MONTHLY MARKET UPDATE
April 2024

Madison INVESTMENTS

Highlights:

- Strong performance in March contributed to one of the best first quarter returns in the past decade, with the S&P 500 Index advancing 3.2% for the month and 10.6% for the quarter.
- While large-cap technology continued to dominate, other sectors contributed significantly to the rally, with a notable 10% bounce in Energy stocks in March. Except for Real Estate, all S&P sectors saw positive returns for the quarter.
- Inflation remained somewhat sticky, with PCE ticking slightly higher to 2.5%; Fed Chairman Powell said the print aligned with expectations.

A strong and broad stock market in March added up to one of the best first quarter returns of the past decade, with the S&P 500 Index advancing 3.2% for the month and 10.6% for the quarter. The S&P 500 set numerous new closing highs, including one on the final trading day of March. This rally was largely a continuation of the bull market of 2023, driven by a stronger-than-expected economy, solid corporate earnings, expectations of Federal Reserve easing, and moderated, if somewhat sticky, inflation. Large-cap technology was still the leading stock market story even as a couple of the former "magnificent seven" faltered this year. But other sectors of the market were major contributors to the rally, including a 10% bounce in energy stocks in March. For the quarter, all S&P sectors other than Real Estate were positive, led by double-digit returns from Communication Services, Energy, Information Technology, Financials, and Industrials.

Bonds were broadly flat for the quarter as yields worked higher. Over the course of the three months, rates in the middle and long end of the yield curve rose close to a half percent. The U.S. Aggregate Bond Index rose 0.9% in March, but was down -0.8% for the quarter. Holders of short-term corporate bonds continued to see the highest yields in decades, with coupons in the 5.5% range.

A much-anticipated inflation report was issued at quarter-end on March 30. The Fed's favorite inflation measure, Personal Consumption Expenditures (PCE), came in at 2.5%, a tick higher than the 2.4% reading in January. However, Fed Chairman Powell appeared to take it in stride, saying the print was "pretty much in line with our expectations." He added that reports that conform to expectations are generally a good thing. Another good sign was the drop in the monthly pace of service price increases from 0.4% to 0.3%, a move which was better than anticipated. A moderation in the rate of service prices was also well received since service inflation has been a major driver of overall inflation over the past years.

So, what are we to make of market and economic prospects going forward? On one hand, there are signs that the positive returns could continue into 2024. Technology companies are expected to prosper behind the AI revolution, even as the broad swatch of U.S. corporations work through how these new technologies will be applied to improve productivity and profits. One example of the spinoff effects from AI is the March Energy Sector rally, fueled by the developing boom in high-energy-demand data centers. Historically, strong first quarters have indicated promising results for the ensuing year, and for reasons that defy analysis, returns are positively correlated with presidential election years. Another boost could come from Federal Reserve rate cuts, which are currently projected as three quarter-point reductions by year-end. On the other hand, the market is trading at a price-to-earnings (P/E) multiple well above its 5-year and 10-year averages, so valuations need to be supported by robust profit growth in 2024. We will soon find out in Q1 earnings reports whether companies are forecasting an acceleration in profitability.

PORTFOLIO MANAGER Q&A - BILL FORD

Bill Ford, CFA
Portfolio Manager, Credit Analyst

As expected, the Fed held rates steady at its last meeting, but it did offer guidance on its expectations for future rate cuts. What should investors take away from the Fed's inflation fight and market expectations?

Markets were focused on the Summary of Economic Projections (SEP), also known as the dot plot, which showed some subtle changes. The median numbers didn't change significantly, especially in terms of rate projections for 2024 or even for 2025 and 2026. However, within those dots, we saw some more dovish outliers (expecting more aggressive rate cuts and lower terminal rates) move up closer to the median. This indicates a Fed whose expectations for rates are shifting towards a "higher for longer" scenario.

Markets had been pricing in more interest rate cuts than the Fed telegraphed following the data in November and December of 2023. The inflation, consumer, and growth data that has come in so far in 2024 has really pushed back on that narrative, and the market has since moved back toward where the Fed said they were all along.

