Weekly Investment Insights

June 10, 2024

VERDENCE CAPITAL ADVISORS

Key Takeaways:

- Manufacturing and service sectors show mixed signals.
- Job openings fall to lowest level in roughly three years.
- The U.S. economy continues to add jobs at a robust pace.
- Growth stocks lead U.S. markets higher.
- Treasury yields fall; municipal bonds lead fixed income.
- Crude oil falls on fears of softening demand.

Weekly Economic Recap –

Job Growth Remains Strong; ECB Cuts Rates

The ISM Manufacturing Index remained in contraction territory (a reading below 50) for the 18th out of the past 19 months. The New Orders Index fell to the lowest level since May 2023 as demand eased. While the prices paid component declined, it still remains well in expansion territory.

The ISM Services Index climbed back into expansion territory (a reading above 50) in May. Business activity, new export orders and delivery times led the gains.

Job openings in the U.S. fell to the lowest level in over three years (8.06 million) in April according to the JOLTS report. The ratio of job openings to unemployed workers fell to the lowest level since June 2021 (1.2). The quits rate (i.e., those leaving their job voluntarily) fell to the lowest level since September 2020.

The U.S. trade deficit widened to the largest since October 2022 (-$74.8 billion) in April as imports of goods surged. The value of motor vehicle imports increased by the most since September 2020 (10.4%).

The U.S. economy added more jobs than expected in May (272K vs. 190K est.) while the unemployment rate increased (to 4.0%). The job creation was led by construction, goods producing, professional/business services, and government jobs. In addition, average hourly earnings increased more than expected (0.4% vs. 0.3% est.).

The European Central Bank met last week and, as expected, cut their benchmark rates by 25 bps. They noted the progress on inflation but did not commit to further rate cuts.

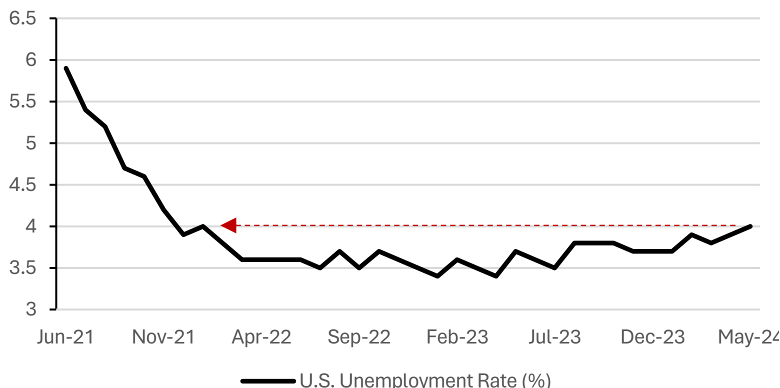
Weekly Market Recap –

Growth Stocks Outperform as Treasury Yields Fall

Equities: The MSCI AC World Index was higher for the first time in three weeks. European equity markets were higher after the ECB moved forward with a 25bps rate cut, which was largely expected by investors. U.S. equity markets were led higher by growth/technology stocks as expectations for Fed rate cuts increased and bond yields fell. The Nasdaq was the best performing index. Small-caps, as tracked by the Russell 2000, were lower for the second time in three weeks.

Fixed Income: The Bloomberg Barclays Aggregate Index was higher for the second consecutive week as Treasury yields fell on expectations for Fed rate cuts in 2H24. Municipal bonds were higher for the first time in four weeks. U.S. TIPS were the only area of fixed income markets that were lower.

Commodities/FX: The Bloomberg Commodity Index was lower for the third straight week. Gold prices were lower for the second time in three weeks after the stonger-than-expected U.S. employment report and data showed top consumer China held off on purchases in May. In addition, grains fell led by wheat on improving crop prospects in the U.S.



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

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Past performance is not indicative of future returns.

Key Takeaways:

- ECB follows Bank of Canada by cutting their benchmark rate.
- Fed and ECB have different mandates; ECB has many economies to consider.
- The ECB rate cut was considered a “hawkish” rate cut.
- ECB is still haunted by negative interest rates.
- Fed can be patient.

Is the Clock Ticking for the Fed?

As expected, the European Central Bank followed the Bank of Canada and cut their benchmark interest rates by 25 bps last week. This was the first rate cut since 2019 and the first time in the history of the European Union where the ECB cut interest rates before the Federal Reserve. However, the bank made it clear this is not the start of a rate cutting cycle and they are committed to “keep policy rates sufficiently restrictive for as long as necessary.” In this Weekly Insights, we discuss why the European Central Bank decided to cut interest rates now and why the Federal Reserve’s path is still uncertain.

- **Different mandates:** The European Central Bank and the Federal Reserve, while two very important central banks, have different mandates. The Fed’s mandate is to promote maximum employment AND stable prices while the ECB’s only mandate is to maintain price stability. Therefore, the Fed must monitor the tightness in the labor market and is not in such a rush to cut rates with inflation still above their target and unemployment well below the 50-year average leading up to the pandemic (4.0% vs. 6.2% avg).

