Kim Brown:
Good morning. I'm Kim Brown, President at JNBA Financial Advisors in Minneapolis, Minnesota. We're recording this discussion on April 9th, 2024. I'm with two members of our investment committee, Mark Rosenkranz, an Investment Strategist, and John Foster, a Senior Advisor and Investment Strategist. Good morning, Mark and John.

Mark Rosenkranz:
Hey, good morning.

John Foster:
Good morning, Kim.

Kim Brown:
Mark, we just wrapped up the first quarter of 2024. Can you share a little bit about what has driven the market so far this year?

Mark Rosenkranz:
Yeah, absolutely. And I think before we dive into what's played out in the last three months or so, I think it's helpful to take a look back at 2023 quick. And the three main themes we saw last year were:

- Rates being raised up until the summer where they reached their plateau.
- The small handful of large U.S. tech stocks were driving overall market performance, which led to a solid year for the stock market but kind of mixed returns on a stock-by-stock level.
- And in Q4 of last year, we saw bonds starting to rally at the end of the year on expected rate cuts. They were factoring about six or so at the end of last year, starting as soon as this March.

So kind of fast-forward to today, what we've actually seen out is in the backdrop, unemployment has remained healthy. Inflation has been the kind of main sticking point. And what we've seen from inflation ticking up is the reluctance of the Fed to start cutting rates until they get the kind of “all clear” signs. So what that's caused is yields to tick back up and really bond markets have pretty flat performance to start the year. So a lot of that kind of same feeling that we had for most of 2023 kind of fast-forwarded back to 2024 playing out.

The good news is that the backdrop for the economy is still remaining fairly strong. We've had good corporate earnings, we've had good unemployment, and really the Fed still continues to share the sentiment that cuts will be coming at some point this year, but they want to be very sure of inflation. We do have an inflation print coming tomorrow morning, which should share some more light on the future path for inflation. But I think when you kind of look at the start of 2024, we've had a lot of the same sentiment as 2023. I think the main surprise though is how the stock market has performed. We've had one of the best Q1s in almost over a decade, and really that is driven by a continued strong backdrop in both corporate earnings and unemployment.

If you would have told me at the start of this year that yields would tick back up to November highs and the stock market would be up 10%, I would have been fairly surprised. And I think underneath the surface, we've also seen some encouraging trends within the stock market. We've seen some good broadening amongst the performance of the Magnificent Seven that kind of drove the performance all of last year compared to the other 493 within the S&P 500. We've seen a little bit of value out-performance. We've seen some upticks in bid caps and better performance in small-cap. And really that kind of broadening health for the stock market is much more encouraging than maybe the small handful of names that drove the markets last year.

I think when you kind of look forward to what's been driving that, we have seen some earnings pick up. 2023 was the year where not only the Magnificent Seven led in terms of price appreciation, but they were the main catalyst for driving earnings growth for the market. And really what you're starting to see across the economy and across the stock market is small, mid, larger companies, they're all starting to get more of that piece of the pie where they're starting to also illustrate earnings growth. And I think that's kind of one of the key aspects that we're monitoring going forward, which John will touch into is just keeping an eye on that earnings growth as one of the bellwethers as unemployment and inflation are kind of more range-bound in their stickier data points and their trends.

Kim Brown:
And how has all this impacted returns for diversified portfolios across JNBA?

Mark Rosenkranz:
Yeah, so as I laid out, the start of 2024 is a lot like 2023 where it's been a lot of U.S. large-cap driven performance. We did see some improved mid-cap, but on the bond side, it has been a pretty flat return environment. And I think it's been almost two years since we've had that sentiment. And I know it's fairly frustrating for a lot of bondholders, but really we are still clipping a fairly high coupon. And really investors for our fixed income side just need to see as rates to just maintain or even potentially go lower as the Fed eventually cuts rates.

But for the meantime, what we saw in Q1 was really just the larger equity portfolios had a little bit more outperformance. At JNBA, we have a lot of levers that we try and pull when in terms of trying to add alpha for long-term strategies. And I'd say one of the bigger levers that we pull is our broad asset allocation. That's our tactical decisions to go more or less into stocks or bonds at any given time. And at the start of the year, our investment committee, which we meet every week, and we use a lot of internal and external resources, we went overweight stocks across all our strategies right at the end of December and the start of January. So really what we saw of that is that overweight to stocks was directly in the S&P 500. And so far in Q1, the S&P 500 is up about 10%, and the broader fixed income basket is about flat. So on a net basis, that's been a fairly positive trade for us. And that's where I'd have to note it's the timing has worked out extremely well. It's not always going to work out like that, but for now, that increased equity exposure has been rewarded so far in Q1, and so we're fairly pleased with performance so far.

Kim Brown:
That's great. John, after such a strong start for equities in Q1, what is our investment committee anticipating for the rest of the year and even beyond?

