Monday, April 24, 2024

SUMMARY-

I. NASDAQ leads stocks lower as 4-week correction widens.

II. Market volatility stems from rate cut reset, geopolitical turmoil, and earnings outlook anxiety.

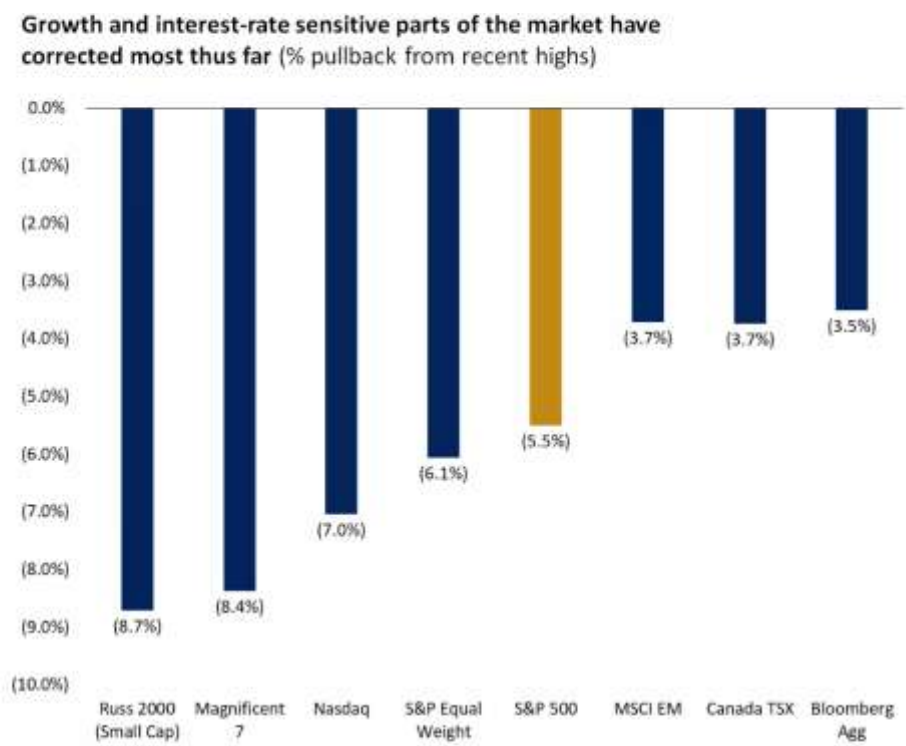
III. Corrections are normal and most don't signal bear markets.

IV. Easing tensions, moderating oil prices, new inflation data, and positive earnings guidance could trigger oversold bounce.

Good morning:

The retreat from the record high that the S&P 500 achieved in late March accelerated last week as the index finished the week down 3.0% to post its third negative result in a row. The NASDAQ's fourth straight weekly decline was steeper at about 5.5% over concerns about upcoming technology earnings, while in contrast, the Dow posted a negligible gain as capital shifted to more defensive sectors in a highly volatile week. The reassessment of expected Fed rate cuts after hotter than expected recent inflation data continues to reverberate through the financial markets. Traders also had to contend with rising geopolitical tensions and military strikes in the Middle East putting pressure on oil prices in recent weeks. While the magnitude of this month's pullback has been relatively contained so far, it seems clear that the tone of the market has shifted to a more cautionary stance as patience for previously assumed imminent rate cuts wears thin.

