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Sarsi LLC, is an Independent,
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Market Newsletter
First Quarter 2024

EXECUTIVE SUMMARY

- Global stocks rose in the first quarter and the rally in US stocks broadened as stocks other than the 'Magnificent 7' joined in. High interest rates and concerns about a recession hurt stocks of small companies.

- The US economy is sailing smoothly so far. There are plenty of jobs. Both consumers and companies continue to spend. The manufacturing sector has recovered and is growing like the services sector.

- Inflation has declined from the peak in 2022, but the last mile to bring it to a level that would be acceptable to the Federal Reserve has been bumpy. This has led to uncertainty among investors about the direction and magnitude of interest rates.

- Declining valuation of office spaces is a concern as it could adversely impact municipal finances as well as smaller banks. However, as of now the situation seems well contained.

- US companies are expected to report that earnings grew 3.2% in the first quarter.

- Currently, stocks are priced at 21 times their expected earnings over the next 12 months, which is above the 30-year average.

- Historically, no matter which party got the reins to the White House, stocks have appreciated over time.

- Historically, reaching an all-time was not a reason for stocks to drop. In the past, they have continued to appreciate.

Table 1: Market indices

(*Returns include dividends reinvested*)	**Quarter to date**	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
S&P 500	10.56%	10.56%	29.88%	11.49%	15.05%
S&P Mid Cap 400	9.95%	9.95%	23.33%	6.96%	11.71%
S&P Small Cap 600	-0.75%	-0.75%	6.50%	2.31%	7.72%
MSCI Emerging Markets	2.44%	2.44%	8.60%	-4.68%	2.61%
MSCI EAFE	5.93%	5.93%	15.90%	5.31%	7.85%
Vanguard Total Bond Market Index	-0.82%	-0.82%	1.53%	-2.53%	0.26%
Investment Grade Credit	-0.10%	-0.10%	5.33%	-1.71%	1.62%
Non-Investment Grade Credit	1.50%	1.50%	13.46%	2.00%	5.21%
Bloomberg Commodity Index	2.29%	2.29%	-0.56%	9.11%	6.38%
Dollar Index	3.11%	3.11%	1.93%	3.87%	1.44%
10 Yr. Rate	4.21% 03/31/2024	3.87% 12/31/2023	3.49% 03/31/2023	1.75% 03/31/2021	2.41% 03/31/2019

Source: S&P Dow Jones, ml.com, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

