Weekly Investment Insights

April 15, 2024

VERDENCE CAPITAL ADVISORS

Key Takeaways:

- Inflationary pressures accelerate in March.
- Fed lacks confidence inflation is moving toward 2%.
- Consumer inflation expectations move higher.
- Equities falter as inflation picks back up.
- Bond yields spike on inflation data.
- Safe-haven assets drive commodity gains.

Weekly Economic Recap –

Inflation Ticks Higher; Fed Needs more Confidence Before Cutting

The NFIB Small Business Optimism Index fell for the seventh time in the last eight months to the lowest level since December 2012. Inflation was the largest problem in operating businesses while only 11% of owners said they intend to add workers in the next three months, the lowest level since May 2020.

Inflation as tracked by the Consumer Price Index increased more-than-expected from a year ago in March (3.5% vs. 3.4% est.) and increased 0.4% from February. Gasoline and shelter costs accounted for over half of the overall monthly advance. Services prices increased 5.3% from a year ago. Core inflation, which excludes volatile food and energy prices, also increased more-than-expected from a year ago (3.8% vs. 3.7% est.).

The Fed's March meeting minutes indicated "participants... expressed the view that recent data had not increased their confidence that inflation was moving sustainably down to 2%." Participants also discussed the appropriate pace of balance sheet runoff, indicating "the vast majority judge it would be prudent to begin slowing the pace of runoff fairly soon." The committee favors keeping the cap on mortgage-backed securities, but adjusting the cap on Treasuries.

Producer prices increased less than expected in March but by the most in 11 months (2.1% YoY). The services gauge increased for the third straight month, driven by an increase in portfolio management services and airfaires.

Consumer sentiment was relatively unchanged in April according to the University of Michigan Sentiment Index. Year-ahead inflation expectations increased to 3.1%, however, while long-term inflation expectations increased to 3% from 2.8%.

Weekly Market Recap –

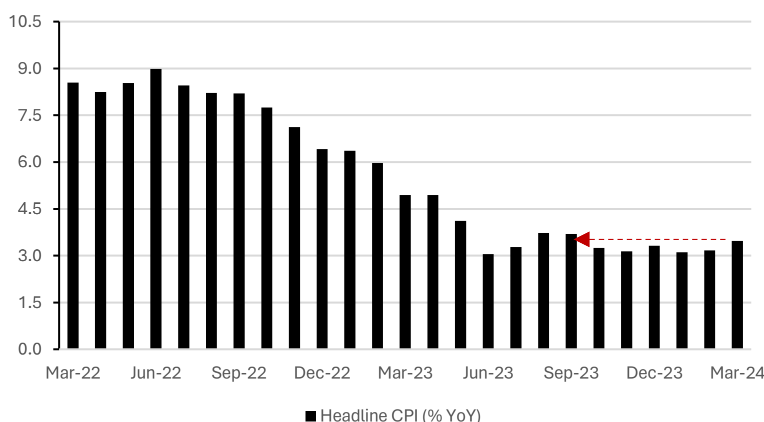
Stubborn Inflation Causes Global Equity Selloff; Yields Rise

Equities: The MSCI AC World Index fell for the second straight week and by the most since the start of the year as inflationary pressures remain stubborn in the U.S. causing rate cut expectations to get pushed out further. All major averages in the U.S. were lower with small-caps, as tracked by the Russell 2000 falling the most. Growth sectors fell less than value sectors as financials fell the most of all 11 S&P 500 sectors.

Fixed Income: The Bloomberg Barclays Aggregate Index was lower for the second straight week as Treasury yields spiked after the hotter-than-expected inflation reading. Leverage loans and floating rate instruments were the only sectors of fixed income higher after the rise in yields.

Commodities/FX: The Bloomberg Commodity Index was marginally higher for the third straight week. Crude oil prices fell for the first time in three weeks as investors assess the inflation reading and the latest developments in the Middle East. Gold prices were higher for the third straight week as investors flock to the safe-haven amid rising tensions in the Middle East.

Headline Inflation Accelerates in March



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

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Past performance is not indicative of future returns.

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Key Takeaways:

- Inflationary pressures remain elevated.
- Service prices contributing the most to headline gains.
- Fed walking a fine line by getting dovish too soon and reigniting inflation.
- Rate cut expectations slashed from six to three since beginning of year.
- Rates to stay higher for longer amid increased pressures.

Fed Walking a Fine Line as Inflation Remains Stubborn

Last week, investors absorbed hotter-than-expected inflation data on both a month-over-month and year-over-year basis. The elevated inflation readings further call into question if the Fed will be able to cut rates anytime soon. The inflation reading was paired with the Federal Reserve's March meeting minutes, which signaled, "participants... expressed the view that recent data had not increased their confidence that inflation was moving sustainably down to 2%."

In this weekly, we wanted to analyze where pricing pressures stand in relation to how they typically grow on an annual basis (over the past 30 years) and how they grew in the year leading up to the pandemic. Then we looked at how prices have grown since the pandemic through last month (annualized basis). As can be seen in the table, prices are increasing at a faster annualized rate across various categories compared to the 30YR annual average. Energy prices have increased on geopolitical tensions in the Middle East and worries of global supply shortages. Food prices, both at home and away from home (i.e., restuarants) are significantly higher and are harming families. Services inflation is growing at an above average pace and is considered "sticky." For example, auto insurance is growing more than double what the historical average has been.

The Bottom Line:

Inflation remains a major issue. Across all major areas of inflation that we analyzed, the annualized rate since the end of the pandemic is exceeding the past 30 year average and well above what we were accustomed to before the pandemic. The progress the Fed has made on inflation was the easy part (supply chain repairs) but the Fed needs to be more clear to investors that we are not near where we need to be. Typically, truly tackling inflation is not a smooth path and comes in waves. If the Fed continues with mixed messages about rate cuts, they can inadvertently fuel inflation as consumers spend with the anticipation of lower rates. In addition, price to earnings multiples across select sectors (e.g., tech) are too high given the expectation that inflation will take longer to reach the Fed's 2% target. While there are three rate cuts priced in the futures market for 2024, we think one or two would be more likely and not until 2H24.

	30YR Annual Average	1YR Change - Dec. 2019 - Dec. 2020	Change - Dec. 2019 - March 2024
Energy	3.9%	-7.2%	6.4%
Gasoline (all types)	5.2%	-15.0%	5.7%
Food at Home	2.6%	4.0%	5.6%
Food away from Home	3.1%	3.9%	5.7%
Shelter	3.0%	1.8%	5.0%
Services	3.0%	1.6%	4.7%
Apparel	-0.1%	-4.0%	1.5%
Furniture and bedding	0.4%	2.2%	3.9%
Medical Care	3.4%	1.8%	2.2%
New Vehicles	1.0%	2.0%	4.7%
Used Cars	1.4%	10.1%	6.5%
Auto Insurance	4.1%	-4.7%	8.8%
Airline Fares	1.6%	-18.4%	0.3%
College tuition and fees	4.7%	0.8%	1.6%

Footnotes: Data is annual as of March 2024.
Source: Bureau of Labor Statistics, FactSet Research, Verdence Capital Advisors.

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