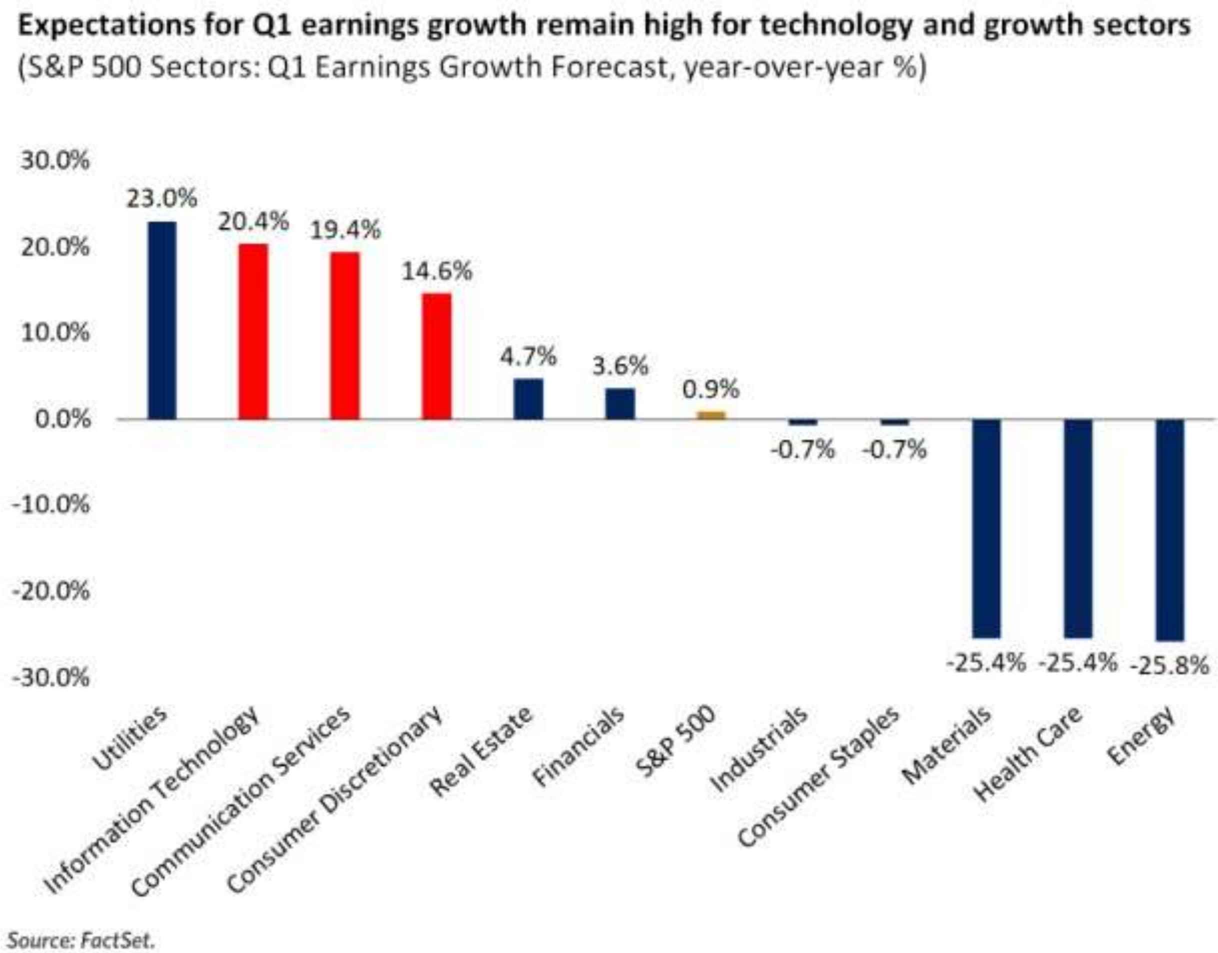
U.S. Federal Reserve Chair Jerome Powell conceded that it's "likely to take longer than expected" to gain sufficient confidence that inflation is on a sustainable downward track. In a speech on Tuesday, Powell reinforced recent messaging about a delayed timeline for interest rate cuts, saying "it's appropriate to allow restrictive policy further time to work." While most are not expecting inflation to resurge to the point where the Fed needs to resume hiking rates, the market's repricing of the timing and magnitude to only one cut in 2024 has been a key catalyst to the equity market's current correction as well as a move higher in short-term treasury bond yields.



