Smarter Way to Invest

A Divergence Emerges Amid Rate Uncertainty

Market Update JANUARY 2024

January brought a month of mixed returns across various asset classes, with certain interest-rate-sensitive segments in the negative. As anticipated, the Federal Reserve kept rates stable, marking the fourth straight meeting in which the Federal Reserve kept rates constant. The recent rally in Small and Mid Cap stocks has cooled, each pulling back with negative returns to kick off 2024, while a market cap divergence has begun to emerge with Large Caps continuing their run higher.

December inflation metrics (released in January) came in mixed, as headline CPI increased to 3.35% year-over-year - above expectations of 3.20% and Core CPI, while decreasing slightly to 3.90% year-over-year, was higher than expectations. Core PCE, however, dropped to 2.93% year-over-year while simultaneously beating expectations of 3.00%. The Federal Reserve primarily focuses on PCE metrics (information sourced from businesses as opposed to consumers) as their preferred proxy for inflation, as the PCE index covers a broader range of goods and services. Thus, the overall inflation metrics point to an encouraging trend of easing inflationary pressures.

Additionally, during the January FOMC meeting the Fed concluded to again hold the federal funds rate steady at the target range of 5.25% to 5.50% [1]. During the meeting, when Fed Chairman Powell was asked about the path forward and potential interest rate cuts, we received some mixed signals: while he expressed confidence in the likelihood of inflation decreasing, stating, "We believe that our policy rate has likely reached its peak for this tightening cycle, and if the economy progresses as anticipated, it's probably appropriate to begin easing policy restraint at some point this year."[1] He then went on to emphasize the importance of gathering more data before commencing the easing cycle and that the Fed is "looking for greater confidence" before making any definitive decisions. He stressed that a rate reduction at the forthcoming March 19–20 meeting appears unlikely, indicating that "Based on the meeting today, I would tell you that I don't think it's likely that the Committee will reach a level of confidence by the time of the March meeting to identify March as the time to do that." [1]

In response to some of the mixed inflation data as well as mixed signals and a degree of uncertainty regarding Fed policy direction, certain market segments with higher interest rate sensitivity saw a sizeable pull-back during January, such as real estate, small cap stocks, and mid cap stocks. This indicates the market may have been overly optimistic in pricing in rate cuts the past two months. Further, we are seeing a divergence emerge between large cap equities and small & mid caps, as large caps continued higher while its small and mid cap counterparts have pulled back with negative returns for the month. This divergence may be indicative of a shift in investor sentiment and risk appetite, as investors seek more stability in established large cap companies. However, a large degree of the divergence can be attributed to the dominance of a select handful of mega cap companies pulling the S&P 500 into positive returns for the month.

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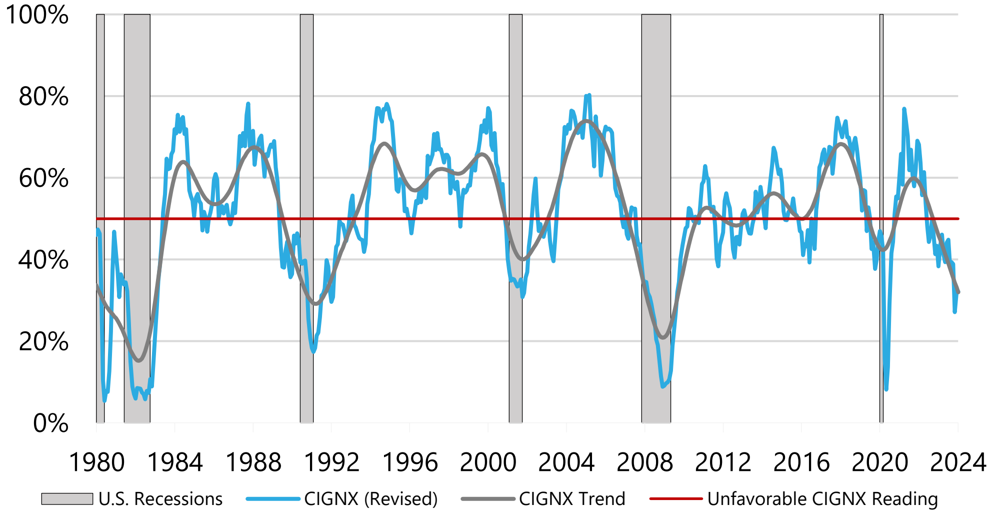
Last year, market performance was dominated by the prevailing theme of the mega cap "Magnificent Seven" tech stocks leading the way for the S&P 500 and the broader market. This has largely been driven by enthusiasm surrounding the Artificial Intelligence industry, with these seven technology and data focused companies reaping a majority of returns. As 2024 kicks off, the Magnificent Seven cohort is again leading the way. NVIDIA Corp. (NVDA) and Meta Platforms Inc (META) have had the most noteworthy gains to start the year, returning 24.24% and 10.22%, respectively, for the month of January. These two stocks alone now account for over 6.5% of the entire S&P 500 index (which is market cap weighted) and have propelled the large cap sector into positive territory. By contrast, the equal weighted S&P 500 index experienced a -0.82% return for the month, indicating the broader market health is less favorable than what it initially appears.

