Madison INVESTMENTS

# MONTHLY MARKET UPDATE
March 2024

Highlights:
- The S&P 500 Index rose 5.2% in February, hitting a new all-time high, with a year-to-date increase of 7.1%.
- Despite the market's strength, consumer confidence unexpectedly declined, possibly due to election stress and ongoing negative news from overseas war zones.
- Consumer spending is softening, as evidenced by declines reported by shipping and delivery companies, while the housing market and big-ticket consumer spending remain sluggish due to high borrowing costs.

An extra trading day on February 29 was additive as the S&P 500 Index rose 5.2% for the month, reaching a new all-time high. Year-to-date, the index is up 7.1%. The tech-heavy NASDAQ also hit a new high. So far this year, the "Magnificent Seven," which powered index returns in 2023, has lost some luster, although market advances continue to be fueled by a small number of technology-centric stocks. Meanwhile, the broader market has shown improved strength. The strong February return saw more than 70% of the S&P 500 stocks positive while small and mid-sized stocks advanced in line with the large-cap indices, even as they face potentially greater earnings pressures from high interest rates and input costs.

Despite the strong market, receding inflation, and unemployment near a 50-year low, February saw an unexpected decline in consumer confidence. Some of this can be attributed to election stress as prospects for a November presidential election featuring two unpopular candidates came into focus. Steady gloomy news from two overseas war zones was an additional cloud.

The strong returns of late 2023 were powered by the prospect of numerous Federal Reserve rate cuts, once seen as beginning as early as March. Consensus has moved to our level of skepticism, but the market has plowed ahead regardless, buoyed, it seems, by the backdrop of a stronger-than-expected economy and the willingness to accept a slower and more cautious Fed. The latest inflation print, coming on leap day, kept the trend in place as the closely observed personal consumption expenditure (PCE) numbers fell right in line with expectations.

One trend to keep an eye on is the softening of consumer spending, as seen in a broad decline reported by shipping and delivery companies. While strong employment numbers continue to support economic growth, much of the world is currently in recession, and we are not immune to a slowdown. Behind the high cost of borrowing, the housing market remains sluggish, as does big-ticket consumer spending, including cars. Slackening demand has led to price declines in many areas of goods, leaving inflation now largely centered on the cost of services.

While the valuations of favored stocks are well below the feverish pitch we saw in the tech boom of the late 1990s, the excitement over the prospects of artificial intelligence and the rosy earnings projections for the year ahead warrant some careful comparisons. Today is quite different in how business momentum and real earnings have boosted the highest flying stocks. At the same time, we always have an eye on risk and see some mounting evidence that expectations may exceed reality.

The remainder of 2024 will likely be dominated by increasing focus on the election. This anxiety may be balanced by expected rate cuts. Lower rates translate quickly into lower borrowing costs, potentially fueling a latent desire for big-ticket consumer items. The U.S. economy remains the strongest in the world.

## PORTFOLIO MANAGER Q&A - JOE MAGINOT

**Following a strong 2023, the S&P 500 is up another 7% this year to date. What risks do you think investors need to consider as we progress through the year? And how do you and the team approach managing risk in both rising and falling markets?**

*Joe Maginot*
*Portfolio Manager, Analyst*

As in any given year, there will always be things to worry about. Right now, investors are grappling with whether inflation will come down, when the Fed will cut rates, and how that will impact employment levels and consumer spending. While these are all risks investors need to consider, when we think about controlling risk within our portfolios, it has to start from the bottom up, looking at the securities we own. We believe the best way to manage risk is by investing in the right companies at attractive valuations. If you can invest in companies that can absorb a wide range of external shocks over various economic and market environments, you should do well over the long term.

**The recent market environment has been selective, to say the least. Can you share an example of how your investment process helps you identify opportunities in different market conditions?**

We want to invest in the highest quality companies out there. The companies with the most attractive growth rates, that participate in growing industries, and are well managed. Often, those companies aren't priced at bargain valuations. So, typically, something has to happen to cause that disconnect, or the market has to sour on those companies. It's typically something happening in the industry at large, the broader economy, or at the company specifically. One example that comes to mind is Lowe's, which has been a long-term holding in the portfolio. The rise in interest rates over the last 12 to 18 months has really depressed activity in the housing market. Lowe's typically benefits from housing turnover, as homeowners often invest significant amounts in repainting and enhancing the appearance of their homes when preparing to sell them to potential buyers. Then, when the property is sold, the new homeowner often begins their own renovation projects, redoing the previous enhancements to suit their preferences, such as repainting walls or installing new flooring.

With most homeowners having mortgage rates much lower than current levels, people are hesitant to sell and move, which has depressed the level of activity in the housing market. As a result, the market has soured on companies like Lowe's, which we still think is an extremely well-run company that generates terrific business economics. We believe Lowe's can do well, even if the underlying environment stays depressed, and that they will continue to return capital to shareholders through dividends and, as importantly, share repurchases. So that's an example in today's environment where the company is certainly out of favor, but we quite like the long-term prospects.

**Can you elaborate on the key factors you consider when evaluating the quality of a company?**

We invest in companies that generate very attractive economics for the owners of the business. In other words, we want attractive and persistent returns on capital, but just as important, we want companies whose products and services are becoming more relevant within the global economy. We want the company to grow with at least the nominal growth of the broader economy. Secondly, we want companies with great balance sheets because that allows them to invest counter-cyclically and oftentimes gain share despite a downturn in their end market. Such as the Lowe's example I just shared. Then, the last piece is management. Simply put, we want the management team to be in the same boat as us, rowing in the same direction.

