VAUGHAN NELSON

Investment Perspective

First Quarter 2024

During the first quarter, the S&P 500 Index rose 10.56% while the Russell 2000 Value Index gained 2.90%. International equity markets also increased with the MSCI EAFE rising 5.07%.

Equity markets continued to rally in the first quarter as the increase in global liquidity boosted equity valuations and firmed underlying inflationary pressures. After more than six quarters of contraction, the global industrial economy is set to stabilize and begin expanding in the second quarter of 2024. Firming commodity prices and broadening equity market participation are confirming indicators that the industrial economy is beginning to improve.

As inflation is beginning to firm, fixed-income markets began reversing the easing in financial conditions experienced in the prior quarter. Despite the higher interest rates, the economic cycle and liquidity conditions will likely remain supportive of risk assets through the November election. Post the November 2024 election, the investment outlook should become less certain, as capital markets will again need to confront the outsized federal deficits and accelerating cost of servicing large public and private debt balances.

The Bloomberg Aggregate Index returned -0.78% for the quarter while the ICE BofA 1-10 AAA-A Municipal Index returned -0.26%. During the quarter, the Federal Reserve paused raising interest rates and continued to indicate that interest rate cuts are likely in 2024 if inflation continues to track towards the Fed's 2% target.

Notably, the market's expectation for easing in 2024 has declined considerably due to stronger than expected economic growth and stickier inflation data through the first quarter. At the beginning of the year, the market anticipated six 25 basis point (bps) interest rate cuts for 2024, now the market is pricing in just two to three 25 bps between now and December. U.S. Treasuries responded to the stronger economic data with yields backing up approximately 30 bps in the intermediate to long end of the curve.

Investment grade credit spreads tightened 8 bps ending the quarter at +85 bps over Treasury yields. With spreads now trading inside their historical averages and with volatility levels low, we anticipate better opportunities to add to Corporate bonds in 2024 should credit spreads widen from these relatively rich levels.

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