Monday, April 15, 2024

SUMMARY-

I. Inflation data eclipses the eclipse as last week's biggest event.

II. Hotter than expected March CPI prompts selloff in stocks.

III. Goods inflation levels off while services inflation remains sticky.

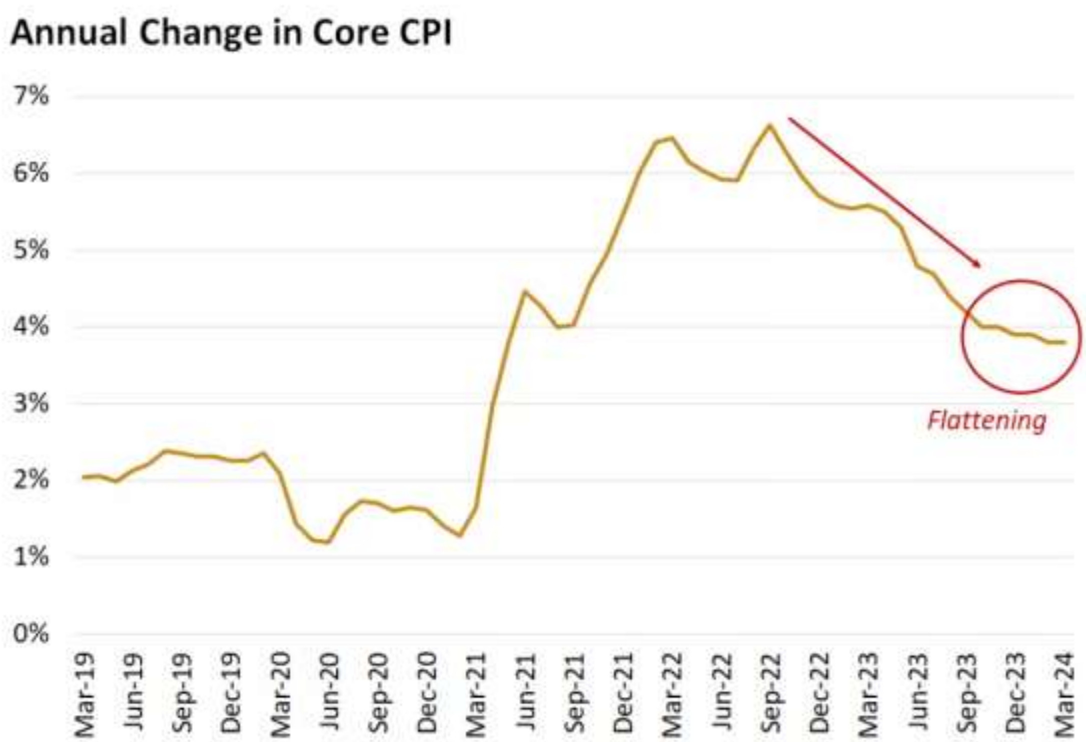
IV. Summer rate cut odds drop below 50% prompting possible pause or correction in equity rally.

Good morning:

Last week began with the rare total solar eclipse causing millions of Americans to don special glasses and peer skyward in hopes a witnessing the phenomenon. However, the most anticipated and market-moving event was Wednesday's release of March inflation data. Without any required eyewear, the report clearly showed that consumer prices rose more than anticipated. In response, expectations of summer rate cuts from the Fed took another hit and a broader selloff in equities ensued. By Friday's close, additional anxiety surrounding an expected attack on Israel by Iran punctuated a difficult week for stocks. Among large cap averages, the Dow led the decline (-2.4%), while the occurrence of certain mega-cap tech companies serving as apparent safe-havens enabled the NASDAQ to lose far less (-0.5%).

March CPI showed prices rose 3.5% year over year, up from 3.2% the prior month. Core CPI, which removes volatile food and energy prices, held steady at 3.8%, but was also higher than consensus expectations. Price increases of services remains the biggest contributor to these results. Medical costs and insurance premiums were particularly a factor in last month's data. While not included in Core CPI, the recent rise in oil prices is also raising concerns about future headline CPI results. Since petroleum-based products and petrochemicals are widely used in manufacturing, along with the transportation of virtually all components and finished goods, the effects of higher oil prices can have far reaching effects on inflation as these higher costs are passed on to consumers.