**Has your approach evolved, considering the increasing role of AI in today's market?**

We're very risk-focused investors; we don't think all returns are created equally, but rather, it's how much risk you take to generate those returns. The proliferation of AI has really forced us to re-underwrite all the companies that we thought had exposure to potential disruption from this. The key question we asked ourselves was: is this a technology that will be subsumed and integrated into the existing technology platforms and companies out there, or will this technology represent a platform shift, where all the companies that benefited in the old world, so to speak, will become obsolete.

For example, we have investments in payment technology companies. AI could be used by malicious actors to make fraudulent transactions. We think payment companies will have to continue to invest in best-in-class authorization and fraud prevention, and we think the incumbents are in the best position to make those investments. Over time, we think it will enhance their competitive positions.

## U.S. EQUITIES (%)

| | Feb | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|
| DJ Industrial Average | 2.5 | 3.8 | 22.0 | 10.3 | 10.9 | 11.6 |
| S&P 500 | 5.3 | 7.1 | 30.5 | 11.9 | 14.8 | 12.7 |
| Russell 1000 | 5.4 | 6.9 | 29.8 | 10.7 | 14.4 | 12.4 |
| Russell 1000 Value | 3.7 | 3.8 | 14.0 | 8.4 | 9.4 | 8.7 |
| Russell 1000 Growth | 6.8 | 9.5 | 45.9 | 12.5 | 18.8 | 15.7 |
| Russell Midcap | 5.6 | 4.1 | 15.5 | 5.5 | 10.3 | 9.5 |
| Russell 2000 | 5.7 | 1.5 | 10.0 | -0.9 | 6.9 | 7.1 |

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

| | February | YTD | Weight |
|---|---|---|---|
| Communication Services | 5.7 | 11.0 | 8.9 |
| Consumer Discretionary | 8.7 | 4.9 | 10.6 |
| Consumer Staples | 2.3 | 3.9 | 6.0 |
| Energy | 3.2 | 2.8 | 3.7 |
| Financials | 4.2 | 7.3 | 13.0 |
| Health Care | 3.2 | 6.3 | 12.5 |
| Industrials | 7.2 | 6.3 | 8.7 |
| Information Technology | 6.3 | 10.5 | 29.8 |
| Materials | 6.5 | 2.3 | 2.3 |
| Real Estate | 2.6 | -2.3 | 2.3 |
| Utilities | 1.1 | -1.9 | 2.1 |

## U.S. EQUITY CHARACTERISTICS - S&P 500

| | February | 2023 |
|---|---|---|
| Price/Earnings Ratio (NTM) | 20.6 | 19.7 |
| Weighted Avg. Market Cap ($B) | 792.1 | 721.7 |
| Dividend Yield (%) | 1.4 | 1.5 |

## INTERNATIONAL EQUITIES (%)

| | Feb | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|
| ACWI | 4.3 | 4.9 | 23.1 | 6.8 | 10.5 | 8.4 |
| ACWI ex USA | 2.5 | 1.5 | 12.5 | 1.3 | 5.4 | 4.0 |
| MSCI EAFE | 1.8 | 2.4 | 14.4 | 4.4 | 6.8 | 4.4 |
| Emerging Markets | 4.8 | -0.1 | 8.7 | -6.3 | 1.9 | 3.0 |
| China | 8.4 | -3.1 | -14.1 | -20.9 | -6.1 | 1.0 |
| Japan | 3.0 | 7.8 | 26.9 | 3.0 | 7.3 | 6.2 |
| Germany | 4.1 | 3.1 | 15.0 | 1.2 | 5.2 | 2.2 |
| United Kingdom | 0.0 | -1.3 | 5.5 | 7.1 | 4.4 | 2.1 |
| India | 2.7 | 5.2 | 37.3 | 12.8 | 13.4 | 10.5 |

## KEY ASSET PRICES

| | February | 2023 |
|---|---|---|
| EUR/USD | 1.08 | 1.11 |
| USD/CAD | 1.36 | 1.32 |
| USD/JPY | 149.90 | 140.92 |
| GBP/USD | 1.26 | 1.27 |
| Bitcoin ($) | 61,198.4 | 42,265.2 |
| Gold ($/oz) | 2,045.0 | 2,066.0 |
| Crude Oil (WTI) ($/bbl) | 78.5 | 75.8 |

## FIXED INCOME (%)

| | Feb | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|
| Government Bond | -1.3 | -1.6 | 2.3 | -3.4 | 0.2 | 1.0 |
| Municipal | 0.1 | -0.4 | 5.4 | -0.2 | 1.9 | 2.7 |
| U.S. Aggregate Bond | -1.4 | -1.7 | 3.3 | -3.2 | 0.6 | 1.4 |
| Investment Grade Corporate | -1.4 | -1.6 | 5.7 | -2.8 | 1.6 | 2.4 |
| High Yield | 0.3 | 0.3 | 11.0 | 1.8 | 4.2 | 4.3 |

## U.S. TREASURY YIELDS (%)

| | February | 2023 |
|---|---|---|
| 3-Month | 5.5 | 5.4 |
| 6-Month | 5.3 | 5.3 |
| 2-Year | 4.6 | 4.2 |
| 5-Year | 4.3 | 3.8 |
| 10-Year | 4.3 | 3.9 |
| 30-Year | 4.4 | 4.0 |

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Large Cap investing is based on the expectation of positive price performance due to continued earnings growth or anticipated changes in the market or within the company itself. However, if a company fails to meet that expectation or anticipated changes do not occur, its stock price may decline. Moreover, as with all equity investing, there is the risk that an unexpected change in the market or within the company itself may have an adverse effect on its stock. Investing in growth-oriented stocks involves potentially higher volatility and risk than investing in income-generating stocks. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

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.

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

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.

The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. 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. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

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.

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