Adaptive Asset Program – Hybrid Program

First Quarter 2024 in Review

Global stock markets rallied in the first quarter as investors anticipated moderation of monetary policy and the economy remained strong. The Federal Reserve recently signaled that its campaign of interest rate hikes is over and that falling inflation may allow it to lower rates in the future. Excitement about the potential of AI technology has helped spur the rise of a small number of large tech stocks to extremely high valuations, overshadowing gains in other market sectors.

Outlook:

Inflation has dropped dramatically from its 2022 high and is approaching the Fed's target. Interest rates and inflation are now close to their median levels for the last 100 years. The negative consequences of ultra-low interest rates are becoming apparent (commercial real estate, for example), and it is likely that the Fed will try to keep economic growth high enough to prevent a repeat.

The "Magnificent 7" (Apple, Microsoft, Tesla, Nvidia, Meta, Amazon and Google) have risen exponentially in value over the last few years and now account for about 30% of the total market value of the 500 stocks in the S&P 500. They are currently trading at a P/E ratio of twice that of the other 493 S&P 500 companies. While their recent success has many clamoring for more of these companies' shares, chasing the hottest stocks can be dangerous. The fear of missing out on easy gains can cause investors to get caught up in bubbles. The more expensive an asset is, the more it can potentially lose if such a bubble bursts. Unwelcome events that can deflate such speculative enthusiasm are likely but are hard to predict.

While the surge of illegal immigrants across the border is unsettling, it is helping to alleviate a labor shortage in the US. Economic growth is a function of population growth and productivity growth. As in many countries around the world, women in the US are having fewer children than would be needed to maintain the population. Without immigration, the labor force will shrink and economic growth will slow. The US economy has outperformed in part because the labor force has continued to expand due to immigration. This contrasts with a country like Japan which has faced extremely low birth rates and immigration levels leading to population shrinkage and economic stagnation.

Higher interest rates have increased the cost of borrowing for consumers and could be behind the persistent negativity of consumer sentiment despite a strong labor market and falling inflation. For the first time in decades, workers in the lowest income quartile have seen their wages rise faster than inflation. However, they do not typically owe as much in mortgages, student loan debt, etc. as the middle class, many of whom have had to adjust to making interest payments much higher than they have seen in their adult lifetimes.

Your account:

Last year we shifted most of our cash balance into short- and medium-term bonds after interest rates rose to attractive levels. We continue to favor international stocks because they are historically cheap compared to US equities. Rate cuts by the Fed this year could lead to a decline in the dollar's value compared to foreign currencies, which would be positive for international stocks. Our pipeline stocks remain attractively valued compared to the rest of the US equity market.

3/31/2024