

## Monthly Market Commentary

April 2024

### US Economy

The Bureau of Economic Analysis reported that US Growth Domestic Product (GDP) slowed to 1.6% annualized rate in the first quarter, much slower than investors anticipated. Meanwhile, the same report noted that a key inflation measure – the core Personal Consumption Expenditures (PCE) Price Index came in at 3.7% in the first quarter, compared to 2% for the fourth quarter.<sup>1</sup> We believe the US economy will continue to slow, which should eventually cool inflation and allow for a modest easing of interest rates and credit conditions into 2025. We believe this dynamic could offer two upshots for markets. First, we anticipate the economy's 2024 pivot into faster growth is likely to be modest – even below its post-WWII trend – because high private debt levels may constrain the rebound. Second, if the economy gains momentum in 2025 as we anticipate, inflation also is likely to pivot higher from its recent trough.

The important point is that slower growth and renewed disinflation could allow the Fed to eventually cut interest rates. Historically, the beginning of Fed rate cuts has been an early economic recovery signal in that we anticipate workers to get new jobs, consumers satisfy pent-up demand, and businesses restock inventories. But if, as we anticipate, a gradual 2024 slowdown does not produce large layoffs, bankruptcies, and inventory reductions, then the recovery could potentially have a slow start. Put another way – without a recession to clear the deck for more spending, next year may start slowly, even if Fed rate cuts eventually generate economic momentum later next year. A slow start to 2025 also implies that disinflation may continue early in the year. However, as interest rate cuts continue, both economic activity and inflation could gain momentum through the year.

### US Markets

US equity markets ended the month down in April, as a slowing economy, sticky inflation, and geopolitical concerns weighed on investors. That said, as we look ahead, we believe positive economic growth could drive corporate sales while cost control could also help anchor profit margins. We believe supply chain issues are mostly in the rearview mirror; wage increases are moderating; labor efficiency (that is, sales per employee) is at all-time highs and trending higher; and interest costs appear manageable. Artificial intelligence is also expected to help produce cost savings, but it has yet to be completely integrated across the economy. As such, we believe S&P 500 Index profit margins are steady and could move back above their long-term trends. While equity markets could remain choppy in the near-term, we believe these factors could aid equities down the road.

<sup>1</sup> <https://www.bea.gov/data/gdp/gross-domestic-product>

## Fixed Income

The Federal Open Market Committee (FOMC) met in late-April/early-May and, as widely anticipated, kept the federal funds rate unchanged at 5.25% - 5.50% for the sixth straight meeting. The FOMC stated recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, the unemployment rate has remained low, and, while inflation has eased over the past year, it remains elevated. The FOMC judges that the risks to achieving its employment and inflation goals have moved into better balance over the past year. The economic outlook is uncertain, and the Fed remains highly attentive to inflation risks.

Looking forward, in considering any adjustments to the target range for the federal funds rate, the Fed will carefully assess incoming data, the evolving outlook, and the balance of risks. Also, the FOMC does not anticipate it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%. 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.

Furthermore, the FOMC announced that beginning in June, it will slow the pace of the decline of US Treasury securities from its balance sheet, reducing the monthly redemption cap from \$60 billion to \$25 billion. The Fed will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at \$35 billion and will reinvest any principal payments in excess of this cap into Treasury securities. We still believe the Fed will attempt to cut rates this year, however, the probability for the federal funds rate to remain on hold at current levels is increasing as inflation remains sticky.

## International Markets

A manufacturing slump in Europe's two largest economies, Germany and France, dragged down the broader region. The factory-led downturn persisted as a world trade recovery remains slowed by a struggling Chinese economy. Among the Eurozone's added headwinds are sizeable budget deficits limiting fiscal stimulus, tight credit conditions, elevated fuel costs, and geopolitical strains. Still, S&P Global's Composite Purchasing Managers' Index survey came within striking distance of expansionary territory for the first time in 10 months, as stronger services growth offset deterioration in the manufacturing sector.<sup>2</sup> The other piece of good news was that overall Eurozone sentiment continued to improve, reinforced by inflation near enough to the European Central Bank's 2% target to bolster the case for a near-term rate cut.

Over in Asia, business surveys showing a March revival in China's business activity included an increase in manufacturing output and the strongest service-industry growth in several months. We question the recovery's staying power in the face of deep-rooted weaknesses ranging from ongoing property-market turmoil, inadequate government stimulus, a high debt burden, and related financial sector strains to a weak global trade environment, deflation, and poor consumer sentiment. Tepid demand from China and other key export markets stymied a manufacturing rebound in northern Asia, while manufacturing

<sup>2</sup> <https://www.spglobal.com/marketintelligence/en/mi/research-analysis/flash-pmis-signal-more-broadbased-expansion-as-growth-rates-improve-in-europe-and-japan-Apr24.html>

growth in Southeast Asia was confined to Indonesia, the Philippines, and Singapore. In Japan, service-sector growth hit a recent high as a weak yen bolstered the country's tourism industry.

## **Commodities**

It has been a little over two years since the war in Ukraine began, and international sanctions were first imposed on Russia's oil industry. Initially, to the surprise of many, there was still a healthy appetite for Russian oil – primarily from China and India. Now two years into the war, though, it is getting more difficult for countries to deal with Russia. Sanctions on everything from insurance on the crude oil being transported, to the tankers themselves, have tightened, making voyages riskier. This has ultimately resulted in lower Russian oil production, as it gets harder to find export markets for Russian oil.

Russia's crude oil production has been shrinking over the past year, and in recent weeks, Ukrainian drones have struck Russian refineries, which we suspect could cause production to slide further as the refineries shut down for repair. In addition to the possibility of lower production, we suspect that reduced refinery activity could lead to supply issues and higher price volatility for petroleum products. In fact, Russia has already implemented a six-month ban on its gasoline exports, in a bid to avoid a domestic shortage. Overall, it appears that the effects of international sanctions and the ongoing war in Ukraine are chipping away at Russia's ability to boost oil production. We believe production could slow further in 2024, and along with the effects of sanctions on exports, we believe global oil prices could become more volatile.

## **What Does This Mean to Me?**

We believe robust financial conditions only make the economy's slowing trend more gradual in our view. Consumer and small business finances remain under some strain while inflation and interest rates have been sticky. If the economy's softening progresses, we anticipate inflation could trend lower into year end, but inflation's hot start to 2024 likely means higher interest rates at year end. Markets may struggle to advance meaningfully past recent highs while uncertainties persist surrounding the path of inflation as well as the timing and magnitude of Fed rate cuts. Still, we would view any periods of equity market weakness as opportunities given that our outlook through 2025 supports improved corporate revenue growth and expanding margins.

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

Sincerely,

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