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Weekly market wrap

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Craig Fehr

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‹ Weekly market wrap

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Key Takeaways:

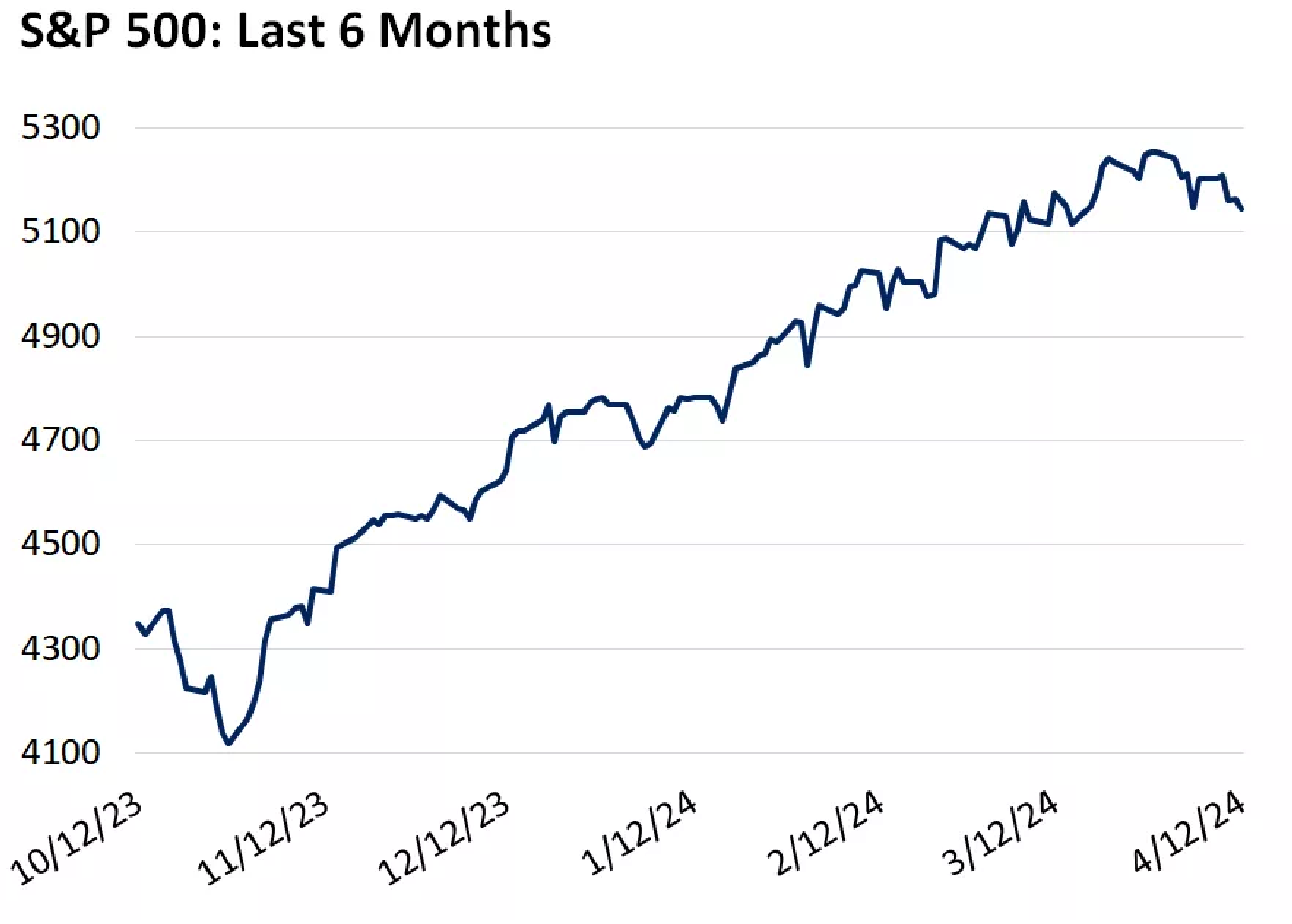
- *A hotter-than-expected inflation report, alongside rising concerns of an Iranian retaliatory strike on Israel, sparked a bout of market indigestion last week. Stocks moved lower, while interest rates and gold prices moved higher.*
- *We think inflation will continue to trend lower, but recent data reveal the pace of improvement has stalled. We don't believe this eliminates the prospects of rate cuts later this year, but it does complicate the picture for the Federal Reserve in the coming months. It's likely the Fed will have to cut rates less than previously anticipated as it waits for further confirmation that inflation is under control.*
- *Stocks have pulled back in recent days but remain only slightly below all-time highs. We think some temporary weakness is reasonable given the strength of the recent rally and the adjustments to policy expectations. That said, markets have handled this news fairly well, which we think reflects the still-favorable outlook for economic and corporate earnings growth.*

Last week's solar eclipse captured a ton of eyeballs (literally), which is logical considering the rarity of the event. But there was another seemingly rare event last week: The stock market turned lower.

