Redhawk Quarterly Commentary

March 31, 2024

Each quarter, Redhawk's Investment Committee provides a Quarterly Commentary. We look at what is transpiring in the investment landscape and provide our perspective on a variety of topics. These are not predictions, and it represents our perspective on important market and economic information designed to help make decisions affecting your long-term financial strategy. Our goal is to help you understand what is going on in the markets so you can more clearly define investment goals, diagnose unintended risks, and utilize portfolios that can achieve a better financial outcome.

Market Commentary

U.S. equities kicked off the year with their strongest start since 2019, as the S&P 500 climbed more than 10% during the quarter. Supported by a robust economy and elevated expectations for interest rate cuts, many economists were optimistic that the Federal Reserve (Fed) achieved a "soft landing," successfully mitigating high inflation without triggering a recession[1].

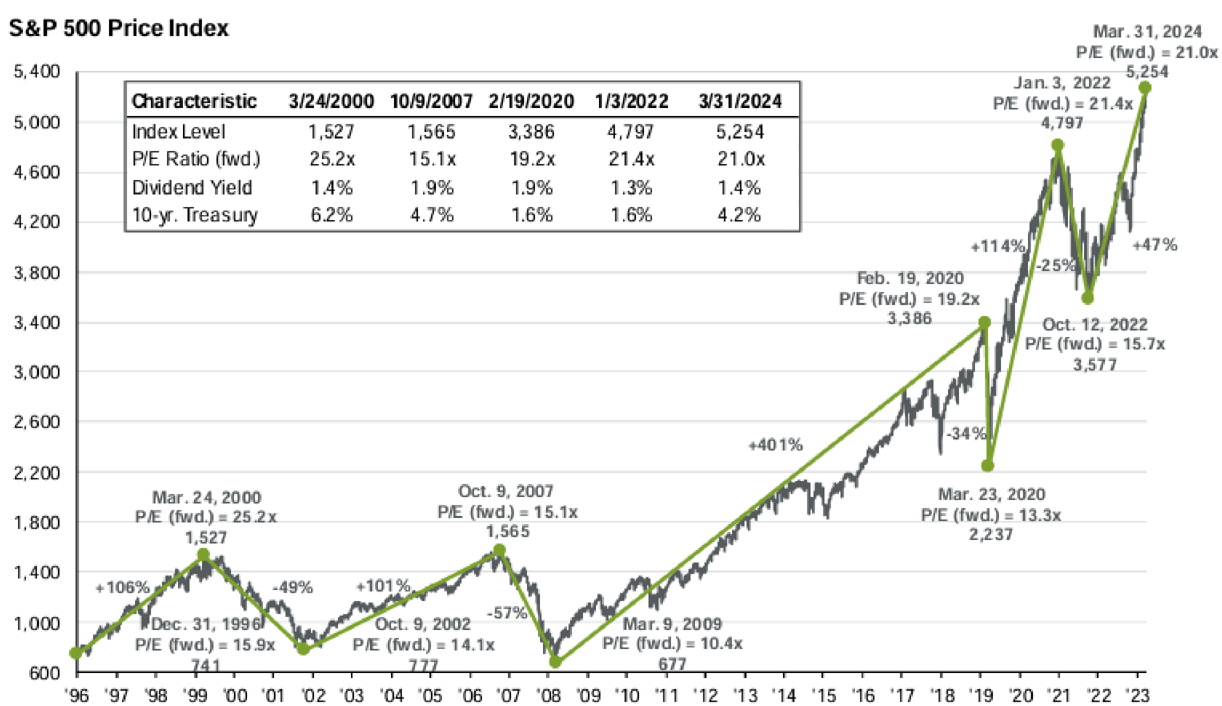
The year began with a modest uptick in volatility, as traders and investors initially booked profits following the strong 2023 gains. However, those small declines intensified shortly after the start of the year when the December Consumer Price Index (CPI), an important inflation indicator, declined less than expected. That reading challenged the idea that inflation was quickly falling towards the Fed's 2.0% target and caused investors to delay the expected date of the first Fed rate cut from March to June[2].

Fears of potentially higher-than-expected rates pushed stocks temporarily into negative territory early in January. However, the declines did not last as fourth-quarter corporate earnings were better than feared which bolstered stocks to recover[3]. Then, in late January, the Fed clearly signaled that rate hikes were over, which investors interpreted as a positive sign, and the S&P 500 hit a new all-time high late in the month and finished with a modest gain, up 1.59%[4].

