MACRO & MARKET

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WILL THIS MOMENTUM CONTINUE?

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2024

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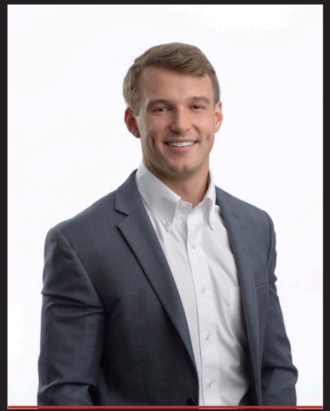


SAM CLEMENT

Associate Managing Director

A letter from our

CHIEF ECONOMIST

After a feverish end to 2023 in both the economy and the markets, the question on everyone's minds was what they would do for an encore to start 2024. Despite the somewhat softer economic data, investors apparently didn't get the news, at least not stock investors, who showed continued optimism. Unfortunately for bond buyers, 2024 started off as a repeat of 2023. Lots of red ink.

The reason behind this pattern lies in the markets' belief that the Federal Reserve will come to the rescue for whatever ails us, and will cut the overnight lending rate. Doing so will make money less expensive in the economy, which should lead to greater lending and money supply growth. Historically, this has always fueled economic activity.

As I type this at the end of the 1st quarter of 2024, investors believe the Fed will potentially cut the overnight rate by 0.75%, or 75 basis points, within this year. The hope is that it will be even more substantial than that. However, for such an aggressive monetary easing to take place, there will have to be a more pronounced decrease in the rate of inflation, and the labor markets will have to cool more than they already have.

Interestingly, there is a noticeable disconnect between the official economic data and the public's perception of reality. The reason is this: the price of essentials appears to be increasing at a higher rate than the Consumer Price Index (CPI). Further, while the official employment data remains robust, the devil is in the details and things aren't as red-hot as they were 12 months ago.

Regardless, investors drove the S&P 500 higher by 10.55% during the 1st quarter, riding heavily on the back of anything involving artificial intelligence (AI). To that end, the 800-pound gorilla in the AI world, Nvidia, was up over 82% during the first three months of the year. This on top of the company's mind-boggling 239% return in 2023.

But how much longer can the good times roll?

The probable-case scenario is that the remainder of the year will not be as easy as the 1st quarter. Unless the Federal Reserve opts for more aggressive rate cuts than anyone currently believes, the markets, already believed to be fully valued, will need a sharp increase in corporate earnings to keep the rally going at this pace. While that isn't likely, weirder things have happened, but the next two quarters could be a little choppy.

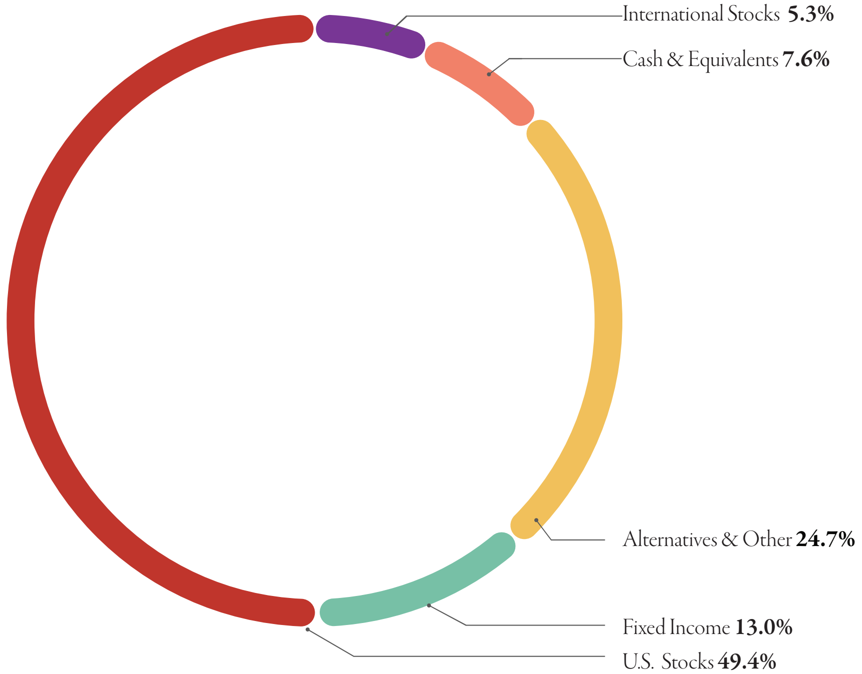
As such, the 1st quarter of 2024 was perhaps the calm before the storm as campaign season unfolds. This proves to be very contentious and could play upon investors' psyches. Even so, the markets have historically tended to do well in presidential election years, and lower rates are ordinarily a good way to soothe the nerves.

In the end, it was a great start to the year in the stock markets. The economy cooled a little but didn't go cold. The Fed is on tap for a few rate cuts this year, and the markets have historically performed well when 1600 Pennsylvania Avenue is up for grabs.

Thank you for your continued support,

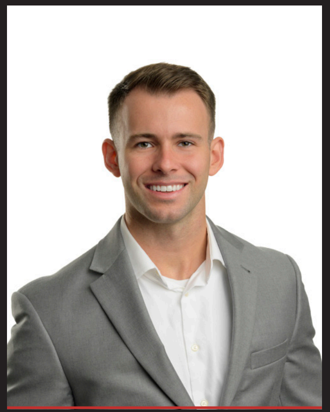
John Norris
Chief Economist

Our Investment Committee distributes information on a regular basis to better inform our clients about pending investment decisions, the current state of the economy, and our forecasts for the economy and financial markets. Oakworth Capital currently advises on approximately $2.2 billion in client assets. The allocation breakdown is in the chart below.



RYAN BERNAL

Analyst



CHRIS COOPER

Portfolio Manager

FIRST QUARTER KEY TAKEAWAYS

Twenty twenty-four kicked off with a surge in the stock market, inflation challenges, elevated interest rates and a clear indicator that artificial intelligence is here to stay.

GROSS DOMESTIC PRODUCT

After a strong finish during the last two quarters of 2023, the U.S. economy took a little bit of a breather during the quarter. This was to be expected, but it was far from the worse-case scenario. To that end, 1st quarter 2024 Gross Domestic Product (GDP) growth should be closer to 2% than the 4% it was to end last year.

THE STOCK MARKET

Stocks sometimes struggle to start the next year. This is largely due to institutional investors rebalancing portfolios and reassessing target allocations. Someone didn't give domestic investors the message, as U.S. stocks continued their surprisingly strong rally during the 1st quarter of 2024.

INFLATION FRUSTRATION

U.S. consumers continue to struggle with the concept of inflation coming down while prices are going up. It is important to remember inflation is the relative rate of change in prices. For example, if a product goes up $1 in price after having gone up $2 the previous period, inflation is actually coming *down*. However, that explanation doesn't help when you are trying to put food on the table.

ARTIFICIAL INTELLIGENCE

The buzzword or acronym for the quarter was AI. It seemed artificial intelligence was everywhere. This is equal parts exciting, scary and creepy, but accelerated computing and AI is here to stay. So, you better learn to love it.

NVIDIA CORPORATION

Prior to 2023, a lot of Americans had never even heard of NVIDIA Corp. By the end of the 1st quarter, everyone had. That is what happens when a stock goes from $146.14, as it was on 12/31/2022, to $942.89 on 3/22/2024. Let's just say, that is an impressive 15-month run.

MARKET DECLINE?

Stocks weren't cheap to start the year. They were even less so by the end of the 1st quarter rally. While it is difficult to predict a market collapse, it is equally difficult to imagine the markets will continue to soar as they did at the start of 2024.

INTEREST RATES

Investors waiting for longer-term interest rates to decline to pre-2022 levels will need patience. Absent a financial system collapse or global pandemic, it is unfathomable to imagine the 10-year U.S. Treasury note falling to less than 2% during the remainder of the decade, if ever. Inflation is too entrenched, and Washington simply borrows too much money.

THE U.S. DOLLAR

The U.S. dollar continued to strengthen during the 1st quarter against other major trading currencies. The primary reason is that interest and deposit rates have remained higher for longer than people envisioned. However, the relative underperformance of the remainder of the G-7 didn't hurt things, either.

