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GO LIVE WITH THE MARKETS

1. The last mile for getting inflation lower can be run at a leisurely

ECONOMIC CONDITIONS

1. Economic conditions are solid, and yet global central banks are still embarking on a synchronized easing cycle. This remains a uniquely positive backdrop for risk assets.
2. Valuations in equity and credit markets are elevated and increasingly reflect this robust backdrop.
3. Historically this has meant slower, but still positive, returns as long as the economy and earnings hold up.

US AND OTHER ECONOMIES

4. The US economy is cooling off from its torrid 4% annualized real GDP growth over 2H 2023 to a more trend-like 2% growth so far in Q1.
5. But this is happening just as the picture is brightening in other regions such as Europe and Japan, as evidenced in March flash PMIs.
6. In most developed markets, labor markets are still fairly tight and inflation is decelerating, so consumers have money to spend.

INFLATION LOWER

7. Monetary policymakers at the Fed have embraced the idea that supply-side improvements like increased immigration means growth can run hotter than previously anticipated without damaging the central bank’s ability to achieve its inflation target over time.
8. The message is that the “last mile” for getting inflation lower can be run at a leisurely pace because inflation expectations are much less at risk of becoming unanchored now than they were when price pressures neared double digits.

That is a positive catalyst for carry strategies and risk-taking in general as it suggests a more predictable macro backdrop.

2. U.S. Equities led both International Developed and Emerging Markets

Q1-24 STRONG

1. U.S. Equities ended Q1 2024 strong. The S&P 500 notched a 10.2% gain for the quarter, breaking through 5200 for the first time ever in March.
2. Since 1950, when the S&P 500 gained in consecutive quarters with a combined advance of greater than 20%, Equities rose over the next 12 months 77.3% of the time with an average return of 9.8%.
3. Resilient job creation and solid wage growth continued to support consumer spending. Better-than-expected corporate earnings were also a catalyst.

FED PROJECTIONS

4. S&P 500 companies delivered a strong 4% earnings beat for Q4 2023.
5. Analysts expect earnings to continue to accelerate this year with consensus estimates calling for 12% earnings growth for the S&P 500 in 2024.
6. The latest Fed projections estimate a median of three rate cuts this year even amid some warmer inflation signals recently.

200 DAY MOVING AVERAGE

7. Mega-cap Technology stocks continued to drive the market, but market breadth has improved some.
8. By the end of Q1, more than 80% of S&P 500 constituents crossed above the 200-day moving average, which aside from a brief cross in January, marks the first sustained period since 2021.
9. Stocks have historically fared well when breadth increased with the S&P 500 up 13.2% on average over the next 12 months.

Growth outperformed Value, but Value could be positioned to catch up given the positive cyclical forces.

From a global perspective, US Equities led both International Developed and Emerging Markets, though Japanese Equities staged a strong rally following more optimism around improvements in Japan's economy.

3. From Soft Landing to No Landing?

1. With inflation normalizing in the 2%-3% range, and economic growth reaccelerating faster than predicted, investors are left wondering if the overused phrase “soft landing” should be substituted for “no landing,” as low levels of volatility remain and the labor market is still very healthy.
2. Despite the strong start, markets will have to deal with bouts of uncertainty due to several risks that have not been priced in.

UNCERTAIN MONETARY POLICY

3. The market has had to grapple with rapidly changing expectations around the size and speed of rate cuts in 2024.
4. At the beginning of the year, markets were pricing in 100+ bps of cuts. Today, the market is only pricing 50 bps of cuts.

RISKS TO CORPORATE EARNINGS

5. The S&P 500 reported Q4 2023 earnings growth of 4.17%, a solid showing given expectations.
6. Some market participants were concerned that falling inflation would mean diminished corporate margins.
7. With EPS growth estimates of 10.8% in 2024, and recent revision estimates upward of 0.58%, any misstep to US earnings should result in a pullback.
8. The rest of the world has recently guided downward.

COMPLACENCY

9. The VIX Index has remained low this year, averaging 13.65. This is just short of the average of 16.86 for 2023, a year in which the S&P 500 had a total return of 26.29%.
10. The market seems to be underpricing volatility at the moment, which could create outsized risk if short volatility positioning turns.

SCAN ME

4. Don't Be Afraid of All-Time Highs

A UNIQUE CYCLE

1. It is important to note that the run for the Magnificent Seven has been underpinned by superior EPS growth at a time when the broader market has been delivering lackluster results.
2. However, the superior fundamentals is expected to narrow substantially in 2024 and even further in 2025.
3. Franklin Templeton believes this could be the catalyst for a more durable rotation that sees the other 493 stocks in the S&P 500 increase participation in a broadening market environment, along with small cap stocks.

Billionaire investor Carlos Slim once famously opined, **"With a good perspective on history, we can have a better understanding of the past and present, and thus a clear vision of the future."**

4. While each economic cycle is unique, they share common elements that can help strategists construct a better mosaic on what to expect moving forward.
5. However, as we progress from a (hopefully) once in a lifetime global pandemic, it has become clear there are more differences between the current economic expansion and history than previously perceived.

LONG TERM INVESTORS

6. Long-term investors should take some comfort from the fact that the S&P 500 achieved its first new all-time high in over a year in January, along with several more during the course of the quarter.
7. While all-time highs may incite fear - asking how much better can things get - history shows that deploying capital at peaks has overall led to better performance than deploying capital when the markets are lower on a 1-, 3-, and 5-year basis since 1989.

Disclosure

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