TRUSTPOINT

Issue No. 45

Market Point

First Quarter of 2024

A Quarterly Economic and Market Commentary by the Trust Point Investment Team

An Overview of the First Quarter of 2024

In the first quarter of 2024, stocks soared in an "Everything" rally, fueled by robust economic growth. Bonds didn't contribute to portfolios' success, however. Persistent inflation led many investors to reassess the timing of future rate cuts. Continue reading to learn more.

For more information, scan this QR code or visit **www.trustpointinc.com/market-point/**.

An Economic and Market Update from Trust Point

TRUSTPOINT

Q1 2024

The first quarter of 2024 was positive for stock investors. The "Everything" rally was propelled by a combination of factors, helping many equity indices reach new highs. Returns from fixed-income markets were disappointing compared to equities as bonds reacted to inflation reports slightly above expectations and the idea that short-term policy rates may not be cut as quickly as originally expected.

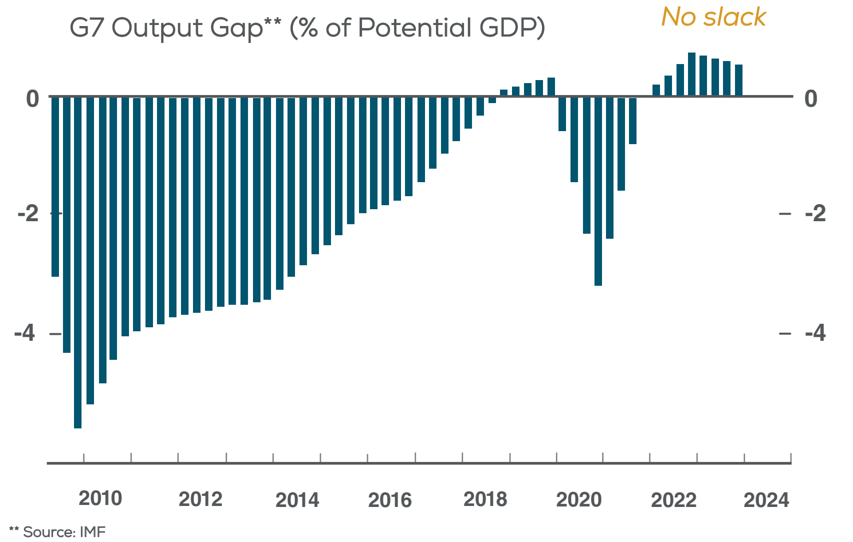
KEY ECONOMIC DATA	As of	Actual	3 Mos. Ago	1 Year Ago
Dollar Index Level	Mar	104.5	101.3	102.5
US Economic Activity				
ISM Manufacturing (>50 = Expansion)	Mar	50.3	47.1	46.5
ISM Non-Manufacturing (>50 = Expansion)	Mar	51.4	50.5	51.2
Non-Farm Payrolls	Mar	303k	290k	146k
Unemployment Rate	Mar	3.8%	3.7%	3.5%
CPI Ex-Food & Energy (yoy)	Feb	3.8%	4.0%	5.5%
Global Economic Activity				
JP Morgan Global Manufacturing Index (>50 = Expansion)	Mar	50.6	49.0	49.6
JP Morgan Global Services Index (>50 = Expansion)	Mar	52.5	51.6	54.3

Source: Bloomberg

The "Everything" Rally Quarter

Over the last few quarters, the global economy has been growing steadily. The U.S. economy has performed extremely well. The combination of continued excitement around AI (artificial intelligence) and its potential for enhancing productivity contributed to the creation of an "everything" rally Goldilocks environment – an ideal state for stock markets in the first quarter. Coincidentally, and maybe not surprisingly, inflation numbers have also surprised on the upside and remain above targets in most regions. Data points, like the output gap (Chart 1), certainly argue for continued sticky inflationary pressures as long as the global economy continues to operate above capacity. Interestingly, the message from major central banks in the first quarter was one of confidence – confidence that policy rates are restrictive enough to eventually bring inflation down, which in turn should allow them to start cutting rates this year.