The rally continued and accelerated in February as fears of a potential rebound in inflation subsided. Inflation metrics released in February largely met expectations and importantly did not imply that inflation was reaccelerating. As such, investor expectations for a June rate cut strengthened and that helped stocks extend the year-to-date gains. Then in late February, Nvidia, the semiconductor company at the heart of the Artificial Intelligence (AI) boom, posted much-stronger-than-expected earnings and guidance. The results further fueled investors' AI enthusiasm and large-cap tech stocks powered the S&P 500 higher into month-end as the index hit a new record high above 5,000.

The final month of the quarter saw even more gains, aided by familiar factors such as solid economic growth, generally as-expected inflation data, AI enthusiasm, and bullish Fed guidance. Broadly speaking, economic and inflation data largely met expectations in March and continued to point towards stable growth and slowly falling inflation. Another strong AI-related earnings from Micron pushed markets broadly higher as the S&P 500 crossed 5,200 for the first time late in the month and ended March with strong gains.

The S&P 500 Index ended the quarter at 5,254 with a forward P/E Ratio of 21.0x and the 10-year Treasury yield closed at 4.2% (see the chart below)[5]. It is interesting to note that the forward P/E ratio has been hovering in the 21.0X range for the last couple of years.



Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of March 31, 2024.

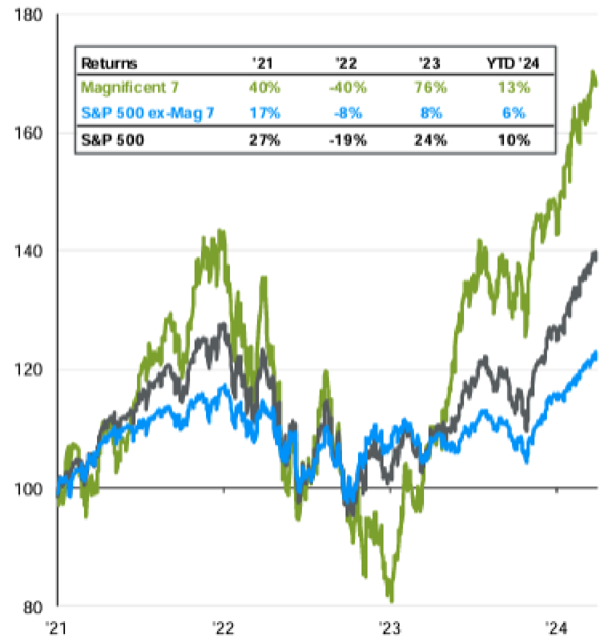
U.S. Market

U.S. shares registered a robust advance in the quarter. Gains were supported by some well-received corporate earnings as well as ongoing expectations of rate cuts later in the year. The pace of monetary policy easing is likely to be slower than had been expected at the end of last year, given resilient U.S. economic data, but that did little to dampen the appetite for equities.

The S&P 500 index was boosted by good corporate earnings, including from some of the Mag 7 (the Mag 7 are the top technology stocks in the S&P 500 Index). The chart to the right shows performance of the Mag 7 and the S&P 500 excluding the Mag 7. While the Mag 7 stocks have dominated market performance since 2023, these seven stocks severely underperformed in 2022, highlighting their greater volatility.

Performance of "Magnificent 7" stocks in S&P 500*

Indexed to 100 on 1/1/2021, price return



Returns	'21	'22	'23	YTD '24
Magnificent 7	40%	-40%	76%	13%
S&P 500 ex-Mag 7	17%	-8%	8%	6%
S&P 500	27%	-19%	24%	10%

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. *Magnificent 7 includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA and TSLA. Earnings estimates for 2024 are forecasts based on consensus analyst expectations. *Guide to the Markets – U.S. Data are as of March 31, 2024.*

Momentum +22.1% was the strongest performing factor over Q1, which significantly outperformed global markets, followed by Quality, which was up 11.2%. Both indices have a large weighting to many of the Mag 7 stocks that have helped to drive strong performance.

Value finished the quarter in positive territory but lagged the broader market, primarily due to a higher weighting to financial stocks as well as not having exposure to some of the more expensive tech names that were the standout performers in markets.