For those of you who prefer your markets to move in a straight line higher, you may not want to stare directly at the chart below. If you do, and if you squint hard enough, you'll notice what appears to be a kink and a downward slope at the right end of the line, as hotter-than-expected inflation data eclipse the enthusiasm around upcoming Fed rate cuts.

This raises the questions: What's up with consumer prices? And does this latest inflation data set a new, dimmer course for stock prices ahead? We've held the view that this rally will eventually need to blink, but broadly, we think there's still a good case for investors to look up.

Stocks stumble after a steady march higher



Source: FactSet. S&P 500 Index.

Chart description

Consumer prices: Sapping the rate cut excitement — but for the right reasons

The headliner last week was the latest Consumer Price Index (CPI) report, providing a fresh look at the all-important trend in inflation. The results were not what markets were looking for, with CPI coming in hotter than expected.

A look at underlying drivers paints a less concerning picture, but the takeaway is that inflation is not moderating fast enough for the Fed to cut rates immediately. But we'd emphasize that inflation's slower-than-desired descent is primarily a function of a strong economy and healthy demand.

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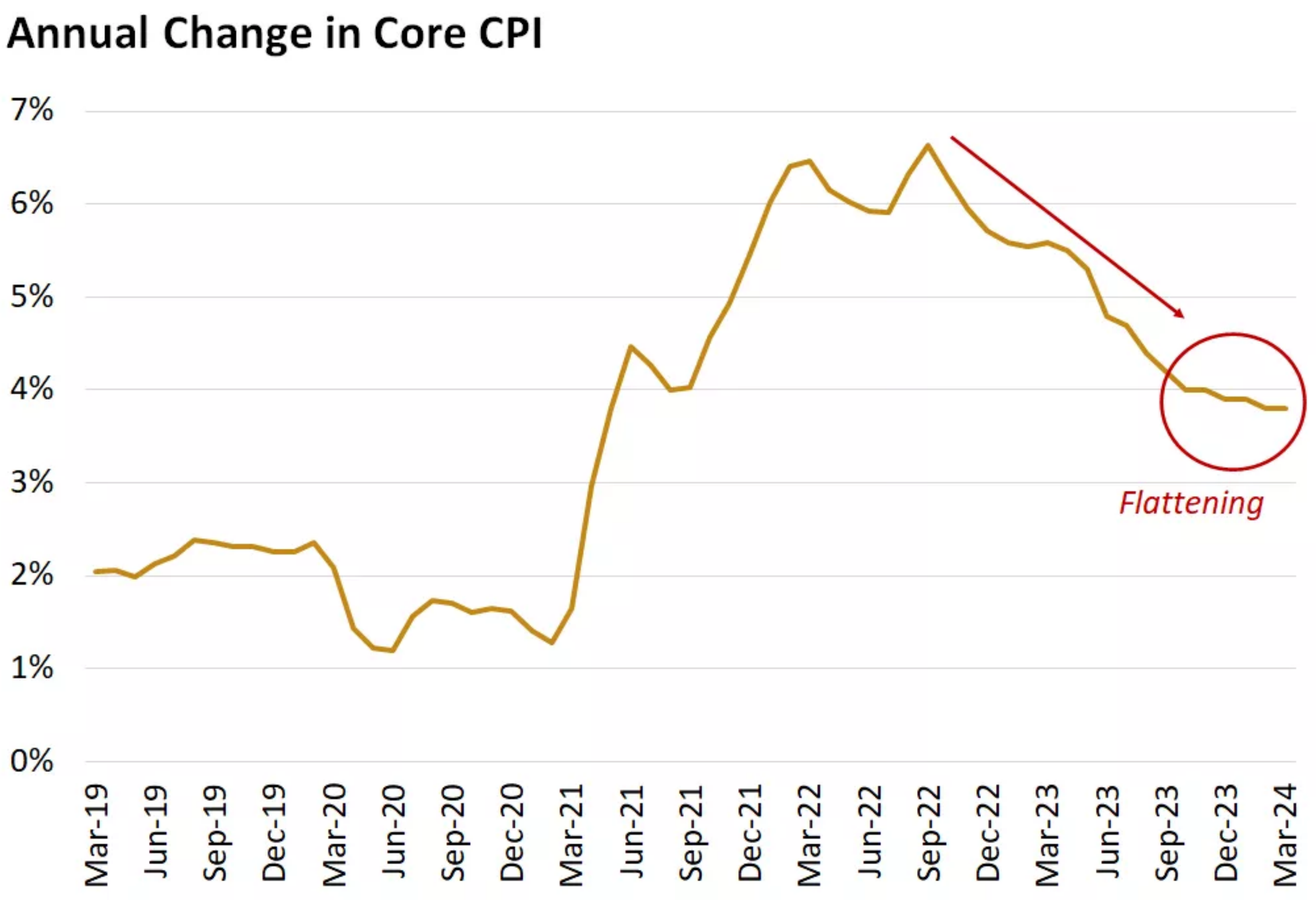
- Consumer prices rose by 3.5% year over year in March, up from 3.2% the prior month. Core CPI, which strips out volatile food and energy prices, held steady at 3.8%, coming in slightly above consensus expectations.

