JOURNEY

JOURNEY WEALTH

Quarterly Market Commentary

April 2024 Q2

Journey Wealth
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Market Recap

The first quarter of 2024 saw a continuation of many of the trends from 2023. Equity market participation has broadened but remains driven largely by a handful of companies. Fixed income markets have remained stable as the Fed continues to push rate cuts down the line and issuance has picked up. Domestically, the economy continued to stroll along, as unemployment remains low and GDP growth appears resilient. Fixed income yields have fallen from their peak but remain at enticing levels relative to the past decade, likely with little upside risk to rates.

Looking Ahead

The Fed has remained opaque on the timing of rate cuts and the path for quantitative tightening. Economic conditions have had little impact on growth, possibly due to a fiscal regime that remains stimulative. Markets anticipate approximately two to three cuts in 2024, barring deterioration in economic conditions. Domestic equity valuations appear stretched in some areas while some other equity segments, including value, small caps and international, appear reasonable. While rate cuts will likely be more gradual than anticipated, fixed income presents a favorable tradeoff given attractive yields.

Leading Topics

Equity Valuations – Returns for US equity markets in 2023 and the beginning of 2024 were impressive. While market cap weighted indices like the S&P 500 performed well, performance was largely driven by a handful of names. At the end of March, the PE ratio for the S&P 500 was just over 28x, the highest level since early 2021 when interest rates were near zero. One hallmark of elevated equity valuations is an increase in IPO activity, which ticked up in the first quarter. The timing of IPOs is managed by educated market participants whose goal is to raise the most capital possible. Historically, increased IPO activity hasn't boded well for future equity returns. Higher valuations are difficult to justify given the interest rate outlook and potential slowing growth in the US and other developed markets. We don't advise making investment decisions based solely on valuations. However, it's important to be aware of concentration risk if your investment allocation is heavily tilted towards domestic equities. The ten largest stocks in the US make up about a third of the S&P 500, a high level of concentration relative to the historical average.

Federal Reserve/Inflation – The Fed expects monetary policy to remain restrictive through at least the end of 2025 to control inflation and anticipates about three rate cuts in 2024. Inflation has improved considerably over the past year, but the last mile has been sluggish. Shelter remains the hottest component of inflation, comprising nearly two thirds of headline CPI. Shelter costs are likely to remain sticky given limited supply. Although rate hikes may be off the table, the Fed has been clear in its intent to leave rates higher for longer, raising the cost of capital.

Fixed Income – Yield to worst is a term for the lowest yield you can receive on a bond without the issuer defaulting. While the value of bonds fluctuates due to interest rate movements, yield to worst is a good indicator of what future returns could look like. Yields across the investment grade universe now sit around 5%. A few years ago, bonds provided little yield and served primarily to mute volatility, whereas they now offer real yield as well as an avenue for capital appreciation. This shift, in conjunction with lofty US equity valuations, has compressed the equity risk premium. The risks of extending duration have been reduced as the likelihood of additional rate hikes has declined.

International – International equity valuations look attractive relative to US equities, particularly those in the large cap growth category. International valuations are close to their 20-year averages, while US valuations are well above their historical average. India, China and emerging markets as a whole are forecast to have more rapid GDP growth than the US over the next five years* and nearly all of the middle-class growth over the next five years is expected to occur in Asia**. While an all or nothing approach runs counter to our investment philosophy, we see maintaining some exposure to international equities as valuable for both risk mitigation as well as an opportunity to gain exposure to growth at a reasonable price.

See Disclosures on final page

On The Horizon...

Journey Wealth is excited to announce our upcoming insights and events focused on providing market commentary and analysis. Join us as we explore the latest trends, strategies, and opportunities to help you navigate the complexities of today's financial landscape.

Mid-Quarter Insights
May 30th, 2024

Quarterly Commentary
July 15th, 2024

Semi-Annual Insights
July 2024

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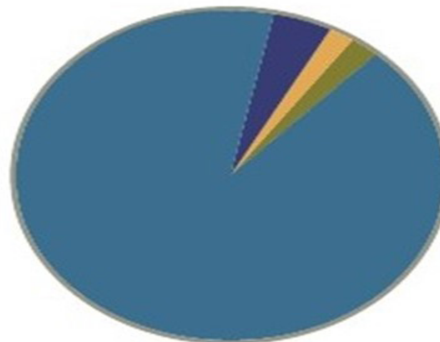
Asset Allocation

Our job is to allocate assets based on the requirements of your individual plan...

and not allow the swings of the market to direct our approach. This is particularly relevant in periods of elevated volatility such as election years, which typically generate positive returns but with higher levels of volatility relative to non-election years. Added uncertainty and volatility are uncomfortable and can change how we feel about investing. However, they shouldn't change your long-term investment plan. It's even more critical in times of elevated volatility to have a long-term allocation target and to stick with it. We believe that your planning needs should dictate your investment allocation choices rather than general uncertainty. Please don't hesitate to reach out to your advisor to schedule time to discuss your financial plan, including your goals and planning assumptions. Letting planning drive the investment approach helps ensure that your portfolio remains aligned with your vision for the future.

