

## Economic Overview

Enthusiasm for owning stocks continued in the first quarter as the S&P 500 returned 10.6%, a second straight double-digit quarterly gain and the strongest start to a year since 2019. Since the last trading day of 2023, the S&P 500 logged 24 successively higher closes and reached a new all-time high on the final trading day of the quarter. Market breadth has improved, although large-cap technology stocks continue to contribute meaningfully to the market's advance. The "Magnificent Seven" stocks were responsible for 37% of the S&P 500's quarterly gain, yet if Alphabet, Tesla and Apple are stripped out, the contribution of the remaining four members of the group increases to 47%. Driving these gains has been Nvidia as the artificial intelligence momentum shows no signs of slowing as the stock increased 82.5% for the quarter. Along with information technology and communications services, cyclical sectors like industrials, financials and energy outperformed the S&P 500 during the first quarter; that's up from just three sectors outperforming the index in 2023. The stock market's ability to rally this quarter is noteworthy as it overcame the backdrop of rising bond yields, which typically would have a negative effect on asset prices.

Consumer Price Index data showed a year-over-year increase of 3.2% in February and 3.5% in March while Core CPI (excluding food and energy) increased 3.8% on an annual basis in both months. The Personal Consumption Expenditures index, or PCE, rose 2.5% over the trailing twelve months in February. Core PCE increased 2.8% over the past year, still above the Fed's stated 2% target. Coming into the new year, the market expected six rate cuts from the Federal Reserve in 2024, whereas the Fed had forecasted three but sticky inflation and strong labor market data have pushed out the timeline for the first anticipated rate cut. The bond market is now more closely aligned with the Federal Reserve's projections that future rate cuts may not come as soon as previously expected by the market as economic activity continues to surprise to the upside giving the Fed all the more reason to hold rates steady. According to the CME Group's FedWatch Tool, markets are betting the Fed is unlikely to cut

rates anytime soon as there is only a 16% chance of at least one 25 basis point rate cut by June 12th, and a 38% chance of the same by July 31st. For the full year, markets are leaning toward 11% odds of no cuts occurring, 32% odds of a single cut, 35% odds of two cuts, and 22% odds of three rate cuts or more. The lack of inflation progress in the first quarter pressured bond yields to the upside with the 2-year, 10-year and 30-year Treasury rates rising 36, 32 and 31 basis points, respectively, for the quarter. As a result, most fixed-rate investment grade bond asset classes declined this quarter. The final reading of 4th quarter GDP was raised to 3.4% from the previous 3.2% estimate, higher than expectations but slower than the 4.9% expansion of the third quarter. The Atlanta Fed projects Q1 GDP to rise 2.9%, slower than Q4's reading, owing in part to the lagged effects of rate hikes and slower consumption.

### Constructive Observations

- The U.S. economy remains resilient supporting the outlook for corporate America and an end to the "earnings recession."
- Despite a lot of industries with inventory overhangs, it appears orders are reaccelerating.
- Global inflation is being tamed without tipping the world into a recession.
- Household balance sheets and debt servicing levels remain healthy.
- Tight labor markets continue to support employment and income levels.

### Cautious Observations

- Depleting savings, tightening credit, and rising interest rates could slow consumer spending, the main engine of economic growth.
- Signs of increased delinquencies for both consumer and commercial lending are emerging.
- Current yield curve inversion is the longest in history.
- Inflation is likely to remain above the Fed's 2%

target this year.

- Global tensions increasing with Iran's attack on Israel adding to the angst.

## Macro Overview

Interest rates remained volatile during the quarter as economic data indicated a resilient economy, raising doubts about the pace of rate cuts in 2024. CPI, PPI, and employment data all came in above estimates, indicating that while goods deflation had provided a tailwind to inflation readings in 2023, stickier services inflation was far from being reigned in. At the March FOMC meeting, Chairman Powell reiterated his confidence that inflation was on a lower glidepath, but the "last mile" would take some time, noting that a strong labor market would not necessarily restrict possible easing. Fed officials continue to monitor incoming data and are looking for additional evidence before feeling comfortable proceeding with a cycle of rate cuts. Inflation is generally declining around the globe but is uneven when examined across geographic regions. As inflation pressures appear to be easing in Europe more rapidly than they are in the United States, the ECB could possibly commence rate cuts before the Federal Reserve.

