Goodman Financial

MONEY MANAGER • FINANCIAL ADVISOR • PHILANTHROPY

FEBRUARY 2024
MARKET COMMENTARY

EQUITY & FIXED INCOME MARKETS COMMENTARY

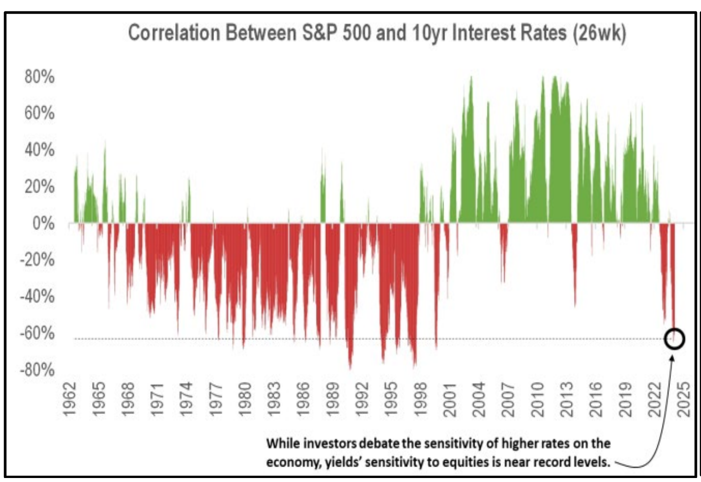
Stocks were broadly higher in February. The S&P 500 rose 5.3%, while the Blended Equity benchmark was up 5.1% for the month. The Mid-Cap S&P 400 Index was up 5.9%, while the Small-Cap S&P 600 Index lagged, up only 3.3% for the month. The Dow Jones Industrial Average Index also lagged, up only 2.5%, while the NASDAQ Composite Index was the star, up 6.2% for the month. International stock indices were mixed in February, with developed markets up 1.7%, lagging emerging markets, which were up 4.6%. Bond indices were mostly lower in February, as the 10-year U.S. Treasury bond yield rose to 4.24%, from 3.95% last month.

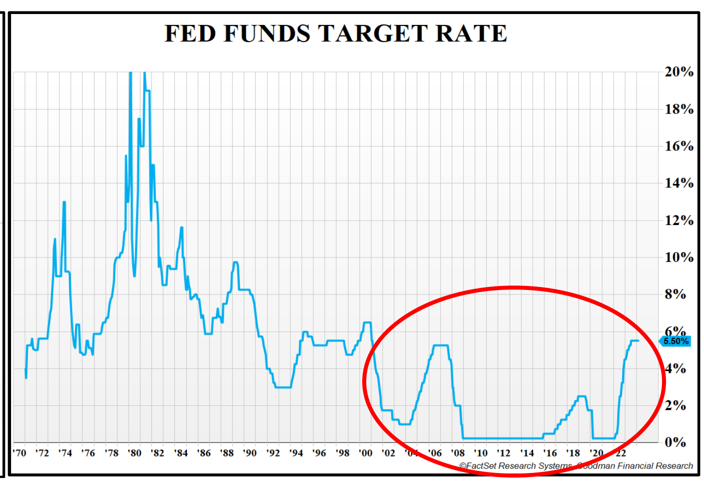
STOCKS AND INTEREST RATES

An investing truism is that when interest rates go up, bond prices go down, and when interest rates go down, bond prices go up. In that way, there is a negative correlation between bond prices and interest rates. The past couple of years have also seen stocks become negatively correlated with 10-year Treasury rates, as seen in the chart below (left) indicated by the red lines in negative correlation territory. What we have seen these past couple of years is quite a change from that witnessed the prior 20 years or so, where stocks were positively correlated with 10-year interest rates, i.e., stocks went up when the 10-year interest rate went up, with a few exceptions. Also seen in that chart is that prior to that aforementioned 20-year period, there was a 30-year period where stocks were predominantly negatively correlated with interest rates, similar to that seen today.

So, the logical question is “what has changed”? We believe it has to do with the current level of the Federal (Fed) Funds rate, the overnight rate that is set by the Federal Reserve. As seen in the chart below (right), the current Fed Funds rate of nearly 5.5% is as high as it has been since 1999 and now exceeds the current rate of inflation that is running in the low 3% range. The difference between the Fed Funds rate and the lower rate of inflation is called the “real” interest rate, which is now positive. As also highlighted in that chart, the Fed Funds rate was near zero since 2008 (excepting the 2017-2019 time period) and was below the rate of inflation in those years (negative real rates). As most readers will recall, this was a period where “cash was trash”, earning next to nothing and therefore causing most investors to buy just about anything that earned more than cash – including stocks – in order to try and keep up with inflation. There was a name given to this period – TINA, which stood for “There is No Alternative” to stocks or other riskier assets vs. keeping one’s money in cash. As we know now, cash in CDs or money market accounts earns over 5% currently and thus, investors no longer have to reach for yield in riskier assets like stocks. Interestingly, that previously mentioned 30-year period of negative correlation of stocks to interest rates was a period where the Fed Funds rate rarely went below 5% and exceeded double digits during much of that period, and importantly was also a period of positive real interest rates.

With inflation having gotten so out of control these past couple of years and still running above the Fed’s 2% target, one has to wonder whether the Fed will be slower in cutting the Fed Funds rate than they might otherwise have been, given recent history? If so, the current period of positive real interest rates could have legs. Of course, knowing what the Fed is going to do is near impossible, but it does seem to us that they might be more cautious lowering rates this time than most investors currently believe. Further, given the unsustainably high levels of fiscal deficits the Federal Government is incurring and the subsequent increases in the supply of Treasuries that need to be sold to finance those deficits, it would not be surprising to see upwards pressure on long-term interest rates. Assuming stocks stay negatively correlated to rates, then those higher rates could be a headwind for stocks, especially the mega-cap growth stocks that have performed so well this past year. At a minimum, it would not be surprising to see stock volatility levels increase in coming years, which would provide a good opportunity for active managers like GFC to shine.





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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.