Cetera® Investment Mangement
Commentary

April 11, 2024

Defying Gravity

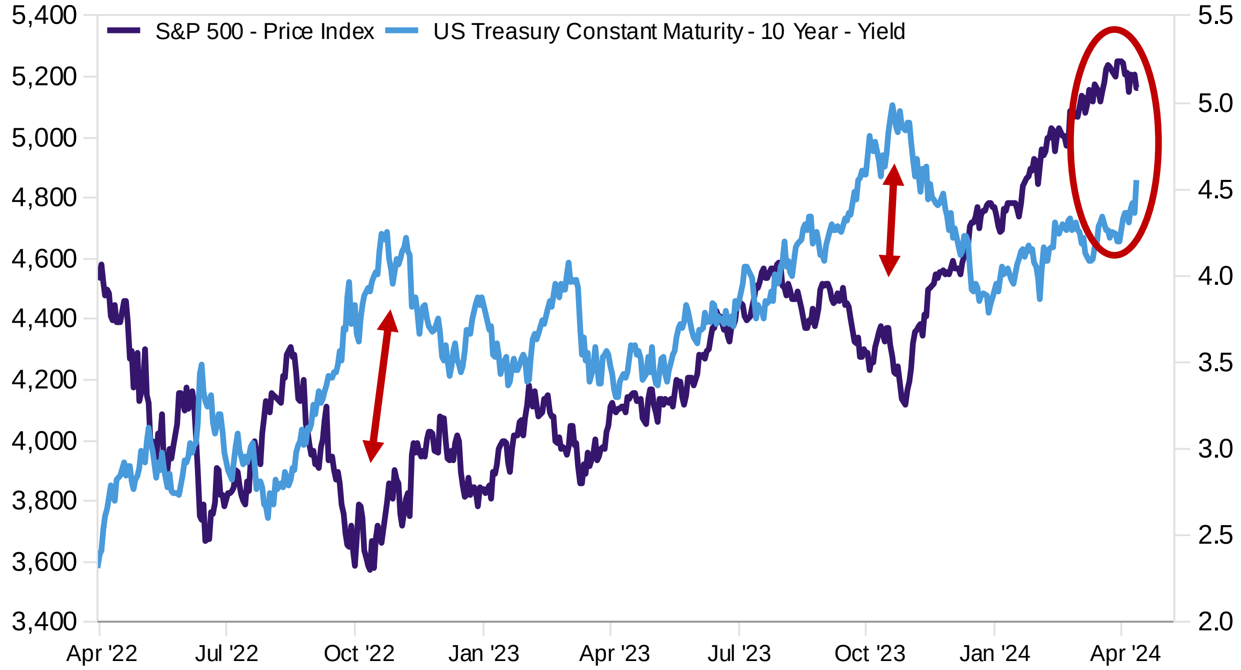
- The S&P 500 has risen more than 25% since its October 2023 low, with little resistance.
- While stock investors have looked past hotter inflation data, bond investors have not.
- As volatility picks up, diversification and staying focused on your goals are even more important.

Stocks, as measured by the S&P 500, are up roughly 25% from their October 2023 low, encountering only minor setbacks along the way. The economic data largely supported this investor bullishness, as we have seen more economic surprises to the upside than the downside. The labor market has also remained on solid ground, recording 26 straight months of an unemployment rate below 4%. This is a feat that has yet to be seen since the 1960s when we saw a streak of 27 months.

However, it hasn't been as rosy in the bond market. With inflation not easing as much as many economists had anticipated, bond yields have been rising as bond investors demand more yield for the increased inflation outlook. Since bond prices move inversely to bond yields, the broad bond benchmarks are down roughly 3% year-to-date.

The 10-year Treasury yield is highly correlated to mortgage rates. Higher bond yields mean higher borrowing costs for consumers and businesses. This is not good for corporations, as they must pay more to finance operations and capital expenditures. Eventually, higher borrowing costs could take a toll on stock prices as we note in the chart below. In October of 2022 and 2023, stock markets reacted negatively to higher bond yields. The S&P 500 (dark purple line) drops when the 10-year Treasury yield (light blue line) rises.

Figure 1: S&P 500 (Left Axis) vs. 10-Year Treasury Yield (Right Axis)



Source: Cetera Investment Management, FactSet, S&P Global, U.S. Treasury Department. Data as of 4/10/2024.

So far in 2024, investors have looked past higher bond yields, but eventually, we would expect bond yields and stock prices to reconcile. Stock investors have largely overlooked hotter- than- expected inflation, thinking it was an anomaly, but the anomaly continues to exist. January inflation data was hot, followed by February and now March. If inflation does not ease as economists expected, stocks will likely follow the trend of the past. If stock investors are correct though, that will be welcomed news for bond investors and yields should fall, pushing up bond indexes.

As we enter the first quarter earnings season, valuations are high in large cap companies, especially large cap growth companies. With persistent inflation, we could see some companies miss earnings. However, we are optimistic the persistent inflation may have helped some companies expand profit margins as producer input costs have risen less than consumer inflation. High valuations leave less margin for error and there are some inconsistencies between the stock market and bond market as we described above. We think this will all lead to volatility in the second quarter as investors become hypersensitive to economic data related to inflation. Additionally, investors will be very in tune with Federal Reserve member speeches.

All this will likely increase the chances of more market swings that we missed in the first quarter. Diversification can help mitigate this volatility. We think the volatility should be short- lived as inflation will eventually ease, and there is a lot of cash in savings accounts and money market assets that could be deployed to buy the dips. The economy and labor market also remain on solid footing. Your financial professional can help you stay focused on your personal financial goals. As always, please contact your financial professional with any questions on tailoring your portfolio to your personal situation.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

The **S&P 500** is an index of roughly 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of large cap universe.