Weekly Investment Insights

April 29, 2024

Key Takeaways:

- US economy increases at a slower-than-expected pace.
- Fed's preferred inflation gauge shows sticky inflation.
- Personal savings rate falls to lowest level since Oct. 2022.
- U.S. equities surge as earnings season continues.
- Yields continue higher as rate cut expectations get slashed.
- Gold prices fall by most since November.

Weekly Economic Recap –

Economic Growth Slows While Inflation Remains Elevated

Durable goods orders increased slightly more than expected in March (2.6% vs. 2.0% est.) led by aircraft and parts (commercial and defense). At the core level (excluding aircraft) orders rose 0.2% after a downward revision to February's data. The orders were led by computers and machinery.

U.S. economic growth increased at a slower pace than expected in 1Q24 (1.6% vs. 2.5% est.). Personal consumption and gross private investment led the strength in the data. However, it is important to note that personal consumption was weaker than expected. The weakness in the GDP report also came from net exports and inventories which both detracted from growth in the quarter.

Pending sales of existing homes rose more than expected in March and at the fastest monthly pace in three months. The strength was led by sales in the south and the west while midwest sales declined.

The Fed's preferred inflation gauge, PCE Core, increased slightly more than expected on a year over year basis (2.7% vs. 2.6% est.) and in line with expectations on a month over month basis (0.3%). Services inflation remains sticky led by transportation services, (e.g., motor vehicle maintenance) which increased at the fastest monthly pace since September 2022.

Consumers continued to spend in March according to the monthly personal spending data. Personal spending rose 0.8% led by spending on services. Since personal income rose less than spending, the personal savings rate fell to 3.2%, the lowest since October 2022 and well below the historical average over the past 30 years (5.8%).

Weekly Market Recap –

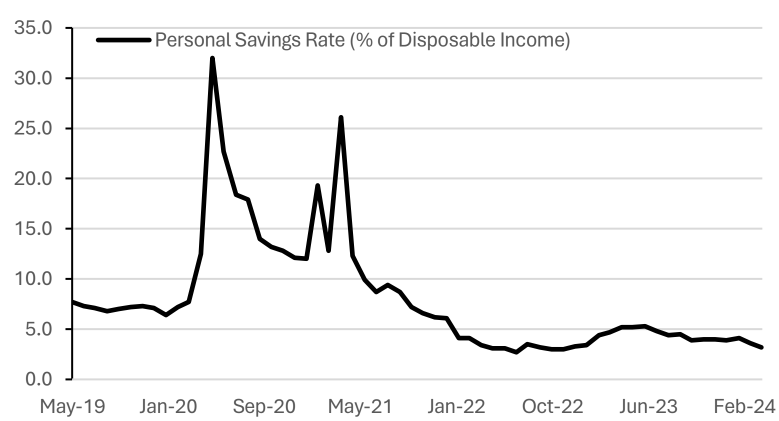
Mega-Cap Tech Earnings Lead U.S. Equities Higher

Equities: The MSCI AC World Index posted its best return since December despite U.S. inflation remaining sticky and economic growth increasing less than expected. Instead, investors welcomed the results of 1Q24 earnings from some of the "magnificent seven" companies. The U.S. led the developed market returns as tech and growth surged. The S&P 500 and Nasdaq both posted their best weekly gain since November.

Fixed Income: The Bloomberg Barclays Aggregate Index was lower for the fourth straight week as Treasury yields moved higher on inflation data and Fed rate cut expectations moved further out in 2024. Credit benefitted from the risk on sentiment as high yield was the best performing fixed income sector. Leverage loans, floating rate bonds and investment grade credit also rallied.

Commodities/FX: The Bloomberg Commodity Index was relatively flat last week. Crude oil prices moved higher on fresh tensions in the Middle East causing global supply concerns. Gold prices fell by the most since November as Fed rate cuts were pushed out and yields remained higher.

Consumer Savings Fall to Lowest since October 2022



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

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Past performance is not indicative of future returns.

Key Takeaways:

- U.S. economic growth slows as consumers starting to show fatigue.
- Consumer savings have evaporated.
- Inflation remains burdensome to the Fed.
- Investors parse through 1Q24 “magnificent seven” earnings data.
- Consumer and inflation are biggest threat to economy and markets.

A Deeper Dive into Last Week’s Data

Last week, investors absorbed a plethora of key economic data, including 1Q24 GDP and PCE inflation. Both reports signaled to us the Fed will have little, if any, room for policy error on their fight to tame inflation without tipping the economy into a recession. The data caused investors to push out Fed rate cut expectations to September, and now only anticipate one rate cut in total this year, according to the Fed fund futures contracts. Investors also continued to grapple with 1Q24 earnings results. Four of the “magnificent seven” components reported key results, including Meta, Alphabet, Tesla, and Microsoft. This week, we provide a deeper dive into last week’s data.

- **Economic growth shows warning signs:** U.S. economic growth increased at a slower-than-expected pace in 1Q24. While the data showed consumers (which make up the majority of GDP) continued to spend, the pace at which they spent was the slowest since 2Q23. The outlook for the consumer also looks weak with the savings rate at the lowest level since October 2022 and credit card debt at a record high.

- **Inflation progress seems stuck:** The Fed’s preferred inflation gauge remains stuck at current levels (2.8% year over year) and above the Fed’s preferred target (2.0%). In addition, the core price index in the 1Q24 GDP report jumped much more compared to 4Q23 (3.7% vs. 2.0%). What we observed from last week’s inflation data is that service inflation is sticky and hard for the Fed to control. Housing costs continue to be a burden to consumers. Additionally, costs for financial and insurance services continue to rise.

- **“Magnificent seven” companies’ earnings results:** Investors digested the latest quarterly earnings results from Meta, Alphabet, Tesla, and Microsoft. Microsoft and Alphabet both announced better-than-expected results, while Meta and Tesla missed expectations. Shares of Meta Platforms were under the most pressure after the miss as CEO Mark Zuckerberg announced the company’s Reality Labs unit posted a $3.85 billion loss during the quarter, but also announced investments in AI are increasing.

The Bottom Line:

The Fed meets this week to set interest rate policy (Wednesday). At this time there is little to no chance of a change in policy which is widely different than the beginning of the year when the futures market was pricing in a second round of rate cuts by this meeting. The biggest threat we see to the economy and the market is the consumer that is growing fatigued and inflation not coming down at the pace the Fed is expecting. Consumers have been resilient but their strength is unlikely to be sustainable as credit card debt is at a record high, savings are depleted and confidence is weakening. Inflation is proving to be a bigger nuisance for the Fed. Service inflation is the hardest to control and prices have shown no signs of abating. Some of the areas that are keeping service inflation high are beyond the Fed’s control (e.g., housing prices, insurance costs). While markets may enjoy the earnings results from the big tech companies, when earnings season is over, investors will be left justifying high market multiples in the face of interest rates that are likely to remain higher for longer.

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