Chart 1: No Economic Slack in The Developed World

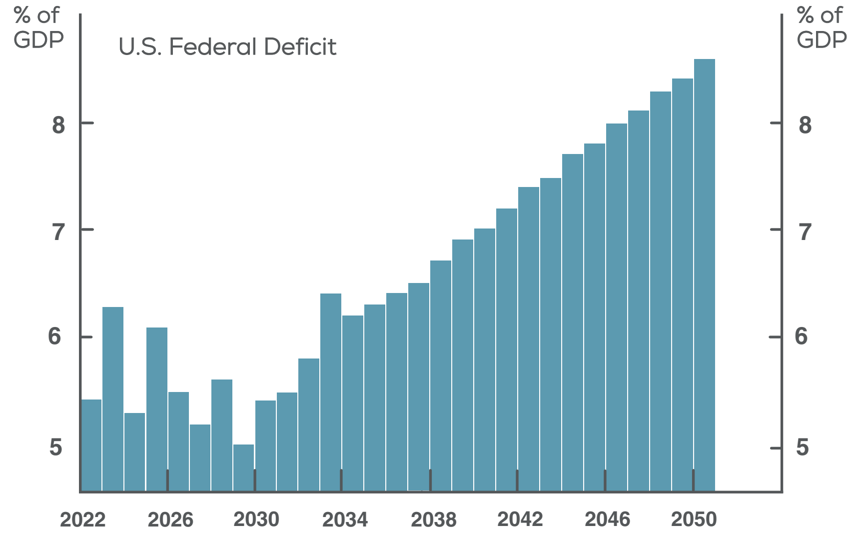


Source: MRB Partners

Fiscal Spending: An Important Catalyst for Growth

U.S. economic growth surprised most forecasters in 2023, and that trend has continued so far in 2024. Supported by excess savings accumulated during Covid, a solid labor market, and solid wage inflation, U.S. consumers have been resilient. Another key factor has been government spending. Various production and investment incentives resulting from two important pieces of legislation signed in 2022 - The CHIPS and Science Act (think semiconductors) and the Inflation Reduction Act (think clean energy) - have been important catalysts in encouraging the build-out of manufacturing capacity and the reconstitution of supply chains. Separately, defense spending has also been robust. More recently, Washington has been working on the Wyden-Smith tax cut proposal, which passed the House but is currently facing hurdles in the Senate. State and local governments have also played a role as they are still benefiting from surplus grant cash from federal transfers during Covid. Overall, government spending has measurably boosted economic growth but at the cost of a continued deterioration in government finance (Chart 2 and 3), raising risks for the future.

