



## VIEWPOINTS

1<sup>ST</sup> QUARTER 2024

ADVISORY NEWSLETTER

**MARKET COMMENTARY**

**FREDRIC W. WILLIAMS**

### *Portfolios, And Cars, Should Always Have Guidance...*

Much like relying on so-called autonomous cars and driverless taxis, putting one's retirement savings on investment autopilot through the use of target-date mutual funds could be similarly perilous. Everyone's personal circumstances are unique, are not necessarily bound by a specific date, and always need the ability to adapt to the possibility of changing circumstances that might initially be exogenous to economics – such as the recent COVID pandemic. But with more employers automatically enrolling their employees in 401k plans, large plan administrators like Vanguard are seeing more than 95% of these enrollee-investors choosing target-date funds by default – somewhat reinforcing a “set it and forget it” mentality.

To put this concept in perspective all one has to do is realize that over the last 16 years target-date funds in 401k plans are now larger than all hedge funds combined – which you might think of as a fleet of self-driving cars attempting to navigate the Los Angeles freeway system at rush hour.

*“Another characteristic of target-date funds that some see as a plus and that other critics consider ominous is that owners rarely touch them, and managers are slow to tweak portfolios, even when they arguably should. For example, when the pandemic panic made stocks cheaper on reliable long-term measures than they had been in years, yet bond yields fell to levels almost guaranteed to lose money after inflation, hardly any retirement savers at Vanguard or Fidelity made a change, according to those companies. They aren't doing it today either when bonds look tempting and a handful of richly valued tech stocks are pushing the markets higher.*

*“In part because they are so big and managers so bureaucratic, tinkering with target-date funds' allocations happens slowly. The asset mix goes through a series of committees...”*

*- S. Jakab, Barron's, 3/4/24*

As we pointed out in this space last quarter, these target-date investment pools are filled with index-based funds whose holdings are overly concentrated due to their capitalization, and price, based weightings that are the basis for holdings in the funds' portfolios. This has led to investor dollars being directed, by fiat, to already price-extended large-cap equities – at the expense of other sectors, and without any regard for fundamental economic analysis.

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This dynamic, along with short-sighted investor behavior that focuses on price movement in a void, could provide opportunities going forward for prudent, and patient, longer term investors:

*“But if Green (Michael – Simplify Asset Management) and Einhorn (David – Greenlight Capital) are right, then today’s famine for investing based on value will become tomorrow’s feast. The rub is that, while a patient individual investor could buy out of favor value stocks today and eventually beat the market, pros not named Warren Buffett rarely have that luxury. Fickle investors are giving their money to winners who have no qualms riding the AI mania, or are deflecting to index funds that do so by default. Being early is the same as being wrong in money management. [unfortunately]*

*“...if critics are right, then investors whose 401(k) balances are rising on the back of concentrated portfolios – particularly younger ones – could take a disproportionate hit as more baby boomers retire and sell in the same proportion that they are buying today.”*

- S. Jakab, Barron’s, 3/4/24

Bottom line, and much like having your car aligned so that you can steer properly, we think what is arguably one of the most significant qualities of life factors for the future – your retirement savings - should similarly be tuned up regularly to make sure it adapts to changing road conditions and is pointing you in the right direction.

## **CAPITAL MARKETS OVERVIEW**

<b>Index Returns</b>			
<b>Equities</b>	<i>Percentage Change for the 1<sup>st</sup> Quarter</i>	<i>Percentage Change for the Year</i>	<i>Annualized 10-Year Returns</i>
S&P 500	<b>10.56%</b>	10.56%	12.96%
MSCI EAFE*	<b>5.78%</b>	5.78%	4.80%
MSCI Emerging Markets*	<b>2.37%</b>	2.37%	2.95%
Bloomberg Commodity Index TR	<b>2.19%</b>	2.19%	-1.56%
FTSE NAREIT Equity REIT Index	<b>-0.20%</b>	-0.20%	6.61%
<b>Fixed Income</b>			
Bloomberg Barclays U.S. Aggregate Bond	<b>-0.78%</b>	-0.78%	1.54%
Bloomberg Barclays U.S. Treasury Inflation-Linked Bond	<b>-0.08%</b>	-0.08%	2.21%
Source: BlackRock, Bloomberg, FTSE™, NAREIT®, YCharts *Returns are calculated with net dividends in USD			
<small>Index returns are for illustrative purposes only and do not represent actual performance of any investment. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.</small>			

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Despite a stubborn inflation rate of 3.5%, equity markets had a solid first quarter. U.S. large cap stocks ended the quarter up 10.6% as the S&P 500 achieved new all-time highs. The small cap Russell 2000 ended March at its highest level since January 2022, gaining 5.2% during the quarter. This strength is a welcome sign that the equity market rally may be broadening. International equity markets also ended the quarter on a strong note, with the MSCI EAFE up 5.9%.

