April 5, 2024

MARKET SIGHT LINES

A Strong First Quarter 2024: We're (Still) Watching for a Slowdown

By Michael O'Keeffe, *Chief Investment Officer*

The U.S. stock market posted strong first quarter results, riding a wave of optimism anchored in a still-strong economy and the potential of artificial intelligence (AI). Both the market impact and potential of AI is seen in the results and performance of the large, tech-oriented "Magnificent Seven" (M7) – Google parent Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla. While as investors we can appreciate these strong results, we're still watching for a slowdown. In this week's Sight|Lines, we review these strong first quarter results and the potential for cracks that may lead to a slowdown and a possible market pullback.

THE TAKEAWAY: DESPITE FIRST QUARTER STRENGTH, IT'S IMPORTANT TO THINK DIFFERENTLY

With positive market and M7 results in the first quarter, we're watching for a slowdown.
In summary:

- The S&P 500 marched higher in the first quarter, reaching an all-time high 25 times.
- The M7 again outperformed, but the rest of the index posted a very good return as well.
- S&P 500 earnings grew 4.1% in the first quarter compared to a year ago, well above the consensus forecast of 1.5%. Absent the M7, earnings declined 4.3%.
- Earnings were more dispersed, with several sectors posting double-digit earnings growth, and others experiencing double-digit declines.
- Fed models are signaling strong economic growth in the first quarter, leading to an increase in Fed officials' median GDP growth forecast for 2024.
- The consensus GDP 2024 forecast sits at 2.2%, above the 1.3% level from January.
- Slowdown catalysts might include the Fed needing to keep rates higher for longer, a softening of jobs and consumer activity, an M7 performance pause, and corporate headwinds that may mute the results of what have been strong-performing companies.

IN-DEPTH: STOCK MARKET RESULTS WERE VERY GOOD IN THE FIRST QUARTER, BUT WE CONTINUE TO WATCH FOR A SLOWDOWN THAT MAY LEAD TO MARKET WEAKNESS

Markets were positive in first quarter, riding the wave of M7 strength. As we look forward, we challenge ourselves to think differently. We anticipate a slowdown, which may have market implications. Going deeper:

- Equity market performance was very good in the first quarter, with the M7 companies leading the way:
  - The S&P 500 returned 10.6% over the period, with the M7 posting a 13.5% return and rest of the S&P 500 earning a still very good return of 9.4%.
  - Other markets and market segments posted good results, but lagged the U.S. large cap strength:
    - The small cap Bloomberg 2000 was up 3.8%.
    - Non-U.S. developed markets, as measured by MSCI EAFE, were up 5.7%, with MSCI Japan leading the way with a 10.4% result.
- Headline S&P 500 earnings were positive in first quarter, but there are signs of weakness:
  - While the 4.1% first quarter year-over-year growth rate is positive, when we exclude the M7 earnings growth of 59%, the other companies had an earnings decline of 4.3%.
  - While four sectors (communication services, consumer discretionary, utilities, and information technology) posted double-digit earnings growth, four (energy, materials, healthcare, and financials) posted double-digit declines.
- 2024 economic results are expected to be positive, with the consensus growth forecast at 2.2% and the Fed's Summary of Economic Projections median estimate at 2.1%, both likely informed by a strong first quarter, estimated by the Atlanta Fed's GDPNow to have grown at an annualized rate of 2.3%.
- We see a number of potential catalysts for a slowdown:
  - Fed officials have reiterated their intent to keep rates higher for longer, with Chair Jerome Powell recently stating: "We do not expect that it will be appropriate to lower our policy rate until we have greater confidence that inflation is moving sustainably down toward 2%."
  - We're watching for more muted consumer activity, fueled in part by a softer job market.
  - Should the larger companies (like the M7) posting strong positive earnings growth experience a slowdown, a performance reversal can be dramatic. For example, Tesla was down 29.3% and Apple was down 10.8% in the first quarter.

CONCLUSION

Driven by optimism anchored in a still strong economy and the potential of artificial intelligence, the U.S. stock market posted very strong first quarter results, again led by the Magnificent Seven. While we, as investors, can celebrate these strong results, we challenge ourselves to think differently and are watching for a slowdown.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

Stifel, Nicolaus & Company, Incorporated | Member SIPC & NYSE | www.stifel.com 0424.6528033.1