Asset allocation: the most important determinant of variance in portfolio performance



Source: Brinson, Hood & Beebower, Financial Analysts Journal, 1986
Brinson, Singer & Beebower, Financial Analysts Journal, 1991

Valuation & Concentration

The returns for US equity markets in 2023 and the beginning of 2024...

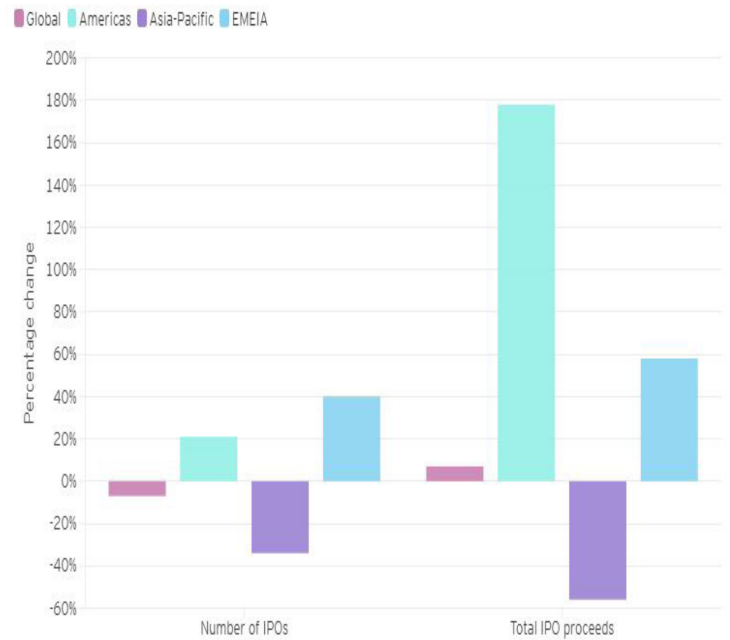
were impressive. While market cap weighted indices like the S&P 500 performed well, both relatively and absolutely, performance was largely driven by a handful of names. At the end of March, the PE ratio for the S&P 500 was around 24x, the highest level since early 2021 when interest rates were near zero. While the growth outlook is up for debate and there are other factors at play, I'd contend that significantly higher rates will have an impact on growth and should play a role in valuations. The current valuation picture in large cap US equities doesn't leave much room for error.

One hallmark of elevated equity valuations is an increase in IPO activity, which ticked up in the first quarter. The timing of IPOs is managed by educated market participants whose goal is to raise the most capital possible. Historically, increased IPO activity hasn't boded well for future equity returns. IPO proceeds peaked in 2021 before plummeting in 2022 and 2023. The prior peak for IPO proceeds was in 2000. These coincide with elevated US equity valuations.

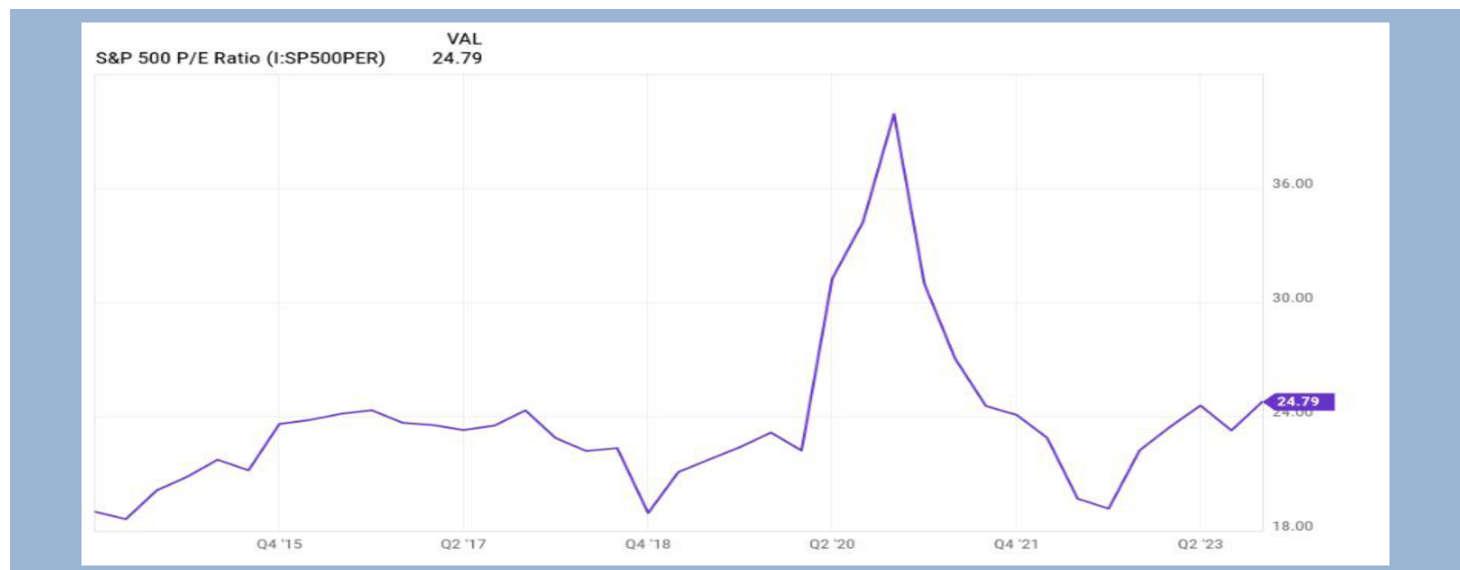
Higher valuations are difficult to justify given the interest rate outlook and potential slowing growth in the US and other developed markets. We don't advise making investment decisions based solely on valuations. However, it's important to be aware of concentration risk if your investment allocation is heavily tilted towards domestic equities. The ten largest stocks in the US make up about a third of the S&P 500, a high level of concentration relative to the historical average. Investors whose portfolios look a lot like the S&P 500 may be underestimating their concentration risk. No one knows for certain if US equities will continue their outperformance over a long investment horizon. However, one of the most important elements of portfolio construction is risk management and we believe that maintaining some allocation to international equities is critical to building a diversified portfolio.

