Market analysis

March 11, 2024

At a glance

Stocks continue to test new highs as investors await Federal Reserve interest rate cuts. Economic data in the U.S. remains solid, though the recent rise in the unemployment rate must be monitored.

Number of the week

8.0%

The increase in fourth quarter earnings for S&P 500 companies compared to a year earlier. Heading into the reporting period, expectations were for a 1.4% increase.

Term of the week

Utilities stocks – Companies that provide basic services such as electricity, natural gas, sewage and water to homes and businesses. The Utilities sector is "defensive," less affected by economic cycles, because consumers always require these services.

"The strong fourth quarter results are favorably impacting 2024 consensus earnings expectations, currently at $242 per share, according to Bloomberg, FactSet and S&P Cap IQ, reflecting year-over-year growth of roughly 10%. At current price levels, valuations are elevated, a near-term headwind; the S&P 500 is trading at 23.2 times 2023 earnings and 21.1 times 2024 projections, on the high side of the valuation range dating to the early-1990s."
- **Terry Sandven,** Portfolio Manager, Chief Equity Strategist, U.S. Bank

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[1] Important disclosures provided on page 4.

Global economy

Quick take: U.S. employment remains resilient, though likely past its peak. Service businesses continue to lead global economic strength.
Our view: The global economy continues to see moderating growth, especially across manufacturing activity, and global inflation is still decelerating. Despite higher interest rates, the U.S. Bank Economic team sees conditions consistent with a soft landing in the U.S.

- **The U.S. labor market remains solid, with non-farm payrolls growing by 275,000 jobs in February.** Negative revisions to December and January numbers means payroll growth averaged a 265,000 gain over the past three months. Average hourly earnings moderated to 4.3% for the past year, returning to a slowing trend in wages after the January surge. The unemployment rate jumped to 3.9% in February from 3.7% in January, the highest in two years, driven by falling employment the four of the past five months. Job openings slipped 26,000 in January, still 1.45 times the number of unemployed, but the rate at which individuals are quitting jobs declined to 2.1%, its lowest since August 2020. Individuals may be concerned about finding better employment opportunities.
- **Purchasing manager surveys from the Institute for Supply Management and S&P Global indicate the U.S. service sector continues to expand** at a modest pace. New orders are solid and backlogs are dissipating. Businesses remain concerned about inflation, employment and geopolitical issues.
- **Service businesses are expanding outside the U.S., according to S&P Global.** Europe returned to expansion for the first time since last July, and China, Japan and the United Kingdom pointed to ongoing growth. New orders grew and backlogs continued to ease with rising employment, though business optimism dipped slightly.

Equity markets

Quick take: U.S. equities continue to inch higher, bolstered by favorable sentiment and both fundamental and technical trends.
Our view: Performance breadth is constructive. Inflation, interest rates and earnings are directionally consistent with higher equity prices. Performance so far in 2024 reflects strong price trend line momentum.

- **Investor sentiment improved, with indices and individual sectors posting favorable results.** The S&P 500 (up 7.4%), Dow Jones Industrial Average (2.7%), NASDAQ Composite (7.2%) and Russell 2000 (2.7%) are all up year-to-date through Friday's close, with 10 of 11 S&P 500 sectors positive. Broad-based sentiment strength is often an indicator of underlying support of higher equity prices.
- **Fundamental factors support advancing equity prices.** Waning inflation, moderating interest rates and stable 2024 earnings projections present a positive backdrop for equities. The fourth quarter reporting period ended with sales and earnings advancing 3.9% and 8.0%, respectively, over year-ago levels according to Bloomberg, above expectations of 3.0% and 1.4%. Consumer and business spending remains resilient, with consumers favoring experiences versus durable goods and business expenditures earmarked largely for technology. The strong fourth quarter results are favorably impacting 2024 consensus earnings expectations, currently at $242 per share, according to Bloomberg, FactSet and S&P Cap IQ, reflecting year-over-year growth of roughly 10%. At current price levels, valuations are elevated, a near-term headwind; the S&P 500 is trading at 23.2 times 2023 earnings and 21.1 times 2024 projections, on the high side of the valuation range dating to the early-1990s.
- **Momentum indicators have become more broad-based.** According to FactSet, as of Friday's close, 75% of S&P 500 companies are trading at or above their 200-day moving average, one level of technical price-trend support. Moreover, six of the 11 S&P 500 sectors have at least 75% of companies within the sector trading at or above the 200-day moving average. This trading pattern of higher highs and higher lows is a constructive momentum indicator supportive of advancing equity prices.

