



POST OAK PRIVATE WEALTH ADVISORS

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Monthly Market Commentary

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February is, as we all know, the month for love. This year, public displays of affection weren't reserved for romantic partners on Valentine's Day. Investors doted on beloved stocks throughout the month, with the S&P 500 closing above 5,000 for the first time and returning over 5% in February. Technology stocks are still the sweethearts of equity investors, with the tech-heavy Nasdaq Composite Index rising over 6% for February and notching a record high on February 29 (last reached in November 2021).

While enthusiasm for artificial intelligence (AI) remains strong and could explain why tech stocks have continued to outshine the rest of the market, February's performance really shows that earnings matter more than anything else when it comes to stock returns.

For a good example of this, consider NVIDIA, a U.S. chip manufacturer that's at the forefront of the AI boom. The company's CEO recently stated that AI is at a "tipping point" as NVIDIA reported Q4 sales had risen threefold over the same quarter last year. But earnings soared eightfold over the same period and smashed analyst expectations. Investors rewarded NVIDIA's stellar financial performance by bidding up its stock to a \$2 trillion valuation, trailing only Apple and Microsoft in capitalization terms. Amazingly, two-thirds of that valuation has come in the last 14 months, since the beginning of last year.

Looking for love in earnings reports

Before I go on a tangent about tech stocks, let's keep the focus on earnings. As of this writing, most S&P 500 firms have reported Q4 earnings and the year-over-year earnings growth rate for those firms stands at 7.9% according to FS Insight. That rate surpasses the earnings growth rate from Q3, effectively closing the book on the idea of an earnings recession—an event many market analysts had been expecting as the U.S. economy battled through rising inflation and interest rates, but it never materialized.

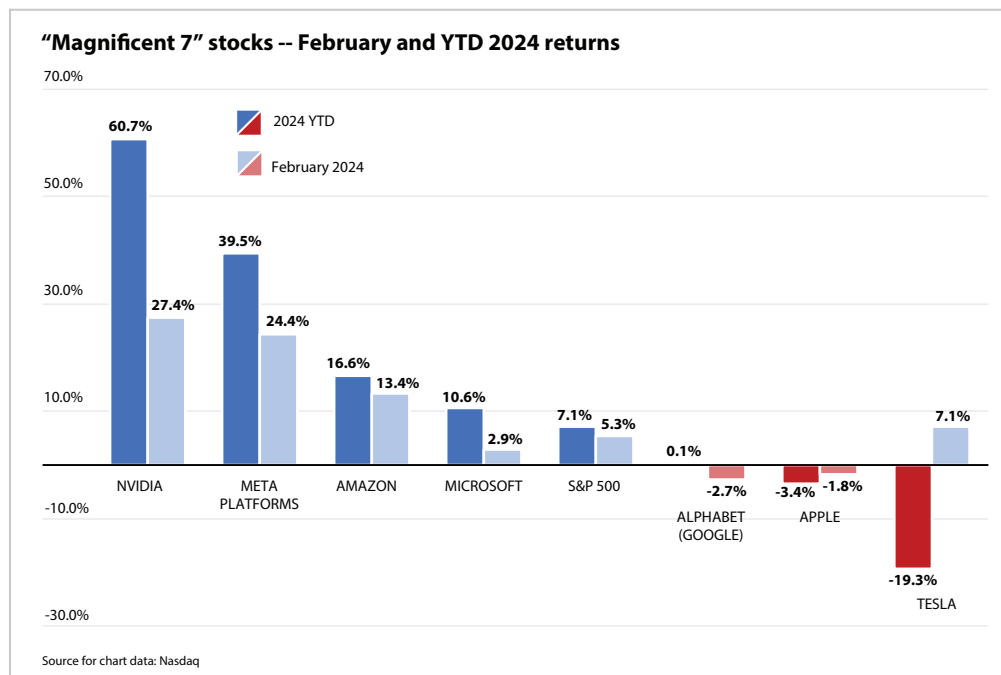
Among the S&P 500 firms that have reported so far, three-quarters have beat analyst estimates, which is fairly consistent with long-term averages. Earnings calls have been generally upbeat, but some executives are tempering forward guidance for the full calendar year, possibly seeking to downplay future expectations with the direction of economy so uncertain. Companies that have surprised to the upside have been rewarded by the market at higher-than-average rates. Likewise, investors have punished firms that disappointed the market with earnings below estimates.