IPO activity YOY change by geography

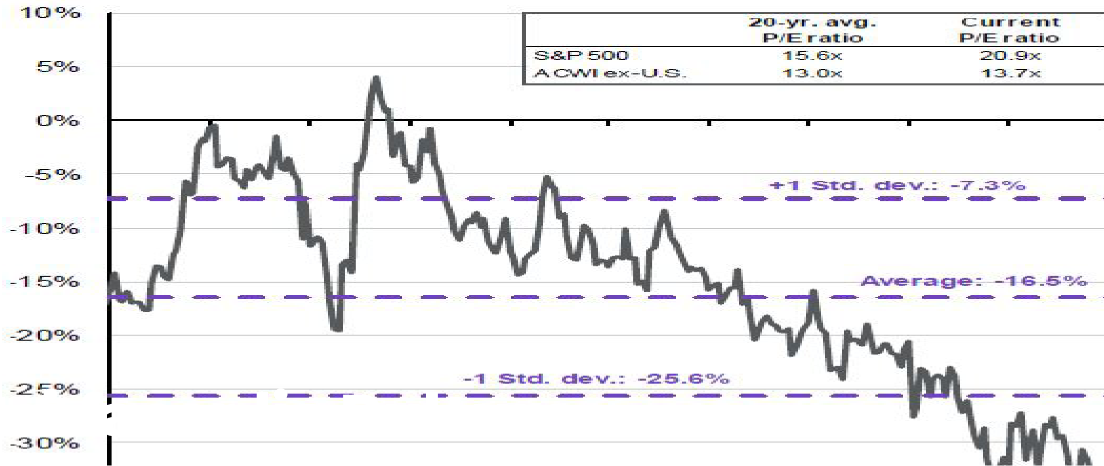
Q1 2024 (% change vs. Q1 2023)