UKRAINE

The war in Ukraine didn't show any sign of abating during the 1st quarter. However, if Kiev doesn't get a lot of money and material from somewhere in a hurry, the unpleasantness there should start winding down by the end of the year. Moscow is currently content to wage a war of attrition, one that the Ukrainians can't possibly win on their own.

OAKWORTH'S PORTFOLIO

Oakworth's Investment Committee's predisposition would be to overweight the technology sector. However, with a price-to-earnings multiple approaching levels last seen in the late 1990s, it would seem the easy money has already been made in the sector, and we have pared our weighting.

THE FEDERAL RESERVE

The markets started the quarter believing the Fed might cut the overnight rate upwards of 1.75% during 2024. They ended it convinced there will be 0.75% in cuts by the end of December. The only question remaining was/is: But when will the Fed start doing it?

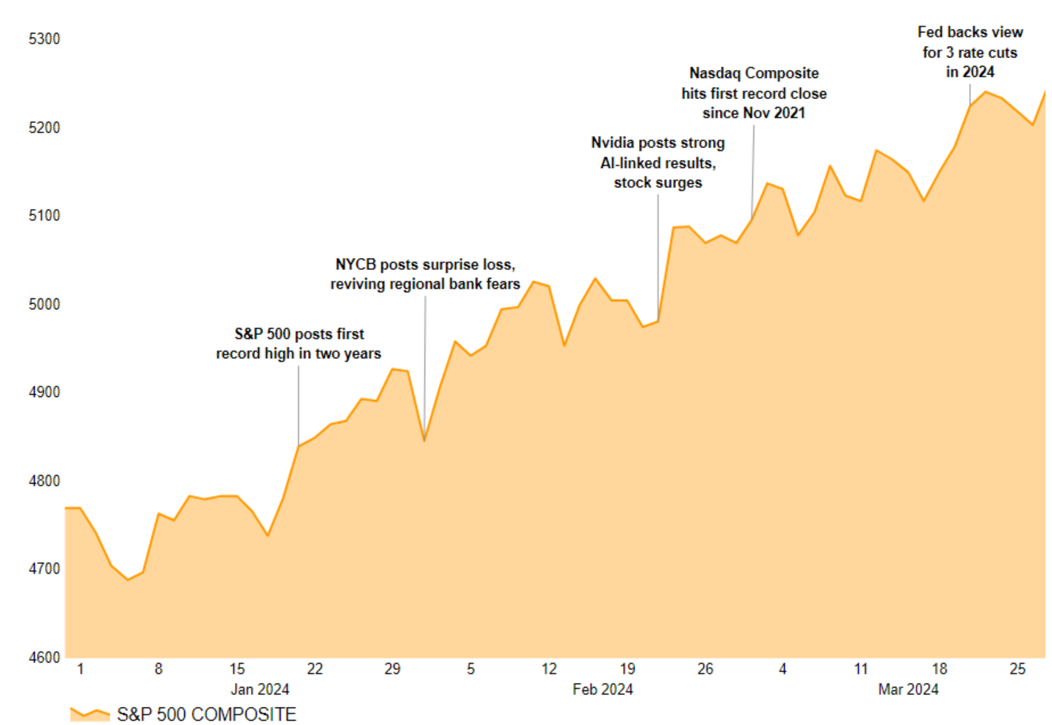
THE ELECTION

For better or for worse, the presidential primaries were effectively over by the end of the first week in March. While the candidates would like to believe this is due to how compelling they are, voter apathy and resignation had much to do with it.

CRYPTO & COMMODITIES

Cryptocurrencies and precious metals also soared during the quarter. It is too early to tell if this means investors are simply excited in these asset classes or worried about others.

U.S. STOCK MARKET'S FAST START TO 2024



Source: LSEG Datastream/Graphic by Lewis Krauskopf

ECONOMIC OVERVIEW

There's a wide disconnect between what economists are saying and what the public is feeling. It should be interesting to see who is more right as the year goes along.

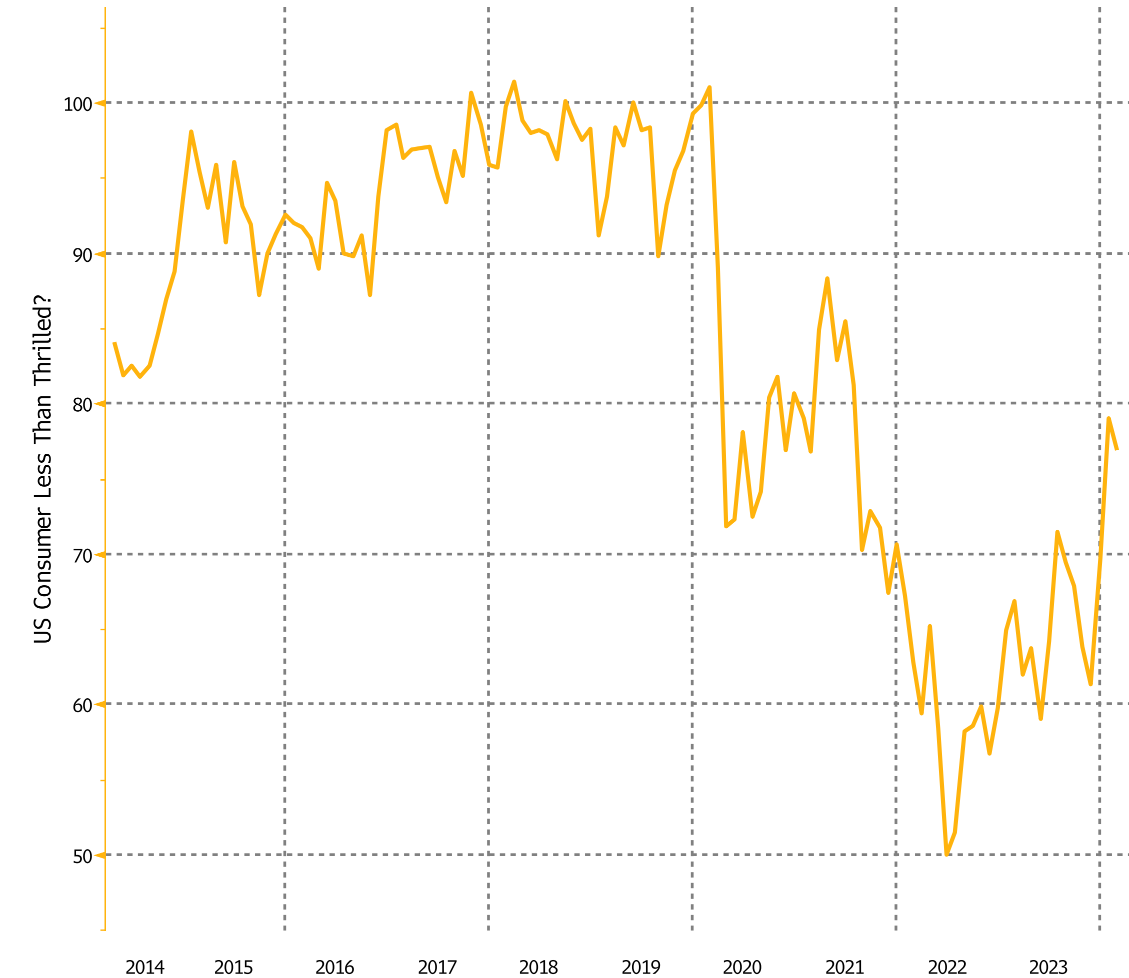
John Norris

After the strong finish to 2023, economists wondered what the U.S. economy could possibly do for an encore in 2024. After all, given the challenges of a declining money supply, an inverted yield curve and a number of other headwinds, the acceleration of the Gross Domestic Product (GDP) was, in a word, impressive. At least that is what the official data would like for us to believe.

Unfortunately for the administration, the average consumer doesn't seem to believe in their apparent good fortune. How else could you explain the persistent public opinion polls showing that the majority of Americans believe the country is headed in the proverbial wrong direction? *[see: www.realclearpoloing.com/polls/state-of-the-union/direction-of-country]*. After all, if things were going as swimmingly as Washington says they are, why are so many people so glum?

SIMPLY PUT, THERE IS A DISCONNECT BETWEEN WHAT THE GOVERNMENT IS TELLING US AND WHAT THE AVERAGE EVERYMAN'S FAMILY IS EXPERIENCING.

