

Quarterly

2024 First Quarter Investment Market Report

Last quarter, we wrote of markets feeling “euphoric” with virtually all markets rallying into year-end on the heels of the Federal Reserve signaling that its nearly two-year series of interest rate hikes is likely over. With rate cuts expected in 2024, that euphoria has continued to propel the S&P 500 to new all-time highs, up 10.6% for the first quarter, exceeding most analysts’ expectations for the entire year! Despite some surprisingly strong economic growth statistics reported during the quarter, more than 70% of the S&P 500 gain came from “multiple expansion,” meaning that investors are just willing to pay a higher price for each dollar of future earnings; i.e., stocks are simply getting more expensive. Over this past quarter, the Price/Earnings multiple for the S&P 500 rose from 19.5x to 21x, which is nearing the 2022 peak of 21.4x, two months before the Federal Reserve began to hike interest rates. Just to put this into context, if the S&P 500 kept up this pace for even two more quarters, it would match the all-time peak multiple of the “dot-com bubble,” so a long-term investment perspective is likely more prudent than “fear of missing out.”

However, there have been some encouraging signs in “how” the U.S. stock market has traded up. Last year, we spoke much of how the 7 largest market capitalization stocks in the S&P 500, dubbed “The Magnificent Seven,” were driving virtually all the gains for the entire index. This changed in the big “everything rally” of the fourth quarter, which saw other sectors of the stock market outperform those 7 behemoth tech companies. By the end of last year, the “Magnificent 7” only accounted for about 60% of 2023 gains in the index, and so far in 2024, that share has been closer to 40%, indicating some healthier “breadth” for the U.S. stock market.

In fact, a couple of the members of the “Magnificent 7” have stumbled in the first quarter of 2024 – Apple and Tesla. Apple fell more than 10% on the quarter as it lacks a “next great” product that could spur a next stage of growth, it has struggled to grow revenues for over a year, it is getting hit by antitrust suits on both sides of the Atlantic, it is facing serious challenges from multiple directions in the vital Chinese market, it has fallen well behind in the artificial intelligence race, and it is not finding overwhelming demand for a \$3,500 Vision Pro headset that costs 7 times as much as a similar competitor and is not comfortable enough for most people to want to wear it for hours at a time.

Beyond all the turmoil in the headlines surrounding the leadership of Tesla and closely associated companies, Tesla is also facing growing resistance to further consumer penetration of electric vehicles and experiencing slowing demand that has taken sales growth from around 50% annually to near zero. The electric vehicle market is getting increasingly competitive, and Tesla’s dated model lineup is no longer the world’s top selling line. Shareholders were also not encouraged when Tesla’s CEO tried to coerce his Board of Directors to grant him an incremental 10%+ of the company or he would take his artificial intelligence research efforts to one of his other companies. This would have diluted shareholders and drained the company of some of the very initiatives in which Tesla shareholders thought they were investing. Oddly, this came as the courts struck down as improper another \$50+ billion award his Board had given him, so the latest attempt would likely face another court battle from shareholders. Added all together, shareholders have been voting with their feet, sending the stock down about 30% in the first quarter. With these two stocks down on the quarter and Alphabet (Google) trailing the remaining market leaders, the press has begun to dub the remaining four “Magnificent 7” stocks as “The Fab Four.”

[continues next page](#)

INDEX	Q1 2024
S&P 500	10.6%
Equal-Weighted S&P 500 Index	7.8%
Dow Jones Industrial Average	6.1%
Nasdaq Composite	9.3%
Russell 2000 (Small Caps)	5.2%

Source: Morningstar Direct

INDEX	Q1 2024
MSCI EAFE (Developed Markets)	5.9%
MSCI Emerging Markets	2.4%

Source: Morningstar Direct; See disclosures for important benchmark information

International Developed equities markets also posted a strong quarter; with equities up nearly 6%, due to the Eurozone economy performing stronger than expected, combined with inflation decelerating faster than it is in the United States. We mentioned the euphoria powering the U.S. stock markets, and with the Swiss National Bank becoming the first major central bank to cut interest rates, the optimism for rate cut powered gains is certainly shared in other markets, as demonstrated by new all-time highs in both Europe and Japan. Japan actually had other reasons to celebrate after crawling out of 30 years of deflation and stagnant markets to hit its first new stock market milestone on the Nikkei Index since 1989.

Emerging Markets equities rode the wave of global optimism to a solid gain for the quarter of 2.4%, but those markets still seem to be weighed down by the lack of economic acceleration in China. The Chinese government is increasingly concerned, so we can expect to see continued efforts out of Beijing to get the Chinese consumer to spend again.

STILL THE BIGGEST QUESTION — WHAT WILL THE FED DO WITH INTEREST RATES?

