Economic and Market Overview

First Quarter 2024

ENVESTNET PMC

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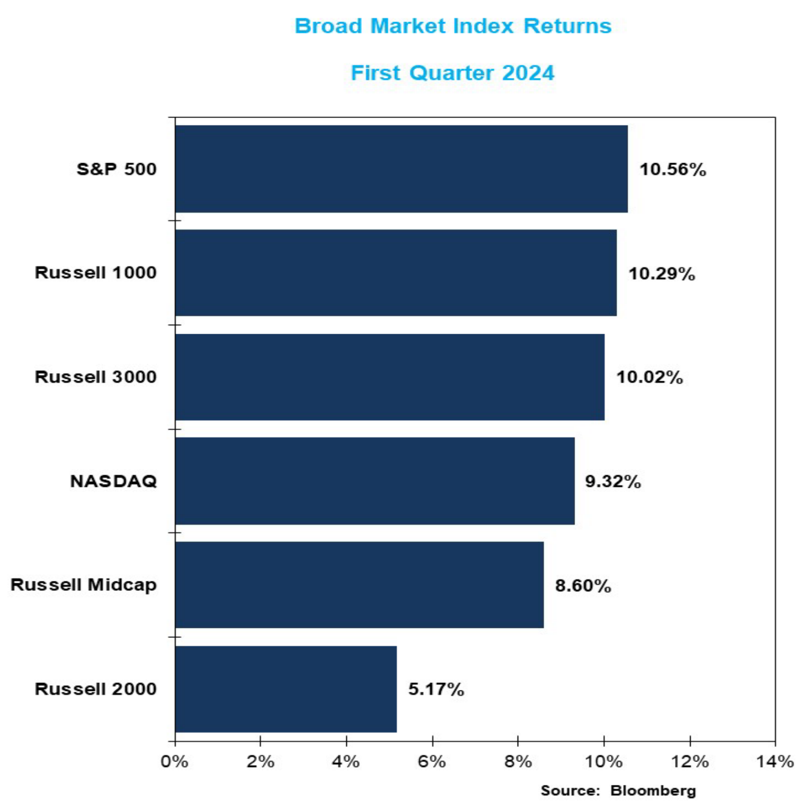
The Economy

The US economy's growth rate slowed somewhat in the fourth quarter of 2023 compared to the unsustainable pace of the prior quarter, but economists remain encouraged by the ability of the economy to perform well for so long. The economy's above-trend growth rate resiliency continues to surprise analysts, who caution that heightened interest rates and still-elevated inflation will eventually mean that consumers will increase their savings rate and growth will slow. Within this context, the Bureau of Economic Analysis released the third estimate of the fourth quarter 2023 real gross domestic product (GDP), a seasonally adjusted annualized rise of 3.4%, a slight increase from the 3.2% prior estimate, but a decrease from the previous quarter. The employment situation was strong in the quarter. The February employment report showed that employers added 275,000 jobs in the month, but that the unemployment rate was slightly higher at 3.9%. The Federal Open Market Committee (FOMC) maintained its federal funds rate target range at 5.25% to 5.50% as inflation data has stabilized at levels that are still above target, but which is expected to show improvement. The FOMC adopted an upbeat but cautious outlook on interest rates, and many analysts believe interest rate cuts could begin at the June meeting, with perhaps two additional cuts to follow later in the year.



