The Weekly Market Update – 6/17/24: May Inflation Data Soothes Investors

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	5,431.60	1.58%	3.37%	13.87%	29.95%	5,433.74	0.0%
Dow Jones Industrial Average	38,589.16	-0.54%	-3.06%	2.39%	17.26%	40,003.59	3.7%
NASDAQ Composite	17,688.88	3.24%	7.99%	17.84%	36.75%	17,688.88	0.0%
Russell 2000	2,006.16	-1.01%	-5.57%	-1.03%	14.66%	2,442.74	21.8%
MSCI EAFE (USD)	2,306.41	-2.64%	-1.72%	3.14%	12.96%	2,398.71	4.0%
MSCI Emerging Markets (USD)	1,076.89	0.35%	3.51%	5.19%	12.35%	1,444.93	34.2%
Bloomberg Commodity Index	102.44	0.61%	2.96%	3.84%	4.57%	237.95	132.3%
Barclays U.S. Aggregate Bond	90.75	1.32%	0.29%	-1.03%	0.50%	112.07	23.5%

Source: FactSet

Both bond and equity prices rallied following the Federal Reserve Bank's (Fed) June committee meeting. The Fed held its overnight bank lending fed funds interest rate target range unchanged at 5.25% to 5.50% (unchanged since July 2023) and signaled that interest rates could remain high for longer. The Fed's Summary of Economic Projections (SEP, last published in March and updated quarterly) projected (median estimate) a 2024 fed funds (overnight interest rate) level of 5.1%, which reflects just one 0.25% interest rate cut before the end of the year. The March 2024 SEP projected three 0.25% cuts. In some environments, a more hawkish (interest rates higher-than-expected) Fed position would create headwinds for stocks (valuation and economic growth concerns). Just a few months ago, many investors discussed the potential for six or seven 0.25% Fed rate cuts this year. But following the mid-week meeting, the S&P 500 rallied to new all-time highs on Wednesday and Thursday, and the U.S. 2-year Treasury yield dropped to 4.70%. We attribute the positive investor reaction to other data in the Fed projections. The Fed sees 2024 U.S. economic growth (as measured by gross domestic product, or GDP) of +2.1%. This was unchanged from the March projection, indicating solid ongoing growth despite high interest rates. 2024 GDP growth of +2.1% would be modestly below +2.4% growth in 2023, an ideal path for the Fed, reflecting an economic soft landing (economy slows but avoids recession) that, along with moderating inflation, could allow them to gradually reduce the fed funds target to a more "normalized level" of interest rates. Last week, investors shared that view (bond prices rallied) as the yield on the 2-year Treasury bond lurched lower (Treasury yields are market-traded and not set by policy). In our view, the 2-year yield often trades in anticipation of Fed policy changes, so it is an indication that investors still see the possibility of more than one 0.25% rate reduction this year. For now, a 2024 "soft landing" scenario appears achievable but elevated interest rates have weighed on some economic segments such as housing, vehicles, and commercial real estate, and could impact corporate debt refinancing. In addition, federal net interest expense continues to rise (both from high interest rates and ongoing budget deficits), foretelling difficult budget decisions down the road.

Inflation data has resumed a downward trend after a first quarter scare. The most widely followed measure of consumer inflation, the consumer price index (CPI, reported by the Bureau of Labor Statistics), was lower than expected. In May, CPI increased +3.3% year-over-year (Y/Y). It had surged from +3.1% (January) to +3.5% (March) in the first quarter. In addition, the May month-to-month (M/M) increase was flat, the first 0.0% month in nearly two years. The core CPI (excludes food and energy), more closely watched by the Fed, increased +3.4% Y/Y and +0.2% M/M. A M/M trend of +0.2% or lower for a few more months would likely be sufficient for the Fed to begin cutting rates as it could alleviate fears of renewed inflation pressure that built in the first quarter. We do not rule out a Fed rate cut in September, which is the last Fed meeting prior to the 2024 election.

The week ahead includes a rare Wednesday market holiday, and traders gather information from a handful of key economic data releases. On Tuesday, the Census Bureau will report May retail sales, an important component of consumer spending. Consensus estimates reflect an upward trend from April when retail sales were flat from the previous month (and up +3.0% year-over-year). Later in the week will be housing data including housing starts (which measures new construction and permits) and existing home sales (a measure of housing turnover). The U.S. economy is expected to grow +1.6% in the second quarter (2Q24), better than +1.3% in 1Q24, but below levels of 2023.

James D. Ragan, CFA
Director of WM Research
(206) 389-4070
jragan@dadco.com

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Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The S&P 400 Index is a market cap weighted index comprised of U.S. stocks in the middle capitalization range, generally considered to be between $200 million and $5 billion in market value. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publicly traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The S&P 500 Equal Weight Index is compiled by S&P Dow Jones. It is an equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization-weighted S&P 500, but each company is allocated a fixed weight, or 0.2%, of the index total at each quarterly rebalance.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

U.S. economic growth: Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. The most recent GDP report can be found at www.bea.gov. It is reported by the U.S. Bureau of Economic Analysis (BEA).

Our definition of an economic "soft landing" reflects a potential trajectory of the U.S. economy following the pandemic, high interest rates and inflation. A "soft landing" reflects positive GDP growth but at levels below 2.3%, which was the five-year average GDP growth prior to the pandemic (2015 to 2019).

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members – the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and four of the remaining eleven Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. The minutes from the most recent FOMC meeting is here.

The Federal Reserve Summary of Economic Projections (SEP) is sourced from federalreserve.gov, as of 3/31/23. Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The Summary of Economic Projections is compiled from Federal Reserve Board members and Federal Reserve Bank presidents.

The consumer price index (CPI) is a measure of average change, over time, in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics. Y/Y is year-over-year and M/M is month-over-month.
The U.S. Personal Consumption Expenditures (PCE) Price Index is an indicator of the growth in consumer spending and measures the value of goods and services purchased by persons who reside in the U.S. It is reported monthly by the Bureau of Economic Analysis. PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE).

Advance Monthly Sales for Retail and Food Services is reported by the U.S. Census Bureau, which collects sales data through a monthly survey.

The U.S. Census reports annualized monthly data on housing starts, permits and completions. It is a widely followed measure to track construction activity in the residential housing market. New Home sales measures sales of new single-family homes and is a measure of the demand for housing. Home price data is monitored from the S&P CoreLogic Case-Shiller Home Price Index.