Monday, April 29, 2024

SUMMARY-

I. NASDAQ leads stock rebound from oversold levels.

II. Earnings continue to outpace expectations.

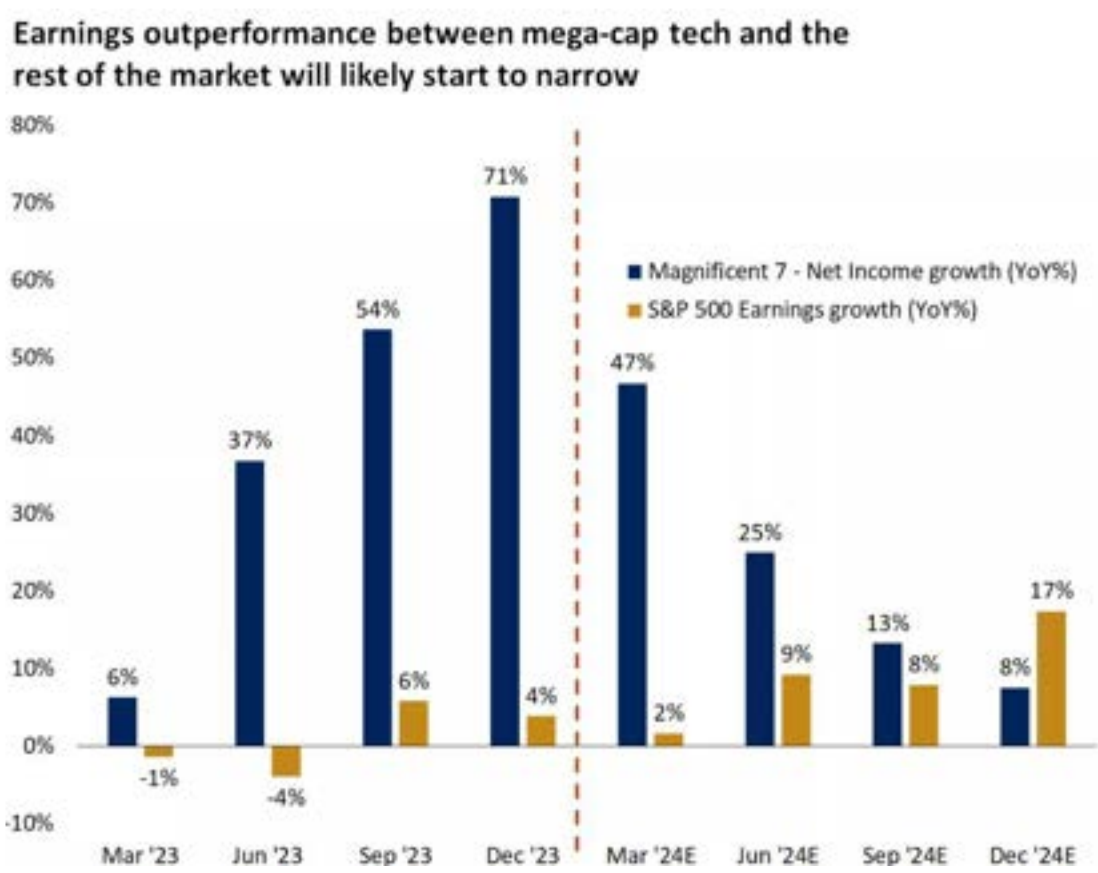
III. Economic growth softens due to net exports but remains solid.

IV. Sticky inflation, market correction, and delayed rate cuts cause consumer sentiment to weaken.

Good morning:

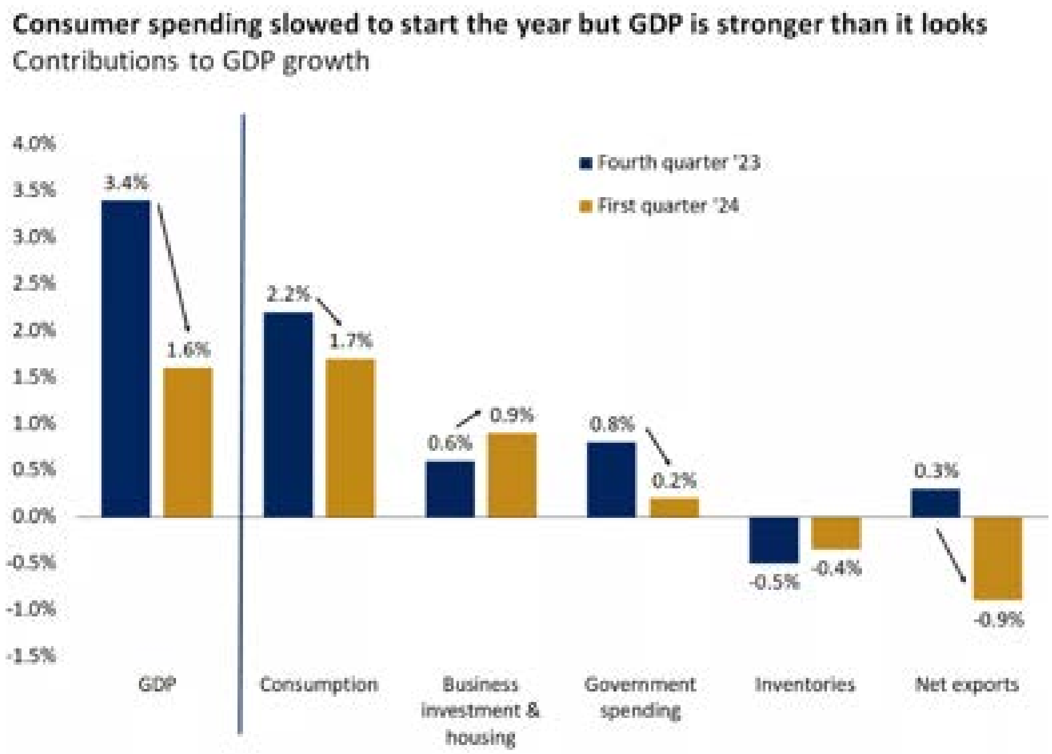
As earnings season hit full stride last week, the S&P 500 and the NASDAQ posted big weekly gains and snapped a three-week string of declines as strong earnings from technology companies helped offset disappointment over the latest economic and inflation reports. The NASDAQ finished 4.2% higher for the week while the S&P 500 was up 2.7%; the Dow lagged, posting a 0.7% gain. As expected, earnings results from several of the Magnificent Seven mega-cap technology companies caused outsized moves in the major averages. With almost half of S&P 500 companies having reported their Q1 earnings, results have been very encouraging as about 80% of companies surprised to the upside beating earnings expectations by an average of 10%.

After the market's rally over the past five months, it is particularly important that corporate profits continue to rise to justify stocks' higher valuations. This is particularly true among many of the mega-cap tech stocks after their remarkable move higher in the past two years. Unlike the internet-driven tech stock bubble in the late 1990's, this tech rally has been far more legitimate, based on strong earnings growth and excitement about the potential of A.I. However, the earnings outperformance and gap with the rest of the market will likely start to narrow in the back half of the year, supporting our view that the rally will broaden to other companies and sectors that have lagged.