Services prices remain the fly in the ointment, with particularly large increases in medical costs and insurance premiums playing a role last month. While not captured in core inflation, the recent rise in oil prices is also driving worries of renewed upward pressure on headline CPI.

The pace of improvement in core CPI has slowed



Source: FactSet. Year-over-year change in U.S. CPI excluding food & energy.

Chart description

- Encouragingly, auto prices moved lower, and the pace of shelter inflation moderated again, hitting its lowest level since June 2022. The sharp drop in goods inflation over the past 18 months has been a key driver of the moderation in overall inflation. Durable goods prices remain in outright deflationary territory, falling again in March. We believe this trend reflects the healing of supply chains and an increase i manufacturing output.

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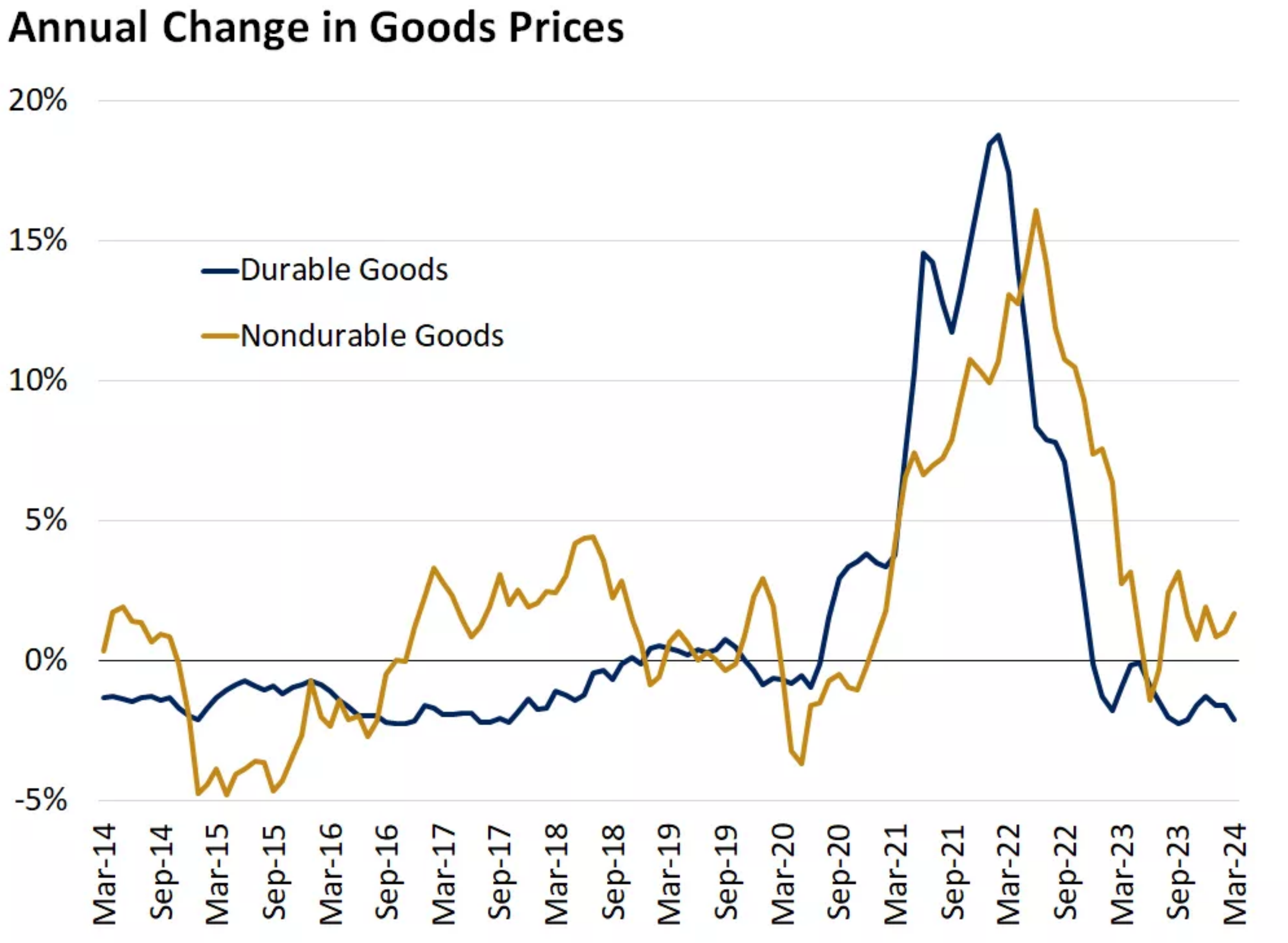
Moderating goods prices continue to help the overall inflation picture