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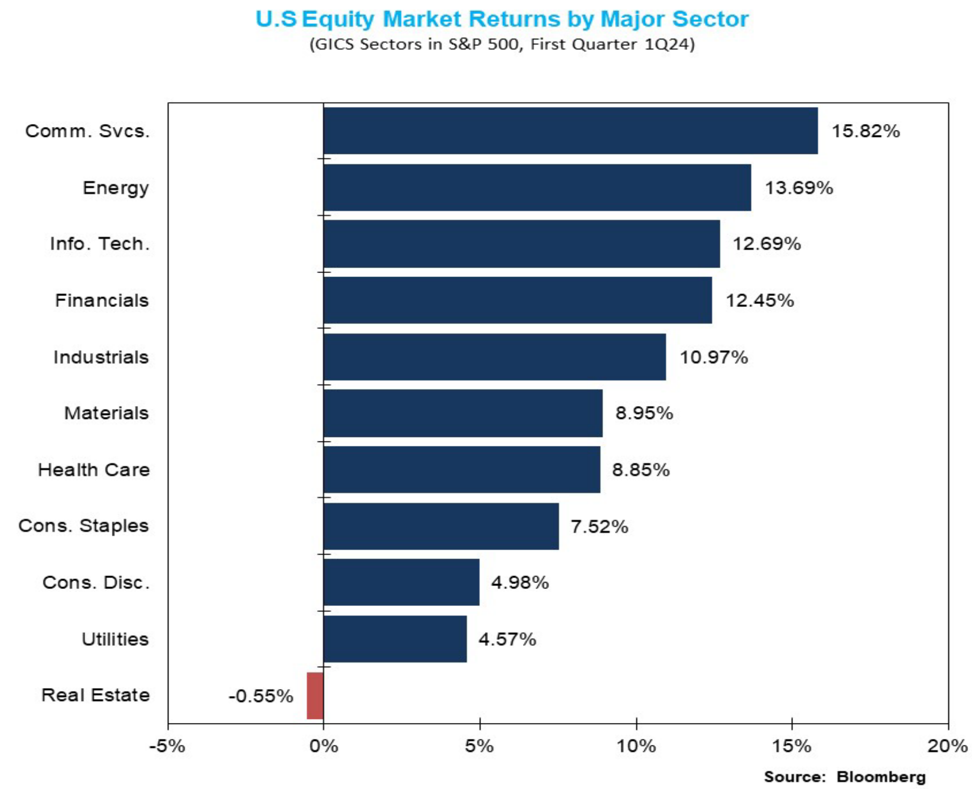
Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

In the latest data available, the Bureau of Economic Analysis released the third estimate of the fourth quarter 2023 real GDP, a seasonally adjusted annualized rise of 3.4%, a modest increase over the 3.2% increase from the prior estimate, but a decrease from the unsustainably high 4.9% number of the previous quarter. The continued strong growth has encouraged, but somewhat puzzled, economists, as the consensus had been that the FOMC's implementation of a higher interest rate regime would have had more of a negative impact on economic activity by this point. There is an expectation that the current trends in growth are unsustainable and will slow the remainder of 2024 as consumers increase their savings rates in the face of higher inflation and with interest rates remaining elevated. Primary drivers of the economy's gains in the quarter were consumer spending, residential spending, and government investment. Inventories were a drag on growth during the quarter. Corporate profits rose by 4.1% (not annualized) during the quarter after increasing by 3.4% in the prior period. Inflation expectations are in line with the prior quarter and remain elevated.



HOUSING

The housing segment remains under pressure from the weight of elevated mortgage rates, as existing-home sales, despite a modest uptick in February, continue to hover at their lowest levels in years. Mortgage rates still remain near 7%, and a decline in mortgage applications signals a softer market ahead. Analysts also point out that affordability remains near a 30-year low, making home affordability for many buyers a problem. In addition, there continues to be a disincentive for homeowners that had previously locked in low mortgage rates to sell, making the inventory of available homes extremely low. Existing-home sales for February (the latest monthly data available) edged higher by 9.5% to an annualized rate of 4.3 million units, down about 3.3% from year-ago levels. The inventory of existing homes declined to a level of 2.9 months of supply, down slightly from levels of the prior year. Existing-home prices in February increased 5.7% from February 2023. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 51, up modestly from a reading of 48 in the prior month. A reading above 50 indicates positive building conditions over the next six months.

