NEVILLE, RODIE & SHAW, Inc. / INVESTMENT COUNSEL
Established 1933
200 MADISON AVENUE, NEW YORK, N.Y. 10016

TELEPHONE: (212) 725-1440
FAX: (212) 689-8746

March 2024

Quarterly Review and Outlook

The strong fundamental resilience of the stock market in the first quarter surprised most investors and strategists alike. The rally that started in the fourth quarter of 2023 continued into the first quarter of this year with the S&P 500 registering a gain of 10.2%. The market's rally followed the Fed's pivot late last year when it moved from a restrictive monetary policy to one of prospective easing as inflation has continued to moderate.

A key supportive factor underlying the market 's rise in the first quarter was the Federal Reserve's continued messaging that interest rates were sufficiently high to quell inflation and that rate reductions could be expected in the foreseeable future if inflation continues to moderate. At its March 20th meeting, the Fed signaled that it was indeed getting closer to pivot away from the current tightening cycle and towards the beginning of rate cuts. Chairman Powell projected that three interest rate cuts would be forthcoming this year. Inflation data throughout recent quarters has provided a clear signal that while significant progress has been made by the Fed in curbing the pace of inflation, it still remains sticky enough to keep rate cuts from becoming imminent. Inflation is difficult to tame, and the Fed does not want to rush into cutting rates only to see inflation reignite. Strength in the jobs market and the overall economy has allowed the Fed to take its time cutting rates and the market has become more comfortable with the idea that rate cuts will not happen until the second half of the year.

Another supporting factor to the market rally has been higher than expected corporate earnings growth. After posting flat growth last year, earnings as measured by the S&P 500 are expected to increase by ~10% this year and 13% next year. Supply chains, which had become restrictive during the pandemic, have for the most part returned to normal which has helped to ease inflationary pressures. Reduced cost pressures have helped corporate operating margins improve to a record high. Following the labor shortages and wage pressures experienced during the pandemic, businesses have focused on becoming more cost efficient. While labor market pressures have eased somewhat with the labor participation rate rising, the job market continues to be tight with the unemployment rate remaining below 4%. Slowing wage growth and rising output has boosted corporate productivity which registered a 2.6% year over year gain in the fourth quarter of 2023. Many companies have turned to the use of technology to boost productivity and have started to explore utilizing artificial intelligence (AI) applications such as OpenAI's ChatGPT (affiliated with Microsoft) to gain operating efficiencies.

The Fed's pivot to an outlook calling for lower interest rates reflecting the moderation in inflation combined with a positive earnings outlook leads us to categorize the current market environment as constructive. Our positive market view is supported by a healthy economy which the Fed forecasts will increase 2.1% on a real (inflation adjusted) basis this year. Solid conditions in the labor market support this view where the trend in weekly unemployment insurance claims is holding steady at a low level. Another piece of corroborating evidence is the interest rate spread between high yield and investment grade bonds which remains tight, indicating investors are sanguine about the economic outlook. We are also encouraged by the broadening of the current rally across sectors, styles and market capitalizations. Last year, market performance was led by the Magnificent 7 stocks consisting of Microsoft, Apple, Nvidia, Amazon, Google, Meta and Tesla which had exceptional run-ups in price. We are now beginning to see money being redeployed into other areas of the market. A risk to this positive view would be if inflation were to turn higher either because of stronger than expected economic growth or a tightening labor market. For now, though, economic indicators suggest a more balanced situation which allows the Fed flexibility to lower rates should inflation continue to moderate. Lastly, we would note that the Presidential election cycle lies ahead of us which could lead to market volatility.

Our investment approach in this environment has remained consistent. We continue to look for companies with competitive advantages, superior growth and strong management teams. Our focus remains in the technology, healthcare, industrials, specialty financial and consumer sectors.

We continue to see fixed income securities as complementary to stocks in providing portfolio diversification. We are finding attractive yields in the short-term market and have been exploring opportunities to extend maturities to lock in interest income streams from longer dated securities. We continue to prefer higher quality securities as the risk reward is not warranted reaching for yield in the risker parts of the credit markets. Municipal securities have been a bit of a challenge as the ratios between tax-exempt and taxable issues has not been as beneficial. We continue to find opportunities in the municipal space but have been mindful of the tax efficiencies that we are currently observing.

As always, we are grateful for your support and encourage you to reach out to us with any questions or concerns you may have regarding your investments or portfolio structure.