CONSUMER SENTIMENT ISN'T WHERE IT SHOULD BE



Source: Bloomberg

As most people know, the Federal Reserve has a dual mandate. The first is to maintain price stability, and the second is to achieve full employment. Essentially, Washington has put the central bank in charge of setting monetary policies that keep everyone working without triggering a commensurate increase in consumer prices. If that sounds like a pretty neat trick, it sort of is.

CONSUMER PRICE INDEX

So, how is the Fed currently doing? If the Bureau of Labor Statistics (BLS) is accurate, as of February 2024, the official Unemployment Rate is 3.9% and the trailing 12-month Consumer Price Index (CPI) is 3.2%. The latter is a marked improvement from February 2023, when it was 6.0%. So, we would have to give the Fed high marks, wouldn't we?

If we all lived in a relative world, perhaps so. However, since you can't fold or spend a relative dollar, I would argue we don't. People deal largely in absolutes when it comes to their livelihoods.

AFTER ALL, PRICES AREN'T GOING DOWN. THEY ARE SIMPLY INCREASING AT A DECREASING RATE.

To that end, what solace is a 3.2% CPI when it was 6.0% in February 2023 and 7.9% in February 2022?

Over the past three years, from February 2021 to February 2024, the U.S. CPI Urban Consumers index has mushroomed from 263.583 to 311.054. That is an aggregate 18.01% increase, or 5.68% when annualized.

To test this out, I went back to some historical data that Sam Clement and I compiled in 2021 and 2022. Back then, we created two different "grocery store" indices. One tracked the "cost of living" (COL) using prices from Walmart.com, which included essential items you have to buy whether you like it or not. Items like laundry detergent, shampoo, Kraft Dinners, paper towels, sandwich bread, milk, ground beef and other less-than-fun stuff.

The other list focused on so-called "cost of living it up" (COLU) items from a local upscale market. These would include things like filet mignon (prime and choice), lump crabmeat, La Crema wines, Stella Artois beer and other potential ingredients for a special meal. Not your boring Tuesday night "breakfast for dinner" sort of thing.

Over the past two years, a few items in the series have either been discontinued or have changed. For example the standard Suave shampoo size in the COL basket has dropped from 30.0 ounces to 22.5 ounces. In the COLU index, the available La Crema Sonoma Valley wines are now the 2022 vintage, not 2018. When there was a discrepancy or missing item, I tried to use the most suitable replacement or alternative available.

That is also what the BLS does when calculating the CPI. The first table below is from data I collected on Walmart.com for zip code 35209. The 2nd is from a specialty market located in zip code 35223.

COST OF LIVING

PRODUCT	MARCH 2022	MARCH 2024	CHANGE
Gain Laundry Detergent (154 ounces)	15.94	15.94	0.0%
Sparkle Paper Towels (2 ply - 6 pack)	6.83	7.28	6.6%
Scott Toilet Paper (8 pack)	5.78	6.48	12.1%
Irish Spring Soap (8 pack)	10.97	11.05	0.7%
Suave Shampoo (22.5 ounces)	1.94	1.94	0.0%
Whole Milk (1 gallon, store brand)	3.42	3.07	-10.2%
Nature's Own Honey Wheat Bread (20 ounces)	3.18	3.65	14.8%
Peter Pan Peanut Butter (28-ounce jar)	3.42	4.79	40.1%
Hellmann's Mayonnaise (30-ounce jar)	4.88	5.97	22.3%
Kraft Mac & Cheese (7.25-ounce box)	1.00	1.24	24.0%
StarKist Chunk Light Tuna (8 pack)	7.62	7.98	4.7%
Lucky Charms Cereal (29.1-ounce box)	5.48	6.48	18.2%
Tropicana OJ (52 ounces)	3.68	3.94	7.1%
Lay's Original Potato Chip (13 ounces, Party Size)	4.48	5.44	21.4%
Coca-Cola (12-ounce bottles, 24 pack)	9.68	13.48	39.3%
Ground Chuck (1 pound)	5.14	5.97	16.1%
TOTAL	**93.44**	**104.70**	**12.05%**

COST OF LIVING IT UP

PRODUCT	MARCH 2022	MARCH 2024	CHANGE
Prime Beef Tenderloin (1 pound)	30.99	32.99	6.5%
Choice Beef Tenderloin (1 pound)	26.99	29.99	11.1%
Ile de France Brie (13.2-ounce wheel)	14.49	11.19	-22.8%
Salmon (Farm Raised 1 pound)	21.3	24.32	14.2%
Ciabatta Loaf	3.99	4.99	25.1%
Russet Potato (1 pound)	1.39	1.99	43.2%
Asparagus (1 pound)	3.99	4.99	25.1%
Brussels Sprouts (1 pound)	3.99	2.99	-25.1%
Land O' Lakes Salted Butter Sticks (1 pound)	6.49	6.99	7.7%
Daisy Sour Cream (16 ounces)	2.49	2.85	14.5%
Regular Lump Crab (8 ounces)	16.99	17.99	5.9%
Ben & Jerry's (1 Pint)	5.19	5.99	15.4%
La Crema Sonoma Coast 2018/2022 Pinot Noir (750 ML)	26.99	29.27	8.4%
La Crema Sonoma Coast 2018/2022 Chardonnay (750 ML)	22.99	23.99	4.3%
Stella Artois Beer (12-ounce bottles, 6-pack)	8.99	11.99	33.4%
O'Henry's House Blend/ Peet's Ground Coffee (12 ounces)	10.99	12.59	14.6%
TOTAL	**208.25**	**225.11**	**8.10%**

What I found wasn't too terribly surprising. The cost of beef remains high but seems to be cooling off a little bit. Alcohol has gone up in price, as has pretty much everything made from grain. However, where the rubber meets the road, the COL basket, which includes the relatively inelastic items, was up 12.05% from March 2022 to March 2024. That is an annualized rate of 5.85%.

On the flipside, and quite unexpectedly, the COLU list saw an increase of 8.10%, which translates to an annual average of 3.97%. That is an almost 2% annualized difference, which isn't insignificant. All the more so when you remember that basket of boring essentials has risen in excess of 12% over the past two years.

AS SUCH, THIS LITTLE SURVEY OF MINE SUGGESTS THE COST OF LIVING IS GOING UP FASTER THAN THE COST OF LIVING IT UP.

This would certainly help explain why the American public is more sour on the economy than the administration would like for it to be.

EMPLOYMENT

Then, there is the whole issue of employment. We have been hearing about the strength of the labor market for years. However, at this time, just how strong is it really?

Since May 2020, with the exception of December of that year, the BLS has announced that the U.S. economy has added payroll jobs every month. While that alone isn't overwhelmingly impressive, the lowest monthly observation has been 136K net, new jobs, which occurred in December 2022. Further, the economy continued to create jobs at a relatively rapid pace after the Fed started raising the overnight rate.

During February 2024, the BLS reported the economy created 275K new jobs. To put that number into perspective, the 40-year average is 135K per month. As such, inarguably, employers have been adding to their payrolls at a relatively feverish pace since the worst of the pandemic. Of course, they shed a lot back in the first part of 2020, too.

Where does the data come from?

Most people don't know the BLS conducts two surveys each month for their labor data.

1. The first is the Establishment Data, which is as the name implies and from where we get the headline jobs created number. It's a payroll survey. The BLS calls employers and asks them whether or not they have been hiring people.