Source: St. Louis Fed. Year-over-year change in U.S. goods CPI.

Chart description

- The overarching takeaway on the inflation outlook is that CPI is losing some of its downward momentum. The pace of moderation has leveled off in recent months, in part because the bulk of the help from falling goods prices has run its course. This means the next phase will require more help from shelter and services.

  Timely rent data suggest there is more room for improvement on shelter prices, which would be welcome relief. Services prices, however, may remain somewhat sticky as we expect them to continue to reflect a healthy consumer demand backdrop.

  This is not the worst problem to have, as a strong economy provides a favorable foundation for markets. That said, the low-hanging fruit of disinflation appears to have been picked. This means the next leg — in which core CPI trends toward the Fed's 2% target — may prove more gradual (and challenging) than hoped.

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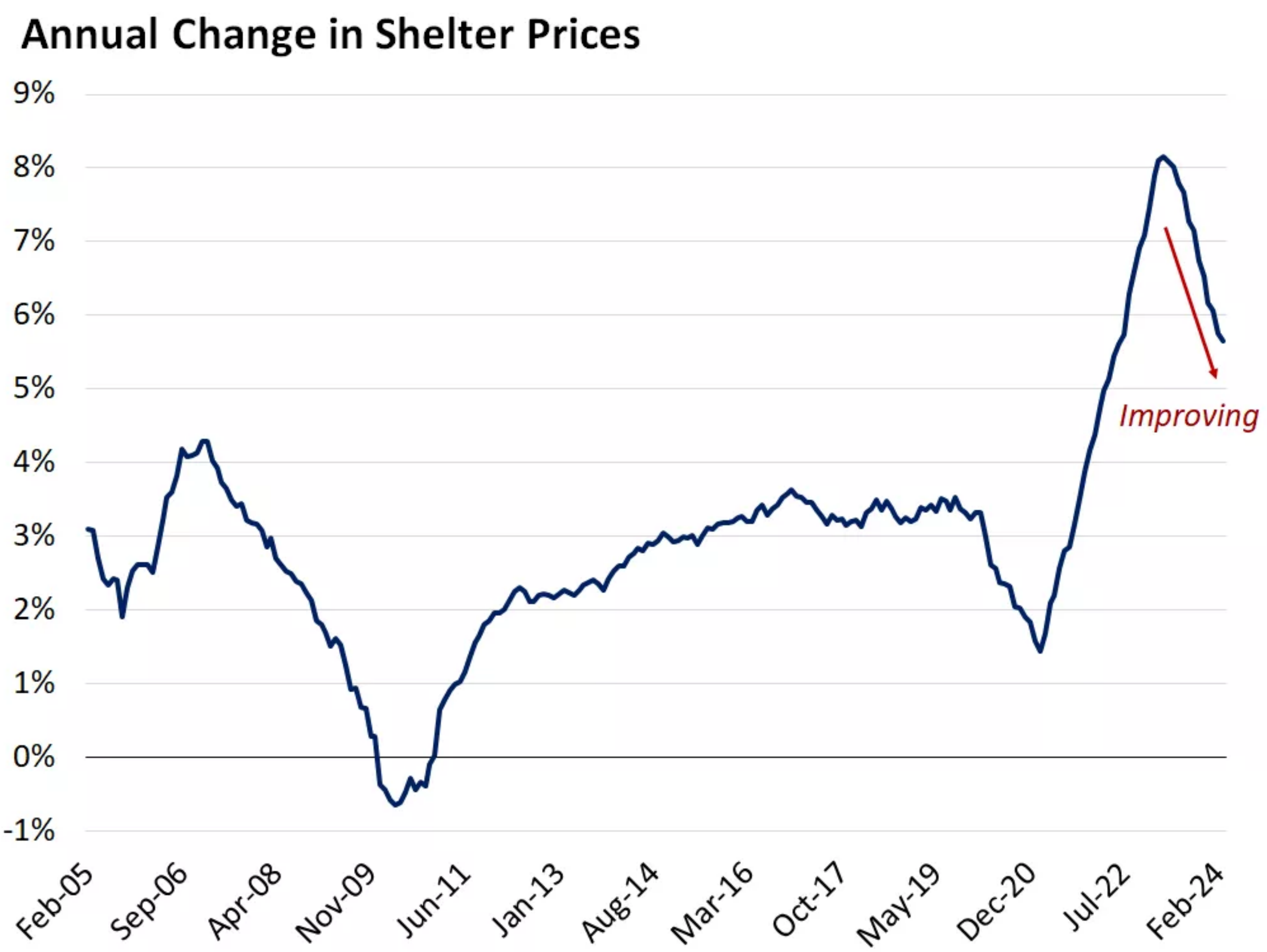
Improving shelter prices will be key for moderating inflation



