Monday, April 8, 2024

SUMMARY-

I. Second quarter starts off with a modest pullback.

II. Manufacturing and labor data prompt concern of delayed rate cuts.

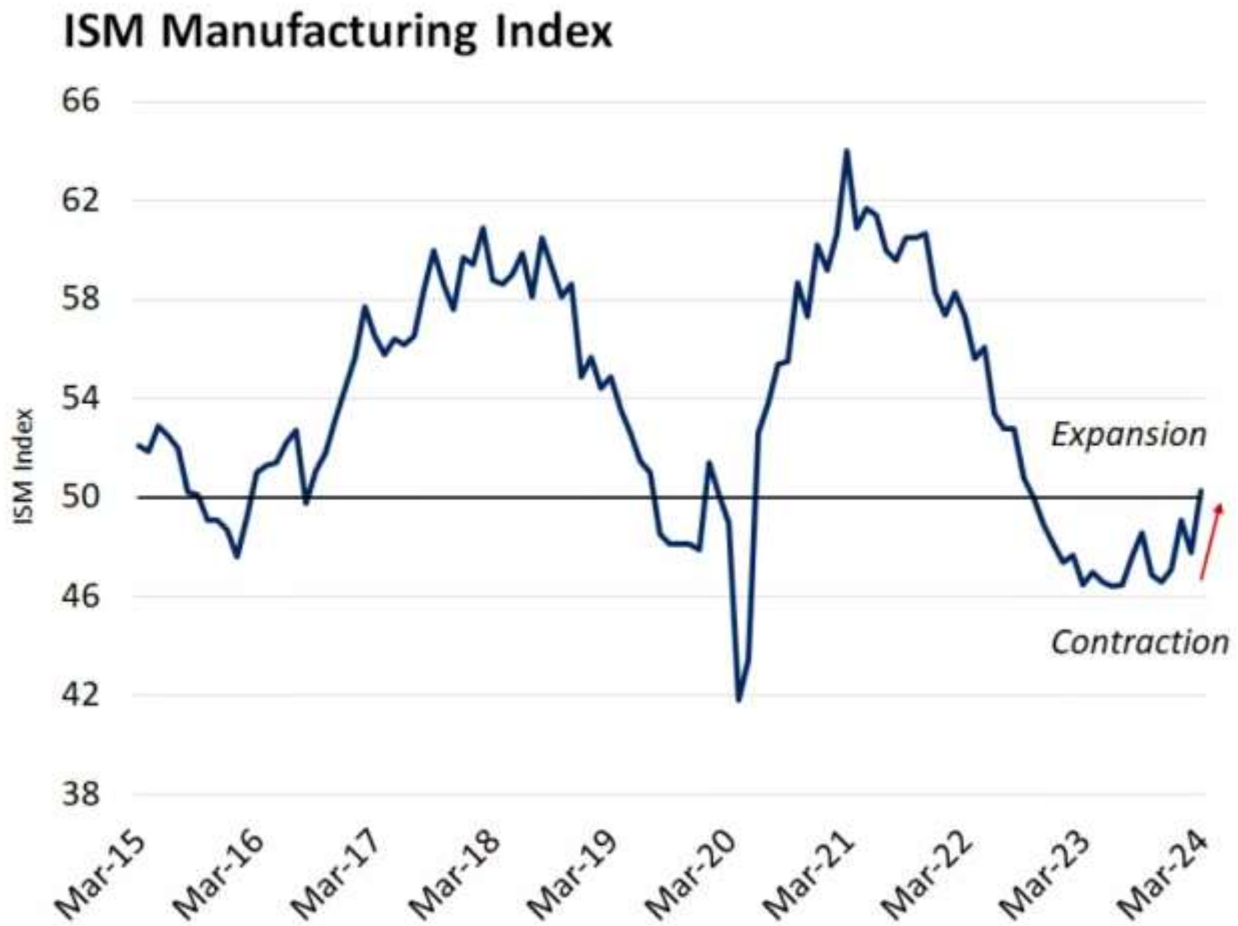
III. Slowing wage growth and quit rates portend weaker employment market to come.

