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QUARTERLY INVESTMENT PERSPECTIVES: Q2 2024

First Quarter Review

Stocks continued their run of strong performance during the first quarter, with the S&P 500 returning 10% and the Dow Jones Industrial Average closing in on a record high level of 40,000. Mid and small cap stocks were positive, with returns of 8.6% and 5.2%, respectively. Drivers of U.S. market returns were positive economic data, with U.S. GDP growing 3.4% to close 2023, consumer sentiment beating expectations, and pending home sales exceeding expectations despite elevated interest rates. Fixed income investments were challenged, as intermediate and long-term yields rose on the prospect that the Fed would not cut rates during the first half of the year. The Barclays US Aggregate Bond index fell (0.8%).

The Federal Reserve held interest rates steady during the first quarter and adjusted their outlook due to inflation data not falling as quickly as some anticipated. Short-term interest rates ended the quarter at 5.3% and economists are forecasting between 2-3 rate cuts this year. In the balance for the Fed's decision-making are (1) the strength of the economy, which would suggest that rates can remain elevated without damaging effects; (2) persistent inflation readings around 3% instead of the 2% level Fed officials desire and; (3) the potential for unforeseen economic weakness that could be avoided if they proactively cut rates to their long-run target of around 3.0%.

While the market has experienced very smooth sailing over the last 6 months, there is likely to be some turbulence as traders assess when and how quickly the Fed may cut rates. Stock investors would prefer rate cuts sooner rather than later, as lower interest rates ease financial conditions and support higher stock market valuations.

The Fed however is seeing the market at all-time highs, the economy performing well, and wondering "Why do we need to cut rates?" To be fair, it is an honest question, and they have valid concerns that cutting rates would fuel the animal spirits on Wall Street and could lead to a rebound in inflation.

Though we do not foresee a recession this year as economic tailwinds remain positive and the balance sheet for consumers and companies in the U.S. remains very healthy, we do expect that there will be a slowdown in growth after last year's 3.4% increase in GDP. Given that the stock market has just risen over 20% in the last two quarters, the economy could be slowing, and the Fed is signaling that rate cuts are further away than many expect, it would not surprise us to see volatility return to the market over the spring or summer months. This would likely be a garden variety correction – which usually averages 15% in a given calendar year – and would likely be met by the Fed cutting rates and yields falling, which would then ease financial conditions. This would likely provide a good long-term entry point for stock investors given the strength of the economy and lower yields on fixed income.

Investment Market	Q1 - 2024
U.S. Large Cap Stocks	10.6%
U.S. Mid Cap Stocks	8.6%
U.S. Small Cap Stocks	5.2%
International Developed Stocks	5.9%
Emerging Market Stocks	2.4%
Barclays US Aggregate Bond	-0.8%
Barclays Global Aggregate Bond	-2.9%

Sources: JP Morgan, as of 1/31/2024

MARKET REVIEW AND OUTLOOK

The U.S. Report Card: "Exceeds Expectations"

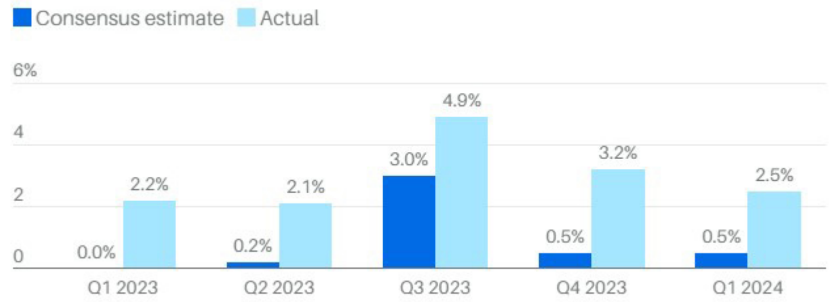
We noted in our annual outlook how the most anticipated recession in U.S. history keeps getting postponed. Indeed, economists have been too pessimistic about the potential for growth in the U.S. as the realized growth rate for GDP has outperformed the forecasts for the last five quarters in a row. For much of 2023, expectations were for growth to be just above the breakeven line; instead, the economy grew at rates between 2-5%.