Source: St. Louis Fed. Year-over-year change in U.S. city average shelter CPI.

Chart description

- This inflation data is being intensely viewed through the lens of what it means for monetary policy settings ahead. We think this complicates the Fed's plans to cut rates but does not eliminate the broader outlook for loosening policy later this year.

  Coming in to 2024, our view was that the markets were far too optimistic about the timing and magnitude of rate cuts this year. Markets were pricing in expectations for six rate cuts in 2024, with the first coming in March. Our expectation was that the first cut would likely be in June, with something closer to three rate cuts in the second half of the year.

  Given the string of firmer-than-anticipated CPI reports to start the year, we think the March data all but eliminates the chance of a cut in June. We think the Fed will r several months of evidence that inflation remains in a downtrend before beginni

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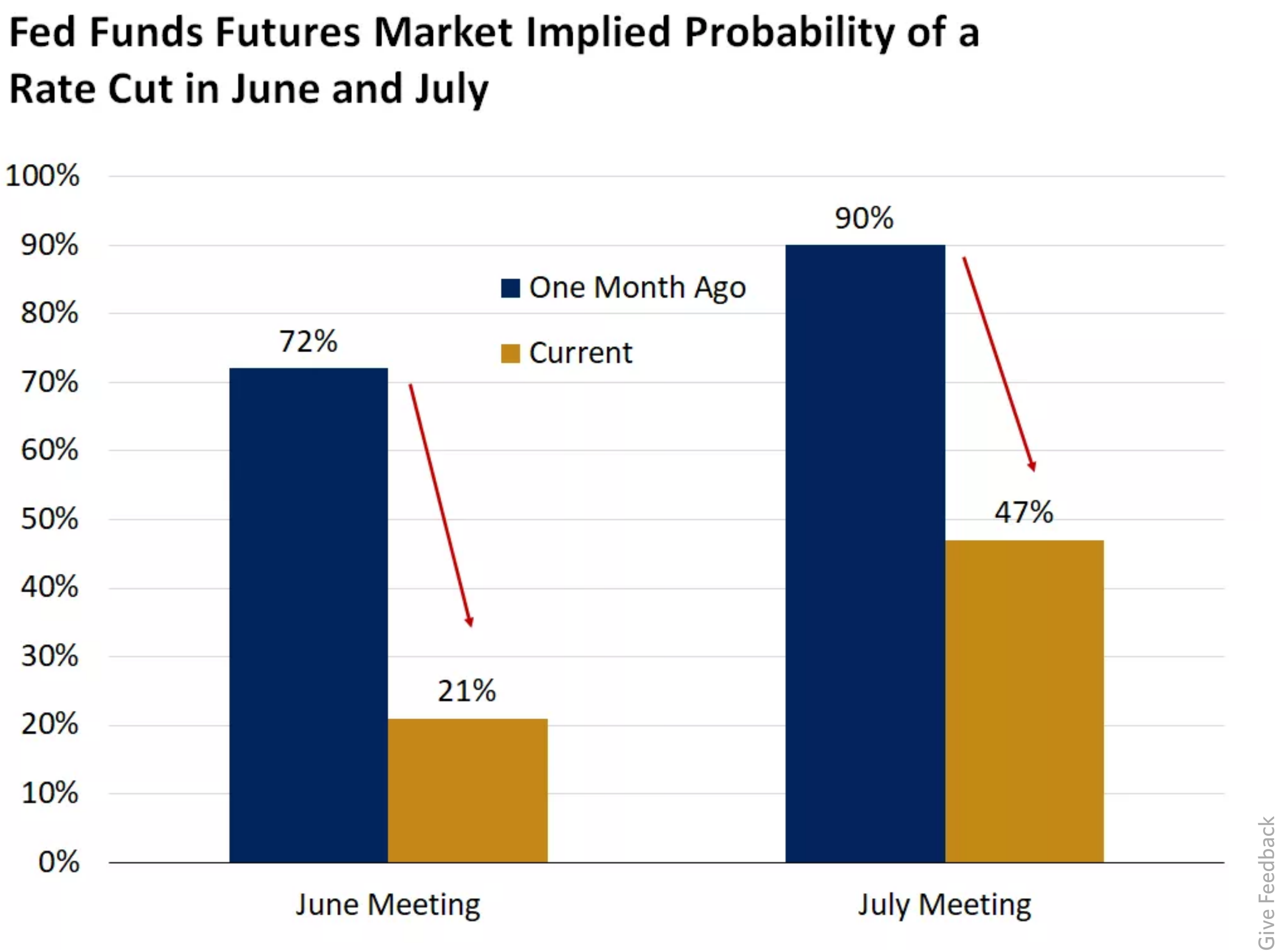
to ease policy. As such, we think the first cut will be pushed back, with fewer cuts this year.

- There are two important elements to highlight:

1. In our view, the next move by the Fed will be a cut — we'll just have to wait a bit longer. The big picture is still one in which monetary policy will get looser this year, a helpful force for the economy and financial markets.
2. While the markets are eager for the first rate cut, it's far more prudent for the Fed to take its time and ensure inflation is headed sustainably lower. The worst outcome for markets, in our view, would be for the Fed to act prematurely and risk fanning the embers of inflation, then have to return to hiking rates. We've seen that movie before (1970s), and it did not go well.

Futures markets quickly lowered rate cut expectations after the CPI report