EMPLOYMENT

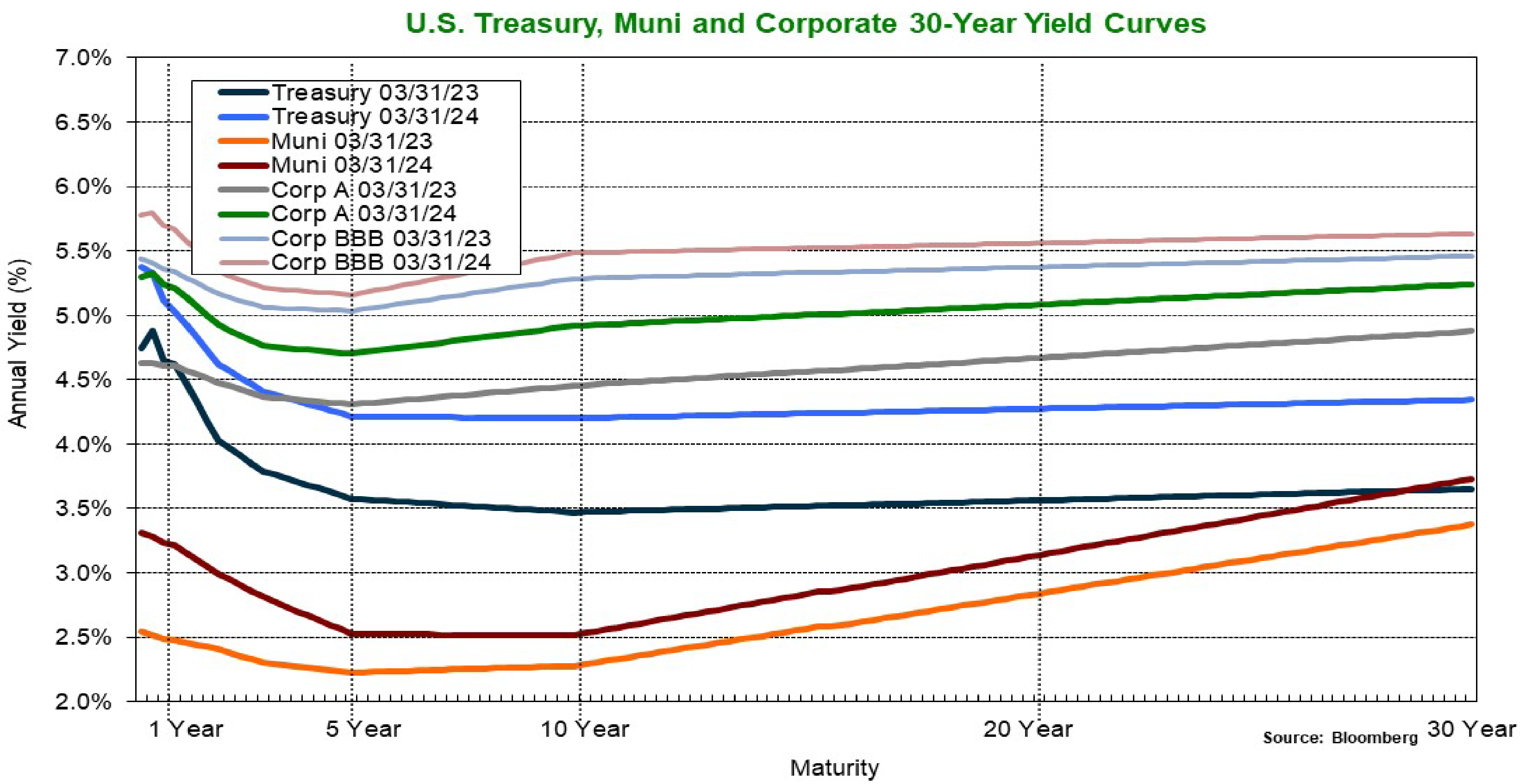
The February employment report (the latest data available) showed the labor market keeps chugging along and exceeding expectations. Employers added 275,000 jobs during the month, above the consensus expectations of a gain of 200,000. Payroll additions have averaged about 265,000 per month over the past three months, which is down modestly from the prior month. Average hourly earnings growth was 0.1% in the month, the most meager rise in almost two years. Economists indicate that, given productivity gains, earnings growth of 4% is consistent with the FOMC's 2% inflation target. The unemployment rate in February came in at 3.9% (the highest since January 2022), and the labor force participation rate eased slightly to 62.5%.

FEDERAL RESERVE POLICY

The FOMC at its latest meeting signaled that it would maintain its current federal funds rate target range of 5.25%-5.50% as the data show that inflation has stabilized, albeit at levels that are still higher than the target of 2%. The committee's Summary of Economic Projections (SEP) included an estimate that the fed funds rate would be 75 basis points lower than current levels a year from now. This is a result of the FOMC's the aggressive interest rate tightening over the past two years has worked, and that inflation will eventually return to target. The committee also had a more upbeat expectation of GDP growth for 2024, revising its forecast upward from 1.4% to 2.1%. Bond yields and equity market returns were relatively flat after the release of the SEP, indicating that the markets had already incorporated the positive news. While inflation has declined from the highest levels of several quarters ago, the early 2024 data show that it remains stubbornly high. For that reason, FOMC Chairman Jay Powell indicated the committee will wait for further evidence that inflation is receding to target before deciding to lower rates.