WSJ Survey of Economists



Source: Y Charts

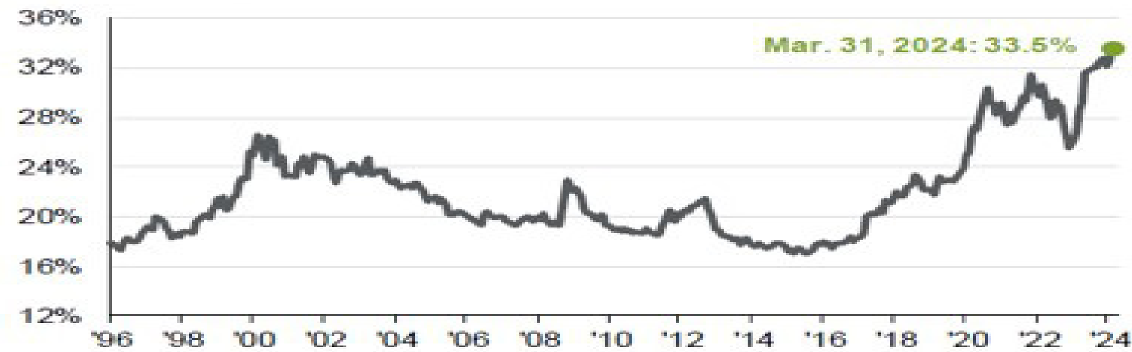


International Equities

Global Gains: Unlocking Value in International Equities vs. US Titans

International equity valuations look attractive relative to US equities, particularly those in the large cap growth category. International valuations are close to their 20-year averages, while US valuations are well above their historical average. The appeal of international equities is greater than just favorable valuations. In an environment where the S&P 500 is arguably more concentrated than ever, international equities offer diversification. At the end of March, about one third of the weight of the S&P 500 was comprised of ten stocks. Seven of those are concentrated in the Communications & Technology sectors. By contrast, the ACWI ex. US Index is far less concentrated, both on an individual name and sector basis. The top ten names only make up about 12% of the index as of the end of March and those companies are spread across six sectors

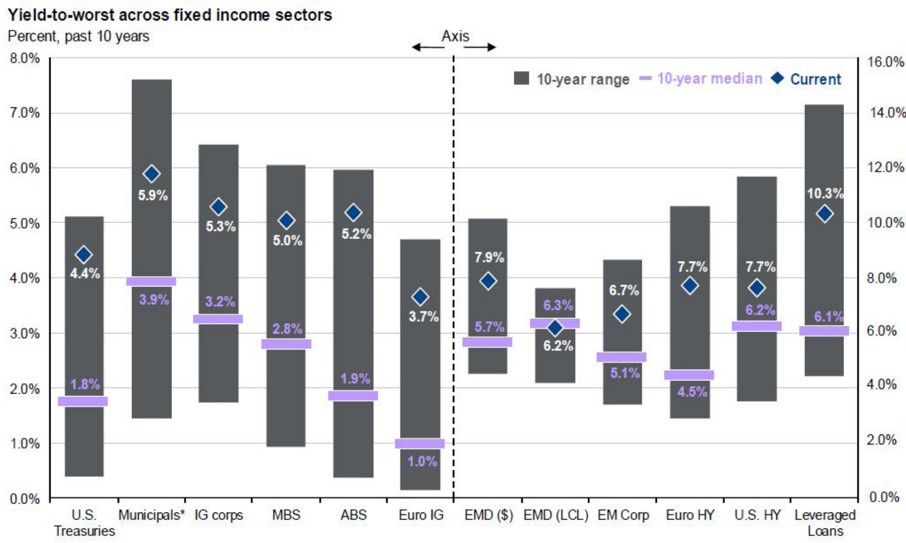
International markets also offer appealing growth prospects. India, China and emerging markets as a whole are forecast to have more rapid GDP growth than the US over the next five years* and nearly all of the global middle-class growth over the same period is expected to occur in Asia**. Economic growth is a complex equation with many variables but it's hard to argue that demographic factors, including middle class and population growth, will play a role. It's difficult to tell which category (US or International) will perform better in the coming decades and not something we'd recommend attempting to predict. While an all or nothing approach runs counter to our investment philosophy, we view maintaining meaningful exposure to international equities as valuable for both risk mitigation as well as an opportunity to gain exposure to growth at a reasonable price



Source: JP Morgan

Fixed Income

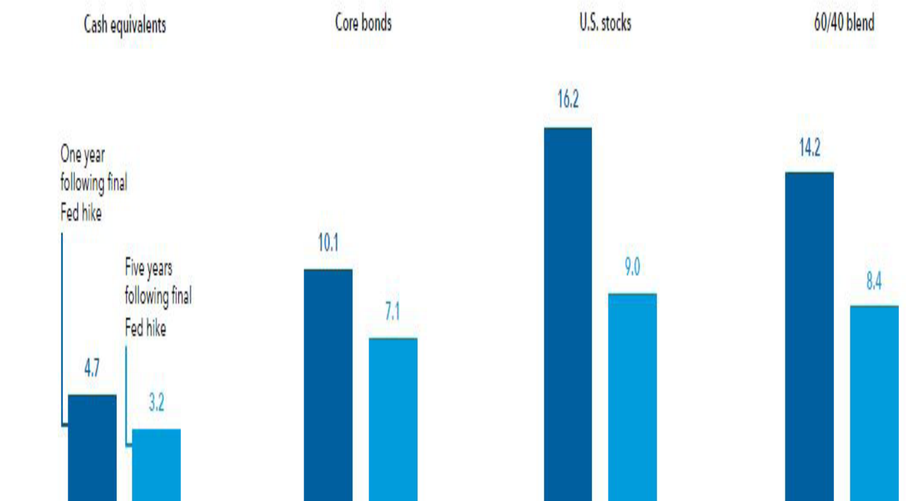
Rate Riddles: Navigating the Fed's Tightrope



Per the Fed Funds futures curve, US short-term interest rates are at or near peak levels. While timing remains uncertain, most agree that the longer-term expectation for short-term rates is downward. Yield to worst is a term for the lowest yield that you can receive on a bond without the issuer defaulting. While the value of bonds fluctuates due to interest rate movements amongst other factors, yield to worst is a good indicator of what future returns could look like if bonds are held to maturity. Yields across the investment grade universe now sit around 5%, an attractive level well above their 10-year averages.

