PENOBSCOT
FINANCIAL ADVISORS

MARKET COMMENTARY

Q1 2024

MARKET REVIEW

Global stocks got off to a strong start in the first quarter of the year, delivering an impressive 8% return. The market was buoyed by the anticipation of an AI-driven productivity surge, particularly in the U.S., which overshadowed uncertainties surrounding prolonged elevated interest rates and the upcoming U.S. elections. While the S&P 500 achieved its first record high in two years, Japan also captured attention with the Nikkei hitting new record highs for the first time since 1989. Other major U.S. indices like the Russell 3000 closed the quarter at unprecedented levels.

The IT and Communication Services sectors were at the forefront of stock market gains, although the spotlight wasn't solely on the "Magnificent 7" names that dominated the U.S. market the previous year. While companies like Nvidia, Microsoft, Meta, and Amazon contributed positively to market performance (making up approximately 40% of the S&P 500's gains), both Apple and Tesla saw a dip. The advance was broad-based across sectors, with 10 out of 11 S&P sectors ringing up gains. The only lagging sector was Real Estate, coming off a robust 4th quarter of 2023.

The bond market, on the other hand, faced challenges with bond prices flat to down over the quarter. Higher interest rate projections were to blame. Late into 2023, bond markets were pricing in expectations of 5-6 Fed Funds rate cuts in 2024. During Q1 of 2024, however, stubborn inflation, a strong employment market, and surprisingly robust GDP made it clear the Fed didn't have adequate cover for such a steep rate cut trajectory and markets adjusted to pricing in only 2-3 cuts during the year.

The U.S. dollar underwent several ups and downs, ultimately closing the first quarter higher. Gold prices advanced to reach record highs. Crude oil prices, which began the year at about $71.00 per barrel, climbed nearly 16.0% to over $82.00 per barrel as oil exporting countries cut back on supplies and Red Sea shipping came under attack. This resulted in a general increase in prices at the pump, slowing the disinflationary trend that carried most of 2023. Home mortgage rates began the year at about 6.62% for the 30-year fixed rate, jumped as high as 6.94% at the end of February, before falling to 6.79% at the end of March.

The foregoing content reflects the opinions of Penobscot Financial Advisors and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that the statements, opinions, or forecasts provided herein will prove to be correct.

LOOKING FORWARD

THE ELEPHANT – AND DONKEY – IN THE ROOM

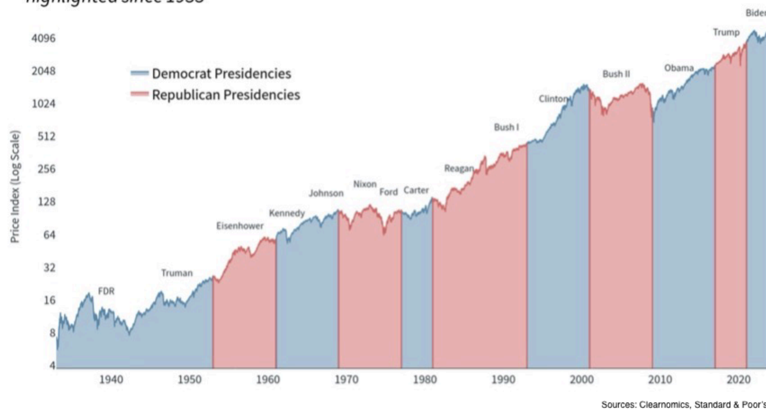
As we enter the heart of the 2024 election season, there will be inevitable back-and forth about the consequential nature of this election relative to others in history.

U.S. Presidential elections certainly have the capacity to create market volatility. In general, markets like certainty and a hotly contested election runs very much in the face of projecting policy into the future. It can be tempting to try to make investment decisions based upon the perceived outcome of an election like the one we are on the cusp of.

History has demonstrated, however, that political and administrative changes happen routinely in the modern market era, and that, despite the routine changes in which party controls the White House, financial markets trudge solidly forward over the long term.