IV. This week's inflation report may eclipse all other events and set tone for market direction.

Good morning:

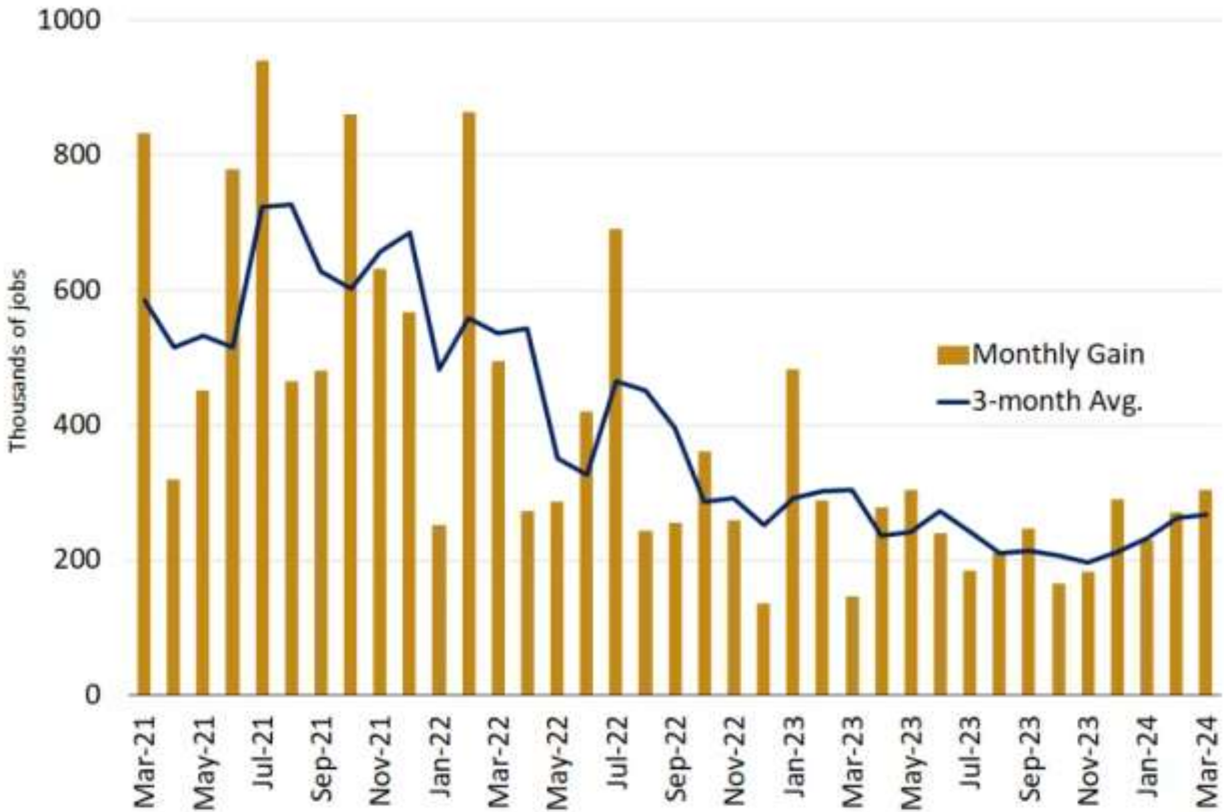
Despite a strong rebound on Friday, equity markets kicked off the second quarter last week on a losing note. Several strong economic readings raised concerns about when the Fed may be able to start cutting interest rates. Monday's ISM Manufacturing report showed that manufacturing activity has returned to expansionary territory for the first time since late 2022. While this is good news on its face, it suggested to some that the Fed may see it as inflationary and therefore be reluctant to start easing rates.

Manufacturing returned to expansionary territory in March for the first time in 18 months.



