SIGMA
PRIVATE OFFICE

Q1 2024 MARKET REVIEW AND OUTLOOK

MARKET REVIEW & OUTLOOK

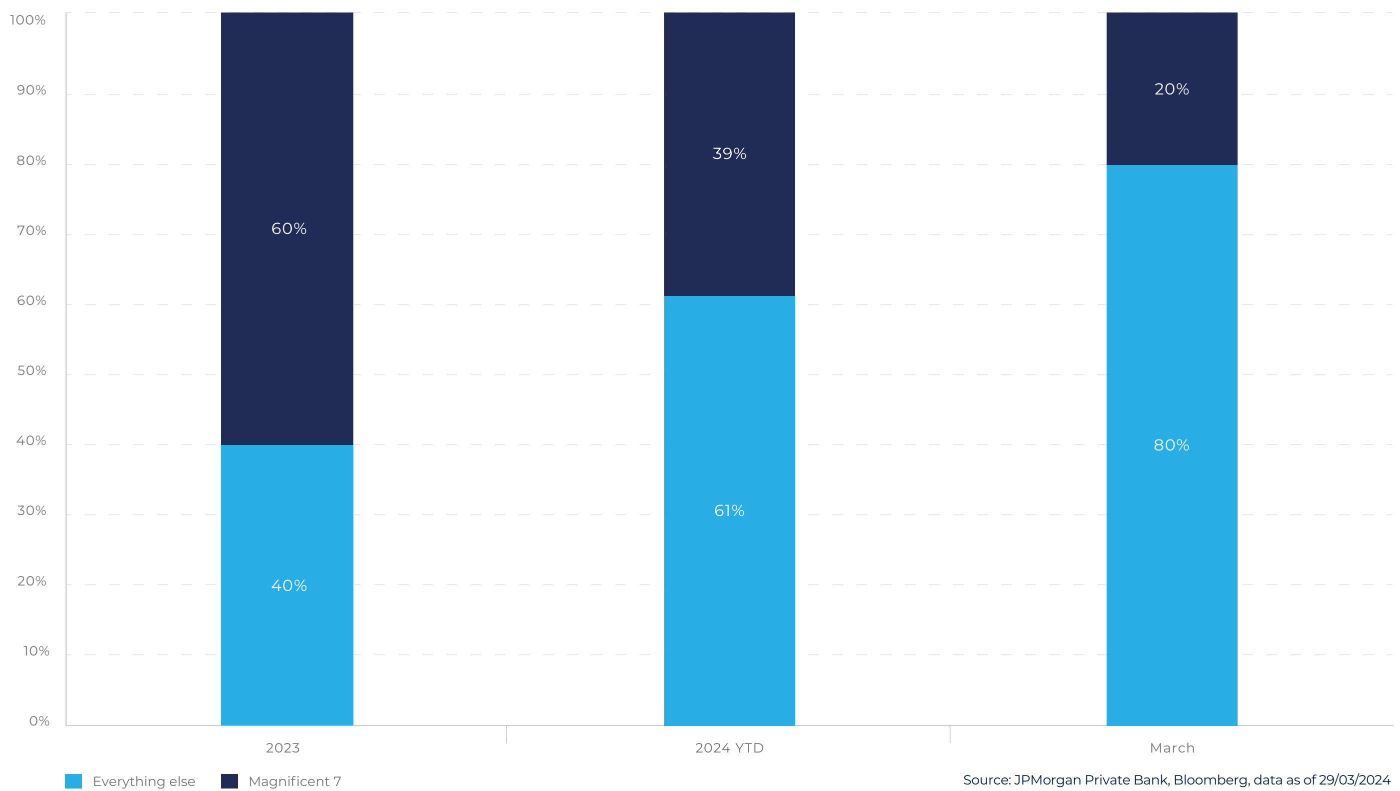
2024 was off to another solid start as the MSCI World Index rose 8.44% in the first quarter, with most major developed market equity indices posting high single digit gains. The S&P 500 set its new longest weekly winning streak record in almost two decades, notching 9 consecutive weekly gains, whilst Japan was yet again the standout performer with the Nikkei 225 up 20.03% in local currency terms and reaching its first new all-time high in 35 years. The widespread positive momentum came despite investors dialling back interest rate cut expectations coupled with slightly hotter than anticipated inflation readings.

While equity markets took it in their stride, bond markets were less immune as US bond yields surged on strong economic data releases. Having started the year at 3.86%, the US 10 Year Treasury yield rose 50 basis points through mid-March, before retracing at the end of the quarter on optimism rate cuts were near.