The Stock Market and Presidencies

S&P 500 price returns on a log scale with presidents and their parties highlighted since 1933

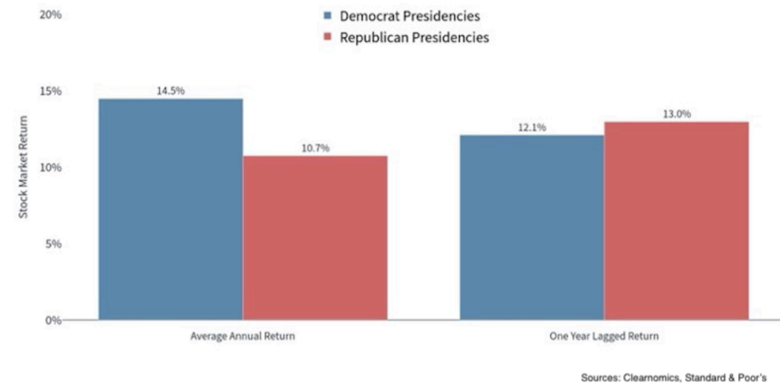


Even if an election is forecasted to go in one direction or the other, entering or exiting the markets based upon anticipated election outcomes has proven not to be an effective approach to managing money.

Stock market rates of return have been robust during Republican and Democratic administrations alike. Different approaches to economic policy between the parties does not seem to have a material impact. When returns are lagged one year (showing returns starting the second year of a presidential term and ending one year into the following term, reflecting the time for new policies to begin to reflect in market performance), there is almost no difference between historical returns across the two parties that have held power since 1933.

Presidential Elections and Stocks

S&P 500 total returns by presidential party
Returns during presidency and lagged one year since 1933

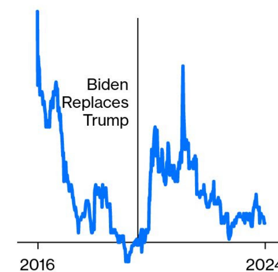


In fact, the short-term movements across market sectors often run directly in contrast to what the conventional wisdom would project.

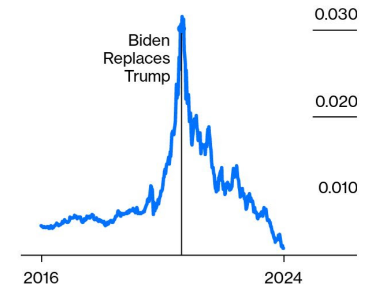
Red Stocks and Blue Stocks: Really?

Sectors don't react to presidential elections the way most would expect

Smith & Wesson/S&P 500



Invesco Winder Hill Clean Energy/S&P 500



Source: Bloomberg

Bloomberg Opinion

The foregoing content reflects the opinions of Penobscot Financial Advisors and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that the statements, opinions, or forecasts provided herein will prove to be correct.

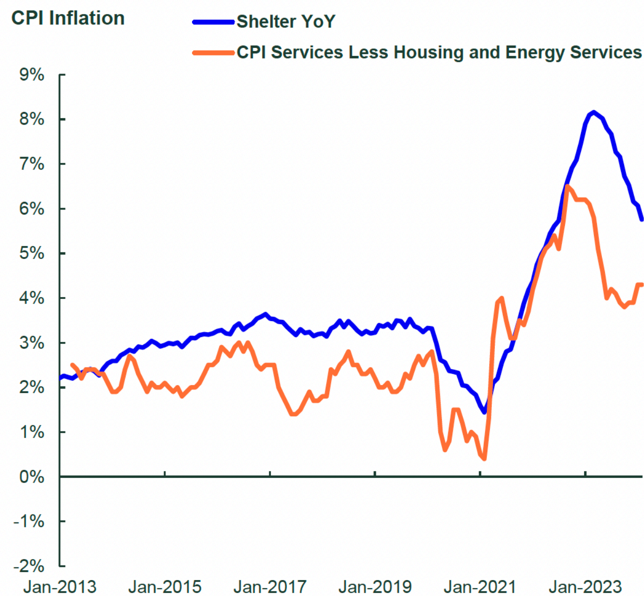
INFLATION – THE 'LAST MILE'

Capital markets are watching the Federal Open Market Committee closely – and the FOMC is watching inflation closely. How and when the Fed finds it appropriate to 'pivot' to a more accommodative monetary policy will depend on their ability to continue to rein in inflation while keeping unemployment low. With jobs numbers still quite robust, price stability remains the key focus.

Inflation can be measured in numerous ways, and we go into the second quarter looking back at a downward trend in most measures of inflation, but arguably a slowing of that downward trend. It seems the path from 9% to 3% was an easier accomplishment than the remaining journey to the Fed's target of 2%.

