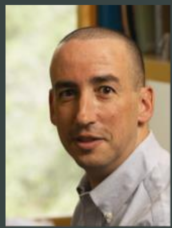

MARKET UPDATE

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Market Update – March 11, 2024

I. Stocks

A. The Big Picture

1. **Last week**: DJIA -.93%; **S&P 500 -.26%**; **Nasdaq -1.17%**; IWM (**Russ. 2000**) **+.46%**
    a. On Friday, NVDA was up ~5% in the first hour of trading and ended the day down 5.55% (but NVDA was still up 6.38% for the week)
        i. NVDA has risen more than sevenfold since Oct. 14, 2022
    b. AAPL, TSLA, and GOOGL have fallen
2. S&P 500 has rallied 122% since March 23, 2020. It's currently trading at **21X** forward earnings.

B. The Bullish Argument

1. **The case for continued gains**: strong economic outlook leading to 11% earnings growth this year. In addition, the rally may be broadening out.
    a. Growing economy – added 275K jobs
    b. Real innovations – AI, healthcare
    c. Growing cash flows expected years into future
        i. Justifying higher valuations (21X forward earnings)
2. Most returns captured by investors have come during times when **borrowing costs are being lowered** or being left unchanged after they were lowered (WSJ)
    a. Rate cuts that are not quickly followed by a recession tend almost invariably to push the stock market to a higher level. (Bloomberg)
3. Maybe **higher productivity** is bringing inflation down and future productivity gains will increase earnings. (WSJ)
4. Margin debt levels do not indicate high leverage in the stock market. (MarketWatch)

C. The Bearish Argument

1. **Potential catalysts for a short-term pullback** could be a really high CPI reading on March 12th, leading to higher interest rates. In addition, there isn't evidence of need to cut rates: unemployment is low, wages are rising, fiscal policy is stimulative, productivity is increasing. (Barron's) (Barron's)
2. Strategists are increasing their price targets, yet **pension funds' allocation to public equities is at a 20-year low**.
    a. If you really want to be scared, Nouriel Roubini ("Dr. Doom") is positive about the markets. (Bloomberg)

D. Other Observations

1. Since 2022, **daily upside moves have been more violent than down days**. Since the beginning of 2024, **realized skew** (realized volatility [standard deviation] on down days minus realized volatility on up days) shifted to its most negative level in 22 years (-2.3).
    a. Last time it was lower was in 2002.
    b. Could explain heavier trading in calls vs. puts. This resulted in lower implied skew.
    c. This violates the adage that markets take an escalator up and an elevator down. (MarketWatch)
2. Roughly **half of S&P 500 stocks are trading below Jan. 2022 levels**. Only ~10% of individual stocks are outperforming the index over the past year.
    a. **But the breadth of the rally is expanding**. Over 60% of S&P 500 stocks have YTD gains. On March 5th, 106 S&P 500 stocks hit new 52-week intraday highs (highest total since May 10, 2021). S&P 500 had 85 straight trading days with more 52-week highs than lows. (MarketWatch)
    b. **More evidence of broadening**: since the recent rally started on October 30th, the S&P 500 is up 24.44%. The S&P 500 equal-weighted index is up 23.37%. The S&P 600 (small-cap) index is up 22.64%.
3. There's much talk about **market concentration**. The top 10 stocks account for 33% of S&P 500 market cap (was 27% in 2000 during tech bubble). The top 10 stocks account for 25% of earnings.
    a. GS research studied previous episodes of heightened concentration over the past 100 years and concluded that the **S&P 500 often rallied in the 12 months following peak concentration**. Notable downturns were 1973 and 2000.
        i. The rallies were often due to positive shifts in macroeconomic outlook. (MarketWatch)
4. **In 2023, only 40% of large-cap mutual funds outperformed the S&P 500**. Over 20 years, more than 90% of active funds lag their benchmark in all US categories. (Bloomberg)
5. **Federal agencies are probing private-equity investment in healthcare**. The issue is whether this type of ownership results in worse care (i.e., are providers forced to subordinate their judgment to the profit motive). PE shops argue that their ownership results in more investment. (WSJ)

II. Rates, Bitcoin, and Gold

A. Rates

1. **UST**: 2-yr 4.48% (-6 bps); **10-yr 4.09%** (-10 bps)
2. **30-year fixed-rate mortgage** averaged **6.88%** as of March 7th. The Mortgage News Daily said it was 6.97%. The 15-year averaged 6.22%. (MarketWatch)
3. Global CCC-rated bonds have returned 6.86% YTD. Easy borrowing conditions have returned. There is a more benign view of the economy. Some bond commentators fear that bonds are priced for perfection. (Bloomberg)
4. The **dollar has fallen** below its 50-day and 200-day moving averages.

B. Bitcoin and Gold

1. **Bitcoin hit $70K on Friday**. It was below $20K at the start of 2023. The overall market value of crypto has reached $2.6T. **Gold has also hit a new all-time high**, trading above $2,200 intra-day on Friday.
    a. Commentators are asking **whether Bitcoin's rise is a sign of a speculative bubble in risk assets or whether there are other factors driving its increase** (e.g., new ETFs, halving, distrust of banking, geopolitical issues, lower rates, stronger economy, etc.) (Bloomberg) (MarketWatch)
2. **Reasons for the simultaneous rallies in Bitcoin and gold**:
    a. Rising asset prices create bullish sentiment and it spills over
    b. Positive liquidity flows
    c. Money had been on the sideline in high-yielding USTs
    d. Anticipation of looser monetary policy
    e. Geopolitical tensions (MarketWatch)
    f. Dollar has started to weaken
    g. 10-year TIPs yield has dropped over 60 bps (to 1.81%) since late October
3. Odd factor with gold: there is **$50/ounce arbitrage** between London and Shanghai – so demand to buy gold and take it to China may be factor.
    a. 24% of central banks say that they will increase holdings of gold in next year (MW)