After Fed hikes ended, stocks and bonds have historically outpaced cash

Average annual return (%)



*Based on an average of the four most recent cycles, which began on March 1, 1995, June 1, 2000, July 1, 2006, and January 1, 2019, respectively.

Sources: Capital Group, Morningstar. Chart represents the average returns across respective sector proxies in a forward extending window starting in the month of the last Fed hike in the last four transition cycles from 1995 to 2018, with data through June 30, 2023. Benchmarks represent U.S. 3-month T-bill (cash), Bloomberg U.S. Aggregate Index (core bonds), S&P 500 Index (U.S. stocks) and a blend of 60% of the S&P 500 Index and 40% of the Bloomberg U.S. Aggregate Index (60/40 blend). Past results are not predictive of results in future periods.

"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas." – Paul Samuelson

Higher rates have shifted the asset allocation dynamic to a degree. A few years ago, bonds provided little yield and served primarily to mute volatility, whereas now they offer real yields as well as an avenue for capital appreciation. This shift, in conjunction with lofty US equity valuations, has compressed the equity risk premium. The risks of extending duration have also been reduced as the likelihood of more rate hikes has declined.

While investment timing is not something we advocate, the relative entry point for longer-term fixed income is difficult to ignore. It's easy to fixate on short-term cash yields around five percent. However, these rates typically fall quickly when the Fed cuts interest rates. Both equities and fixed income tend to healthily outperform cash and cash equivalents in the years following the final rate hike. While the path forward for inflation and the Fed are uncertain, we believe the upside risk for interest rates is minimal. As such, we view the price risk of holding longer-term fixed income instruments as lower than the reinvestment risk you bear when holding excess cash and cash equivalents.

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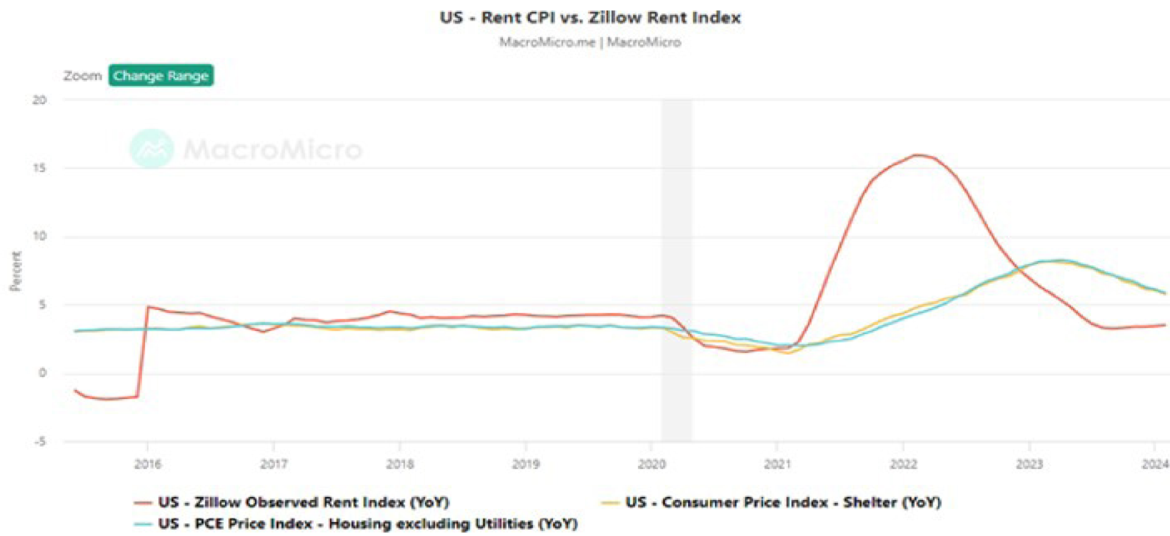
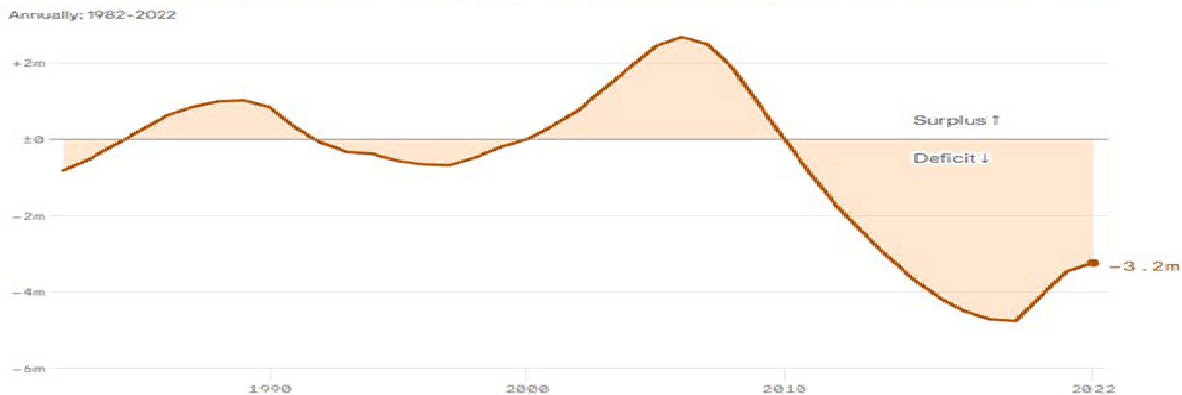