While the Fed thinks inflation is trending in the right direction, and it looks like there hasn't been too much collateral economic damage, they are not quite ready to cut. Without an exogenous event or shock that would cause a big economic slowdown or concern within the financial system, we think aggressive rate cuts are unlikely.

With corporate spreads at historically tight levels, are investors being adequately compensated for taking on risk in the corporate bond market right now?

We believe this is a time for more discipline rather than opportunity-seeking in the bond market. Throughout most credit cycles, we tend to see that spreads grind tighter and tighter when things are good, and people feel better about taking more risk and chasing yield. Then, there tends to be a sudden gap wider when something happens that causes investors to reassess risk levels and pull back from taking more credit risk. Over the past 15-20 years, this happened in the global financial crisis, the European debt crisis, the Fed being perceived as having overtightened at the end of 2018, COVID, and in 2022.

In each of those cases, we went from a point where spreads had been wider to a point where they got tighter and tighter, which was good if you were exposed to credit risk in those scenarios. But then you reach a point where you're not being compensated for taking credit risk. It feels terrible at the time because you think you're giving up yield, but it is important to be disciplined in those times.

When risk reprices and spreads move wider, they tend to move very quickly, usually due to something that nobody saw coming. We tend to be fairly conservative on credit risk; we believe now is a better time to be more defensive. We will certainly take it on, but we want to be careful about how and when we do.

With rate cuts widely expected to come later this year, how is the portfolio positioned? Where are you finding opportunities to add value?

From a rates perspective, the market is finally in alignment with the Fed. The shorter end of the yield curve will depend more on monetary policy and the timing and pace of cuts, while the longer end will be more defined by where the terminal rate ultimately lands. As much as one can have an opinion on where rates will move, we think both long and short rates are moving toward fair value. Short-term rates may be more likely to move down than up, but we don't have a strong conviction on this. Without a strong conviction on rates, we're staying much more neutral to our benchmarks.

When it comes to credit, I would come back to the idea of discipline. We add value by maintaining our flexibility, pulling back on credit exposure, staying higher quality, and waiting for whatever shakes loose to make credit spreads widen.

One area where we are still seeing spreads at attractive levels is within the US regional bank sector, particularly with the Super Regionals (the larger regional banks). We have to be selective here, but we are maintaining an overweight to the sector. It has been a year since Silicon Valley Bank and First Republic sparked fears within the banking sector, and wider spreads in the sector can still be attributed to this. Regional banks tend to have a little more exposure to commercial real estate and offices, which is becoming a greater area of concern. But as we look at the regional banks we have exposure to, we feel very confident that these types of risks are well contained. We will shy away from the banks that are more exposed to higher stress or troubled areas.

U.S. EQUITIES (%)

	March	QTD	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	2.2	6.1	6.1	22.2	8.7	11.3	11.8
S&P 500	3.2	10.6	10.6	29.9	11.5	15.0	13.0
Russell 1000	3.2	10.3	10.3	29.9	10.5	14.8	12.7
Russell 1000 Value	5.0	9.0	9.0	20.3	8.1	10.3	9.0
Russell 1000 Growth	1.8	11.4	11.4	39.0	12.5	18.5	16.0
Russell Midcap	4.3	8.6	8.6	22.3	6.1	11.1	9.9
Russell 2000	3.6	5.2	5.2	19.7	-0.1	8.1	7.6

U.S. EQUITY CHARACTERISTICS - S&P 500

	March	2023
Price/Earnings Ratio (NTM)	20.2	19.7
Weighted Avg. Market Cap ($B)	803.9	721.7
Dividend Yield (%)	1.4	1.5

U.S. EQUITY SECTORS - S&P 500 (%)

	March	QTD	YTD	Weight
Communication Services	4.3	15.8	15.8	9.0
Consumer Discretionary	0.1	5.0	5.0	10.3
Consumer Staples	3.5	7.5	7.5	6.0
Energy	10.6	13.7	13.7	3.9
Financials	4.8	12.5	12.5	13.2
Health Care	2.4	8.8	8.8	12.4
Industrials	4.4	11.0	11.0	8.8
Information Technology	2.0	12.7	12.7	29.6
Materials	6.5	8.9	8.9	2.4
Real Estate	1.8	-0.5	-0.5	2.3
Utilities	6.6	4.6	4.6	2.2

