Weekly Investment Insights

March 25, 2024

Key Takeaways:

- Homebuilder sentiment climbs on expectations for sales.
- Fed keeps rates steady, increases inflation forecast.
- Leading indicators increase for first time in two years.
- Global equities rally on dovish central banks.
- Bonds rally as rate cuts priced in.
- Commodities fall but Black Sea disruptions a concern.

Weekly Economic Recap –

Housing Shows Signs of Life

Homebuilder sentiment improved in March as the NAHB Housing Market Index rose three points to the highest level since July 2023. A measure of expected sales in the next six months increased to the highest level since June 2023, while prospective buyers' traffic increased to a seven-month high.

Housing starts rose more than expected in February and at the fastest pace in nine months, led by single-family home construction, which increased by the most since April 2022 (+11.6%). Building permits, a leading indicator for future construction activity, also rose more than expected.

The Federal Reserve held interest rates steady at 5.25% - 5.50% at their March meeting and insinuated three quarter-percentage point cuts by the end of the year. The Committee increased their estimates for GDP growth this year to 2.1% (from 1.4% in December) and marginally increased their estimate for core inflation to 2.6% (from 2.4%). During his press conference, Chairman Powell indicated it could be "appropriate to slow the pace of [balance sheet] runoff fairly soon," and rate cuts are likely to come "at some point this year."

Sales of existing homes increased at the fastest pace in a year (+9.5% MoM) in February fueled by sales of single family homes. However, the months' supply dropped to 2.9 months (20YR average is 5.4 months) and the median selling price rose to $384,500, the highest price since November.

The Leading Indicators Index increased for the first time since February 2022 led by average weekly hours worked and climbing stock prices. New orders, the interest rate spread and consumer sentiment remained weak.

Weekly Market Recap –

Dovish Central Banks Fuel Equity Rally

Equities: The MSCI AC World Index posted its best one week rally this year due to optimism about global central bank rate cuts and better than expected economic data in the U.S. Japan was the global leader after investors cheered the Bank of Japan's end to negative interest rate policy. Within the U.S., the S&P 500 made a new record high led by technology. Growth stocks outperformed value and large cap stocks outperformed small and midcap stocks.

Fixed Income: The Bloomberg Barclays Aggregate Index rose for the fourth time in the past five months as bond investors anticipate U.S. rate cuts as early as June. Emerging market bonds and investment grade credit led the gains in fixed income.

Commodities/FX: The Bloomberg Commodity Index fell for the first time in four weeks as weakness in industrial metals overshadowed strong gains in grains. Wheat led the gains in grains on persistent supply concerns due to the conflict in the Black Sea.

Homebuilder Sentiment Jumps in March

Footnotes: Data is as of March 2024.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

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Key Takeaways:

- More than twenty central banks held policy decision meetings last week.
- Bank of Japan puts an end to negative interest rate regime.
- Federal Reserve keeps rates unchanged, pencils in three cuts for 2024.
- Bank of England moves forward with a dovish pause.
- Swiss National Bank becomes first major central bank to cut interest rates.

Central Bank Wrap Up

Last week, central banks responsible for setting policy on six of the ten most-traded currencies met to decide the path forward for nearly half of the global economy.[1] The Bank of Japan announced the end to the world's last negative interest rate regime. The Federal Reserve kept interest rates unchanged as the Committee continues to see an economy that is "performing well." The Bank of England kept interest rates unchanged but hinted rate cuts could be on the horizon amid inflation falling faster than expected. This week, we review the busy week for monetary policy decisions and what it means for markets going forward.

- **Bank of Japan ends negative rates:** Inflation in Japan has exceeded the BOJ's 2% inflation target since April 2022. As a result, the Bank of Japan raised their policy rate for the first time in seventeen years, in a decision that ended eight years of negative interest rates. The central bank also announced plans to abandon its yield curve control policies which capped long-term interest rates around zero. However, BOJ Governor, Kazuo Uedam noted the need to maintain an accommodative policy stance until inflation expectations settle at 2%.

- **Federal Reserve maintains policy:** As inflation has reaccelerated in the U.S., the Federal Reserve is committed to navigate the "bumpy road" to 2%, according to Chairman Powell. The Committee kept interest rates unchanged but suggested the possibility of three rate cuts this year. Powell told reporters cuts are "likely to come at some point this year," but the Committee needs "more confidence" inflation is on track to 2%. The Committee increased their estimate for 2024 GDP growth to 2.1% (from 1.4% in December), but also increased their estimate for core inflation to 2.6% (from 2.4%).

- **Bank of England delivers dovish pause:** The Monetary Policy Committee in England voted 8-1 in favor of keeping rates unchanged at 5.25% (one member voted for a 25bps cut). This was the first time in this tightening cycle no members voted for rate increases. Governor Andrew Bailey confirmed "we're not yet at the point where we can cut interest rates, but things are moving in the right direction." He also noted that key indicators of inflation remain elevated."

- **Swiss National Bank shocks market:** The Swiss National Bank became the first major central bank to cut interest rates (by 25bps) in a move that surprised markets. The bank sees inflation remaining below 2% (currently at 1.2% YoY) "over the next few years." Officials also revised their expectations for consumer prices lower to 1.4% (from 1.9%) for 2024. President Thomas Jordan noted policy easing "has been made possible because the fight against inflation has been effective."[2]

The Bottom Line:

The move by the Bank of Japan solidifies the view that investors need to adapt to the end of easy global monetary policy. We agree with market expectations that the peak in the Fed funds rate has been reached but we are not as optimistic about the Fed's flexibility. We still think rate cuts are a 2H 2024 story but think the Fed needs to be very careful not to reignite inflation by taking a dovish stance. Commodity prices remain a significant threat to the work the Fed has done to reduce inflation.

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Past performance is not indicative of future returns.

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