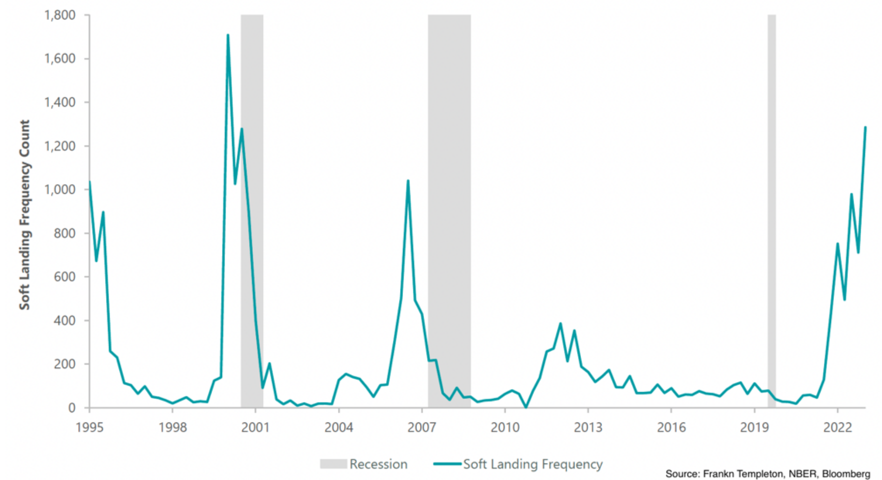
While price increases on consumer goods have slowed markedly, the cost of services has been more stubborn. Housing costs spiked most significantly, and, while they've slowed their increases, their rate of growth still stands near 5%. Stripping out housing and energy, we see other service components of the Consumer Price Index (CPI) leveling out and even climbing slightly in recent reports.

Whether or not this is representative of a resurgence in inflationary pressure is yet to be determined, but until the overall trend returns to disinflation, markets are likely to push back any projections of rate cuts. The further back they continue to push the more of a headwind that capital markets will face in the upcoming months.

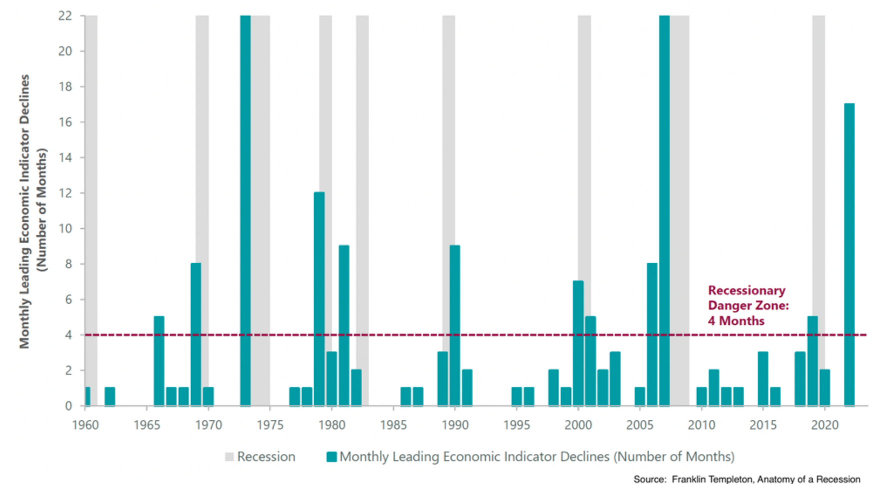


IS THE 'BASE CASE' INEVITABLE?

Conventional wisdom has migrated from near certainty of a recession two years ago to a 'base case' of inflation coming back down without a recession at all. This 'soft landing' scenario should not be looked at as inevitable. In fact, history shows that recessions and the term 'soft landing' being used in analyst reports actually have a high level of correlation. The last two times (2000 and 2007) when this many analysts projected a soft landing, a recessionary period followed shortly thereafter.