1. https://www.federalreserve.gov/monetarypolicy/files/monetary20240131a1.pdf

MARKET SENTIMENT= MIXED

Signal Update JANUARY 2024

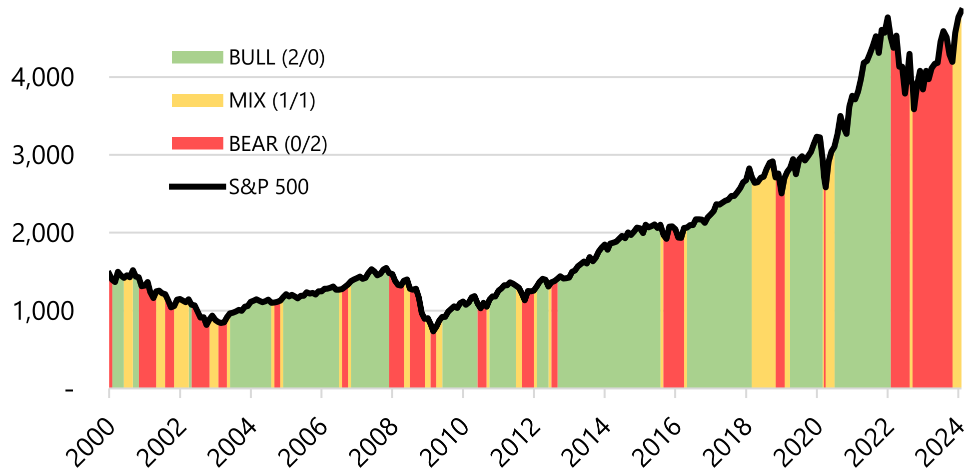
CIGNX = 32.1



Our **CIGNX** Economic Indicator has a revised reading of **32.1**, down slightly from last month's revised reading of **39.2**. While the reading is up slightly from last month, this is indicative of continued sluggish economic activity and a continued unfavorable trend in economic activity. This remains well below our baseline threshold of **50.0,** indicative of unfavorable conditions, and is below the baseline reading of **40.0**, which we typically interpret as the economy experiencing recessionary conditions. **Our overall economic outlook remains unfavorable.**

MONTH (2023)	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
CIGNX (Revised)	32.1											
CIGNX Trendline	32.0											

ALPHA = Positive (Buy) OMEGA = Negative (Sell)



Our short-term **(Alpha)** signal remained **Positive** during the month of January, while our intermediate-term signal **(Omega)** remains **Negative**, indicating the near-term market trajectory is favorable while the long-term outlook for the market trajectory is unfavorable. We remain in a "Mixed" positioning across each of our Dynamically managed Portfolios, with a slightly reduced exposure to equities. **Our overall market sentiment outlook is Mixed.**

MONTH (2023)	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
ALPHA	BUY											
OMEGA	SELL											

Asset Class Indices	S&P 500 Index	S&P 400 Index	S&P 600 Index	U.S. Agg Bond Index	S&P GSCI Index	S&P 1500 Real Estate
Monthly	1.68%	-1.71%	-3.95%	-0.27%	4.47%	-4.93%
Year to Date	1.68%	-1.71%	-3.95%	-0.27%	4.47%	-4.93%

Market Review JANUARY 2024

U.S. Lg Cap Stocks

The S&P 500 Index posted a positive gain in January, returning 1.68% for the month, establishing a head-start year-to-date relative to it's mid and small cap counterparts. Last year, we observed a prevailing theme of large and mega cap outperformance, and 2024 has started off with a similar theme. The 'Magnificent 7' greatly outperformed the broader index, boasting a 9.83% return, compared to the equal weighted S&P 500 which saw losses of -0.82%. The mega cap names are again leading the pack, and the broader market appears to be struggling to start the year amidst uncertainty of when we are likely to see cuts in interest rates.

U.S. Md Cap Stocks

The S&P 400 Mid Cap Index saw a decrease in the month of January, with a -1.71% return to start the year. While trailing large caps, this sector saw less of a pullback than small caps, which tend to have even more sensitivity to economic and interest rate environments. While not quite as sensitive to the prevailing conditions as small cap stocks, the prospects of prolonged uncertainty around when we will see a changing rate policy have certainly put downward pressure on the mid cap sector.

U.S. Sm Cap Stocks

The S&P 600 Small Cap Index has underperformed both its large and mid cap counterparts, with a sizable loss of -3.95% for the month of January. It seems the optimism of rate cuts that propelled strong returns to close out 2023 have begun to subside, and with a hint of hesitance from the Fed regarding near-term rate cuts, small caps experienced a large pull-back This year will likely see a similar prevailing theme, with small caps exhibiting the greatest degree of sensitivity to interest rates and economic health as compared to large and mid caps.

U.S. Bonds

The Bloomberg U.S. Aggregate Total Return Index experienced flat performance in January, posting returns of -0.27%, down from last months rally of 3.83%. This decrease is attributable to a decline in yields particularly in longer duration bonds which declined over 2.00% for the month due uncertainty of previous rate cut optimism. High yield and shorter-term duration bonds eked out slightly positive returns. Yield curves remain inverted as a result of declining long-term yields, with the 2-10 year Treasury Yield spread inverted by 28 basis points, and the 10yr – 3mo spread inverted by 143 basis points as of the end of January.

Alternative Assets

The S&P GSCI Total Return Index posted strong returns of 4.47% last month. However, certain precious metals, particularly gold and silver, have struggled with negative returns of -1.42% and -3.99%, respectively. Other commodity sub asset classes within the GSCI index have exhibited strong positive gains to start the year. In particular, oil has led the way, with brent crude oil spot price seeing a 6.81% increase for the month of January.

U.S. Real Estate

The S&P 1500 Real Estate Index has posted a sizeable loss of -4.93% for the month, the largest decline of any asset class in January. This comes after two consecutive months of strong returns to close out 2023, amid optimism of a Fed Pivot in the near term. However, like other interest rate sensitive market sectors, real estate has struggled thus far in 2024. Real Estate Investment Trusts (REITs) often trade similarly to long duration bonds as their cash flows are generally consistent and provide for stable and predictable dividends. Thus, REIT share prices can be highly sensitive to changes to the discount rate (interest rates).

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