasonality may be contributing to the slowdown, as inflation tends to be higher earlier in the year and then lower later in the year. Is the early 2024 rise the result of previously agreed upon contractual price increases, or does it hint at something more under the surface? Federal Reserve Chair Jerome Powell believes the early 2024 inflation bump is seasonal and short-term in nature. The market is less certain and more divided.

FIGURE 2 – Headline and Core Consumer Price Index (CPI)



Source: U.S. Department of Labor. Latest available data as of 3/31/2024.

The chart also demonstrates that getting back to the Fed's 2% inflation target will be bumpy and uneven. The latest risk is rising oil prices, with the price of a regular gallon of gasoline jumping by over +20% during Q1. Falling energy prices helped to ease inflation pressures during the past two years, but there is now a question about whether that trend can continue with gas prices rising.

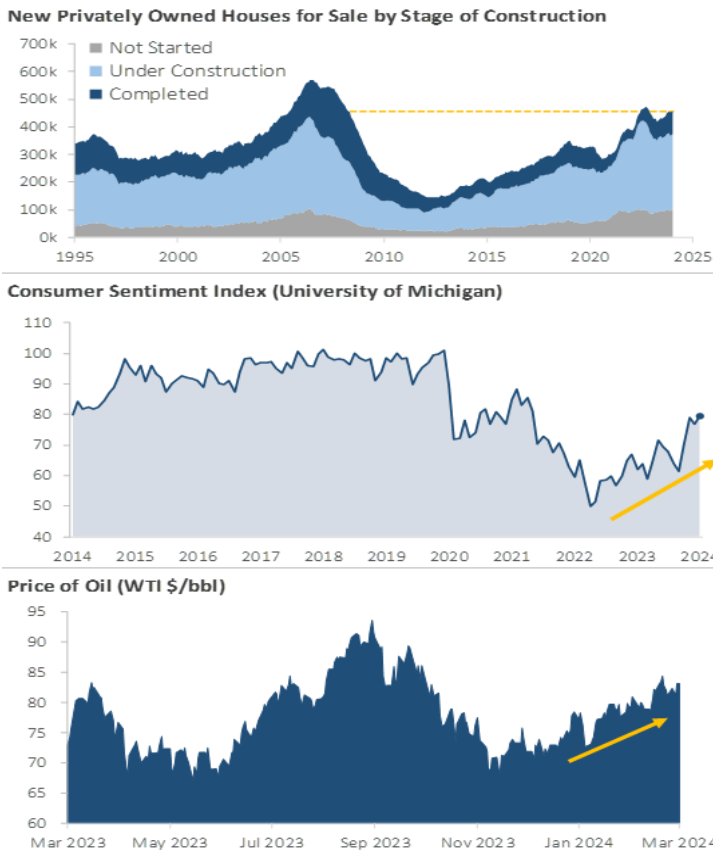
U.S. Economy Remains Resilient

The U.S. economy remains resilient despite higher rates. Figure 4 graphs three data points that underscore this resilience. The top chart graphs the number of new homes for sale by stage of construction: not started; under construction; and completed.

The chart shows home construction activity is at levels not seen since before the 2008 financial crisis, despite the average year fixed-rate mortgage sitting near a 15-year high of 7%. The middle section shows consumer sentiment rose to a 2.5-year high in March after setting a record low in June 2022.

U.S. Economy Remains Resilient (cont.)

FIGURE 4 – Data Highlights the U.S. Economy's Resilience



Multiple factors are contributing to the improved sentiment, including a tight labor market, rising stock prices and home values, expectations for a continued decline in inflation, and a solid economic backdrop. The bottom chart tracks the price of a barrel of West Text Intermediate crude. Crude oil prices have risen from approximately \$70 per barrel at the start of the year to \$83 per barrel at the end of Q1, an increase of roughly +18.5%. Oil is a cyclical commodity, so rising oil prices suggest demand is strong and may hint at underlying strength in the U.S. economy.

