NEWPORT CAPITAL GROUP

Market Commentary and Outlook

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U.S. Economy and the Federal Reserve

U.S. equity market momentum continued during the first quarter as the S&P 500 ended the quarter at a record high on the strength of solid corporate earnings. Economic growth in the U.S. remains above trend, with an increased likelihood, in our view, that the economy should be able to avoid a recession in 2024. While we still expect economic growth to weaken due to the lag effect of significant interest rate hikes over the past two years, a still resilient job market should be able to support consumption, which represents about two-thirds of our economy. The job market remains our key determinant for when and if economic weakness appears.

The job market remained resilient in the first quarter as the economy added 829K nonfarm jobs in the quarter as compared with 577K in the third quarter. The unemployment rate ended the quarter at 3.8% and has remained in a narrow range between 3.7% and 3.8% since the summer. Wage inflation was up 4.1% yr./yr. in March. Inflationary pressures, while continuing to moderate from levels at forty-year highs, remained at elevated levels in the first quarter, driven primarily by high shelter and gasoline costs. The March Consumer Price Index was up 3.5% yr./yr., which compares to a 3.4% yr./yr. increase in December. While the yr./yr. gains in inflation have come down from over 9% in the summer of 2022, they remain "sticky" and above the Fed's 2% target. Oil prices, which moved higher in the first quarter on heightened geopolitical uncertainty, could remain elevated as we approach the summer driving season. Stubborn inflationary trends could impact the Fed's monetary policy actions and are a market risk.

The U.S. Federal Reserve maintained its target federal funds rate in the range of 5.25% to 5.50% during the first quarter. We continue to believe the Fed has ended its tightening cycle, which increased rates eleven times from a 0.00%-0.25% level in March 2022. Fed guidance in March maintained a forecast of three 25 basis point (bps) cuts in 2024. During the first quarter, market expectations decreased from six 25 bps cuts to three cuts on still elevated inflation data and a resilient economy. As always, a potential market risk remains if expected interest rate cuts do not materialize.

Capital Markets Performance

Interest rate volatility continued during the first quarter, with rates moving higher across the curve on better-than-expected economic data and lower market expectations for interest rate cuts this year. The 2-year Treasury ended the quarter up 36 bps at 4.59%, while the 10-year Treasury yield ended the quarter up 32 bps at 4.20%. With the movement higher in rates, the Bloomberg Barclays U.S. Aggregate Index was down 0.8% in the quarter, with four out of six sectors recording losses. Lower rated bonds and shorter duration bonds were relative outperformers in the first quarter.

U.S. equities were up sharply again in the first quarter on stronger than expected economic data and corporate earnings. The S&P 500 ended the quarter up 10.6% and at a record high. Large caps outperformed mid and small caps in the quarter, with growth leading value across market capitalization. Large Cap Growth (11.4%) was the best relative performer in the first quarter. Ten of the eleven S&P 500 sectors were positive performers in the first quarter, led by Communication Services (15.8%) and Energy (13.7%). Real Estate was the only negative performer (-1.1%).

International stocks had positive returns in the first quarter but were negative-relative performers compared to the S&P 500. The MSCI ACWI ex USA Index gained 4.7%, while the MSCI Emerging Markets Index was up 2.4%. MSCI Pacific (6.7%) was the strongest-relative performing region in the quarter.

Like the U.S. Federal Reserve, both the Bank of England and the European Central Bank have paused their rate hikes as inflationary pressures moderate globally; they are both expected to begin rate cuts sometime this year. The Bank of Japan ended eight years of negative interest rates at its March meeting, representing the country's first interest rate increase in twenty years. The U.S. dollar (DXY) strengthened by 3.1% in the first quarter and has appreciated by 2.0% over the past year.

Outlook and Portfolio Positioning

While we still expect the U.S. economy to slow in 2024, the odds of the economy avoiding a recession this year have improved, in our view, due to continued resiliency in the job market. Stubborn inflation, central bank interest rate policy and geopolitical tensions around the globe remain market risks.

We remain balanced in our equity positioning between growth and value, as we believe market performance will broaden across the market sectors because of elevated valuations for many growth stocks. A weaker U.S. dollar, improving Chinese economic growth and attractive relative valuations remain potential catalysts for international markets, especially emerging markets. We believe valuation and quality remain the key factors driving global equity performance.

Our fixed income portfolio remains positioned toward intermediate duration and a tilt toward quality, consistent with our expectations for economic data to weaken this year. Despite continued rate volatility year to date, we continue to believe interest rates for this economic cycle peaked in mid-October of last year. Investors should focus on the "income" component of fixed income returns in 2024, as we expect interest rates to remain range-bound throughout the year.

Despite market volatility, it is important to stay diversified and invested for the long term. History shows that time in the markets produces better outcomes than attempting to time the markets.

As always, we thank you for your continued support and trust in Newport Capital Group.

Disclosures

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