III. The Economy

A. Jobs report

1. The US economy **added 275K jobs** in February (198K expected). Health care, leisure and hospitality led the job growth.
    a. But job growth for the **last two months** was **revised down by 167K**.
2. The unemployment rate rose from 3.7% to **3.9%** (highest level in 25 months).
    a. More people are looking for work.
        i. The participation rate was steady at 62.5%. Population was larger.
    b. The number of women in the labor force reached a record high.
3. **Hourly wages** increased by only **.1% MoM**. The prior month, it had been .6%.
    a. YoY wage growth decelerated from 4.4% to **4.3%**.
4. **Implications**:
    a. Job creation and moderate wage gains support consumer spending.
    b. Gradual cooling of the labor market may help ease inflation.
    c. Gradual labor market cooling may allow the Fed to lower rates (MW) (Bl.)

B. Consumer Sentiment Anomaly

1. The **consumer sentiment anomaly** refers to the idea that the **economy seems to be doing well, yet consumer sentiment is weaker than expected**.
2. A new study argues that if inflation was measured correctly, we'd understand this anomaly better.
    a. The researchers found that there is a **strong historical correlation between changes in the Univ. of Michigan's Consumer Sentiment index and consumer borrowing costs. But CPI doesn't fully reflect these costs**.
3. Consumer borrowing costs have skyrocketed over the last couple of years. In addition to credit card debt and car loans, mortgages are much higher. Considering the average cost of a home plus the mortgage rate, the cost of housing has more than doubled since the pandemic, yet CPI is only up 20%.
4. The authors calculate that if the CPI fully reflected higher borrowing costs, it would have peaked at 18% in Nov. 2022 and would still be around 8%.
    a. They conclude that the anomaly isn't the gloomy consumer; it's the exuberant stock market.
5. Up until 1983, the CPI used to include consumer borrowing costs. They did this by taking house prices, mortgage rates, property taxes, insurance, and maintenance costs as inputs.
    a. This overstated inflation because housing is also an investment. OER was designed to be the consumption piece (what it would cost to rent the house).
6. **Others have tried to explain this anomaly** as irrationality of consumers, inflation affecting low-income consumers, the level of prices (rather than the inflation rate), the unsettling nature of inflation (after low inflation), bleed-over from broken politics and dysfunctional gov't (MarketWatch) (Bloomberg)

C. China

1. **China set its growth target around 5%** -- an ambitious goal
    a. This may put pressure on leaders to add more stimulus
        i. They have to overcome property slump, deflation, struggles w/ US, heavy debt, and weak demographics
2. Also set a **3% inflation goal** (which means 8% nominal growth)
    a. Yet, they are currently in deflation
3. Authorities vowed "to prevent overcapacity" in key industries, as companies suffer from squeezed profit margins after cutting prices to remain competitive. (Bloomberg)
4. Investors don't trust China's economic data. For a WSJ analysis of this issue, here's the link. (WSJ)

IV. The Fed

A. General Fed News

1. Fed Chair **Powell** testified before Congress. He reiterated that the **Fed is in no rush to cut rates** until they are confident that inflation is under control.
    a. He did say that it would **likely be appropriate to begin lowering rates at some point this year.** (Bloomberg)
    b. Brisk inflation and hiring data in January haven't altered the Fed's expectation of rate cuts.
2. The Fed continues to **balance the risk** of cutting rates too soon (reigniting inflation) vs. the risk of waiting too long (job losses and recession). (WSJ)
3. The Fed's **Beige Book** suggested slight economic increase:
    a. No supply chain issues or major effects on prices
    b. Demand for loans "stable to down"
    c. Wage growth more in line with historical averages

B. Atlanta Fed President Bostic Spoke About Three Issues (Atlanta Fed)

1. **Inflation** has slowed, but **risks remain**
2. **Uncertainty is rampant**, making it premature to claim victory against inflation (Jan. inflation readings surprisingly high)
3. **Widely varying risks contribute to uncertainty** (economic news that is too strong, price pressures that are widespread, geopolitical concerns, budget risks in US)

C. Key Points from Cleveland Fed President Mester (Cleveland Fed)

1. **Growth is expected to moderate** in 2024:
    a. Lower-income families are becoming more cautious
    b. Uptick in credit card debt and slight increase in delinquencies on consumer loans
    c. Business spending on equipment and software expected to moderate given restrictive credit conditions
2. **Better balance between labor supply and demand has slowed wage growth**
    a. There is potential for higher trend productivity growth due to pandemic-induced automation investments and new technologies like generative AI
3. **Despite the strong labor market, consumers were unhappy about the economy until recently**
    a. Positive real wage gains are helping sentiment
4. **Risk management will be hallmark of future monetary policy decisions**
    a. If inflation expectations continue declining, maintaining current nominal Fed funds rate for too long would effectively tighten policy
    b. Bigger mistake would be moving rates down too soon without sufficient evidence of sustainable path to 2%
5. **Risks abound**
    a. Easing financial conditions could spur resurgence in activity, leading to imbalances that fuel inflation
    b. Bank stress has subsided and many banks have diversified liquidity sources, but stress could return for banks relying on uninsured deposits while exposed to commercial real estate needing repricing at higher rates
    c. Strong growth could indicate higher neutral rate of interest, meaning policy might be less restrictive than thought and need to remain restrictive for longer