Bonds Trade Lower After a Strong Fourth Quarter

Source: U.S. Census Bureau, University of Michigan. Data as of 3/31/2024.

While stocks started the year off with strong gains, bonds traded lower during Q1. 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 rated bonds, posted a total return of -0.7%. It was a sharp reversal from Q4, when the index posted its first quarterly gain since Q1 2023 and its biggest quarterly gain since 1989.

In the corporate bond category, investment-grade bonds underperformed high-yield bonds during Q1. Over the past twelve months, high-yield corporate bonds have generated a total return of +8.8%, which factors in the interest payments received. Investment-grade corporate bonds generated a +3.5% total return over the same period. The high-yield bond universe continues to benefit from multiple themes. First, the group yields 7.83% at the end of Q1, which is 2.45% higher than investment-grade bonds. This extra yield helps boost high-yield's total return. Second, as Figure 4 highlights, the U.S. economy has remained resilient despite higher interest rates. With the U.S. economy expanding at a solid pace, high-yield bonds' credit risk has remained stable, limiting the number of defaults.

Second Quarter Outlook-Themes to Watch

The big investment themes were mostly unchanged during the first quarter. Stocks continued to trade higher, and the U.S. economy remained in expansion mode. 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, 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. We will continue to monitor financial markets and the economy, and adjust portfolios as needed.

Election Year Reverberations

It seems highly probable that this year's presidential election will feature President Biden vs. former-President Trump in a replay of the 2020 election.

Regardless of your political persuasion you likely have strong feelings and opinions about this election. These strong feelings will be amplified in the media. A messy slug-fest seems inevitable.

An increase in market volatility and anxiety should be expected as we navigate through this election year. Each side will proclaim the other will be a calamity for the economy and stock market.

Nonetheless, a "stay-the-course" mentality will be the wisest course to take. As a Financial Advisor I have managed client funds through seven presidential elections. Despite the worry and anxiety, they produced, the Dow Jones has grown from around 6,000 to 40,000 (4/1/96 – 4/1/2024). It has never been profitable to base investment decisions on political opinions.



Bottom Line?

We are optimistic that a looming, widespread economic recession, which was widely forecast, will be avoided. As usual the key metrics are those associated with consumers, jobs, spending, credit availability, and the like. All of these are stable.

The markets are at all-time highs, and this is also boosting consumer behavior and supporting economic stability. Valuations for stocks are stretched in some areas, and inexpensive in others. Sound judgment in asset allocation is paramount.

Finally, a presidential election year will bring added market anxiety and general unpleasantness at times but remember to keep your focus on the economic fundamentals, not the political narrative.

As always, we are here to answer any questions you may have. Happy Spring!! *Jon Lokken*

Shred Event



Please join us for a complimentary drive-thru shredding event.

When: Monday, April 22, 2024

Time: 10:00am –12:00pm

Where: Lokken Investment Group
Parking Lot

1413 Savannah Road, Lewes DE 19958

Stop by our office in Lewes with any documents, hard drives, or floppy disks that need shredding. Light refreshments will be provided.

Please **RSVP** by calling 302-645-6650 or
email gcaceres@lokkeninvest.com

Upcoming LIG Community Events

Tax Planning In Retirement Seminar

April 17, 2024
10am-11:30am
Lewes Public Library
RSVP Required

Lunch & Learn

May 21, 2024
12pm-2pm
Big Fish Grill
RSVP Required

Estate Planning Seminar

May 8, 2024
10am-11:30am
Lewes Public Library
RSVP Required

Tax Planning In Retirement Seminar

June 5, 2024
10am-11:30am
Lewes Public Library
RSVP Required

***If you would like to attend any of these events please RSVP to gcaceres@lokkeninvest.com or call Gabriela at 302-645-6650**

Upcoming Office Closures



Memorial Day

May 27, 2024
Market Holiday



Juneteenth

June 19, 2024
Market Holiday



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