

April Sees Federal Reserve Rate Cut Expectations Dampen

In April, the S&P 500 experienced its first 5% pullback since October 2023. This wasn't surprising since the market had advanced over 25% from then and investors were brimming with optimism about future stock market gains. With bullish sentiment tempered, attention should focus on earnings results to re-assert the market's upward momentum.

Raymond James Chief Investment Officer Larry Adam is constructive on the market, saying: "While the scope of scenarios for Federal Reserve (Fed) rate cuts has contracted, accelerating earnings and a still healthy economy should support the market going forward."

Most sectors were down for the month with energy outperforming because of increases in oil prices related to unrest in the Middle East and with utilities outperforming due to their defensive characteristics. Technology underperformed the S&P 500. However, the earnings outlook for technology companies remains positive. The worst performer was real estate, no surprise since it's the most interest rate-sensitive sector.

Bond yields rose to year-to-date highs as expectations for Fed rate cuts have been delayed due to persistent inflation and stronger-than-expected growth. And on the international front, central banks in Europe and the U.K. are looking more likely to cut interest rates if their rising unemployment remains under control, thanks in part to their lower Consumer Price Index (CPI), which doesn't factor in housing costs as heavily as the U.S.

Before we move ahead, let's take a look at the year-to-date results:

	12/29/23 Close	4/30/24 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	37,689.54	37,815.92	+126.38	+0.34%
NASDAQ	15,011.35	15,657.82	+646.47	+4.31%
S&P 500	4,769.83	5,035.69	+265.86	+5.57%
MSCI EAFE	2,241.21	2,285.03	+43.82	+1.96%
Russell 2000	2,027.07	1,973.91	-53.16	-2.62%
Bloomberg Aggregate Bond	2,162.21	2,099.06	-63.15	-2.92%

*Performance reflects index values as of market close on April 30, 2024. Bloomberg Aggregate Bond and MSCI EAFE reflect April 29, 2024, closing values.

Steady growth expected to continue

U.S. real Gross Domestic Product (GDP) came in lower than expected at 1.6% quarter over quarter, annualized, but has the potential to climb higher throughout the year in the subsequent revisions as the Bureau of Economic Analysis collects more robust data on the performance of the economy. The CPI spooked markets for a third consecutive time to cap a stronger than expected first quarter for U.S. inflation, sending markets down and analysts back to the drawing table to try to figure out how many, or if any, rate cuts are now expected during the year. U.S. retail and food services sales were stronger than expected in March as employment and income growth continue to drive demand. Housing was a mixed bag, with existing home sales down while new home sales regained lost momentum from February.

Equities facing a short-term bounce

Ongoing inflation pressure led to a reset in Fed expectations and higher bond yields, causing the S&P 500 to pull back -4.1%, the Nasdaq -4.4% and the Russell 2000 -7.1% for the month. But this is expected with the market having gotten ahead of itself by rising 28% in just five months. Inflation should still be on its way down, albeit on a bumpier path than perhaps expected. Short-term indicators suggest that we are due for a brief slowdown, but with conditions allowing for recovery to a stronger market overall throughout the next 12 months. Upcoming Q1 earnings reports and bond yields will serve as indicators of what's to come.

Large caps outperform amid higher yields

Fear of inflation, as well as unrest in the Middle East, increased equity volatility in April with the S&P 500 falling below the 50-day moving average. Energy, utilities and consumer staples outperformed while real estate, consumer discretionary and technology sectors fell short. Small cap companies underperformed their large cap counterparts largely driven by the move to higher yields.

Expected rate cuts less likely

Fears of reaccelerating inflation have called into question whether the Fed will make good on its promise to cut interest rates throughout the year, with some worried that it may even go in the opposite direction and raise interest rates should inflation rise. The expectation of five cuts in 2024 back in January had dwindled to three by March and is now at two or fewer based on Fed funds futures trading. These trends have consequently increased Treasury yields, with interest rates increasing roughly 50 basis points on durations of five years and beyond.

Amid two wars, oil prices are near six-month highs

In addition to the Russia-Ukraine war, which involved drone strikes on Russian refineries in March, Israel's war in Gaza has also increased the risk premium in oil prices. In April, Israel's airstrike on the Iranian consulate in Syria was met with Iran's first-ever direct missile attack against Israeli territory, though both sides are refraining from all-out war. Such geopolitical unrest has contributed to the near six-month highs in oil prices observed at the end of April, unwelcome news ahead of the summer driving season that is unlikely to subside in the absence of a durable ceasefire.

TikTok faces ban as U.S. strengthens trade stance against China

As part of a \$95 billion aid package signed by President Biden in April to assist Ukraine, Israel and Taiwan, a provision was enacted that will require popular social media platform TikTok to divest from ByteDance, its Chinese parent company, within the next 12 months or face a permanent ban on U.S. operations. It is expected that China will not allow divestment and therefore it is increasingly possible that TikTok will no longer operate in the U.S. by mid-2025. This move comes during a period when the U.S. is taking a more assertive stance against China on tech and trade policy, which could soon involve tariffs on items sensitive to national security issues like semiconductors, solar technology and electric vehicles.

Europe predicting rate cuts with U.K. likely to follow

Considering economic data and events in the Middle East, many investors have been skeptical that the central banks in Europe will cut interest rates as previously indicated. However, bank leaders have remained optimistic and, partly resulting from their confidence, European sovereign bonds have not seen the same rise in yield as their U.S. counterparts. Senior officials at the European Central Bank have signaled strongly that subdued inflationary pressures, if sustained, will allow for a rate cut as soon as June.

In the U.K., the equity index hit a new all-time high after Bank of England Governor Andrew Bailey implied the likelihood of following in their European counterpart's decision to cut interest rates in the coming months. However, there is still ambiguity regarding that decision, which could prove sensitive to factors such as private sector wage growth, which remains higher than the central bank would like.

When comparing CPI in Europe to that of the U.S., it's important to consider that the stickiness of domestic inflation and higher CPI in the U.S. is largely the result of the much higher weighting of housing costs, which have risen faster than other prices that contribute to the overall calculation. It should be noted that in Europe, owner-occupier housing costs are not included at all.

The bottom line

With uncertainty regarding inflation, the Fed and international conflicts, there are significant risk factors at play. However, statistics seem to point toward a positive upswing in the markets over the course of the next 12 months. And despite the first 5% pullback in the S&P 500 in six months, our outlook continues to be positive in the long term.

We're glad to be able to bring you these updates and hope you find them helpful. Your financial goals are always top of mind, so please don't hesitate to reach out regarding any questions or concerns you may have.

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