Inflation: Slow But Steady

Inflation has moderated substantially from the near double-digit year-over-year prints we saw in 2022. CPI has come down over the past twelve months from the mid-6% range to about 3.2%. This has been accomplished without a significant increase to unemployment or a dramatic slowdown in economic growth, at least not that we've seen thus far. However, the monthly pace of inflation is still well above the Fed's target, about 0.4% for the month of February. The labor market remains tight but has shown signs of loosening. Housing is the most critical segment, making up about two thirds of the headline CPI figure.

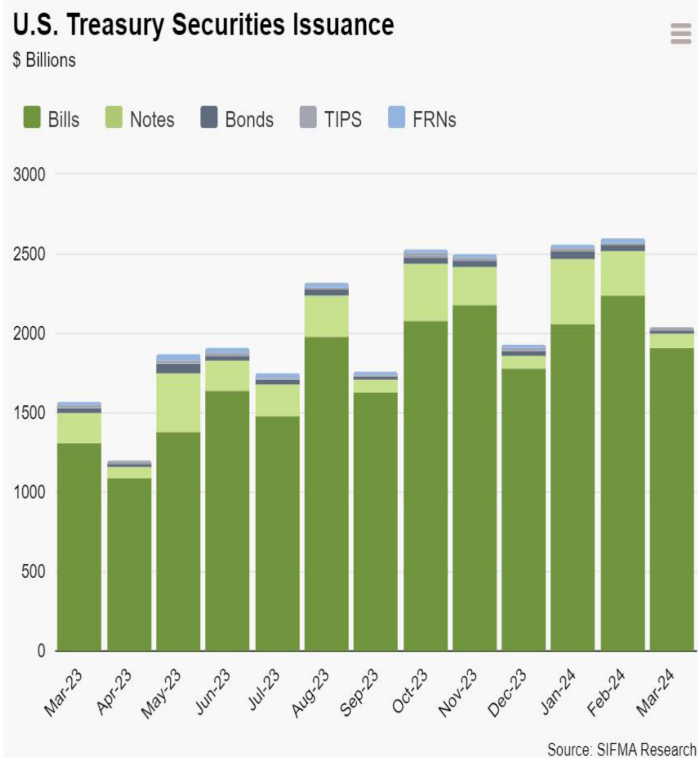
The pace of rate hikes is a double-edged sword for housing. While higher rates slow housing activity, they can also constrict supply. Homeowners with 3% or 4% mortgages now face higher barriers to selling given the current rate environment. These constraints are on top of a housing market that is already under-supplied. After 2008, housing starts dropped dramatically, contributing to a housing shortage further exacerbated by the increase in building material costs during COVID. Yet, measurement of the shelter component of CPI is complex. The CPI uses leases in place, regardless of when they were signed, to measure shelter costs. The Zillow Rent Index uses new leases and indicates that shelter inflation may be considerably lower. A combination of increased housing starts and alleviation of measurement lags should continue to chip away at the shelter component of CPI, although progress will likely continue to be gradual. At this point, the shelter element is driving nearly all of the remaining inflation above the Fed's target.

