First Affirmative FINANCIAL NETWORK
Invest for a Sustainable Future

Don't React... Anticipate!

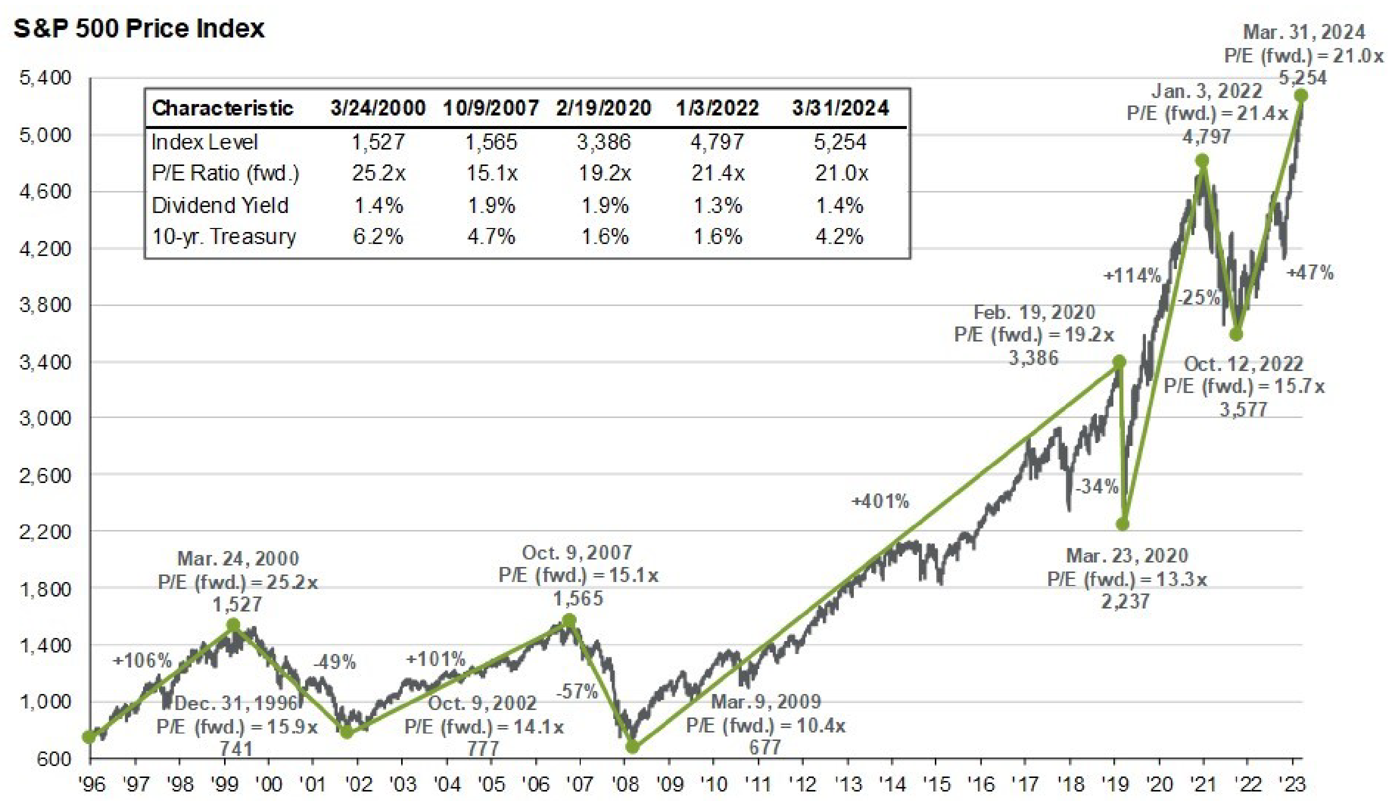
By Theresa Gusman
April 23, 2024

Overview

Following a 24.3% rise in 2023, the S&P 500 advanced 10.6% in the first quarter. By quarter end, the S&P 500 had reached an all-time high, exceeding the January 2022 peak by 10% and the March 2020 COVID low by 135% (see Figure 1). Equity market performance remained highly concentrated in the first quarter as the so-called Magnificent Seven advanced 13% (despite a sharp decline in Tesla), more than two times the 6% rise in the other 493 stocks in the S&P 500. Reflecting the continued narrow tenor of the market, sustainability-themed strategies continued to underperform – albeit to a lesser degree.

The US economy and corporate earnings remain strong although (1) the "data dependent" Fed and headline-driven market observers are moving toward our higher for longer stance on inflation and interest rates, (2) geopolitical risks remain high, and (3) major elections loom. Against this backdrop, we continue to believe markets could be choppy – reacting to the latest Fed pronouncement, or government or corporate data release -- amid trend increases in the mid-to-high single digits with better breadth as 2024 progresses.

Figure 1. S&P 500 at Inflection Points – Bull and Bear Markets, 1996 to Date



Characteristic	3/24/2000	10/9/2007	2/19/2020	1/3/2022	3/31/2024
Index Level	1,527	1,565	3,386	4,797	5,254
P/E Ratio (fwd.)	25.2x	15.1x	19.2x	21.4x	21.0x
Dividend Yield	1.4%	1.9%	1.9%	1.3%	1.4%
10-yr. Treasury	6.2%	4.7%	1.6%	1.6%	4.2%

Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of March 31, 2024.

