MARKET REVIEW & OUTLOOK

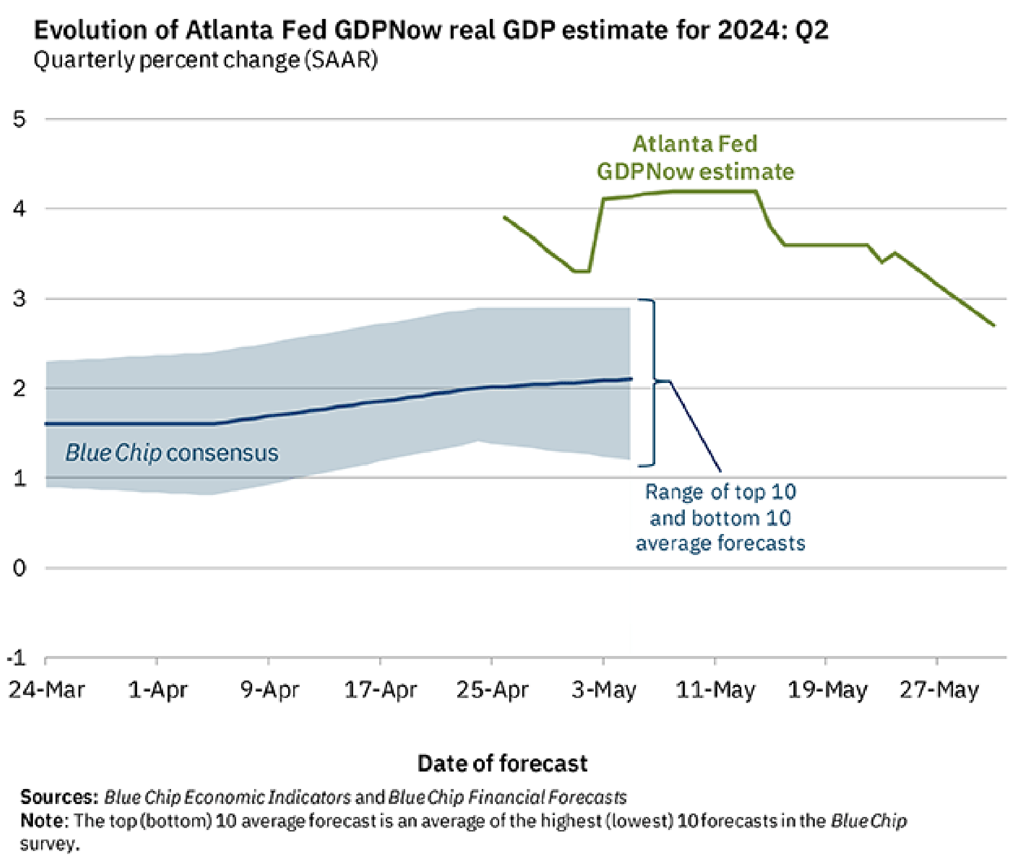
MAY 2024

KEY TAKEAWAYS

- The equity markets took a one-way trip to new record highs into the 3rd week of the month and then ran into some turbulence as the month drew to a close.
- The U.S. 10-year Treasury Yields had a big dip into mid-month and then bounced back through month end.
- Crude oil remained under $80 for the month, bouncing around in the upper $70's.

The U.S. Economy

The second look at 1st quarter GDP came in weaker at 1.3%, lower than the weaker than expected initial report of 1.6%. The core PCE, the imbedded inflation measure, eased from the initial 3.7%, to 3.6%. The 2nd quarter, estimates for GDP from GDPNow have eased from 4% to near 2.5% and the Blue-Chip consensus forecast rose to just over 2.0%, as shown in the chart below. Economic activity weakened, and the PCE deflator held well north of the sweet spot of "2%" inflation. One report is not a trend, but now 2nd quarter estimates are moving in the wrong direction. The Fed is still in a bind and is talking more about inflationary concerns versus growth concerns. It seems the Fed has moved to the hold and hope phase.



Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

The U.S. 10-year Treasury yield started the month reversing a lot of the big jump in yield from April, but by mid-month yields found support and moved higher, though fell back the last few days of the month to end near the middle of the range. The market is battling the strength of inflation and Fed rhetoric against bouts of weak economic reports. Again, the Fed seems to be boxed in and it will likely cave to whichever outcome starts driving more pain. Right now, the economy is strong enough that the Fed has more focus on inflation, but if the economy starts to print negative numbers, do they start cutting rates even if inflation is holding high? If they do, then the only thing that would meaningfully quell inflation at that point is a hard landing, which none of us would enjoy. The Fed is meeting in mid-June, so we will have to wait a couple of weeks to see what the Fed's updated thinking is on the matter. The drop in yields provided a tailwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF increased +1.68% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.51%, down from April's close of 4.69%.

The Dow Jones Industrial Average rose +2.30%, the S&P 500 jumped +4.80%, and the small cap iShares Russell 2000 ETF rose +5.04%. The international markets traded like the U.S. markets. The MSCI EAFE iShares Core International Developed Markets ETF Index popped +5.08%, and the MSCI Emerging Markets iShares Core ETF Index increased +1.60%.

