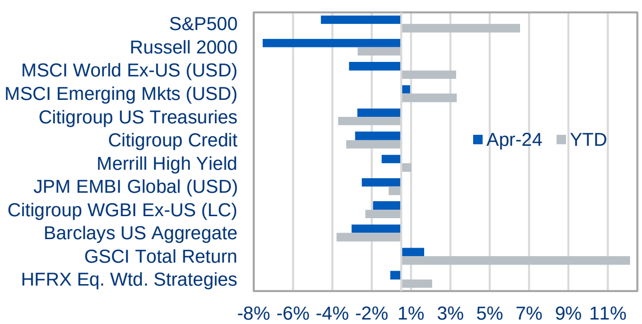
Strategic Investment Group®

Global Market Review

With growth above trend and inflation above target, markets are now expecting that Fed policy will remain tight for longer than previously thought. The combination of high inflation, high rates, and high valuations sent U.S. equities sharply lower in April, eroding previous gains. Outside of the U.S., advanced economy equity markets also declined while emerging markets managed a small gain. U.S. Treasury yields rose as markets reassessed the future path of inflation and Fed policy. Investment grade and high yield bonds also fell in price, although credit spreads remained quite tight, mirroring high equity valuations. The prospect of persistent high interest rates spurred the appreciation of the U.S. dollar against most major currencies. Gold reached a record high during the month, buoyed by geopolitical concerns, stubbornly high inflation, and purchases from China. Oil prices fell in April but remain solidly higher so far this year.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Global equity markets retrench on inflation persistence.

Stubborn Inflation and Fed Persistence Roil Equities

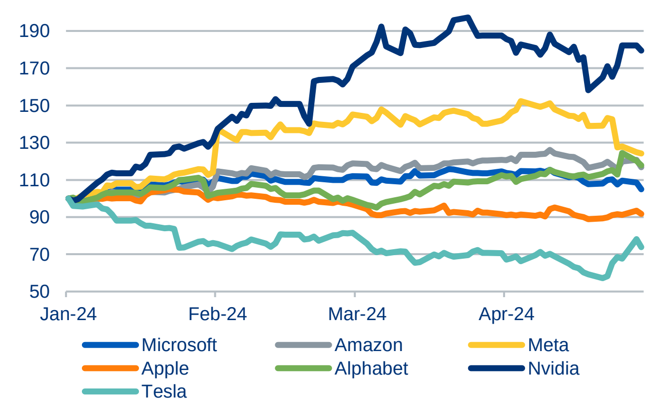
After five months of successive strong gains, the S&P 500 index fell 4.1% in April. Higher inflation and the prospect that the Fed would maintain its current tight policy stance for much longer than previously hoped were the main drivers of the decline. Stretched equity valuations did not help the cause. The declines were broad-based across market segments. Both growth and value fell 4.4%. The sharpest declines were experienced by small-cap stocks, which lost 7.0% percent in April, reflecting their particular sensitivity to higher rates and input prices. Large cap stocks fared relatively better, but still lost a sizeable 4.3%. Despite April's widespread declines, the S&P 500 remains up 6.0% so far this year.

The 12-month forward P/E multiple of the U.S. equity market remains quite high relative to its own history and other markets. The tech sector is especially overvalued, in part reflecting the surge in investor interest in AI stocks.

While never truly monolithic, the Magnificent 7 group of mega-cap tech stocks appeared until recently to be a relatively cohesive force driving the market's strong gains, elevated valuations, and high concentration. After spiking 107% in 2023, the Magnificent 7 are up 15% so far this year. However, there is increasing divergence in the performance of members of the block. Fims with the strongest claim to be beneficiaries of the AI revolution like NVIDIA (+79%) and Meta (+24) are leading the pack, while others with lesser claims to the AI mantle like Apple (-8%) and Tesla (-26%) are lagging (Exhibit 1).

Exhibit 1. The Divergent 7

Source: Bloomberg. Index. January 1, 2024 = 100.



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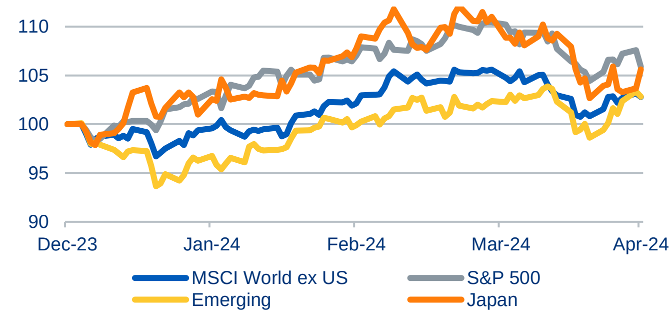
Advanced Equity Markets Also Decline in April

Equity markets in advanced economies followed the U.S. market lower, while emerging equity markets managed a small gain. The MSCI World ex-U.S. index of advanced equity markets lost 2.6% in April but remains up 2.8% so far this year. European and Japanese market declines contributed to April's loss. Both markets, however, remain up for the year, with the Japanese equity market performing particularly well despite a steep depreciation of the yen (Exhibit 2).

Exhibit 2. Global Equity Markets Retrench in April

Source: Bloomberg. Index. January 1, 2024 = 100.