Bond markets

Quick take: Falling Treasury yields fueled a broad rally in the bond market last week. Market interest rates indicate expectations that the Federal Reserve (Fed) will cut rates by the June meeting.
Our view: Slight softening in labor market data released last week keeps the Fed on track for rate cuts midyear. This favors normal fixed income allocations, which capture the material yield available on high-quality bonds. High valuations somewhat limit price appreciation potential in high yield bonds, but normal modest allocations to high yield debt can improve current income.

- **Fed Chairman Jerome Powell reaffirmed his expectation to cut interest rates later this year in his semiannual Congressional testimony.** Powell's appearance was his last chance to clarify his outlook for monetary policy before the Fed entered its standard pre-meeting blackout period Saturday. He adhered to earlier messaging that the Fed simply needs to gain confidence in the inflation outlook before reducing rates and signaled market pricing for a likely June rate cut is appropriate. Inflation data this week will give the Fed more context on progress toward its price stability goal ahead its March 20 meeting.
- **The European Central Bank (ECB) expects to follow a monetary policy normalization path similar to the Fed.** The ECB held rates steady last week with the intent to see more data before deciding the appropriate timing for rate cuts. ECB President Christine Lagarde bluntly suggested the ECB will gain a lot more information on inflation risks by the June meeting. The prospect of easier rate policies across most global central banks creates a favorable outlook for high-quality bonds, but central bankers remain cognizant of inflation risks that merit caution.
- **High valuations offer issuers a chance to refinance debt.** Corporate and municipal bond issuance is off to its hottest start for the first two months of a year since 2020. Increasing bond supply can be a technical headwind, with prices needing to adjust to entice buyers, but strong investor demand continues to prop up corporate and municipal bond valuations. While high valuations somewhat limit opportunities for further price gains, this refinancing window allows issuers to strengthen their financial positions by extending debt maturities. Investors can benefit from the meaningful income generated on riskier bonds, and valuations can stay elevated as long as demand remains strong.

Real assets

Quick take: Real assets posted a strong week of performance as interest rates declined. Positive performance across all real asset sectors and sub-sectors was broad based. Infrastructure traded the best, with Utility stocks gaining more than 3%. All Real Estate sub-sectors except for data centers beat the S&P. Commodities also beat the broader market; precious metals led, but agricultural commodities and industrial metals also performed well. However, the market may be more concerned with the U.S. fiscal position, evidenced by both gold and bitcoin achieving new all-time highs despite the resilient economy.
Our view: Diversified publicly traded real estate remains inexpensive relative to private real estate. Tangible assets with stable cash flows present relative opportunities if currently strong investor sentiment erodes. Commodities remain vulnerable if consensus expectations for falling inflation and decelerating growth come to fruition.

- **Real Estate outperformed the S&P 500 by 1.6% last week.** Residential and cell tower companies posted the strongest returns while data centers and industrial properties lagged. Public real estate continues to trade at discounts to private markets (individual properties), and we continue to see relative value opportunities in the publicly traded space.
- **Infrastructure stocks outperformed the broader market by 2.6% last week.** Utilities and airports led performance gains while railroads and toll roads were detractors. Railroads were the only sub-sector posting negative returns. Utilities were the top-performing sector in the S&P 500 last week.
- **Crude oil prices fell 1.1% last week after a few attempts to breach the $80 price level**. Prices remain rangebound, buffeted by both bullish and bearish news flow. Over a longer-term horizon, the crude market appears undersupplied, which should act as a tailwind to prices. However, we acknowledge downside risk to prices in the event of a resolution to tensions in the Middle East or if economic growth disappoints.

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