Stocks will Need to Deliver on Earnings, but Remember, the Fed has Rate Cuts in its Back Pocket

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Equity Markets Post Worst Month of 2024

Amid hotter inflation, hawkish Fed commentary, and geopolitical tensions, all three major stock market indices were down in April. The Dow Jones Industrial Average (-5.0%) had its worst month since September 2022 while both the Nasdaq Composite and S&P 500 posted their largest monthly declines since September 2023 (-4.4% and -4.2%, respectively). US mid-caps (-6.0%) were among the worst performers, followed by US small-caps (-5.5%) and US value (-4.3%). Bonds were also down as 7-10 year US Treasuries fell 3.1%, investment grade corporates decreased 2.6%, and the US Aggregate Bond Index declined 2.4%. Aside from crude oil (-0.4%), commodities fared well as silver was up 5.7%, gold increased 3.0%, and broad-based commodities gained 2.4%.

Exhibit 1: Trailing Returns as of April 30, 2024

	Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities	Broad-based Emerging Markets (SPEM)	0.69%	6.80%	2.91%	9.80%	-3.44%	2.90%
Equities	International Developed Equities (SPDW)	-3.32%	2.91%	1.88%	8.18%	1.34%	5.91%
Equities	US Growth (SPYG)	-3.87%	5.22%	8.24%	26.35%	6.29%	13.91%
Equities	US Large-Caps (SPY)	-4.03%	4.28%	5.94%	22.26%	7.94%	13.10%
Equities	US Value (SPYV)	-4.27%	3.11%	3.39%	17.92%	9.09%	11.34%
Equities	US Small-Caps (SPSM)	-5.51%	0.77%	-3.24%	12.55%	-0.32%	7.08%
Equities	US Mid-Caps (SPMD)	-5.96%	5.10%	3.28%	16.66%	3.21%	9.42%
US Fixed Income	Municipal Bonds (MUB)	-0.94%	-1.25%	-1.20%	1.89%	-0.83%	1.30%
US Fixed Income	Treasury Inflation Protected Notes (SPIP)	-1.32%	-2.08%	-1.13%	-1.66%	-1.92%	1.91%
US Fixed Income	High Yield Credit (JNK)	-1.33%	0.13%	0.27%	7.93%	0.51%	2.53%
US Fixed Income	US Aggregate Bond Index (SPAB)	-2.42%	-2.94%	-3.20%	-1.45%	-3.57%	-0.21%
US Fixed Income	Investment Grade Corporate Bonds (SPBO)	-2.56%	-2.66%	-2.72%	1.12%	-3.02%	1.02%
US Fixed Income	US Treasury 7-10 Year (IEF)	-3.13%	-4.45%	-4.38%	-5.37%	-5.14%	-1.13%
Commodities	Silver (SLV)	5.71%	15.02%	10.42%	4.53%	0.06%	11.39%
Commodities	Gold (GLD)	2.99%	12.43%	10.83%	14.53%	8.54%	11.81%
Commodities	Broad-based Commodities (BCI)	2.43%	4.22%	4.60%	2.10%	6.32%	6.47%
Commodities	Crude Oil (USO)	-0.44%	10.52%	17.60%	15.99%	21.90%	-5.91%

Source: FactSet. Data as of April 30, 2024. 1Y, 3Y, and 5Y numbers are annualized.

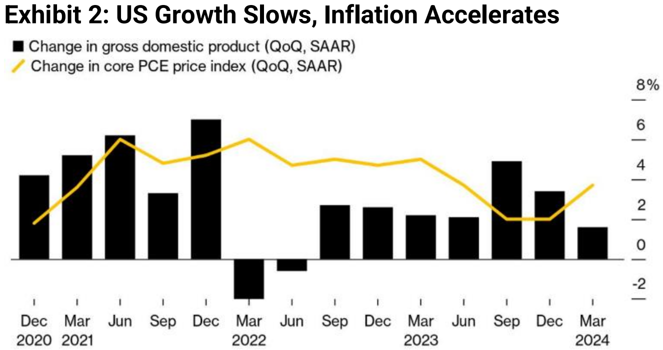
Fed Points to a Lack of Progress on Inflation

In his latest speech at the Wilson Center's Washington Forum, Federal Reserve Chairman Jerome Powell revealed that monetary policy may have to remain restrictive for longer. "More recent data shows solid growth and continued strength in the labor market, but also a lack of further progress so far this year on returning to our 2% inflation goal," he stated. This followed stubborn March Consumer Price Index (CPI) prints released earlier in the month, the latest of three straight hotter than expected inflation reports in 2024. His messaging, along with that of other policymakers, has turned more hawkish and contrasts with last month's Fed forecast of three 25 bps rate cuts in 2024. At today's May FOMC meeting, the Fed is largely anticipated to keep interest rates unchanged, leaving the fed funds rate at the 5.25–5.50% range. Now, only one to two 25 bps rate cuts are priced in for 2024, with the first to occur in either November or December per the CME FedWatch Tool.

Stagflation or Slow Disinflation?