The Fed kept interest rates on hold at 5.25-5.5%. U.S. inflation ticked up slightly to 2.5% year-over-year in February, from 2.4% in January (as measured by the Personal Consumption Expenditure (PCE) metric). Fed chair Jerome Powell communicated that the central bank would be "careful" about the decision on when to cut rates.

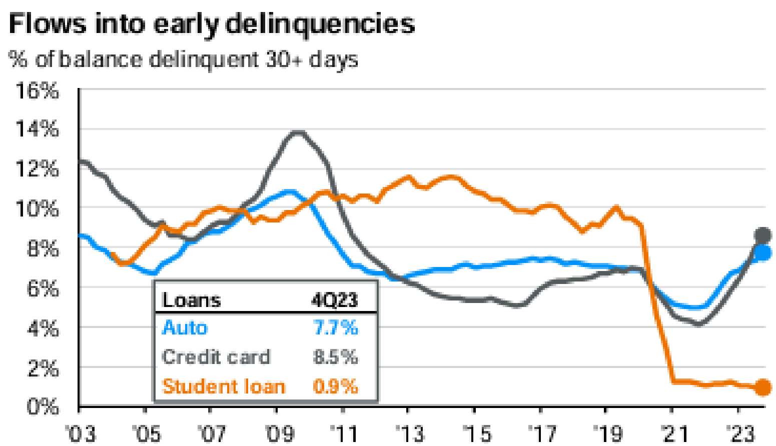
The economy continued its resilience as the annualized GDP growth for Q4 was revised up in the third estimate to 3.4%. Nonfarm payrolls were robust although the unemployment rate rose in February. The ISM manufacturing PMI signaled expansion after sixteen straight months of contraction, rising to 50.3 in March[5].

The first quarter gains were led by communication services +15.8%, energy +13.7%, information technology +12.7%, and financials +12.5% sectors (see the chart below outlined in red). Real estate lagged the most and was down -1.1% for the quarter[5].

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech.	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	3.9%	2.4%	13.2%	8.8%	10.3%	29.6%	9.0%	2.3%	12.4%	6.0%	2.2%	100.0%	Weight
Russell Growth weight	0.5%	0.7%	6.4%	5.8%	14.9%	44.0%	12.0%	0.8%	10.6%	4.1%	0.1%	100.0%	
Russell Value weight	8.1%	4.8%	22.7%	14.3%	5.0%	9.4%	4.6%	4.6%	14.2%	7.7%	4.7%	100.0%	
Russell 2000 weight	7.3%	4.5%	15.9%	17.6%	10.8%	15.0%	2.1%	5.6%	15.3%	3.3%	2.5%	100.0%	
1Q24	13.7	8.9	12.5	11.0	5.0	12.7	15.8	-1.1	8.8	7.5	4.6	10.6	Return (%)
YTD	13.7	8.9	12.5	11.0	5.0	12.7	15.8	-1.1	8.8	7.5	4.6	10.6	
Since market peak (February 2020)	109.3	67.8	48.1	61.4	46.8	120.6	53.1	10.0	52.6	37.6	7.5	65.8	
Since market low (March 2020)	374.9	162.6	159.5	176.9	115.0	220.4	114.3	76.6	111.7	81.1	66.9	150.4	
Beta to S&P 500	1.2	1.1	1.1	1.1	1.2	1.1	1.0*	0.8	0.7	0.6	0.5	1.0	β
Correl. to Treas. yields	-0.2	-0.5	-0.5	-0.6	-0.6	-0.7	-0.8	-0.8	-0.6	-0.5	-0.7	-0.7	ρ
Foreign % of sales	36.8	50.5	28.8	32.5	33.1	57.0	48.1	17.3	34.4	39.7	1.2	41.0	%
NTM earnings growth	-2.6%	1.9%	11.4%	9.7%	11.1%	17.6%	16.4%	2.5%	14.3%	5.7%	8.7%	11.3%	EPS
20-yr avg.	100.3%	13.7%	20.6%	13.9%	16.9%	12.3%	11.1%*	6.9%	7.9%	7.6%	4.7%	10.9%	
Forward P/E ratio	13.0x	21.5x	16.0x	21.6x	25.6x	28.4x	19.0x	16.9x	19.1x	20.2x	16.1x	21.0x	P/E
20-yr avg.	13.5x	14.9x	12.5x	16.3x	19.6x	17.9x	18.6x*	17.0x	15.0x	17.5x	15.6x	15.6x	
Buyback yield	4.3%	1.3%	2.2%	1.9%	1.5%	1.4%	3.4%	-1.6%	1.0%	0.7%	-0.7%	1.7%	Bbk
20-yr avg.	1.8%	1.0%	0.5%	2.3%	2.5%	3.0%	1.8%	-1.4%	1.9%	1.8%	-0.7%	1.8%	
Dividend yield	3.1%	1.8%	1.7%	1.5%	0.8%	0.7%	0.8%	3.8%	1.6%	2.8%	3.6%	1.4%	Div
20-yr avg.	2.8%	2.4%	2.3%	2.2%	1.4%	1.2%	1.2%	3.8%	1.9%	2.8%	3.8%	2.1%	

