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Monthly Market Commentary

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US Economy

In our view, fading post-pandemic supports soon may be leaving the economy to its own, late-cycle devices. We believe key tailwinds related to rapid disinflation – supporting real (inflation-adjusted) incomes and restraining interest rates – are likely in the rearview mirror as supply chains, oil, and other commodity markets rebalance (perhaps slightly firming inflation into 2025). Pent-up demand for certain goods and services seems to be losing steam, as evidenced by softening retail sales and personal spending data. Still in doubt is the extent of labor-market rebalancing from catch-up hiring in the aftermath of the pandemic. Job growth's true strength has been tough to surmise, muddled by diverging employment measures. Even the more robust non-farm payrolls data has been concentrated in less economically sensitive health care and government hiring. And, softening around the edges is becoming increasingly apparent from broadening layoffs, reduced temporary hiring, and job openings, along with a low quits rate signaling worker caution.

Unusually accommodative financial conditions, tied to rapid disinflation and an early reprieve from elevated interest rates, has been a key factor cushioning – and delaying – an economic slowdown this cycle. The recent rally in risk assets, increase in financing activity, and ample market liquidity all suggest real interest rates are not inordinately high at current levels. Historically, financial conditions have tightened heading into an economic downturn, but the unusually early break in inflation this cycle has alleviated this pressure point. That said, we do anticipate the US economy slowing by mid-year, though as markets gain more clarity on the future path of inflation and interest, this could provide opportunities for investors to increase equities in their portfolios.

US Markets

US equities markets (using the S&P 500 Index as proxy) reached all-time highs in March, led by easing financial conditions, the anticipation of future Federal Reserve rate cuts, and a resilient job market. That said, we believe equity markets could struggle to advance meaningfully past recent highs in the near term if the economy slows, the disinflation trend pauses, interest rates remain elevated, consensus earnings expectations shift lower, or optimistic market sentiment snaps back to reality. After an earnings recession in 2022 and 2023, we anticipate only modest earnings growth this year. As such, we continue to favor investors remain defensively positioned. We will continue to look to position for the eventual rebound we anticipate ahead as opportunities present themselves.

Fixed Income

The Federal Open Market Committee (FOMC) met in March and left the federal funds rate unchanged at 5.25% - 5.50% for the fifth straight meeting. The FOMC stated that "it will not be appropriate to reduce the federal funds target range until inflation moves sustainably toward 2%." Citing recent indicators that economic activity has been expanding at a solid pace, including strong job gains and low unemployment. The FOMC judges that the risks to achieving its employment and inflation goals are moving into better balance. The Fed did note the economic outlook in uncertain, and the FOMC remains highly attentive to inflation risks.

Looking forward, in considering any adjustments to the target range for the federal funds rate, the FOMC stated they will carefully assess incoming data, the evolving outlook, and the balance of risks. The Fed noted they will continue to take into account a wide range of information, including readings on labor market conditions, inflation pressures, inflation expectations, and financial and international developments. We still believe the Fed has reached its terminal policy rate for this cycle and that the Fed will proceed cautiously and attempt to move away from being overly restrictive. Attention will remain on the timing and the extent of rate cuts during 2024. The FOMC has forecasted three rate cuts in 2024, but we find the FOMC is still priced for a too-optimistic outcome regarding future Fed rate cuts in 2025. As the dis-inflation base effect wears off, we believe it could prove difficult for inflation to move quickly towards the Fed's 2% inflation target.

International Markets

After narrowly avoiding a recession in 2023, Europe's economy continued to slow. Overall activity in the Eurozone improved as stabilization in most of the region's service sector helped offset weakness in Germany's manufacturing industry. Overall Eurozone growth remained constrained by tight credit conditions, soft global trade, elevated fuel costs, and geopolitical conflicts. Disinflation is buoying consumer purchasing power and should limit the economic slowdown, in our view. Further, easing wage inflation could set the stage for European Central Bank rate cuts around mid-year.

Over in Asia, recent business surveys in China showed Lunar New Year travel and tourism supporting service-sector activity just enough to nudge the economy forward, despite a contraction in trade-sensitive manufacturing. Further fiscal and monetary policy support of the kind announced by government officials in early March, if not more, likely will be needed to meet a 5% growth target for an economy hampered by high debt loads, subdued global trade, an ongoing property market crisis, deflation, and eroding investor confidence. China's weak domestic demand, and an export push to compensate for it, contributed to an export-led decline in Japanese manufacturing and helped stifle a fragile factory rebound in northern Asia.

Commodities

Gold has been a shining star over the past 12 months, reaching all-time highs of $2,325/troy ounce (as of this writing). While most commodities rallied in 2021 and 2022, gold underperformed. Clearly things have changed in the past 12 months. Behind the recent strength has been a range-bound US dollar, heightened geopolitical risks, record purchases from emerging market central banks, and near record purchases from consumers in emerging markets.

As we move through 2024 and into 2025, we anticipate new tailwinds to emerge – such as interest rate cuts by the FOMC. In past Fed rate cutting cycles, investors have often viewed gold as an attractive investment alternative. The reason is that gold is a non-interest-bearing asset. As interest rates fall, yields on competing high-quality interest-bearing assets, such as US Treasuries, often fall too, making gold an attractive investment alternative. We are anticipating more of the same in 2024 as the Fed likely embarks on a new interest rate cutting cycle, and disinflation, not higher inflation, sets in.

What Does This Mean to Me?

Ultimately, we believe a gradual US economic slowdown could prevail, potentially stemming from the combination of several catalysts. These include decelerating real income growth, an unusually low household savings rate, rising credit card delinquency rates (particularly among lower-income earners), weak consumer sentiment, and the cumulative, lagged effect of higher interest rates and tightened bank credit on housing activity, and their impact on household and small-business credit quality. However, abnormally low financial stress – unless it turns higher due to some unforeseen risk event – could serve as a shock absorber, potentially preventing a sharper economic pullback. And market expectations for a near-term Fed pivot to interest rate cuts are helping cement historically low financial stress and feeding into our anticipation for a shallow slowdown. As such, should markets get choppy as we move forward, we continue to encourage investors to remain patient and strategically deploy sidelined cash, as opportunities present themselves.

If you have any questions or concerns, please do not hesitate to reach out to us at any time.

Sincerely,

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Stocks are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities.

Investing in commodities is not appropriate for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk.

[2] https://www.eia.gov/dnav/pet/PET_MOVE_EXPC_A_EPC0_EEX_MBBLPD_M.htm

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility.   Investing in emerging markets accentuates these risks.

Investments in fixed-income securities are subject to market, interest rate, credit, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can cause a bond's price to fall. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

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