Chart 2: The Scary Path of U.S. Federal Deficits

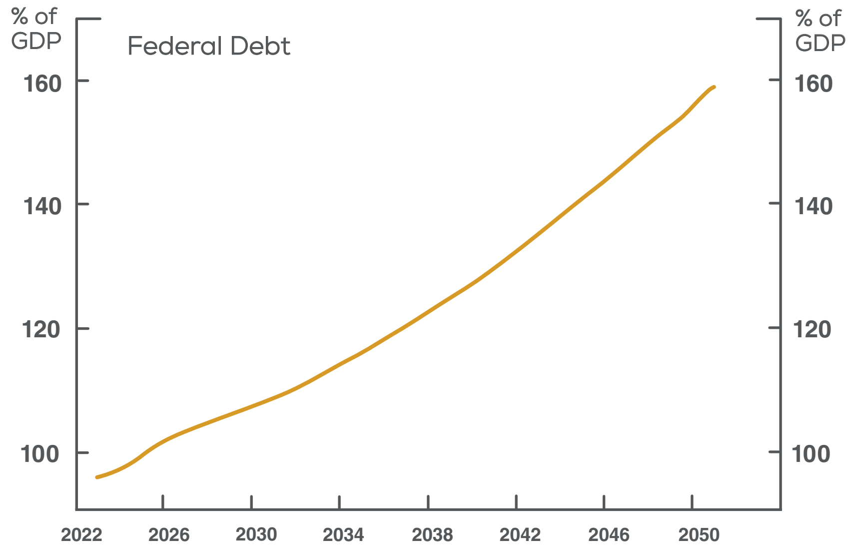


Source: Congressional Budget Office, BCA Research

Risk and Opportunities Ahead

A well-diversified portfolio spreads risk among different investments across various asset classes. This mitigates the impact of any individual investment's performance. Combined with patience, this strategy increases the chances of long-term success for investors. This is why we dedicate a significant amount of time ensuring we select investment opportunities in the right proportion for our clients with the goal of always maximizing returns for various levels of risk. At times, changing conditions and/or perceptions can create opportunities and require adjustments to portfolios. In the first quarter, we made changes with the goal of increasing exposure to secular growth opportunities in equities while reducing exposure to bonds. From an asset allocation standpoint, we now view the current risk/reward outlook between stocks and bonds as "balanced". High-interest rates provide attractive expected returns for bonds, while resilient economic data and growing optimism surrounding corporate earnings contribute to a positive outlook for stocks.

Chart 3: ... And Debt



Source: Congressional Budget Office, BCA Research

An Equity Market Update from Trust Point

TRUSTPOINT

Q1 2024

The global stock market rally of 2023 has continued into 2024. Returns have been strong, with the MSCI All Country World Index up 24% from November 2023 through the end of the first quarter of 2024. Key areas of the market, like U.S. mega-cap tech, have delivered significant earnings growth over the last year, justifying their above-average valuations and performance. Economic conditions have become more supportive for equity prices, and growth opportunities are emerging in sectors beyond tech.

EQUITY BENCHMARK TABLE

US Economic Activity	Quarter-End	3 Mos. Ago	1 Year Ago	3 Years Ago	5 Years Ago
S&P 500	5,254	4,770	4,109	3,973	2,834
Dow Jones Industrial Average	39,807	37,690	33,274	32,982	25,929
NASDAQ	16,379	15,011	12,222	13,247	7,729

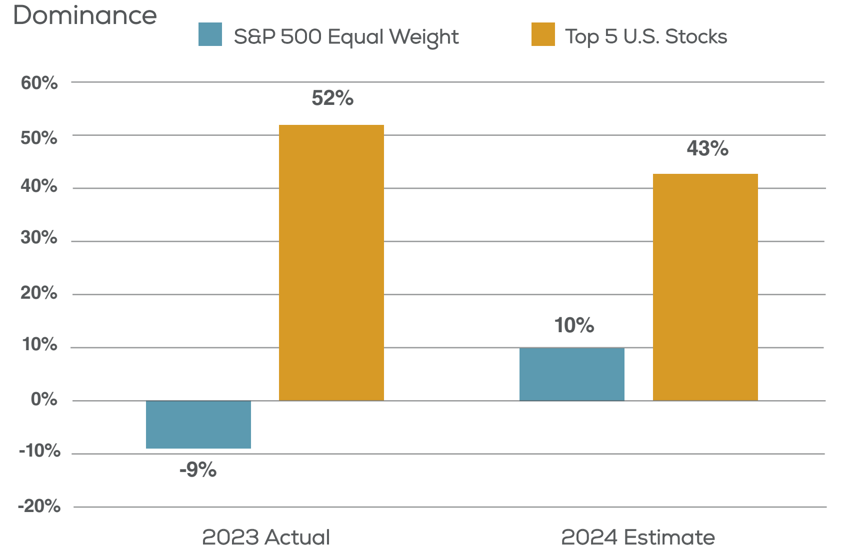
Equity Returns (%)	3 Month	YTD	1 Year	3 Year (Ann)	5 Year (Ann)
US Large Cap Growth	11.4%	11.4%	39.0%	12.5%	18.5%
US Large Cap Value	9.0%	9.0%	20.3%	8.1%	10.3%
US Mid Cap Growth	9.5%	9.5%	26.3%	4.6%	11.8%
US Mid Cap Value	8.2%	8.2%	20.4%	6.8%	9.9%
US Small Cap Growth	7.6%	7.6%	20.3%	-2.7%	7.4%
US Small Cap Value	2.9%	2.9%	18.8%	2.2%	8.2%
International Large Cap Developed (US Dollar)	5.8%	5.8%	15.3%	4.8%	7.3%
International Small/Mid Cap Developed (US Dollar)	2.4%	2.4%	10.4%	-1.4%	4.9%
Emerging Market (US Dollar)	2.4%	2.4%	8.2%	-5.1%	2.2%

Source: Bloomberg, Morningstar

Will U.S. Tech Stocks Follow the Fate of 1990 Japan?