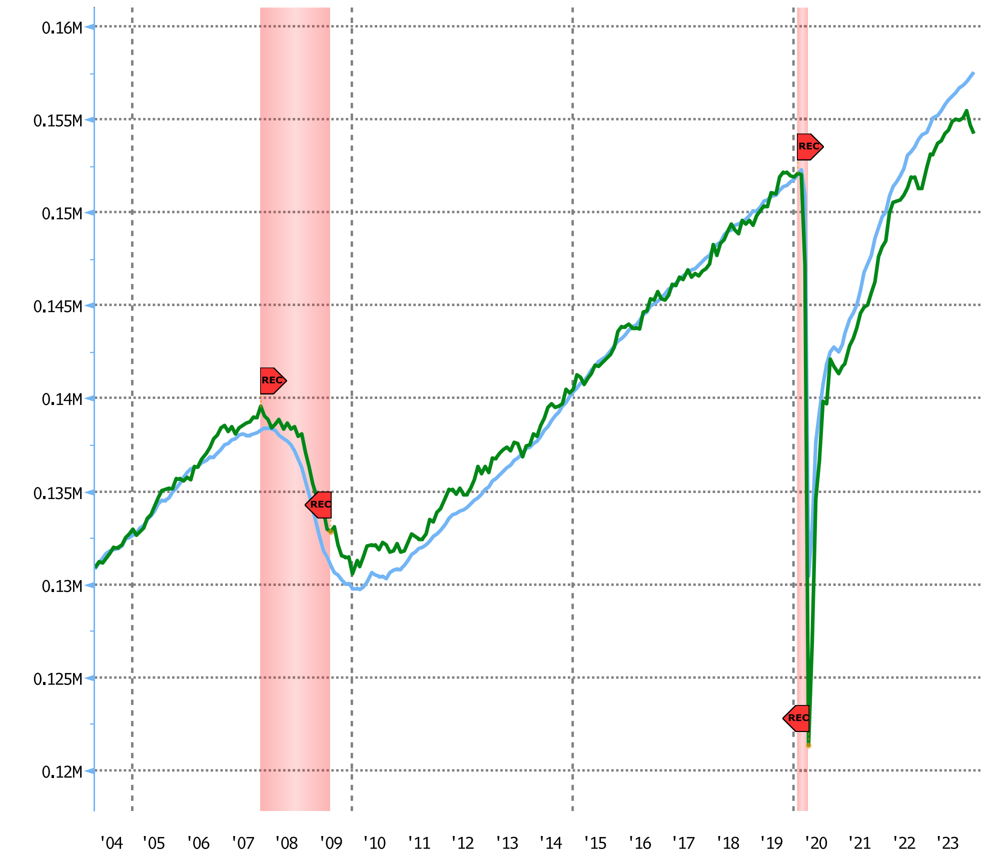
2. The second is the Household Data. This is also as the name implies and is a population survey. The BLS calls individuals and asks them about their employment status. Ordinarily, these two surveys would move in the same general direction, even if their absolute numbers didn't agree.

The Establishment Data focuses on jobs at businesses and government agencies, while the Household Data focuses on the employment status of individuals. One last thing, the Unemployment Rate comes from the Household Data.

As a result, the monthly Employment Situation report, arguably the most important economic release, is a mixture of apples and oranges.

Recently, there has been a growing gap in the two surveys. Due to axis scale problems caused by the massive job losses in March and April 2020, the chart below doesn't best illustrate the current wide disparity. Unfortunately, the best way to describe it is to give you the data.

PAYROLLS OR HOUSEHOLDS? WHO IS TELLING THE TRUTH?



Source: Bloomberg

In December 2019, just prior to the pandemic,

- The Establishment Data suggested there were 151,792K jobs in the U.S. economy.
- By comparison, the Household Data reported there were 151,909K.
- This is a relatively slight **117K difference**, which is basically a rounding error given the size of the U.S. workforce.

Fast-forward to February 2024, a little over four years later:

- The Establishment Data suggested there were 157,808K jobs.
- By comparison, the Household Data reported there were 153,985K.
- This a **gap of 3,823K** payrolls or jobs, which ceases to be insignificant.

What's more, the Household Data suggests employment recently peaked in November 2023 at 155,459K. As such, if American households are to be believed, the U.S. economy lost 1,4574K jobs over a three-month time frame ending in February 2024.

Conversely, the Establishment Data has suggested the economy created an additional 794K payrolls over that same time frame.

Clearly, that is an awkward 2,268K job differential between the two series in such a short period (1,457K + 794K).

If that weren't enough of a head-scratcher, since the end of 2019, the BLS has reported 6,016K net, new payroll jobs from the Establishment Data. That is a not quite triple the 2,076K job growth from the Household Data. Clearly, something appears to have broken down in the BLS's methodology. Outside of the bizarre economic data from 2020, the current disparities in the data sets are unprecedented.

Whew. I'll admit those last few paragraphs were a confusing read. However, trying to make sense of all the conflicting economic data has been equally baffling. Further, sometimes your eyeballs and ears know what they know.

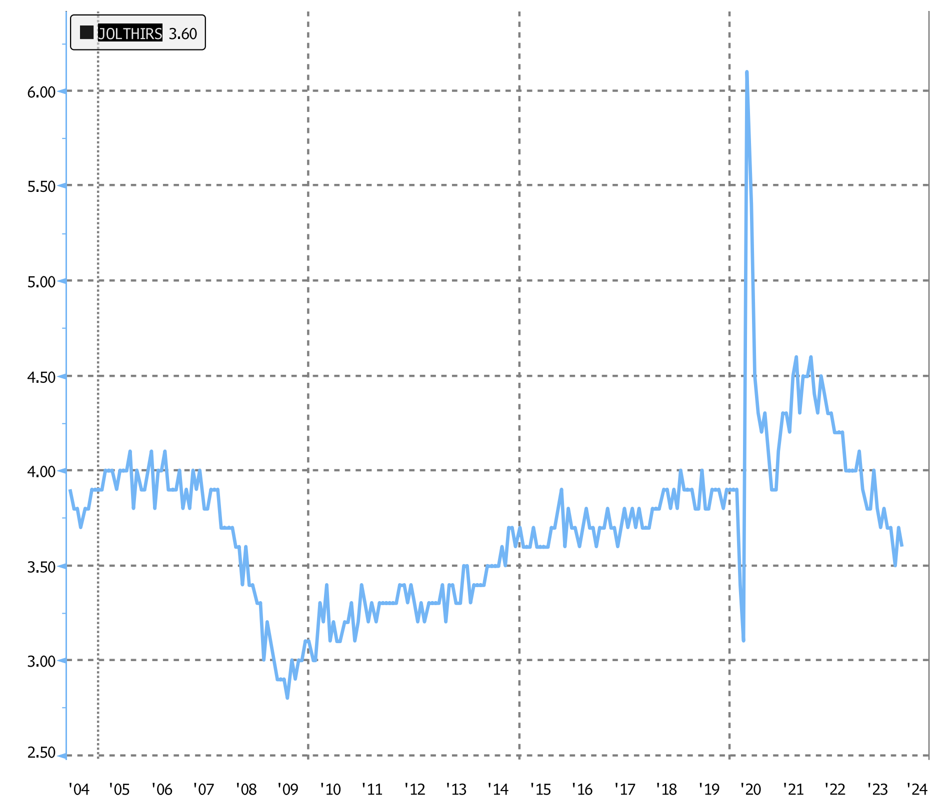
For instance, the BLS currently estimates there were 8,863K job openings in January 2024. While down considerably from March 2022's all-time high of 12,182K, the January total is still historically high. Prior to the pandemic and its economic fallout, the highest reported number of openings was 7,594K in November 2018.

What's more, the monthly average since the series inception in December 2000 through December 2019 was 4,489K. Therefore, January's number of job openings was roughly double the pre-pandemic average. As such, it would seem there are jobs littering the streets.

Perhaps.

Although the number of job openings always gets the headline, the more meaningful number is the so-called Hires Rate. This is effectively the total number of gross hires divided by the total number of jobs. The higher the number, the hotter the job market. For instance, in May 2020, as the labor markets rebounded from April and March's shutdowns, the U.S. Hires Rate was a massive 6.1%. The most recent observation, January 2024, was 3.6%, whereas it was 4.1% and 4.3% in January 2023 and 2022 respectively.

HIRING IS BACK TO NORMAL, MAYBE EVEN SLIGHTLY WEAKER



Source: Bloomberg

By this measure, the jobs market is basically back to historical norms. Employers still have plenty of job positions available, but they are filling them at a much slower pace. If they can find their unicorn, great, but they aren't in a huge hurry to throw warm bodies at open positions. Trust me, if you are a college senior trying to find a job, you are painfully aware of this.

Combined, the labor market is okay. However, it isn't as red-hot as it was OR as white-hot as the media would suggest. Couple this with persistently high inflation, especially for the "un-fun" inelastic goods, and you have a pretty wide disconnect between what economists are saying and what the public is feeling.

It should be interesting to see who is more right as the year goes along. In case you want to track the results at home, just follow that link from the second paragraph, and you will have a pretty good idea of who the winner will be.

