Market commentary notes

Monthly call notes
Monday, June 3, 2024

Wealth Management

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The Fed FOMC meeting – Not much new came from the Fed last month.

The Beige Book on economic conditions reports no Fed regions with negative growth. A couple were flat to up modestly and most were up modestly to moderately. There were shortages of workers in various categories, so while the overall employment picture might be called "healthy," there were spotty shortages.

Neel Kashkari, the president of the Minneapolis Fed, opined that he'd like to see several months of progress toward lower inflation rates before the Fed eases rates. That seems to be a largely consensus view among the presidents and governors and most importantly, seems to reflect Chairman Powell's perspective.

That contrasts with what we are seeing from other central banks. In Canada and Europe, there is more of an inclination to lower short-term rates sooner than in the U.S. That reflects the substantially weaker economic performance of those countries (although Canada had a monster new employment surge after a couple of months of weak employment growth).

When U.S. short-term rates are higher than those elsewhere while we have good economic performance, that typically has two impacts. First, that attracts investments to the U.S., which raises the value of the U.S. dollar. Second, that in turn tends to increase our imports (because foreign goods become a little cheaper) and reduces our potential exports of non-commodity goods and services. Therefore, if other countries reduce their short-term rates ahead of the U.S., that amplifies these effects, causing more investment funds to come to the U.S., increasing our imports and creating a headwind for many of our exports.

When you're investing in this kind of environment, you probably want to emphasize U.S. equities. To the extent that you invest outside of the U.S., you may want to use investments that hedge back to the U.S. dollar and within that, emphasize countries, industries and securities that are heavy on foreign exporters into the U.S.

Earnings — The 1Q earnings season is pretty much over. The summary is that earnings in total grew 5.9% for the quarter which is about 2.5% better than expectations at the start of the quarter. My sense is that this is largely a trend that will continue throughout 2024 and that it will on average be supportive of the U.S. stock market. Why is it happening when 1Q GDP growth was mediocre? My explanation starts with inflation raising production costs for companies, squeezing profits a year ago. Companies adjusted by raising their selling prices to restore their margins. Then, inflation dropped more rapidly than anticipated, creating a windfall for those companies. I think that's what led to the profit surge, partly recovery from the previous profit squeeze and partly the result of price increases intersecting with cost stabilization and even declines. Companies generally may be the beneficiaries of that combination for the rest of this year.

Employment — We don't have a May figure for new payroll growth, so our latest is still April, which was up 175,000, a strong figure but down from the average of the second half of last year. We also have a 2023 report on wage growth in the 10 major metropolitan counties, including Chicago, New York, L.A., Miami-Dade, Dallas, and Maricopa. Records indicate that average wages were up 3.6%, which is better than the inflation rate. That coupled with the increasing jobs numbers, means that total earnings probably increased something like 5–5.5% last year. That's enough so that we likely can continue to avoid a recession. [https://www.bls.gov/cew/home.htm, June 3, 2024]

May — We go the other way — After a dip in the major stock and bond indexes in April, we saw a reversal (again) in May. The S&P 500 rose 4.96% versus a 4.8% drop in April. Midcaps and small caps were up similarly, also reversing their April dips. Even the bond index was up 1.7% (meaning yields declined) which reversed their April move in the opposite direction. The bonds index is still underwater for the YTD at -0.87%. Oil (WTI) is up just 3.6% from 12 months ago, at just under $75. Gold is up 19.4% from a year ago.

Global stock indexes

Total Index	May %	YTD %	1 yr %	2023 Est PE Trailing/ Projected
S&P 500	4.96	11.30	28.19	23.27/21.76
S&P Mid Cap	4.39	7.87	24.97	18.25/16.49
S&P Small Cap	5.04	1.59	20.34	26.69/16.44
FTSE All REIT	5.29	-4.31	9.03	
MSCI All Country xU.S.	2.90	5.79	16.74	
MSCI Emerg Mkt	0.56	3.41	12.39	

Source: Morningstar as of May 31, 2024. Estimated PE's are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 29, 2023. Projected PEs are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	May %	YTD %	1 yr %
Bloom Agg Intermed	1.70	-0.87	2.00
ICE BofA U.S. Convertibles	2.27	1.03	10.53
S&P GSCI	-1.90	9.52	18.37
Bloom U.S. Corp HY	1.10	1.63	11.24

Source: Morningstar as of May 31, 2024.

Sector performance — In May, the energy and consumer discretionary sectors were down, with industrials about flat. The best performers, YTD were communications (+20.4%), IT (+16.9%) and Utilities (+14.15%). The latter surged in May, up 7.8%.[https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, June 3, 2024] [https://digital.fidelity.com/prgw/digital/research/sector, June 3, 2024]

Commodities

Commodity and food price changes, current month and YoY

Total Index	May %	YoY %
Copper	1.0%	23.7%
Lumber	-7.3%	-0.2%
Cotton	-4.3%	-12.1%
Sugar	-3.2%	-23.8%
Coffee	9.8%	22.5%
Wheat	4.9%	7.0%
Corn	-6.1%	-16.9%
Oil	-4.6%	3.6%
NatGas	22.3%	13.5%

Source: https://tradingeconomics.com/commodities, June 3, 2024

Five of these nine major commodities saw prices decline in May, like April and March. For these nine, the average one-year price change was a rise of 1.8% after two months of average declines.

Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 19 of the 48 saw price declines in May, compared to 16 last month and 24 in March. Eighteen saw lower prices than a year ago which is about the same as last month and fewer than the month before. This reinforces my impression that we're pretty much at the end of the significant price declines at the front end of the production process. That suggests to me that we're pretty much in a period of price stabilization. Getting inflation rates down from here will be harder and could take longer than anticipated.

U.S. economy

The U.S. economy at a crossroads ...

GDP estimates

[https://www.bea.gov/data/gdp/gross-domestic-product, June 3, 2024] [https://www.atlantafed.org/cqer/research/gdpnow, June 3, 2024] The second estimate for 1Q 2024 GDP growth came out at a reduced real rate of 1.3%. The GDP price deflator (not what the Fed focuses on) came in at a modest 2.4%. The PCE price index, which the Fed does watch, came in at 3.3%. Consumer spending, exports and government spending all grew slower than the previous estimates. [FactSet, 29 May, 2024] GDPNow is estimating +2.7% for the current quarter, down from a +3.3% estimate a few weeks ago. [https://www.atlantafed.org/cqer/research/gdpnow, June 3, 2024] [https://www.census.gov/econ/indicators/advance_report.pdf, June 3, 2024] [https://www.bea.gov/news/2024/gross-domestic-product-first-quarter-2024-advance-estimate. June 3, 2024]

U.S. PMI statistics

The May PMI Manufacturing number rose a bit to 51.3 from 50. The Services PMI surged to 54.8 from 51.3. Together, they point to a significant uptick in economic activity. [Trading Economics, PMI statistics June 3, 2024]. [Trading Economics, https://tradingeconomics.com/country-list/services-pmi June 3, 2024]

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. The May numbers indicate that manufacturing expanded in 22 of our 38 countries. That's up from 20 last month and 19 the month before. Germany, France and Italy all came in under 50, although Germany and France had improved from April. Japan also broke above 50 (50.4) for the first time in a year. Spain improved to 54 and South Korea had its best reading in two years. The GDP-weighted average manufacturing PMI was 49.9, the highest reading since September 2022. EU's Services PMI rose further to 53.3 and Germany, Italy, and Spain all were in the mid-50s. France was a bit of a laggard at 49.4. Japan at 54.6. China stayed about where it was at 52.5. [https://tradingeconomics.com/country-list/services-pmi, June 3, 2024]

Here's our updated graph of Manufacturing PMIs

Source: Author's calculations based on published PMI statistics, as of June 3, 2024.

Table summary

Region	Manu PMI	Last Month	12 mo. Ago
U.S.	51.3	50	48.4
19 majors	50.4	49.8	48.7
38 world	49.9	49.2	48.2
EU	47.3	45.7	44.8
China	51.7	51.4	50.9

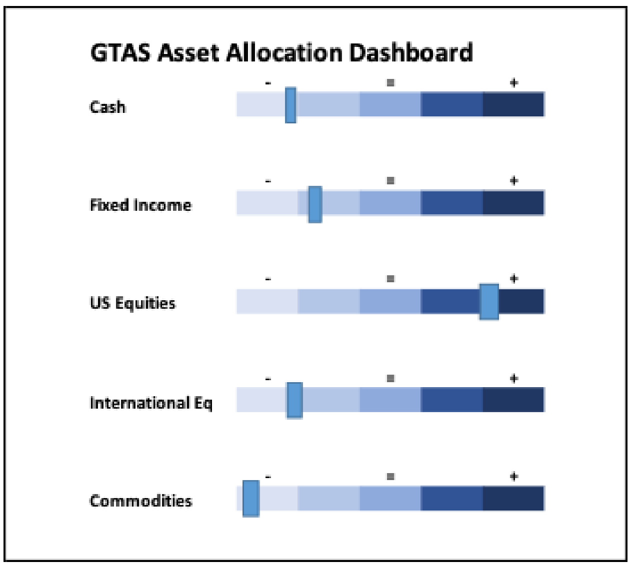
Source: Author's calculations based on published PMI statistics, June 3, 2024

Investment strategy

I doubt that we've seen the summer dip yet. By that, I mean that the summer might still bring some stock market turbulence. That said, I'm optimistic about where the year will end. It seems to me that better earnings growth, combined with decent consumer income increases, could lead to a stock market uptick in the fall. In all, I think we'll end the year with the S&P where it is now or up a few points. I think longer-term bonds might sell off (yields rise) a little bit more. That's why we're sticking with shorter-term bonds unless there's a reason to go out to further maturities. Credit spreads are very tight—meaning that you aren't being compensated for buying lower-quality (riskier) bonds relative to high-quality bonds. So, we're sticking to the higher quality stuff, including treasuries.

Where international investing is concerned, we think it makes sense to stick with vehicles that hedge back to the U.S. dollar.

GTAS Allocation chart



(+/=/-) represents our group's views over a 6- to 18-month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results.
You cannot invest directly in an index.

Bar Agg Intermed — Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY — Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT — FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles — ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality (e.g., it includes investment-grade, speculative-grade, and non-rated issues). The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. — MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt — MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

S&P 500 — S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI — S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap — S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap — S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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