Table 2: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

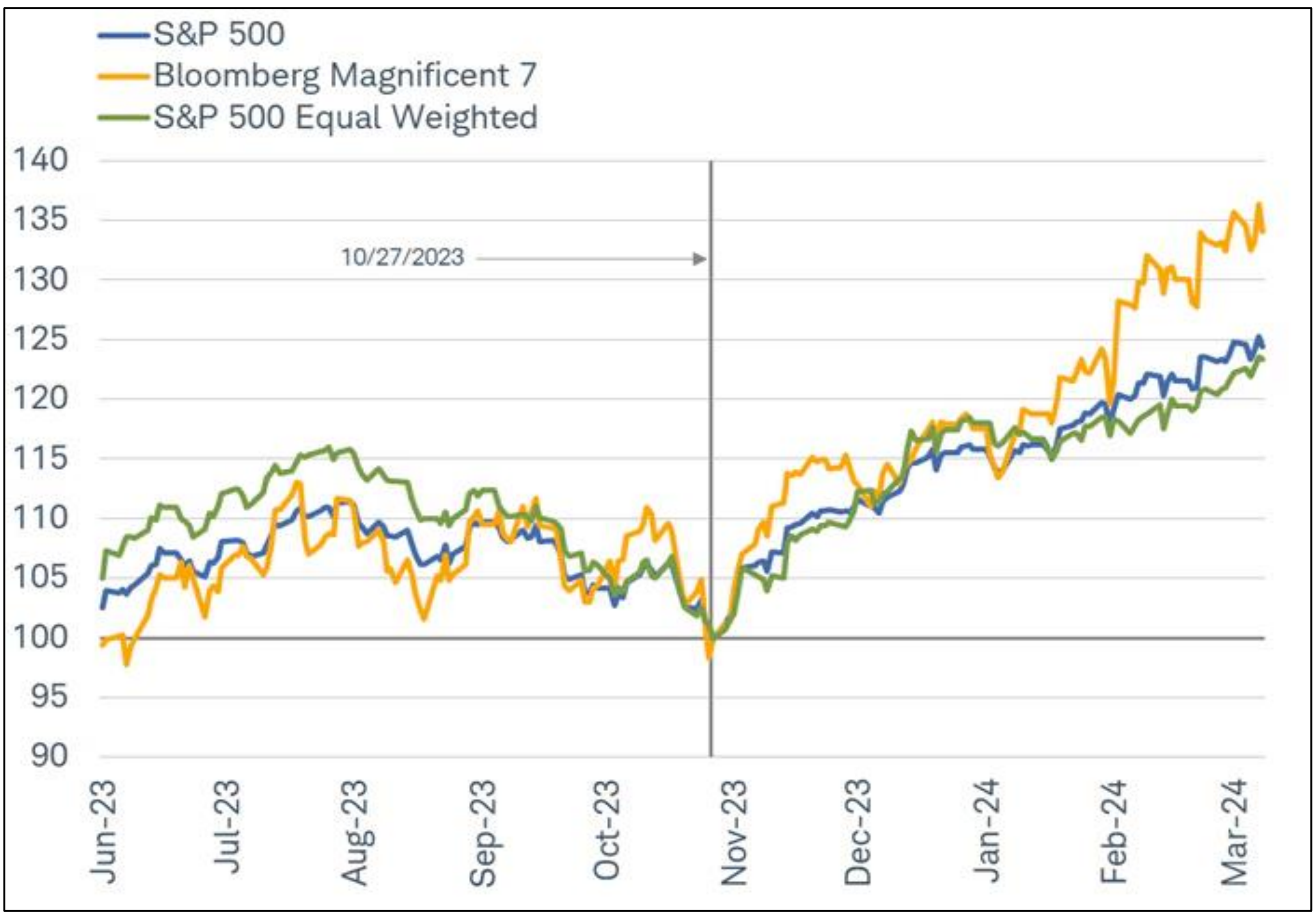
As of 04/05/2024			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	303,000	Positive	The employment situation continues to be strong as the economy added more jobs than expected. The unemployment rate fell to 3.8% and has been below 4% since early 2022. There was a net upward revision in the jobs number for the last two months.
Weekly Claims for Unemployment Insurance	221,000	Positive	Initial claims for unemployment insurance continues to be in the low 200's reflecting a strong employment situation. The four week average is a low 214K.
ISM Manufacturing Index (over 50 indicates growth)	50.3	Positive	Manufacturing activity in the US is improving as this index is above 50 for the first time since November 2022. A sharp rebound in production and new orders helped. Employment in factories remained weak.
ISM Non Manufacturing Index (Over 50 indicates growth)	51.4	Positive	The growth in services has moderated recently, however this is the 15th straight month of expansion. The price gauge fell to a 4 year low, alleviating concerns of inflation in the services sector.
Consumer Prices (Month over month change)	0.4%	Positive	Consumer prices rose 3.2% from a year ago. Core CPI, which excludes food and energy, rose 0.4% from the previous month and 3.8% from a year ago. Inflation has fallen significantly from the peak in 2022, but the last mile to tame it has been choppy.

