Vestor Capital
INVESTMENT & WEALTH MANAGEMENT

Economic and Investment Outlook

April 9, 2024

Equity Market Update

Equity indexes are off to a strong start in 2024. U.S. large-cap indexes are particularly strong due in part to a handful of technology stocks that boast strong business fundamentals which investors are recognizing. While U.S. and international small-cap stocks are only up 2%, this is a respectable start to the year. Developed large-cap international stocks have posted strong gains of almost 6%, while the emerging market index is up only 2% due to a drag from Chinese stocks which comprise a large portion of the index.

The much-anticipated recession has yet to materialize, and the U.S. economy continues to expand and with it, corporate earnings growth. The economy has absorbed higher interest rates and inflation which we do not find surprising. While the post financial crisis economy was characterized by extremely low inflation and interest rates, that was actually an exception. Much of history looks more like today with slightly higher inflation and interest rates, and those periods were conducive to a healthy economy and equity market. There is concern that the strong start to the year portends future weakness. Interestingly, since 1950, of the 16 times that the S&P 500 has gained at least 8% in the first quarter only once did the index lose ground the rest of the year. While the past is not a perfect predictor of the future, this provides a reasonable rebuttal to those who are bearish.

Total Return Performance for the Major U.S. and International Stock Market Indexes

Equity Index	*YTD March 31, 2024*
United States	
Dow Jones Industrial Avg.: 30 Stock Composite	**6.14 %**
S&P 500 Composite: U.S. Large Cap	**10.55 %**
NASDAQ Composite: Technology Heavy	**9.32 %**
S&P 600 Small Cap: U.S. Small Cap	**2.45 %**
International	
MSCI EAFE Large Cap: Europe, Asia & Far East Large Cap	**5.83 %**
MSCI EAFE Small Cap: Europe, Asia & Far East Small Cap	**2.09 %**
MSCI EM Emerging Market: Emerging Market Countries	**2.13 %**

Source: Bloomberg, L.P.

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Economy

The graph below highlights the fact that debt payments as a percent of disposable income are at very low historical levels. This would likely be surprising to many as the recent focus from financial commentators has been on the higher absolute level of interest rates. Higher wages coupled with consumers locking in lower mortgage rates are two factors that have kept this ratio down.

One of the most important measures of a healthy economy is employment which continues to be extremely strong. The March jobs report was solid with over 300,000 new jobs created and the unemployment rate is at 3.8% which is at generationally low levels. Weak births and restrictive legal immigration laws have kept the supply of labor down which should lead to a lower long-term unemployment rate.

The most widely viewed measure of the economy is gross domestic product (GDP) which continues to be robust. 2023 GDP growth of 3.2% is above the long-term average of about 2% which has surprised many economists who expected the higher interest rate environment to negatively impact GDP. Due to the service nature of our economy, GDP growth is historically quite steady with the exception of "Black Swan" events such as the Financial Crisis or COVID which are the two big events that shook the economy over the past 25 years. We remain positive on economic growth as we expect the healthy labor market to continue.