There was a notable performance divergence among S&P 500 sectors over the quarter. Real estate, which is particularly sensitive to interest rates, fared worst (down 0.5%), while the second-worst performing sector, utilities, gained a solid 4.6%. Communication services was the top-performing S&P 500 sector over the first quarter of 2024, gaining 15.8%. The information technology sector's 12.7% gain over the quarter was largely dominated by AI-leader Nvidia, which ended the quarter up 82.5%.

Following the conclusion of the fourth quarter 2023 earnings season, earnings growth for the period was revised upwards to 4.2%. This improved outlook was primarily driven by the communication services and consumer discretionary sectors. Full-year earnings growth projections for 2024 were at 11.0% at the end of March.

Current S&P 500 valuations remain well above historical averages. The forward 12-month price-to-earnings ratio is 21.1. The information technology sector valuations reached new local highs, climbing to 28.4, as price gains outpaced earnings growth expectations. Even though tech sector valuations are high, they remain significantly lower than what was seen during the Tech Bubble, where forward PE ratios peaked at 55.2 in March 2000.

It was a slow start to the year for fixed income markets, as investors continued to wait for potential interest rate cuts. The Bloomberg U.S. Aggregate Bond Index ended the first quarter down 0.8%. International developed market bonds fared worse, ending the quarter down 4.3%.

Gold, which ended the quarter up 7%, ended the month at an all-time high, breaking above \$2,200 per ounce for the first time. West Texas Intermediate (WTI) crude prices also climbed higher over the quarter on ongoing geopolitical tensions, breaking past \$80 per barrel for the first time since November. This has led to rising gasoline prices, and the national average per gallon by the end of March was \$3.53, its highest price in more than a year.

As mentioned above, current headline inflation is 3.5%. This is well above the Federal Reserve's stated target of 2%. To address inflation, the Fed began an aggressive rate-hiking cycle which began in March 2022 when inflation was 8.5%. Despite higher rates, robust spending has kept the U.S. economy strong as confirmed by the final gross domestic product results for 2023. Fourth-quarter GDP growth was revised upwards from 3.2% to an

annualized 3.4%. The personal consumption component grew 3.3%, and the federal government component rose by 2.4% in the fourth quarter.

There were further signs of economic strength over the first quarter of 2024. Manufacturing sector activity grew for the first time since October 2022, as evidenced by the ISM Manufacturing PMI's March reading of 50.3 (a reading above 50 signals expansion in the sector). The U.S. is an outlier in global economic growth, far outpacing its developed nation peers. For example, in 2023, real GDP grew by 1.9% in Japan, 0.1% in the United Kingdom, and declined by 0.3% in Germany.

After higher-than-expected CPI reports, market expectations for both the number and timing of interest rate cuts in 2024 have fallen. In early January, markets were priced for six to seven rate cuts; however, this fell to three anticipated cuts by the end of March, more closely aligned with the Fed's predictions. Market forecasts for the timing of the first cut moved from March to July. Even though inflation has recently risen, the Fed's latest economic projections, released at the March Federal Open Market Committee (FOMC) meeting, indicate that the Fed expects faster economic growth, lower unemployment, and, notably, an increase in core personal consumption expenditures.

If inflation stays higher and long-term bond yields remain under control, higher equity valuations may be sustained, but persistently high interest rates may continue to challenge the interest-rate-sensitive areas of the market. The Fed has maintained that it will likely cut interest rates three times this year, meaning it has acquiesced to a higher inflation target. If policymakers can contain longer term bond yields while tolerating higher inflation, the economic backdrop could continue to support above-average equity valuations.

## **OPA NEWS & COMMUNITY EVENTS**

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**OLD PORT ADVISORS TURNS 30!** – Seems like it was just yesterday, but 2024 is the 30<sup>th</sup> anniversary of OPA (né Investment Management & Consulting Group in 1994), and our firm remains poised to continue moving forward into the coming decades. We'll be reaching out during the next few months to share the details of the celebration event planned for October in Portland – and we'll look forward to seeing you there!

**OPA ADDS NEW PARTNERS** – We are pleased to announce that four members of our Senior Management Team have become partners in Old Port Advisors. Tracy Rogers, Jason Foster, Ben Daigle, and Jake Kenyon have been part of OPA's leadership group for years, and now have also become Principals along with Fred Williams, the firm's original founder. They have demonstrated outstanding leadership and vision in their respective roles within the firm, and we fully expect them to continue driving growth and innovation in the years to come.

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