Source: FactSet, Refinitiv Datastream, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management. All calculations are cumulative total return, not annualized, including dividends for the stated period. Since market peak represents period from 2/19/2020 to 3/31/2024. Since market low represents period from 3/23/2020 to 3/31/2024. Correlation to Treasury yields are trailing 2-year monthly correlations between S&P 500 sector price returns and 10-year Treasury yield movements. Next 12 months (NTM) earnings growth is the percent change in next 12-months earnings estimates compared to last 12-months earnings provided by brokers. Forward P/E ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates and J.P. Morgan Asset Management. Buyback yield is net of share issuance and is calculated as last 12-months net buybacks divided by market cap. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Beta calculations are based on 10-years of monthly price returns for the S&P 500 and its sub-indices. *Communication Services (formerly Telecom) averages and beta are based on 5-years of backtested data by JPMAM. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of March 31, 2024.

The U.S. economy continued to defy expectations in the face of high-interest rates. Consumer spending tracked at a solid 2.6% pace in the first quarter, but households started to feel the pain and early delinquencies for auto loans and credit cards increased substantially (see the chart to the right)[6].



Source: FactSet, FRB, J.P. Morgan Asset Management. *Guide to the Markets – U.S. Data are as of March 31, 2024.*

This increase in delinquencies can be attributed to the following:

1. Consumer spending growth has outpaced income growth by a wide margin, leaving households increasingly reliant on credit.
2. Excess savings are largely depleted for all but the highest-income households.
3. Credit card and auto delinquency rates have risen beyond pre-pandemic levels.

The latter is one of the clearest signals that financial strain weighed heavily on households, which will likely negatively impact spending in the future.

Business investment came in as expected and it cooled from a faster pace in the first half of last year due to several factors. Businesses responded with lower profits relative to the earlier phases of the recovery and absorbed higher financing costs. Additionally, private sector hiring slowed last year. The job vacancy rate remained elevated relative to past historical cycles, even as it continued to trend down slowly.

After a slow January, digital asset markets took off in February and March which resulted in one of the strongest quarters in recent history. Bitcoin and Ethereum returned 68.8% and 59.9%, respectively. Bitcoin reached a new all-time high in March as these strong returns were generated primarily because of a high demand following the launch in January of eleven physically backed Bitcoin ETFs (exchange traded funds). Since the launch, significant inflows of $12.1 billion have poured into the Bitcoin EFTs.

Fixed Income Markets

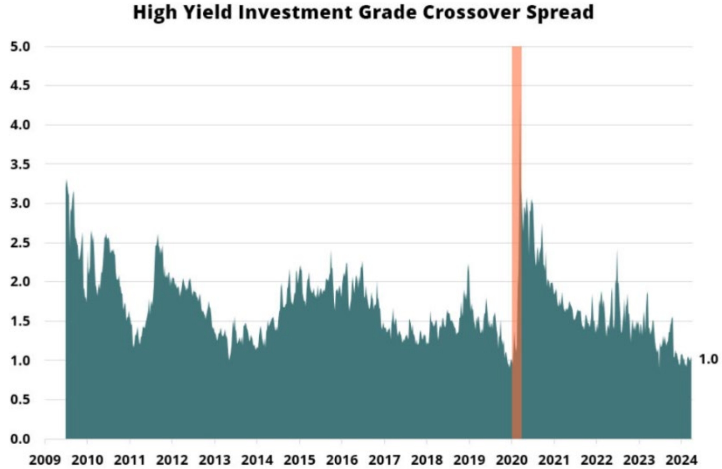
The U.S. bond markets were volatile during the first quarter. As the central bank narrative progressed from policy rate hikes to policy rate cuts, the market got ahead of itself and by year end 2023, had priced in six rate cuts (25bps each) by the Fed for the 2024 calendar year. Fast forward three months and a combination of resilient economic data and “higher for longer” guidance from central banks has led to the market revising its 2024 rate cut expectations down to just three. In response, the U.S. Treasury 10-year yield rose from 3.88% to 4.20% by the end of March. The 2-year Treasury yield increased by 36bps to 4.59% (see the red circles in the chart to the right)[7].