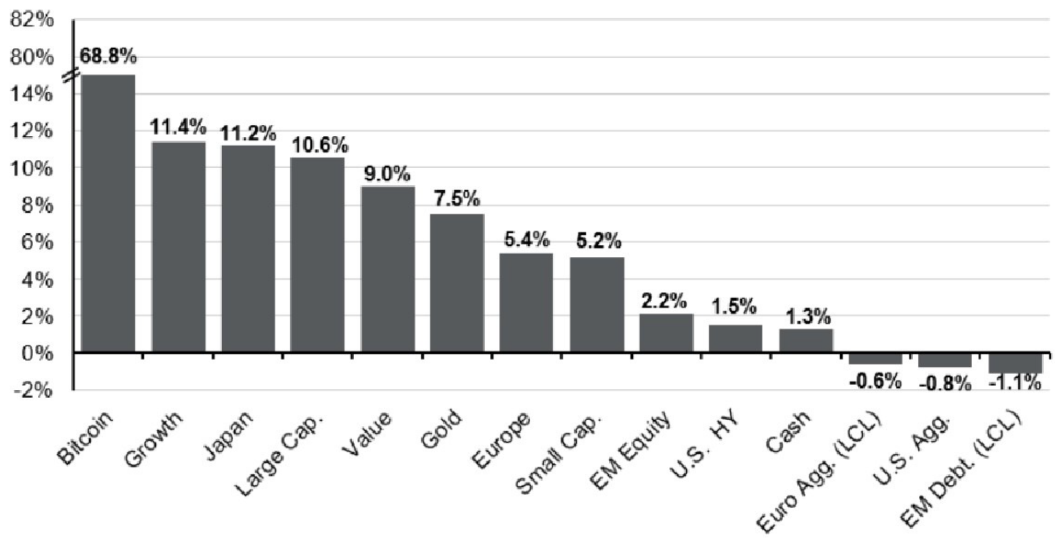
Source: J.P. Morgan Asset Management Guide to the Markets – U.S. Data are as of March 31, 2024

First Quarter Performance – Equities: Strong Gains, Narrow Breadth

"Risk-on" concentrated performance prevailed in the first quarter amid strong economic growth and now fading consensus expectations of interest rate cuts. Bitcoin (+68.8%) was by far the top performing asset class in the first quarter. Among traditional asset classes, US Growth, Japan, and US Large Cap (S&P 500) stocks were the top performing categories in the first quarter, and US Value was not far behind. Europe, Small Cap, and Emerging Markets delivered less than half the returns of the top performers, and fixed income faltered (see Figure 2).

Figure 2. 1Q 2024 Asset Class Returns

Total returns



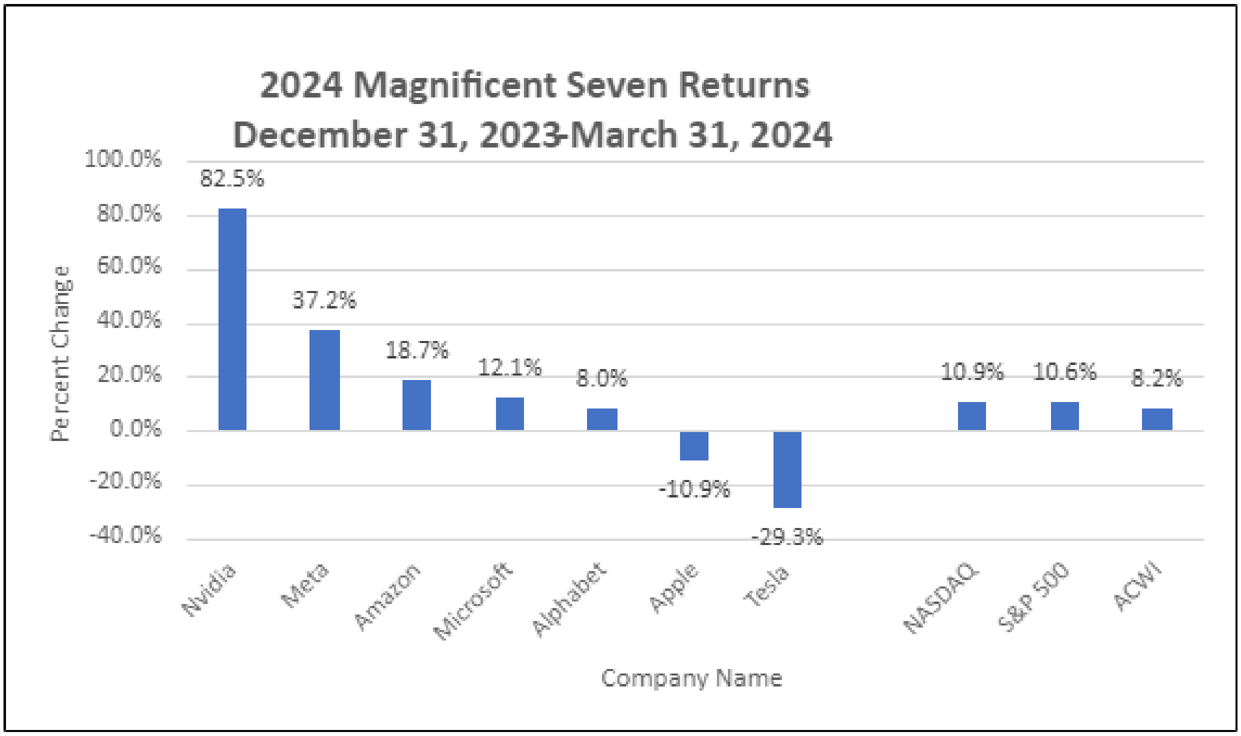
Source: Bloomberg, FactSet, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management.

Large cap: S&P 500, Small cap: Russell 2000, Growth: Russell 1000 Growth, Value: Russell 1000 Value, EM Equity: MSCI EM Equity (USD), Europe: MSCI Europe Equity (USD), Japan: MSCI Japan Equity (USD), U.S. Agg: Bloomberg US Aggregate, High Yield: Bloomberg U.S. HY Index, Cash: Bloomberg 1-3m Treasury, EM Debt (LCL): Bloomberg EM Local Currency Government, Euro Agg. (LCL): Bloomberg Euro Aggregate Government Treasury, Gold: NYMEX Gold near term, Bitcoin: CoinMarketCap.

Data are as of March 31, 2024.