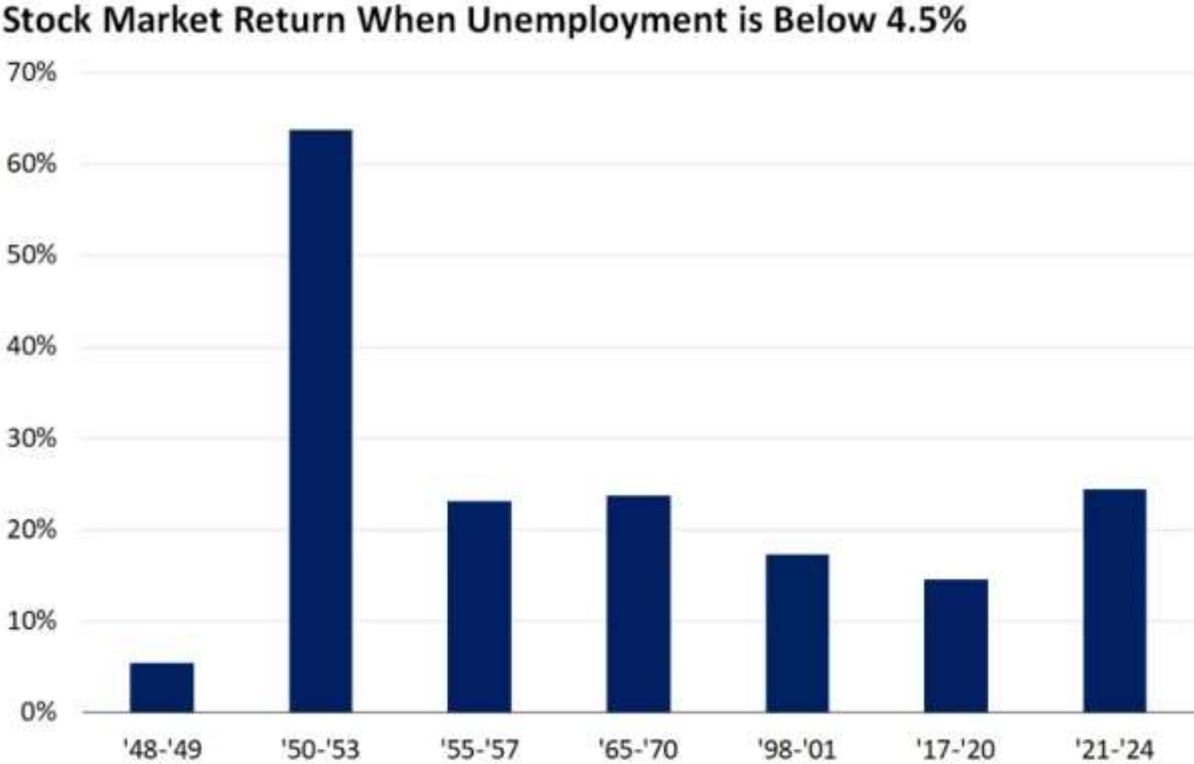
Source: FactSet.

Then on Friday, March payroll data revealed that 303,000 new jobs were created last month, vastly exceeding consensus estimates of 200,000. While these were the highest monthly gains in a year, hiring was most prevalent in health care, government, construction, and leisure & hospitality sectors. Economists and the Fed no doubt agree that the tight labor market is directly responsible for the continued above average level of consumer spending that is so critical to overall GDP growth rates.



Unemployment remained below 4.0% at 3.8% for its 26th consecutive month below 4.0%. This has not been accomplished since a similar stretch of time between 1967-1970. Reaction to this data was another example of mixed emotions. While a clearly healthy sign for workers and our economic health, it can easily be seen as adding inflationary pressure precisely when the Fed is trying to tamp inflation rates down. Perhaps the conclusion that labor markets may soon start to soften and inflation rates have already come down significantly were

