

## COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

## MARKET RECAP

The US Equity market continued on its upward trajectory in the first quarter of '24. The promise of easier monetary policy got the market going at the end of '23, and that momentum spilled over into this year. We again saw solid breadth of performance across various factors, including sector affiliation and size. The S&P 500 Index returned 10.6% in Q1, with S&P 500 Growth returning 12.7% and S&P 500 Value at 8.1%. The NASDAQ was up 9.3% while the Dow Jones Industrial Average was up 6.1%. Small-caps, represented by the Russell 2000 Index, were up 5.2%. International markets also started the year positively. The MSCI EAFE Index of international developed market equities was up 5.9% in USD terms in the quarter. Japan was the standout performer among the developed markets, with the Nikkei 225 up 12.4% in Q1. The MSCI Emerging Markets index was up 2.4%. After being the best performer in Q4 of last year, the S&P 500 Real Estate sector was the worst performer in Q1, down 0.5%. All the other sectors generated positive returns, led by Communication Services (15.8%), Energy (13.7%), and Technology (12.7%). The S&P GSCI Commodity Index gained 10.4% during the quarter. The Energy commodity complex exhibited particular strength during the quarter, with WTI Crude Oil up 16.1% and Gasoline futures up 31.1%. Fixed income assets were down for the quarter, with the Bloomberg Global Agg Index down 2.1% and US Agg Index down 0.8%. The US Intermediate Treasury Index was down 0.4% while the High Yield Corporate Index was up 1.5%. The US 5-Yr Municipal Index was down 0.4% in the quarter. The US Dollar registered a 3.1% appreciation in the quarter versus other currencies as measured by the DXY Index.

## MARKET RECAP AND OUTLOOK SECOND QUARTER 2024

## KEY POINTS

Note: All returns include invested cash flows expressed in U.S. dollar terms

MARKET SCORECARD as of 03/29/2024	TOTAL RETURN IN USD	
	Q1	2024 TR
DOW JONES IND AVG	6.1%	6.1%
S&P 500	10.6%	10.6%
NASDAQ	9.3%	9.3%
MSCI EAFE EQUITY (GROSS)	5.9%	5.9%
RUSSELL 2000 INDEX	5.2%	5.2%
MSCI EMERGING MARKET EQUITY (GROSS)	2.4%	2.4%
BLOOMBERG GLOBAL AGG BOND INDEX	-2.1%	-2.1%
BLOOMBERG INTERM. TREASURY	-0.4%	-0.4%
BLOOMBERG INTERM. GOVT/CREDIT	-0.2%	-0.2%
BLOOMBERG 5 YEAR MUNI INDEX	-0.4%	-0.4%
BLOOMBERG HIGH YIELD CORP INDEX	1.5%	1.5%
ishares S&P GSCI COMMODITY TR INDEX	10.4%	10.4%

- Equity market's strong momentum from Q4 of last year continued into Q1 of this year. Performance was once again broad-based in terms of various market sectors, factors, and geographies.
- The Fed's jawboning has continued to set the tone for investors' expectation of easing monetary policy in '24. A more dovish Fed and expansionary fiscal policy continue to provide fertile conditions for continued nominal earnings growth.
- The Fed seems to be caught between a rock and a hard place. Inflation is not low enough to allow for aggressive monetary easing, while the US government and the US consumer both need lower interest rates to deal with what has become a record debt burden.
- Stretched equity valuation and sentiment as well as preponderance of structural issues in the US economy make us more cautious than consensus.
- It is our expectation that long-term interest rates are likely to continue moving higher due to several structural issues, including pervasive inflation and large government budget deficit.

