April 15, 2024

THOUGHTS TO START YOUR WEEK

HOORAY FOR TAX DAY!!

It is our honor to address you on this most important day! For all of you procrastinators...this is it! Midnight tonight in the mailbox or over the wires.

Too late for extensive tax planning but remember that you have until the date your tax return is due to contribute to an IRA. If you have filed for an automatic extension, you have until October 15 to contribute for 2023 and reduce your tax exposure. Of course, you will remember that even if you have filed for an extension, you still must pay your projected tax liability today to avoid interest and penalties.

Weekly Economic Insights From Our Investment Managers

While last week's solar eclipse caught the media's attention, inflation data was Wall Street's excitement. On Wednesday, the annual core consumer price inflation (CPI) rate, which excludes volatile items such as food and energy, came in at a near three-year low of 3.8%, matching February's reading and ever so slightly above the market forecasts of 3.7%, yet markets took this as an excuse to unload some excess froth. Thursday, producer prices (PPI) in the US were up only 0.2% month-over-month, the smallest increase in three months, and below forecasts of a 0.3% rise and equity markets largely gained back Wednesday's losses. On Friday, US import data added a little fuel to recent inflation concerns as did JP Morgan Chase's CEO, Jamie Dimon, when he warned about persistent inflations' effect on the economy, but the trifecta occurred when reports that Israel was preparing for an imminent attack by Iran surfaced sending Oil prices higher (think inflation again) and adding another dose of geopolitical risk to a market that was already on edge.

Key Takeaway:

There was nothing too exciting about last week's economic data, yet bond investors continued to price in "High for Longer" interest rates (as can be seen in the CME FedWatch tool), and stock investors took note. New tensions in the Middle East provided the perfect catalyst for traders to push the S&P 500 down to the 50-day moving average, a widely followed technical indicator (blue line on the chart above). None of this should come as a surprise to readers of these missives, as I've been telegraphing the idea over the past few weeks that I believed valuations have gotten a little ahead of themselves; markets appeared technically overbought given the recent advance; and we may be due for a pause or pullback when considering historical data.

The Week Ahead:

This week's pivotal report is Monday's Retail Sales release. Falling short of expectations for two consecutive months, this report reflects a cautious outlook among retailers, marked by disappointing earnings and a growing chorus of warnings about consumer spending. If retail sales disappoint again, signaling trouble for the consumer, brace for heightened volatility, potentially significant, as a slowdown in consumer spending raises the specter of a hard landing.

Additionally, we will gain insight into April's economic activity with the release of the Empire Manufacturing and Philly Fed Indices and given last week's concerns about inflation, the price indices could hold even greater significance than the headline figures, which are often quite volatile. We will round it out with some real estate and jobs data.

1:30PM Update: Retail Sales came in more than double expectations, but the market still decreased due to interest rate worries.

Tidbits & Technicals: (New developments noted in *italics*)

Current Headwinds:

- Valuations seem frothy given the current rate environment, leaving the markets subject to a potential swift pullback
- "Higher for Longer" – Risk that the Federal Reserve waits too long to begin lowering rates and threatens economic growth
- 10-year treasury yields broke out to new highs for the year, signaling that bond investors may be beginning to believe in the "Higher for Longer" thesis

Current Tailwinds:

- Optimism surrounding Artificial Intelligence (AI)
- Fed pivoting from raising rates to potentially cutting in the future
- Strong labor market
- Solid economic growth
- Continued earnings growth (the pace of which may be slowing)
- Momentum
- Participation is broadening with value, cyclicals, and smaller-sized companies beginning to show a strong upward bias

Sentiment:

- Credit spreads remain tight, signaling the bond market (aka "smart money") is not worried about a recession soon.
- The VIX (CBOE Volatility Index) has broken through this year's "complacency zone."
- *The CNN FEAR & Greed Index dropped into Neutral territory last week, signifying investors' enthusiasm has dried up a bit.*
- *The CME FedWatch Tool graphic illustrates a significant (30%) drop in expectations for a June rate cut this year.*

Intermarket Trends:

- The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) all posted new highs in the past few weeks, signifying a positive trend.
- Bond investors have been pricing in the idea of "Higher for Longer" recently, with 10-year treasury yields above this year's trading range to make new highs.
- The US Dollar is trading near the upper end of this year's trading range due to foreign central banks being the first to cut rates and others taking further rate hikes off the table while the Fed continues its campaign of tough rhetoric.
- Gold continues to set record highs.
- Industrial metals caught a bid recently, and copper recently broke out of a multi-month trading range to the high side. Discussions on supply shortages are emerging.
- Oil is trading near the top of its 2024 range but well below last year's highs.

Tying it all together:

The recent uptick in market volatility, marking the first significant fluctuation since the rally began in October '23, is not unexpected given the high equity valuations and recent investor complacency. Concerns about the prospect of prolonged high interest rates are emerging among bond investors, evident in the surge of longer-term interest rates to new yearly highs.

"Sticky Inflation" is the current topic du jour; however, nobody ever said the battle against it was going to be easy, and the robust economy continues to chug along. It was not long ago when everyone was screaming recession, but we are not hearing that word every day now. I believe this too shall pass. The next focus will likely turn to the upcoming elections, and it will be interesting to see how all this interest rate talk plays out in the political arena.

From a technical perspective, the current short-term set-up looks good. The textbooks generally agree that after a strong advance, markets take a breather and retreat to some significant technical level and the primary trend resumes. With equity markets recently making a series of all-time highs, the primary trend is undoubtedly up, so do not take this recent bout of volatility too strongly. Markets pull back quite often, and this is all perfectly normal in a bull market. The 50-day moving average is the first "level" I see on the charts, and it did appear to provide some stopping power on an intraday basis on Friday. Time will tell if that is all we need to shake off some of the excess or if buyers' interest resides at some lower point in the auction process. *For those interested—the next level of potential support I see is the green shaded gap on the first chart with the round number of 5000 sitting square in the middle.*

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