While the story last year was that the economy consistently exceeded expectations, the reality in 2024 may be that the economy and forecasts are much more closely aligned. JP Morgan expects that GDP growth will average 0.7% for 2024, down from the 2.8% average growth rate last year. Elevated monetary policy is likely to take a broader toll on growth, as consumers feel the increased effects of higher interest rates and their savings balances continue to diminish.

JP Morgan summarizes the balance of headwinds and tailwinds well – "There are numerous reasons to expect consumer spending growth to slow next year from its firm pace in 2023: diminished excess savings, plateauing wage gains, low savings rates, and less pent-up demand. Additionally, the restart of student loan payments and an uptick in subprime auto and millennial credit card delinquencies are emerging signs of stress for some consumers. On the flipside, household balance sheets and debt servicing levels remain healthy. Tight labor markets continue to support employment and therefore income levels. Considering the cross currents, we think consumer spending growth can stay positive overall in 2024, but at a lower rate than 2023."[1]

Economists have been too pessimistic about U.S. economic growth.

Change in U.S. real GDP, seasonally adjusted annualized rate



Note: First-quarter 2024 Actual is Atlanta Federal Reserve GDPNow forecast; estimate as of first day of each quarter.

Sources: Bloomberg, Bureau of Economic Analysis

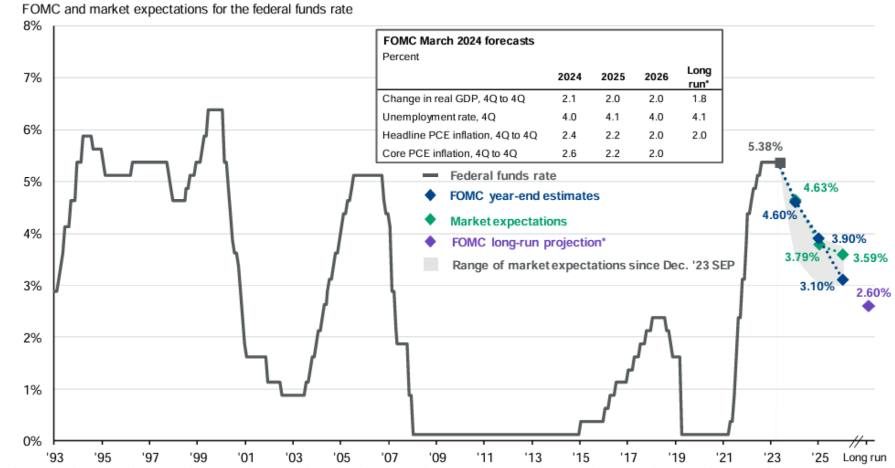
MARKET REVIEW AND OUTLOOK

As the economy grows at a slower rate, this will likely lead to lower inflation and give the Federal Reserve more bandwidth to start lowering interest rates. So far, the Fed has threaded the needle of lowering inflation rates around while not sending the economy into a tailspin. With inflation back at much more manageable levels, they can now pivot to a more relaxed interest rate policy to provide support for the economy rather than a brake. In the long-run (over the next five-plus years) they expect interest rates to average around 2.5%. By the end of 2024, they expect rates to come down to the 4.6% level from 5.38%. This would imply that they cut rates three times in the back half of the year and then cut rates another 3 times to 3.90% by the end of 2025.

The Fed's pivot from rate hikes to cuts will help soften the blow that any unforeseen economic risks may inflict. Business executives have been able to weather customer delays in purchasing or investment because of higher rates and now they know that based on the Fed's forecasts, the high interest rate environment is not going to last forever. The vast majority of companies have been able to refinance their debt positions over the three years prior to rate hikes and lock in low overall interest costs to help bridge the gap between now and the next round of rate cuts. The exact timing of when the Fed starts cutting rates is of interest to the stock market because some of the recent rally has been built on the hope that they would cut rates sooner rather than later. However, from an economic perspective, whether rate cuts happen in the second quarter, the third, or the fourth quarter of this year is less of a concern.

