



March 2024 Capital Markets Commentary

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“Strive not to be a success, but rather to be of value.”

Albert Einstein

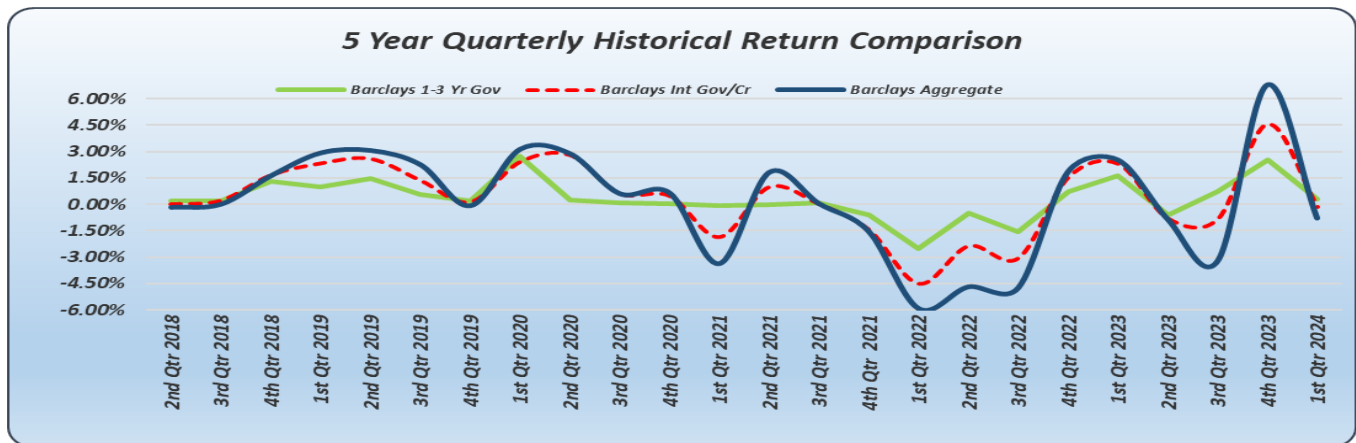
Fixed Income

The Fixed Income markets started 2024 rather weakly. After a strong 4th quarter return of +6.82% and a 1-year return of +5.53 on the Bloomberg Aggregate Index, the fixed income markets experienced a minor correction as March ended. The upward pressure on yields, to start the year, driven by a market that is finally understanding that the Fed is in no big hurry to lower rates, moved returns in to negative territory to end the quarter.

During the quarter, yields rose across the Treasury curve. The 2-Year Treasury increased from 4.23% to 4.59% and the 10-Year rose from 3.88% to 4.20% during the quarter. Interest rates moved higher, due to weakness that was driven primarily by the realization that the Fed is, and always was, data dependent on where rates would go. This was reinforced by the FOMC’s decision to leave Fed Funds unchanged again through March. And although inflation has improved, it is still higher than the Fed’s target, along with an economy that continues to move forward strongly.

The FOMC met during the quarter, as scheduled, and just like the previous meetings, left the target Fed Funds in a range of 5.25% to 5.50%. Inflation is still higher than the Fed would like, and most Fed governors are content with where rates are, and the minutes show that the Fed could remain higher into the 4th quarter.

As we can see, returns were negative on the long and intermediate parts of the curve during the quarter. The Barclays U.S. Aggregate posted a -0.79% return for the quarter. The Barclays Intermediate Index was at -0.15%. However, on the short end of the curve, we saw positive a return, with the 1-3 Year Government Index at +0.29%. At the truly short end of the curve, the 1 Year T-Bill returned +0.83% for the quarter. The 10-year Treasury yield ended the quarter at 4.20%. The 5-year Treasury yield ended at 4.21%, and the 2-year Treasury yield ended at 4.59%.



Fixed Income Markets - Looking Ahead

At the March meeting, just like the September, November, December, and January meetings, the Fed paused. (Why? There is still a reason.)