U.S. stock markets hit new all-time highs during the first quarter, with the largest stocks carrying the bulk of the weight. Their global dominance reminds us of Japan in the late 1980s. At that time, the largest five stocks in the global market were all from Japan. Investor exuberance quickly pushed those stocks higher, resulting in lofty valuations. Eventually, reality set in, and lofty expectations came back down. The Japanese stock market fell suddenly. It has taken over 30 years for the benchmark equity index in Japan to return to the 1990 levels. Today, the largest five stocks are all U.S. tech or tech-related companies. Are U.S. stocks likely to follow the same fate as Japan? We would argue that the top U.S. stocks have rightly attained their dominance. In 2023, the equal weight S&P 500 index saw a contraction of -9% in Earnings Per Share (EPS), whereas the top five U.S. stocks achieved an average EPS growth of 52%. Looking ahead, average analyst expectations for EPS growth in 2024 are 43% for the top five stocks and 10% for the equal weight S&P 500 index (Chart 4). In summary, the continuation of U.S. tech dominance hinges on the stability of their earnings growth.

Chart 4: Earnings Per Share Growth Justifies Top Stock Dominance

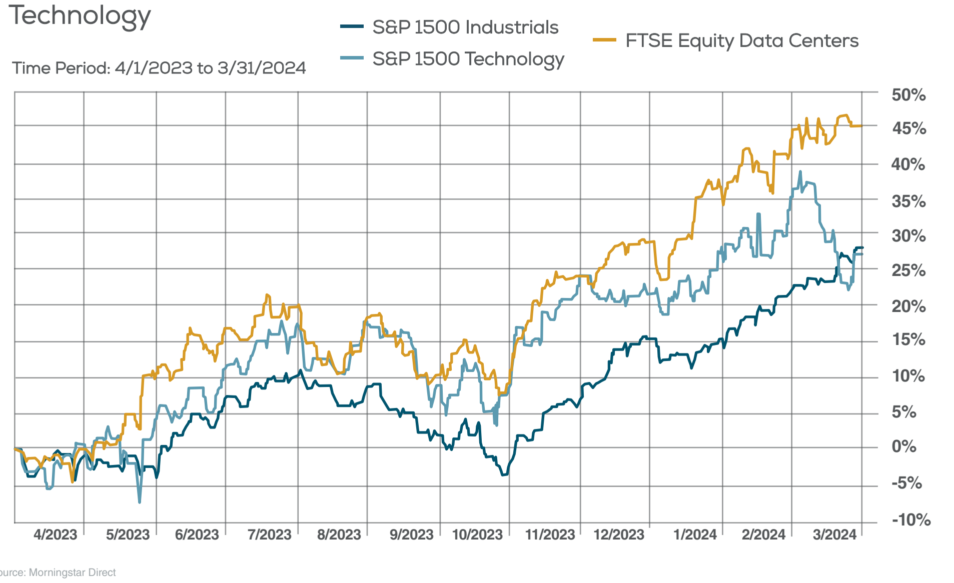


Source: Factset

Long-Term Opportunities in Artificial Intelligence

It has been well-documented that the "Magnificent 7" stocks led market returns in 2023, and AI is a big reason. Large U.S. tech companies within the Magnificent 7 are well-positioned for the AI infrastructure build-out as they have been able to use their market dominance and balance sheets to finance much of the early capital expenditures. Other early beneficiaries include semiconductor companies responsible for providing the chips that drive the computing power for generative AI models to train and develop. Software-as-a-Service (SaaS) companies are starting to integrate AI models into daily operations, boosting productivity and, consequently, profits. Real estate companies that own and lease the data centers where cloud computing technologies are housed, and industrial companies that are involved with the build-out of new, high-end facilities, are also benefiting (Chart 5). Everything from bricks and mortar to air conditioning needed to keep these high-end computers cool is also currently benefiting from AI. As seen with previous structural technology changes, the winners today may not be the winners tomorrow. During this quarter, we have increased portfolio exposure to quality growth companies that are likely to continue to benefit from the economy-wide benefits of artificial intelligence.

