AMI Quarterly Commentary

Growth Through Stability

Q1 ▪ 2024

Capital Market Outlook

The stock market, as defined by the S&P 500, rallied 10.6% in Q1, only the sixth time there have been two consecutive quarters of double-digit gains since 1950. This momentum reflects optimism that the Fed will skillfully navigate a "soft landing", supporting continued economic growth with well-timed rate cuts. We are somewhat skeptical that the market rally can be supported simply by the hoped-for rate cuts, which may or may not come this year. However, the economy remains in good shape, albeit slowing, and the improved market breadth we saw later in Q1 is an encouraging signal of broad-based resilience.

Inflation continued to moderate in Q1, however, the pace slowed in recent months and Core PCE, the Fed's preferred measure, held at 2.8% in both January and February. This is still above the Fed's 2.0% target, reflecting elevated prices in many service areas. The broader labor market headlines remain robust with nonfarm payrolls rising 303k in March, well ahead of the 214k estimate, lowering the unemployment rate to 3.8%. However, most of the gains in recent months have come from part-time workers and from the Government (including Education and Healthcare). In addition, the unemployment rate is being somewhat artificially held down by fewer workers in the labor market after many retired during the Covid period. Both bear watching as they are not necessarily indicative of a healthy economy. The economy continued to grow at good pace with Q4 GDP growth at 3.3% but is expected to further moderate to 2.8% in Q1 as the restrictive monetary policy slows the economy.

The Fed reiterated its "data-dependent" approach, meaning it wants to see inflation back to 2.0% before contemplating rate cuts, by keeping rates steady after last hiking in July 2023. The Fed's messaging indicates that it will appropriately pull back on its restrictive monetary stance as inflation nears its target. The Fed's internal polling, called the "dot plot", suggests three rate cuts in the second half of 2024 to sustain the economic expansion but some recent comments by Fed members suggest no cuts in 2024, which we would view as further restricting economic growth. Investors began the year with an aggressive six cuts for 2024 but the recent stall in progress on inflation has brought investor expectations back inline with the Fed.

The economy has been remarkably resilient, and most signals today suggest ongoing expansion. The recent deceleration in consumer spending bears watching, as this has been a key driver of economic growth, but it is quite possible the slowdown is temporary. Importantly, other signals remain or have recently turned positive, with ISM Manufacturing unexpectedly expanding in March after 14 months of contraction. ISM Services remained in positive territory, albeit growing at a slower pace and slightly above contraction territory. Leading Economic Indicators also turned positive in February after being negative for the prior 16 months.

Capital Market Outlook

Corporate earnings for Q4 were generally solid and while most companies do anticipate some slowdown in 2024, the outlook remains positive overall. Current S&P 500 estimates call for a still-robust 10% earnings growth in 2024 and while this appears aggressive, it reflects an economy that has proven more resilient than feared despite tight monetary conditions. That said, risks remain, especially geopolitical conflict that has the potential to drive commodity prices higher and slow progress on lowering inflation.

Looking forward, we believe equities remain the best place to invest for long-term capital appreciation. However, we recognize that nuanced challenges lie ahead. Elevated valuations primarily reflect the quality of companies able to grow revenues and profits even in more challenging periods. Also, while unique factors have concentrated returns in a narrower group of stocks recently, we expect breadth to continue to improve, especially if the Fed does cut rates which could help make the current economic expansion more durable. At AMI, our commitment to long-term investment in high-quality businesses is designed to navigate through these uncertainties. We always strive to position our strategies to capitalize on long-term opportunities and mitigate risks.

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