	Yield		Return			
U.S. Treasuries	3/31/2024	12/31/2023	2024 YTD	Avg. Maturity	Correlation to 10-year	Correlation to S&P 500
2-Year	4.59%	4.23%	0.24%	2 years	0.75	-0.02
5-Year	4.21%	3.84%	-0.78%	5	0.94	-0.07
TIPS	1.85%	1.72%	-0.08%	7.3	0.71	0.30
10-Year	4.20%	3.88%	-1.67%	10	1.00	-0.13
30-Year	4.34%	4.03%	-4.08%	30	0.93	-0.16
Sector						
U.S. Aggregate	4.85%	4.53%	-0.78%	8.4	0.87	0.24
IG Corps	5.30%	5.06%	-0.40%	10.8	0.60	0.48
Convertibles	6.64%	7.26%	2.09%	-	-0.10	0.87
U.S. HY	7.66%	7.59%	1.47%	4.9	-0.02	0.76
Municipals	3.49%	3.22%	-0.39%	13.3	0.68	0.27
MBS	5.04%	4.68%	-1.04%	7.5	0.79	0.24
ABS	5.76%	5.65%	1.59%	3.6	0.24	0.22
Leveraged Loans	10.26%	10.59%	2.65%	4.4	-0.28	0.60

Source: FactSet, J.P. Morgan Asset Management. *Guide to the Markets – U.S. Data are as of March 31, 2024.*

Corporate bonds outperformed government bonds in the quarter. The additional yield that investors demand for investing in riskier corporate bonds is called the credit premium. The credit premium compensates investors for taking on additional risk such as default risk and liquidity risk. The market’s current confidence in the economy and corporate balance sheets helped to explain strong current demand for corporate debentures[8].

High Yield Investment Grade Crossover Spread



Source: Bloomberg, QV Investors

Along with an attractive all-in yield for investment grade and non-investment grade bonds, robust fund flows into fixed income have compressed credit premiums as a result. This can be observed in the credit premium between BB rated (non-investment grade) bonds and BBB rated (investment grade) bonds, otherwise known as the crossover spread. It is a good indicator to show market optimism, and the very narrow spread suggests that investors are being thinly compensated for owning lower credit quality relative to higher credit quality at this juncture (see the chart above)[8].

International Markets

Global equity markets had a terrific first quarter and the gains were broad based as the tech-names, large-caps, mega-caps, and small caps all advanced. Investors were happy with the quarterly performance around the world, as thirty-four of the thirty-six developed markets tracked by MSCI were green for the first quarter of 2024 and gained 5.93% (see the chart on the right)[9].

UK equities rose 3.11% over the quarter (see the chart on the right). Financials, industrials, and the energy sector outperformed, along with some of the other economically sensitive areas of the market. Market expectations moved to price in a sooner-than-expected first UK interest rate cut as inflation undershot the Bank of England's (BoE) forecasts[9].

The Japanese equity market experienced an exceptionally strong quarter and was up 11.16% (see the chart on the right). During the quarter, foreign investors played a leading role in driving the rally. This was fueled by increasing optimism over Japan's positive economic cycle, characterized by mild inflation and wage growth. This quarter marked a historic moment as the Nikkei reached its all-time high and surpassed the 40,000 yen level[9].