Two years have passed since the Fed’s first interest rate hike of this cycle, and roughly eight months have passed since the Fed’s last rate hike. While interest rates have indeed remained higher for longer, interest rate volatility has declined as the Fed has shifted from an “increasing rate policy” to a “peak rate policy” stance. Currently it seems that the base case is that the Fed will cut rates two times in 2024 based on current economic data and inflation. This is after the bond markets, based on the December FOMC meeting, had the Fed cutting 6 times in 2024. Current expectations are that short-term rates finish the year slightly higher than the market’s forecast, and longer rates may be locked into their current base levels.

The Fed’s top priority of inflation containment remains. And, while progress has been achieved, the Fed’s desired target of 2% remains a goal. As the year progresses, Fixed Income markets may need to be wary.

Equity

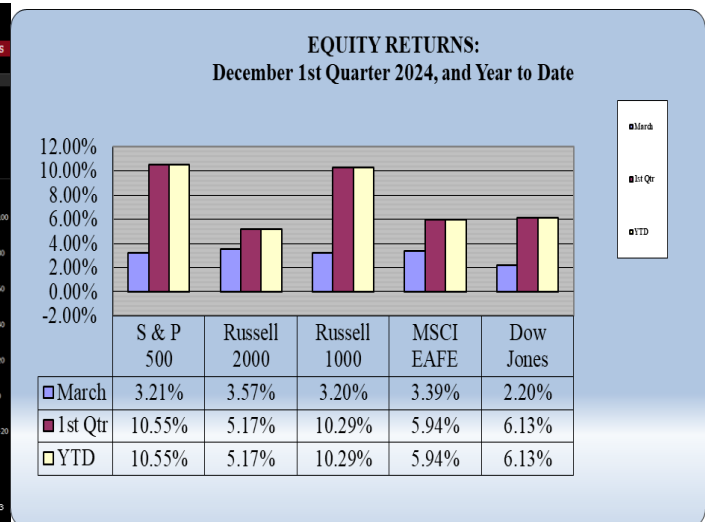
For equities, the 1st quarter opened up seemingly as strong as 2023 ended.

Reinforced by the combination of a solid economy, better-than-expected corporate earnings, and an apparent end to the Federal Reserve’s interest rate hikes, stocks rallied 25% in 2023.

Equity markets had a continued stellar run in the 1st quarter, with the S&P 500 up over 10% and nearly 30% from October’s low. Improving economic tenets such as moderating inflation, a resilient labor market, and stronger than anticipated GDP growth moved risk assets higher, with recession fears fading into the background. Policy statements from the Federal Reserve, of an end to interest rate hikes, has created further momentum, and cash, sitting on the sidelines got pulled into the market.

While the stock market saw intermittent selloffs during the quarter, it continued marching higher as corporate earnings and a strong labor market renewed hopes that the economy will avoid a recession. As mentioned above, the S&P 500 index rose 10.5% during the first three months of the year, its best first-quarter performance since 2019. The Dow Jones Industrial Average and the Nasdaq Composite also gained during the quarter earning 5.6% and 9.1%, respectively.

Both U.S. and International equities were positive in the 1st quarter. On the U.S. side, the S&P 500 ended with positive return for the quarter, showing a return of +10.55%. The Russell 1000 index returned +10.29%, the Russell 2000 index returned +5.17%, and the Dow returned +6.13%. The International markets also closed with positive returns, posting a +5.94% for the quarter.



Equity Markets - Looking Ahead

2024 – How does 2024 play out? As we move into the 2nd quarter of 2024, the outlook for stocks is still positive.

(A reiteration) In 2022, the S&P 500 slid close to -20% in the wake of the Fed’s decision to rapidly hike interest rates. However, equity markets advanced in 2023, recovering some or all the lost ground from 2022.