Since most of the U.S. economy is based off consumer consumption, it's important to keep tabs on that dynamic. Some signals are suggesting consumer spending may be tapped out, particularly in the low to middle-income segments. Several consumer-driven companies such as Foot Locker, Nike, and Lululemon have cut sales and earnings expectations recently, noting weakness in these income cohorts. Credit card delinquencies are rising, particularly among younger age groups. The fact that student loan payments have begun again after years of deferrals could be a factor. Personal savings have been coming down rapidly as pent up Covid-era savings are quickly returning to normal levels. Consumer confidence has been moving sideways for the last six months with no real observable trend.

Employment statistics remain firm as both the unemployment rate, at 3.8%, and the number of unemployed people, at 6.4 million, changed little in March. The unemployment rate has been in a narrow range of 3.7% - 3.9% since August 2023. Initial jobless claims remain at low levels and continuing unemployment claims have recently peaked and flattened out. Job market details appear

less favorable than headline statistics though, as the bulk of growth in jobs have been part-time workers; in fact, full-time employment peaked last summer and has steadily declined since. Leading indicators of the labor market: temporary employment, average weekly hours, overtime hours, and aggregate hours have all been declining, consistent with late-cycle activity.

U.S. Manufacturing PMI recently showed an uptick and a bit more strength than the services side of the economy, but both show readings above 50, which indicates growth.

Despite much higher mortgage rates, the housing market is in decent shape, with building permits and housing starts rising. Single-family housing starts rebounded in February thanks to milder weather, climbing 11.6%. House prices have continued to increase above inflation levels, indicating a strong market, but affordability issues could pose a risk. Median home prices fell 1% in the quarter but have risen 6% year-over-year. Housing related stocks have been one of the best performing industries in the stock market year-to-date. We are in a new housing inventory deficit position, meaning that new housing starts are lagging new household formations. It will take years of increasing housing starts to fill the gap.

## Markets Overview

### Equities

Corporate earnings releases for the 4th quarter were generally positive, although the pace of earnings surprises slowed below 3rd quarter levels. Within the S&P 500, 74% of companies exceeded earnings expectations, down slightly from 78% in the third quarter, but in line with the trailing pre-pandemic average. 63% of companies beat Wall Street's revenue estimates. Year-over-year 4th quarter EPS growth was 9.9% for the S&P 500 against expectations of 4.3% heading into the quarter. The market estimates 1st quarter EPS growth of 4% and 9% for the full year.

Among the various Russell indices, growth stocks outperformed value stocks last quarter. Within large-cap, growth stocks returned 11.4% vs. 9.0% for value. Mid-cap growth returned 9.5% vs. 8.2% for mid-cap value and small growth returned 7.6% vs. 2.9% for small value. Leading sectors included Communication Services (15.8%), Energy (13.7%),

Information Technology (12.7%), Financials (12.5%) and Industrials (11.0%). Laggards for the quarter were Real Estate (-0.5%), Utilities (4.6%) and Consumer Discretionary (5.0%).

Based on S&P indices, small-cap stocks underperformed large-cap stocks by almost 8% in the first quarter, returning 2.5%. The dominance of large-cap stocks has been a multi-year phenomenon in the United States. Within corporate America, a dichotomy is emerging among small business owners compared to CEOs of large companies. Small businesses have been pressured by the toll taken by inflation on their cost structures particularly as it relates to labor, healthcare, and insurance. The NFIB Small Business Optimism Index has been declining recently. In contrast, the U.S. Business Roundtable shows that CEOs of larger companies have become more confident recently.

On the international front, developed-market equities rose 6%, lagging the domestic U.S. market, but a 6% quarter is still a respectable absolute return. Europe (+5.4%) underperformed the Pacific region (+6.8%), with Japanese stocks the standout exception this quarter. Japan is starting to hike rates as their economy has been one of the better performers, globally, as it emerges from a deflationary era. The Nikkei index climbed above 40,000 in March, for the first time ever, topping its record highs reached back in 1989. The index rose over 20% in the first quarter.

Emerging market stocks returned 2.4% in the first quarter. Chinese stocks declined a little over 2% this quarter. The Chinese economy has been suffering from a protracted property downturn, mounting local government debt and weak private-sector spending. Fitch recently cut its sovereign credit rating on China to negative, citing risks to public finances as the government directs more spending towards infrastructure and high-tech manufacturing, shifting away from the property sector.