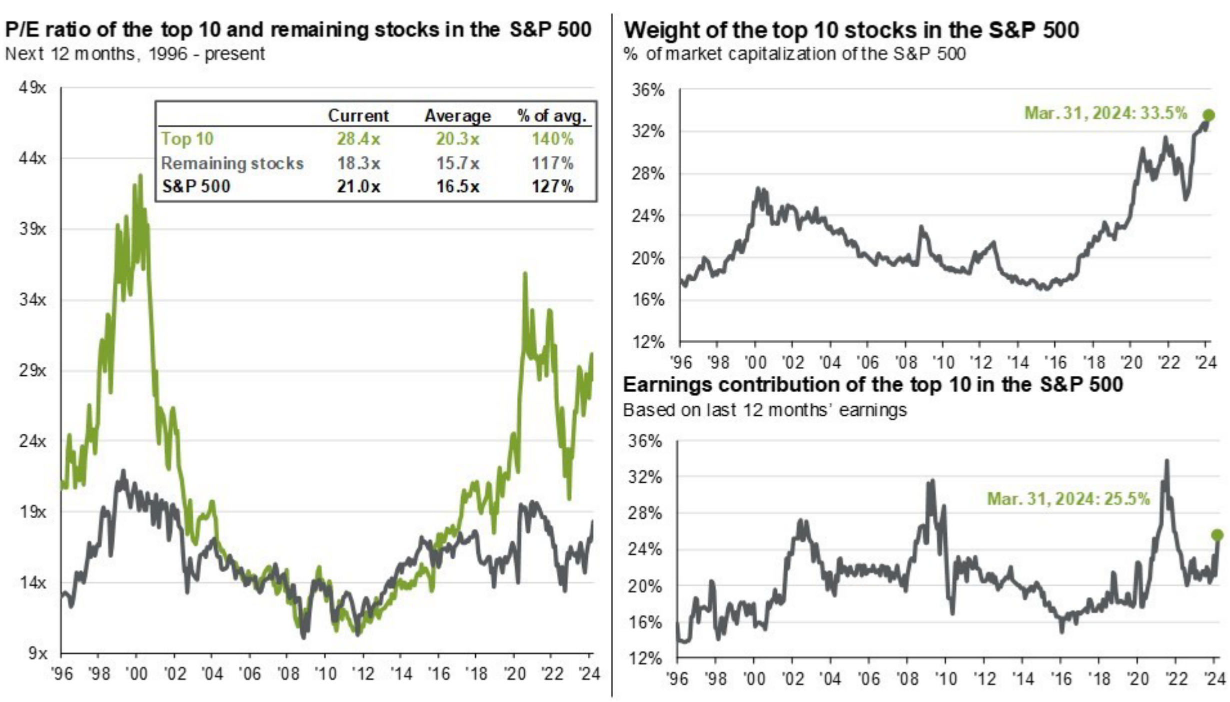
Equity market performance remained concentrated in the first quarter, although the gap between the performance of the equal and market cap-weighted S&P 500 indices narrowed. As the Magnificent Seven transitioned to the Fabulous (Fab) Four – with Tesla plunging 29.3%, Apple falling 10.9%, and Alphabet (+8.0%) underperforming the broader market (see Figures 3 and 4) – the S&P 500 (market capitalization weighted) advanced 10.6%, outpacing the 8% increase in the equal weighted index. At quarter end, the Top 10 stocks comprised a third (33.5%) of the market capitalization of the S&P 500 – the highest in recent history. Although the Top 10 stocks comprised only 25.5% of the last twelve months' earnings, a few of these are among the fastest growing large cap companies. According to FactSet, five of the seven companies in the "Magnificent 7" are projected to be the top five contributors to year-over-year earnings growth for the S&P 500 for Q1 2024. These five companies (in order of highest to lowest contribution) are NVIDIA, Amazon.com, Meta Platforms, Alphabet, and Microsoft.

Figure 3. Magnificent Seven Returns, First Quarter 2024



Source: First Affirmative, Data are as March 31, 2024

Figure 4. S&P 500 Index: Concentration



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
The top 10 S&P 500 companies are based on the 10 largest index constituents at the beginning of each month. As of 3/31/2024, the top 10 companies in the index were MSFT (7.2%), AAPL (5.6%), NVDA (5.1%), AMZN (3.7%), META (2.4%), GOOGL (2.0%), BRK.B (1.7%), GOOG (1.7%), LLY (1.4%), AVGO (1.3%) and JPM (1.3%). The remaining stocks represent the rest of the 492 companies in the S&P 500.
Guide to the Markets – U.S. Data are as of March 31, 2024.

Source: J.P. Morgan Asset Management Guide to the Markets – U.S. Data are as of March 31, 2024

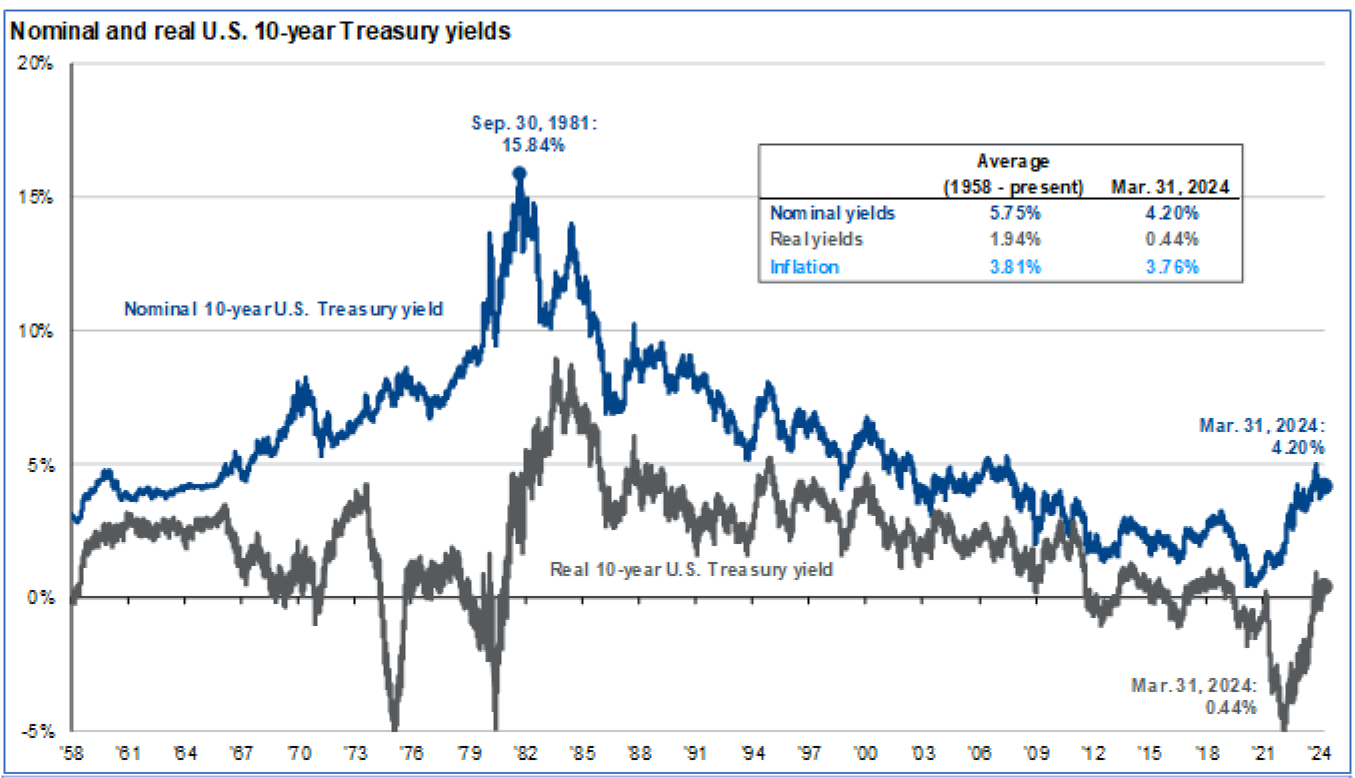
Inflation and Interest Rates – Higher for Longer, Unless…

