Monthly Commentary

May 6th, 2024

Goldilocks in Trouble? Or Just April Showers? | Steve Henderly, CFA

What child doesn't know the story of "Goldilocks and the Three Bears"? In the classic fairytale, Goldilocks explores the home of three Bears who are out for a walk. In the story, Goldilocks created some problems for the Bear family; breaking a chair, sampling and eating all of another bears' breakfast. She is ultimately found asleep in one of the bear's beds but manages to quickly escape out the window and avoid disciplinary consequences for her trespass. Much like enjoying porridge of a perfect temperature, investors experienced attractive advance in their investments during Q1 of 2024 due to an economic landscape that seemed "just right": lower inflation and a resilient economy. It was believed these favorable dynamics would permit the Federal Reserve to not only stop raising interest rates but cut them multiple times in 2024, bringing relief to those with elevated debt before any painful "discipline" was experienced.

Style	April	YTD
Bloomberg Bond Idx	-2.5%	-3.3%
Foreign Stocks	-2.6%	+2.5%
S&P 500	*-4.1%*	*+6.0%*
Large-Cap Stocks	-4.2%	+5.3%
Avg US Stock Fund	-5.1%	+3.2%
Mid-Cap Stocks	-5.6%	+3.1%
Small-Cap Stocks	-6.1%	-0.8%

April "Showers" …unfortunately a 3rd consecutive month of "resilient" inflation and softer/slower growth greeted investors in April. At the same time, the idea of higher interest rates being the new normal (versus a short term corrective action to normalize inflation) appears to be taking hold, a departure from the prolonged era of ultra-low rates that's persisted since the 2008-09 financial crisis. These not "just right" conditions in April sent the S&P500 down 4.1%. Financial assets were probably due for a breather following very strong performance over the preceding 5 months. Bonds, also suffered as interest rates jumped; 10-year US Treasury bond yields rose toward 4.75% during the month, a level not seen since October, and meaningfully above what was a 3-month range of between 4.00-4.35%.

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The recent spike in interest rates is in no small part due to deficit spending by our US Government and renewed worry that the level of debt is appearing unmanageable longer-term. Compounding this concern in April was the surge in US debt issuance, as the government ramped up borrowing in April to finance continued fiscal stimulus measures and tax revenues also coming in shy of estimates. This surge in supply exerted upward pressure on bond yields, adding to the apprehension surrounding rising interest rates. "Is the bill or penalty (for persistent deficit spending) coming due?" Traders also cite April 15 as a seasonal liquidity headwind as many investors must trim from investments to raise cash for tax payments. Both items create a squeeze on stocks and bonds, but also underscores the delicate balance between stimulus-fueled expansion, and the challenges of sustaining economic growth financed by debt.

Just 3 months ago, the market anticipated as many as 5-6 rate cuts this year; now the consensus expects just 1 in September… *maybe*. Inflation data is not cooperating with the idea that rate cuts are appropriate (which the US Government would benefit; roughly one-third of all its outstanding debt needs refinanced in the next 12 months), and it complicates the picture for policymakers seeking to stimulate the economy in an election year. History reveals that the Fed being on "pause" should not be feared. Markets tend to over perform well during a pause versus when the Fed is active (see chart).

Length Of Fed Pauses & S&P Performance

Last Hike Date	First Cut Date	Days	S&P Return During The Fed Pause
5/1/1974	7/1/1974	61	-6.1%
3/3/1980	4/1/1980	29	-8.7%
5/8/1981	6/1/1981	24	1.0%
8/21/1984	10/2/1984	42	-1.8%
2/24/1989	6/5/1989	101	13.3%
2/1/1995	7/6/1995	155	19.2%
5/16/2000	1/3/2001	232	-7.4%
6/29/2006	9/18/2007	446	22.1%
12/19/2018	8/1/2019	225	19.2%
7/26/2023	5/1/2024	280	12.4%
	Average	146	5.6%

Beyond just the election year, there are a number of arguments why inflation may remain "sticky" and stubborn:

- **Budget Deficits:** Interest expense reached 17% of tax revenue in March – historically a level above 14% triggered austerity.
- **Budget Indexed to Inflation:** 65% of the federal budget is indexed to inflation (cost of living adjustments made on SS, Medicare, Medicaid, VA benefits) - these items challenge government spending
- **Labor Markets:** Remain tight; continue to apply upward pressures on wages.
- **Environmental Regulations:** Utility companies pass increased cost to generate energy along to consumers.
- **M2 Money Supply:** 36% higher today than pre-covid and is now growing again.