## Fixed Income

Borrowers continue to navigate uncertainty around when the Fed may begin cutting rates. The Bloomberg Aggregate Bond Index fell 0.8% last quarter as yields increased on the back of hotter than expected U.S. inflation data. Investors who accepted more duration risk, or sensitivity to shifting yields, felt the most pain. Within the U.S. Treasury market, 1-3 year maturities eked out a slightly positive 0.3% return. 3-5 year maturities declined 0.5% and 5-7 year maturities declined 0.9%. 7-10, 10-20 and 20+ year maturities

fell by 1.4%, 2.4% and 3.8% respectively.

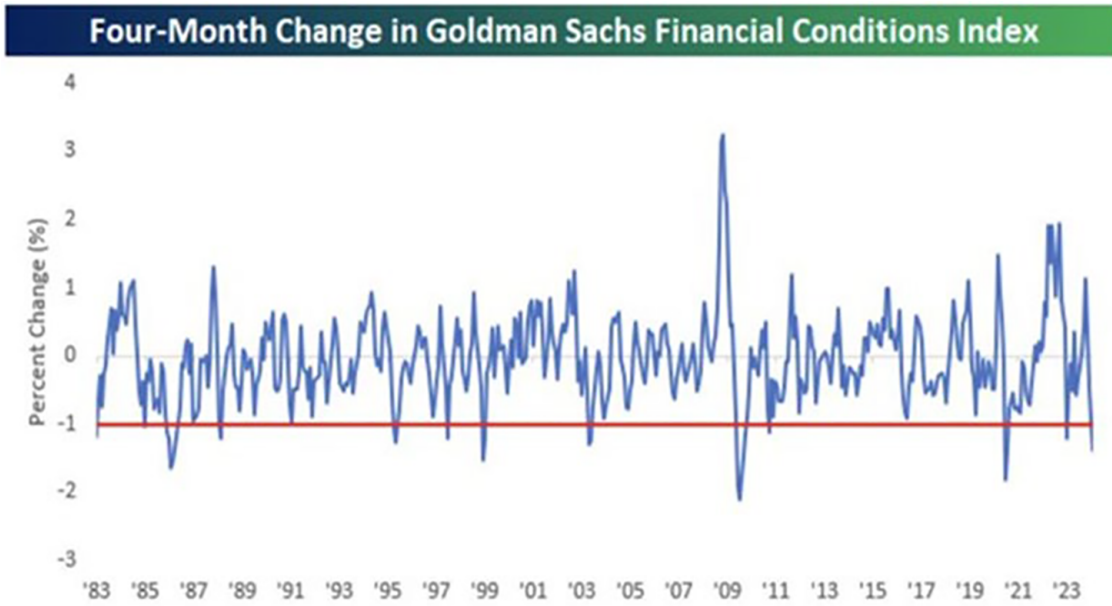
Corporate bond spreads (the premium paid by companies over U.S. Treasuries) remain historically tight, indicating investors are not receiving significant compensation for assuming credit risk, relative to “risk-free” U.S. Treasury bonds. Strong corporate fundamentals, relatively high yields, combined with record new issuance that has been well-received by the market, however, has led to strong inflows into the I/G corporate bond asset class. The first quarter saw a record level of new issuance of \$529.5 billion, far outpacing the previous high of \$479 billion in the first quarter of 2020. New bond issuance among public companies is fueling M&A activity, which is likely to continue for the foreseeable future. For the time being, yield – not spread – is driving the investment-grade market that is dominated by institutional investors. The Bloomberg Barclays U.S. Credit Index, which measures the fixed rate, investment grade taxable corporate bond market, declined by 0.4% in the first quarter. Credit-sensitive sectors like bank loans and high yield bonds, which are more resilient when yields rise, were among the few positive fixed income segments this quarter. High Yield bonds returned 1.5% for the quarter and bank loans returned 2.5% as corporate cash flows and debt serviceability remain well-supported. Many issuers, especially in the high yield arena, were able to take advantage of low rates in recent years and push out maturities well into the future, suggesting they may be less impacted from higher rates.

