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# Commerce Trust Market Brief with Scott Colbert
## 02/20/2024

**Scott Colbert**: Good morning, it's Tuesday, February 20th, we're back from a three-day weekend and the markets are open. So far this year, we've seen positive returns, particularly to larger cap stocks. The S&P 500 (Index) is up now 5.15% including dividends on a year-to-date basis. Those returns, though, of course, are still driven by a very narrow subset of stocks. Just four of those stocks account for 60% of the return.

There's an awful lot of movement in the top 10 stocks over (long) periods of time. If we go all the way back to the year 2000, we actually only have one stock that remains in the top 10 today and that's Microsoft. As you can see from the graphic, we've highlighted the top 10 stocks at the turn of the century, year 2000, and the top 10 stocks today. Microsoft still remains the largest stock, but all the others have disappeared. You can see that it's a volatile list and that's why we don't really want to focus on only the top four or five stocks that tend to drive returns in the short period and recognize that over long periods of time, the list changes.

While equity market returns are generally positive so far this year, bond market returns are negative. Interest rates have been gradually rising as the years progressed. The two-year Treasury is now up about 35 basis points from where it started the year, with a current yield of about 4.6%.The 10-year Treasury has marched up about 40 basis points, beginning of the year with a 3.88% yield, and now a 4.28% yield as the markets opened this morning.

What is driving those interest rates higher? Basically, the three trends that are affecting the market overall. What are those three trends? Number one has to do with economic growth. The idea of a soft landing has pretty much taken hold with consensus. Frankly really, it's no landing at all, because economic growth last year accelerated.

GDP (gross domestic product) last year increased by 2.5%, in 2002 it only increased by 1.9%. The unemployment rate has held very steady at 3.7%. Basically, there aren't too many cracks in the job market. New unemployment claims are exceptionally low, and job openings actually ticked back up, and they're still higher than they were pre-pandemic. The second trend has to do with inflation, and this is a little more complicated.

As you probably heard, inflation is coming in a little hotter than the markets expected so far this year. For January's CPI print, the Consumer Price Index, we saw the overall price index increase by 31 basis points. More troublesome was the core CPI, which increased by 39 basis points. Now a little bit of inflation for one month doesn't sound so bad, but the CPI in aggregate, the top line CPI, including food and energy, is still up on a 12-month trailing basis by 3.1%. The markets were hoping to see the CPI finally break that 3% threshold and were disappointed.

Probably even more disappointing was that re-acceleration in core prices. The core CPI, when we ex out food and energy, is still up a rather stubborn 3.9% on a year-over-year basis, identical to where we ended the year.

What's driving these higher inflationary results? Probably two things, both of them we believe are probably temporary. First off, you've got seasonality. Early in the year, many industries try to raise their prices and generally, it tends not to stick or it's a one-time-only increase. The second point, and probably a little less seasonal, has to do with the easing of financial conditions, which is also pushing up some prices.

Our third point would then be, of course, with higher inflation and the Federal Reserve (Fed) pushing back on the timing for the first interest rate cut, we've seen a bit more volatility in the market and, of course, higher interest rates. The market at the beginning of the year expected to see the first Fed rate cut in March. They were almost 100 percent certain it was coming that quickly. In fact, they had priced in two rate cuts by May.

The Federal Reserve, of course, had never suggested they were about to cut rates in March and even produced that so-called dot plot that suggested the first rate cut was coming in May or June, and now the market has heard them. The market is pretty certain that the first rate cut will come in June, but, of course, as they push back on the rate cuts, interest rates have risen.

How have these trends impacted your portfolio and has it changed any of our conviction? Number one, we like the bond market, and we only like it even better today with interest rates a bit up. You're able to lock in now higher interest rates than you were at the beginning of the year for basically five, six, seven, eight years and earn 5% to 5.5%. In terms of the stock market, we recognize that it's still a fairly narrow market, but we continue to look downward in capitalization for better values, particularly in those mid-cap stock areas, the kind of companies that we want to grow into the S&P 500, probably at a more rapid pace than the overall large-cap market can grow this year.

We'll be back in several weeks to talk with you about all the economic and financial market information that's impacting your investment portfolios.

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