- **ECB is responsible for more than one country:** The ECB sets interest rate policy for 20 different countries. This makes their job more complex than the U.S. because the economic environment may be very different depending on the country.

- **Hawkish tone:** Despite recent data that inflation is sticky in the EU, the ECB opted to cut rates. The decision was not unanimous as one member wanted to keep rates unchanged. However, we often reference that the comments from central bankers are just as important as the move. The ECB made “hawkish” comments by clarifying that inflation has eased substantially but this move should be viewed as a “moderation in policy restrictiveness” and made no commitment to further rate cuts.

- **No desire to get back to zero:** It is important to remember that deflation/disinflation was a reason the ECB had to adopt a negative interest rate policy for many years leading up to the pandemic. This is not an environment they want to experience again. With inflation coming down and growth weak at the end of 2023, adjusting monetary policy seems prudent for the ECB.

- **Fed can be patient:** While economic growth has turned upwards in the EU, last year the region printed two back-to-back negative quarters of GDP (3Q and 4Q). To compare, the U.S. was printing robust growth numbers in 2023 and has only seen a slowing in 1Q24. This may have been an incentive for the ECB to act now. In addition, inflation, at the headline level, has fallen more in the Eurozone than the U.S. Eurozone inflation peaked at 10.6% and has fallen to 2.6%. U.S. headline inflation peaked at 9.1% and sits at 3.4%.

The Bottom Line:

The ECB’s move does not change our view that the Fed will have to wait until year end or beginning of 2025 to cut rates. While economic growth is slowing, primarily led by a constrained consumer, the labor market remains strong and inflation progress has stalled in many metrics. There is no need for the Fed to rush to cut rates simply because the ECB cut rates. The Fed has the ability to wait and get more information about inflation and what the recent data on wage pressures means for the future outlook for inflation.

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Global Equities Rally as Global Central Banks Ease Rates

U.S. Equities	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	38,799	0.3%	0.1%	0.5%	17.6%	3.9%
S&P 500	5,347	1.4%	3.2%	4.0%	27.2%	12.8%
Russell 1000 Growth	3,533	2.7%	4.7%	5.1%	35.7%	16.1%
Russell 1000 Value	1,723	-0.8%	0.4%	1.3%	16.3%	6.8%
Russell Midcap	3,227	-1.2%	-1.0%	-1.5%	16.3%	4.4%
Russell 2000	2,027	-2.1%	-1.7%	-2.4%	8.9%	0.6%
Nasdaq	17,133	2.4%	5.0%	5.5%	31.8%	14.5%

International Equities	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	794	1.1%	2.3%	3.3%	21.9%	10.1%
MSCI EAFE (USD)	2,369	0.6%	1.8%	2.4%	16.0%	7.7%
MSCI Europe ex UK (USD)	2,701	1.2%	3.5%	3.7%	18.8%	9.3%
MSCI Japan (USD)	3,916	-0.2%	-0.9%	-3.5%	14.2%	6.8%
MSCI UK (USD)	1,249	-0.3%	0.9%	7.6%	15.1%	8.5%
MSCI EM (USD)	1,073	2.4%	0.7%	5.0%	10.7%	5.9%
MSCI Asia ex Japan (USD)	691	3.2%	2.4%	7.6%	11.1%	8.6%

Fixed Income	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	5.1%	0.4%	0.5%	-0.6%	2.4%	-1.2%
U.S. Govt/Credit	5.0%	0.4%	0.5%	-0.6%	2.7%	-1.2%
U.S. 10 Year Treasury	4.4%	0.5%	0.6%	-1.6%	-1.3%	-2.8%
U.S. TIPS (1-10YR)	4.8%	0.0%	0.6%	0.5%	3.3%	0.6%
U.S. High Yield	7.9%	0.4%	0.4%	1.1%	10.7%	2.1%
EM Bonds (USD)	7.2%	0.1%	0.3%	1.0%	8.5%	1.6%
Municipal Bonds	3.8%	1.1%	-0.3%	-0.9%	3.3%	-0.9%

Commodities	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	239	-1.0%	-0.3%	5.0%	6.7%	5.7%
Crude Oil (USD/bbl)	$76.1	2.5%	-2.2%	-2.0%	5.9%	4.4%
Gold ($/oz)	$2,293.8	-1.9%	-2.3%	5.8%	17.5%	11.7%
Copper	$448.4	-3.1%	-3.6%	16.4%	19.4%	16.2%
Wheat	$627.5	-7.5%	-6.2%	13.1%	-9.3%	-3.6%
U.S. Dollar	105	1.0%	-0.1%	2.4%	1.6%	3.8%
VIX Index	12.2	-5.4%	-7.6%	-15.4%	-12.3%	-1.8%

Footnotes: Data is as of June 7, 2024.

Source: Bloomberg Finance LP, Verdence Capital Advisors.

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