MONTHLY UPDATE

CARY STREET PARTNERS

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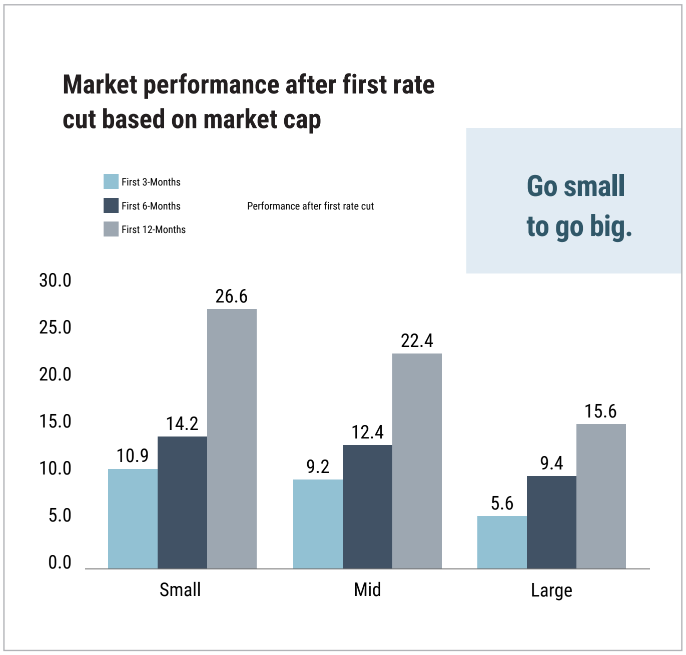
Markets were generally favorable over the course of February. The S&P 500 Index has advanced 5.34% since the end of January. Comparable returns for the NASDAQ 100 and Russell 2000 are 5.39% and 5.65%[1]. Much of February's focus was around jaw dropping earnings from semiconductor chip maker Nvidia. The company, which is a market heavyweight, reported Q4 results well beyond street estimates and guided substantially higher regarding Q1 revenue. Nvidia is a leading beneficiary of the dramatic adoption rate of generative artificial intelligence (AI). Accelerated computing and AI demand is surging across industries. Nvidia chips are used to train leading AI models. Nvidia data center business, where graphics cards are used for AI training, posted sales growth of 409% over the last year. This was not a small company a year ago, consequently the huge gains in revenues does not come with a small base effect asterisk.

From a technical perspective, equities were short term overbought entering 2024. Those short term overbought conditions were worked off during the first weeks of January. Long term momentum remains decisively to the upside. There is a reasonable chance of a market consolidation short term, but any potential pullback should be well contained and buyable.

Beyond Nvidia, market breadth is continuing to improve. This market is moving past the "it's all about the Magnificent 7" storyline that looks increasingly worn out. Breadth initially began to improve early last summer, and after an early fall retreat, accelerated into year end.

Over the last six months there has been a massive reassessment of growth prospects as productivity driven GDP has surprised to the upside. Markets are beginning to see good economic news as good market news. Earnings are coming out of the trough, and we hear anecdotally of companies pulling forward earnings guidance for this year. Rates always matter, so that potential bogeyman still bears watching, but the Fed has removed its tightening bias, and our viewpoint is that the 10-year Treasury yield put in a major high at 5% last fall. Combine a resilient economy with fading inflation, a central bank shifting to an easing bias, add in plenty of investors overallocated to cash and short-term paper and you end up with a rising appetite for risk assets.

As breadth continues to improve and earnings accelerate, we see a prime beneficiary being small and mid-cap stocks. This is a good space to consider adding exposure during market pullbacks. Current valuations are more attractive based primarily on company size, with small caps being most attractive on this basis. While valuation is a poor tactical guide, it does lend support to the long-term trend that we see coming to the forefront as risk appetite increases. Small caps typically lead out of earnings troughs and typically lead after the first Fed funds rate cut takes place.



Market performance after first rate cut based on market cap

Source: Federal Reserve Board; Haver Analytics; Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies.

[1] Bloomberg

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