

Primary Market Drivers

Inflation

February Core PCE came in at +0.3% m/m, slightly below expectations for +0.4%. The y/y figure was in line with expectations at +2.5%. Powell noted that the figure was more in line with what the Fed is looking for, though it is unclear if the past two months' Core PCE data represents a slight moderation or a new normal. Either way, inflation data has been stubborn in 2024. Recall February CPI rose 0.4% m/m, in line with expectations. The y/y figure increased +3.2%, which was slightly higher than expectations for an increase of +3.1%. February PPI came in well above expectations at +0.6% m/m vs +0.3%. The y/y pace was +1.6%, which was the biggest move up since September 2023. March's data could be pivotal as the Fed is running short on time to start cutting.

Fed Policy

No change from last week. At its last meeting, the Fed left rates unchanged at 5.25% - 5.50%, the fifth consecutive month without an adjustment. The decision was a foregone conclusion, though investors were far more interested in what the central bank had to say regarding future policy. Despite inflation proving stubborn to move below 3% and an economy remains stronger than most would've anticipated, the Fed stuck to its "75 bps worth of rate cuts in 2024" plan established at the beginning of the year. Powell's tone was decidedly more dovish than it has been in some time, and the market took notice. CME's FedWatch Tool currently places odds of a June cut at just under 75%, up significantly from last week. Suddenly, the "data-dependent" Fed seems rather determined to cut rates as the election looms.

Economic Data

Investors didn't get a chance to react to Friday's slightly lower-than-expected Core PCE data or Powell's thoughts during the Macroeconomic & Monetary Policy Conference due to the Good Friday holiday. With this data in mind and lots of important data on tap this week, expect markets to move as we kick off Q2. This week brings important data from manufacturing, services, the consumer, and the labor market. We get ISM Manufacturing (4/1), JOLTS (4/2), Factory Orders (4/2), ADP Employment Report (4/3), ISM Non-Manufacturing (4/3), Challenger Job Cuts (4/4), Consumer Credit (4/5), and the main event, Nonfarm Payrolls (4/5).

All referenced market information, statistics, and economic data were gathered from StreetAccount, a paid subscription data service provided by FactSet Research Systems Inc.

Market Returns 3/28/24 (Close)

Category	Ticker	YTD%
Domestic Equity		
S&P 500	SPY	10.39%
Dow Jones	DIA	6.02%
Large-Cap Growth	QQQ	8.56%
Large-Cap Value	IVE	7.92%
Mid Caps	MDY	9.87%
Small Caps	IWM	5.04%
International Equity		
Developed Intl	EFA	5.99%
Emerging Markets	EEM	2.16%
Fixed Income		
Core Bonds	AGG	-0.74%
Corporate Bonds	LQD	-0.87%
High Yield Bonds	HYG	1.51%
ST Treasuries	IEI	-0.65%
LT Treasuries	TLT	-3.71%
International Bonds	BNDX	-0.01%



Performance data and stock chart were gathered from eSignal, a paid market screening application provided by Intercontinental Exchange, Inc.

Current Environment Summary

What's Working	What's Not	What's Next
Long-Term Disinflation	Economy Slowing in Certain Areas	March Nonfarm Payrolls (4/5)
Fed Pause / Three Rate Cuts Projected	Core Inflation Stubborn & Elevated	JOLTS (4/2) & ADP Employment (4/3)
Strong Labor Market & GDP	Yield Curve Inversions Persist	Will rally continue to broaden out?
Earnings Growth	Interest Rates Remain Elevated	What's the next big market driver?
Recession Unlikely	Ongoing Global & Domestic Conflicts	
Bull Market & New All-Time Highs	Federal Deficit	

Ken Hartley, CFA

I have been thinking about this commentary all weekend. Do I fully disclose that this discussion is a byproduct of an “April fools’ day” prank, or leave it up to the reader to decide? Well, here goes.....