US and European equity indices climbed to new all-time highs as markets were buoyed by robust corporate earnings. Following a year of very narrow market breadth with the Magnificent 7 driving the majority of returns in 2023, we saw a wider contribution in the first quarter of 2024 as illustrated in Chart 1. US equity markets marginally outperformed their European counterparts but for the first time in over a year we saw the S&P 500 outperform the NASDAQ 100 over the quarter. Notably, the S&P 500 equal weighted index also outperformed the market cap weighted index by 1.15% in March, in a sign of widening breadth.

CHART 1

THE EQUITY RALLY HAS BEEN BROADENING OUT SO FAR THIS YEAR



Source: JPMorgan Private Bank, Bloomberg, data as of 29/03/2024

Despite this widening breadth, Growth sectors have continued to outperform Value as they lead the re-emergence from last year's earnings recession. Communication Services, Information Technology and Consumer Discretionary are expected to be the largest contributors to the 3.4% earnings growth forecasted for the S&P 500 in Q1, with a bulk of that coming from the likes of Meta, NVIDIA and Amazon.com. While these names have come under a lot of focus for their dominance, Goldman Sachs rightly noted that since December 2019, the Magnificent 7 has collectively delivered a 28% annualised return, with 20% coming from sales growth, 7% from margin expansion and only 1% from multiple expansion: a far cry from the comparisons drawn to the IT Bubble of the early 2000s.

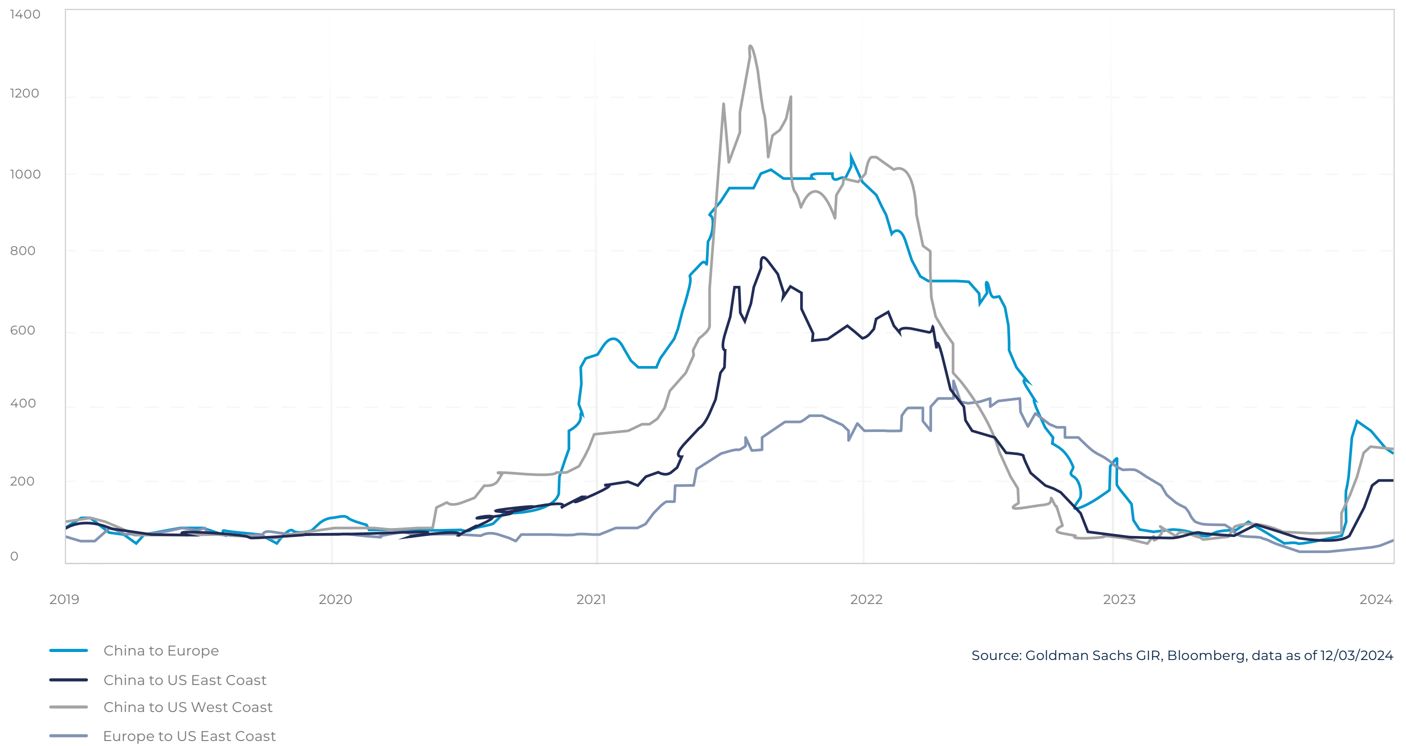
Furthermore, secular growth trends, particularly in Artificial Intelligence, are bolstering growth-oriented sectors by providing consistent tailwinds. As companies leverage AI advancements, they are likely to grow their addressable markets while also experiencing enhanced productivity and competitive advantages, contributing to their ongoing stock performance. However, there is potential for a resurgence in value sectors in the latter half of the year, contingent upon a rebound in economic growth. Indicators such as Leading Economic Indicators (LEIs) and Purchasing Managers' Indexes (PMIs) suggest early signs of this economic revival, which could be further supported by a decline in interest rates. Despite this, we still favour quality growth stocks over the longer term for their superior business models and financial fundamentals.