SPECIAL REPORT

Corporate Earnings Season

David McGrath

It is not a stretch to say that corporate earnings are the single most important factor in determining a value for that company, or its stock price. Each quarter, every publicly traded company announces their financial results of the previous quarter and give updates (or guidance) on current conditions and any changes in expectations for future quarters.

To better understand the earnings season, and how to interpret the data we receive, we must first understand the goals of both the analysts and corporate management.

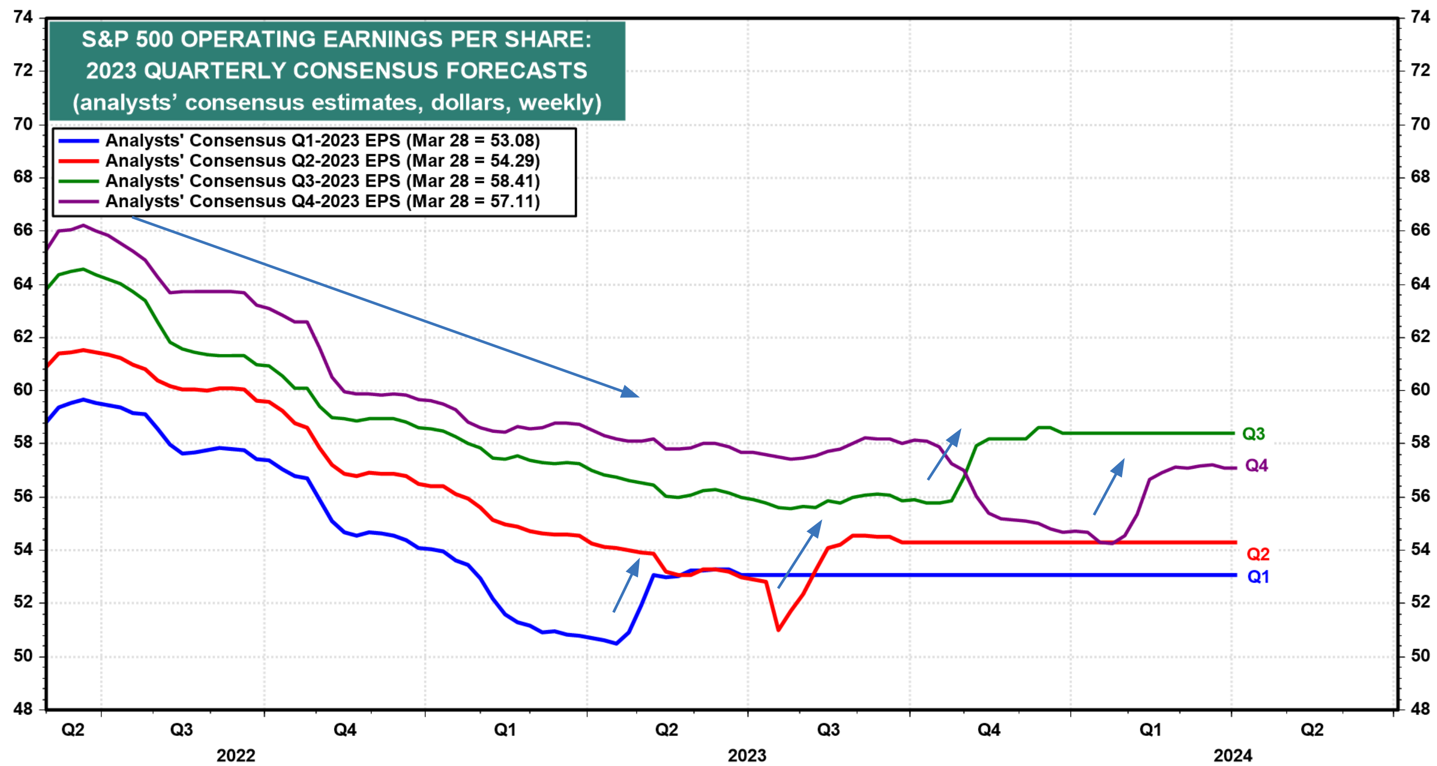
- The analyst receives much of their information from the companies they cover, and they want to keep a good working relationship with the management of those companies.
- Management, on the other hand, wants the analyst to portray their leadership of the company in a positive light. Job security for both parties.

With that in mind, let's look at some of the most common trends of earnings season:

1. Preliminary projections: Analysts typically start to provide earnings estimates 12 months before the start of that year (in January of 2024 we start to see earnings estimates for full year 2025).
2. Guidance adjustments: Analysts start earnings estimates with VERY optimistic glasses on. Those first earnings estimates are almost always lowered over the next 24 months.

3. Earnings management: Corporate management never wants to have their actual quarterly earnings come in lower that the analysts' consensus estimates. Over the past 10 years (i.e., 40 earnings seasons) 74% of companies have had their earnings results beat the analyst's final consensus estimates. The average 10-year earnings "beat" is 6.7%.

S&P 500 EARNINGS



Source: LSEG Datastream and © Yardeni Research.

Twenty-twenty three ended up a very typical year for earnings. As indicated in the chart above, the past four quarters for the S&P 500 earnings estimates moved consistently lower until just before earnings were announced, and like magic, actual earnings ended up higher than the last estimate. Each quarter finished significantly lower than where the estimate started, but each quarter still ended up beating the final estimate.

This is why it's important to take forward earnings estimates with caution when determining how expensive the stock market is currently trading. An optimistic earnings estimate will produce an artificially low price-to-earnings (P/E) ratio.

Earnings season can also give us information on how the eleven economic sectors of the S&P 500 are performing. Different sectors that show unusually strong or weak performance may give us some clues on the health of the economy. Additionally, we look for individual stocks with earnings performance that is significantly different from other companies in the same sector.

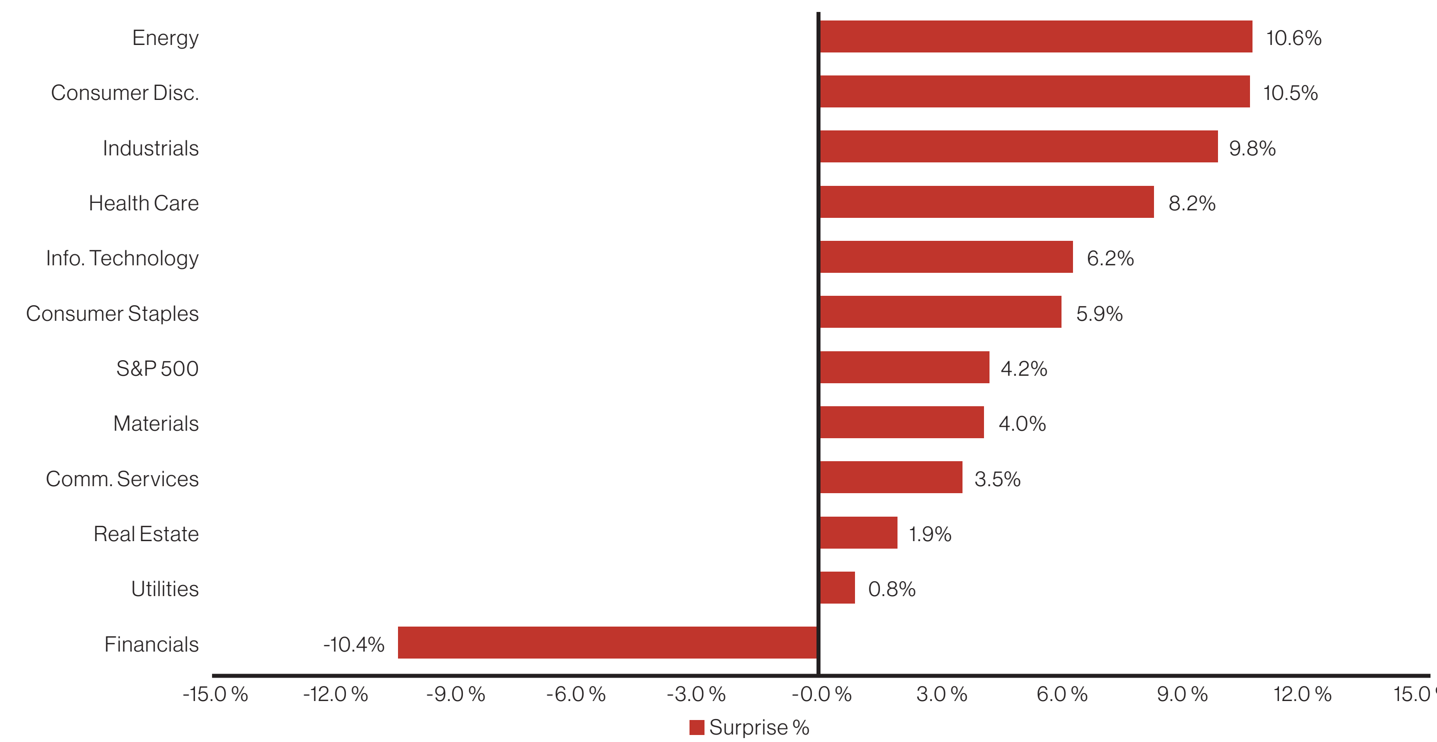
Moving forward, our Investment Committee will review each earnings season, providing our takeaways from the previous season and a perspective preview on the next. With only about four to five weeks separating the end of one earnings season from the beginning of another, there is scarcely any downtime in between.

