

Strong Economic Data Gives Reason to be Constructive on Markets

S&P 500 & Nasdaq Notch Best February in Nearly a Decade

Amid a resilient economy and strong AI-related earnings, equities shrugged off inflation worries in February. All three major indices posted new all-time highs, and both the S&P 500 and Nasdaq posted their best February since 2015. US growth (+7.2%) was among the best performers, followed by US mid-caps (+5.8%) and US large-caps (+5.2%). Aside from high yield credits (+0.3%), bonds were mostly down as 7-10 year US Treasuries fell 2.1%, investment grade corporate bonds decreased 1.4%, and the US Aggregate Bond Index declined 1.4%. Commodities produced mixed returns as crude oil and gold rose (+3.4% and +0.5%, respectively) while broad-based commodities and silver fell (-1.4% and -0.9%, respectively).

Exhibit 1: Trailing Returns as of February 29, 2024

Index/ETF	1-Mo	YTD	3-Mo	1-Y	3-Y	5-Y
Equities						
US Growth (SPYG)	7.19%	10.27%	14.43%	38.36%	10.29%	15.84%
US Mid-Caps (SPMD)	5.76%	3.94%	12.97%	12.83%	6.59%	10.08%
US Large-Caps (SPY)	5.22%	6.89%	11.78%	30.11%	11.76%	14.63%
Broad-based Emerging Markets (SPEM)	3.78%	0.00%	3.36%	9.42%	-4.14%	3.08%
US Small-Caps (SPSM)	3.21%	-0.90%	11.80%	6.37%	2.28%	7.87%
US Value (SPYV)	2.91%	3.20%	8.92%	21.46%	12.63%	12.44%
International Developed Equities (SPDW)	2.85%	1.82%	7.51%	13.82%	3.19%	6.55%
US Fixed Income						
High Yield Credit (JNK)	0.30%	0.44%	3.81%	10.61%	1.13%	3.09%
Municipal Bonds (MUB)	-0.22%	-0.17%	2.08%	5.22%	-0.05%	1.92%
Treasury Inflation Protected Notes (SPIP)	-1.12%	-0.16%	1.78%	2.18%	-1.11%	2.55%
US Aggregate Bond Index (SPAB)	-1.35%	-1.62%	1.86%	3.31%	-3.17%	0.51%
Investment Grade Corporate Bonds (SPBO)	-1.41%	-1.48%	2.51%	6.18%	-2.67%	1.99%
US Treasury 7-10 Year (IEF)	-2.08%	-2.01%	1.68%	1.36%	-4.80%	-0.23%
Commodities						
Crude Oil (USO)	3.44%	10.07%	4.59%	9.13%	21.05%	-5.16%
Gold (GLD)	0.46%	-0.97%	0.30%	11.48%	5.36%	8.83%
Silver (SLV)	-0.86%	-4.82%	-10.38%	7.84%	-5.61%	7.22%
Broad-based Commodities (BCI)	-1.44%	-1.08%	-3.76%	-4.22%	6.37%	5.18%

Source: FactSet. Data as of February 29, 2024. 1Y, 3Y, and 5Y numbers are annualized.

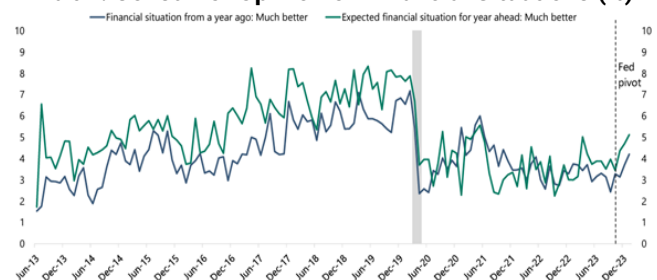
Markets Slash Rate Cut Expectations

As the fed funds rate remains in the 5.25–5.50% range, investors are anxiously awaiting interest rate cuts from the Federal Reserve. However, after hotter than expected inflation prints were released earlier in the month, the bond market has cooled off its rate cut implications. In the beginning of the year, six 25 bps cuts for 2024 were priced in. Bond traders now see that number to be only three 25 bps cuts, converging with the Fed’s median dot plot projections released in December. Although both January CPI and PPI readings came in above expectations, yesterday’s January PCE release came in level with estimates, calming near-term concerns that inflation was resurging. Nonetheless, both core annualized PCE and CPI are still above target (2.8% and 3.9%, respectively), their descent to 2% appears stubborn, and risks of inflation reaccelerating remain present. Only one month of data is unlikely to affect the Fed’s path for rate cuts, expressed from the FOMC minutes that stated, “Most participants noted the risks of moving too quickly to ease the stance of policy and emphasized the importance of carefully assessing incoming data in judging whether inflation is moving down sustainably.” Per the CME FedWatch Tool, there is currently a 54% chance that the first 25 bps cut will occur at the June meeting.

Did the Fed Make Inflation’s Decline Harder?

Since December 2023 when the Fed announced rate cuts ahead, consumers have been more optimistic about the economy and their financial situation. Could this have stimulated hotter growth and inflation?