Chart 5: Artificial Intelligence Benefitting Sectors Beyond Technology



Source: Morningstar Direct

What Goes Up, Must Come Down

As stock investors, we know that the long-term rewards come with short-term risks. Risk is commonly measured in standard deviations or volatility. However, not all volatility is negative, as stock investors do not complain when stocks exhibit volatility to the upside. Rather, it is the downside risk that most investors care about. These downside risks can come from various sources and lead to significant declines during economic downturns or recessions, modest declines during periods of economic weakness or growth concerns, and minor declines due to simple mean reversion. In fact, intra-year drawdowns in the S&P 500 index have averaged 14.2% since 1980. Through the first quarter, the max drawdown was only 1.7%, which would be the lowest over the last 44 years. While we acknowledge that we cannot perfectly predict the future, we can ensure that we are prepared for the inevitable next drawdown (Chart 6). Though changes made to equity portfolios in recent months will capture more future growth, certain equity strategies still maintain downside protection relative to the broader market. Positions are reassessed daily, and should conditions change, equity portfolios will be adjusted accordingly.

Chart 6: Frequency of Market Drawdowns Since 1950

Environment	-5% or more	-10% or more	-15% or more	-20% or more	Recession[1]
Average Frequency	About three times per year	About once per year	About once every three years	About once every six years	About every six and a half years
Average Length	43 days	109 days	251 days	370 days	317 days

[1]National Bureau of Economic Research as of May 2022

Source: Capital Group

A Fixed Income Update from Trust Point

TRUSTPOINT

Q1 2024

Global bond yields rose at the start of the year against a backdrop of economic and key inflation data that came out stronger than anticipated. Although the Fed has made progress moderating inflation, recent monthly readings have come out slightly above expectations. To combat persistent inflation, the Fed is communicating a more cautious approach. This indicates that rate cuts may begin later in 2024 than investors were anticipating just a few months ago.

FIXED INCOME BENCHMARK TABLE

US Yields (%)	Quarter-End	3 Mos. Ago	1 Year Ago	3 Years Ago	5 Years Ago
3 Month T-Bill	5.4%	5.3%	4.7%	0.0%	2.4%
2 Yr US Treasury	4.6%	4.3%	4.0%	0.2%	2.3%
10 Yr US Treasury	4.2%	3.9%	3.5%	1.7%	2.4%