INTERNATIONAL EQUITIES (%)

	March	QTD	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	3.1	8.2	8.2	23.2	7.0	10.9	8.7
ACWI ex USA	3.1	4.7	4.7	13.3	1.9	6.0	4.3
MSCI EAFE	3.3	5.8	5.8	15.3	4.8	7.3	4.8
Emerging Markets	2.5	2.4	2.4	8.2	-5.1	2.2	2.9
China	0.9	-2.2	-2.2	-17.1	-18.9	-6.3	1.2
Japan	3.0	11.0	11.0	25.8	3.7	7.8	6.7
Germany	3.8	7.1	7.1	14.8	1.1	6.3	2.7
United Kingdom	4.5	3.1	3.1	10.9	7.7	5.1	2.9
India	0.8	6.1	6.1	36.8	12.3	11.5	9.7

KEY ASSET PRICES

	March	2023
USD/EUR	1.08	1.11
CAD/USD	1.35	1.32
JPY/USD	151.22	140.92
USD/GBP	1.26	1.27
Bitcoin ($)	71,333.7	42,265.2
Gold ($/oz)	2,231.0	2,066.0
Crude Oil (WTI) ($/bbl)	82.4	75.8

FIXED INCOME (%)

	March	QTD	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	0.6	-0.9	-0.9	0.1	-2.7	0.0	1.0
Municipal	0.0	-0.4	-0.4	3.1	-0.4	1.6	2.7
U.S. Aggregate Bond	0.9	-0.8	-0.8	1.7	-2.5	0.4	1.5
Investment Grade Corporate	1.2	-0.4	-0.4	4.1	-1.9	1.4	2.5
High Yield	1.2	1.5	1.5	11.2	2.2	4.2	4.4

U.S. TREASURY YIELDS (%)

	March	2023
3-Month	5.5	5.4
6-Month	5.4	5.3
2-Year	4.6	4.2
5-Year	4.2	3.8
10-Year	4.2	3.9
30-Year	4.3	4.0

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In addition to the ongoing market risk applicable to portfolio securities, bonds are subject to interest rate risk, credit risk and inflation risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Credit risk is the possibility that the issuer of a security will be unable to make interest payments and repay the principal on its debt. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

The Dow Jones Industrial Average® (The Dow®), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The S&P 500® Index is an unmanaged index of large companies and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 89% of the total market capitalization of the Russell 3000 Index.

The Russell 1000® Growth Index is designed to track those securities within the broader Russell 1000 Index that FTSE Russell has determined exhibit growth characteristics.

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Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index.

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The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries (excluding the US) and 23 Emerging Markets countries. With 1,843 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

Emerging Markets - MSCI Emerging Market Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

China - MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

Japan - MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

Germany - MSCI Germany Index is designed to measure the performance of the large and mid cap segments of the German market.

United Kingdom - MSCI United Kingdom Index is designed to measure the performance of the large and mid cap segments of the UK market.

India - MSCI India Index is designed to measure the performance of the large and mid cap segments of the Indian market.

Government Bond - Bloomberg US Government Index measures the performance of the U.S. Treasury and U.S. Agency Indices, including Treasuries and U.S. agency debentures. It is a component of the U.S. Government/Credit Index and the U.S. Aggregate Index.

Municipal - Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

U.S. Aggregate Bond - Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Investment Grade Corporate - Bloomberg U.S. Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

High Yield - Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Weighted Avg. Market Cap: measures the size of the companies in which the portfolio invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share.

Price-to-Earnings (P/E) Ratio: measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's earnings per share of stock in a portfolio.

Dividend Yield: the portfolio's weighted average of the underlying portfolio holdings and not the yield of the portfolio.

A basis point is one hundredth of a percent.

Bond Spread is the difference between yields on differing debt instruments of varying maturities, credit ratings, and risk, calculated by deducting the yield of one instrument from another.

Yield Curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward-sloping curve), inverted (downward-sloping curve), and flat.

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