2024 Developed Markets Monthly Total Returns

Index	Jan.	Feb.	Mar.	Q1
Ireland	5.18%	3.82%	5.98%	15.72%
Netherlands	6.07%	5.06%	3.63%	15.48%
Denmark	5.03%	3.57%	6.01%	15.32%
Italy	0.36%	5.81%	7.22%	13.86%
Israel	1.70%	8.78%	1.68%	12.50%
Japan	4.62%	3.00%	3.16%	11.16%
S&P 500 (US Large Caps)	1.68%	5.34%	3.22%	10.56%
USA (MSCI)	1.56%	5.37%	3.18%	10.41%
Spain	-1.42%	-1.29%	11.29%	8.29%
Germany	-0.96%	4.19%	3.83%	7.15%
France	0.08%	2.65%	3.13%	5.94%
MSCI EAFE (Int'l Markets)	0.58%	1.84%	3.40%	5.93%
Russell 2000 (US Small Caps)	-3.89%	5.65%	3.58%	5.18%
Canada	-0.71%	0.71%	4.19%	4.18%
UK	-1.34%	0.03%	4.47%	3.11%
Belgium	-2.25%	-0.17%	4.26%	1.74%
Sweden	-4.15%	4.87%	1.14%	1.66%
Australia	-1.57%	-0.56%	2.99%	0.81%
Austria	0.78%	-7.55%	7.85%	0.49%
Singapore	-4.39%	0.88%	3.83%	0.15%
Switzerland	-0.31%	-2.20%	1.67%	-0.87%
FTSE NAREIT (REITs)	-4.86%	1.93%	1.78%	-1.30%
Finland	-0.34%	-3.56%	0.66%	-3.25%
New Zealand	-2.34%	-0.84%	-0.54%	-3.68%
Norway	-5.73%	-3.03%	2.09%	-6.67%
Hong Kong	-9.72%	4.59%	-6.45%	-11.67%
Portugal	-8.73%	-6.75%	-3.51%	-17.88%

*Total Returns based on MSCI index data unless otherwise indicated.

Source: Novel Investor. Data as of 3/31/2024.

Emerging markets

Emerging market (EM) equities gained 2.44% over Q1 2024 but underperformed compared to developed market peers (see the chart below)[9].

Peru +15.83% was the top-performing country aided by currency and monetary policy easing measures including a reduction in the country's reference rate to 6.5% and a lowering of the reserve requirement ratio for local currency deposits. Turkey +14.62% also posted strong returns as the central bank continued its orthodox monetary policy approach by increasing interest rates over the quarter. Colombia +14.64% benefited from monetary policy developments as the central bank lowered interest rates[9].

Taiwan +12.51% achieved strong growth in the quarter, driven by on-going investor enthusiasm for AI-related stocks and technology companies[9].

India +6.12% also outperformed, helped by local currency strength ahead of April's general election, in which incumbent Prime Minister Modi seeks a third term[9].

South Korea +1.78% posted a positive return but underperformed broader EMs due to weakness in speculative AI and battery stocks[9].

China -2.19% dragged on returns, however investors displayed cautious optimism that the gloom surrounding China may be starting to lift. South Africa -6.72% was a poor performer against a backdrop of political uncertainty, while Brazil -7.33% underperformed on profit-taking after the market's robust performance in 2023. Finally, Egypt -29.73% generated the worst returns over the quarter on the back of its 35% currency devaluation[9].

2024 Emerging Markets Monthly Total Returns

Index	Jan.	Feb.	Mar.	Q1
Peru	-2.19%	7.24%	10.43%	15.83%
Colombia	1.94%	1.68%	10.60%	14.64%
Turkey	10.31%	3.16%	0.72%	14.62%
Taiwan	-1.15%	5.45%	7.94%	12.51%
Kuwait	6.97%	2.18%	-0.90%	8.32%
Greece	5.85%	3.36%	-2.69%	6.46%
Philippines	0.96%	5.47%	-0.07%	6.41%
India	2.42%	2.77%	0.82%	6.12%
Saudi Arabia	-0.76%	6.61%	-0.99%	4.76%
Poland	-3.12%	6.26%	0.58%	3.54%
Malaysia	-0.33%	2.35%	0.99%	3.03%
Indonesia	-1.63%	3.23%	1.07%	2.64%
MSCI EM (Emerging Markets)	-4.63%	4.77%	2.52%	2.44%
South Korea	-9.99%	7.43%	5.26%	1.78%
Mexico	-1.85%	-2.81%	5.40%	0.53%
Hungary	2.78%	0.66%	-2.89%	0.48%
United Arab Emirates	-0.29%	-1.06%	1.72%	0.35%
China	-10.61%	8.39%	0.95%	-2.19%
Qatar	-4.93%	5.01%	-3.46%	-3.62%
Chile	-10.98%	5.59%	2.14%	-4.00%
South Africa	-5.71%	-5.62%	4.83%	-6.72%
Brazil	-5.89%	0.26%	-1.78%	-7.33%
Czech Republic	-6.57%	-4.22%	3.12%	-7.73%
Thailand	-7.93%	0.74%	-0.93%	-8.11%
Egypt	19.75%	-12.49%	-32.94%	-29.73%

*Total Returns based on MSCI index data unless otherwise indicated.

