Marketline March 2024

Stocks:

Thus far, 2024 has seen strong stock returns, while bonds have been much less impressive. Companies have navigated higher interest rates with aplomb – for the most part – and earnings have held up well. The albeit ever-receding promise of lower interest rates helps as well. The month of March saw all the US indices tack on 2% to 3% in price appreciation, while the Canadian, Mexican, and European indices rose anywhere from 3.5% to 4.2%.

Rising stocks hid a shift this month: technology stocks lost momentum, while industrials and energy stocks gained favor. The US is spending copious amounts of money to subsidize the manufacturing of a variety of products – a factor that helps explain why the economy has avoided a recession. Just today, as I write this, factory data was strong and producer prices were up much more than expected. Strong pricing can help companies recoup losses from higher costs, and we've seen that play out during the last year. However, all this spending may cause headaches later on. Already, Intel is hitting "pause" on the expansion of its fabrication facilities, as capacity increases cause soft pricing. And we can see by the numbers that while electric vehicle sales are still growing, EVs are piling up on dealer lots. One of the basic rules of economics involves supply and demand: if supply increases and demand remains constant, prices must fall. We may be facing that consequence in several industries currently enjoying taxpayer subsidies.

In our niche, where we seek undervalued stocks, pickings have been slim. We've migrated one former resident in our portfolios back to our buy list – Dollar Tree – and found a couple of new names in the finance and tech sectors, but it's taken three months to rustle up those ideas. That's the impact of record highs on stocks – fewer cheap names. Still, there's almost always some opportunity brought about by investor overreaction: when Target was hurt by merchandising issues in 2023, the stock fell from the 160s to about 110 by last November. Now it sits at $178 after a series of much better-than-expected earnings.

Bonds:

As we noted above, manufacturing data announced today was stronger than expected. Bond investors have responded by bidding yields up and prices down. The highly anticipated decreases in short-term interest rates look far less likely. While I haven't read even a whisper of speculation in this vein, the probability of a Fed decision to either hold off on rate decreases indefinitely, or to *hike* rates from here *is greater than zero*.

So let's get to the numbers. The short end of the curve remains generous relative to the past several years, with bills offering yields in the 5.3% area, the one-year at 5.02%, the ten-year at 4.2%, and the thirty-year at 4.34% - note that with today's news, all these numbers are higher. Also note that the yield curve remains inverted, and has now broken the former record for longest-lasting inversion. We don't see an end to the tension around the timing of rate changes in the near term, largely because inflation remains sticky. Reasons for this range from a robust money supply to vast quantities of deficit spending and lagging productivity growth – but another factor is the lag inherent in any economic change. It can take months for a policy change to affect activity – and it wouldn't be surprising if it takes years in this case.

What does the future hold for rates? After so many months of yields in the 4% to 5% area, it's difficult to make a case that we'll see declines to the 2s or even 3s that prevailed in the recent past. The federal government's ever-rising deficits are not responsive to higher rates, which means it borrows – unlike companies and consumers – no matter what it costs. That phenomenon is continuing to support higher yields for now.

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