On the economic data front, Q1 2024' releases highlighted the continued resilience of the global economy, driven by strength in the US. US fourth quarter GDP growth came it at 3.4% annualised which was well ahead of the 2% growth expected, whilst Euro Zone GDP growth was flat q/q as the bloc narrowly avoided the shallow recession that was anticipated.

As for inflation, in the US the last two CPI readings have come in slightly hotter than expected but tailwinds across the labour market, shelter and supply chains indicate inflation is still on track to fall from current levels of around 3% to the Fed's 2% target. Likewise, in Europe and the UK, disinflationary progress continues to be made despite concerns geopolitical developments in the Red Sea shipping corridor could bring renewed inflationary pressures. While the risk warrants some attention, as ships reroute around Africa making Asia-Europe voyage times 30-40% longer, the recent spike in freight rates is not comparable to those seen during the height of the pandemic, as shown in Chart 2. Furthermore, research by Goldman Sachs estimates only a 0.1% increase to global core inflation as a result, given sea freight only comprises a small share of final goods prices and the limited scope to push through price increases in a relatively benign demand environment.

CHART 2

SEAFREIGHT RATES HAVE SPIKED, BUT NOTHING COMPARED TO THE PANDEMIC



Source: Goldman Sachs GIR, Bloomberg, data as of 12/03/2024

Investors remain fixated on the interplay between inflation and economic growth dynamics globally and Central Bank's abilities to balance the two. At the March FOMC meeting, the Federal Reserve's decision to keep interest rates unchanged for the 5th consecutive meeting was expected, but more importantly, with the hiking cycle behind us the market has turned all attention to the timing of interest rate cuts. Jerome Powell reiterated their forecast for 3 cuts this year while also raising their economic growth projections. However, commentary aired on the side of caution, reminding market participants of the risks of cutting too early and that the path to 2% inflation may be bumpy.

Likewise, the European Central Bank (ECB) and Bank of England (BOE) held interest rates steady at their March meetings. Both signalled the first cuts could come as soon as June if macroeconomic forecasts are met and inflation continues to show signs it is under control. Markets are forecasting a 75-basis point reduction by the Fed, ECB, and BOE for the year, following the Swiss National Bank's lead as the first among the G10 to lower rates (0.25% reduction from 1.75% to 1.50% on 21st March 2024). A cutting cycle should be positive for stocks and bonds but with the US seemingly weathering higher rates just fine, we currently don't foresee an urgency for rates to drop so soon and do not think the continuation of this young bull market is contingent on it either.

This quarter, the Bank of Japan (BoJ) also became the last central bank to end its experiment with negative interest rates, delivering its first rate hike in 17 years by raising rates from -0.1% to 0% – 0.1%. The decision was widely anticipated but leaned towards a more accommodative stance, to ensure the reflation isn't temporary, as the BoJ continues to influence long-term rates by purchasing long dated Japanese Government Bonds (JGBs). These changes aim to alleviate the adverse effects on banks and encourage lending to stimulate domestic economic activity, but don't mark a drastic change to policy. The divide between domestically oriented businesses and export-driven multinationals persists, with the weak Yen benefiting exporters at the expense of import-reliant sectors. Nonetheless, paired with the recent progress on corporate reforms, the outlook for Japan is much brighter than it has been for decades.

