Weekly Investment Insights

May 13, 2024

VERDENCE CAPITAL ADVISORS

Key Takeaways:

- Consumers slowing pace of credit card usage.
- Unemployment claims climb to highest level since August.
- Consumer sentiment plummets as inflation expectations climb.
- Value sectors lead U.S. equities higher.
- Municipal bonds lead performance.
- Commodities higher for first time in three weeks.

Weekly Economic Recap –

Inflation Expectations Surge as Consumers Grow Pessimistic on Outlook

In March, consumers increased credit by the smallest amount this year ($6.3 billion) as consumers' spending on credit cards increased at the slowest pace since falling three years ago. The increase in total credit was driven by non-revolving credit, such as loans for vehicles and school tuition.

Initial claims for unemployment benefits increased last week to the highest level since August 2023 (231K) and by more than consensus estimates (212K). More than half of the increase was attributed to increases in New York as public school workers are allowed to apply for benefits during spring break, which boosted the numbers.

The Bank of England (BOE) held interest rates steady at their May meeting (5.25%) and signaled restrictive monetary policy was taming inflation in the region. BOE Governor Andrew Bailey stated, “the latest [inflation] figures were encouraging, but [the bank] is not at a point where we can cut rates.”

The University of Michigan Consumer Sentiment Index plummeted to its lowest level in six months (67.4). Consumers across all age and income levels grew increasingly worried about inflation, employment, and interest rates. Year-ahead inflation expectations increased to 3.5% (from 3.2%).

Weekly Market Recap –

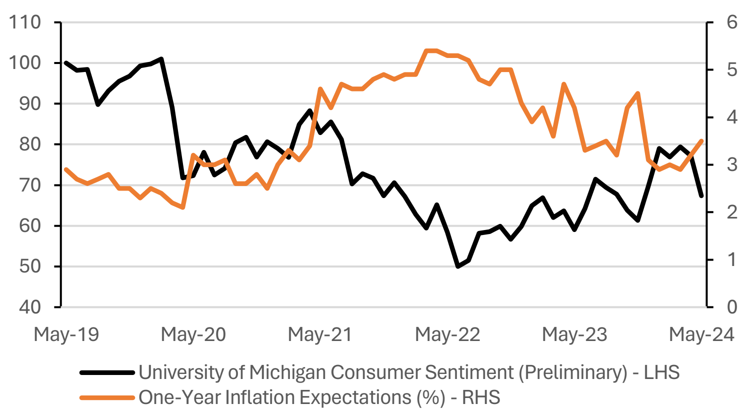
Global Equities Rise on Rate Cut Optimism

Equities: The MSCI AC World Index was higher for the third straight week as investors assess the Fed’s likelihood of rate cuts later this year. European and United Kingdom equities led the gains in the developed world on softer than expected central bank rhetoric. Within the U.S., value stocks outperformed growth stocks on gains in financials and utilities.

Fixed Income: The Bloomberg Barclays Aggregate Index was marginaly higher for the second consecutive week as softer data kept yields lower. The 10YR yield held steady at the 4.50% level. Municipal bonds led the gains in fixed income while short term Treasuries and high yield lagged.

Commodities/FX: The Bloomberg Commodity Index was higher for the first time in three weeks led by agriculture products. World wheat stockpiles for the 2024-2025 season are expected to be below average and the lowest in eight years, according to the U.S. Department of Agricultural’s initial forecast. Gold prices were higher for the first time in three weeks after weaker-than-expected jobs data caused investors to anticipate Fed rate cuts later this year.

Consumers Expect Higher Inflation; Sentiment Falls



Data is as of April 2024.
Source: FactSet Research Systems, Verdence Capital Advisors

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Past performance is not indicative of future returns.

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Key Takeaways:

- Is Sell in May and go away still a thing?
- The age-old adage has lost its validity.
- Summer is still weakest period of performance.
- Inflation cannot be ignored.
- Deficit and debt issuance is a risk to stocks and bonds.

Sell in May and go Away?

Most investors are familiar with the age old adage, “sell in May and go away.” It has been a historical investment phrase that suggests traders go away for the summer months and markets tend to be volatile and weak. However, with the advancements of technology, business can be performed nearly anywhere so this theory has lost some of its validity. What we can confirm is that since 1945, the S&P 500 has posted its weakest performance in the months of May to August compared to the months of January to April and September to December. The Index has been up 68% of the time since 1945 during the summer months and the average return has been 2.1%. This compares to 4.0% in January to April and 3.9% in September to December, on average. Instead of using historical theories as a precedent when making investment decisions, we will look at fundamentals and valuations to decipher if risks (both upside and downside) are priced into assets. Unfortunately, we see many risks this summer which could lead to volatility and potential market pullbacks. Some of the factors we are monitoring that could disrupt this momentum driven rally include:

- **Inflation proving problematic:** This week we will receive data on inflation at the consumer and producer level for April. Inflation has been trending higher and that is a problem. This is not only seen in headline inflation data (e.g., CPI, PPI) but also in reports on manufacturing prices, service prices and most recently consumer inflation expectations. This is a challenge for the Fed and if it continues, rate cut hopes for 2024 may be completely crushed.