The first quarter is in the books. There was a measurable broadening in several parts of the market. Most notably, mid-caps. The bulwarks of tech that have carried this market for the last 5 quarters seemed to slow, with some components entering an individualized bear market. The fixed income market behaved, for the most part. However, the 2-to-10-year inversion expanded to 60 basis points. The yield curve inversion has been in place for 18 months now. Historically, signaling a recession that has yet to materialize. Does market history even matter anymore?

The Chinese economy has shown resilience in the face of a housing downturn like 2007-2008 in the United States. The difference has been that only developers are declaring bankruptcy, not the banks. Maybe because the Chinese government keeps them afloat with direct capital injections and reduction of lending rates. But the Chinese consumer is still reeling from capital losses on their homes that aren’t even built yet. The one thing that has changed is Chinese manufacturing has ramped up. China once again is running trade surpluses with the world by flooding markets with cheap products (think EV’s). Combine this with a concerted effort between China and Russia to trade oil for Chinese yuan (CNY). The CNY will not challenge the US Dollar (USD) for reserve currency status any time soon. However, the USD will be pressured by this behavior and from expected rate cuts in the US.

As we get later into the calendar year and closer to the election, watch the Fed’s behavior. Chairman Powell understands the optics of rate cuts coming in Q3, so close to an election. Powell has been able to deflect criticism of the massive tightening in such a short period. He now must walk the tight rope of economic growth versus inflation that seems to have stopped coming down, possibly drifting higher. US Treasury Secretary Yellen heads to China this month. It would be interesting to be a fly on the wall during those high-level talks.

Don Moenning

March was a solid month for equities as all style-boxes finished in positive territory. While there were plenty of drivers, including the end of earnings season, stubborn inflation data, the Fed reiterating its three cut projection, and important economic data, stocks finished the quarter strong and we now have plenty of major categories pushing towards double digit returns YTD.

Over the past few years, we typically see the winner at month-end at one extreme of the style-box, usually Large Growth or Small Value, with Large Growth winning most often over the past 18 months. In March, things were different. The two biggest gainers were Mid-Cap Growth and Large-Cap Value. Seems random, but I think we’re seeing a trend that actually makes a lot of sense for the time being.

Investors are very aware that Large Growth is a crowded trade. The market is concentrated at levels we haven’t seen in decades and leading the charge are a small handful of tech-oriented mega-caps. Everyone agrees this trade needs a breather, despite the obvious drivers and tantalizing long-term potential. We saw some exhaustion creep in during March, with Large Growth posting the lowest monthly return of all major style-boxes at +1.27%.

Small Value, on the other hand, has a real problem. In an interview with 60 Minutes in early February, Jerome Powell said that commercial real estate (CRE) “feels like a problem we’ll be working on for years,” adding that “it’s a sizable problem.” Last Friday at the Macroeconomics & Monetary Policy Conference, he reiterated his concern with this: “I think the commercial real estate problem will be with us for some years. But it’s just a question that some banks, and it’s mostly small banks, it’s definitely not the very large banks, have concentrations of commercial real estate, and it looks like they will be realizing losses over time.” Not exactly a ringing endorsement for regional banks, which small-cap and small-cap value funds have healthy exposures to.

So, with a resilient economy, Fed cuts on the horizon, solid earnings, and an environment that doesn’t look like it’s going to fundamentally change anytime soon, investors seem to be “broadening out” from Large Growth, but continue to steer clear of Small-caps. Mid-caps (particularly Mid Growth) have become the darling of early spring, offering strong growth potential without the stigma of being so overcrowded (Mid Growth broke to new all-time highs in late February and hasn’t looked back). Large Value and Core offer more dependable return profiles without any of looming problems in CRE.

Whether this explanation is right or wrong, it seems investors have hopped on the Mid-cap and Large Value/Core rotation trade for the time being. With the Fed not expected to do much until June (and at that, only a 57.2% chance of a cut), I do feel that we could see a sustained intermediate-term “broadening out” move, just not exactly the way we have been envisioning it.

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