## Real Assets

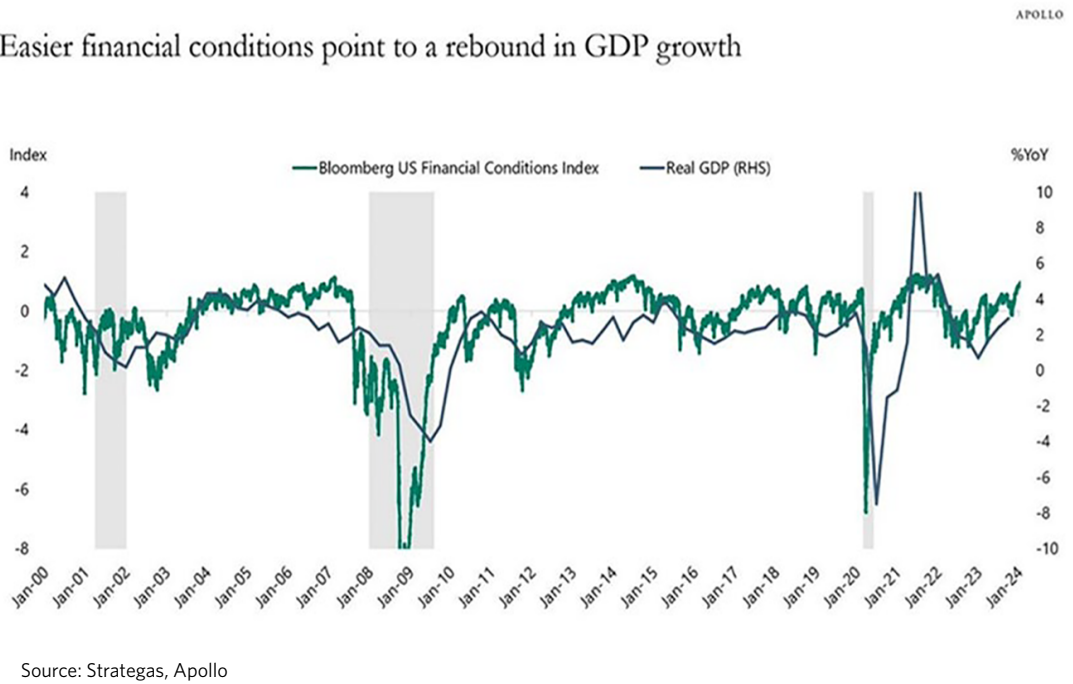
In aggregate, commodities were modestly positive (1-2%) for the quarter; however, this benign return masks significant dispersion among sub-sectors. Conflicting signals exist between oil, which is a global commodity and is reasonably strong due to OPEC’s production restraint and natural gas, which is much weaker and is generally a regional commodity. The various petroleum-based products increased 13-19% this quarter, whereas natural gas fell by almost 30%. The winter has been quite mild in the U.S., leading to oversupply conditions. The recent policy decision to restrain international shipments of liquefied natural gas (LNG) has caused concern that the policy may become enshrined for the longer run, which would meaningfully curtail the export opportunity for natural gas. Grains declined 8% this quarter. Industrial metals were a mixed bag with aluminum and zinc falling, but copper and zinc rising modestly. Gold returned 7% and silver rose 4%.

# Charts of the Quarter

Financial Conditions Have Eased Since the October 2023 “Powell Pivot”