4TH QUARTER RECAP & 1ST QUARTER PREVIEW

The largest financial stocks typically lead off the earnings report, and the 4th quarter earnings season started off with a whimper. Many of the largest financial companies showed large one-time charge-off's that significantly lowered their earnings. The "leader" in the one-time charge-off category was Citigroup, recording $4.66 billion, which reduced earnings to a loss of $1.16 for the quarter and expected earnings of $0.81. After the dust settled on earnings from the financial sector, total earnings came in 10.4% below expected earnings.

CHARGE-OFF: WHEN A DEBT IS DEEMED UNLIKELY TO BE COLLECTED AFTER A BORROWER FAILS TO MAKE PAYMENTS FOR A PROLONGED PERIOD OF TIME.

S&P 500 SECTOR-LEVEL EARNINGS SURPRISE %: Q4 2023



Source: FactSet

Thankfully, things improved from there, as the remaining 10 economic sectors all reported earnings above analysts' expectations. This outperformance was led by the energy (+10.6% above expectations), consumer discretion (+10.5%) and industrial stocks (+9.8%). The S&P 500 ended the quarter 4.2% above the analysts' expectations, while actual revenue was 1.2% above expectations.

- For the full year of 2023, S&P 500 earnings are expected to close around $222.30 in earnings per share.
- This is only 1.4% higher that the earnings for full year 2022, which closed at $219.19.
- As we head into the first earnings season of 2024, analysts are expecting S&P 500 earnings growth of 10.6%, up to $243.60.
- The bulk of that earnings growth is expected to come in the 4th quarter, with a 17.3% increase year over year.

S&P 500 EARNINGS			
	2023 ACTUAL	**2024 ESTIMATE**	**% GROWTH**
1st Quarter	53.33	54.94	3.0%
2nd Quarter	54.50	59.22	8.7%
3rd Quarter	58.91	63.35	7.5%
4th Quarter	55.56	65.18	17.3%
Full Year	222.30	242.69	9.2%

Not as much earnings growth is anticipated in the coming quarter, with expectations set at just a 3% increase compared to the first quarter of 2023. As we move through the first earnings season, we would not be surprised to see earnings slightly exceed expectations, followed by lowered guidance for the rest of the year.

THE FINANCIAL SECTOR

After such dismal earnings last quarter, the spotlight will remain on the financial sector this earnings season. With continued concerns over the valuation of commercial real estate in major cities, the banks that have a larger percentage of their loan portfolio committed to commercial real estate (including Wells Fargo, Citizens, M&T and Zions) will be carefully monitored. Other interesting points to consider from bank earnings will be net interest income (NII) and loan loss reserves. This will give us some insight on how the banks feel about the health of the economy. Higher loan loss reserves could indicate growing financial strain on consumers. However, with an unemployment rate still below 4% and wages growing at just above 4%, the consumer still appears to be in good shape.

TECHNOLOGY AND COMMUNICATION SERVICES

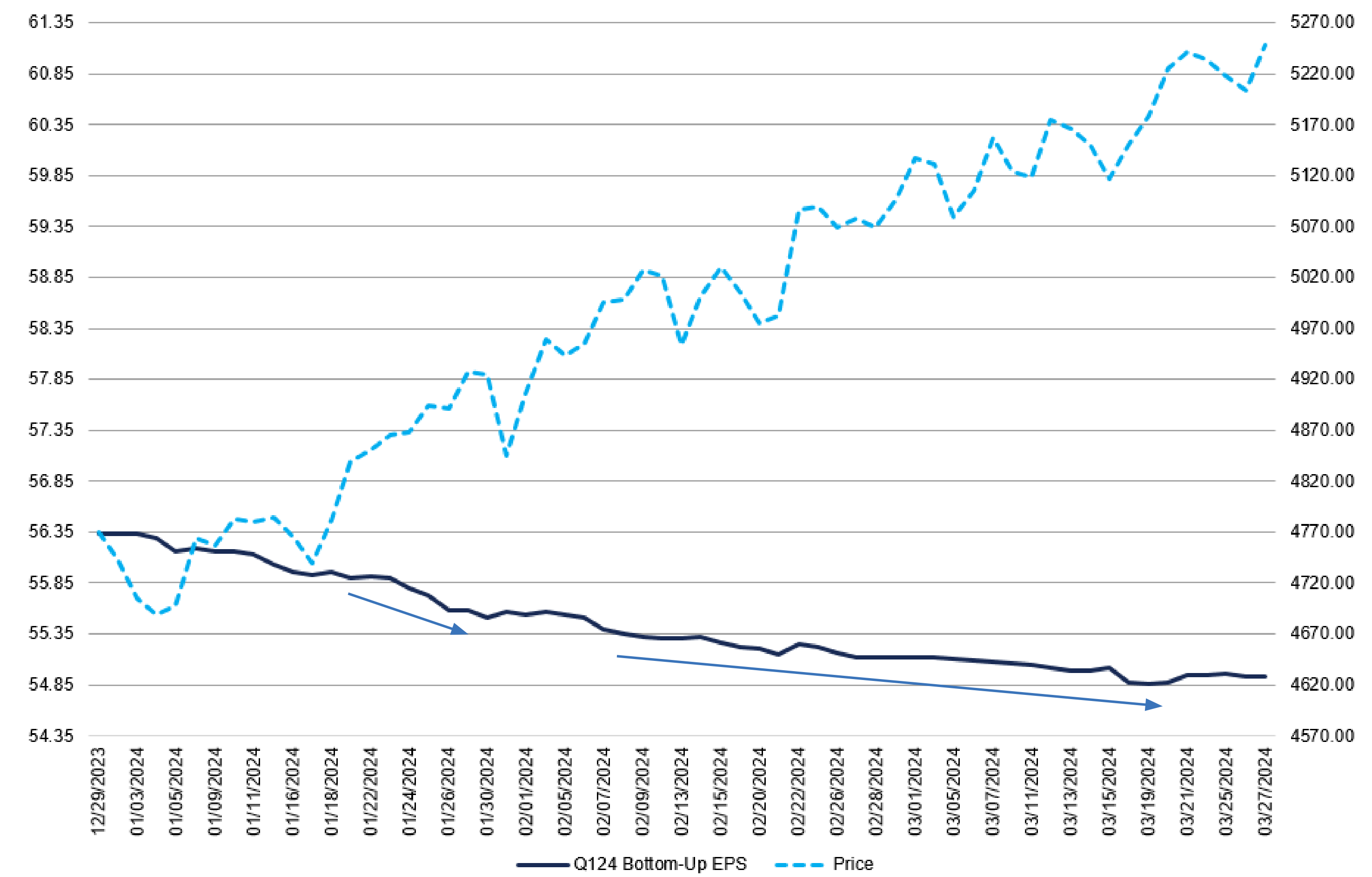
Some of the technology and communication services stocks that have shown very strong earnings growth the past few quarters, led by NVIDIA, Amazon and Meta, will try and keep up that impressive growth trend. Any hint of slowing growth could lead to trouble for a stock with a higher valuation.

CONSUMER DISCRETIONARY

Finally, earnings season is usually completed with some of the best-known retail companies. It is always interesting to get a gauge on the strength of the consumer and what are they spending their hard-earned cash on.

