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Commerce Trust Market Brief with Scott Colbert
April 10, 2024

Scott Colbert: Good morning. It's Wednesday, April 10th, and the markets are open, but they're trending down. We know that the equity markets have provided very strong returns for the first quarter of the year. The S&P 500 (Index) up a bit more than 10%. Small-cap stocks (as measured by the Russell 2000 Index) up about 5%. International stocks (as measured by the Vanguard Total International Stock Index) up about 4.2%, and only the bond market (as measured by the Bloomberg Aggregate Bond Index) is down, as interest rates have risen.

So far this (second) quarter, for the first 10 calendar days of the quarter, we've watched the equity markets retrench a bit. The S&P 500 has given back about 2% of its returns and now is only up 8.6% on a year-to-date basis. The Russell 2000 has given up almost all of its gains, (and) is now only up about 0.5%.

The Bloomberg Aggregate that measures the broad bond market is probably down about 2.3%, and international stocks have been dented a bit when you include large-cap and emerging market stocks. They were up 4.2% that first quarter, now they're only up about 3.4%, giving back about 80 basis points of those returns.

So, why this retrenchment? Well, it has to do with the irony of good economic news being bad for the financial markets. Good economic news basically pushing out the probability, or possibility, of the Federal Reserve (Fed) cutting interest rates this year. The first piece of good economic news was the employment report that came out earlier this month. In March, we added over 300,000 jobs, and that was about 100,000 more jobs than expected. For the quarter, we added 789,000 jobs, and this was a reversal of a downtrend in employment growth on a quarter-by-quarter basis. The previous quarter, we had only added 637,000 jobs, so in essence, this was a reversal in job growth, a creation of an additional 24%. That was the first piece of good economic news that basically dampened the market's expectations for rate cuts.

The second came out just this morning with regards to inflation. The CPI (Consumer Price Index), both on a nominal and on a core basis, came in hotter than expected. Basically, on a year-over-year basis, whether you're looking at core or top-line inflation, they're largely unchanged on a 12-month trailing basis from where they were at the end of the year. This is in contrast to the market's expectations of some fall, or rollover, in inflation. We're not getting it either in the PCE (Personal Consumption Expenditures Price Index) statistics that I've put up on our chart as well, because the PCE inflation is a rather sticky 3%, also making no progress.

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Why aren't we making any progress when all the economists thought we were? Well, we knew that housing was going to come down, and housing has come down. It was running at 6.2%, a large contributor to inflation at the end of the year. It has fallen to 5.7%, but offsetting that is almost everything else. When we look at this so-called super core index, which basically exes housing out of the CPI, as well as food and energy, we've seen a marked jump in almost all other inflation except for housing so far this year. This essentially means that inflationary statistics are largely unchanged and because they're unchanged, the expectation now that the Fed will begin to reduce rates has been pushed back and back and back.

How much further back have the rate cuts been pushed? Let's take a look at an interesting chart. At the beginning of the year, and this is almost hard to imagine, just three months and 10 days ago, the market was expecting six rate cuts this year, beginning basically last month in March. As of today, because of the better-than-expected job growth and because of the sticky inflation, we now see the market pushing back on almost any rate cuts this year at all. In fact, the first rate cut now, as estimated by the market, is likely to come in November or December, and then perhaps a second one next year, in early 2025.

Bottom line, this good economic news has pushed back the outlook for the Federal Reserve to cut interest rates. As such, the equity markets have given back some of those very positive gains. We'll be back in a couple of weeks to discuss all the changes to the financial markets that's impacting your investment portfolios.

In considering whether to trade or invest, you should inform yourself and be aware of the risks. Past performance is no guarantee of future results. And the information in the commentary provided is subject to change based on market or other conditions. Diversification does not guarantee a profit or protect against all risk.

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