CONTACT US:

9757 Fairway Drive
Powell, Ohio 43065
614.389.4646

WWW.NVESTWEALTH.COM

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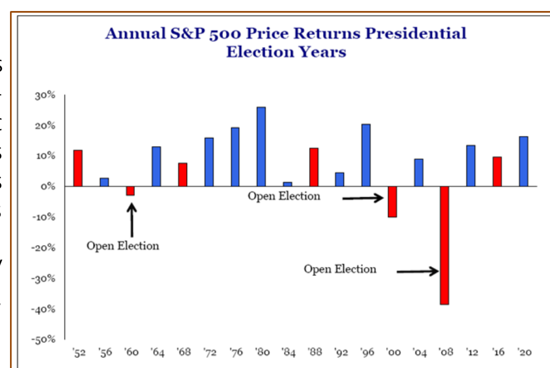
Since the first disappointing inflation data arrived in February, market leadership seems to be shifting. Stocks most linked to economic growth are struggling for direction, while commodities, energy, and financials are faring better. The market is suggesting that inflation and interest rates are likely to remain higher for longer. Bond prices also suggest concern for stubborn inflation, lessening the prospects for lower interest rates (which would boost the price of bonds).

The Federal Reserve's dual mandates - maximum employment and stable prices - are challenging because they often compete against each other. How to encourage economic growth (directly tied to employment) while managing inflation? While the central bank remained committed to its accommodative stance, the evolving economic landscape prompted a reassessment of the trajectory of monetary policy, contributing to market volatility and repositioning among investors.

As we consider what the market path may look like for the balance of 2024, we generally remain constructive despite sharing concerns about government spending and growing debt long-term. New debt issuance should subside over the coming months, easing the recent liquidity squeeze which created upward pressure on yields. Additionally, participation among stocks leading into "April Showers" was broad and corporate bond yields do not signal financial strain; historically it is rare for the market to get into serious trouble from these conditions. So far in 2024, 80% of US public companies are beating earnings estimates; companies are doing OK amid the current rate and inflation environment.

The November election will increasingly be discussed and fretted about by many, but presidential re-election years are historically positive for the markets as those seeking re-election will use levers at their disposal to avoid economic weakness when voters go to the polls (see chart). It is important to separate political viewpoints from decisions about remaining invested or not. Financial markets continue to advance regardless of which party is in control. However, different areas of the economy may do better/ worse depending on political policy. Over the long-term, the economy's bias is upward and one needs to be invested to reap rewards.



Although Goldilocks appears to be receiving some stern warnings for her trespass, April showers spurned from constrained liquidity (debt issuance and tax payments) seem likely to blow through. April witnessed a recalibration of market expectations as investors contended with the prospect of higher interest rates, increased treasury issuance, slowing economic growth, and a shift in the Fed's policy outlook. Market turbulence is never fun, but is normal – especially following robust strength. Against a backdrop of evolving macroeconomic dynamics, market participants should remain vigilant and expect bumps during periods where debt issuance is elevated. The ability for governments, companies, and consumers to finance their activities can create heightened uncertainty. We continue to invest in company stocks with emphasis on high free cash flow, dividends, and cheaper relative valuations.

Did you know: The price of bitcoin (an asset we eschew as "investment") appears to be a reasonable proxy for market liquidity. When liquidity is abundant and/or expanding, bitcoin seems to do well, and vice versa. In April, spot bitcoin prices dropped 17%, consistent with the idea that overall market liquidity was squeezed amid treasury financing activity and tax payments.

Nvest Engagement:

Delivering financial peace of mind is our ultimate goal. A quick summary below of the content our team shared over the past month via LinkedIn and Facebook. We hope you find these updates useful and informative. Please take a moment to follow us to receive on-going updates:

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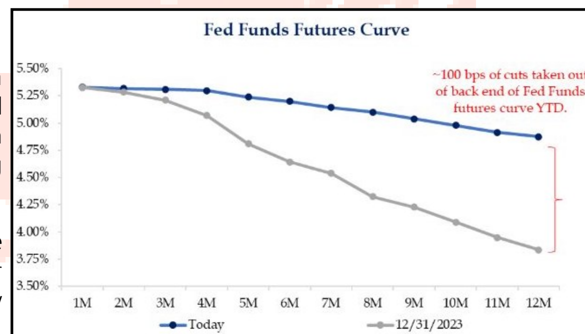
- *"In this world, nothing is certain except death and taxes."* Benjamin Franklin's famous quote still rings true today. Due dates for 2024 estimated tax payments: 4/15, 6/17, 9/16, & 1/15
- Unexpected financial challenges can obscure from view well planned goals – a sort of "financial eclipse". An organized and holistic financial plan can illuminate the path forward even during challenging times. **LINK**
- Warmer than expected CPI & PCE prints over the past several months altered the trajectory for projected Federal rate cuts. The market is now projecting only one rate cut in 2024 (see chart).



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Due Dates for 2024 Estimated Tax Payments

2024	2024	2024	2025
April 15	June 17	Sept. 16	Jan. 15
Q1	Q2	Q3	Q4

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