The chart below shows the great start to the year for equity prices (dotted blue line), but we have not seen a corresponding move-up with earnings expectations (solid line). We did see a decline in 2024 earnings expectations while the financial stocks were struggling through fourth quarter 2023 earnings season, but the successful remainder of earnings season allowed for this year's earnings expectations to regain most of that lost ground.

S&P 500 CY24 BOTTOM-UP EPS: DEC 31 - MAR 27



Source: Fact Set

IN SUMMARY

The move-up in stock prices over the first three months of 2024 can be supported with good 2024 corporate earnings. As I write this piece next year, the final 2024 earnings growth needs to be closer to the 9.2% growth that the analysts currently expect, and not a repeat of the 1.4% growth that we realized in 2023.

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FIRST QUARTER EQUITIES

Given the sharp upward trend over the past five months, what future economic conditions is the market anticipating?

DAVID MCGRATH

The stock markets kicked off 2024 on a high note, building on an incredibly strong finish at the end of 2023. That market momentum continued, and stocks realized solid returns in the first quarter.

- The S&P 500, with a 10.2% return for the quarter, showed its strongest opening to a year since 2019.
- The last trading day of the quarter, the S&P 500 logged its 22nd all-time high over the last three months.
- All major indices were up in the 1st quarter.

INDEX	1ST QUARTER RETURN
S&P 500	10.2%
Dow Jones Industrial Avg	5.6%
NASDAQ	9.1%
EAFE International Index	5.1%
S&P Mid Cap 400	9.5%
S&P Small Cap 600	2.0%

SECTORS

As we turn to economic sector returns, we have a surprising sector leading the pack: energy. Energy was the beneficiary of rising oil prices, with a barrel of oil increasing from $71 up to $83 in just three months. Communication services also stood out, led by Meta and a nice rebound in Disney shares, which surged by 35%.

ECONOMIC SECTOR	1ST QUARTER RETURN
Energy	12.4%
Communication Services	11.7%
Financials	11.7%
Industrials	10.4%
Healthcare	8.4%
Basic Materials	8.2%
Technology	7.9%
Consumer Staples	6.2%
Utilities	3.5%
Consumer Discretion	2.2%
Real Estate	-2.4%

The consumer sectors, both discretionary and staples, as well as utilities and real estate, were among the slowest performing over the last three months.

THE MAGNIFICENT SEVEN

In recent quarters, we discussed the stellar performance of the Magnificent 7 stocks, and the narrow market leadership through most of 2023. The first quarter of 2024, however, saw the breakup of the Magnificent 7. Two of the seven stocks continued at a remarkable pace, with NVIDIA (+82.3% for the quarter) and Meta (+35.6%) showing significant gains above the overall market. Amazon (+17.5%), Microsoft (+12%) and Alphabet (+8%) had solid performances in the quarter as well. The two laggards were Apple (-11.3%) and Tesla (-30.6%).

Both Apple and Tesla were hit with concerns over slowing growth, a situation that is never good for stocks with valuations significantly above the market average. Their underperformance capped the returns on both the technology sector (where Apple is a major player) and the consumer discretionary sector (significantly influenced by Tesla) in the last quarter.

NVIDIA

The standout individual stock of the first quarter was, again, NVIDIA. After a great 2023, NVIDIA gained roughly 1 trillion sixty-nine billion dollars (**$1,069,000,000,000**) in valuation in the first quarter of 2024 alone. To put this performance in perspective, the market capitalization of Chevron, IBM, American Express, Pfizer, General Electric and Citigroup has a combined value of $1.056 trillion as we ended the 1st quarter. The market capitalization of NVIDIA increased over the last 12 weeks by more than the total market value of those six companies *combined.*

NVIDIA's VALUATION GAIN IN Q1 2024 > COMBINED MARKET CAPITALIZATION OF: CHEVERON + IBM + AMERICAN EXPRESS + PFIZER + GENERAL ELECTRIC + CITIGROUP

Consider this: Apple was the first U.S. company to have a market cap of over $1 trillion, and that was in 2018. NVIDIA gained more than $1 trillion of *valuation* in three months. Simply amazing! At some point, the law of large numbers will make it very difficult for a company this size to continue to grow at its current pace.

LOOKING AHEAD

The stock market is considered a leading economic indicator – meaning the market will start to move before we see the evidence that the economy is changing. Given the sharp upward trend over the last five months, what future economic conditions is the market anticipating?

The market is interpreting signs of slowing inflation as a signal that the Federal Reserve might start lowering interest rates at some point this year. There is growing optimism in the stock market that the Federal Reserve will be able to navigate a "soft landing" for the economy. This means that the Federal Reserve will be able to bring down interest rates to a more normal, neutral, level without causing the economy to fall into a recession.

Continued strong economic data over the last 3 months has reduced the number of anticipated interest rate cuts expected by the markets this year. Initially, the stock market had priced in six to seven interest rate cuts (of 0.25% each), but as we finish the quarter that expectation has dropped to 3 rate cuts. This makes the 10.2% return for the S&P 500 in the 1st quarter even more impressive.

There is also growing optimism around the potential that artificial intelligence, or AI, will allow corporations to become more efficient. At some point, this should allow profit margins to expand, resulting in higher earnings. However, we are still early in the AI story, and it certainly does not appear that AI will significantly boost corporate earnings much higher anytime soon. As a matter of fact, not much has pushed corporate earnings higher this past year.

Whatever the reason, stocks continue to have momentum on their side as we move into the 2nd quarter. With earnings expectations for the year drifting down over the last three months, the rise in equity prices have made this market more expensive.

	12/31/2023	3/21/2024
S&P 500 Price	4,769	5,254
2024 Expected Earnings	244.45	242.69
P/E Ratio	19.5	21.6

There are two ways stock prices move up: either earnings improve or the market trades with a higher P/E multiple. With P/E now at 21.6 times expected earnings, it would be difficult to call this market inexpensive. With the market already well above a more typical valuation of 18 times earnings, we could really use some significant upside surprises in corporate earnings over the next few quarters.

For 2024, the first quarter is projected to have the smallest expected growth compared to the same period from last year. It would certainly help validate the current valuation of the stock market if we can show first quarter earnings well above the current expected 3% growth over first quarter 2023 earnings.

If we do not see corporate earnings come in well above current estimates, it would not be surprising to see the stock market bounce around current levels, at least until we get election results in November.

ALLOCATION

"Don't look a gift horse in the mouth"

Sam Clement

The proverb "Don't look a gift horse in the mouth" comes to mind when looking back on the market's returns for the first quarter of the year.

The phrase advises against critiquing or finding fault with something given as a gift. Boy, was the first quarter a gift . In my line of work, a chart that moves in one direction – up and to the right – is a gift.

The market has been on a historic run since November of last year, driven by several factors:

- The Treasury issued fewer coupon bonds than expected, affecting the supply of government securities.
- Inflation has been largely trending in the right direction, easing concerns over purchasing power and interest rates.
- Earnings have exceeded expectations, indicating stronger corporate health and profitability.

WHILE ALL THESE REASONS PROBABLY HAVE SOME TRUTH TO THEM, ONE UNDERLYING TRUTH ALWAYS HOLDS IN SUCH MARKET CONDITIONS: THERE HAS BEEN STRONGER DEMAND TO BUY THAN THERE HAS BEEN TO SELL.

I am talking about sentiment. The market has teetered between "greed" and "extreme greed" on the CNN fear and greed indicator for quite some time, and while this is not a great indicator for future returns, I would argue it does a pretty good job of gauging current sentiment. It raises the question: Who is left to be bearish? Especially considering there has not been a day when the market has been down 2% in over six months? Where the indices are closing in on double-digit returns in the first quarter?

This market can be described as "not letting bears in." If you have been bearish and waiting for a large pullback to be able to put money to work, then you've been out of luck.

OAKWORTH INVESTMENT COMMITTEE'S STRATEGIC ALLOCATION

So, what does this mean for our allocation? What have we done, and how are we positioned for where we are going?

In our last issue (4th quarter, 2023), I wrote about how technology stocks had been outperforming. While this largely continues to be the case, we are seeing more names, more sectors and even smaller companies starting to contribute as well. This broadening out has been something that we have been expecting to happen. I also wrote that this didn't mean tech would do poorly, or even that it would underperform, just that more names would start to contribute.