The “data dependent” Fed and headline-focused market pundits are moving toward our higher for longer stance on inflation and interest rates. At 3.76% in March, the Consumer Price Index (CPI) is hovering around the long term (1958-present) average (see Figure 5). The 10-year Treasury yield, however, is more than 25% below its long-term average. As a result, real yields remain inordinately low. Barring a US economic slowdown, which we view as unlikely, or a geopolitically driven spike in oil prices, we believe inflation will continue to hover around current levels. We do not anticipate a data-driven rate cut and may, in fact, see a post-election hike.

Higher for longer interest rates will not only affect consumers and debt-laden businesses, but also the federal government (see Figure 6). In 2024, the federal government is slated to spend $870 billion on Net Interest Expense, about the same as Defense spending and just 10% below Non-Defense Discretionary spending (i.e., everything other than Social Security and Medicare/Medicaid). The Congressional Budget Office (CBO) is targeting 2.6% inflation this year, declining to 2.2% in fiscal 2027-28 and holding steady thereafter. According to the CBO, interest rates will follow a similar trajectory. Given the magnitude of federal borrowings, even marginally higher for longer inflation and interest rates could have a significant impact on the federal budget – and by extension US taxpayers and the economy.

Against this backdrop, we continue to believe markets could be choppy – reacting to the latest Fed pronouncement or corporate or economic data release -- amid trendline increases in the mid-to-high single digits with better breadth as 2024 progresses.

Figure 5. Nominal and Real US 10-Year Treasury Yields

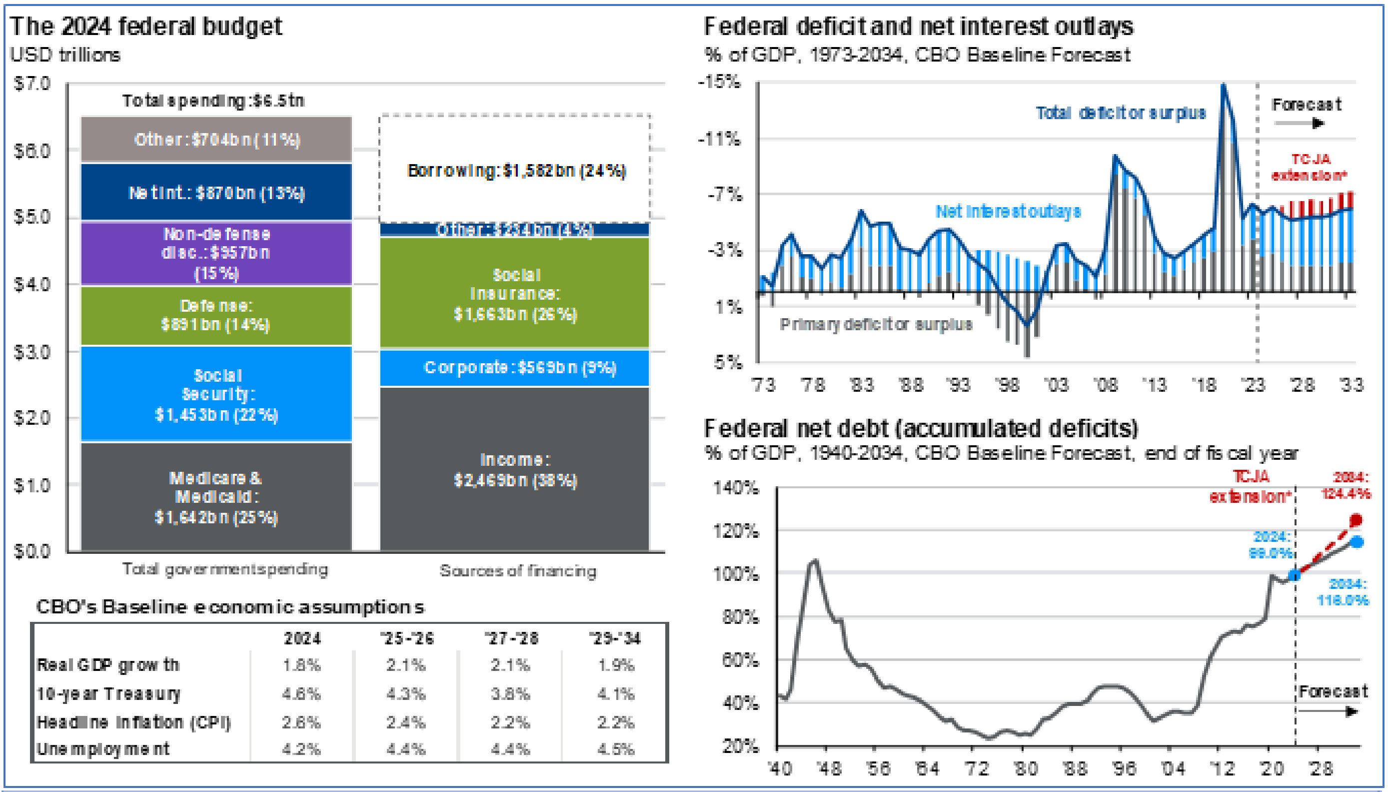


Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.

Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month’s core CPI figures until the latest data are available.

Guide to the Markets – U.S. Data are as of March 31, 2024.

Figure 6. US Government Federal Finances



	2024	'25-'26	'27-'28	'29-'34
Real GDP growth	1.8%	2.1%	2.1%	1.9%
10-year Treasury	4.6%	4.3%	3.8%	4.1%
Headline inflation (CPI)	2.6%	2.4%	2.2%	2.2%
Unemployment	4.2%	4.4%	4.4%	4.5%

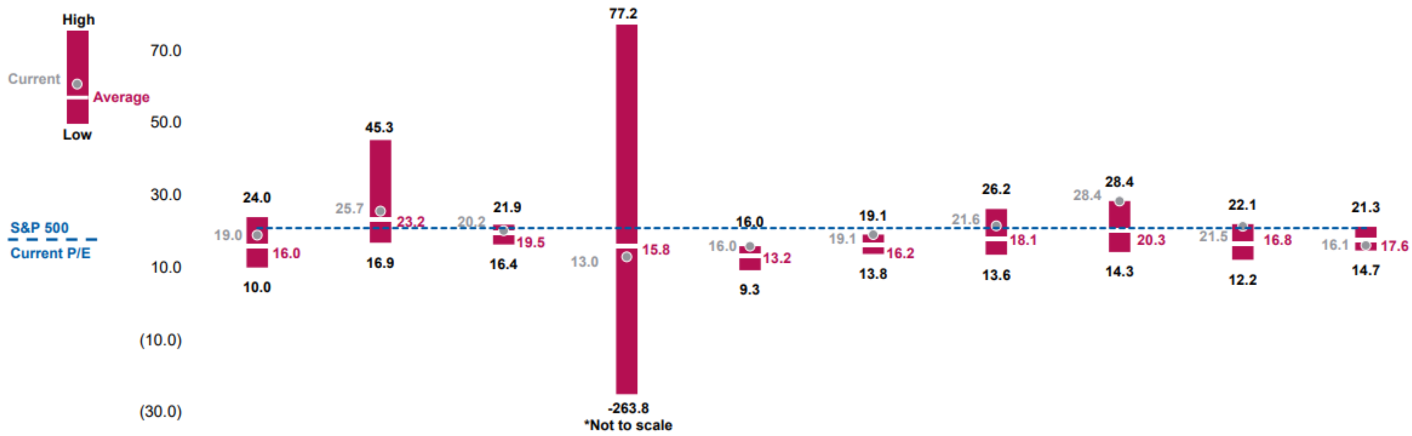
Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department. Estimates are from the Congressional Budget Office (CBO) February 2024 An Update to the Budget Outlook: 2024 to 2034. "Other" spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. *Adjusted by JPMAM to include estimates from the CBO May 2023 report "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues" on the extension of TCJA provisions. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets – U.S. Data are as of March 31, 2024.

Amid Economic Resiliency, Earnings Growth Remains Strong

As shown in Figures 7 and 8, global equity markets are fairly valued to modestly overvalued. The valuations of growth-oriented categories (Russell 1000, S&P 500) and sectors (Information Technology) are above their 10-year averages, while global small cap stocks and value-oriented sectors (Energy, Utilities) are below their 10-year averages. According to FactSet, based on the average improvement in the earnings growth rate during the current earnings season, the index will likely report year-over-year growth in earnings of more than 7% for the first quarter. Fair valuations and 7% earnings growth underpin our expectation that markets will post trendline mid-to-high single digit returns in 2024.

Figure 7. Valuation Analysis – S&P 500 Sectors: Current NTM P/E v 10-year High, Low, Average

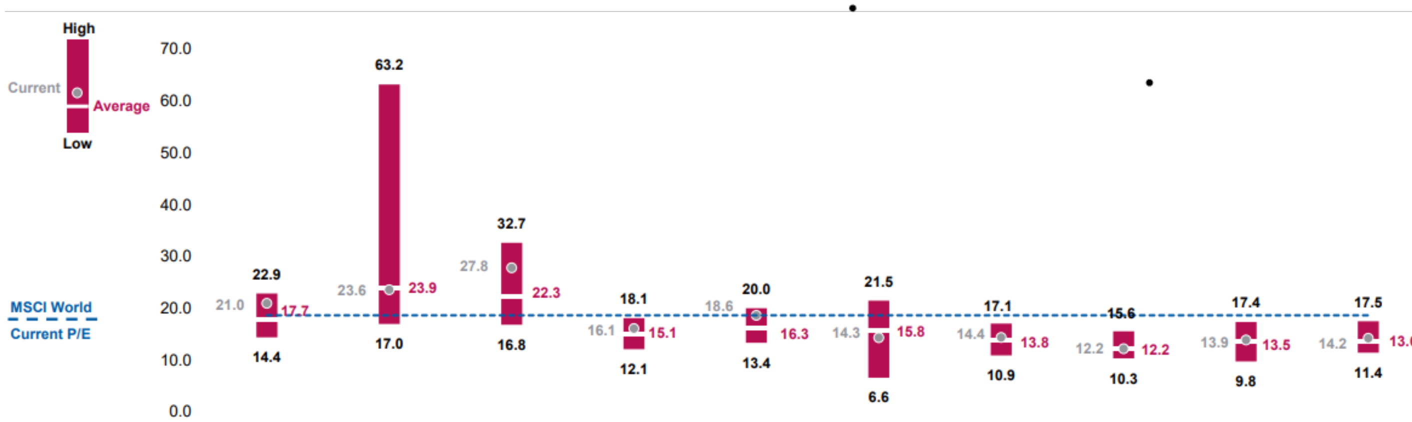


	Communication Services	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Utilities
High Date	8/20	6/20	12/21	4/16	3/24	3/24	8/20	3/24	7/20	3/22
Low Date	5/18	2/16	4/18	7/20	3/20	3/20	12/18	4/14	9/15	6/15