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

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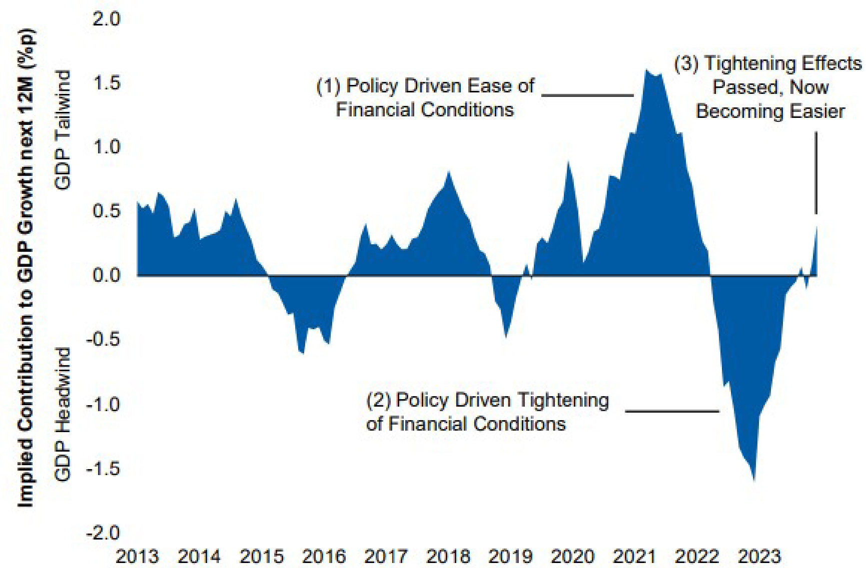
The bigger takeaway is that their pivot from hiking rates to potential future rate cuts has provided enough easing of financial conditions that it has already benefitted areas like the housing market (which saw better than expected sales and a drop in mortgage rates over the last three months) to high yield bond markets (which saw spreads compress, signaling easier borrowing conditions). The prior chart from Eaton Vance shows that the Fed relaxing their policy stance has shifted financial conditions from a burden on GDP growth to a slight boost to GDP growth. As they cut interest rates at some point in the next year, that lift to GDP will continue to increase and help offset the slowdown after last year's impressive growth.

Financial Conditions Are Now a Tailwind For Growth
Contributions to GDP growth over next year (in percentage points)



Note: Sign of this financial conditions index is reversed to better visualize headwind/tailwind.