For two years now, the biggest drivers of U.S. markets have been inflation and the policy responses of the Federal Reserve to combat that inflation, and with the “everything rally” in Q4 of last year, bond markets seemed to get ahead of themselves. Part of the fuel for this was excessive optimism about the number of interest rate cuts we would see from the Federal Reserve in 2024. The Fed projected 3, but the market was hoping for 6. Those expectations have come back to reality now, so we saw bond markets trade off a little in the first quarter. With the U.S. economy continuing to grow at a healthy pace and the last few yards of the inflation battle proving stubborn, the market is now wondering if we will even see those 3 interest rate cuts.

INDEX	Q1 2024
Bloomberg US Aggregate Bond Index	-0.8%
Bloomberg Global Aggregate Bond Index	-2.1%
Bloomberg Municipal 5-Yr Index	-0.4%

Source: Morningstar Direct; See disclosures for important benchmark information

SOFT LANDING? WHAT LANDING?

Last quarter, in our year-end commentary, we discussed 3 possible scenarios for the economy in 2024:

- The “Goldilocks” case, meaning that we get the “soft landing” (not too hot, not too cold) for the economy that had become the consensus market expectation. In this scenario, the Fed interest rate hikes of the last couple of years finally slow down the economy enough to bring inflation under control, yet keep the U.S. economy from dipping into a recession.
- The recession case (too cold!) which had preoccupied the market in 2023, but is becoming less and less likely as strong economic numbers continue to roll in month after month.
- The stubborn inflation case (too hot!) which we described as the scenario fewest market participants were concerned about, despite this being the most common source of unpleasant surprises over the last couple of years. The key line from that description was:
“It might not make any sense for the Fed to start cutting rates and fuel further economic growth in that situation, meaning interest rates stay higher for longer than the market is currently anticipating, or even have to go up further if inflation warrants it.”

We are currently straddling the Goldilocks case and the stubborn inflation case, but the recent momentum seems to be toward the stubborn inflation case. So far, the bond market has reacted much more to the possibility of delayed interest rate cuts as the U.S. stock market has still clung to strong economic growth and the promise of a coming productivity boom powered by artificial intelligence.

So far, the bond market has reacted much more to the possibility of delayed interest rate cuts as the U.S. stock market has still clung to strong economic growth and the promise of a coming productivity boom powered by artificial intelligence.

A SPLIT ECONOMY?

This split reaction in the markets is happening concurrently with what we see as the development of a “split economy.” The U.S. economy has undergone a huge transformation in the past several decades. In the 1980s we were a goods-based economy with a much higher share coming from manufacturing. Now we are a services-based economy in which the children of 1980s steel workers are more likely to be much higher paid software engineers. We have also seen a demographic shift with the “baby boomers” retiring, often with substantial accumulated savings and either a low fixed-rate mortgage or no mortgage at all on their house. The latter groups in each of these last two sentences are much less sensitive to changes in interest rates than those in the former. Therefore, we see a dilemma unfolding for Federal Reserve policymakers in that the lower income segment of the population that is more rate sensitive is suffering after two years of higher interest rates while the upper income segment of the population is prospering as they have been much less impacted by higher rates, allowing them to feed a strong economy in aggregate.

A few examples:

- Credit card delinquencies for people in their 20s and 30s have spiked because they tend to have lower incomes, less savings, lower credit scores, and frequently carry balances on their cards, which are now carrying much higher rates.
- Auto loan delinquencies for people in their 20s and 30s are nearly back to the levels we saw in the 2008 recession (for the same reasons stated above), while delinquencies for older age groups have remained much more subdued.
- Bank lending activity has been in a steep decline ever since the high-profile bank failures (i.e., Silicon Valley Bank) a year ago – lower paying, goods-oriented jobs are more dependent on employer growth through financing capital improvements than higher paying, service-oriented jobs.
- Rents have skyrocketed the last couple of years while the more affluent homeowners largely refinanced at lower rates, so they have not seen their mortgage payments go up.

We have also seen a demographic shift with the “baby boomers” retiring, often with substantial accumulated savings and either a low fixed-rate mortgage or no mortgage at all on their house.

The overall economic health of the country seems to be accelerating because the upper incomes drive much more of the spending in the economy.

There are many more examples of how the effects of two years of interest rate increases are impacting different segments of the population very differently. The overall economic health of the country seems to be accelerating because the upper incomes drive much more of the spending in the economy. For example, the top 20% of incomes are responsible for about 40% of the consumer spending, so that spending continues to create inflationary pressures while the lower incomes have been forced to significantly curtail spending because they may be struggling to even make their car payments.

The short-term trend (3 months) in inflation has actually turned positive again, so the Federal Reserve is certainly hoping that is a blip and not a new trend. The data could change direction one way or the other in the coming months, but as of the end of Q1, the trend seems to be toward fewer interest rate cuts this year. However, the unenviable position of the Federal Reserve is that on the one hand, if higher interest rates are having diminishing effects, is it worth the pain it is inflicting on some to wring out the last bit of inflation? Or, on the other hand, if they lower interest rates prematurely, does it unleash another wave of even more damaging inflation, requiring additional interest rate increases? History would tell us that the latter is the more damaging possibility, but in an election year, we can expect to hear parties from all sides arguing the former.

