Weekly Investment Insights

March 18, 2024

Key Takeaways:

- Consumers see inflation staying elevated.
- Headline inflation increases more than expected on energy costs.
- Consumer spending increased modestly in February.
- Equities under pressure as inflation picks up.
- Treasury yields move higher on hotter-than-expected CPI reading.
- Energy prices lead commodity gains.

Weekly Economic Recap –

Inflation Picking Up Again

Consumer expectations for inflation over the next three- and five-year periods increased sharply in February according to the New York Fed Survey. Consumers see inflation edging up to 2.7% in the next three years and 2.9% in the next five years, both ahead of the Fed's 2.0% target. Notably, however, the one-year expected rent costs fell to the lowest level since December 2020.

Inflation as tracked by the Consumer Price Index increased slightly more than expected in February at the core level (0.4% MoM vs. 0.3% MoM est.) due to used car prices and airline fares. At the headline level, inflation rose the most in five months due to rising energy costs, specifically gasoline, which increased for the first time in five months.

The NFIB Small Business Optimism Index decreased in February, marking the 26th straight month the Index has been below the 50-year average. Business owners reported inflation as their single most important problem, up three points from last month, and replacing labor quality as the top problem.

Prices paid to producers as tracked by the Producer Price Index increased in February more than expected and by the most in six months (+0.6% MoM). The increase at the headline level was attributed to energy prices. Core PPI, excluding energy and food prices, also increased slightly more than expected (+0.3% vs. +0.2% est.).

Consumers increased spending in February as retail sales increased (+0.6% MoM) after falling to start the year. Eight of thirteen categories of the Index increased for the month. Spending at auto dealers increased the most since May.

Weekly Market Recap –

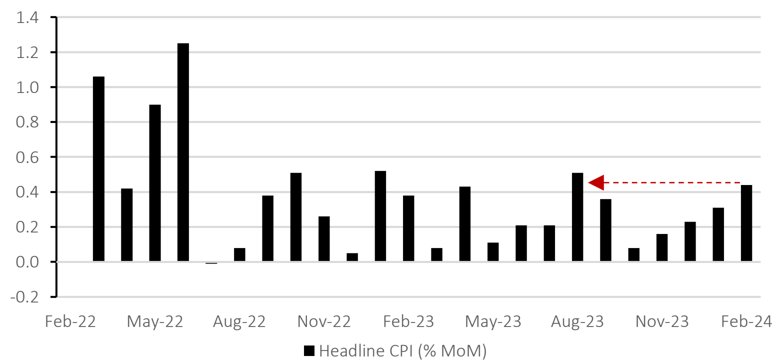
Global Equities Falter as Inflationary Pressures Accelerate

Equities: The MSCI AC World Index was lower for the first time in eight weeks as U.S. inflationary pressures showed signs of accelerating in February. The major averages in the U.S. were lower for the second straight week. In the large cap space technology led the declines on uncertainty around Fed rate cuts. Small caps underperformed large cap stocks after the Russell 2000 posted its worst week in 10 weeks.

Fixed Income: The Bloomberg Barclays Aggregate Index posted its worst one week decline since October after hotter than expected inflation data. Leverage loans and floating rate bonds were the only areas of fixed income to post a modest gain for the week.

Commodities/FX: The Bloomberg Commodity Index was higher for the third straight week led by energy. Natural gas prices surged by the most since January. Crude oil was higher for the second time in three weeks on supply concerns emphasized by Ukrainian attacks last week on Russian refineries.

Headline Inflation Increases by Most Since August



Footnotes: Data is as of February 2024
Source: FactSet Research, Verdence Capital Advisors

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com

Past performance is not indicative of future returns

Key Takeaways:

- President Biden releases a sweeping $7.3 trillion budget proposal.
- Months of negotiations are likely to change the proposal many times.
- Proposal calls for increased taxes for the wealthy and corporations.
- Spending patterns to remain egregious.
- U.S. deficit reaches inordinate levels given net interest costs.

Biden's 2025 Budget Proposal

Last week, President Biden released his $7.3 trillion budet proposal for the fiscal year 2025 which outlined his spending and revenue plans. President Biden aims to reduce the deficit by $3 trillion over the next 10 years and increase spending on programs to assist lower income earners cope with inflation. The budget outlines plans to increase the corporate income tax rate to 28% (from 21%) and establishes a 25% income tax rate for those with wealth of at least $100 million. It is important to understand the process to finalize a government budget of this magnitude, as we are likely months away from seeing any concrete decisions made. In this weekly, we aim to outline the budget process and provide an overview of President Biden's spending plans (as is) and their potential implications for the economy.

- **Budget approval process:** Finalizing a budget takes months of negotiations and planning on the part of many different government agencies. Roughly 18 months prior to the start of the next fiscal year, the Office of Management and Budget (OMB) collaborates with various government agencies to put together the President's budget proposal. The President is required to submit the budget to congress in February. After February, months of negotiation between the House and Senate take place to finalize the budget before a September 30th deadline (the government's fiscal year starts October 1st).

- **Overview of budget:** Over the next 10 years, the proposal would raise tax receipts by $4.97 trillion. The tax bill would be footed by individuals earning more than $400,000 annually and large corporations. The tax increases are part of the sweeping spending package which includes expanding child tax credits, reducing the cost of healthcare and a new tax credit that would provide $10,000 to first-time home buyers. The spending package aims to provide further relief for middle income families amid persistent inflationary pressures. According to the U.S. Treasury Department, the proposed budget (as is) would bring down the total deficit by ~$3 trillion.[2]

- **Deficit to improve, but still not good:** While the government deficit is projected to improve with this proposal, government spending remains egregious. Most of Biden's spending plans come from "mandatory" programs, including Social Security, Medicare, and Medicaid, which combined account for ~60% of the spending proposal.

- **Current state of government spending:** Last week, the U.S. budget deficit widened to $828 billion for the first five months of the fiscal year, which was ~18% higher than a year ago. The increase has been attributed to rising interest costs, which totaled $433 billion in the first five months of the fiscal year. According to Biden's 2025 proposal, net interest payments are projected to total $890 billion for FY 2024 and are projected to exceed defense spending as a percent of GDP.

The Bottom Line:

While we are not political analysts, it is clear that government spending is a major issue. Higher interest rates have increased our interest payments to inordinate levels. Biden's proposal is unlikely to gain momentum given the Republican led House. However, we are concerned businesses may pause spending as the future of tax rates remains unclear which can impact GDP. In addition, this is likely to be an election topic as most Americans feel squeezed by higher prices.

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com

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