I already mentioned NVIDIA as a beneficiary of the market's ardor, but other Magnificent 7 stocks also saw share price boosts after wowing investors with earnings beats. Meta Platforms (parent of Facebook and Instagram) tripled their earnings from Q4 of their previous fiscal year,

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and its stock price jumped nearly 20% the day following their announcement. Amazon reported a surge in net income in Q4 over the previous year, which exceeded analyst estimates and helped the stock rise 10%.



But love can also be fickle, as two tech stalwarts discovered last month. Both Apple and Microsoft issued positive earnings results as well and beat analyst estimates, but Microsoft underperformed the broad market in February and Apple dropped 2% for the month. Tesla has been a notable exception this year, and not in a good way; profits declined in Q4 and sales are expected to slow this year, which has depressed the firm's stock price since the start of the year.

For a non-Magnificent 7 example, consider Palo Alto Networks; the firm posted profit growth that was ahead of expectations but also lowered their forward guidance, citing softness in cybersecurity market. Its shares plunged 28% the next day, although have since recovered 20% by month-end.

Straight shooting from the Fed

It's encouraging to see investors responding to news on earnings or financial performance, whether good or bad, because these fundamentals are ultimately what drives value for investors. I think we've grown somewhat accustomed to seeing the market react to Federal Reserve statements and decisions—or even expectations of Fed statements and decisions based on the latest economic data—so this proactive behavior on the part of investors is refreshing to witness.

It's also been refreshing to hear the Fed and Fed chairman Jerome Powell take a more direct tone when speaking to the market about the path ahead for interest rates. Speculation of a Fed rate cut in March was quashed after the most recent FOMC meeting on January 31, as the Fed chair effectively aligned market expectations with the Fed's intentions to consider policy easing no sooner than this June. But Powell was even more forthright about the central bank's outlook for inflation and interest rate policy during an interview on "60 Minutes" this past month. From the transcript:

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“...the broader situation is that the economy is strong, the labor market is strong, and inflation is coming down. And my colleagues and I are trying to pick the right point at which to begin to dial back our restrictive policy stance. That time is coming. We’ve said that we want to be more confident that inflation is moving down to 2%. And I would say... that I think it’s not likely that this committee will reach that level of confidence in time for the March meeting.”

(I encourage you to watch Powell’s interview, which you can view on YouTube or find on Google.)

Those economic points Powell cited are all valid—we have strong growth, a healthy jobs market and a favorable trend of falling inflation—but we should remember that improvement in the economic climate doesn’t happen smoothly or swiftly. I’ve written before that inflation won’t come down in a straight line, and that’s definitely the case in this cycle. Consumer prices actually increased in January by 0.3% over the previous month, with core prices (excluding food and energy) rising at a higher rate of nearly 0.4%. And while the annual pace of Consumer Price Index (CPI) growth was reported lower at 3.1% (down from 3.4% in December) this number still disappointed investors who were expecting a bigger drop in the annual inflation rate.

With the path to the Fed’s 2.0% inflation target remaining rocky right now, I’m looking for at least one rate cut, maybe two, to come in the second half of this year. That’s different from what the market is expecting—three rate cuts before year-end, according to recent readings of Fed funds futures. But if this projection for 1-2 rate cuts bears out, the potential for market volatility rises. So, it’s important that investors not let their guard down, despite some hopeful signals in the economic data and positive vibes in the stock market.