For our portfolios, this meant finding areas to trim over the 1st quarter. Naturally the outperformance of tech stocks resulted in a greater overweighting than we wanted in our portfolio. As a result, we trimmed the sector a bit with a goal of obtaining a more balanced distribution between growth and value investments. This rebalancing effort has been difficult to achieve given the continued run that the technology sector has been on.

With a portion of funds raised from the tech sector, we added to our gold exposure as well as our cash reserves.

GOLD

Gold, the long-loved precious metal, seems to have had a second wind, as the oft-sleepy asset has outperformed many stock indices through the 1st quarter. While the metal is commonly viewed as a hedge against inflation, gold's performance is more directly correlated with real interest rates. That means any given interest rate minus the expected inflation over that period. In essence, gold can be considered a non-interest-bearing currency. Naturally, if you had a stash of cash sitting around or hidden under your mattress, and the real rate you could earn on it was high, you would probably take it out from under your mattress and find a more effective place to invest the money. However, if real interest rates are low or declining, the desire decreases, as the opportunity cost of holding excess cash in a non-interest-bearing form diminishes. This is largely the framework that I look through for precious metals, specifically gold. Additionally, simple supply and demand always plays a role. As central banks and individual investors pick up their demand for precious metals, it can create this upward movement in prices – much like we saw in the 1st quarter.

CASH

Cash, on the other hand, remains the silver lining of a rising rate environment. The higher rates of 2022, in response to the uptick in inflation, continue to linger, and the market expectations for rate cuts continue to be pushed back further. The mantra "higher for longer" has been here to stay. This is not inherently a bad thing, as the delay in rate cuts is a reflection of the continued strength of the economy. While the Fed waits to gain greater confidence that inflation is headed back toward their 2% target, they continue to be able to buy themselves time with nothing seemingly breaking in the economy yet. As long as this continues to be the case, the rates on cash will remain elevated even if they do come down slightly towards the end of the year.

For us, cash on hand is optionality. It will always be "dry powder" and nice to have a sliver of cash in a portfolio; however, when cash is generating positive real yields, it also has become a significant asset class. It currently takes the beauty of bonds, in generating income, without any interest rate sensitivity. We will take it while we can.

FIXED INCOME

Bonds, on the other hand, continue to struggle over deciding what the going narrative should be.

- Should yields move lower because higher interest rates must eventually impact the economy?
- Or should they move higher as the incoming economic data continues to be strong?
- Should rates move lower as inflation trends lower?
- Or should they move higher as the Treasury is forced to issue more notes and bonds than they ever have?

The narrative literally changes daily, influenced by varying economic data, Treasury auctions and comments from the Fed. All in all, this has led to very little action from the fixed income markets over the 1st quarter of the new year. While the stock market has chosen its narrative, the bond market continues to be perplexed. Frankly, I understand the confusion. At times, the mix of data that we use to build our mosaic doesn't always seem to be congruent. While some data points show signs of strength, others are showing signs of weakness. Because of this, as well as the favorable rates we locked in in the 4th quarter – as previously discussed – we felt it prudent not to make any significant changes to our bond portfolio.

Credit spreads and municipal bond spreads have not risen enough to justify taking any bets on the riskier parts of the commercial paper space or the municipal bond space, where the risks are often unconsidered. Consequently, we have continued to maintain a heavy weight toward Treasuries as well as investment-grade corporate bonds, the highest rated in this category.

OUR OUTLOOK

Take all of this, and what do you get as far as our outlook? The easy response is that the phenomenal rally that we have had over the past few months should not last forever. This by no means signals a significant pullback. It could be a period of choppiness or a period of doldrums. Such a phase could emerge in the next quarter, later in the year or even farther down the line.

We do not want to look a gift horse in the mouth; however, we do want to be prepared to capitalize on any opportunities that present themselves over the coming few quarters. As always, we will continue with our mandates of protecting downside and maximizing risk-adjusted returns.

CATCH MORE FROM OUR INVESTMENT COMMITTEE EXPERTS

MEET THE MEMBERS:
Our Investment Committee

Our Investment Committee experts are responsible for overseeing the investment decisions on behalf of Oakworth Capital Bank. Their objective is to manage investment strategy, monitor the performance of all portfolios and conduct research to identify key opportunities.

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READ OUR BLOG:
Common Cents

Started over 20 years ago, Common Cents is a weekly blog written by Chief Economist John Norris detailing and explaining the events that impact our economy. John distills the latest information, making it easy to understand how these events affect daily life.

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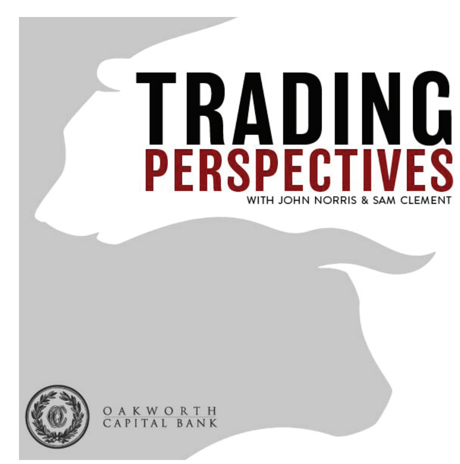

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SECOND QUARTER PREDICTIONS

Delayed rate cuts, softening labor markets, bank consolidations and other projections from our Investment Committee.

- The Fed will delay cutting the overnight lending target rate for as long as the economy allows. **At the earliest, the Fed will make its first move to cut rates in June.** However, the July FOMC is looking increasingly more likely.

- After consecutive strong quarters, **the stock market will take a breather during the 2nd quarter.** As defined by the forward price-to-earnings (P/E) ratio and the S&P 500, large cap domestic stocks look as "fully valued" as they have in the past two years. Earnings must either pick up significantly or the Fed will have to cut the overnight rate more aggressively for the "good times" to continue on as they have been.

- The labor markets will finally show some visible signs of softening. Analysts have been scratching their heads for the past couple of months over conflicting data. **During the 2nd quarter, the official unemployment rate could increase above 4% for the first time in two years.**

- The situation in Gaza will continue to polarize the American public while it galvanizes Israel. By the end of the conflict, **the historically strong ties between the United States and Israel could be permanently impaired.**

- The disconnect between the official economic data and how the public feels about the economy will continue. While the headline numbers have been robust, **American consumers are still facing significantly higher pricing for a lot of goods and services, particularly food and housing.**

- **Controversy over the EPA's tailpipe emission mandates in March will boil over into the 2nd quarter.** The debate is likely to shift toward recognizing that what works well in densely populated areas may not be as practical and efficient in rural ones. As with a lot of issues in the country, this one will quickly devolve into the two coasts versus everyone in the middle.

- If Congress doesn't approve additional funding for Ukraine by the end of the 2nd quarter, it will be hard to envision it approving anything prior to the general election. If this happens, **Kiev will have a difficult time continuing to defend its country and might be forced to eventually come to the proverbial table with Moscow.**

- **We will eventually find out the reason for all the recent secrecy from the royal family.** Since Americans seem to prefer airing their dirty laundry in public, we won't ever really understand what all the fuss is about.

- The sheer deluge of Treasury debt issuance, coupled with stickier-than-expected consumer prices, will keep upward pressure on longer-term interest rates. **At some point in 2024, the Federal Reserve will have to pause its "quantitative tightening" program to keep the yield to maturity on the 10-Year Treasury from increasing too much.**

- **The proposed Tik-Tok ban has the potential to further alienate America's largest geopolitical adversary while potentially violating the First Amendment.** At some point, the public will have to wrestle with the question: is deterring China worth infringing on my Constitutional rights?

- The combination of higher interest rates and troublesome commercial real estate loans will force many underperforming banks to look for potential suitors. **Ultimately, the outcome will be that a number of mediocre, small- to mid-size firms will join forces to cut expenses and grow.**

- Ongoing drought conditions in the Midwest, leading to persistently higher beef and grain prices, are continuing to put the squeeze on fast food franchisees. Further complicating their problems is the persistent inability to find capable people willing to work for reasonable pay. **As a result, many national chains will shutter stores and some regional ones could close for good.**

- **If a Trump victory in November becomes readily apparent, there will likely be an even greater surge in illegal migration in the weeks and months leading up to the year's end.** It has the potential to make the problems our border patrol has had over the last several years look like a walk in the park.

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