Weekly Investment Insights

June 17, 2024

Key Takeaways:

- Headline inflation shows signs of easing.
- Fed still needs more confidence on inflation; no change in rates.
- Consumer confidence unexpectedly declines.
- Growth sectors surge on cooling inflation.
- Yields fall on lower inflation and concern over consumer.
- Crude oil prices climb on tight market expectations.

Weekly Economic Recap –

Inflation Easing, but Fed Still Not Confident to Cut Rates

Small business optimism increased to the highest level of the year in May as five of the 10 components that make up the index increased for the month. Headline optimism was driven by a 7-point improvement in the share of owners who expect the economy to improve.

Headline inflation, as tracked by the Consumer Price Index, was unchanged from the previous month and increased 3.3% year-over-year. Shelter prices remain sticky, growing 0.4% for the month. Energy prices fell during the month with gas prices tumbling 3.6%. Core CPI, which excludes volatile food and energy prices, increased at the slowest annual pace since (3.4%) April 2021.

The Federal Reserve kept interest rates unchanged and cited the need for greater confidence that inflation is coming down before cutting rates. Additionally, policymakers reduced their expectations for rate cuts this year from the March meeting. They now only expect one rate cut, down from expecting three rate cuts at their March meeting. The Fed also announced plans to shrink its balance sheet at a slower pace.

The Producer Price Index unexpectedly fell 0.2% in May, reversing a 0.5% increase in the previous month. Goods prices fell 0.8% during the month, which was the largest decline since October 2023, driven by sharp declines in energy prices.

Consumer confidence as measured by the University of Michigan Sentiment Index unexpectedly dropped to a seven month low as Americans feel pessimistic about household finances amid rising prices.

Weekly Market Recap –

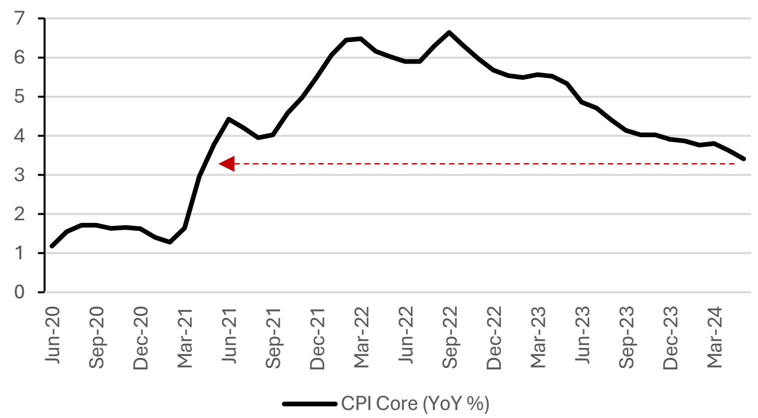
Growth Sectors Outperform, Yields Fall on Inflation Data

Equities: The MSCI AC World Index was higher for the second straight week as investors cheered the cooling inflation data. Growth and technology led U.S. market performance for the week. The Nasdaq Composite Index was higher for the second straight week and closed at a record high. The small-cap Russell 2000 was lower for the second staight week. European equities were dragged lower by political uncertainty in France.

Fixed Income: The Bloomberg Barclays Aggregate Index was higher for the second consecutive week. Treasury yields fell sharply on easing inflation data and concerns about the consumer as sentiment deteriorated. All sectors of fixed income were higher for the week. Treasuries and investment grade corporate bonds were the best performing sectors.

Commodities/FX: The Bloomberg Commodity Index was higher for the first time in four weeks. Crude oil prices were higher for the first time in three weeks on expectations summer demand will drain inventories, leading to a tighter market. Gold prices were higher on rate cut expectations.

Core Inflation Eases to Slowest Since April 2021



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

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Past performance is not indicative of future returns.

Key Takeaways:

- Inflation data softer for May.
- Select goods prices in deflation.
- Service inflation still a major concern for consumers.
- Fed is limited on how it can tame housing inflation.
- Inflation in nondiscretionary items threatens a soft-landing scenario.

Inflation Overview – The Good, the Bad, and the Still Ugly

Last week, we received a variety of inflation indicators for the month of May and equity markets cheered the data after the unexpected uptick in inflation to start the year. The headline Consumer Price Index was unchanged for the month, bringing the annual growth rate lower (to 3.3%). In addition, the Producer Price Index unexpectedly declined at the fastest pace in seven months. Despite the improving inflation data, the Federal Reserve tried to temper rate cut expectations. Fed Chairman Jerome Powell reiterated, the committee needs “more confidence” that inflation is coming down before cutting rates. In this weekly insights, we take a deeper dive into the inflation data, and outline the good, the bad and the ugly we found in the reports.