INTEREST RATES

Fixed income securities' prices were lower (and yields higher) during the quarter, as the bond market softened on concerns that inflation remains higher than the FOMC's target level of 2%. In addition, inflation readings from January and February showed an uptick in prices, reversing the modest decline over the prior few months. Even after the FOMC recently released its Summary of Economic Projections indicating that the committee expects the fed funds rate to be 75 basis points lower in a year, the fixed income market had little reaction. For its part, the FOMC would like to see additional data demonstrating that inflation will eventually trend to target before lowering the fed funds target rate. Many economists still believe the committee's efforts have been enough to bring inflation back to its target rate of 2% to 2.5%, and that the FOMC may begin to cut rates as soon as its meeting in June. The committee expects the fed funds rate to end the year at 4.63%, approximately 0.75% lower than current levels. As mentioned above, the FOMC maintained the target range on the fed funds rate at 5.25%-5.50%.



The shape of the Treasury yield curve remained in the same inverted shape as compared to that at the end of the fourth quarter, but it shifted somewhat higher. Yields on the very short-term maturities of up to one year rose as much as 25 basis points, while yields in the intermediate- and long-term segments of the curve increased between 25 and 40 basis points. By the end of the quarter, the yield on the benchmark 10-year US Treasury note was higher, ending at 4.20%, compared to 3.88% on December 31.

The yield on the 10-year Treasury meandered higher throughout the quarter, peaking in the latter part of March. Within this context, the yield on the 3-month Treasury Bill settled at 5.37% at the end of the quarter, slightly higher by three basis points from the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 4.21%, compared to 3.85% on December 31, and as mentioned above, the yield on the 10-year Treasury Note settled at 4.20%, compared to 3.88% over the same period. The yield on the 30-year Treasury Bond was higher, ending the period at 4.34%, compared to its beginning level of 4.03%.

Total returns on fixed income securities were largely negative during the quarter. The Bloomberg Treasury 5-7 Yr. Index declined by 0.9% for the quarter. The Bloomberg US Credit Corporate 5-10 Yr. Index fell 0.2% during the three months. High yield securities, which often follow the performance of equities, were higher, posting a gain of 1.5%. Municipals were little changed in the quarter, as the Bloomberg Municipal Bond Index declined by 0.4%. Prices of non-US fixed income securities posted losses in the quarter, as the Bloomberg Global Aggregate ex-US Index slumped 3.2%.

EQUITIES

Stock prices were mostly higher for the second consecutive quarter. With the exception of stocks in one sector, gains were broad-based. The economy’s continued above-trend growth, solid gains in the labor market, and an expectation that the FOMC will soon act to lower interest rates has buoyed stock prices. From the outset of the quarter the S&P 500 trended higher, closing out the quarter at its highest point. When the quarter ended, the S&P 500 Index had advanced 10.6%.

Performance of the 11 primary economic sectors was positive for the quarter, with the exception of one sector. Communications Services, Energy, and Information Technology were the strongest performers on a relative basis, generating returns of +15.8%, +13.7%, and +12.7%, respectively. The Real Estate, Utilities, and Consumer Discretionary sectors were the poorest relative performers, posting returns of -0.6%, +4.6%, and +5.0%, respectively.

