ACIMA
PRIVATE WEALTH

ECONOMIC & INVESTMENT PERSPECTIVES

March 1, 2024

FEBRUARY: STOCKS & BONDS DIVERGE

Figure 1: 2/29/2024 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-1.5%	-1.6%	3.3%	-3.6%	6.3%
Investment Grade Corp Bonds	LQD	-1.9%	-2.4%	6.0%	-3.4%	9.6%
U.S. Treasury Bonds	GOVT	-1.3%	-1.5%	2.3%	-4.3%	4.9%
U.S. 20+ YR Treasuries	TLT	-2.3%	-4.5%	-4.1%	-13.7%	14.3%
Muni Bonds	MUB	-0.2%	-0.2%	5.2%	-0.8%	7.1%
US High Yield	HYG	0.3%	0.4%	10.1%	-1.0%	7.9%
Non-US Corp Bonds	IBND	-1.1%	-3.5%	7.9%	-4.9%	7.9%
Emerging Markets Bond LC	EMLC	-0.2%	-1.7%	7.8%	-5.0%	7.3%
Global Equity						
ACWI Global Equity	ACWI	4.5%	4.8%	23.3%	-0.4%	25.6%
ACWI Global Equity ex US	ACWX	3.0%	1.3%	12.6%	-0.8%	15.1%
International Developed	EFA	3.0%	2.5%	14.9%	-0.4%	17.6%
Emerging Markets	EEM	4.2%	-0.5%	7.5%	-4.8%	9.9%
Global Equity by Region						
United States	VTI	5.3%	6.5%	28.6%	-0.3%	32.8%
Europe	IEUR	2.3%	1.3%	12.4%	-0.6%	18.3%
Asia ex-Japan	AAXJ	4.5%	-1.1%	2.9%	-6.8%	8.1%
China	MCHI	6.7%	-4.3%	-15.7%	-22.6%	9.6%
Japan	BBJP	4.4%	7.7%	26.5%	-0.3%	25.7%
Latin America	ILF	0.9%	-3.3%	24.0%	-5.8%	26.9%
US Equity						
US S&P 500	IVV	5.2%	6.9%	30.3%	-0.4%	33.5%
NASDAQ 100 QQQ	QQQ	5.3%	7.2%	50.6%	-0.4%	54.0%
US Large Growth	IWF	6.6%	9.2%	45.5%	-0.8%	49.5%
US Large Value	IWD	3.6%	3.6%	13.8%	-0.3%	19.5%
US Eqwt S&P 500	RSP	4.0%	3.2%	13.0%	-0.3%	22.1%
US Mid Cap	IJH	5.9%	4.0%	13.0%	-0.4%	24.5%
US Small Cap	VTWO	5.6%	1.4%	10.0%	-1.2%	25.8%

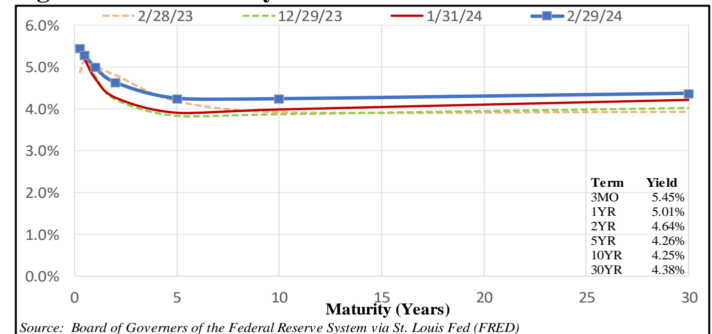
Hotter-than-expected inflation data drove interest rates higher (and bond prices lower), but another batch of solid corporate earnings reports buoyed stocks in February, pushing US equities to new all-time highs. Performance highlights for the month and year-to-date (YTD) are summarized below.