- **The Good - Goods prices falling for consumers:** Consumer prices when you exclude food, energy and shelter were unchanged in May. However, several goods categories saw price declines for the month. Apparel and new vehicle prices dropped. New vehicle prices have fallen for four consecutive months and are now down over the past year. In addition, airline fares dropped at the fastest pace in almost a year and are down 5.9% over the past year.
- **The Bad – Service inflation still a problem:** Service inflation within the CPI report continues to accelerate. The Fed has expressed concern in the past about service inflation as that is difficult to control. Over the past year, service inflation within the CPI report has grown by more than 5%. Food away from home (restaurants) prices accelerated in May and are growing 4% (YoY). Insurance costs have been another key driver of sticky inflation as homeowners’ insurance is rising near the fastest pace in nine years, and auto insurance premiums have surged 20.3% year-over-year. Lastly, while electricity services were flat in May, prices are still growing by almost 6% on a year-over-year basis.
- **The Ugly - Shelter and housing inflation not letting up:** Housing and shelter costs account for over a third of the weighting in the Consumer Price Index. Shelter inflation has increased 0.4% every month for the past four months and is up 5.4% year over year. The Fed noted at their meeting that “there are big lags in [housing] data that may take several years before improvements show up.” However, there are structural issues within housing that may restrain the improvements. Supply is a major issue. A report earlier this year estimated that the U.S. is short over 7 million homes. Supply is something the Fed cannot fix.

The Bottom Line:

We acknowledge that the data on inflation last week was softer. However, we remind investors that this is one month of data. We, similar to the Fed, need to see more consistent soft readings before we can expect rate cuts. When you look at the underlying details, inflation is a growing risk to a soft landing scenario. Last week, we also received a report that showed consumer sentiment deteriorated due to inflation weighing on personal finances. Inflation is still growing in areas that are not discretionary for consumers (e.g., insurance, electricity, services) so they are squeezed. While producer prices declining and consumer prices accelerating may bode well for company margins, it does not work for consumers. Consumers are overloaded with debt and wages are not keeping pace with the rising costs in areas that are not discretionary for consumers.

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Global Equities Fall on Rate Fears and Geopolitical Tensions

U.S. Equities

	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	38,589	-0.5%	-2.2%	-0.4%	15.9%	3.3%
S&P 500	5,432	1.6%	3.7%	5.8%	26.1%	14.6%
Russell 1000 Growth	3,655	3.5%	7.3%	9.1%	35.3%	20.2%
Russell 1000 Value	1,703	-1.1%	-2.2%	0.3%	14.0%	5.6%
Russell Midcap	3,218	-0.2%	-2.5%	-0.6%	14.5%	4.1%
Russell 2000	2,006	-1.0%	-3.6%	-0.9%	8.7%	-0.4%
Nasdaq	17,689	3.3%	7.2%	9.9%	30.9%	18.3%

International Equities

	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	797	0.4%	1.6%	3.8%	19.4%	10.6%
MSCI EAFE (USD)	2,306	-2.6%	-1.8%	0.1%	9.8%	4.9%
MSCI Europe ex UK (USD)	2,594	-3.9%	-2.7%	-0.7%	11.3%	5.0%
MSCI Japan (USD)	3,881	-0.9%	0.2%	-2.0%	8.3%	5.8%
MSCI UK (USD)	1,228	-1.7%	-2.4%	5.3%	11.4%	6.7%
MSCI EM (USD)	1,077	0.5%	0.0%	3.5%	9.0%	6.4%
MSCI Asia ex Japan (USD)	694	0.5%	1.3%	5.6%	9.6%	9.2%

Fixed Income

	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	4.9%	1.3%	1.7%	1.8%	3.7%	0.1%
U.S. Govt/Credit	4.8%	1.3%	1.7%	1.7%	3.9%	0.1%
U.S. 10 Year Treasury	4.2%	1.9%	2.4%	1.8%	0.6%	-1.0%
U.S. TIPS (1-10YR)	4.6%	0.5%	0.9%	1.6%	4.0%	1.1%
U.S. High Yield	7.9%	0.3%	0.8%	1.4%	10.4%	2.3%
EM Bonds (USD)	7.1%	1.0%	1.2%	2.3%	9.0%	2.6%
Municipal Bonds	3.7%	0.7%	0.4%	-0.1%	3.9%	-0.2%

Commodities

	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	241	0.7%	-0.2%	4.8%	6.7%	6.4%
Crude Oil (USD/bbl)	$79.1	1.7%	-1.0%	-2.0%	7.3%	7.4%
Gold ($/oz)	$2,333.0	0.4%	-3.9%	7.6%	18.5%	12.5%
Copper	$449.5	-2.8%	-12.7%	7.4%	13.6%	13.5%
Wheat	$628.5	-2.3%	-8.3%	10.0%	-17.2%	-6.1%
U.S. Dollar	106	0.4%	1.1%	2.0%	3.2%	4.2%
VIX Index	12.7	3.6%	-5.7%	-12.1%	-8.8%	1.7%

Footnotes: Data is as of June 14, 2024.

Source: Bloomberg Finance LP, Verdence Capital Advisors.

[1] https://nypost.com/2024/02/28/real-estate/the-us-housing-supply-is-short-7-2-million-homes/

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