- **Budget deficit alarming:** According to Strategas Research Partners, April tax collections were weaker than anticipated but government spending jumped 23% in the month. As a result, the budget deficit is hovering near $2 trillion and is at risk of worsening further, especially if the labor market weakens and tax revenues fall short of expectations. This means more Treasury debt issuance. The next quarterly refunding announcement (when the Treasury announces the size of issuance for the upcoming quarter) occurs on July 31, 2024. Last year a surprise increase in issuance created volatility in both stock and bond markets.

- **Valuation correction:** The forward PE multiple of the S&P 500 has increased ~5% over the past month making the multiple over 20% above its historical average since 1990. This is occurring while Fed rate cuts are being pushed out, the economy is weakening, and inflation is proving difficult to control. If this persists, we see a valuation led correction likely.

- **Politics/Geopolitics:** In July and August we will see the Republican and Democratic conventions. The race to the White House will be in its final innings. Candidates will set more defined goals that could impact market sentiment. In addition, geopolitical tensions around the world are more profound.

The Bottom Line:

The coming months will bring many economic, political and valuation risks to the markets. We find a 10% pullback likely as investors accept that interest rates will remain higher for longer, we may not see the rate cuts that are priced in at current levels and there is even a slight risk we may see an increase in rates before year end.

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Global Equities Rally on Weaker Data

U.S. Equities	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	39,513	2.20%	2.80%	2.70%	20.30%	5.50%
S&P 500	5,223	1.90%	1.30%	4.30%	28.20%	10.00%
Russell 1000 Growth	3,388	1.60%	1.20%	2.30%	36.40%	11.30%
Russell 1000 Value	1,740	2.20%	1.20%	6.40%	19.50%	7.60%
Russell Midcap	3,293	2.00%	0.60%	5.00%	22.10%	6.30%
Russell 2000	2,060	1.20%	1.60%	2.90%	18.80%	2.10%
Nasdaq	16,341	1.20%	1.10%	2.40%	33.90%	9.10%

International Equities	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	782	1.70%	1.40%	5.10%	21.90%	8.20%
MSCI EAFE (USD)	2,346	1.80%	2.00%	6.70%	12.70%	6.30%
MSCI Europe ex UK (USD)	2,657	3.40%	3.10%	7.50%	13.10%	7.10%
MSCI Japan (USD)	3,878	-2.20%	-2.80%	2.70%	16.20%	5.70%
MSCI UK (USD)	1,259	2.50%	6.00%	12.00%	12.50%	8.90%
MSCI EM (USD)	1,072	1.00%	1.50%	8.40%	12.30%	5.50%
MSCI Asia ex Japan (USD)	681	1.20%	2.60%	10.10%	10.50%	6.60%

Fixed Income	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	5.10%	0.10%	0.80%	-0.50%	-0.10%	-2.00%
U.S. Govt/Credit	5.00%	0.10%	0.60%	-0.50%	0.10%	-1.90%
U.S. 10 Year Treasury	4.50%	0.00%	0.70%	-1.60%	-4.80%	-3.70%
U.S. TIPS (1-10YR)	4.90%	0.10%	0.70%	0.70%	1.00%	0.00%
U.S. High Yield	7.90%	0.00%	0.70%	1.30%	10.40%	1.50%
EM Bonds (USD)	7.20%	0.50%	0.40%	2.10%	7.60%	1.20%
Municipal Bonds	3.60%	0.50%	0.70%	0.10%	2.80%	-0.60%

Commodities	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	241	1.50%	0.40%	7.40%	5.60%	6.20%
Crude Oil (USD/bbl)	$78.80	0.70%	-6.80%	1.00%	8.80%	7.20%
Gold ($/oz)	$2,360.50	2.60%	0.70%	17.80%	16.80%	13.80%
Copper	$469.40	2.50%	11.60%	28.00%	27.80%	22.10%
Wheat	$663.50	2.90%	17.00%	11.70%	-2.20%	3.40%
U.S. Dollar	105	0.10%	-0.80%	0.20%	2.40%	3.80%
VIX Index	12.6	-7.00%	-20.60%	-2.90%	-25.90%	0.80%

Footnotes: Data is as of May 10, 2024.

Source: Bloomberg Finance LP, Verdence Capital Advisors.

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