Exhibit 2: Consumer Opinion on Financial Situations (%)

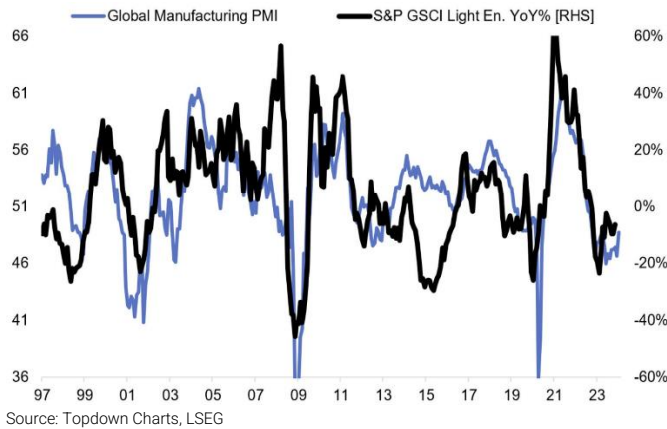


Source: FRBNY, Haver Analytics, Apollo Chief Economist

Is Resurgence Risk Priced In?

Improvements in manufacturing PMIs have historically coincided with increasing commodity prices and ultimately inflation. As manufacturing PMIs are forecasted to improve further, could this increase the risk of inflation resurging?

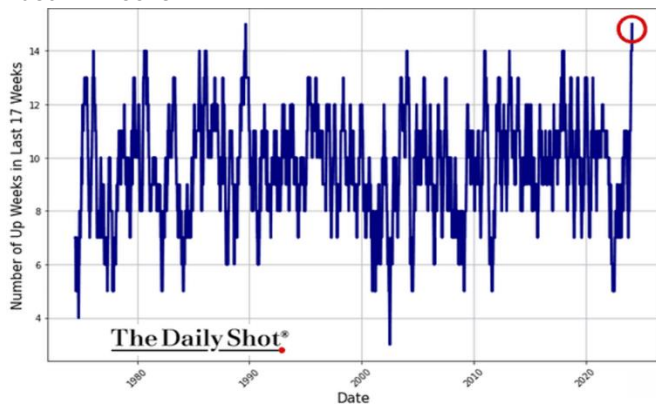
Exhibit 3: Commodities vs. Global Manufacturing PMI



Longest Weekly Winning Streak Since 1989

The S&P 500 has posted a positive weekly gain for 15 out of the past 17 weeks. This marks its longest winning streak in approximately 35 years.

Exhibit 4: S&P 500 Weekly Performance – Up Weeks in Last 17 Weeks



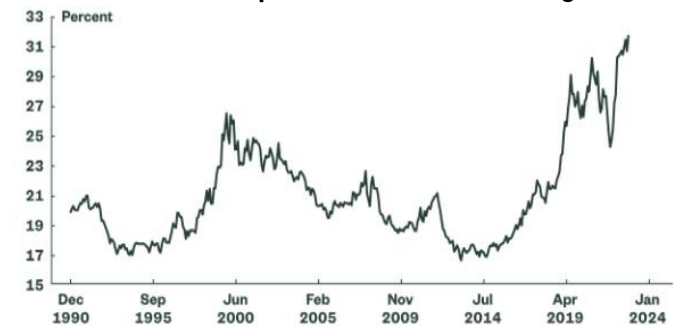
Strong Economic Data Gives Reason to be Constructive on Markets

We are the most constructive we’ve been on markets in over two years. Why? Throughout that period, investors had to cope with rampant inflation, an abundance of Fed interest rate hikes, negative real rates, an earnings recession, and corporates dealing with wage increase while preparing their balance sheets for a recession that

hasn’t occurred. In our view, the environment has recently changed as we’ve come across stronger than expected economic growth, an earnings recovery, positive real rates, rate cuts on the horizon, an anticipated alleviation of funding pressures, and an optimistic setup for a broadening out of the market/change in market leadership.

Among improving PMIs, a resilient labor market, and leading indicators no longer signaling a recession, we’ve recently established an overweight to US equities and reduced negatively correlated alternatives. We’ve maintained our quality exposure but have split our risk towards half equal weight and half quant/smart-beta ranked products as we believe market breadth will eventually increase. At this point, it’s prudent risk management to diversify away from market-cap weighted products with heightened concentration risk.

Exhibit 5: S&P 500 Top 10 Constituent Total Weight



Though we find the international picture to be trickier in Europe with heightened recession risks and effects of China exporting deflation, we deem Japan to be attractive. It has a combination of appealing estimate revisions, high growth estimates, and strong price momentum while also having a cheap valuation. Additionally, Japan’s projected earnings are expected to outpace both the US and Europe, and its GDP has more room to grow.

On the fixed income side, we’ve been vocal about rotating out of T-Bills and into the capital markets. We are barbell our risk among corporates, Treasuries, and munis, and we’ve recently added a position in agency mortgage-backed securities which have high spreads, attractive YTM, and low prepayment risk.

We continue to own gold as an alternative as rates have come down but uncertainty around actual rate cuts remains. Moreover, we remain very bullish on having an allocation to inflation sensitive assets as resurging inflation ignited by lower rates shifting back demand curves seems to be a risk that it not priced in.

Lastly, we believe the market's behavior will continue to favor large-cap/market-cap weighted quality/growth if economic data stays strong and less rate cuts are anticipated. Until there is more confidence around rate cuts and their timing, we feel small-caps, value, option-overwriting strategies, and EM may continue to struggle.

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