MONTHLY MARKET UPDATE
May 2024

Madison INVESTMENTS

Highlights:

- Stubborn inflation and a resilient economy had shifted speculation to one, two, or maybe zero cuts in 2024.
- Uncertainty weighed on stock and bond valuations in April. The S&P 500 Index ended the month down -4.2%, bringing the year-to-date return to 5.6%.
- Attention shifted to earnings sustainability amidst historically high valuations, with positive earnings reports surpassing expectations, particularly in the Technology sector.
- Concerns arise over the resilience of consumer spending, particularly among low-income consumers, despite overall strength in the job market.

If the best remembered phrase from long-serving Federal Reserve Chair Alan Greenspan is "irrational exuberance," then current Chairman Jerome Powell's may well be "data dependent." Powell's obsession has become the market's. This past April was another in many months of seesawing sentiment over the state of inflation and the state of the economy and their effects on Federal Reserve policy. Early this year, optimism over falling inflation produced widespread belief that interest rate cuts would be dropping as frequently as Caitlin Clark's threes. By the end of April, stubborn inflation and a resilient economy had shifted speculation to one, two, or maybe just zero cuts in 2024. Worriers went so far as to postulate another rate increase, a possibility Chairman Powell brushed off, to the market's relief, in his May 1 statements.

All of this uncertainty was a drag on stock and bond valuations in April. From top to bottom, the S&P 500 Index flirted with a -6% drop but rallied to end the month down -4.2%, bringing the year-to-date return to 5.6%. Interest rates worked higher, chipping away at bond valuations. The bellwether 10-Year Treasury began the month at 4.2% and ended nipping at 4.7%. Small and midcap stocks, which are more interest-rate sensitive, trailed larger stocks. And among larger stocks, the most dramatic earnings continued to be concentrated in mega-cap technology.

With the growing recognition that the stock market is not going to have the tailwinds of reliable rate cuts, attention has shifted to earnings sustainability. This is particularly pointed since valuations are historically high. The evidence by month end was generally positive with more than half of the S&P 500's market cap reported. Earnings were beating expectations by 8.4%, well above the historic average of 4.8%. Forward projections show a continuation of the overall trend with some significant gaps between the market-leading Technology sector and trailing sectors Materials and Energy.

As we've warned in the past, the buoyant economy's reliance on a resilient consumer may be fraying, particularly at the low end. While the job market continues to show strength, consumer confidence has recently dipped, and this has been showing up in sales at some of the nation's largest discount retailers. Meanwhile, middle- and high-income consumers appear to be in good shape. This is particularly clear in the housing market, where sales of expensive homes, often purchased on a cash basis, are outpacing more moderate-priced housing, where high mortgage rates are suppressing turnover and sales.

Looking forward, the best chance for Federal Reserve action appears to be September, after which we anticipate the traditional pause for the election season. While recent inflation prints have caused some consternation, we think the revival of the 1970s term "stagflation" is overblown. The prospect of high and rising inflation in conjunction with a recessionary economy is extremely rare and requires extenuating circumstances. Yes, inflation is sticky, and getting the personal consumption expenditure (PCE) inflation rate down from 2.8% to the targeted 2.0% may be difficult, but the slowing GDP reading for the first quarter suggests that inflationary pressures should eventually abate.

MONTHLY Q&A - MATTHEW GOETZINGER

We've been hearing a lot in the press about the valuation differences between small and mid cap companies versus large cap companies. What is your team currently seeing in your research?

I like to say price is what you pay, and value is what you get. So, when discussing valuation, I think you have to take into account the underlying business quality and the sustainability of growth. There are some areas in the market that we do think are fairly full in terms of valuation. But at the same time, there are also areas of the market that are experiencing some pressures and are presenting some opportunities to really take a look at what we feel are some nice, high-quality businesses.

Matthew Goetzinger, CFA
Senior Analyst

Another item getting a lot of press attention lately is earnings growth. Predominantly, mega-cap tech has driven most of the earnings growth. However, if you look beyond mega-cap tech, earnings have been relatively flat and negative in many areas. What has the team been seeing in your portfolios as far as the potential for earnings acceleration in the back half of 2024?

We've been quite pleased with the underlying fundamental performance of our companies. Certainly, I would acknowledge that the first quarter GDP readout was fairly weak. Inflation remains a bit stubborn and elevated, and I think that that's causing some pressures across durable goods in some areas. I think it's important to step back and remind our investors of our core emphasis, which is identifying what we believe are all-weather vehicles. And that means that we insist that our companies can perform in a variety of macroeconomic environments.

How are you feeling about valuations these days? Mega cap tech looks like it's trading on a price-to-earnings basis well above its 5-, 10-, and even 15-year averages. Where are you and your team finding the most opportunity today?