Source: JPMorgan Guide to the Markets 3/31/2024

U.S. Market Outlook

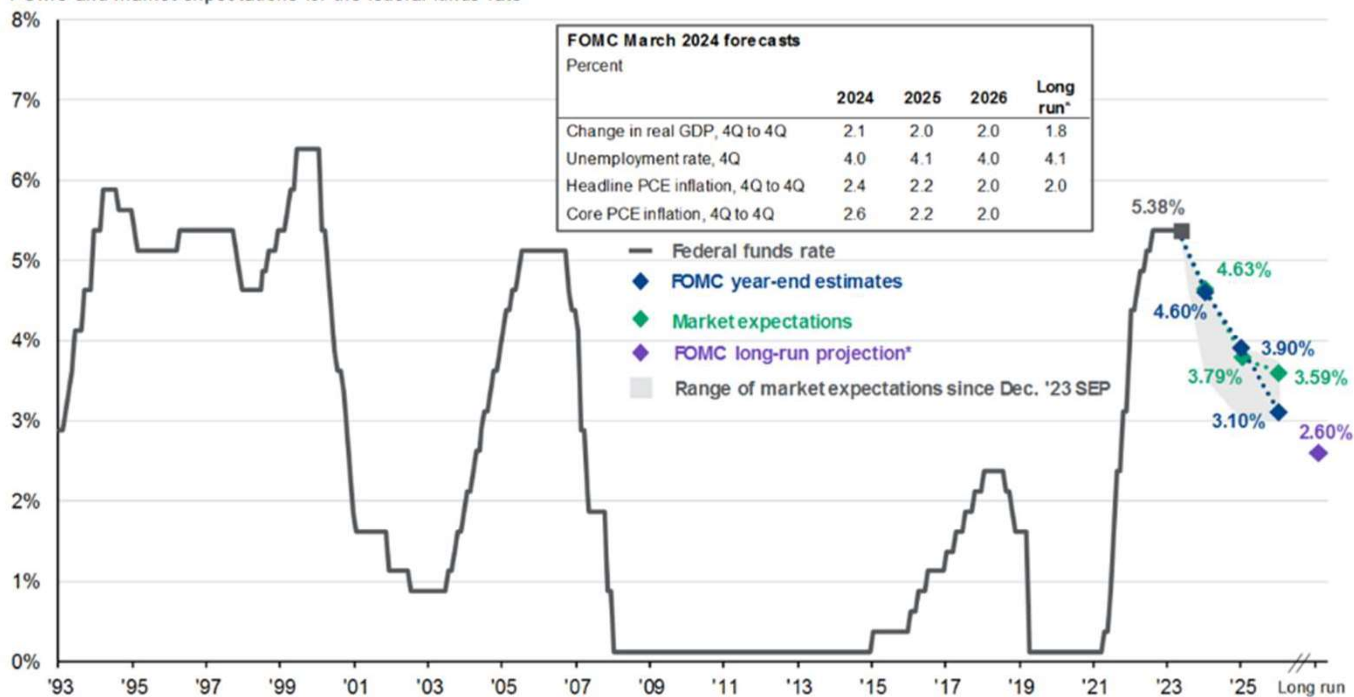
We noted in our last commentary that the setup for equities in 2024 was good and thus far that has been the case. We certainly did not expect 2024 to start off this strong, but markets tend to be more volatile than we expect on both the upside and downside. We would not be surprised if we had a market pullback as investors digest gains. Markets tend to backfill while advancing as investors take profits and new entrants use pullbacks to accumulate stock, which is a sign of a healthy market. Long-term interest rates have risen recently due to concern over fewer interest rate cuts in 2024, which has caused bond prices to fall. We would use this weakness as an opportunity to purchase bonds as we believe interest rates are close to peaking. Finally, we continue to recommend alternative investments including private debt and equity, along with infrastructure assets which have solid long-term potential and provide additional portfolio diversification.

Inflation, Interest Rates & Fixed Income

While inflation has fallen dramatically over the past year, it remains over 3% and the Federal Open Market Committee (FOMC) continues to state that their goal is to get inflation down to 2% where it has generally been since 2008. Interestingly, for much of the period before 2008, inflation was above 2% and there was no wrangling or gnashing of teeth. We imported deflation from China during the period of low inflation and that tailwind is easing. We believe that it would be wise for the FOMC to delicately walk back their insistence on reducing inflation to a magical level of 2%. We believe that a 3% inflation level that is gradually easing is not a concern. In fact, the current higher interest rate environment is healthy as there is a real cost of capital which is good for investors and reduces speculative business decisions due to cheap money.

Interest rates were artificially low for much of the past 15 years and the recent rise has been a healthy development for fixed income investors who suffered for many years as short-term interest rates did not even cover inflation, which is a more typical relationship. We do not expect the era of ultra-low interest rates to return again. The graph below highlights the FOMC long-run projection is for a federal funds rate of 2.6%, which is well below current levels.

