



1Q24 Market Overview: Something Like a Phenomenon

Risk appetites remained unsated in the first quarter even as markets tempered their expectations for the number and magnitude of Federal Reserve rate cuts in 2024. A combination of robust economic growth and stubborn but manageable inflation appeared to bolster hopes that a soft landing could be achieved with only limited additional policy intervention, fueling equity markets. The S&P 500 Index returned 10.6% in the first quarter, while the MSCI World Index gained 8.9%; growth continued to broadly outpace value.¹ The rate outlook grew hazy following the release of a hot inflation print in early April, however, driving futures traders to further recalibrate their expectations.²

Among the more curious developments during first quarter 2024 was the concurrent new highs established by both equity markets and gold prices despite interest rates—both nominal and real—that persist at levels not seen since before the global financial crisis. High interest rates generally would be expected to weigh on equity valuation multiples, while the price of gold historically has been inversely related to changes in the real interest rate. Perhaps the most plausible explanation for this phenomenon is a

1. Source: FactSet; data as of March 31, 2024.

2. Source: Reuters, CME Group; data as of April 8, 2024.

KEY TAKEAWAYS

- Equity markets continued to march high in the first quarter. Though the “Fed pivot” trade of fourth quarter 2023 lost some of its luster, increased confidence about a soft landing buoyed investor sentiment in early 2024.
- Despite benchmark interest rates shifting slightly higher across the yield curve, both equity markets and gold prices established a series of new record highs during the first quarter.
- Massive levels of deficit spending globally may have prompted a structural shift toward a higher rate of nominal drift. Resilient companies whose performance patterns tend to drift in concert with nominal growth may benefit.
- It’s been our experience that the gold market sometimes serves as the metaphorical canary in the coalmine, sussing out potential dangers before they manifest in asset prices more broadly.

fundamental shift to a higher rate of nominal drift in the global economy, the cause of which can be traced to the very large primary deficits currently facing many of its largest participants. In our view, the persistence of higher levels of nominal drift ultimately may result in multiple expansion for the resilient businesses well-positioned to benefit from it.

Set Adrift

The world's largest economies—including the US, China, the euro zone, Japan and India—have been growing their stocks of government debt at a fairly rapid rate, continuing to run primary deficits even as mounting interest expenses drive total debt burdens still higher. The stimulative impact of this spending appears to have buoyed activity in general, with everything from equities and gold to wage growth (4.7% in the March reading of the Atlanta Fed's Wage Growth Tracker³) and corporate earnings and revenues (forecast at 10.9% and 5.1%, respectively, for S&P 500 companies in 2024⁴) being marked higher.

While the loose financial conditions that have resulted from ongoing deficit spending appear to have promoted economic resilience in the face of a higher cost of capital, they also are complicating the Federal Reserve's efforts to fully rein in inflation. The hot inflation print released in early April was a good reminder of the ongoing push-pull between fiscal and monetary policies. At 3.5% on a headline basis, the March consumer price index was above expectations and may derail the 2024 rate cuts that both the market and the Fed appear to want. Interest expenses on the country's massive debt pile will continue to increase as lower-yield bonds roll off and are replaced with bonds at current rates, creating a whole other set of problems for the country.

The stimulative impact of deficit spending can fuel nominal drift in excess of prevailing interest rates.

The challenging fiscal picture in the US brings to mind what we refer to internally as the "India paradox." Typically, high interest rates—and thus high discount rates—could be expected to weigh on equity market valuation multiples. Not so in India. Despite a 10-year government bond yield that has averaged more than 7% since 2014, the MSCI India Index has delivered an annualized return of 13.6% over the past decade and trades at a trailing price-to-earnings ratio of 26.2x as of the end of March. For comparison, the MSCI USA Index also trades at a P/E ratio of 26.2 and has a 10-year annualized return of 12.9% in an environment of 2.4% 10-year Treasury yields.⁵ While this confluence of high interest rates and high multiples in India may seem illogical at first glance, it seems less so if you consider the stimulative impact that deficit spending has had on the country's nominal economic growth, which has averaged around 10.2% since 2014 (including the Covid-related contraction in 2020)—well in excess of long-term interest rates.⁶

Without a primary deficit—as was the tendency in US budgets from World War II through 2000—nominal drift is driven solely by interest rates and assets are priced at a risk premium to that. Primary deficits can fuel levels of nominal drift in excess of prevailing interest rates, often to the particular benefit of certain sectors and companies that serve as claims on nominal growth and whose performance patterns tend to drift in concert with it. This tendency has been quite evident in India, for example, where there are a number of large consumer staples businesses whose exposures to nominal economic drift may represent a very attractive risk premium relative to Indian sovereign debt despite the high valuation multiples that they command.

