Market Update

First Quarter 2024

The S&P 500 has continued its steady ascent that started at the end of last October, finishing the first quarter up about 27% on a price basis since then, and about 10% year-to-date. In 2023 only three sectors outperformed the S&P 500, and by wide margins, but the rally has broadened considerably. In 2024 several more have outperformed or are at least inline, and the dispersion of sector returns is significantly lower. After all the attention paid to the leadership concentration in last year's S&P 500 returns, the index has succeeded despite year-to-date drops of 11% drop in Apple and a 29% in Tesla. The meaningful increase in the yields of the 2-yr and 10-yr Treasurys during the first quarter might have been expected to be a headwind to equity valuations, but much of the recent price gains are attributable to multiple expansion.

Equity Markets (Total Return)	1Q'24	1-Year
Dow Jones Industrials	6.1%	22.2%
S&P 500	10.6%	29.9%
S&P 400 Mid-Cap	10.0%	23.3%
S&P 600 Small-Cap	2.5%	15.9%
MSCI All-Country World	8.3%	23.8%
MSCI Foreign Developed Markets	5.9%	15.9%
MSCI Foreign Emerging Markets	2.4%	8.6%
US Bond Markets (Total Return)	**1Q'24**	**1-Year**
Bloomberg US Treasury	-1.0%	0.1%
Bloomberg US Municipal	-0.4%	3.1%
Bloomberg US Corporate Investment Grade	-0.4%	4.4%

Inflation's steady fall from the peak in mid-2022 has stalled around 3.5%, well above the 2% average that the Federal Open Market Committee (FOMC) targets over time. Financial conditions are being tightened by the Fed not purchasing new bonds with maturity proceeds of its existing holdings, and while the FOMC stopped increasing short-term rates last year, the real cost of borrowing has continued going up as inflation has come down. There has been consensus around at least some amount of interest rate cuts this year, but expectations and forecasts for the number of rate reductions have come down since December with the economy showing strength. For some reason, throughout this entire post-pandemic interest rate cycle investors have tended to expect a flatter and lower path of interest rates than what the FOMC is forecasting at any given moment. While rates might end up being "higher for longer," equity investors have not been deterred because it reflects a better outcome than other possible scenarios. Rates are not higher for longer because the FOMC is struggling to get inflation down from truly elevated levels, and they are not needing to rush to lower them in response to an impending economic slowdown that was so widely expected to be long-since upon us.

While surely every reader is well aware of the emergence of artificial intelligence (AI), we suspect some if not many may not yet have used some of the available AI chat-bots. What follows is how Alphabet's free offering, named Gemini, responded to the prompt "write an approximately 200-word review of the

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first quarter of 2024 in the US capital markets." The result is impressive, although we are not quite ready to give up writing this piece in-house as some of the nuance is slightly off target:

"The first quarter of 2024 marked a dramatic shift in the U.S. capital markets. After a period of anxiety, investor sentiment flipped bullish on receding inflation concerns. The Federal Reserve's perceived dovish stance, hinting at potential interest rate cuts, further fueled optimism. This "risk-on" environment sent equity markets soaring, with the S&P 500 reaching all-time highs. The tech sector, particularly companies at the forefront of artificial intelligence, were key drivers of this rally. The bond market also saw a revival, with issuance rising significantly compared to the previous year. This presented a golden opportunity for corporations, especially those with investment-grade ratings, to raise record amounts of capital at stable borrowing costs. The IPO market, dormant for some time, displayed signs of life with the highest number of traditional offerings since late 2021. Overall, the first quarter painted a picture of a revitalized capital market. Optimism reigned supreme, with deal activity flourishing across various sectors. However, some analysts remained cautious, questioning the disconnect between a seemingly bullish stock market and a bond market still pricing in potential economic slowdown. Only time will tell if this market exuberance is sustainable."

Obviously, investor interest in all things related to AI has been extremely heightened since ChatGPT was launched in late 2022. The stock prices of the most immediate beneficiaries of what is presumed to be near-limitless spending on the infrastructure to support AI's widespread use have skyrocketed. The degree to which some of those companies were deliberately positioned for the first wave of spending varies, and to the extent some have limited or no competition today, that is unlikely to stay the case for long.

This trend, and its economic effects are things we are paying close attention to. At a very high level, there are no clear losers in a move to the adoption of AI. Yes, particular sorts of jobs might be lost over time (certainly not yet reflected in the current tight job market), but there are no particular sorts of companies that are now poor investments to be avoided simply because AI is increasingly viable. Also, the widespread adoption of AI has the potential to drive a productivity-led economic boom which benefits most all companies. Shares in the initial beneficiaries of spending on AI infrastructure are not yet widely held in BFO client portfolios. However, our clients do tend to have significant exposure to the biggest spenders and early adopters, which are most likely to develop commercial uses for it, as well as secondary beneficiaries such as utilities and industrial companies which will benefit from increased energy demand and the need for spending on energy infrastructure.

The information contained in this market update has been taken from sources which we deem reliable. We do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed herein reflect our judgment at this date and are subject to change.

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