- Bonds: The US Aggregate index (AGG) fell 1.5% in February (-1.6% YTD) as yields rose. Long-term Treasuries (TLT) are highly sensitive to interest rates, falling 2.3% (-4.5% YTD). Corporate bonds (LQD) lost 1.9% (-2.4% YTD), while high yield (HYG) rose 0.3% (+0.4% YTD) as credit spreads narrowed. Non-US bonds were down marginally this month but have under-performed YTD as the US dollar strengthened.
- Global equity (ACWI): +4.5% in February (+4.8% YTD).
- US Equity: The broad market (VTI) rose 5.3% (+6.5% YTD), and the S&P 500 (IVV) was up 5.2% (+6.9% YTD). Small (VTWO) and mid cap stocks (IJH) were strong this month but have under-performed YTD. At the sector level, gains were broad-based this month, but YTD returns have been led by communications (XLC), technology (XLK) and financials (XLF), while more interest rate-sensitive utilities (XLU) and real estate (XLRE) sectors are down YTD.
- Non-US Equity: Developed markets (EFA) rose 3.0% this month (+2.5% YTD), led by Japan (BBJP +4.4%, +7.7% YTD). Emerging markets stocks (EEM) rose 4.2% (-0.5% YTD) on continued strength in India (INDA +2.5%, +4.8% YTD) and a bounce in China (MCHI +6.7%, -4.3% YTD).

Interest Rates and the Economy

The yield curve (Figure 2) plots the interest rates (vertical axis) for various US Treasury maturities (horizontal axis). Yields rose in February amid uncertainty regarding the timing and magnitude of potential Federal Reserve (Fed) interest rate cuts as recent data indicated that despite moderating significantly, inflation remains persistently above the Fed's 2% target. The inverted yield curve (short-term > long-term yields) continues to signal economic slowdown or recession ahead, with the 10-year US Treasury yield at 4.25%, well below the Fed Funds target rate (5.25-5.50%).

Figure 2: US Treasury Yield Curve

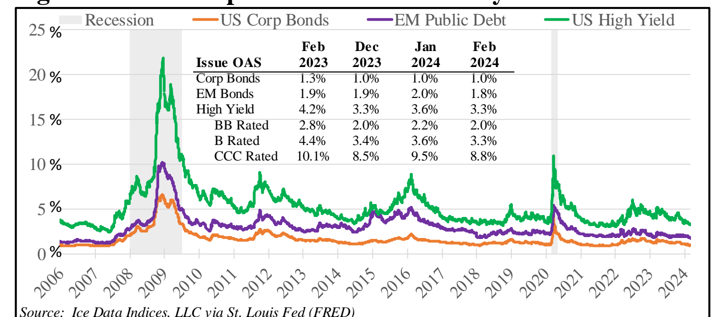


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism, while high or widening spreads signal fear. Spreads narrowed in January and remain below historically average levels.

- Investment grade corporate bond spreads were stable at +1.0% this month and are well below year-ago spreads of +1.3%.
- High yield (non-investment grade) spreads narrowed to +3.3% and are down from +4.2% a year ago. The riskiest bonds (rated CCC & below) declined to +8.8% over Treasuries and are still down significantly from +10.1% spreads one year ago.
- Emerging market spreads narrowed to +1.8% but have been very stable over the past year. Emerging market credit has out-performed US bonds due to higher yields and stable currencies.

Figure 3: Credit Spreads vs. U.S. Treasury Yields



Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

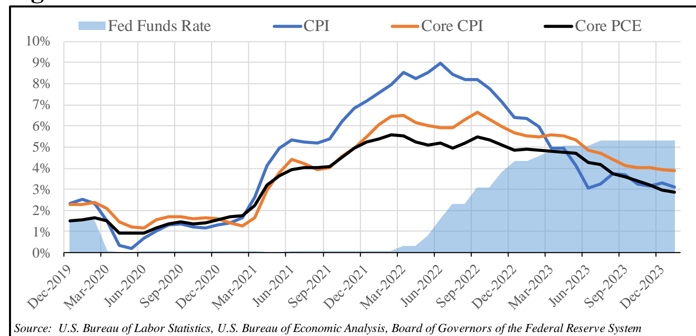
Dual Mandate: Inflation & Employment

Markets continue to be driven by changing expectations for the future path of interest rates. The Fed has held short-term rates steady at 5.00-5.50% since last June, but their rhetoric has shifted.

