EQUITY MARKET UPDATE

FIRST QUARTER 2024

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Market Review

Equity markets continued to be kind to investors as we started 2024. Resilient economic growth and reassuring corporate earnings allowed stocks to build upon last year's gains. Growth-oriented stocks continued to outperform, although market gains were fairly broad. For the first quarter, the S&P 500® Index gained 10.6% to record highs and the Russell 2000® Index advanced 5.2%. Three primary forces seem to be driving markets: the economy, Fed policy and artificial intelligence (AI).

Let's take a look at these forces. First and foremost is the economy, which has been a positive surprise. A year ago, calls for a recession or so-called "hard landing" were widespread as investors thought higher interest rates would put the brakes on economic growth. Investors then shifted towards acceptance of a "soft landing" as the economy kept chugging along. Now, many pundits are embracing the notion of "no landing" as the economy continues to surprise to the upside. In fact, fourth quarter Gross Domestic Product (GDP) grew 3.2% as compared to expectations for 2%. What's more, growth has surpassed 2% for six straight quarters, defying calls for economic weakness.

Then there's the Federal Reserve's interest rate policy. Late last year, policymakers indicated the rate hike cycle had ended alongside evidence of cooling inflation. They even signaled the likelihood of interest rate cuts in 2024 in order to stimulate the economy amidst any signs of weakness. The notion of a shift to more accommodative policy helped prompt a violent year-end rally for stocks. Recent economic strength makes such cuts less likely, yet markets have continued rallying anyway. So what gives? For one, it appears investors are prioritizing reduced recession risks over delayed rate cuts. Two, while rate cuts may take longer than thought to come to fruition, the Fed is standing at the ready and providing an implicit backstop to the economy and markets.

Finally there's the powerful theme of generative artificial intelligence (AI), which stormed onto the scene early last year and continues to captivate market participants. The new era of AI holds tremendous promise and could drive workforce productivity, enable cost savings and lead to a vast array of new products and services. Corporations are spending heavily to incorporate generative AI into their businesses and enablers of the technology, particularly large cap technology companies, continue to lure investors. Case in point is Nvidia (NVDA), which makes the computing chips with massive power and scale required to support generative AI demand. Shares of NVDA were up an astonishing 82% in the first quarter after more than tripling last year.

Overall, the current environment does indeed appear to be very supportive of equities. The economy is on firm footing, the policy backdrop is constructive, and a generational technology shift is creating new growth opportunities. The primary negative is that the market's overall valuation now seems to reflect much of the good news. Many stocks are hitting new highs and the S&P 500 is now trading at 21x earnings estimates for this year, relatively high when compared to recent years (the 10-year average is 18x). As one might expect, investor sentiment has also improved dramatically. We wouldn't say investors are euphoric, but they are definitely feeling much better versus a year ago when pessimism was widespread.

This all leads us to say the market's risk/reward profile seems more balanced following a stretch of robust gains. We are still finding deals, many of which fall outside the large cap technology arena. However, we are sensitive to higher valuations and the overall opportunity set is a somewhat smaller than 6-12 months ago. Thank you for your trust and please refer to our portfolio letters for performance updates and specific ideas.

Sincerely,

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