March 2024

MONTHLY MARKET INSIGHTS

Key takeaways:

- Artificial Intelligence ("AI") euphoria and further evidence of an economic "soft landing" led to broad equity market gains in February.
- S&P 500 companies reported strong fourth quarter earnings; however, most of the strength can be attributed to the Magnificent Seven stocks.[1]
- The Federal Reserve ("the Fed") will likely delay its first rate cut until their June meeting.

The equity market strength observed in January carried over into February, as continuing evidence of a "soft landing" scenario and strong corporate earnings bolstered US bourses throughout the month. In February, the S&P 500 returned 5.34%, while the tech-heavy NASDAQ returned 6.22%.[2] The S&P 500 equal-weighted index returned 4.16% in February, reflecting a renewal of market breadth; however, performance still lags the market-weighted index.[3] Small-cap stocks pared back January losses, with the Russell 2000 index returning 5.65%.[4]

The fourth-quarter earnings season is in its final innings, as 93% of US companies have reported as of the end of February.[5] US earnings were strong, increasing 8% year-over-year, with US companies on aggregate beating consensus expectations.[4] However, strong US earnings in Q4 can mainly be attributed to the "Magnificent Seven," which reported earnings growth of 56%, while S&P 500 earnings, excluding the "Magnificent Seven," declined by 2%.[6]

The most notable earnings release of the season came from Nvidia, which reported strong fourth-quarter results catalyzed by surging demand for the chips needed to support the development of artificial intelligence infrastructure. Sales more than tripled, while earnings increased more than eightfold from a year earlier, comfortably beating analyst expectations.[7] Amazon and Meta also reported strong results at the beginning of the month, leading to a strong run-up in their respective stock prices.

On the other hand, Apple and Tesla are both showing weakness, with both stocks recording price declines over the month. We are uncertain if weakness in Apple and Tesla is a harbinger of looming broad-market pressure. Still, the concentration of the equity market creates vulnerabilities that present significant risks for equity investors going forward. The hype surrounding AI is the primary catalyst driving market returns. While we believe that AI will be a secular growth theme for years, we recognize that the recent run-up in AI-adjacent stocks is susceptible to mean-reversion that may lead to a broad market pullback later in the year.

1. Magnificent Seven constituents: Apple, Microsoft, Amazon, Alphabet, Nvidia, Tesla, Meta Platforms.
2. Bloomberg, return indicates index's total return.
3. Id.
4. Id.
5. Matejka, Mislav, et al. "Q4 Earnings Season Tracker." Equity Strategy - Research - J.P. Morgan Markets, J.P. Morgan, 1 Mar. 2024, markets.jpmorgan.com/research/email/scx/-lbks38b/akskj46VyH0FaJq4q1Y-8A/GPS-4640917-0.
6. Id.
7. Fitch, Asa. "Nvidia Earnings: Ai Craze Tripled Sales over Last Year, ..." Wall Street Journal, www.wsj.com/business/earnings/nvidia-nvda-q4-earnings-report-2024-cc7c257d. Accessed 4 Mar. 2024.

Stock valuations remain rich, with the S&P 500 forward price-to-earnings multiple ending the month at 21.13x.[8] So far, the market has looked through the 10-year US Treasury yield increase of 34 basis points over the past month, as strong economic fundamentals appeared to support valuations.[9] Nonetheless, we view valuations as stretched and anticipate that any further gains in equity markets will be mainly attributable to fundamental earnings growth rather than multiple expansion.

The backup in rates during February likely reflects fading optimism from the bond market about the magnitude and timing of rate cuts. Comments from Fed officials over the past few weeks reflect a shift in Fed thinking that will likely delay the first cut until the June meeting. Robust economic data alleviates the concern of an impending recession spurred by restrictive policy. Further, many Fed governors have expressed the desire to see inflation data come closer to their 2% target before cutting rates, especially as strengthening economic activity increases the risk of a reacceleration of inflation.

The January core PCE price index rose by 0.42% month-over-month, slightly above expectations, reflecting a year-over-year increase of 2.85%.[10] While still above the Fed's 2% target, core PCE has decreased from 4.9% a year ago, showing a meaningful disinflationary trend. The lagged effects of shelter inflation should continue to put downward pressure on inflation throughout the year, and provide the Fed the support to cut rates later this year. We forecast that the Fed will wait for more evidence of inflation returning to target and will push off their first rate cut until their June meeting. With core services prices, excluding housing, increasing 0.60% in January, we continue to believe that the "last mile" of inflation will prove challenging and will lead the Fed to only cut rates three times in 2024.[11]

8. Bloomberg.

9. Id.

10. Id.

11. Hatzius, Jan. "USA: Pushing the First Cut Back to June Following Recent Fed Comments; Now Expecting 4 Cuts in 2024 and 4 in 2025." Goldman Sachs, 22 Feb. 2024, publishing.gs.com/content/research/en/reports/2024/02/23/038b06d8-29f8-4dd1-8b6a-4a0650df437d.html.

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