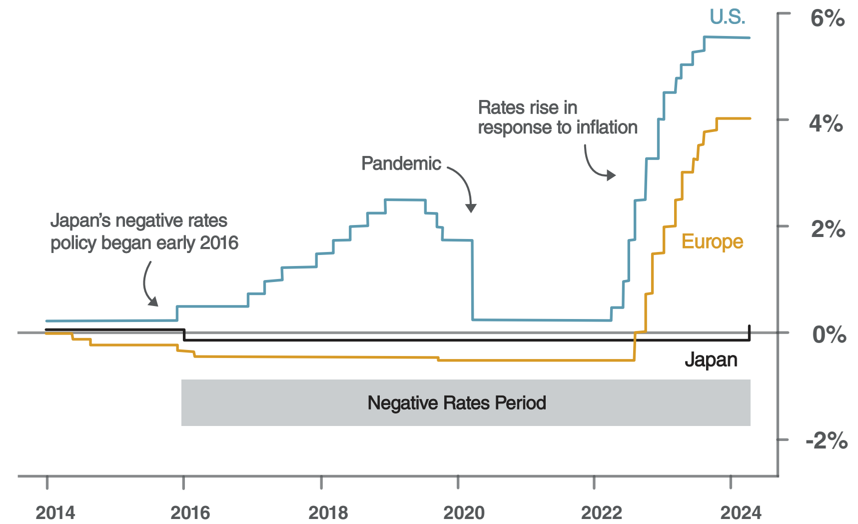
Global Economic Activity	3 Month	YTD	1 Year	3 Year (Ann)	5 Year (Ann)
US Intermediate Treasuries	-1.1%	-1.1%	-0.2%	-3.0%	0.0%
US Treasury Inflation Protected Sec.	-0.1%	-0.1%	0.5%	-0.5%	2.5%
US Mortgages	-1.0%	-1.0%	1.4%	-2.8%	-0.4%
US Short-Intermediate T/E Munis	-0.3%	-0.3%	2.0%	-0.3%	1.2%
US Investment Grade Corporates	-0.4%	-0.4%	4.4%	-1.9%	1.5%
US Senior Bank Loans	2.5%	2.5%	12.5%	6.0%	5.5%
US High Yield	1.5%	1.5%	11.0%	2.2%	4.0%
Int'l Bonds Ex-US (Hedged)	0.6%	0.6%	5.9%	-0.4%	1.0%
Int'l Bonds (Unhedged)	-2.1%	-2.1%	0.5%	-4.7%	-1.2%
Emerging Market Debt (US Dollar)	1.3%	1.3%	9.6%	-1.5%	0.5%

Source: Bloomberg, Morningstar

The End of an Era

In the aftermath of the 2008-2009 economic downturn, central banks cut rates aggressively, with some entering negative territory, in efforts to stimulate spending, growth, and inflation. As a result of zero and negative interest rate policies, there have been multiple points in recent memory when global negative yielding debt rose above $10 trillion, and even approached $20 trillion. Most developed market central banks have since lifted rates well above zero, but the Bank of Japan was the remaining anchor with policy rates remaining in negative territory. After decades of battling low growth and deflation, the Bank of Japan has recently put an end to its negative interest-rate policy as it recently lifted its policy rate just above zero (Chart 7). This marks the end of global central banks experimenting with extremely low rates and represents a continuation toward normalized policy after years of incredibly low interest rates. As a result, after years of guaranteed losses for investors (via negative yields), savers are again being rewarded with attractive interest rates out of high-quality bonds.

Chart 7: Japan Lifts its Policy Rate Above Zero, Ending the Era of Negative Interest Rates