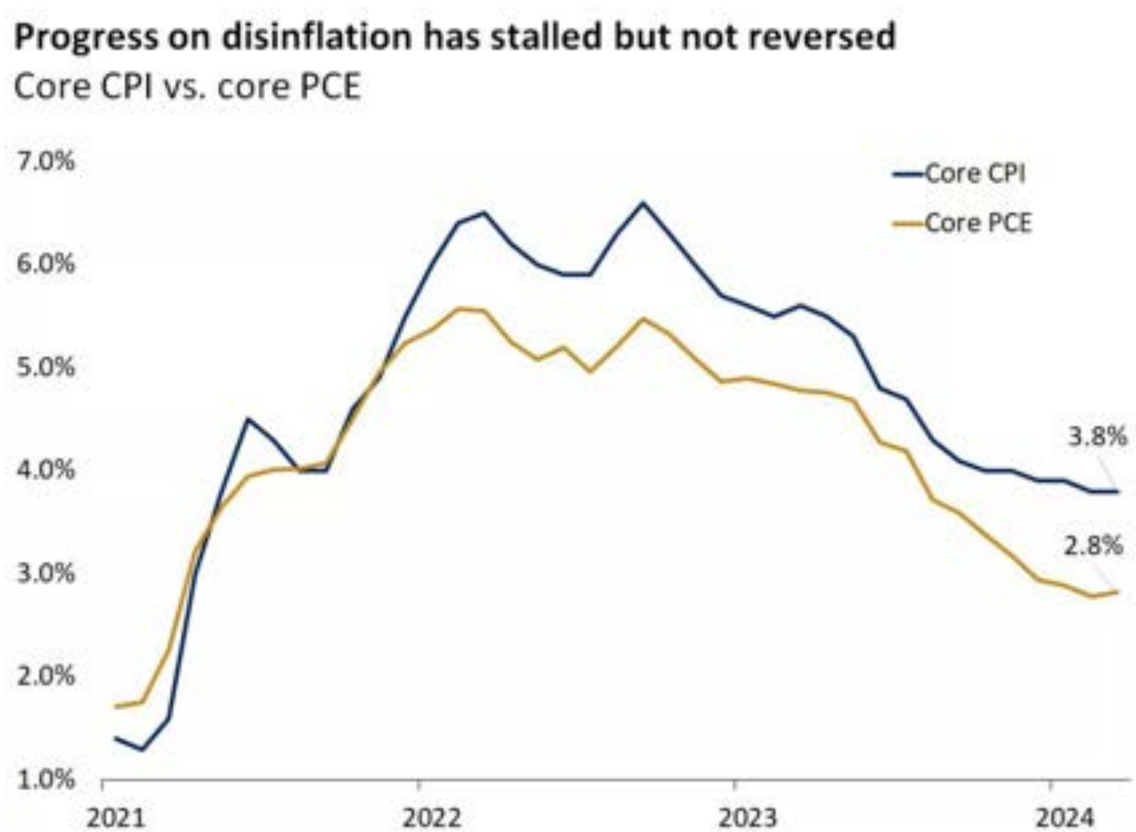
Source: FactSet

Although inflation data has remained sticky in recent reports, economic growth is clearly starting to slow. After running above the 2% potential annualized growth rate for the past six quarters, the advance estimate of first-quarter GDP indicated that growth slowed notably to 1.6% from a 3.4% annualized pace, missing consensus expectations. Although demand for services remained strong, consumption of goods along with spending on larger ticket items has started to fall. This is likely due to some households feeling the weight of higher interest rates along with diminished savings after two years of post-pandemic spending. As the calculation of GDP includes net exports, this weaker result may not be as indicative of our domestic economy as it appears at first glance. Many economists acknowledge the slowing growth rates after last year's second half economic surge but are no longer predicting an imminent recession. Instead, expectations suggest growth could reaccelerate in 2025 when the Fed's easing cycle finally kicks in.



Source: FactSet

Friday's release of the Fed's preferred measure of inflation, the core personal consumption expenditures price index (PCE) which strips out volatile food and energy prices, confirmed earlier reports that the rate of price increases has stopped declining. The data showed that prices increased in March by 0.3% from the prior month and 2.8% from a year ago, holding steady from February. Although they have stated that inflation data may not show progress each month, the Fed still needs to believe the annual rate of inflation is on a sure trajectory towards its 2.0% target before they will initiate any rate cuts. Markets have actually been fairly accepting of this new "higher for longer" interest rate scenario as they shift the start of rate cuts into the back half of the year and into 2025. However, should inflation suddenly start to rise, prompting the Fed to resume rate hikes, all bets are off. Both equities and fixed income assets would likely recoil sharply like other Fed-triggered temper tantrums from the market's past. For now, though, inflation rate declines have merely paused and not turned higher.



Source: Bloomberg

Last week's rebound did not completely erase this month's losses but may have eased some anxiety about a more protracted correction. However, the market's recent downturn on the heels of higher inflation numbers may have been partly to blame for softening consumer attitudes. Last Friday's release of the University of Michigan's consumer sentiment survey noted a turnaround from March when the index climbed to its highest level in 32 months. We expect continued volatility (in both directions) in the coming weeks but remain cautiously optimistic for positive gains for equities from current levels through year end.

This week should be driven by another large group of key earnings results, along with the non-farm payrolls report. Additionally, markets will again hang on any commentary from the Fed as they hold another Federal Open Market Committee (FOMC) meeting mid-week.

Have a great week!

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