	Latest Release	Recent Trend	Notes
Producer Prices (Month over month change)	0.6%	Positive	Wholesale prices rose the most in 6 months showing the uneven path of inflation. Producer prices have risen 1.6% from a year ago. Core prices rose 0.3% from the previous month and 2% from a year ago.
Retail Sales (Month over month change)	0.6%	Negative	US retail sales improved from a sharp decline earlier in the year, helped by rising gas prices. Although the US consumer is in good shape, retail spending has been moderating lately impacted by the cold weather, inflation and reduced savings. Spending is shifting to services from goods.
Consumer Confidence (Conference Board)	104.7	Positive	Consumer confidence has been hovering over 100 and has held steady recently. Based on surveys, consumers are feeling good about present conditions in general, but are concerned about food, gas prices and the political environment.
Durable Goods Orders (Month over month change)	1.4%	Negative	Orders for durable goods improved sharply from the previous month. Business spending on equipment improved as well. Core capital goods, which strips out defense and aircraft orders improved to 0.7% - it businesses are willing to spend on investments.
Industrial Production (Month over month change)	0.1%	Negative	The latest number was better than expected, but the previous two month's numbers were revised down. Utility output fell sharply.
Capacity Utilization	78.3%	Positive	Capacity utilization is down from over 80% in 2022, but is hovering around its long term average.
Housing Starts	1.521 Million	Positive	Housing starts is strong, in particular single family housing starts that hit a two year high. Price cuts and incentives to some extent eased the hurdle of high mortgage rates for first time home buyers. Builders are also reducing the size of homes to manage costs.
Home Prices (Case-Shiller Home Price Index- Year over Year)	6.6%	Positive	The 20 city index is at an all time high, so is the national index.
GDP (Real, Annualized)	3.4%	Positive	GDP growth in the 4Q of 2023 was lower than the previous quarter, but at a good level. Consumer and Government spending as well as residential and non residential investment spending contributed to the growth.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ismword.org, www.nahb.org

US stocks, especially those of larger companies, rose in the first quarter of 2024, helped significantly by continued investor excitement about artificial intelligence and their hopes for interest rate cuts by the Federal Reserve (Fed). While the largest stocks in the technology sector (aka 'The Magnificent 7") rose the most, stocks in sectors such as energy, industrials and financials kept up with the overall market, as the stock market rally showed welcome signs of broadening out. As a result, an index of S&P 500 stocks with equal weighting kept pace with the market cap weighted index (Fig 1). The only sector in the S&P 500 index that posted a negative return was REITs, which fell after a strong fourth quarter. Stocks of smaller companies lost ground because of uncertainty about the timing and magnitude of interest rate cuts and investor angst that high interest rates could tip the economy into a recession, which would hurt smaller companies more than larger ones. Non-US stocks rose as well but could not keep up with the blistering pace of domestic stocks. Japanese stocks rose sharply and reached the highest level since 1989. Interest rates rose during the quarter and interest rate sensitive bonds fell (Bond prices are inversely related to interest rates). Credit sensitive bonds rose during the quarter benefiting from the continued strength of the US economy.

Fig 1: The US stock market rally has broadened to include stocks other than 'the magnificent 7'



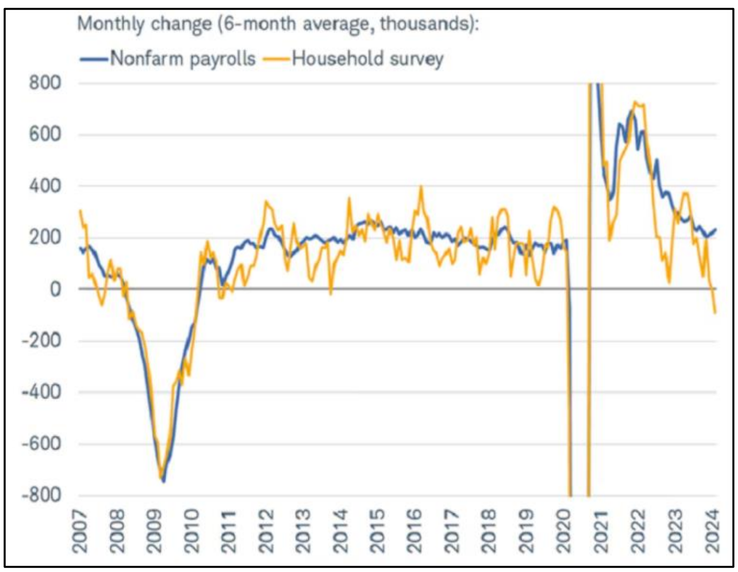
Source: Charles Schwab. (Magnificent 7 = Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla)