Last week's first preliminary GDP print for Q1 2024 came in at 1.6%, below both the 2.2% estimate and last quarter's 3.4%. At the same time, inflation via PCE (Personal Consumption Expenditures Index) for the period rose 3.4% for the quarter, marking its biggest gain in a year. This raised stagflation concerns, an environment characterized by lower growth, higher inflation, and rising unemployment. However, as growth hasn't weakened notably and the labor market remains strong, it is more likely the US is facing slow disinflation.

Exhibit 2: US Growth Slows, Inflation Accelerates

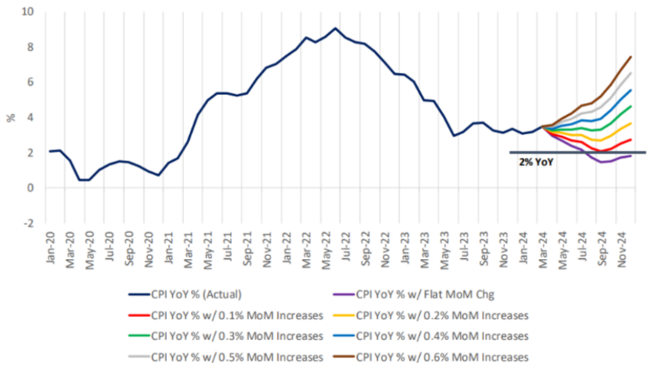


Source: Bureau of Economic Analysis, Bloomberg

Will CPI Remain Above Target in 2024?

As per Bespoke Investment Group, the chart below displays various annualized CPI paths through the end of 2024 based on different month-over-month readings held constant. The only scenarios that bring year-over-year CPI below or close to the Fed's 2% target through December is if each monthly measure until then is flat (purple line) or increases by only 0.1% (red line), which seems unlikely.

Exhibit 3: Potential Paths for YoY CPI Based on Constant MoM Prints

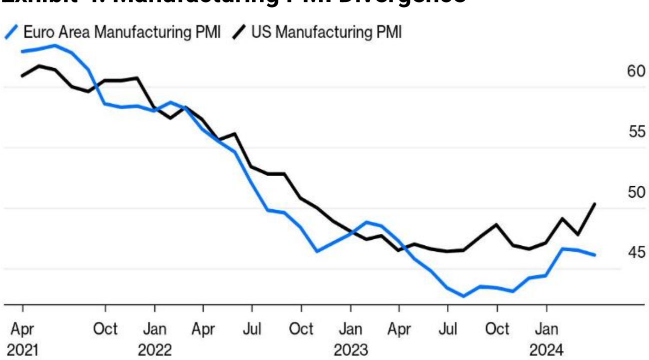


Source: Bespoke Investment Group

Europe to Cut Ahead of the US

Europe appears to be experiencing greater economic troubles than the US. For instance, manufacturing PMIs in the US have recently improved into expansionary territory, while in Europe, they seem to be trending lower. Additionally, credit standards in Europe remain restrictive while loan demand is falling. Inflation prints have also been coming in lower in Europe relative to the US, and if they continue to show disinflationary progress, it may warrant the ECB to initially cut interest rates as soon as June.

Exhibit 4: Manufacturing PMI Divergence

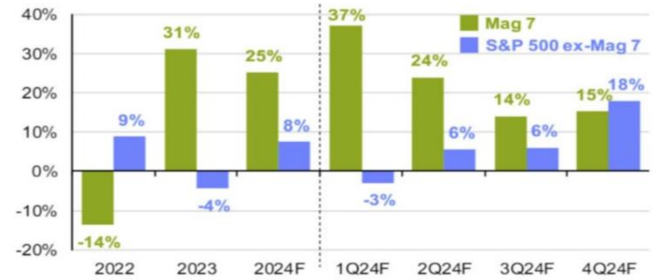


Source: Bloomberg. Data shows latest PMIs for March 2024.

Broadening Earnings Growth

Earnings growth for the Magnificent Seven has been impressive, but it's expected to slow after Q1 2024. Meanwhile, forecasts show earnings growth for the S&P 500 excluding the Magnificent Seven outpacing that of the seven towards the end of 2024. It's unlikely these select stocks will continue to grow indefinitely. Is it time to consider broadening one's exposures?

Exhibit 5: Earnings Growth — Pro Forma EPS, Y/Y



Source: JP Morgan Asset Management, NewEdge Wealth Weekly Note, Callum Thomas

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There's always room to be bearish, but we find it hard to believe that the average US high quality stock won't trend higher in the next 15-18 months. Expectations are high and stocks will likely need to deliver on their earnings, but in the end, the Fed has a few rate cuts in its back pocket should circumstances take a turn for the worse.

In the past six months, the market has gone from pricing in two 25 bps cuts in 2024 to seven to just slightly more than one today. This volatility is more of a reason why we encourage investors not to be tactical, but to stay strategically long.

We'd rather be OW stocks that have strong, high quality franchises, pay dividends, and can provide a call option on earnings compared to bonds which are likely to struggle with still-elevated inflation and less rate cuts to occur than originally priced in.

Additionally, we've owned gold in our ETF portfolios for many years. Interestingly, since October 31st, 2022, through April 30th, 2024, it is up 40% cumulatively, outperforming the S&P 500's return of 33% over the same period. Here are three reasons why we still find gold attractive: 1) Headwinds of inflation, 2) looming deficit concerns/more money being printed, and 3) increased economic volatility.