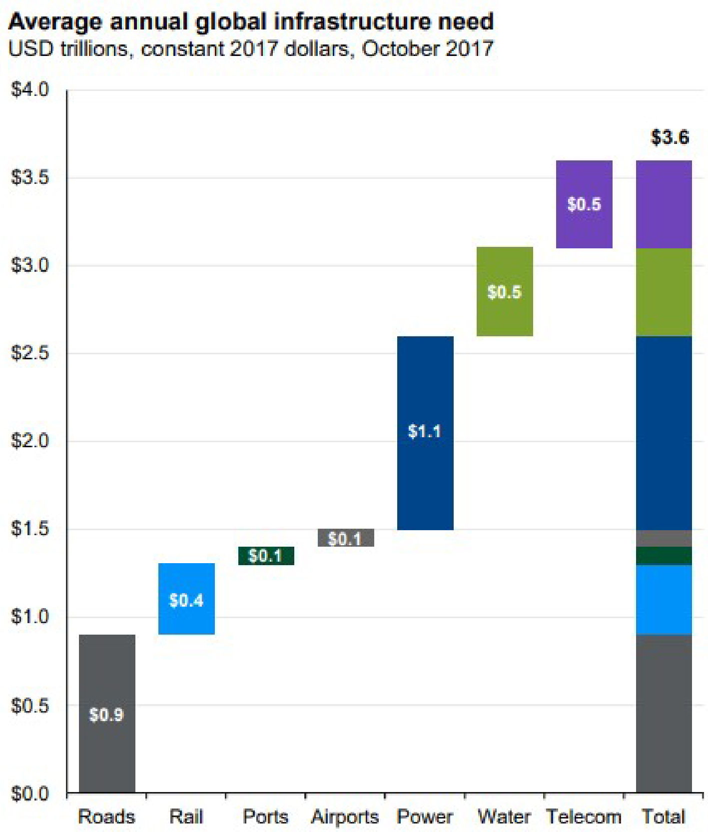
MARKET REVIEW AND OUTLOOK

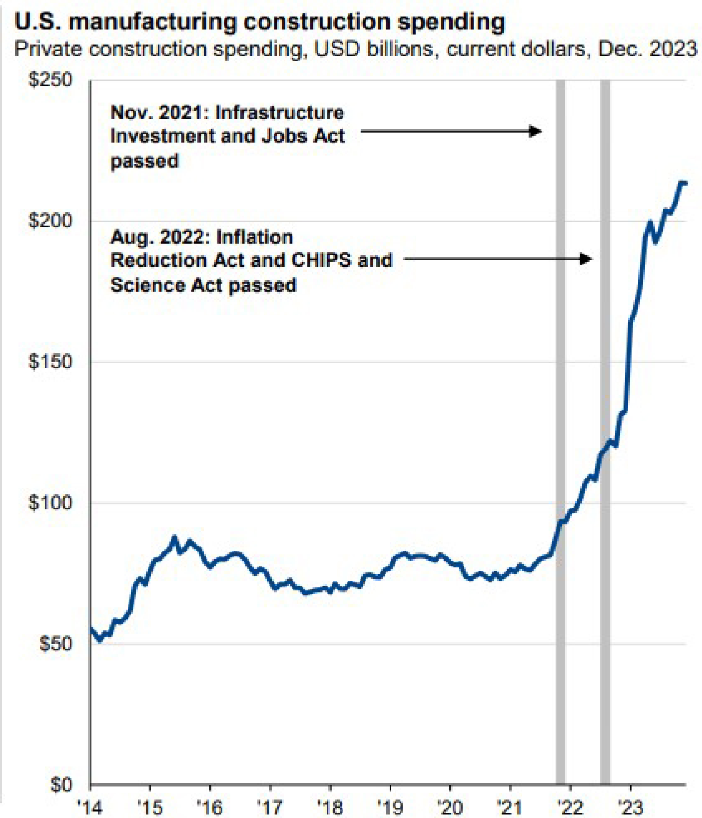
The Infrastructure of Everything

One of the major investment themes that we have explored for client portfolios and future investment allocations is that of infrastructure investments. Infrastructure could take on a variety of different meanings, depending upon the industry, but the more we look at the investment the more we think about the infrastructure of everything. In some applications, this looks like physical infrastructure such as railroads, highways, utility plants and distribution means, and ports, among other areas. In this particular sector, JP Morgan and PWC estimate the annual need for infrastructure investment to be around $3-4 trillion.

Whether it is maintenance on existing infrastructure such as power lines in California, or highways in the northeast, or railroad expansion in Florida, the needs are obvious. Additionally, with the increased proliferation of electric vehicles, the demand on the energy grid and the need for charging stations make the case for further investment and development within infrastructure.

We have explored investing in this space through both publicly traded companies as well as private investment vehicles and believe the asset class offers a very compelling place in the portfolio for steady capital appreciation, strong dividend payments, and lower volatility than traditional equity investments. Over the last three years, the Lazard Global Listed Infrastructure Fund has returned 9.13% annualized, compared to 10.86% for the S&P 500, and an annualized loss of (2.83%) for the Barclays US Aggregate Bond Index. Listed infrastructure has been able to achieve returns that are very similar to traditional equities and well in excess of bonds, while providing a volatility level that is over 25% less than equities.