As we enter the second quarter of 2024, conditions remain good for U.S. equities. U.S. corporate earnings were widely expected to exceed those of 2023, potentially improving at a stronger clip in 2024 as inflation and interest rates come down—this, despite lingering economic worries. And, for now, bad news is good news; even with the Fed holding steady on rates.

A positive beginning of the year is typically a prelude to a positive year, and the correlation seems to hold 80% of the time. In 2024 we have an election year, and historically this is the second-best year in the four-year political cycle. These historical signals of a strong start, combined with what could be a peak in interest rates and positive earnings guidance, bode well for equities. Within this context, equities look well positioned to outperform bonds and cash this year, but high valuations indicate investors need to be selective, in their investments.

Historically, both the stock and bond markets performed well in the months after the last rate hike. Prospective Fed ease has likely been fully priced into equities, so it is necessary for earnings to take over as the primary driver of this ongoing bull market. Going forward, remember we are in an election year. Anything can happen.

The Economy

The Economy

As expected, the Federal Reserve again left interest rates unchanged at its March meeting. The Federal Reserve has now left their policy rate at a 5.25%-5.50% range for five consecutive meetings and Chair Powell has gone on record as saying a rate cut is likely their next move once members have more confidence that inflation is moving toward the 2% target. However, although the Fed members note that there has been progress in taming inflation, they seem to want to see indications that lower inflation is both continuing and enduring before embarking on rate cuts to prevent their monetary policy from becoming overly restrictive. Economists anticipate overall economic growth and consumer spending will remain healthy through 2024, as the labor market remains robust and wage gains exert less pressure on consumer wallets.

Throughout the recent rate hike cycle, the Fed stressed the lagging, cumulative impacts stemming from higher rates. Many economists at the start of 2023 expected those impacts to quickly result in slower economic activity, reduced hiring, and higher unemployment. It did not. The first quarter of 2024 saw a continuation of many of the same storylines as 2023. Inflation and the responding rate hiking cycle continued to exert on our economy and financial markets, but none with enough punch to tip the overall economy into recession. Inflation continues along its slow and bumpy descent from its highs, but questions remain about the end of this policy. In the 1st quarter, labor markets remained historically strong and economic growth continued near long-term trends. However, interest rates drifted higher during the quarter, as solid growth delayed any promise of a rate-cutting cycle. Falling inflation in a strong economy suggests that at least some of the spike to a 9% inflation rate was indeed “Temporary” (I don’t want to use Transitory) but the speed of progress on the inflation front is causing concern. During the last two quarters, questions for FOMC have turned from “When will they stop hiking?” to “When will they start cutting?” And despite higher rates during the quarter, eagerness about the prospects for cuts without the recession that typically accompanies them fueled gains in equity markets.

The Economy - Looking Ahead

Economic Growth? Jobs? Inflation? Recession? Global problems? We continue with the same subplot.

The downward trend in inflation has bolstered market confidence that monetary policy is now sufficiently restrictive as to achieve the FOMC’s longer run goals. But, although the U.S. economy may be slowing from its stellar growth in the second half of last year, it appears to be merely slowing, as any signs of a recession have not yet appeared in actual or survey data. Jobs and wage growth are slowing but remain supportive of consumer spending. Growth in financial assets and real estate values are further boosting consumer confidence, particularly among the higher income portion of the population. Currently an important catalyst for continued spending growth is the increasing number of recently retired people who have been willing to draw down their savings in their early retirement years while they are still relatively healthy. This dynamic could help reduce any cyclical slowdown in spending caused by a weakening economy in the near future.

Although inflation seems to be trending slightly lower, many analysts and economists are concerned that the last part of the Federal Reserve’s battle with inflation will be difficult.

The Fed has been on guard for inflation staying sticky and will see early 2024’s inflation reports as disappointing. Although it appears this Fed rate hike cycle is over, never say never. Inflation needs to cool much more to take a rate hike completely off the table.

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