The US economy is growing at a decent pace, defying all expectations of a recession that pundits had previously called for due to rising interest rates. Employment continues to be strong despite anecdotal evidence of large layoffs, especially in the technology sector. Under the surface of strong headline employment growth there are some worrying signs such as a sharp increase in part-time employment and a rising unemployment rate. The unemployment rate is calculated from the household survey, which has been weaker than the payroll numbers which is calculated from the establishment survey (Fig 2). However, there is no denying that there are plenty of jobs being created in the economy. This has supported consumer spending which is more than 2/3rd of the US economy. Among businesses, the services sector continues to grow, and the manufacturing sector has recovered from the weakness seen in previous quarters and is growing as well.

While inflation has declined from the peak in 2022, the last mile to bring it to a level that would be acceptable to the Fed has been bumpy (Fig 3). This has led to uncertainty among investors about the direction and magnitude of interest rates. The Fed Chair Jerome Powell has recently reiterated that interest rates are likely to trend lower from here but has not given the specifics of cuts, except to say that the Fed would need more data showing that inflation is heading toward its 2% target level, before initiating rate cuts. Interestingly, the financial market now expects a smaller number of rate cuts than the members of the Fed.

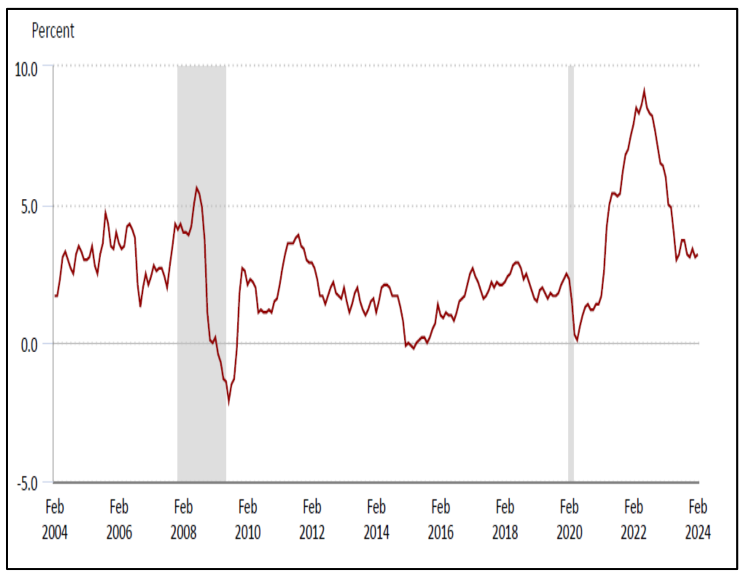
One of the risks facing the US economy (Apart from politics and geopolitics) is the declining valuation of office spaces, which could adversely impact municipal finances as well as smaller banks. However, as of now the situation seems well contained and there is a perception that the Fed and the US Treasury are prepared to take action to contain any stress in this sector.

Fig 2: Household survey vs payroll.



Source: Charles Schwab

Fig 3: CPI (12-month change)