The whole team is really a student of market history. We know that there are always opportunities out there that we can uncover. Our focus always remains on being intellectually honest with our work, emphasizing our team's collaborative nature, and leveraging each individual analyst's insights. Right now, we definitely are finding some areas of the market that are presenting opportunities. There are some great businesses and brands that are under pressure within consumer, some related to some factors around GLP-1 (a diabetes drug that's now also approved as a weight loss drug) impacts, but really kind of idiosyncratic opportunities across business services and technology.

Sometimes, for an active manager, it's more important to generate excess returns from companies you pass on or areas you don't own. What are some warning signs you and your team look for as far as companies or situations to avoid?

Our process has always been to look down before we look up. Meaning that we're always trying to insist on a margin of safety within our recommendations and valuation assessments. So, what we're really trying to assess with our qualitative assessments is the durability and strength of the company's competitive moat. And so if we can't satisfy ourselves that is being met in our research and our field research efforts, then we'll simply move on to the next opportunity.

U.S. EQUITIES (%)

	April	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	-4.9	0.9	13.3	5.9	9.6	11.1
S&P 500	-4.1	6.0	22.7	8.1	13.2	12.4
Russell 1000	-4.3	5.6	22.8	7.0	12.9	12.1
Russell 1000 Value	-4.3	4.3	13.4	5.2	8.6	8.4
Russell 1000 Growth	-4.2	6.7	31.8	8.5	16.5	15.5
Russell Midcap	-5.4	2.7	16.4	2.4	9.1	9.4
Russell 2000	-7.0	-2.2	13.3	-3.2	5.8	7.2

U.S. EQUITY CHARACTERISTICS - S&P 500

	April	2023
Price/Earnings Ratio (NTM)	19.9	19.7
Weighted Avg. Market Cap ($B)	782.1	721.7
Dividend Yield (%)	1.4	1.5

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

	April	YTD	Weight
Communication Services	-2.1	13.4	9.1
Consumer Discretionary	-4.3	0.4	10.3
Consumer Staples	-0.9	6.6	6.2
Energy	-0.8	12.8	4.1
Financials	-4.2	7.8	13.1
Health Care	-5.1	3.3	12.3
Industrials	-3.6	7.0	8.8
Information Technology	-5.4	6.6	29.2
Materials	-4.6	3.9	2.4
Real Estate	-8.5	-9.0	2.2
Utilities	1.6	6.3	2.3

INTERNATIONAL EQUITIES (%)

	April	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	-3.3	4.6	17.5	4.3	9.4	8.2
ACWI ex USA	-1.8	2.8	9.3	0.3	5.0	3.9
MSCI EAFE	-2.6	3.1	9.3	2.9	6.2	4.4
Emerging Markets	0.4	2.8	9.9	-5.7	1.9	3.0
China	6.6	4.3	-6.8	-17.6	-5.5	2.1
Japan	-4.9	5.6	19.2	2.5	6.4	6.4
Germany	-3.7	3.1	6.9	-1.3	4.1	2.2
United Kingdom	1.9	5.1	7.3	6.8	5.1	2.6
India	2.3	8.5	34.4	13.5	11.9	10.1

KEY ASSET PRICES

	April	2023
EUR/USD	1.07	1.11
USD/CAD	1.37	1.32
USD/JPY	157.54	140.92
GBP/USD	1.25	1.27
Bitcoin ($)	60,636.0	42,265.2
Gold ($/oz)	2,292.0	2,066.0
Crude Oil (WTI) ($/bbl)	84.3	75.8

FIXED INCOME (%)

	April	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	-2.3	-3.2	-2.7	-3.7	-0.5	0.8
Municipal	-1.2	-1.6	2.1	-1.1	1.3	2.4
U.S. Aggregate Bond	-2.5	-3.3	-1.5	-3.5	-0.2	1.2
Investment Grade Corporate	-2.5	-2.9	0.8	-3.0	0.8	2.1
High Yield	-0.9	0.5	9.0	1.5	3.7	4.3

U.S. TREASURY YIELDS (%)

	April	2023
3-Month	5.5	5.4
6-Month	5.4	5.3
2-Year	5.0	4.2
5-Year	4.7	3.8
10-Year	4.7	3.9
30-Year	4.8	4.0

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Investments in midsize companies may entail greater risks than investments in larger, more established companies. Midsize companies tend to have narrower product lines, fewer financial resources, and a more limited trading market for their securities, as compared to larger companies. They may also experience greater price volatility than securities of larger capitalization companies because growth prospects for these companies may be less certain and the market for such securities may be smaller. Some midsize companies may not have established financial histories; may have limited product lines, markets, or financial resources; may depend on a few key personnel for management; and may be susceptible to losses and risks of bankruptcy.

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.

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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.

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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.

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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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