Source: FactSet as of 3/31/24. NTM P/E is market price per share divided by expected earnings per share over the next twelve months. The Real Estate sector is excluded from this 10-year chart since the sector was created on August 31, 2016. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Source: Eaton Vance Monthly Market Monitor, March 2024

Figure 8. Valuation Analysis – Regions/Styles: Current NTM P/E v 10-year High, Low, Average



	S&P 500	Russell 2000	Russell 1000 Growth	Russell 1000 Value	MSCI World	MSCI World ex USA Small Cap	MSCI EAFE	MSCI EM	MSCI Europe	MSCI AC Asia Pac
High Date	8/20	6/20	8/20	3/21	8/20	8/20	8/20	1/21	6/20	1/21
Low Date	12/18	9/22	2/16	9/22	12/18	9/22	9/22	10/18	9/22	12/18

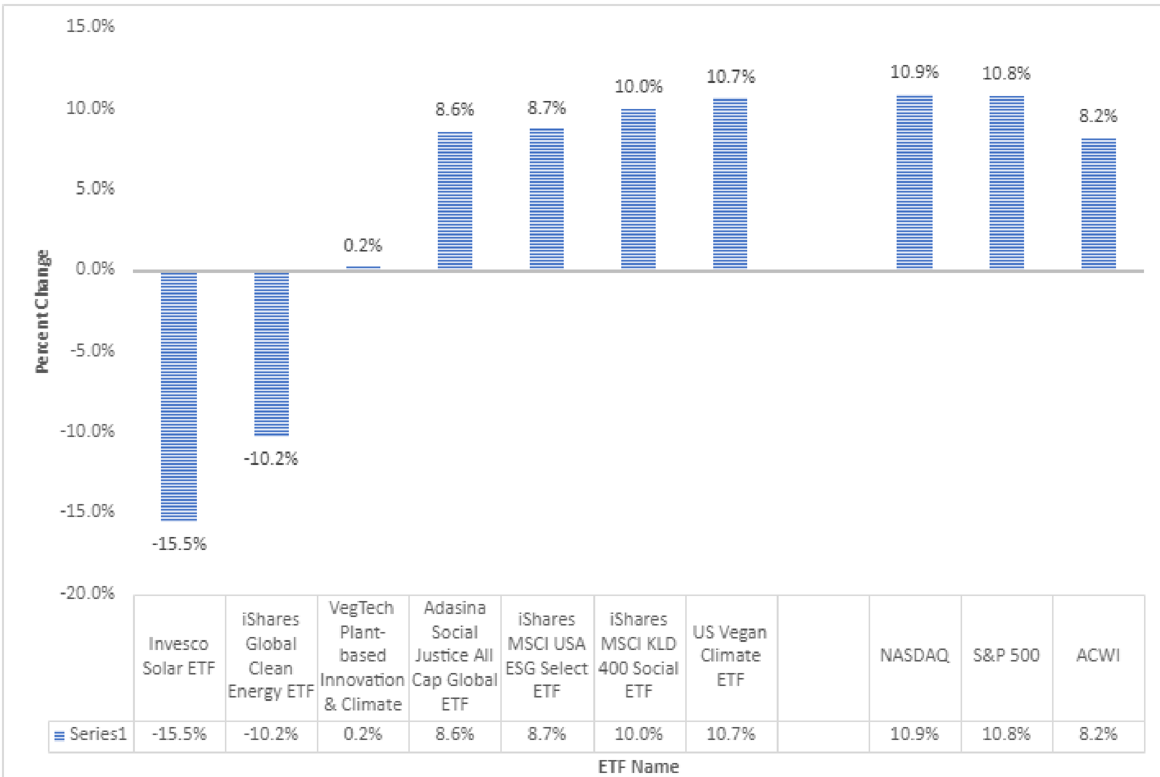
Source: FactSet as of 3/31/24. NTM P/E is market price per share divided by expected earnings per share over the next twelve months. Data provided is for informational use only. See end of report for important additional information. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Source: Eaton Vance Monthly Market Monitor, March 2024

Investing in the World as You Want it to Be

The narrow tenor of the equity market in the first quarter resulted in continued underperformance of selected sustainability-themed strategies (see Figure 9). As we know, the market reflects the world as it is today. Values-aligned investors invest in the world as they want it to be and look to achieve long term financial and impact goals aligned with their values.

Figure 9. Selected Sustainability- Themed ETFs – Returns, 12/31/2023 – 3/31/2024



Source: First Affirmative, Data are as March 31, 2024

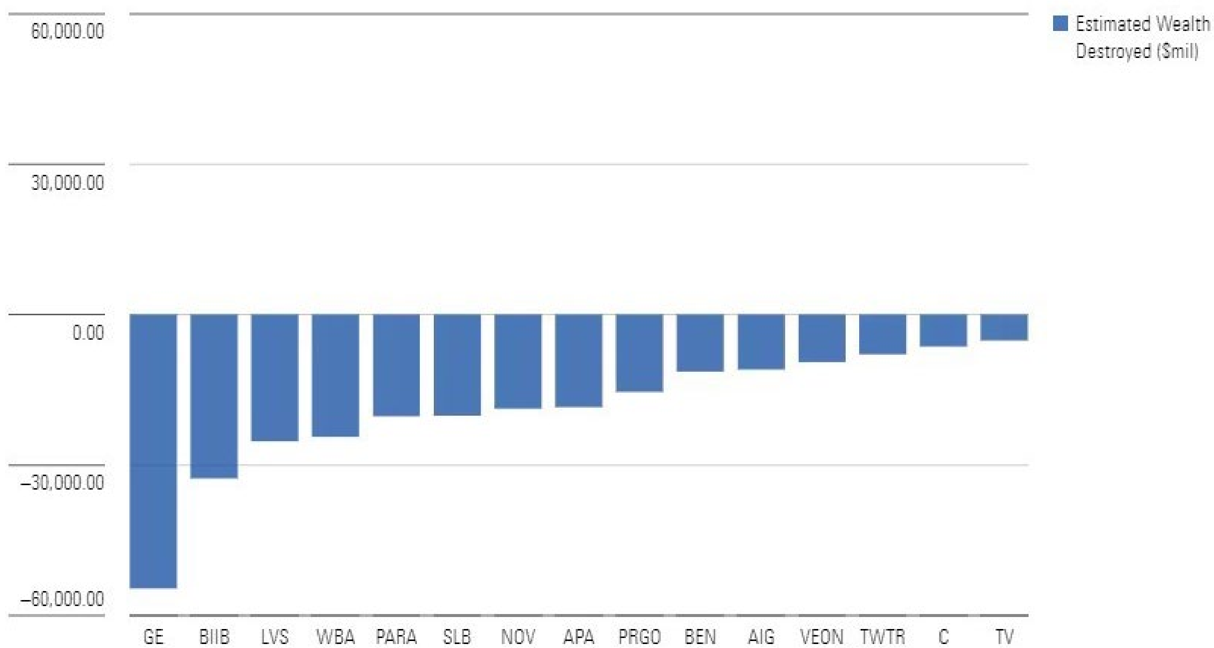
Many empirical studies demonstrate that investing in the world as you want it to be can also yield competitive long-term financial returns. Over the past decade, values alignment often meant incorporating selected environmental, social, and governance preferences into portfolios. Morningstar recently identified the top 15 wealth-destroying (Figure 10) and wealth-creating stocks over the past decade. More than one-third of the stocks on the "wealth destroyer" list -- including General Electric, Las Vegas Sands, Schlumberger, APA Corporation (formerly Apache Oil), NOV Inc. (formerly National Oilwell Varco), and Twitter – are among the stocks most often excluded from values-aligned portfolios over the past decade.