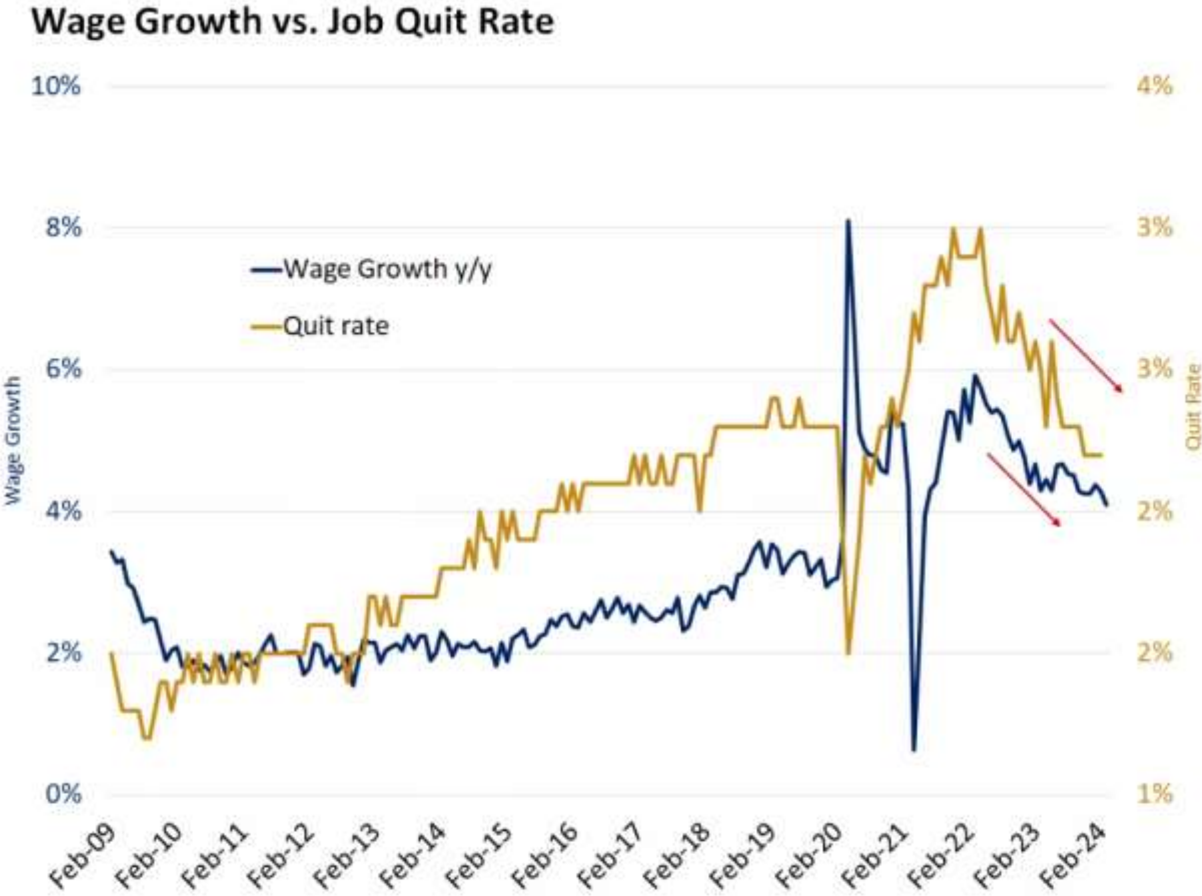
enough to motivate some equity buying by mid-Friday, paring the week's losses. Since the end of World War II, stocks have managed strong gains during periods when inflation was below 4.5%. Again, with the fact that 2/3 of GDP is directly tied to consumer spending, it is understandable that more Americans working will be an important catalyst to both economic and stock growth.



Source: Bloomberg – S&P 500 Index

Two aspects of this report from the Bureau of Labor Statistics were *less* inflationary and may signal weaker employment conditions on the horizon. Employees quitting their jobs (often for another position with higher pay) declined again last month suggesting easing pressure on wage

growth. Additionally, hourly earnings grew at an annual pace of 4.1%, down again in March to its lowest level since 2021. These trends are being closely watched by the Fed as they contemplate the timing of their pending easing campaign.



Source: FactSet, Bureau of Labor Statistics.

While many look to the skies today for a view of the solar eclipse, the week's biggest event in the market will undoubtedly be Wednesday's CPI report. Expectations are for core CPI to have ticked down to 3.7% in March, down from 3.8% in February. This reading, which excludes food and energy prices, is

directly indicative to many of what the Fed may use to determine whether rate cuts can commence this summer. Any surprisingly hotter CPI result will likely trigger disappointment among equity traders who have been pricing in falling short-term rates for the past six months.

Have a great week!

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