Source: Bloomberg

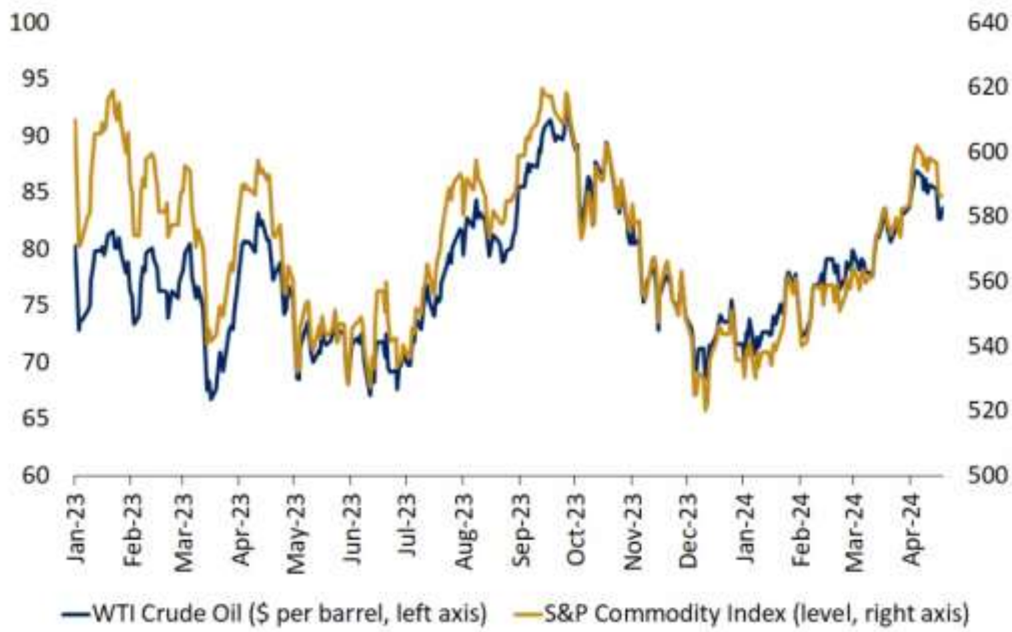
As most long-term investors come to learn, market corrections are an unpleasant but regular part of nearly every year. Most such pullbacks of 5-10% do *not* expand into "bear market" declines of >20% and can serve to keep stock prices from becoming overvalued relative to earnings and historical levels. With no new major military actions in the Middle East this weekend, attention will likely revert to corporate earnings on deck this week. While early in this first-quarter earnings season with only 14% of S&P 500 companies having reported, some patterns have started to emerge. Among the first to report results each quarter are the major U.S. banks which have generally exceeded expectations. However, there was rising concern on bank forward-looking guidance, and whether net interest income could be maintained in this new "higher for longer" interest rate environment as the cost of holding deposits remains elevated. As a result, the financial sector pulled back last week as expectations for future earnings were adjusted lower.

Several large mega-cap technology companies will report earnings this week, including a few of the so-called "Magnificent Seven." The expectations are high for these companies heading into earnings season, and while they have pulled back 6-7% in recent days, many of these stocks are still up over 20% since late October 2023. Given the focus on guidance, it will be important for these companies to deliver solid outlooks for market volatility to remain contained in the technology and growth sectors. Historically, tech stocks are the higher-volatility parts of the market, and they tend to pull back more than the broader market in periods of down markets. However, strong earnings results and favorable guidance could reignite some positive momentum in the technology-driven sectors and the markets more broadly. Furthermore, with these names among the very largest companies that trade, market-cap weighted indices like the S&P 500 could be heavily influenced by any price movement that occurs in these stocks that are given such an outsized weighting in the index.



We remain cautiously optimistic that this month's correction after a solid move higher in stocks is not the beginning of something more protracted. Bear markets tend to occur when the economy is in or entering a recession. Our current economy remains resilient as evidenced by last week's U.S. retail sales data coming in at double expectations further highlighting the healthy level of consumer spending. Additionally, bear markets (like 2022) tend to occur when the Fed is *hiking* rates. Although this last mile in its campaign to bring inflation down to the 2.0% target is proving more difficult, we believe the Fed will remain patient and committed to lowering rates as its next move. The far-reaching impact of energy costs on prices of goods and services has many economists closely watching the commodity. The price of U.S. crude oil briefly spiked around 4% to more than $85 per barrel late Thursday in the wake of the latest hostilities between Israel and Iran. However, prices quickly reversed course as tensions eased somewhat, and Friday afternoon's price of around $83 marked a roughly 3% decline for the week. Keeping a lid on oil prices will be important if inflation is going to resume its descent.

Oil and commodity prices move slightly below recent highs as hopes rise for easing geopolitical tensions



Source: Bloomberg.

Thursday's scheduled release of the U.S. government's initial estimate of first-quarter GDP is expected to show that the economy remained on a solid growth track but slowed relative to last year's fourth quarter when GDP grew at a 3.4% annual rate. An estimate released on Tuesday by U.S. Federal Reserve economists projected a first-quarter growth rate of 2.9%. Along with this growth data, other key economic reports also have the potential to be market-moving this week. New and existing home sales data, durable goods orders, and unemployment claims all could reveal hints at the economy's trajectory. The week concludes with Friday's important PCE report (Personal Consumption Expenditures Price Index), along with the University of Michigan's Index of Consumer Sentiment.

Although it is feasible that the current correction could continue for a while, the possibility of an oversold bounce could also materialize as this morning's solid opening portends. However, this could also come following a more dramatic washout move lower in equities like we have seen in recent years. In this case, though, it seems more likely that any evidence of continued progress on inflation or earnings growth could prove more than enough to halt the selloff and get stocks back on track.

Have a great week and Happy Passover!

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