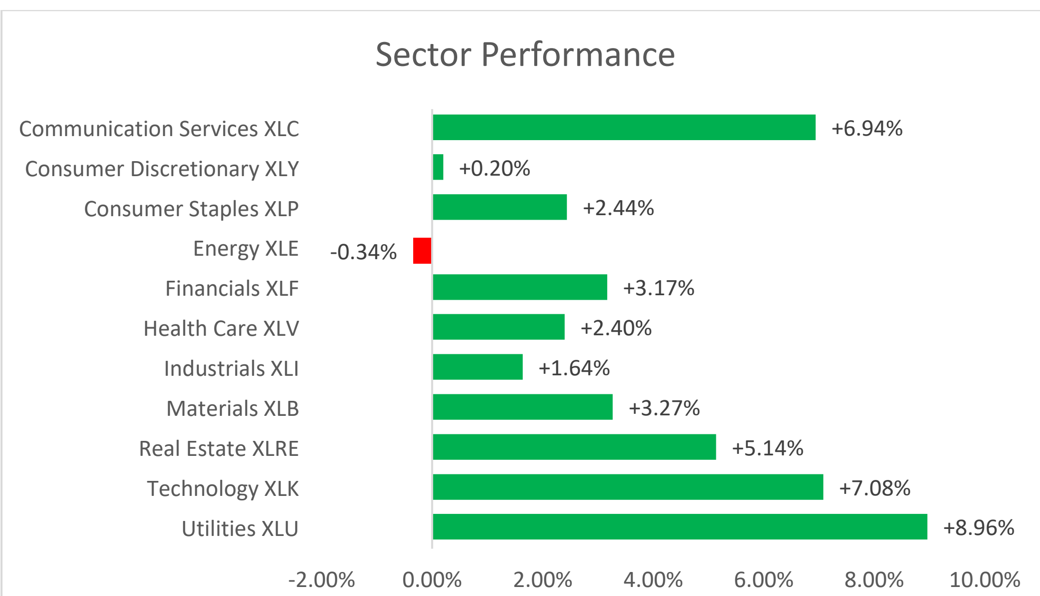
May's performance was generally green with only Energy mildly in the red.

The best performers were…

- Utilities: +8.96%
- Technology: +7.08%
- Communication Services: +6.94%

The worst performers were…

- Energy: -0.34%
- Consumer Discretionary: +0.20%
- Industrials: +1.64%



Source: https://www.morningstar.com

Oil Report

The oil market broke below the $80 level at the start of the month and then traded in basically a $3 range of the upper $70's, stymied by the $80 level a couple of times. The market continues to balance reports of inventory builds/excess supply versus the escalating geopolitical tensions with Russia, China, and the Middle East. Prices weakened modestly on talks the OPEC+ meeting was only going to be virtual, interpreted to mean no meaningful cuts, but then they changed back to an in-person meeting, so a little gamesmanship going on as well. The current NYMEX WTI Crude Oil futures settled at $77.16 posting a loss of almost 6% from the prior month's close of $81.93 a barrel. RBOB gasoline, which is down almost 15% from the April 16th peak, followed Crude for the month and dropped over 10% vs. April's close. Pump prices have even backed down, so maybe this year the market front ran the usual July 4th peak. If so, that could provide some relief for both drivers and inflationary pressures. Of course, there is always something to worry about and the next round is the forecast of a surge in the number of named tropical storms and cat 3+ hurricanes this summer. As we know, weather forecasters are generally wrong, hopefully that holds court here! 😊

The Rest of the Data

The April ISM Manufacturing Index fell back below 50, to 49.2 from March's reading of 50.3. The ISM Services Index unexpectedly slumped to 49.4 in April, from March's print of 51.4. The prices paid component for Services firmed and moved closer to elevated levels and Manufacturing prices continued firming, moving to elevated levels. Any reading below 50 generally indicates deteriorating conditions. Consumer confidence increased to 102.0 in May, which compares to a slight upward revision of 97.5 in April. The unemployment rate increased to 3.9%, while the economy added 175,000 jobs in April, a significant miss from expectations of 240,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.3% in April, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate decreased modestly to +3.4% on a non-seasonally adjusted basis. The CPI ex Food and Energy decreased to 3.6% over the last year. The economic data is showing signs of softening, but inflationary pressures are not clearly declining, and holding higher than the Fed target of 2%. However, employment reports remain good. The market has removed expectations for a September rate cut, and rate cut expectations, for 2024, are bouncing between 1 in November and 1 in December versus just 1 cut, in December, down from 6 at the start of 2024. The signs of potential stagflation are present, i.e. slow growth, and robust inflation, leaves the Fed's likely only action as hold and hope. The Fed seems to have really painted itself into a corner of two bads. We will continue to monitor economic activity along with inflation reports.

Summary

Interest rates backed off the one-way trip higher and equity markets rejoiced with a strong rally and many markets hit all-time highs. The Fed and the interest rate market have continued to reduce and push out rate cut expectations on the back of reasonable economic activity and the lack of sustained progress on decreasing inflationary pressures. Additionally, the geopolitical tensions are keeping many areas of the market on their toes. There has already been a lot of noise around the November election, which is likely to really ramp up in the next month or two. Will this be a distraction that detracts from economic activity or are people so well-conditioned from the chaos of the last few elections that there may not be any disruption to economic activity? The crosscurrents are many and varied, which continues to lead to the importance of risk management and being properly positioned in alignment with your risk tolerance. We will continue to keep an eye on the Fed as well as economic data to try and parse out the next directional move in the markets.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growth and interest rates, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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