## INVESTMENT OUTLOOK

Investors continue to look forward towards potentially easier monetary policy in '24. The consensus view that inflation could finally be in the rear-view mirror has given the equity market the necessary momentum to carry on to new all-time highs. The Fed's deliberate messaging around lowering rates and ceasing asset sales in the near future has helped generate increased prospects for a soft economic landing. When combined with an already expansionary fiscal policy, this has created buoyant conditions for nominal revenue and earnings growth. It needs to be observed, though, that investors' expectations for the amount and the timing of interest rate cuts have changed significantly since the beginning of the year due to positive economic growth surprises but also stubbornly high inflationary readings. Whereas the market entered the year expecting seven quarter-point rate decreases in '24 with the first one being in March, investors now expect only two cuts with the first one coming in September. We remain more cautious than the consensus. The reasons for that include stretched valuation and sentiment as well as the preponderance of structural issues that lie underneath, what is on the surface, a growing US economy. With energy prices gaining momentum through Q1 and with higher wage expectations embedded into the service sector's labor compensation dynamics, we expect to see sticky inflation through the rest of the year. That has the potential to push interest rates higher and beyond investors' comfort zone, which we would characterize as 5% on the 10yr US Treasury. If we add to that the fact that the US equity market is trading at the 97th percentile of cycle-normalized earnings valuation (CAPE) going back to 1880, yellow warning lights become that much brighter. It is our view that current cash rates give us adequate compensation to carry tactical underweights in both the US Equities and the US Fixed Income. On the equity side, our preference is for sectors such as Energy, Utilities, and Materials at the expense of Consumer Discretionary, Financials, and Technology. We see good value in international equity markets as well as commodities. We have opted to use a combination of short and intermediate term securities to achieve duration of 105% of our fixed income benchmark.

## GLOBAL MACROECONOMIC REVIEW & OUTLOOK

Our key responsibility as custodians of our clients' assets has been to provide them with prudent investment management decision making over the long term, one that is grounded in a disciplined approach that balances risk and reward. Academic literature points to strong empirical evidence of a wide difference between average and realized returns. What that means is that human psychology forces investors into suboptimal decisions by making them overconfident at the peaks and regrettably pessimistic at the troughs. We look to guard against such blind spots with our macroeconomic research and our focus on earnings trends and valuation, which then translates into our proprietary security selection. That research today gives us a clear signal that we ought to be cautious despite the equity market's exuberance. As Warren Buffet famously once said, "be fearful when others are greedy and be greedy when others are fearful." That maxim describes well our positioning given today's market conditions. Although the rate of inflation has moderated over the past 18 months, rising commodity prices, easing monetary conditions, and alarmingly loose fiscal situation make that most likely only a temporary development. The long-end of the yield curve confirms that view, having moved higher during Q1, with the 10yr US Treasury yield up 45bps in Q1 and 100bps since March of '23. Market history suggests that we are at the point in the economic cycle when an inverted yield curve should start to un-invert, with long-term rates moving higher. That has historically been a signal for weaker economic growth and potentially a recession. Growth remains good for now, with employment data being the key source of economic strength. Still, we have enough skepticism concerning official government statistics on employment and inflation that we are not willing to ignore an unprecedented divergence between the two key employment surveys, BLS and Household, which shows a gap of 9 million jobs. It looks as though job creation is primarily coming from part-time employment, where we have seen 1.9 million new jobs since March of last year. Full-time jobs in the US are down 1.4 million in the same time period. Moreover, if the US economy is near full employment and inflation is still meaningfully above the Fed's target of 2%, wouldn't additional monetary stimulus by the Fed only reignite inflationary flames? Commodity prices are hinting exactly at that risk. In other words, the Fed seems caught between a rock and a hard place. Lower rates would help the US government and the US consumer deal with record debt levels but would also hurt its fight against inflation. The Fed's policy tools are at this point ineffective at best and counter-productive at worst in what is likely to be a period of below trend growth accompanied with rising inflationary readings, creating a stagflationary economic environment. For equity investors in particular, valuation becomes challenging to sustain in such market conditions. Fixed Income assets have traditionally benefited in times of slowing economic growth. However, a structural shift in inflationary and term premiums of long-term interest rates that started in '22 dampens our expectations this time.

## INVESTMENT TEAM

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