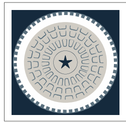


Goodman Financial

MONEY MANAGER • FINANCIAL ADVISOR • PHILANTHROPY

MARCH 2024
MARKET COMMENTARY

EQUITY & FIXED INCOME MARKETS COMMENTARY

Stocks were broadly higher in March. The S&P 500 rose 3.2%, while the Blended Equity benchmark was up 3.9% for the month. The Mid-Cap S&P 400 Index and the Small-Cap S&P 600 Index were up 5.6% and 3.2% for the month, respectively. The Dow Jones Industrial Average Index was up 2.2%, while the NASDAQ Composite Index was up only 1.8% for the month. International stock indices posted gains in March, with developed markets up 2.7%, with emerging markets up only 1.8%. Bond indices were marginally higher in March, as the 10-year U.S. Treasury bond yield slightly dropped to 4.20%, from 4.24% last month.

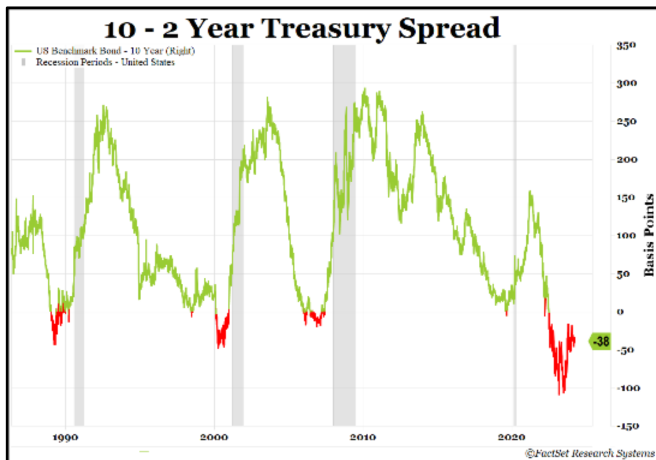
YIELD CURVE INVERSION MAKES HISTORY

Upon reading the above headline, you may ask "what is a yield curve inversion, and why should I care?". So first, let's start with what a "yield curve" is. A yield curve represents U.S. Treasury yields across the maturity spectrum of 1 month to 30 years. The curve is presented as a line on a chart with interest rates on the side y-axis and maturities on the bottom x-axis. The normal state of the yield curve is upwardly sloping, i.e., the interest rate increases as maturities increase. The reason for this is that bond investors want to be compensated with a higher interest rate to take on the risk of uncertainty that comes with longer maturity time horizons – just think of all the things that could go wrong or happen over the next 30 years!

Ok, now that we have a better understanding of what a yield curve is, then what is a yield curve inversion? Well, as we mentioned, the normal state is an interest rate yield curve that is upwardly sloping. In an inversion, shorter dated treasury bills yield MORE than a longer dated treasury bond. Inversions almost always occur when the Federal Reserve (Fed) has aggressively raised the overnight Federal Funds rate which they alone control. The Fed's intentions about the future direction of that rate then further dictate how investors perceive what the Fed Funds rate will likely be over the next few years, and thus in that way affects market treasury rates for a few years along the maturity spectrum. So, what an inverted yield curve really represents is an aggressive Fed hiking regime, usually started when the economy is growing at an unsustainable rate, such that inflation begins to rise beyond the Fed's 2% target rate.

So, why do we care that a yield curve inversion exists? Well, the Fed is raising rates for a reason – to cool economic growth in order to slow inflation. The problem is that the Fed almost always overshoots and cools things down TOO much, such that an economic recession occurs. In that way, yield curve inversions are a tremendous predictor of impending economic recessions. In fact, since 1957, there have been 10 yield curve inversions and only one (in 1966) was not ultimately followed by a recession. As seen in the chart below (left), the difference between the 10-year and 2-year Treasury rate has been negative (i.e., inverted) since July 5, 2022 (as indicated by the red color), for over 630 days and counting. As seen in the chart below (right), courtesy of Deutsche Bank, the duration of this current inversion just passed the length of the August 1978 inversion to become the longest on record since 1957.

For a lot of reasons, many investors are choosing to ignore the yield curve inversion and are now solidly in the "soft landing" camp, whereby they believe the Fed has managed the current hiking regime in such a way as to avoid a recession. As we have consistently communicated these past number of months, we kindly disagree with this assessment. Historically, there are long and variable lags to the ultimate harmful impact of higher rates, and just because there has been an historic lag this time, doesn't mean we are out of the woods yet. Accordingly, we have been tilting our equity holdings to a more defensive posture in anticipation of potential economic weakness and remain comfortable in that stance. Importantly, the S&P 500 and NASDAQ indices have had huge runs and to our thinking, at this point are fully pricing in a soft landing. So, in the event we are correct in our prediction, our defensive stocks should hold up better than those aforementioned indices.



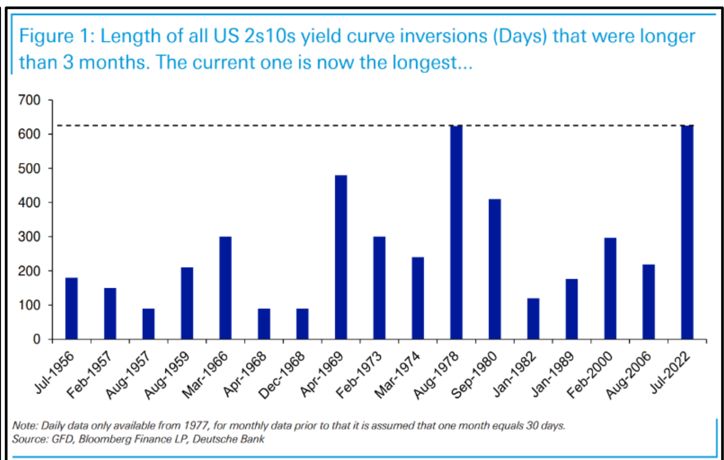
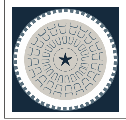


Figure 1: Length of all US 2s10s yield curve inversions (Days) that were longer than 3 months. The current one is now the longest...

Note: Daily data only available from 1977, for monthly data prior to that it is assumed that one month equals 30 days.
Source: GFD, Bloomberg Finance LP, Deutsche Bank



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REFERENCED INDICES

You cannot invest directly in an index. Index results assume the reinvestment of all dividends and interest.

- **S&P 500 Index** - a market-cap weighted index composed of the common stock of 500 leading companies in leading industries of the U.S. economy.
- **S&P 400 Mid-cap Index** – a market-cap weighted index composed of the common stock of 400 mid-sized companies reflecting the distinctive risk and return characteristics of the U.S. mid-cap equities sector.
- **S&P 600 Small-cap Index** – a market-cap weighted index composed of the common stock of 600 small-sized companies reflecting the distinctive risk and return characteristics of the U.S. small-cap equities sector.
- **Blended Equity Benchmark** – a customized index comprised of a blend of a 50% weight to the S&P 500 Large-Cap Index, 30% to the S&P 400 Mid-Cap Index and 20% to the S&P 600 Small-Cap index)
- **Dow Jones Industrial Average Index** – a price-weighted index composed of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.
- **Nasdaq Composite Index** – an index that measures all Nasdaq domestic and international based stocks listed on the Nasdaq Stock Market.
- **Barclays Intermediate Govt/Corp Index** – the index includes investment grade, US dollar-denominated, fixed-rate treasuries, government-related and corporate securities with less than 10 years to maturity.

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