Q1 Quarterly Market Commentary

"Courage taught me no matter how bad a crisis gets ... any sound investment will eventually pay off." - Carlos Slim Helu

Navigating Market Volatility: Insights on the S&P 500's Performance and Strategies for Portfolio Allocation

The S&P 500 Index returned 10.55 percent during the first quarter of 2024 off the heels of an 11.68 percent return in the fourth quarter of last year. This big run up can largely be attributed to the market's belief that the Federal Reserve is going to start cutting interest rates materially beginning in the first half of this year. However, inflation data came in higher than expected in every month so far this year and the S&P 500 is starting to come back to reality a bit as we begin Q2. Where the market was pricing in roughly 3 interest rate cuts previously, it has now become the subject of much debate. There are members of the Federal Reserve, for example, that have posited zero interest rate cuts in 2024.

To be clear, a correction in the market would be warmly welcomed by us. We have mentioned before that markets like the one that we have experienced over the past 6 months are what make us nervous. The S&P 500 rarely increases over 20 percent in this short of a time frame based purely on fundamentals. Equity valuations, while not extreme, have become elevated, and the positive inflation story that everyone was hoping for may take much longer to come to fruition. Furthermore, there is a possibility that interest rates will remain higher even after we have brought inflation down to the Fed's 2 percent target. There seems to be overly optimistic assumptions around what the "normal" level of interest rates will be under "normal" economic conditions. We believe that the zero-interest rate environment that we lived through post financial crisis was abnormal and what we are experiencing now is much closer to reality.

When the Federal Reserve does begin to cut interest rates there are a few scenarios that may play out in markets that could benefit your portfolios. One of these is the performance of international and emerging markets equities. Historically, US equities and international equities have tended to jostle in and out of favor relative to one another roughly every three to five years. Due to several factors, US equities have had an outsized and meaningfully longer run of outperformance than its historical average. This has brought international valuations to a level rarely seen relative to US valuations. We believe that eventually, there will be a return to the mean, and international equities are poised to experience a favorable run of their own. There is no guarantee that this scenario will play out of course, and US equities still make up the lion's share of your equity allocation, but being aware of these dynamics in markets has allowed us to position your portfolio to capture some of this upside if this scenario does play out.

Just as it is important to have some international equity exposure in your portfolio it is also important to allocate a percentage of your assets to emerging market equities. A huge factor in the outperformance of emerging markets relates to the performance of the US dollar. When the US dollar is strengthening, emerging markets tend to struggle. When the US dollar is weakening, emerging markets tend to do well. Just as US equities have outperformed international equities for longer than historical averages, the US dollar has been on a multi-year bull run that has extended for a period much longer than historical averages. When this trend reverses, which may occur when interest rates cuts begin, having an allocation to emerging markets equities will be fruitful.

Regards,

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