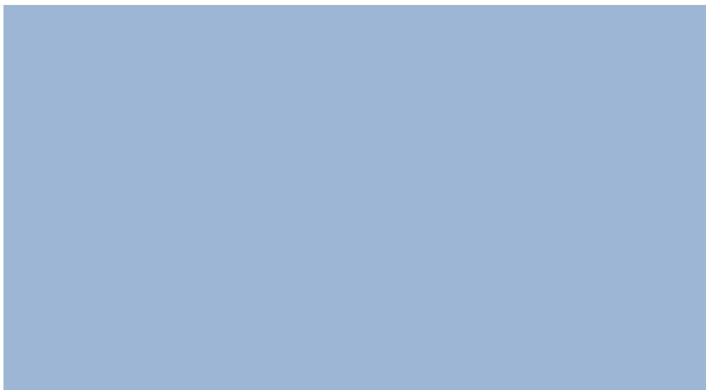


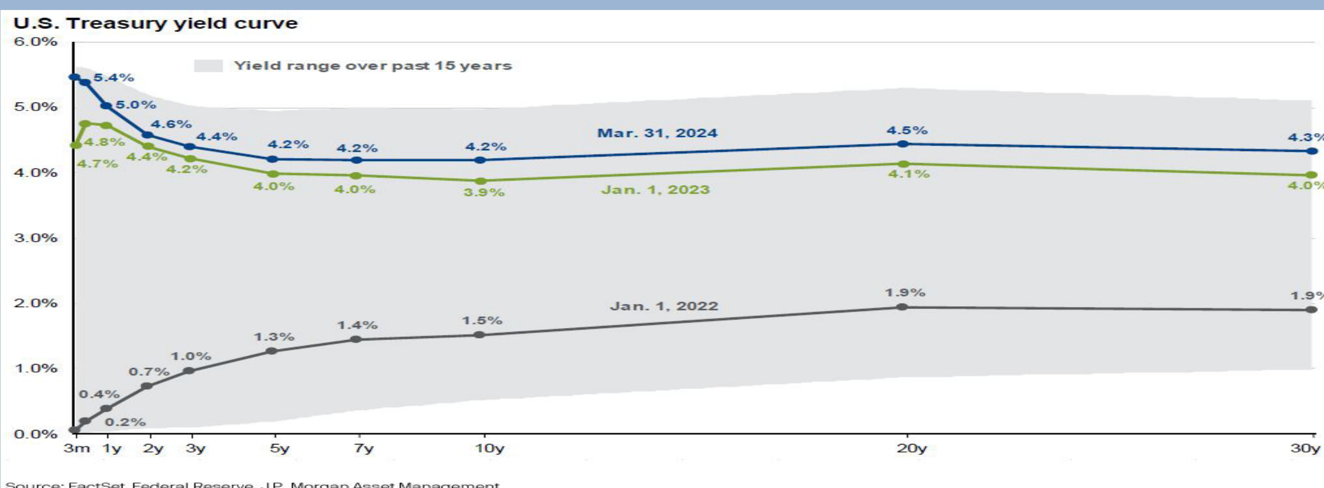
Federal Reserve

Rate Rollercoaster: Buckle Up for the Fed’s Wild Ride

Fed policymakers expect about three rate cuts in 2024 and for policy to remain restrictive through at least 2025. Per the March Fed minutes, balance sheet reduction is likely to continue but the possibility of additional rate hikes is minimal. Although additional rate hikes are likely off the table, the Fed has been clear with its intent to leave rates higher for longer. The market began the year with an expectation of six rate cuts and that expectation has gradually shifted to be much closer to the Fed’s indicated 2-3 cuts. The longer end of the yield curve has made almost parallel moves upward as the market has digested the shift, raising the cost of capital for consumers and businesses. The shift is not solely due to the Fed’s rate outlook. The longer end of the curve is also driven by Treasury issuance, which has increased markedly over the past twelve months. In March, the Treasury issued almost 50% more securities than in March of 2023. Alongside the reduction in the Fed’s balance sheet, these dynamics should support higher rates at the long end of the curve, regardless of the Fed’s actions at the short end.