Easier financial conditions point to a rebound in GDP growth

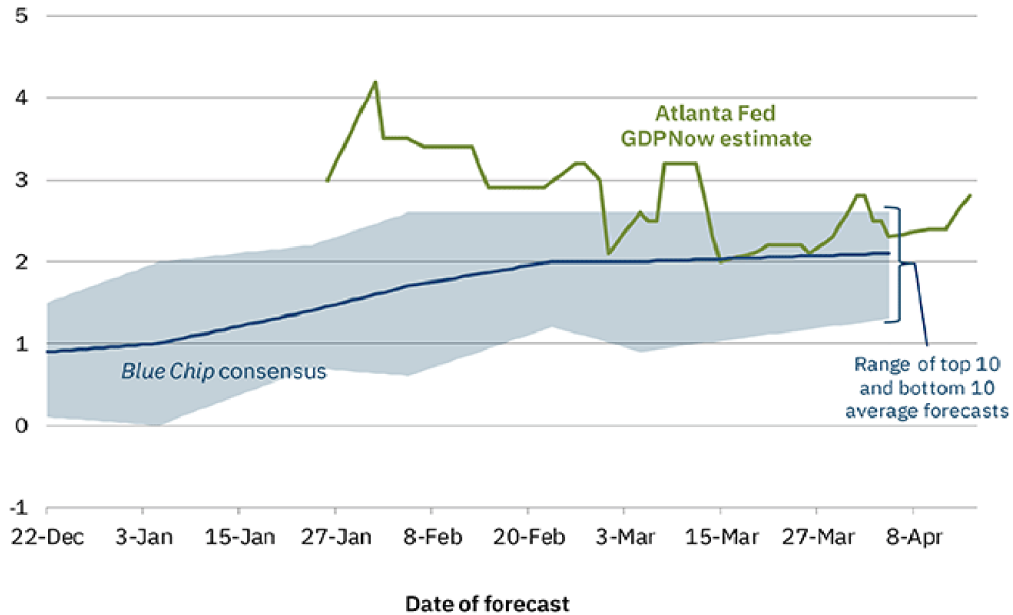


Source: Strategas, Apollo

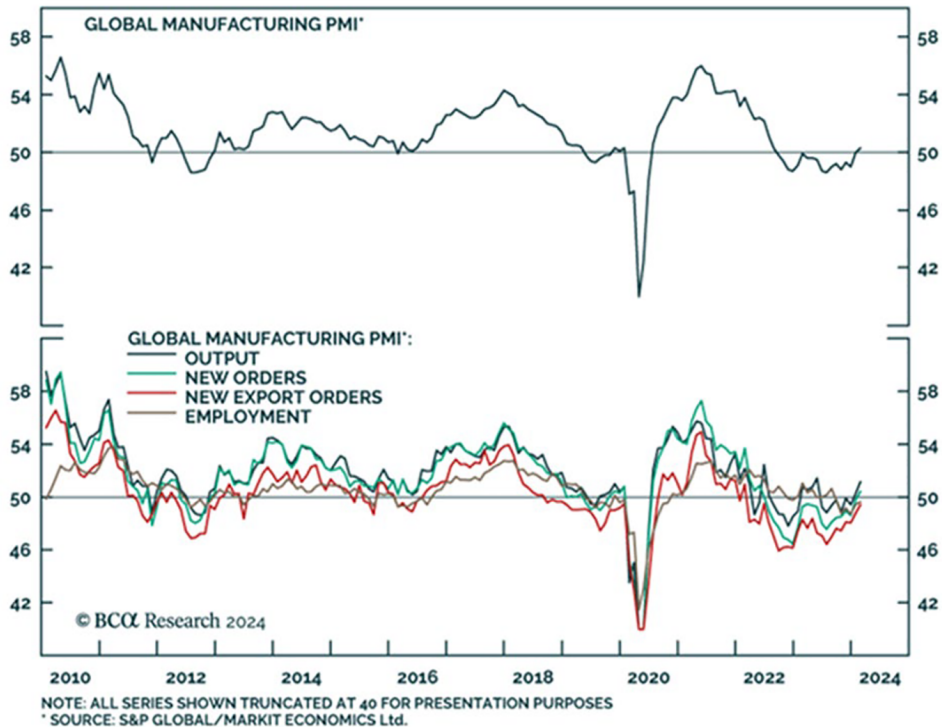
# Charts of the Quarter

## US Growth Remains Resilient / Global Manufacturing Showing Signs of Life

**Evolution of Atlanta Fed GDPNow real GDP estimate for 2024: Q1**  
Quarterly percent change (SAAR)



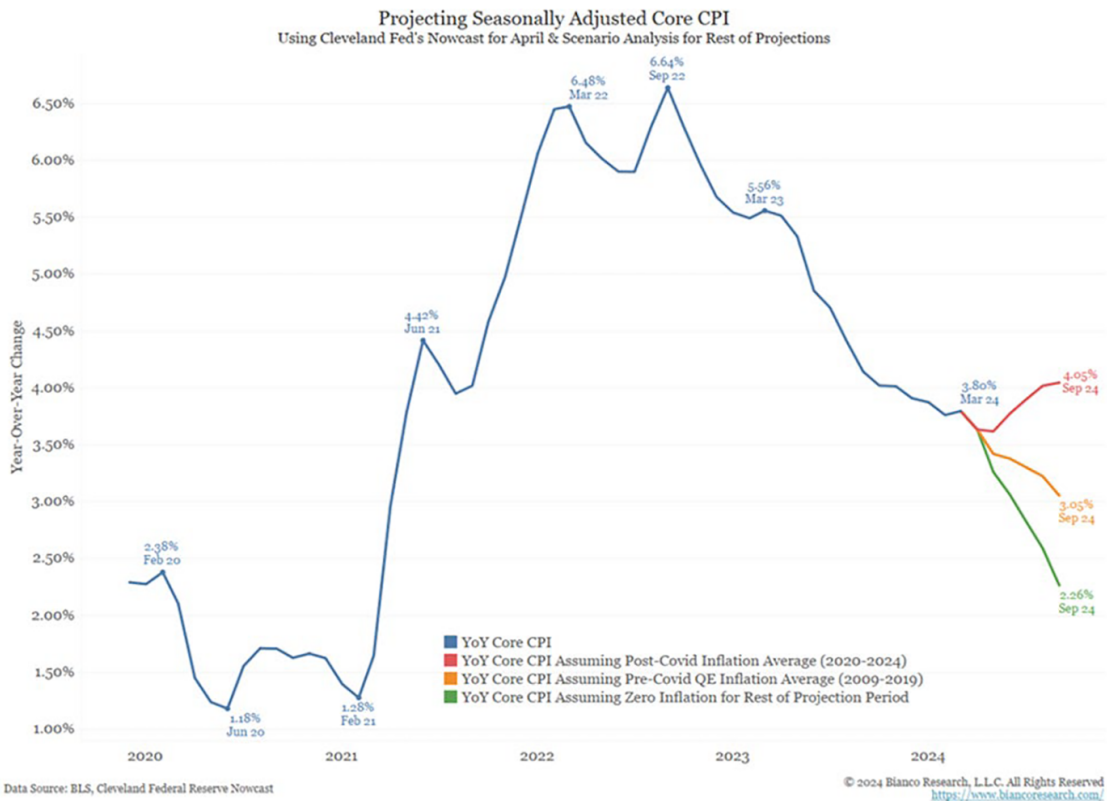