Nominal drift may also explain the persistent success of certain names in the US tech space, where multiples continue to expand for companies viewed as "staples" in today's high-tech world. It's reasonable to think that the persistence of higher levels of nominal drift in developed markets ultimately may result in multiple expansion for businesses well-positioned to benefit from it. Like in India, this may include traditional consumer staples companies, whose modest valuation multiples in developed exchanges imply a low-risk claim on nominal drift.

3. Source: Current Population Survey, Bureau of Labor Statistics, Federal Reserve Bank of Atlanta; data as of April 10, 2024.

4. Source: FactSet; data as of April 5, 2024.

5. Source: Organization for Economic Co-Operation and Development, MSCI; data as of March 31, 2024.

6. Source: Organization for Economic Co-Operation and Development; data as of March 31, 2024.

Gold Surges Despite Headwinds

Tumultuous geopolitical conditions continue to feed into the investment environment from the top down, even without the emergence of a truly global conflagration. Deteriorating global relations have prompted ever-rising defense budgets across the developed world, for example, contributing to the deficit spending and nominal drift we mentioned above. They're promoting a risk premium in oil prices, while supporting better-than-expected demand and sticky supply levels. And they also may be a key factor behind gold's resilience in the first quarter and throughout the current rate-hike cycle.

Despite the seeming headwinds of higher real interest rates and a stronger dollar, the gold price broke sharply higher in March, rallying more than 8% over the month to finish at an all-time nominal high above \$2,200.⁷ It's been our experience that the gold market sometimes serves as the metaphorical canary in the coalmine, sussing out potential dangers before they manifest in asset prices more broadly. Global central banks, perhaps themselves extra-sensitive to these dangers, have been massive buyers of gold in recent years, which has helped support the metal's price. At 1,037 tonnes, net purchases of gold by central banks in 2023 was second only to 2022's record level of 1,082 tonnes; buying has continued to be strong in 2024, with central banks adding an additional 64 tonnes to their coffers year to date through February.⁸ Notably, emerging market central banks have been the primary buyers, led by the People's Bank of China, which has upped its gold reserves for 16 consecutive months.

The Price of Resilience

For some time now, assets promising growth have been assigned premium valuations, suggesting a low level of risk aversion in the markets. Should the environment become more complex—if the soft-landing scenario fails to play out, or sovereign debt concerns promote a broad repricing of government paper, or if any one of the global military hotspots ignites into broader conflict—the market may start to value potential resilience over expected growth. This is not as strange as it seems; in the mid to late 1990s, companies as straightforward as Coca-Cola and Clorox, for example, were trading at earnings multiples of 50x or more.⁹ Resilience has traded at a premium in the past, and there's no reason to believe it won't do so again under the right circumstances.

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7. Source: World Gold Council; data as of April 9, 2024.

8. Source: World Gold Council; data as of April 3, 2023.

9. Source: FactSet; data as of March 31, 2024.

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Risk Disclosures

All investments involve the risk of loss of principal.

A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

Investment in gold and gold-related investments present certain risks, including political and economic risks affecting the price of gold and other precious metals, like changes in US or foreign tax, currency or mining laws, increased environmental costs, international monetary and political policies, economic conditions within an individual country, trade imbalances, and trade or currency restrictions between countries. The price of gold, in turn, is likely to affect the market prices of securities of companies mining or processing gold and, accordingly, the value of investments in such securities may also be affected. Gold-related investments as a group have not performed as well as the stock market in general during periods when the US dollar is strong, inflation is low and general economic conditions are stable. In addition, returns on gold-related investments have traditionally been more volatile than investments in broader equity or debt markets. Investment in gold and gold-related investments may be speculative and may be subject to greater price volatility than investments in other assets and types of companies.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

The **price-to-earnings ratio (P/E ratio)** is a valuation ratio of a company's current share price compared to the earnings per share. Generally, a high P/E ratio means that investors are anticipating higher growth in the future.

Atlanta Fed Wage Growth Tracker is a three-month moving average of median wage growth based on hourly data.

Consumer Price Index For All Urban Consumers (CPI-U) measures the changes in the price of a basket of goods and services purchased by urban consumers. A price-return index only measures price changes.

Indexes are unmanaged and one cannot invest directly in an index.

MSCI India Index (Gross/Total) measures the performance of the large and midcap securities of the Indian market. With 136 constituents, the index covers approximately 85% of the Indian equity universe. The index provides total returns in US dollars with net dividends reinvested.

MSCI USA Index (Gross/Total) measures the performance of the large and midcap securities of the US market. With 627 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US. The index provides total returns in US dollars with net dividends reinvested.

MSCI World Index (Net) measures the performance of large and midcap securities across 23 developed markets countries around the world. The index provides total returns in US dollars with net dividends reinvested.

S&P 500 Index (Gross/Total) is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 80% coverage of US equities, it is also considered a proxy for the total market. The S&P 500 includes dividends reinvested. A total-return index tracks price changes and reinvestment of distribution income.

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