Looking ahead, 2024 is the year of elections; almost 50% of the world's population will head to the polls this year, which is more than ever before. In the US, it is now clear we will likely have a rematch between President Joe Biden and former President Donald Trump. The elections will bring with it endless policy debate and uncertainty could fuel market volatility but more often than not, the status quo of political gridlock persists and acts as an underappreciated tailwind for global stocks. Even so, global economies and markets are fluid, and we will keep a watchful eye over developments on behalf of our clients.

> “We currently don't foresee an urgency for rates to drop so soon and do not think the continuation of this young bull market is contingent on it.”

SOME TRUTHS ABOUT INVESTING AT ALL-TIME HIGHS

As global equity markets continue to notch new all-time highs, a sense of nervousness understandably arises among some investors. The questions "is now a good time to invest" and "are equities too expensive" are perhaps the most frequent in the current market environment. However, a look back through history suggests it is as good a time as any to invest and traditional valuation metrics like the price-to-earnings (P/E) ratio are not predictive of equity market returns.

In Chart 3 we see the numerous all-time highs the S&P 500 has reached over the decades; the same goes for other equity indices globally. This sustained upward momentum, driven by continuous economic development and earnings growth, paves the way for subsequent peaks.

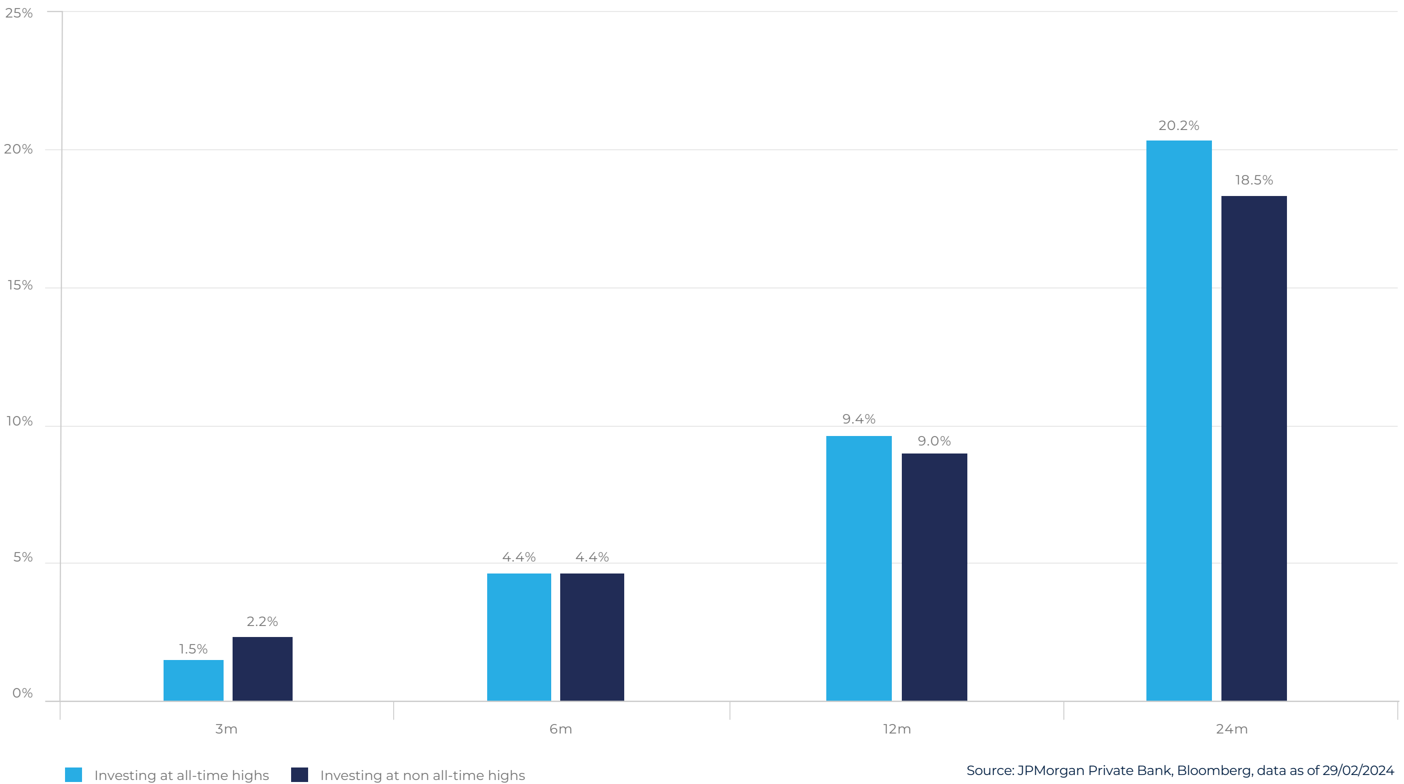
CHART 3

ALL-TIME HIGHS ARE MORE COMMON THAN YOU MIGHT THINK

Source: JPMorgan Private Bank, Bloomberg, data as of 29/02/2024

Furthermore, empirical evidence, as outlined in Chart 4, illustrates why investors should not fear investing at perceived market highs. Contrary to common misbeliefs, returns are near identical when investing at all-time highs versus investing at any other time. In other words, it is not about the timing of your investments so much as it is about being invested, something we so often talk about.

CHART 4
INVESTING AT ALL-TIME HIGHS HAS NOT NOTABLY IMPACTED RETURNS



Source: JPMorgan Private Bank, Bloomberg, data as of 29/02/2024

The strong equity market returns over the past 18 months also raises the worry among some investors that they have missed all the upside or that a correction must be "just around the corner". However, the reality is that corrections cannot be timed as they can occur at any given point throughout a bull market and typically require a catalyst whereby sentiment unexpectedly sours. Moreover, market participants tend to underestimate the strength of positive momentum in the early stages of a new bull market and its self-reinforcing nature, allowing markets to continue their upward trajectory even after periods of robust gains. Chart 5 demonstrates this ongoing strength in S&P 500 returns in the months following gains in all four months from November to February.