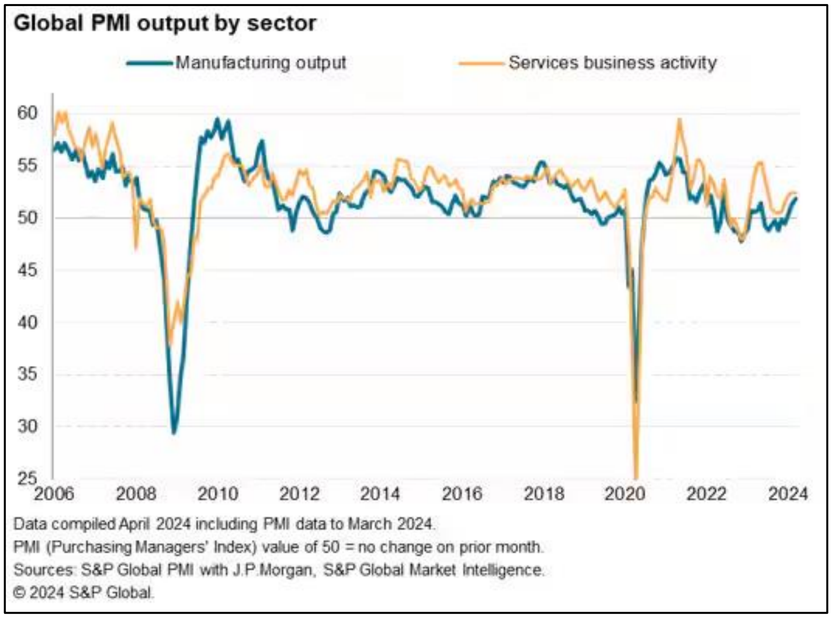


Source: US Bureau of Labor Statistics

Like the US economy, economies around the world are recovering from the downturn last year. The S&P Global Purchasing Manager's Index surveys show that the global economy gained growth momentum for a fifth successive month in March. The Index, which covers manufacturing and services in forty countries, hit 52.3 in

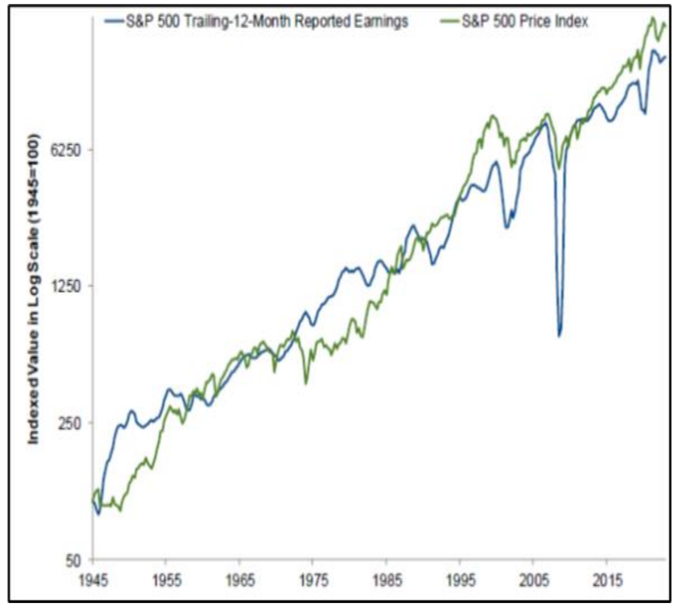
March reflecting the momentum. The surveys also show that the recovery is broad based, as both the services and manufacturing sectors are expanding (An Index level over 50 as see in Fig 4)

Fig 4: Global manufacturing and services sectors are growing.