John Foster:
Yeah, Kim, I think looking at the rest of the year, we'd expect volatility to pick up a little bit here. You know, it is an election year. A lot of times in election years, you'll get a pretty good start to the year. And then as you work into summer, volatility tends to increase up until the time of the election. So I think we're certainly after a very strong start to the year, the market's probably prone to a little bit of extra exuberance, perhaps a bit too giddy, so to speak, after a real strong start. And a lot of times, summer into the election, you'll see some pullbacks, you'll see some volatility, and then the market tends to be quite strong from election day to inauguration. So then perhaps a Q4 rally that lasts into the beginning of 2025. So that'd be what we'd expect in the short run.

I think more intermediate term to longer term, we'd really look at valuations to say, okay, well, what's going to be areas of the market that you'll want to be exposed to? And to give an idea, Mark talked a lot about large-cap growth and how that's really led the rally. Since the market bottomed back in 2022, we had that nasty bear market in 2022 where large-cap growth stocks lost almost 40% of their value, and they've been the area of the market that's really driving the market higher the last five quarters. But if you look at valuations, large-cap stocks across the board trade at about 22 times earnings with a 1.4% dividend yield. Large-cap growth stocks trade at 30 times earnings with a dividend yield of just 0.6%. So those are valuations that are very fully valued. But then other areas of the market, for example, like small-cap value stocks, trade at just 12 times earnings and have almost a 3% dividend yield - so about a third the valuation and about two times the yield of their large-cap counterparts. And then foreign shares, both international and emerging markets trade at just 12 to 13 times earnings and have about a 3.5% dividend yield. So you're getting much better valuations, much lower yields from small-cap and foreign shares than you are large-cap shares. Valuation is always a terrible indication of timing. But if you're looking three to five to 10 years out, valuation usually the number one driver of performance. So in the short run, we'd expect some volatility and momentum to continue for large-cap stocks. But in the long run, really you want to be starting to get positioned for eventual leadership change to some of these areas of the market that are historically cheap.

For fixed income, as Mark had mentioned, yields got below 4% right around the start of the year on a 10-year treasury, and now yields got this week up to 4.4%. So we've seen about a half percent backup and the yield on a 10-year treasury. And bond sentiment went from a bit exuberant where people were expecting yields to continue to plummet as they were looking for six rate cuts by the Fed. And now with just two to three rate cuts priced in and bond yields back up to 4.4% on the ten-year treasury, we'd expect bonds to probably perform a bit better the second half of the year; you're getting a good amount of income and probably a chance as the Fed does eventually come through with some rate cuts, perhaps the second half of the year, some price appreciation on bonds. And so after a bumpy start to the year for fixed income, we'd expect better returns here the second half of the year for bonds.

Kim Brown:
Yeah. And John, as you mentioned, we're rapidly approaching another election season, so what are you guys thinking about what investors can anticipate as we focus more and more of our attention on election day coming up in November?

John Foster:
Yeah, I think there's ... It's an interesting election, right? Because this cycle, it's two known quantities as both candidates have served four years in office. And so a lot of times there's a big unknown in terms of what policies might be, how people might govern, and this time around what the market hates is uncertainty. But the market's seen both these candidates in action. And so there should be fewer surprises perhaps than an election where you just haven't seen people govern, you haven't seen their style of government, or what types of policies they might implement. And as mentioned though, markets do tend to have a bit of handwringing ahead of election and then are able to move past it.

Kim Brown:
Yeah. Mark, do you want to add anything to that?

Mark Rosenkranz:
Yeah, it is always a tricky time of year whenever we get to these cycles. And what I encourage anyone when they're kind of thinking about the political landscape and how it impacts your investments is kind of being aware of what's going on outside of the election, so to speak. You can look at all kinds of data of when this party wasn't president or this party held Congress or vice versa, which was better for the markets long term. And a lot of those data points, while they're true, they can be a little misleading just looking at the context of what was going on in the environment. There's been a lot of cycles of the economy from a global pandemic during the last election to wars to stock market rallies and busts. Sometimes there's a lot more going on than just the politics that are impacting markets. The headlines have been a lot more driven where you see a little bit more volatility as John touched on, but the kind of go-forward performance that can be a little bit harder to project and generally relies on more than just who's in office. Even the most aggressive policies from either candidate, those take time to play out, and those may not impact overall stock market or corporate earnings for one, two, three, five, 10 years. So it's important to kind of keep the perspective of what matters on the short and the long term for stocks and bonds and how that can be impacted by politics long-term, but how the noise can impact the short-term and increase the volatility.

Kim Brown:
Thank you, John and Mark for the great discussion today. And thanks to you, our listeners. We hope you will visit jnba.com and tune into our other podcasts and videos where we cover both investment and financial life planning topics. Thank you for your continued trust in JNBA, not just as your financial advisor, but also as your advocate. Please reach out if you need anything at all. You can find our contact information at jnba.com.

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