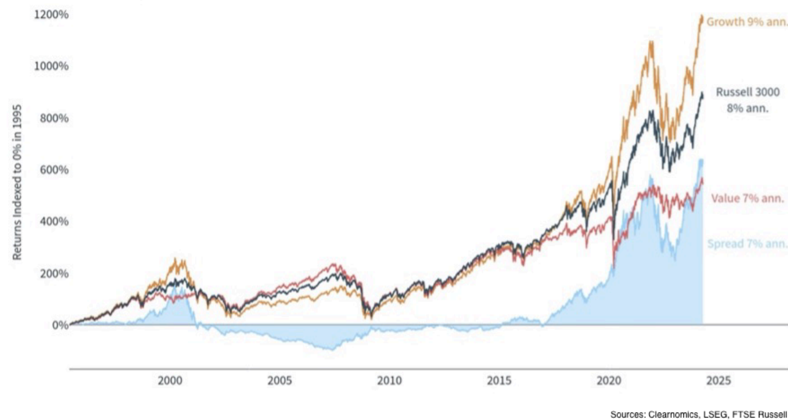
Leading Economic Indicators have been declining steadily over the past year. Since 1960, there has been a high level of correlation between Monthly Leading Economic Indicator declines of 4 or more months, and recessions following.



The foregoing content reflects the opinions of Penobscot Financial Advisors and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that the statements, opinions, or forecasts provided herein will prove to be correct.

HOW FAR CAN GROWTH GO?

Growth stocks, which investors rely upon for price appreciation more than dividend distributions, have historically performed similarly to value stocks, which tend to kick out more cash to investors. Since the COVID pandemic, however, the performance of growth stocks has exceeded that of value stocks by an unprecedented margin.

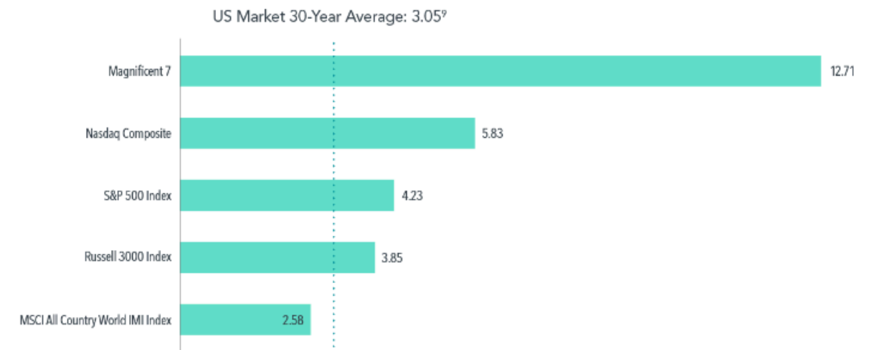


Based largely on long-term historical trends, many analysts see this divergence as temporary. Frequent projections are that through either relative underperformance of growth stocks, or relative outperformance of value stocks, the chasm between their performance is likely to narrow.

Indeed, the largest companies in the US economy fall into the growth category and a relatively small number of these companies can be credited with a significant amount of the gains posted by the major US stock indices.

The result of this run-up is that a sense of 'irrational exuberance' has set in to some areas of the market, whereby others seem to be reasonably priced. One example of data that may support this premise is measured in ratios of price-to-book-value.

The seven largest S&P 500 components, Apple, Amazon, Tesla, Alphabet, Nvidia, Microsoft and Meta are priced at market values that result in price-to-book ratios almost four times what the US market has averaged over the past 30 years. This is well in excess not only of historical norms, but more than three times the level of the broader market indexes currently.



Such valuations could arguably be justified by higher earnings potential. The explosive growth in the areas of artificial intelligence technology, an area where most of these companies have significant exposure, certainly commands a relative premium in pricing. Many analysts, though, caution that earnings growth for these companies would need to be sustained at levels that are optimistic if unachievable. The term 'priced for perfection' is tossed about widely when referring to the 'magnificent seven'.

OUR TAKE

The recent five months of nearly uninterrupted solid gains have come at the same time as markets have absorbed the reality that 2024 may not see as many interest rate cuts as was the conventional wisdom at the beginning of the period. That reality could leave the market more exposed to shocks, but it also leaves us with a Fed who has plenty of arrows in its quiver to provide liquidity through lower rates in case things turn recessionary. Even though parts of the market are arguably expensive, we feel that there are plenty of companies trading at reasonable valuations. Tilting toward companies with strong earnings and reasonable valuations, both domestically and abroad, appears more prudent as these trends continue. Considering the potential crosscurrents around valuations, rate policy, geopolitical events, and the election, this is as good a time as any to assess any portfolio drift or unnecessary concentration.

The foregoing content reflects the opinions of Penobscot Financial Advisors and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that the statements, opinions, or forecasts provided herein will prove to be correct.