Source: McKinsey Global Institute, U.S. Census Bureau, Whitehouse.gov, J.P. Morgan Asset Management.
Data are based on availability as of February 29, 2024.

The need for $3 trillion of infrastructure investment will be a boost to U.S. capital investment in years to come.

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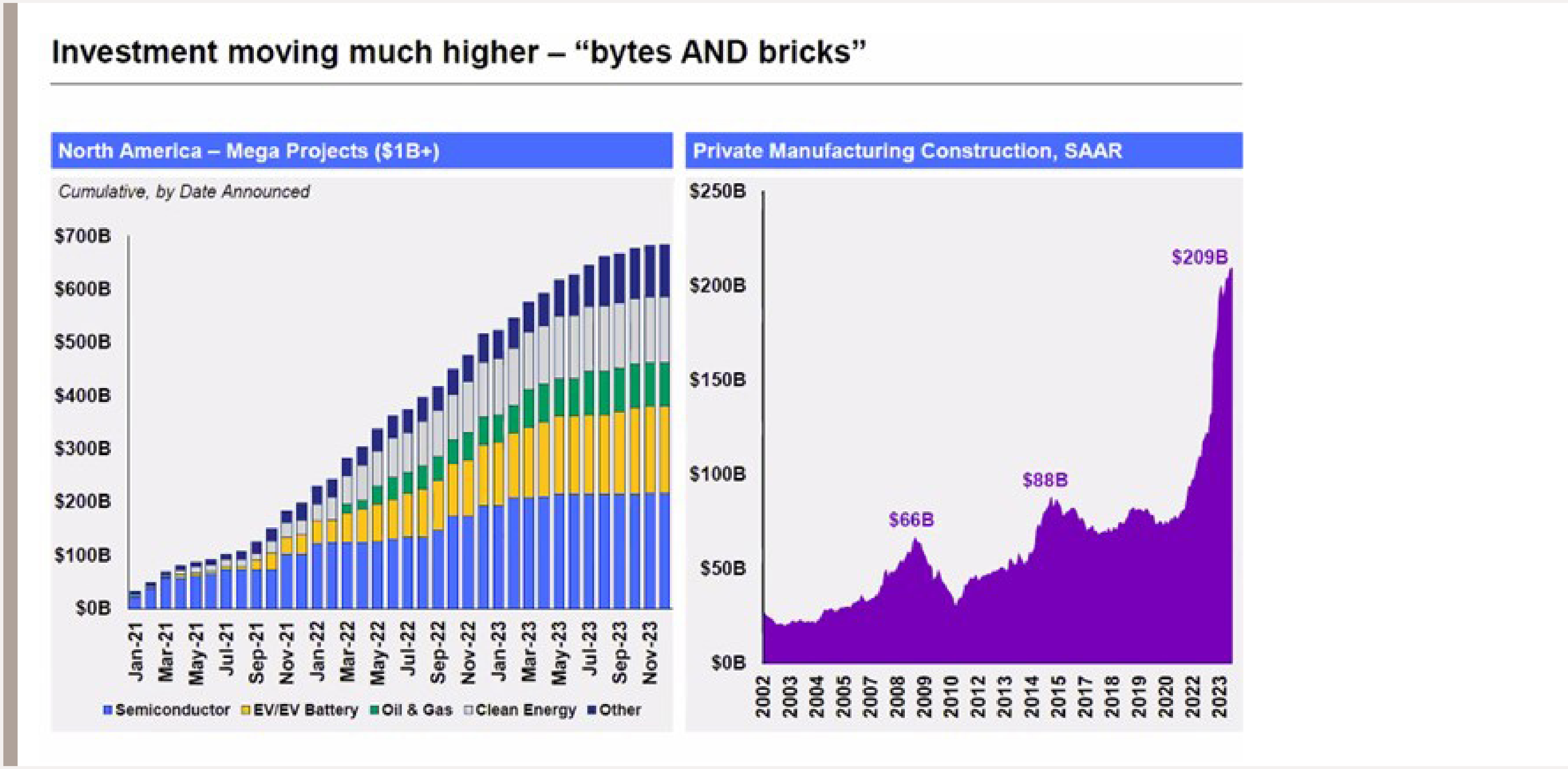
In addition to physical infrastructure in the traditional sense, we have also continued to research digital infrastructure and the buildout of additional technology spending as it relates to artificial intelligence. Nvidia and its AI powered chips have been the market darling and a clear winner, rising over 225% over the last year. However, the evolution of technology infrastructure is much more widespread than one company producing chips. Whether it is robotics, 3D printing, or data storage, there are significant “pick and shovel” opportunities as technology makes its way into nearly every industry. McKinsey predicts that more than 50 billion devices will be connected to the “internet of things” by 2025.[2]

