Monday, May 20, 2024

SUMMARY-

I. CPI report shows inflation moderating again in April.

II. Stocks and bonds celebrate as rate cut hopes back on track.

III. Broadening market helps Dow reach 40,000 for the first time.

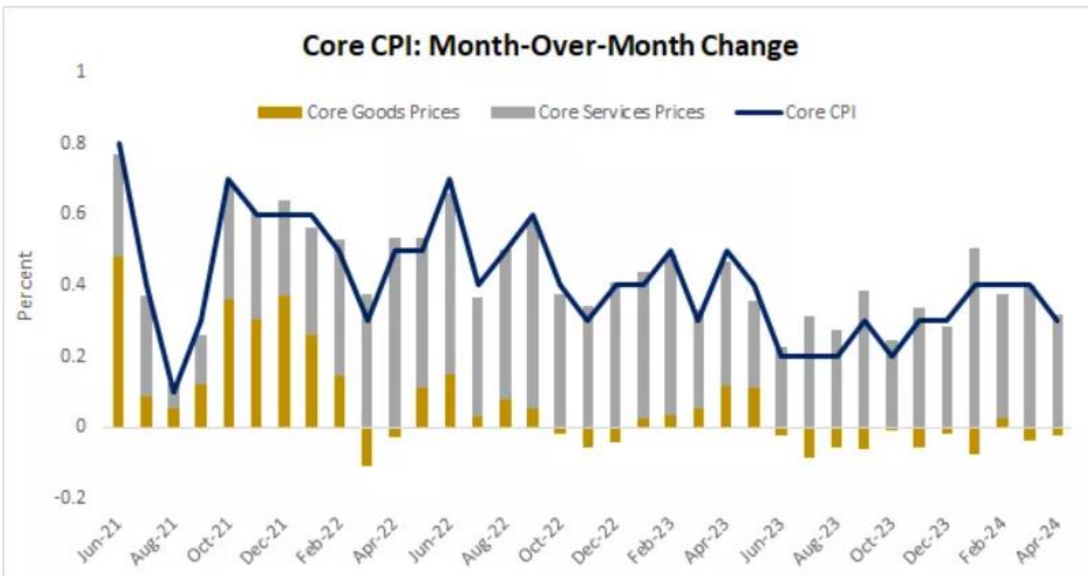
IV. Rising earnings estimates portend further gains for equities.

Good morning:

Stocks and bonds both breathed a further sigh of relief last week as the April Consumer Price Index (CPI) report signaled consumer price pressures are once again gradually moderating. In response, equity averages rallied to new highs while interest rates pulled back in the bond market. Markets celebrated with renewed anticipation that the Fed will begin cutting rates at some point this year. Leading major averages higher was the financial sector that helped the Dow reach a new milestone of 40,000 by Friday's close. The S&P 500 Index surpassed 5,300 while the NASDAQ outpaced other large cap indices gaining 2.1% for the week.

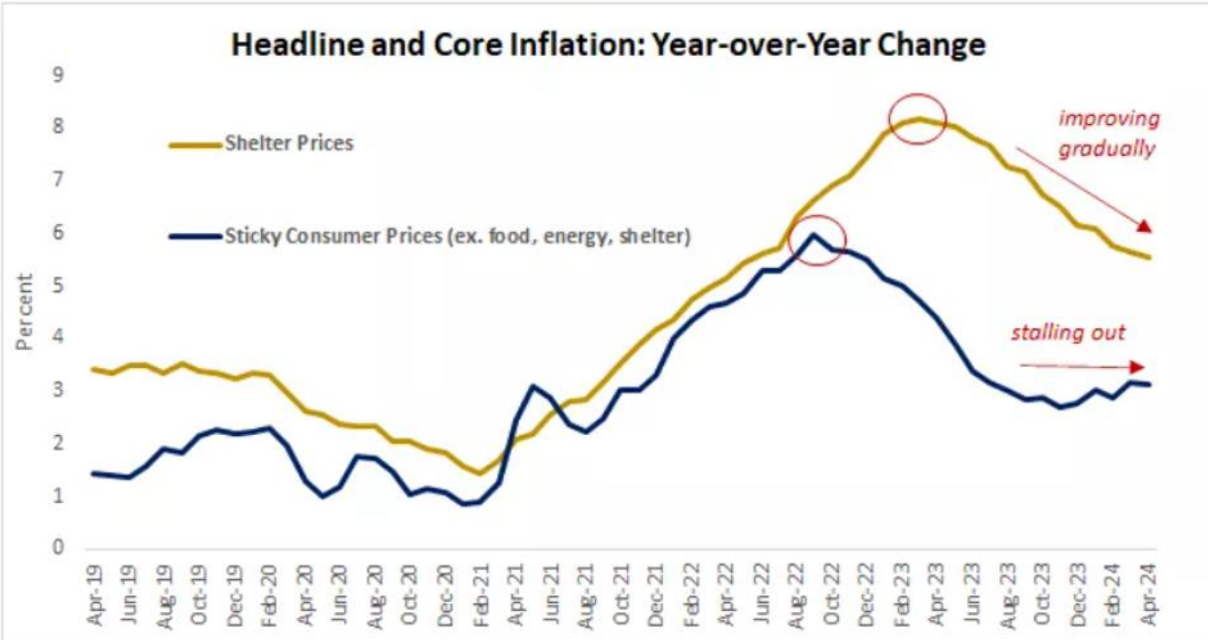
The underlying trends within the CPI report were encouraging as Core CPI fell to 3.6% year-over-year, its lowest reading in three years. Stubbornly high prices for services showed some easing in April as goods prices continued to decline. Falling auto and home furnishing costs helped this report, while shelter costs remained a major inflation contributor with prices only moderating gradually.