Source: S&P Global

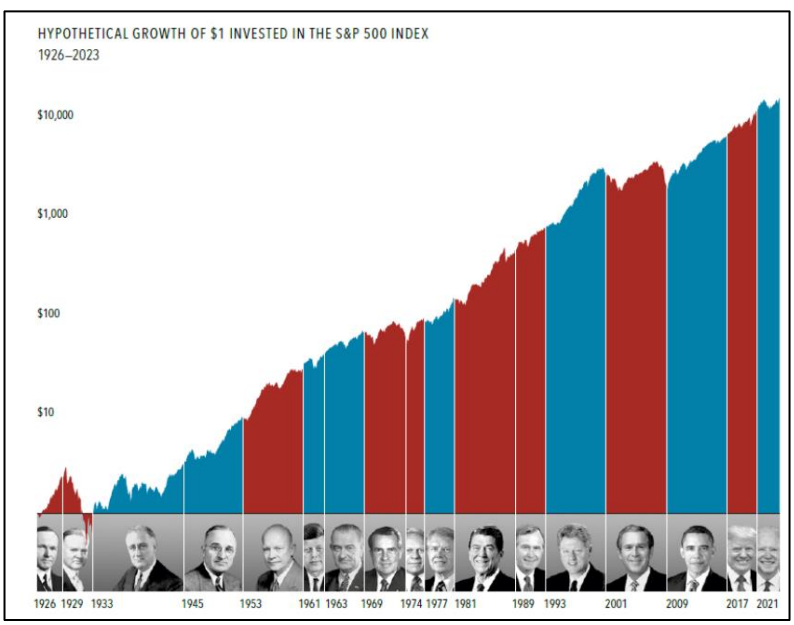
Fig 5: S&P 500 price vs earnings



Source: Goldman Sachs

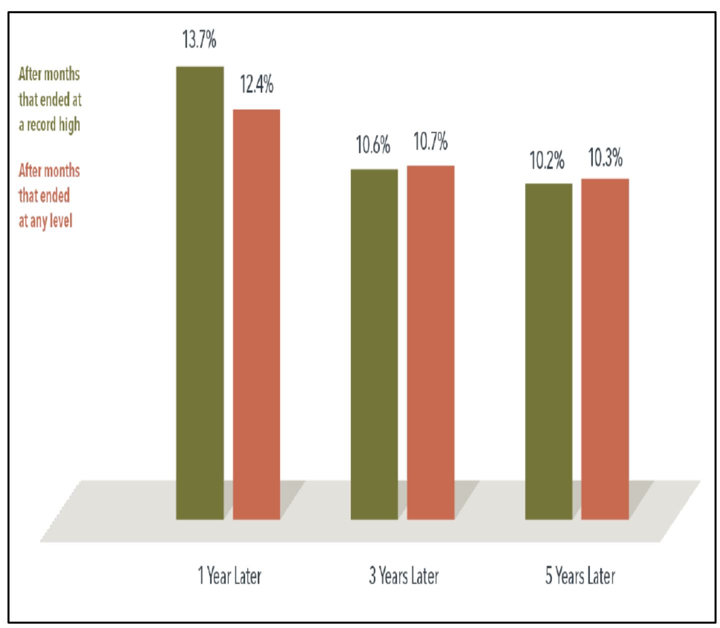
US companies that are members of the S&P 500 index will start reporting first quarter earnings and as a group they are expected to show that earnings grew 3.2% from last year. If that were to happen, it would be the third straight quarter of year over year earnings growth. Continued earnings growth bodes well for stocks, as over the long-term stock prices track earnings growth (Fig 5). Currently, stocks are priced at 21 times their expected earnings over the next 12 months, which is above the 30-year average of 17 times.

Fig 6: Stocks and the party in power



Source: Dimensional Fund Advisors

Fig 7: Stocks after making all-time highs.



Source: Dimensional Fund Advisors

The US Presidential election & the stock market

The 2024 US election is likely to be a contentious and chaotic one. Politics tugs at people's heartstrings and they are likely to look for connections between which party wins and the future path of stock prices. However, as seen in Fig 6, historically no matter which party got the reins to the White House, stocks have appreciated over time. While Government policies have an impact on stock performance, there are other factors that are as important if not more important, such as actions of the Fed, technological innovation, and corporate efficiencies.

Stock performance after making all-time highs.

The US stock market hit an all-time high in January 2024 when it surpassed the previous peak set in 2021. Since then, it has continued to rise, and investors are beginning to wonder if this is a peak from which stocks can only fall. However historically, reaching an all-time was not a reason for stocks to drop. In fact, in the 1163 months between 1926 and 2022, stocks reached an all-time high 30% of the time according to research by Dimensional Fund Advisors. After setting an all-time high, stocks were up one year later 81% of the time and were up 5 years later 86% of the time. The annual returns in those instances were comparable to any other time as seen in Fig 7.