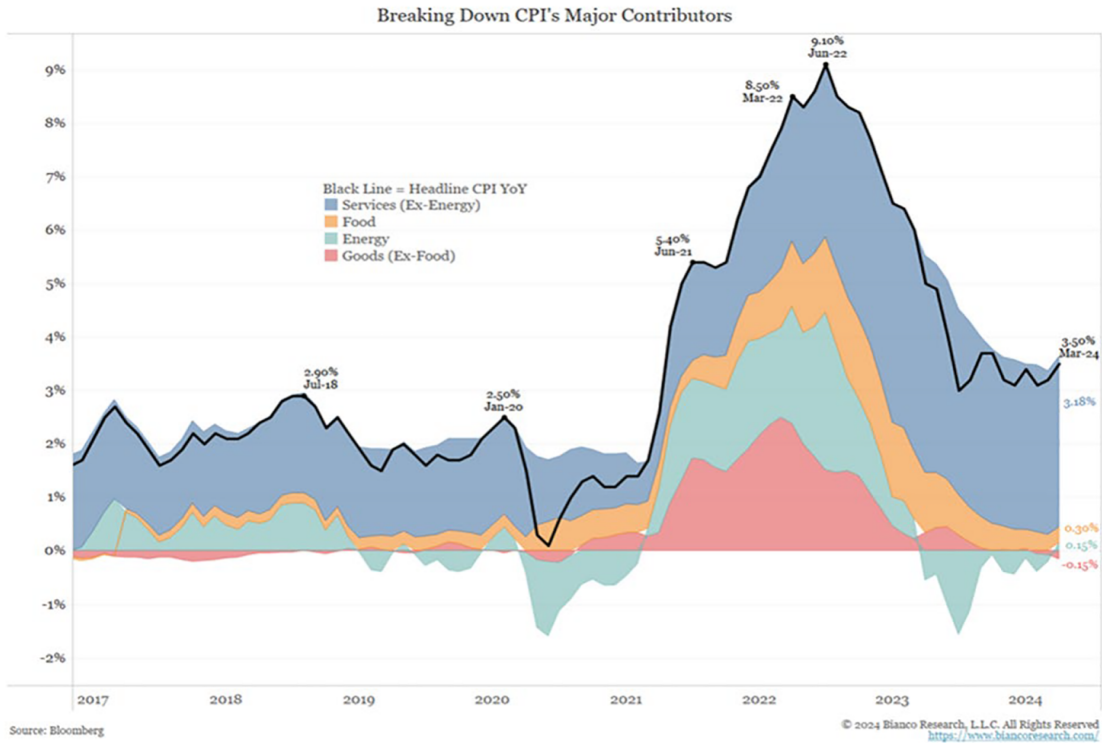
**Sources:** Blue Chip Economic Indicators and Blue Chip Financial Forecasts  
**Note:** The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.



Source: Atlanta Fed, Bank Credit Analyst

# Charts of the Quarter

## The Last of the Fed's Inflation Battle Looks to be Bumpy



Source: Bianco Research





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