Source: Novel Investor. Data as of 3/31/2024.

Economic Outlook

A positive January for U.S. stocks is typically a prelude to a positive year. 2024 is also an election year, historically the second-best year in the four-year political cycle (behind year three).

The quarter closed with a mixed macroeconomic environment. On the positive side, growth appears stable, the Fed will most likely deliver the first rate cut in four years, and AI enthusiasm will keep earnings estimates high. On the negative side, while inflation has fallen, it remains sticky and presents a significant hurdle to overcome. The strong rally of the last six months has left the S&P 500 at previously historically valuations while investor and analyst sentiment are very bullish and, potentially, complacent. So, while the outlook is currently positive, it is essential we continue to monitor the macroeconomic horizon for risks because at current stretched valuations and with sentiment very bullish, the market is vulnerable to a negative surprise.

Specifically, while it is true that economic growth has remained resilient in the face of higher rates, some data is pointing to a loss of momentum. Retail sales missed expectations in January and February while the unemployment rate jumped to the highest level since 2022 during the first quarter. Neither number warrants concern about the economy right now, but both serve as a reminder to watch data closely as a continued economic expansion is not guaranteed.

Inflation, while retreating, has hit a wall, and is going to present a significant challenge for the Fed. Core CPI, one of the Fed's preferred measures of inflation, has barely declined over the past several months as it sat at 4.0% year-over-year in October and in February was just 3.8% year-over-year. Meanwhile, other indicators of inflation have hinted at a rebound in prices. If inflation bounces back, it will reduce or even eliminate the number of Fed rate cuts in 2024 and that disappointment could pressure stocks and bonds.

To that point, economists have significantly lowered their outlook from 6-7 rate cuts starting in March down to 2-3 rate cuts in the latter half of the year. However, these rate cuts are not guaranteed and if the Fed does not cut rates in 2024 as markets expect, that will result in disappointment and a potential decline in stocks and bonds.

Investor enthusiasm towards the potential for AI remains a critical part of the bull market and that AI integration will lead to a profitability and earnings boom, not just for tech companies, but for the entire market. However, that is also not guaranteed and so far, AI integration has produced a lot of flashy headlines but not a lot of profit maximization for non-tech industries. If AI fails to broadly boost profits and demand declines, that will be a significant negative for this market.

Geopolitical uncertainty remains at heightened levels. In just the past several years alone, we have seen a war in Ukraine, a war in Israel, terror attacks, and an ever-escalating trade war with China. Events can arise quickly and have a dramatic impact on the global economy.

The deteriorating U.S. debt situation is at an unprecedented level. Ignoring unfunded liabilities stemming from entitlement spending, the U.S. national debt stands at over $33 trillion. This could contribute to ongoing interest rate volatility.

Bottom line, this historic rally is currently supported by positive fundamentals and AI enthusiasm. But we cannot let the currently positive set up blind us to risks and that is why we are focused on managing both reward and risk in portfolios, because despite the powerful performance this market remains vulnerable to negative news.

We continue to focus on managing both risks and return potential. We understand the risks facing both the markets and the economy and are committed to helping you effectively navigate this challenging investment environment.

Acknowledgements

1. Redwood Investment Management, "Tip Offs and Tipping Points - Q1, 2024 Market Commentary," https://rwdpub.s3.us-west-1.amazonaws.com/RIM_Q1_Commentary_F_Private_Debt_848ddcd7be.pdf?utm_campaign=Redwood%20Quarterly%20Commentaries&utm_medium=email&_hsenc=p2ANqtz-_EeyJWH52sEu4fwED-7iCy1yugoUIub1mG_pH6xa55uFQHhsAiiInxbw4yRc0RkbOJmxlvM_67RyS-4kdT0FGLiI4fIA&_hsmi=303511575&utm_content=303511576&utm_source=hs_automation
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It is not enough to own a portfolio personalized for your situation, based on your comfort with risk and long-term financial goals. You must be patient and disciplined, too. With Risk-Guard™, our risk management process, our investment committee is reviewing the market conditions and underlying investments on a weekly basis. Please contact your Redhawk financial advisor to learn more.

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