Broadening outperformance among sectors

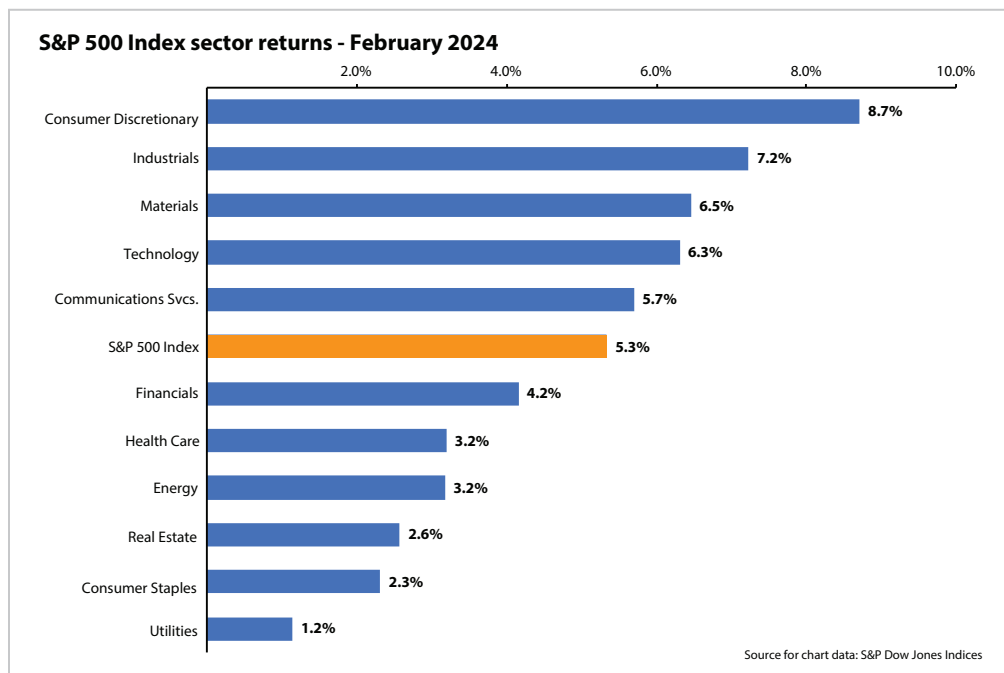
The “Magnificent 7” stocks have also been influential on sector-level returns so far this year, driving outperformance of a few sectors at the expense of others. It’s not all technology, however; consumer discretionary led the way in February, thanks mostly to the performance of Amazon, where the rally in its stock price was strong enough to overcome a poor month from Tesla. Communications was strong as well, where Meta Platform has helped the sector rise to the top year-to-date performer.

Bucking the trend among sector outperformers were old-school industrials and materials stocks, which actually bested tech for the month and demonstrated how expanding breadth of performance can help make a healthy market. While there were no negative sector returns this month, utilities, consumer staples and real estate were the top laggards in February.

When we see tech stocks leading the market month after month, it’s easy to make the case for allocating to this sector in client portfolios. But to me, the case for tech is bigger than that. It’s become essential for investors to have exposure to technology stocks in order to be successful. Tech firms will take the place of the blue-chip stocks of yesterday (if some are not there already) that investors will consider must-own securities in order to participate in American economic growth story.

We favor at least a market-weight allocation to technology, but the sector will continue to be more volatile than others, and because as wealth managers we must remain cognizant of managing

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our clients' exposure to risk by balancing within other sectors of the market and economy. We expect to always maintain a position in tech, but look to diversification to help us manage the inherent risks of the sector.

A spring break for stocks?

Stocks are off to their best start of the year since 2019, with the S&P 500 and Nasdaq indexes both up over 7% for the past two months. But investors should remember to temper expectations going forward. After such a good run since the equity market low last October, it wouldn't be surprising to see stocks pull back or at least take a "spring break" rest in the near term. Stocks don't go up in a straight line either, so the challenge for investors in the coming weeks will be to maintain patience and perspective if stocks do pause for a breather. I believe 2024 will be a good year for stocks, but also expect some spells where returns will be hard to come by.

On behalf of everyone at Post Oak Private Wealth Advisors, I thank you for your ongoing trust in our services and confidence in our strategies. As always, please don't hesitate to contact us if you would like to discuss your portfolio or your overall wealth management plan.

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