WHAT DOES THIS ALL MEAN FOR CLIENT PORTFOLIOS?

Given the dilemma stated above, if inflation remains stubborn or only slightly resurgent, we would expect the Fed to give the current level of elevated interest rates more time to slow the economy rather than inflict more pain on more rate-sensitive sectors. If inflation were to show signs of a sustained reacceleration, there would be no choice but to raise rates further, but there is no sign of that at this time.

The U.S. bond market currently seems more pessimistic on the course of interest rates than the U.S. stock market, but they will likely get aligned in one direction or the other in the coming months. With the S&P 500 posting a surprisingly blockbuster first quarter, but also approaching record

valuations, trying to predict the timing or the direction of the next 10% move in stocks is more guesswork than foresight. In addition, with the possibility of resurgent inflation punishing both stock and bond markets, we want to make sure we protect portfolios in such an environment. What we will continue to do is build “durable” portfolios that we are constantly working to strengthen to face the range of markets that we will likely see in the next several years. For most clients, this has meant selecting additional ways to add

diversification, which we are continuing this year, including, in some cases, utilizing other asset classes whose movements have little or no correlation to the traditional stock and bond markets. Given the high valuation of the S&P 500, we believe many of these diversification efforts could not only lower risk, but also improve potential returns for portfolios as a whole over the next several years.

-Dennis Follmer
Chief Investment Officer, Montis Financial
April, 2024

FINANCIAL PLANNING NEWS:

This time of year, taxes seem like an appropriate topic, so we wanted to examine a common mistake that investors confuse with tax planning. There is a saying in the investment management industry:

“Don’t let the tax tail wag the dog!”

It refers to the common practice of avoiding prudent investment decisions simply because the investor does not want to pay capital gains taxes. That does not mean that it is always prudent to take capital gains when investment strategy alone would dictate selling an investment. There are times when investors should absolutely hold off on selling investments with high implied capital gains, such as when there is a looming change in tax status that would drastically reduce or eliminate the capital gains tax liability. Another example would be when capital gains taxes could be greatly reduced by waiting for the gain to become a long-term capital gain, taxed at a much lower tax rate, rather than a short-term capital gain.

However, far too often investors are simply reluctant to sell a stock or a fund that they would otherwise sell simply because they do not want to pay the capital gains tax. For example, portfolio rebalancing is critical to successful long-term outcomes for investors. When equities markets have had prolonged bull markets and have become overweight in a portfolio, rebalancing back to target levels (i.e. selling some equities to restore target weights in other investments) helps control risk when there is inevitably a future market decline. Other times, a successful investment may have experienced a spectacular period of growth and investors become emotionally attached to an investment that has made a significant contribution to their wealth, but even the greatest investments cannot outperform forever and may even experience significant declines when the market realizes future growth will be much slower. The opportunity cost of investing that money elsewhere could more than offset the avoided taxes over time. Also, if the investment does decline in value, then the decline could be larger than the avoided capital gains taxes (and then when finally sold, there will still likely be some capital gains taxes on top of the loss).

You can expect your Montis financial advisor to identify these situations to you and help remove emotion from the equation, while evaluating all relevant tax consequences with you to work toward the best move for you.

Montis Company News: An Exciting Milestone

We are delighted to announce that we are expanding to new office space, conveniently located within our current office building. Our growth over the years has been fueled by the trust and support of our valued clients. This move represents an exciting milestone in our journey. The new space provides ample room for our growing team to continue to deliver exceptional service through collaboration and innovation. We look forward to welcoming our clients, partners, and friends to visit our new office.

Important Disclosure Information

Please remember that past performance is no guarantee of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Montis Financial, LLC ("Montis"), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful). Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from Montis. No amount of prior experience or success should not be construed that a certain level of results or satisfaction if Montis is engaged, or continues to be engaged, to provide investment advisory services. Montis is neither a law firm, nor a certified public accounting firm, and no portion of the commentary content should be construed as legal or accounting advice. A copy of the Montis' current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request or at www.montisfinancial.com. Please Remember: If you are a Montis client, please contact Montis, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing, evaluating, revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. Unless, and until, you notify us, in writing, to the contrary, we shall continue to provide services as we do currently. Please also remember to advise us if you have not been receiving account statements (at least quarterly) from the account custodian.

Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational and comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Montis account holdings correspond directly to any comparative indices or categories. Please Also Note: (i) performance results do not reflect the impact of taxes, (ii) comparative benchmarks and indices may be more or less volatile than your Montis accounts, and (iii) a description of each comparative benchmark and index is available upon request.

MONTIS
FINANCIAL, LLC
Independence. Objectivity. Value.