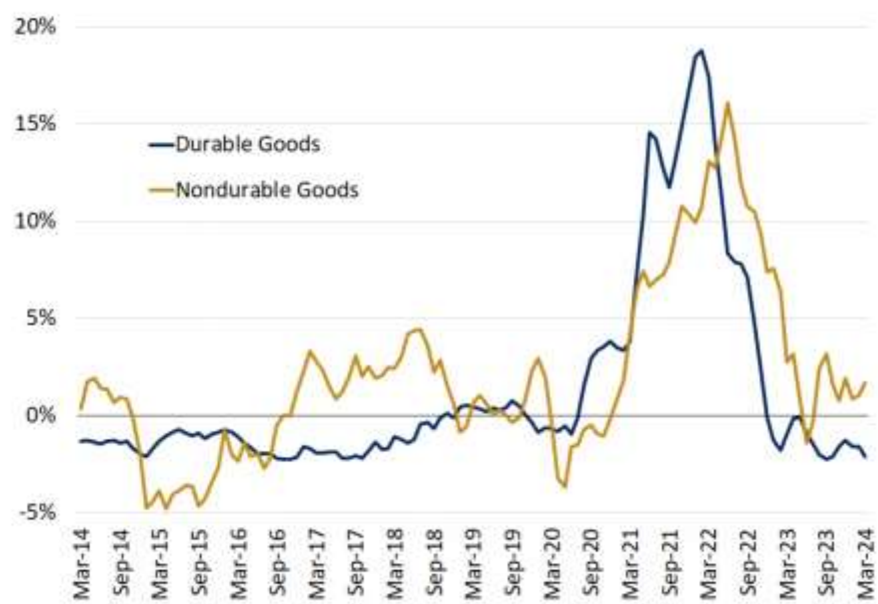
The pace of improvement in core CPI has slowed



Source: FactSet. Year-over-year change in U.S. CPI excluding food & energy.

A big part of the decline in the CPI over the past 24 months has been the goods component. This is why any hint that rising energy prices might reverse this trend is concerning. Since the pace of declining price increases on goods appears to have leveled off, the next phase of inflation reduction will require more help from shelter and services if the Fed's 2.0% target is to be achieved. This "last mile" of the campaign to bring inflation to this target is proving more challenging than some may have anticipated. However, this is likely due to the underlying strength of the economy where demand for housing and many services remains high. This indicator of a healthy consumer keeping prices "sticky" supports improving corporate earnings and stock prices but could mean that the path to 2% inflation may take longer than anticipated.

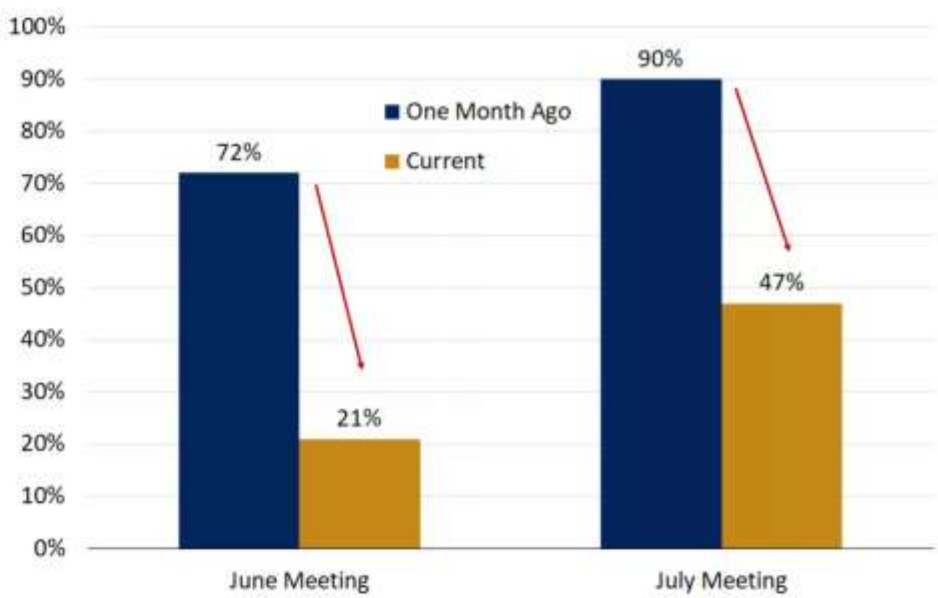
Annual Change in Goods Prices



Source: St. Louis Fed. Year-over-year change in U.S. goods CPI.