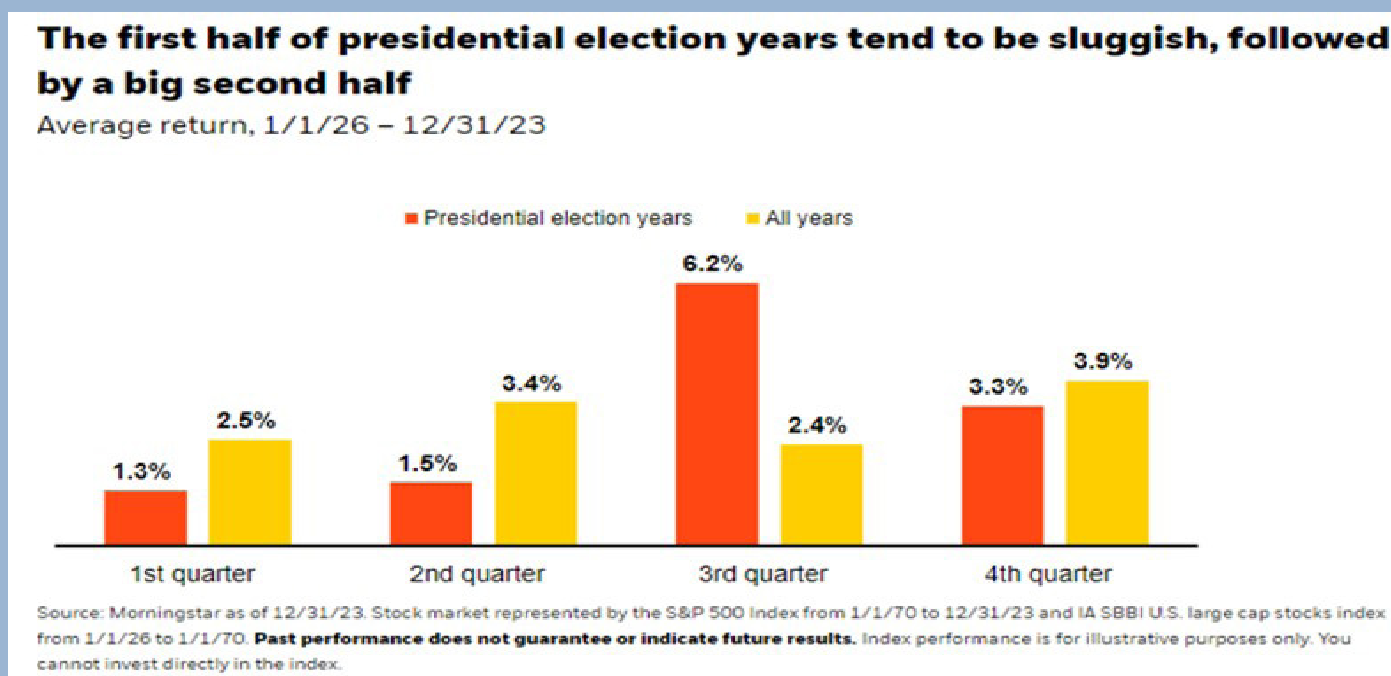




Source: Factset, Fed, and JP Morgan Asset Management

Behavioral Finance

For most people it is difficult to entirely separate emotions from investing. That can become even more challenging in periods where there are a lot of inflammatory and hyperbolic headlines flying around. As our world has become more interconnected, this issue has become more acute. For many, elections provide a perfect storm of uncertainty and anxiety that can amplify emotions. It's perfectly okay to be concerned about politics but please don't let it impact your investment decisions.



Equity markets tend to be risk averse, whether that risk is a geopolitical event, an election outcome or the path of interest rates. Markets don't like uncertainty. If you look at election years historically, markets tend to perform poorly relative to non-election years in the first half of the year and rally in the second half as the outcome and its impact becomes clearer. The first quarter of this year was anomalous relative to the typical presidential election year. Volatility was muted and returns were impressive. While each cycle has its idiosyncrasies, there's still plenty of potential for volatility as the second quarter progresses. The confluence of interest rate uncertainty, geopolitical instability and an election cycle create the opportunity for volatile markets.

Added uncertainty and volatility are uncomfortable and can change how we feel about investing. However, they shouldn't change your long-term investment plan. It's even more critical in times of elevated uncertainty to have a long-term allocation target and to stick with it. We believe that your planning needs should dictate your investment allocation choices rather than general uncertainty.

See Disclosures on final page

What's It All Mean...

Equity Valuations & Concentration

US equity markets performed well over the past year but valuations are pricing in a path free of any significant bumps in the economic road. Additionally, US equity markets are historically concentrated in a handful of companies and sectors.

The Housing Problem

Inflation has improved gradually over the past two years. Housing makes up about 2/3 of the total CPI figure. While the CPI measurement of shelter costs is a lagging indicator and may be exaggerated, the tight housing market is the key to the remaining inflation problem.

Rates & The Yield Curve

The Fed has made its intent clear: to be slow to reduce short-term rates barring an economic shock. Long-term rates are likely to be driven by dynamics in the Treasury market as well as the Fed's actions, with larger Treasury issuance likely to support higher long-term rates than we've seen in the recent past.

Shifting Asset Allocation Dynamics

The entry point for fixed income appears favorable as equity valuations have increased and the likelihood of additional rate hikes has declined. Fixed income offers attractive yields with a lower level of reinvestment risk than cash and equivalents.

International Opportunities

US growth equities have driven markets over the past decade but we believe there are opportunities outside of this narrow neighborhood. In addition to favorable valuations, international equities offer better diversification prospects than their more concentrated US counterparts.

Emotions & Markets

Uncertainty contributes to market volatility, which can lead to poor decision-making. This is even more true in election years, when concerning headlines abound. Keep in mind, that even if you could predict an outcome, it's impossible to predict how markets will react to that outcome. It's even more critical in times of elevated volatility to have a long-term allocation target and to stick with it. We believe that your planning needs should dictate your investment allocation choices rather than general uncertainty.

Relevant Disclosures

*Per the Oxford Economics Global Economic Outlook Report (https://www.oxfordeconomics.com/resource-hub/)

**Per World Data Lab, Visual Capitalist (visualcapitalist.com)

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