We believe that bonds remain attractive due to higher rates accompanied by a healthy economy. While short-term rates remain high, they are likely at or near peak levels. In the event that the economy temporarily weakens, high-quality bonds with longer terms, or duration, would rise in value providing the defensive feature that they have typically provided over time.



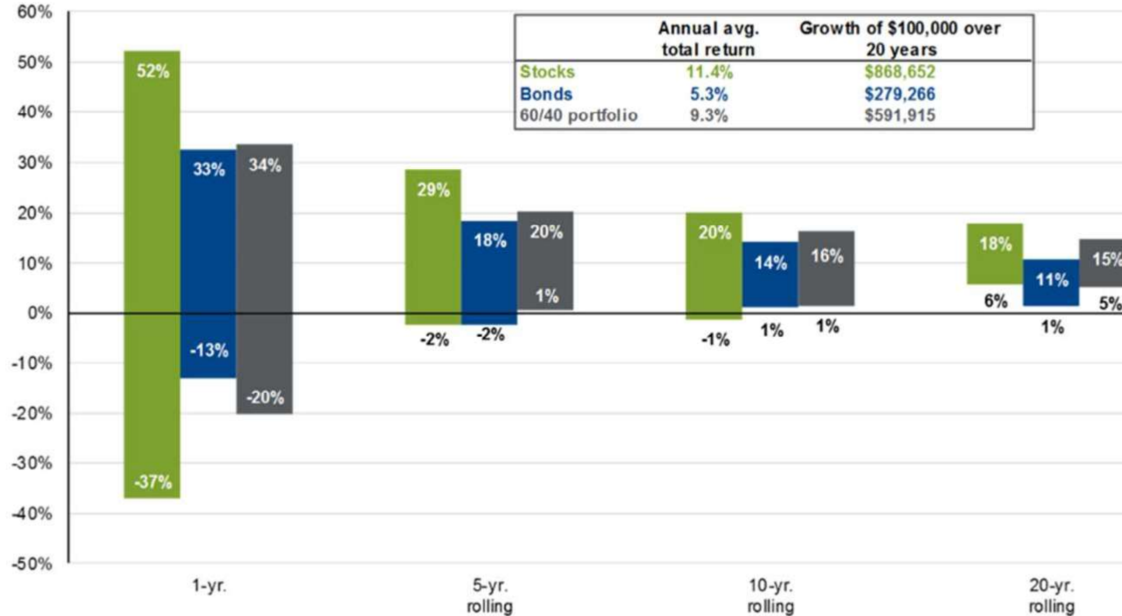
FOMC March 2024 forecasts
Percent

	2024	2025	2026	Long run*
Change in real GDP, 4Q to 4Q	2.1	2.0	2.0	1.8
Unemployment rate, 4Q	4.0	4.1	4.0	4.1
Headline PCE inflation, 4Q to 4Q	2.4	2.2	2.0	2.0
Core PCE inflation, 4Q to 4Q	2.6	2.2	2.0	

Source: JPMorgan Guide to the Markets 3/31/2024

Summary

The adage that markets climb a wall of worry has never been more true than today. Wars in the Middle East and Ukraine, higher interest rates and a host of other concerns have not negatively impacted world equity markets. It is interesting to note in the graph below that an investment in a portfolio of 60% equities and 40% bonds has had a positive return over 5, 10 and 20-year rolling periods dating back to 1950. This is important to keep in mind to avoid anxiety during periods of excessive market volatility.



Source: JPMorgan Guide to the Markets 3/31/2024

Our economy continues to perform well, employment is strong and inflation is slowly improving, providing the foundation for a healthy equity market. Markets typically pull back 10% once per year and we would not be surprised to see a normal market pullback soon. Nevertheless, this does not at all affect our positive long-term view of the market.

It is important to remember that economic forecasting is very difficult and fraught with error. This is why we suggest to take all forecasts with a grain of salt and simply remember that over time economies and companies grow, leading to wealth creation. Periods of weakness and volatility are the price you have to pay to enjoy the long-term rewards. Enjoy spring flowers and trees budding, and leave navigating the market to us. Happy Spring!

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