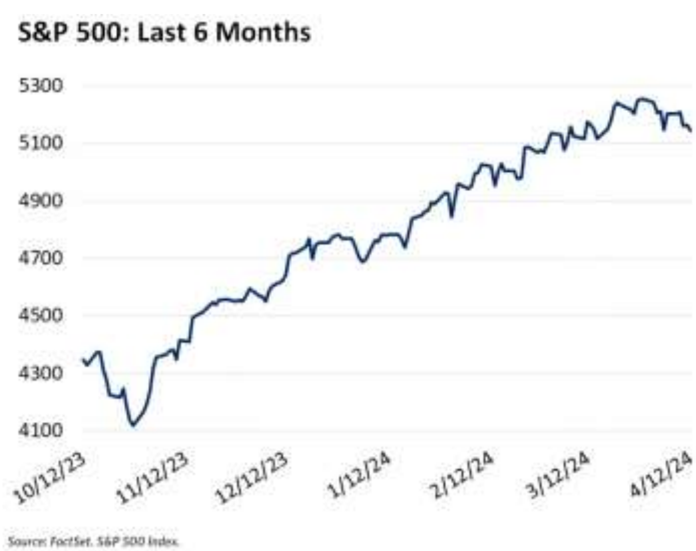
It is clear now that the market's expectation for rate cuts coming into 2024 was overly optimistic. At that time, bond futures were pricing in expectations for six ¼% rate cuts this year with the first one coming in March. The loss of downward inflation momentum in Q1 has not only kept the Fed on the sidelines in March but has all but removed the likelihood of a June easing. Not wanting to be blamed for reigniting inflation by cutting too soon, we believe the Fed will now need a few more months of evidence that inflation remains in a downward trend before starting to cut rates. Even when they do start to ease, it could be a longer and slower campaign than usual as they want to be careful not to trigger any resurgence in price increases. In response to last week's CPI report, Fed Funds futures quickly adjusted down the expectations of June and July rate cuts.

Fed Funds Futures Market Implied Probability of a Rate Cut in June and July



Source: CME FedWatch Tool. 30-day Fed Funds Futures pricing data.

The weekend's massive ariel attack on Israel by Iran was successfully defended but may not spell the end of the market's concern about an escalating conflict in the Middle East as Israel contemplates its response. After an impressive move higher in equities over the past six months, a pause or mild correction would not be unusual. In fact, a period of consolidation may prove healthy to the overall bull market as it may prevent some areas of the market from getting too overvalued. It could also serve to help broader sector rotation as capital shifts to more defensive and undervalued areas of the market like consumer staples during periods of turmoil and uncertainty. Since most still believe the Fed's next course of action will be cutting rates, the future for equities remains favorable despite the occasional loss of short-term upward momentum. The trillions that remain in sidelined cash may prompt asset managers to use such pullbacks as buying opportunities to redeploy some of these funds at more favorable prices.



As today is the filing deadline for 2023 income taxes, please remember to either file your returns or your request for extension by the end of today!

Have a great week!

Mark and Jeff

Mark S. Loftus, CFP®
Managing Partner & Founder, LPWP
Registered Principal, RJFS
CA Insurance License #0C83705

Jeffrey C. Preusser, CFP®
Senior Partner, LPWP
Registered Principal, RJFS
CA Insurance License #0E01600

O: 630.566.9200 // T: 844.890.8750 // F: 630.566.9292
1901 Butterfield Road, Suite 100, Downers Grove, IL 60515
www.loftus-preusser.com

Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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