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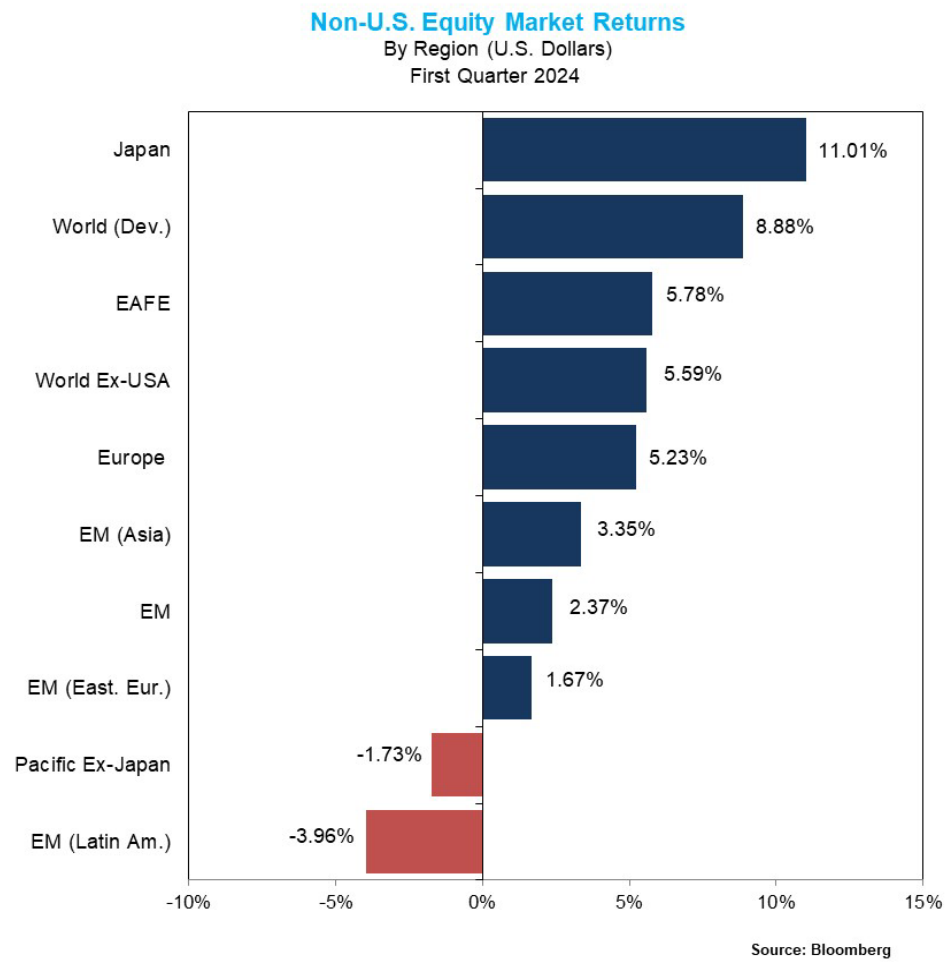
The Russell 1000 Index of large capitalization stocks generated a 10.3% total return. Within the large cap segment, growth stocks significantly outperformed value stocks. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps and finished the quarter with a total return of 5.2%. Small cap growth outperformed small cap value. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a gain of 9.3%. The Dow Jones Industrial Average of 30 large industrial companies posted a gain of 6.1%.

Real Estate Investment Trusts (REITs) were modestly lower during the quarter, with the DJ US Select REIT Index down 0.4%. Commodities posted gains, with the Bloomberg Commodity Index advancing by 2.2%.

International stocks generated positive results during the quarter, and generally were in line with US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, advanced by 4.7%. The MSCI EAFE Index of developed markets stocks was higher by 5.7%. Regional performance was mixed for the quarter. Japan was the strongest performer on a relative basis, with a return of 11.0%. Latin America was the poorest relative performer, declining 4.0%. Emerging markets stocks were higher, as the MSCI Emerging Markets Index advanced by 2.4%.



Outlook

The US economy has recently performed above-trend and at unsustainable levels, and while the consensus among economists is that there will be an inevitable slowing in the months ahead, it will still perform better than most of the rest of the world. The global economy has been hampered by the lingering effects of the pandemic and its aftershocks, and while the US has come out of it fairly well, Europe, Canada, and Southeast Asia have struggled. Economists are maintaining a cautiously optimistic outlook for the US economy, and are considering several key factors that might influence growth trajectories. The first is the FOMC's monetary policy, which analysts expect to become more accommodative in coming months following two years of aggressive interest rate increases to combat inflationary pressures. The FOMC will attempt to bring about a so-called "soft landing" for the economy, aiming to continuing to bring inflation down to its target level of 2% while at the same time sustaining consumer spending and business investment, critical drivers of economic activity. Second, the labor market continues to recover steadily and admirably from the pandemic-induced downturn, with employers adding jobs at levels exceeding expectations. The unemployment rate remains low, even though it has recently begun to tick up ever so slightly. Third, fiscal policies, including infrastructure investment initiatives and targeted stimulus measures, are expected to bolster aggregate demand and foster long-term productivity gains. These efforts aim to address infrastructure deficiencies, enhance competitiveness, and promote sustainable growth. Economists cite several risks to the generally positive outlook, including persistent supply chain disruptions which are exacerbated by geopolitical tensions and natural disasters, uncertainties surrounding trade policies, and unexpected geopolitical developments. In addition, while the presidential election cycle does not directly impact the economy, markets will be paying increasing attention to developments in that arena. Overall, while economists believe the US economy is poised for continued growth in the remainder of 2024, policymakers and investors would be wise to remain vigilant in navigating the evolving and emerging challenges.

Brandon Thomas, *Co-Founder* and *Co-Chief Investment Officer,* Envestnet

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment- grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard (GICS)** sectors, developed by Standard & Poor's and MSCI Barra.