Core inflation cooled in April, thanks to relief in services prices.



Source: Bloomberg. Core inflation excludes food and energy prices.

It appears that the next leg lower for inflation will require more help from shelter prices as it represents one of most household's largest expenses. While the rate of housing and rent price increases from recent elevated levels appears to be slowing, many would welcome a period of price decreases to make their monthly cashflow stretch as far as it once did. Although this may occur in certain real estate and rental markets in the country, it is not widely expected.

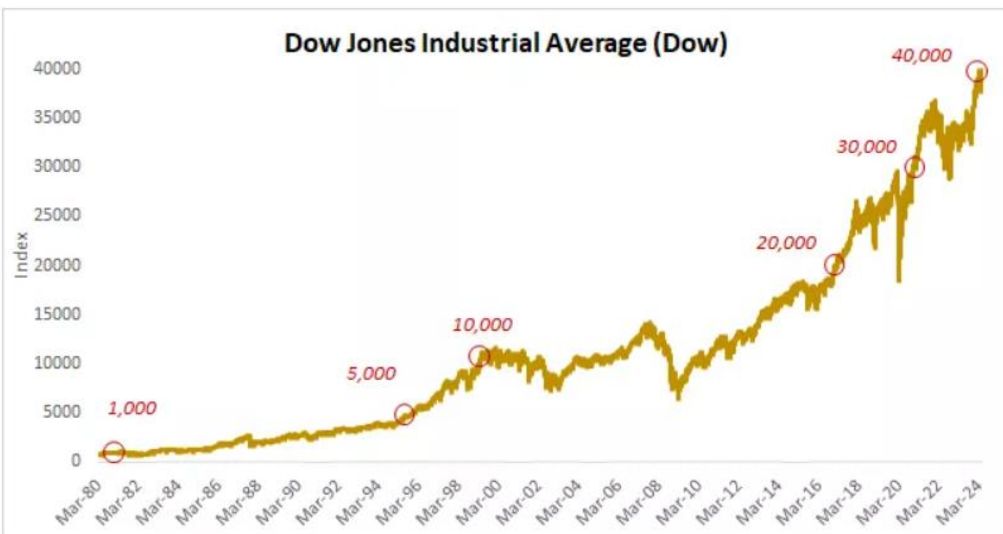


Source: Bloomberg

Last week's move higher in equities was yet another example of the market broadening out. While a good portion of the market's ascent since the October 2022 low has been powered by the prolific gains in the technology sector, particularly the "Magnificent Seven" and enthusiasm for all things AI, the recent moves higher in additional sectors like financials, industrials, energy, and utilities is a very positive sign for the overall health of this bull market. Many such previously under-loved areas of the market still trade at far lower valuations in addition to paying generally higher dividend rates.

The Dow Jones Industrial Average's touching of another large round number (40,000!) on Thursday is interesting but not necessarily significant to the market's current valuation (relative to profits or history). It does, however, remind us of the U.S. stock market's healthy rally over the past few months, as well as the past several years. Stocks were able to achieve these gains despite a steady stream of Fed policy and inflation risks, calls for imminent recession, and the competing allure of elevated money market and CD yields. Although equity markets often "climb a wall of worry," they are once again living up to their long-term historical trend of outperforming all other asset classes.

The Dow since 1980.



Source: Bloomberg. Dow Jones Industrial Average index. The Dow Jones is an unmanaged index and cannot be invested in directly.

Fortunately, the history of the Dow reaching past milestones did not signal an end to the uptrend. As the chart below illustrates, the Dow did not only hang onto its gains two years later but in most cases added to them. With the prospect of rate cuts on the horizon, strong earnings momentum, and generally reasonable valuations among industrials, we believe chances look good for the Dow's gains to continue for the foreseeable future.