This requires more data storage, faster data transfer speeds over existing cellular networks, and improved network capability. It also unlocks greater efficiencies for companies outside of the technology field, whether it is UPS identifying the best routes for package delivery, Regeneron searching for a breakthrough drug, or an accounting firm more adeptly syncing a client’s plan with the latest changes in tax law, the applications are endless.

Some of the investment opportunities may come in the public equity markets, in particular within the mid and small cap space as rising growth companies find new ways to harness the technological revolution. These opportunities are also likely to continue proliferating in the U.S., which has been the primary hub for innovation and has a significant share of the global technology sector. There are also likely to be plentiful opportunities within private markets, as start-up companies attract seed and venture capital funding. Private equity firms have amassed $2.6 trillion dollars in dry powder according to S&P Global Market Intelligence, which will find a home this year and next as interest rates start to move lower and confidence in economic stability increases.[3]



Rapid adoption of artificial intelligence is spurring significant investment in technology infrastructure and applications.

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Closing Thoughts

After another quarter of strong equity returns, we are pleased to see markets continuing to stabilize and provide strong capital returns to investors. Between COVID, rising rates, and rising geo-political risks, the last four years have been turbulent and unsettling. However, the U.S. economy has been resilient, and investors have been rewarded for not taking a short-term view, but rather focusing on the long-term fundamentals.

As we move into the middle of the year, we would caution that stocks may face some volatility, whether from profit-taking after such a strong run, near-term economic softness, the Fed keeping rates elevated, or some other unforeseen risk. For investors who have enjoyed the ride in equities and have near-term liquidity concerns, assessing the stock and bond mix within their allocation would be prudent as fixed income yields remain attractive and an increase to bonds could both lock in elevated rates and cushion against potential market swings.

If a correction does occur within the market, we do not believe it is cause for intermediate-term concern. The economy may slow after a strong year of growth, but this would likely be a result of capital investment seasonality rather than a sign of fundamental weakness. The labor market remains very strong, balance sheets are in excellent shape, and while near-term interest rates are elevated, the Fed will likely cut rates as we move into the back half of the year. The easing of financial conditions provides material support to economic growth and corporate outlooks and we expect it will help the economy to navigate a soft landing. As always, we look forward to speaking with you about your personal investment plan and strategy.

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All data as of 3/31/24 via Bloomberg, JP Morgan, McKinsey, S&P Global, Morningstar, and the Wall Street Journal.

Charts via, in order of appearance, BEA, KKR, KKR, BNY Mellon, Capital Group, WhartonHill, BNY Mellon, KKR.

1 - 2024 Economic Outlook: Insights & Trends | J.P. Morgan (jpmorgan.com)

2 - Top 10 tech trends for next 10 years (according to McKinsey) | World Economic Forum (weforum.org)

3 - https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/private-equity-firms-face-pressure-as-dry-powder-hits-record-2-59-trillion-79762227