Not surprisingly, all the members of the Magnificent Seven are among the wealth creators (Figure 11). Apple, Amazon.com, Microsoft, Alphabet (Google), Nvidia, Meta, and Tesla, created about $12.0 trillion in shareholder value over the past 10-years, making up about three fourths of the total for the top 15. As a group, the wealth destroyers wiped out an estimated $281.2 billion in shareholder wealth over the past 10 years. That's a big number, but far less than the estimated $15.9 trillion in wealth created by the top 15 stocks on the positive side.

Although decidedly less "scientific" than the empirical studies, the wealth destroyer versus wealth creator analysis – combined with our analysis of 10-year sector performance (Figure 12) -- suggests that values alignment and financial performance are not mutually exclusive over the long term. For the future, our Values-Aligned Direct Index Solution (VADIS) represents the future of hyper-customized portfolio management and enables clients to invest in the world as they want it to be. By combining trusted personal financial advice, leading sustainable and responsible investment expertise, and scalable technology, VADIS enables advisors to provide personalized portfolios aligned to each client's financial goals and values.

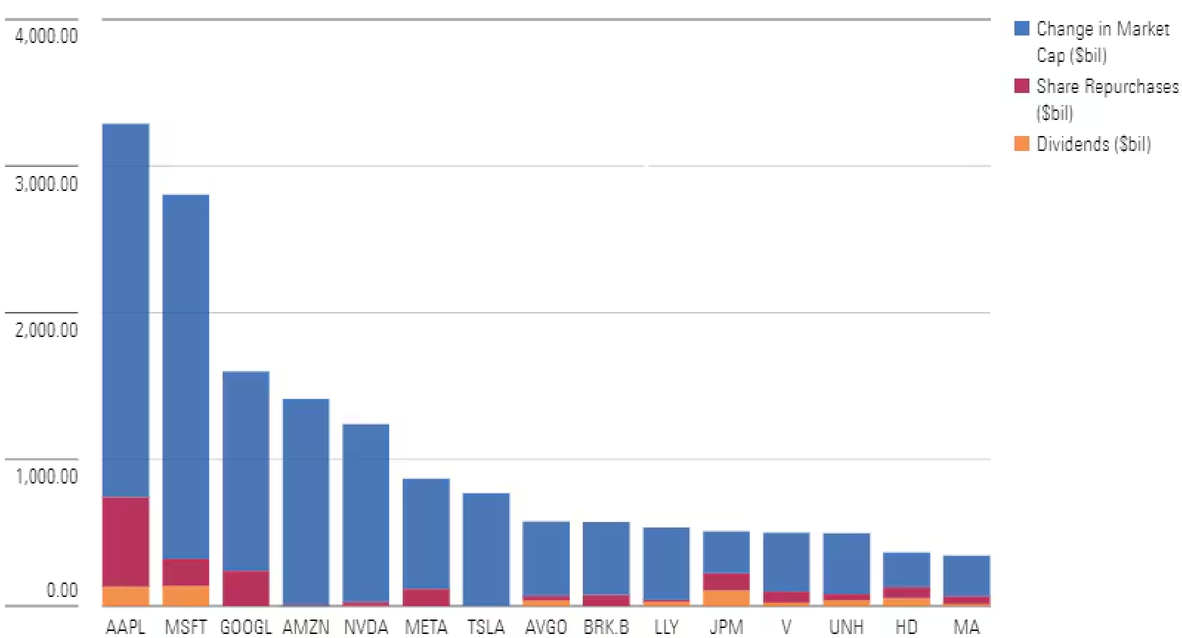
At First Affirmative, we remain convinced investors must take responsibility for the impact their money has in the world. Since 1988, we have served individuals and institutions seeking to achieve financial returns and align their portfolios with their values to meet both their financial and impact objectives.