- June-October 2023: Hawkish Fed-speak pushed longer-term yields higher and stocks lower with the narrative that interest rates would remain higher for longer to fully tame inflation.
- November 1, 2023: With inflation moderating, the Fed pivoted to a more dovish stance, predicting three rate cuts in 2024 (median FOMC forecast). Yields plummeted and stocks soared.
- 2024 YTD: Economic strength continues (strong growth and employment) with inflation still above the Fed's 2% target, tempering rate cut hopes and pushing longer-term yields up.

The Fed's "dual mandate" is to promote price stability and maximum sustainable employment. These goals often conflict, but the Fed has thus far made significant progress on inflation (Figure 4) without negatively impacting the job market (discussed later).

Figure 4: Inflation vs. Interest Rates

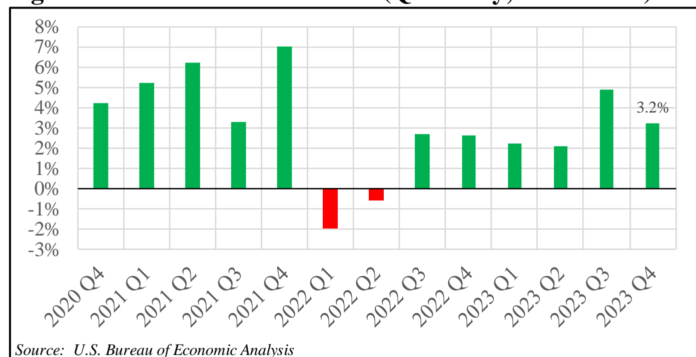


Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, Board of Governors of the Federal Reserve System

- CPI: Headline inflation peaked at 9.0% in June 2022 but has declined steadily to 3.1% as of January 2024.
- Core CPI: Excluding food and energy, the most volatile components of inflation, the so-called core CPI inflation has declined from a peak of 6.6% to 3.9% year-over-year.
- Core PCE: Personal Consumption Expenditures (PCE) excluding food and energy, the Fed's preferred inflation metric, has declined from 5.6% to 2.8%. The 3-month average suggests an annualized run rate of 2.6%, still above the Fed's 2% target.

Despite the Fed's aggressive efforts to slow growth and inflation by raising interest rates, the economy has remained resilient. Real GDP (Gross Domestic Product, the value of all final goods and services produced in the US, net of inflation) grew at an annual rate of 3.2% last quarter (Figure 5), well above the 2.4% average annual rate during the economic expansion from 2011-2019.

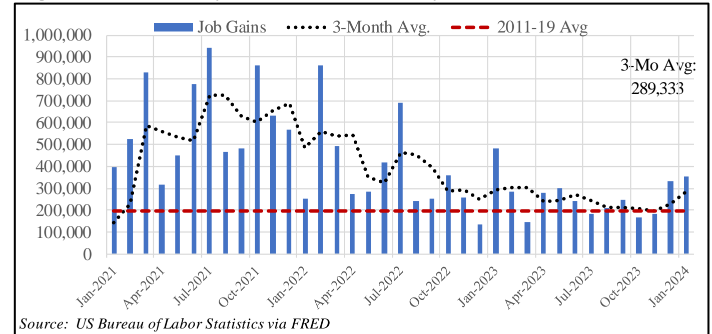
Figure 5: US Real GDP Growth (Quarterly, annualized)



Source: U.S. Bureau of Economic Analysis

This resilient economic growth has fueled continued strength in the employment market, as illustrated in Figure 6.