Milestone	Date	Return Over Next 2 Years
1,000	November 20, 1980	15.6%
5,000	November 21, 1995	63.6%
10,000	March 29, 1999	1.0%
20,000	January 25, 2017	29.1%
30,000	November 24, 2020	18.3%
40,000	May 16, 2024	?

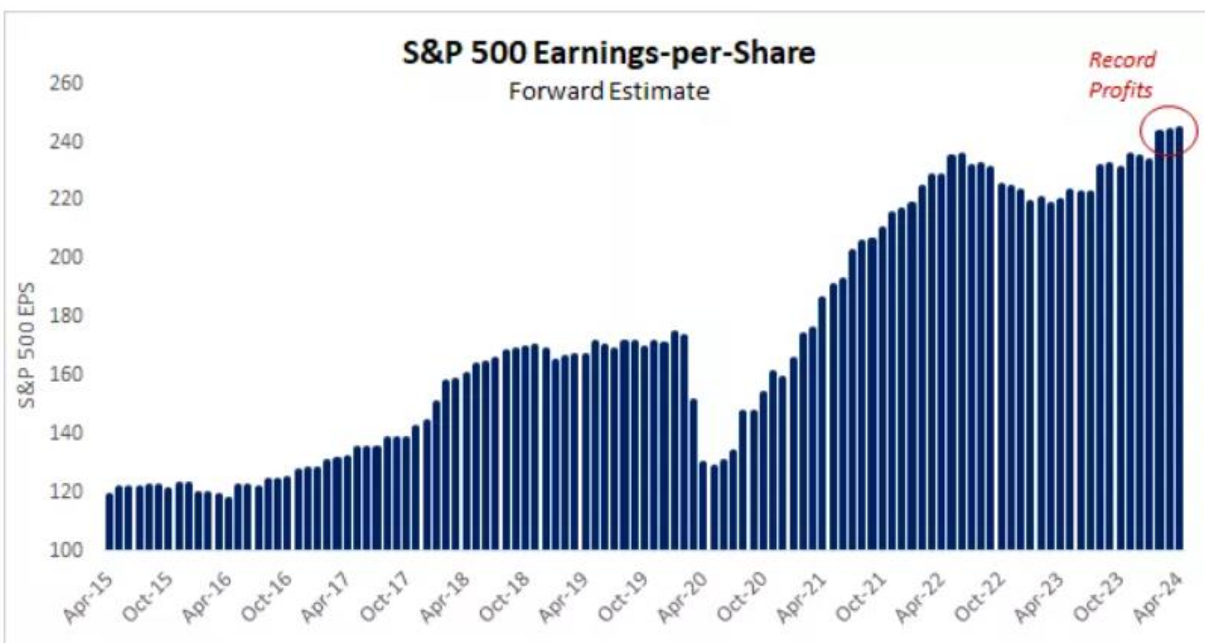
Source: Bloomberg, Dow Jones Industrial Average index.

Similarly, the S&P 500 reached another new high last week and marked a 10% gain since reaching a new high-water mark at the beginning of this year. Further illustrating the resiliency of the asset class, the chart below shows that after surpassing previous peaks, stocks have mostly gone on to log strong gains.

New All-Time High	Return Over Next 12 Months	Return Between New High and Next Market Peak
Jan. 2024	9.9%*	?
Aug. 2020	32.5%	45.0%
Mar. 2013	20.9%	148.4%
May 2007	-6.6%	2.9%
Jul. 1989	8.9%	488.4%
Nov. 1982	19.7%	185.9%
Jul. 1980	13.1%	18.1%

Source: Bloomberg, S&P 500 Total Returns

Once again, we believe odds favor continued appreciation in the equity markets on the horizon. Yet another factor, and perhaps the most important ultimately, is the rising consensus estimates for S&P 500 earnings in the coming quarters. Of course, it is always a good idea to be prepared for occasional volatility and unforeseen exogenous events that can trigger a kneejerk market reaction in the short run. Additionally, some traders may opt to take profits after four weeks of positive market results, but we remain cautiously optimistic that any pause in the recent positive momentum will be short lived.



Source: Bloomberg, Forward S&P 500 12-month consensus earnings estimates.

Economic data this week includes home sales figures along with the S&P Global Manufacturing PMI report, both of which will be viewed through the familiar prism of the timing of potential future Fed rate cuts. There are also still a few key earnings reports from widely owned companies that could move markets as they report this week. Barring anything unexpected arising, the path of least resistance for equities seems to be higher.

Have a great week!

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S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market.

The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system.

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