Adding to the already long list of investor concerns in a young bull market, the S&P 500's forward 12m P/E ratio recently surpassed 20x, bringing discussions around market (over)valuation to the forefront. However, concentrating on valuation metrics alone is an oversimplified way of determining if a stock is cheap or expensive and does not determine the future direction of the stock price.

Moreover, a forward P/E ratio has inherent limitations as it is based on analysts' expectations of future profits, not past earnings, which the market has already assimilated into stock prices. As such, high forward P/Es often surface when earnings estimates are conservative, and the market is already anticipating a rebound. Therefore, during the early stages of a bull market for example, forward P/Es might appear inflated not because stocks are overvalued but because analysts are recalibrating their earnings projections to catch up with the market's recovery trajectory.

CHART 5
POSITIVE MOMENTUM IN EARLY BULL MARKETS CAN BE SELF-REINFORCING

S&P 500 Performance When Higher November, December, January, and February

		S&P 500 Index Returns		
Year	March	Calendar Year Return	Final 10 months of the Year	Next 12 Months
1950	0.4%	21.7%	18.6%	26.6%
1954	3.0%	45.0%	37.6%	40.6%
1955	-0.5%	26.4%	23.7%	23.3%
1961	2.6%	23.1%	12.8%	10.3%
1971	3.7%	10.8%	5.4%	10.1%
1983	3.3%	17.3%	11.4%	6.1%
1986	5.3%	14.6%	6.7%	25.2%
1991	2.2%	26.3%	13.6%	12.4%
1993	1.9%	7.1%	5.2%	5.4%
1996	0.8%	20.3%	15.7%	23.5%
1998	5.0%	26.7%	17.1%	18.0%
2004	-1.6%	9.0%	5.8%	5.1%
2013	3.6%	29.6%	22.0%	22.8%
2017	0.0%	19.4%	13.1%	14.8%
2024	2.3%	?	?	?
Average	2.1%	21.2%	14.9%	17.4%
Median	2.4%	21.0%	13.4%	16.4%
% Higher	78.6%	100.0%	100.0%	100.0%
Average Year	1.1%	9.3%	8.1%	
Median Year	1.4%	12.0%	9.0%	
% Higher	64.9%	71.6%	73.0%	

Source: Carson Investment Research, FactSet, data as of 29/03/2024

Ultimately, all that really matters for a long-term investor is determining and maintaining the correct investment strategy that is aligned with your risk tolerance and financial objectives, irrespective of the pursuant market environment. Rather than attempting to time the market or react to short-term volatility, a disciplined approach that leverages the power of compounding returns is more likely to yield success. In knowing this, you can look beyond immediate market conditions and focus on the long-term growth that has characterised equity investing over many decades.

Thank you for taking time to read our Market Review.
Sigma Investment Committee

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