Figure 6: Monthly US Non-Farm Payroll Data



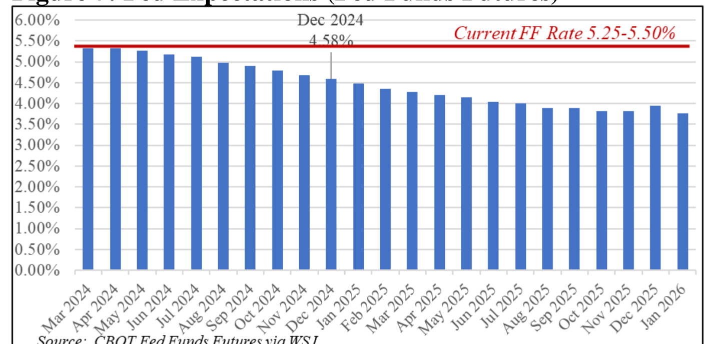
Source: US Bureau of Labor Statistics via FRED

After millions of jobs were lost during the pandemic, the job market recovered rapidly, and there are more workers today than ever before. Though the rate of growth has cooled versus 2021-2022 levels, job creation has remained remarkably strong, consistently out-pacing the 2011-2019 expansionary period when roughly 197,000 jobs were added monthly on average. In fact, hiring appears to have re-accelerated over the past several months, with 353,000 jobs added in January alone (most recent data). Unemployment is now just 3.7% and has remained below 4% for 24 straight months, the longest such period in decades. Despite aggressive Fed rate hikes, economic and job growth have remained strong, defying recession forecasts and confounding economists.

Bottom Line

Stocks and bonds diverged in February as solid corporate earnings fueled stock returns even as interest rates moved higher. Recent data suggests that the economy remains strong, with above-average economic, employment and wage growth reigniting inflation concerns and tempering expectations for imminent Fed interest rate cuts. Investors continue to be hyper-focused on every new data point, trying to ascertain what the Fed will do next, and there will be plenty to digest in the coming weeks, including the monthly jobs report (March 8), new inflation data (March 12), and the next Fed meeting (March 19-20). Current expectations for the Fed Funds target rate from the futures market (Figure 7) reflect investors' belief that the Fed has finished hiking interest rates and that they will cut rates at least three times in 2024 (0.25% each), beginning by mid-year. Whether those rate cuts occur because the Fed engineers a "soft landing" (no recession) or because the economy weakens significantly (causing the Fed to take stimulative action) remains to be seen. Diversification continues to be critical, with solid bond and cash yields offering an attractive complement to stocks as the story continues to unfold.

Figure 7: Fed Expectations (Fed Funds Futures)



Source: CBOT Fed Funds Futures via WSJ

Disclaimer:

ACIMA Private Wealth LLC ("ACIMA" or the "Firm") is a federally registered investment adviser based in Richmond, Virginia since January 2016. The Firm is a fee-only investment advisory firm with the intent to provide exceptional service to high-net-worth individuals, families, trusts, charitable foundations and institutions. ACIMA's purpose is to implement integrated wealth management solutions that meet the financial needs and reflect the personal values of our clients. For additional important information regarding ACIMA, its investment management services, compensation, conflicts of interest, and other matters, is contained in its disclosure document, Form ADV Part 2A and Wrap Fee Brochure. A copy of which is available on through the Firm's website or upon request to the Chief Compliance Officer at (804) 422-8450.

The information and views contained in this document were prepared and compiled by ACIMA. The statements provided herein are based solely on the opinions of ACIMA and are solely for informational purposes only. It is not a research report, as such term is defined by applicable law and regulations, and is not a solicitation or an offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Any opinions provided herein should not be relied upon for investment decisions. The information contained herein was obtained from sources believed are reliable but has not been independently verified by ACIMA and for which no guarantee of accuracy is proffered.