Figure 10. Top 15 Wealth-Destroying Stocks Over the Past Decade



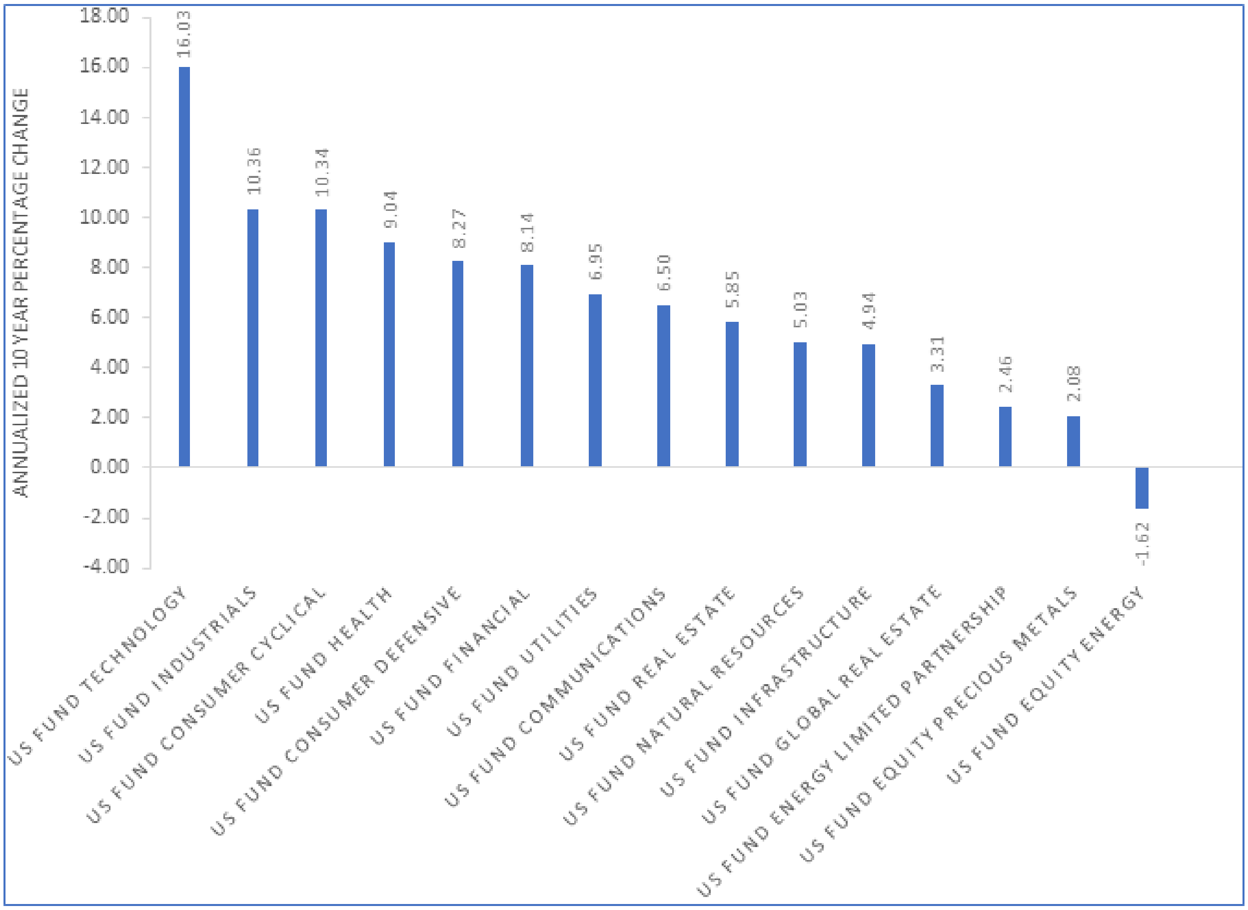
Source: Morningstar Direct and author's calculations. Data as of Dec. 3, 2023. The dollar amount for X Corp. reflects the change in market capitalization from Jan. 1, 2014 through June 30, 2022.

Figure 11. Top 15 Wealth-Creating Stocks over the Past Decade



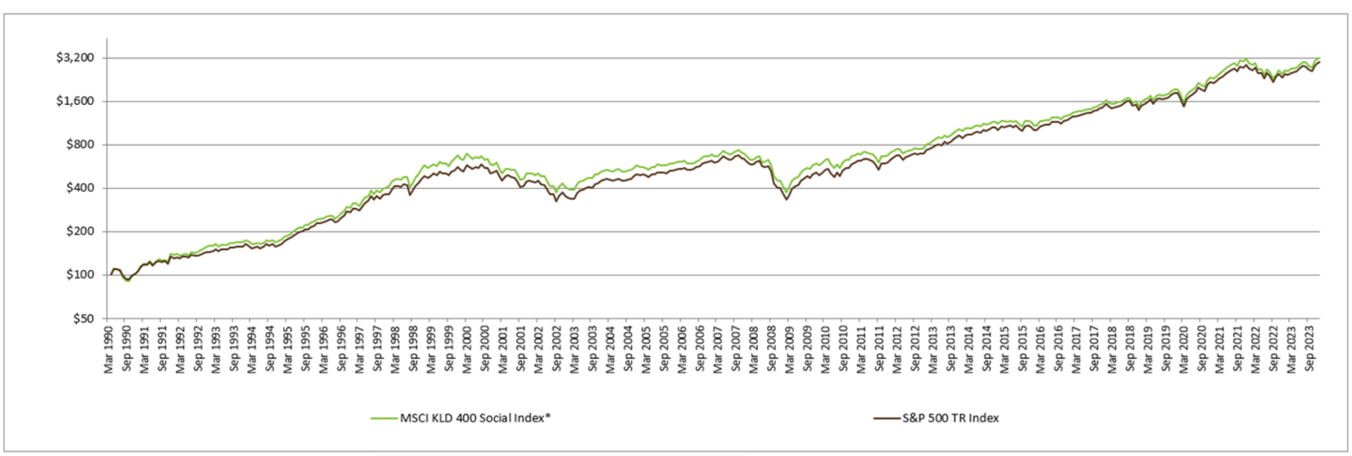
Source: Morningstar Direct and author's calculations. Data as of Dec. 31, 2023.

Figure 12. Morningstar Category Average Annual Returns by Sector, 10 Years Ended March 31, 2023



Source: Morningstar, First Affirmative

Figure 13. MSCI KLD 400 vs S&P 500 Indices, March 31, 2023



	MSCI KLD 400 Social Index*	S&P 500 TR Index
Annualized Return Since 5/1/90:	12.48%	10.49%

Source: Morningstar. *Data prior to 9/1/2010 is that of the MSCI KLD 400 Social Index GR, while data since 9/1/2010 is that of the MSCI KLD 400 Social Index NR. Indices are unmanaged groups of securities. Index performance does not include the impact of cash, fees, or transaction costs. Investors cannot invest directly in indices but may purchase mutual funds or other investment products designed to track the performance of various indices.

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