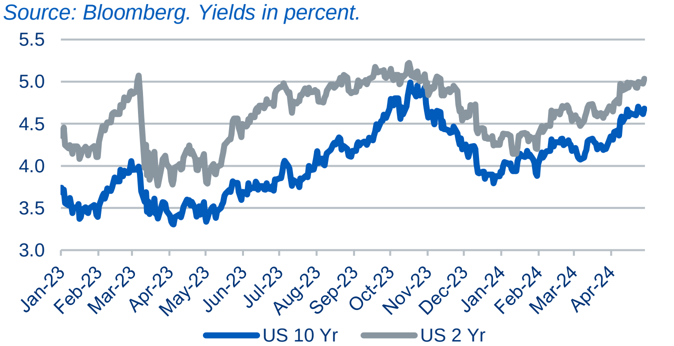
Emerging equity markets rose 0.4% in April to bring their gain so far this year to 2.8%. China, which has been a major drag on the performance of the broader emerging equity market index, recovered strongly in April, rising 6.6%. Despite continued vulnerability arising from the property and financial sectors, policy stimulus and an improved growth outlook buoyed sentiment. The Chinese market is up 4.3% so far this year and is outpacing other emerging equity market regions.

U.S. Treasury Market Reassess Fed Policy Path

Equity and credit risk premiums remain low despite elevated uncertainty about the persistence of inflation and the path of Fed policy. These risks are compounded by geopolitical risks, notably in the Middle East, which have the potential to severely disrupt the oil market and contribute to further price pressures.

Exhibit 3. U.S. Treasury Yields Adjust to Higher for Longer

Source: Bloomberg. Yields in percent.



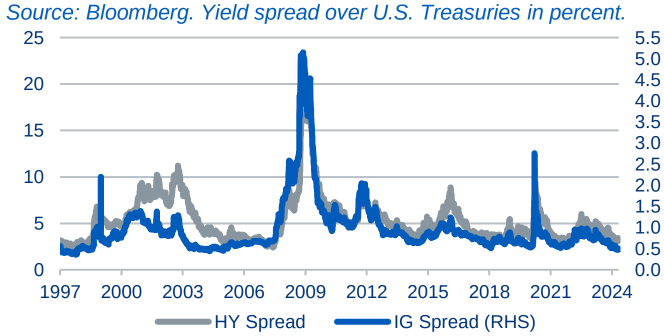
The uncertainty surrounding the future path of Fed policy has been reflected in the large swings in the yield on 2-year U.S. Treasuries and in the futures market where expectations for the number of Fed rate cuts this year has fallen from six to, perhaps, one (Exhibit 3). The May 1 meeting of the FOMC in which Chair Powell lamented the lack of progress in reducing price pressures confirmed this turn in market sentiment.

U.S. Treasury yields rose across the maturity spectrum in April. The increase was led by an increase in real yields, while long-term inflation expectations remained little changed. U.S. Treasury prices in aggregate fell by 2.2% in April, with securities with maturities of 10+ years declining 5.8%.

U.S. credit markets also lost ground in April. Investment grade and high yield credit declined by 2.5% and 0.9%, respectively. Credit spreads, however, remained tight relative to long-term history (Exhibit 4). Low spreads have persisted despite rising issuance by corporate borrowers across the credit spectrum and an uptick in default rates.

Exhibit 4. U.S. Credit Spreads Remain Tight

Source: Bloomberg. Yield spread over U.S. Treasuries in percent.



Expectations that U.S. economic growth and interest rates will continue to be significantly higher than its main trading partners have buoyed the U.S. dollar this year. The dollar's strength is a decidedly mixed blessing. While a strong dollar is contractionary and thus complements the Fed's inflation fighting task, its appreciation has the undesirable effect of undercutting exports, making imports relatively attractive, and thereby contributing to a worsening of an already large current account deficit. Emerging markets, especially those with significant dollar-denominated external debt, have in the past been vulnerable to a combination of higher global interest rates and dollar appreciation. While the dollar has been strong, gold has been even stronger, reaching a record high in April of $2,400 per ounce. In 2022-23, central banks, led by China, purchsed large quantities of gold to diversify their offical reserves. These official purchases have now been joined by heavy retail purchases of gold by Chinese speculators.

Performance of Major Market Indices through 04-30-2024

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	-4.1%	-4.1%	6.0%	22.7%	8.1%	13.2%
Russell 2000	-7.0%	-7.0%	-2.2%	13.3%	-3.2%	5.8%
MSCI World Ex-US (USD)	-2.7%	-2.7%	2.8%	9.1%	2.9%	6.3%
MSCI Emerging Mkts (USD)	0.4%	0.4%	2.8%	9.9%	-5.7%	1.9%
Citigroup US Treasuries	-2.2%	-2.2%	-3.2%	-2.8%	-3.7%	-0.5%
Citigroup Credit	-2.3%	-2.3%	-2.8%	1.0%	-3.1%	0.9%
Merrill High Yield	-1.0%	-1.0%	0.5%	8.9%	1.5%	3.5%
JPM EMBI Global (USD)	-2.0%	-2.0%	-0.6%	6.8%	-2.4%	0.5%
Citigroup WGBI Ex-US (LC)	-1.4%	-1.4%	-1.8%	0.5%	-4.1%	-1.7%
Barclays US Aggregate	-2.5%	-2.5%	-3.3%	-1.5%	-3.5%	-0.2%
GSCI Total Return	1.2%	1.2%	11.6%	13.3%	15.4%	7.5%
HFRX Eq. Wtd. Strategies	-0.6%	-0.6%	1.6%	5.2%	0.4%	2.7%