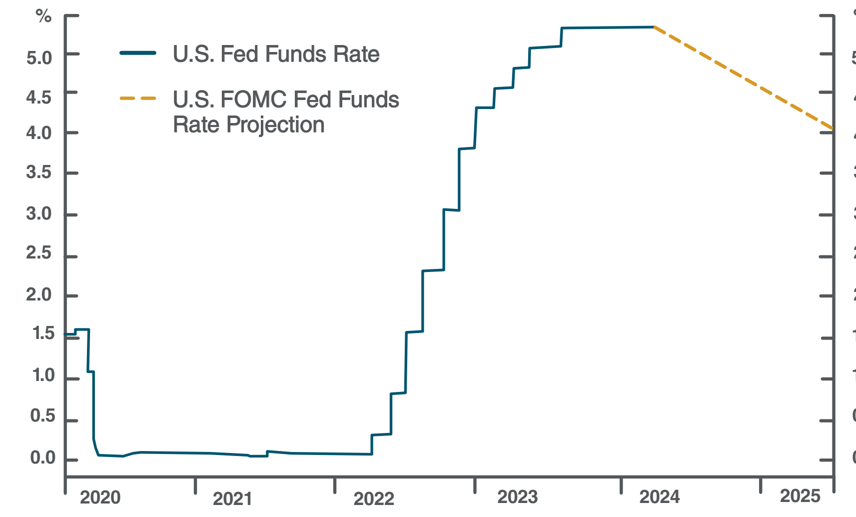


Source: Bloomberg

March Madness

Expectations for changes to Fed policy this year have swung, leading to volatility in the bond market. The Fed would like to ease the burden of high borrowing costs by lowering the Fed Funds rate but wants to take a cautious approach. The Fed has a fine line to walk; if it lowers rates too quickly, it risks a reawakening of inflation concerns. If it does not lower policy rates quick enough, it risks keeping rates too high and restrictive for too long, which can cool the economy, pushing it into recession. Based on the most recent projections, the Fed is forecasting to slowly lower the Fed Funds rate from the current peak rate of 5.3% to 4.6% by the end of this year (Chart 8). The Fed is likely to remain flexible, and if inflation starts to again become a concern, the Fed may lower the rate by less than what is currently projected. The hidden benefit of the March volatility is that with a more cautious approach from the Fed and potentially higher-for-longer policy rates, interest rates are likely to stay elevated and continue to provide investors with attractive yields relative to the last decade.

Chart 8: The Fed Wants to Lower Policy Rates This Year But Will It Be Able To...

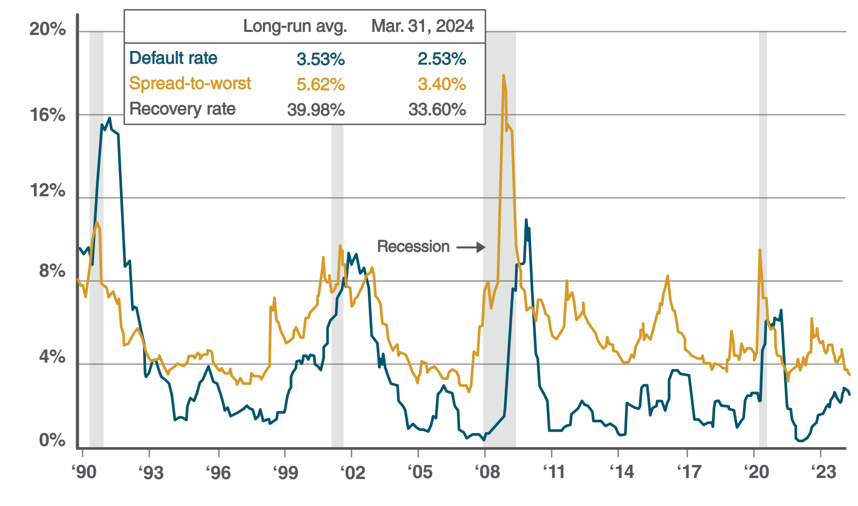


Source: BCA Analytics

Investment Implications

With persistent inflationary pressure and central banks adopting more normalized policy rates, we have maintained a cautious approach to interest rate risk. As rates have moved higher this year in response to stronger growth and inflation, our fixed-income portfolios have less sensitivity to rising rates and have outperformed the broad bond market. In addition, the yield curve remains inverted as short-term bonds provide a higher yield than longer-term bonds, so we continue to favor high-quality short-term bonds with attractive risk/return characteristics. In the corporate sector of the bond market, we do not believe that the "spread" or additional yield relative to Treasuries compensates investors enough to justify the additional risk. High-yield corporate bonds only offer 3.4% more yield than a risk-free Treasury, which is approaching historical lows, while default rates have picked up (Chart 9). There are areas of higher-quality credit, such as mortgage-backed securities and other securitized products, which offer better valuations. We have increased our allocations to these higher-quality areas of credit markets. We continue to favor attractive yield, and valuations in high-quality, short-term bonds and are positioning portfolios with an up-in-quality bias.

Chart 9: High-Yield Corporate Spreads Well Below Average, While Defaults Have Picked Up



Source: JP Morgan

Market Point

Market Point is a quarterly market commentary designed to provide you with an overview of economic conditions, as well as equity and fixed income market summaries for the quarter.

This commentary is offered by the Investment Management team. The individuals contributing to Market Point are pictured from left to right: Randy Van Rooyen, CFA®, Yan Arsenault, CFA®, CAIA®, Steve Brudos, Brandon Hellenbrand, CFA®, Christine Doll, Nolan Gaffney, CFA® and Matthew Wittenberg. Please feel free to contact any team member with questions.







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