Source: CME FedWatch Tool. 30-day Fed Funds Futures pricing data.

Chart description

Stock prices: The first stumble in an impressive march higher

The U.S. stock market has rallied sharply since October 2023, powered in large part by the outlook for Fed rate cuts in 2024, in addition to the AI-fueled enthusiasm behind the tech sector's surge. The magnitude of the rally might only have been outdone by its steadiness, with the S&P 500 logging nine consecutive weekly gains and a string of new record highs along the way.

Equities appear to have lost some of that oomph so far in April, but the recent weakness is barely noticeable when compared to even routine market pullbacks. We would not be surprised if the markets used this recalibration of Fed rate expectations as an excuse to take a breather, but to us, the underpinnings of the broader uptrend in stocks remain intact.

- Market declines — even modest ones — are never pleasant. But we'd point out that, all things considered, equities are behaving fairly well given the sizable adjustment in rate cut expectations.

  Over the last two years, we've seen the stock market react sharply to the downside when data or commentary indicated the Fed would need to tighten policy further or keep policy tight for longer. We think it is a positive sign that so far in 2024, markets have ratcheted down expectations for rate cuts significantly — from six at the beginning of the year to two as of last week — without a dramatic tantrum.

  We think the primary driver of this is an economy that continues to exhibit signs of strength, including some pockets of acceleration (manufacturing, business investment). This supports an outlook for corporate profit growth, even as policy is poised to remain restrictive awhile longer.

Equities have been more resilient to higher rates recently versus previous periods of rising rates

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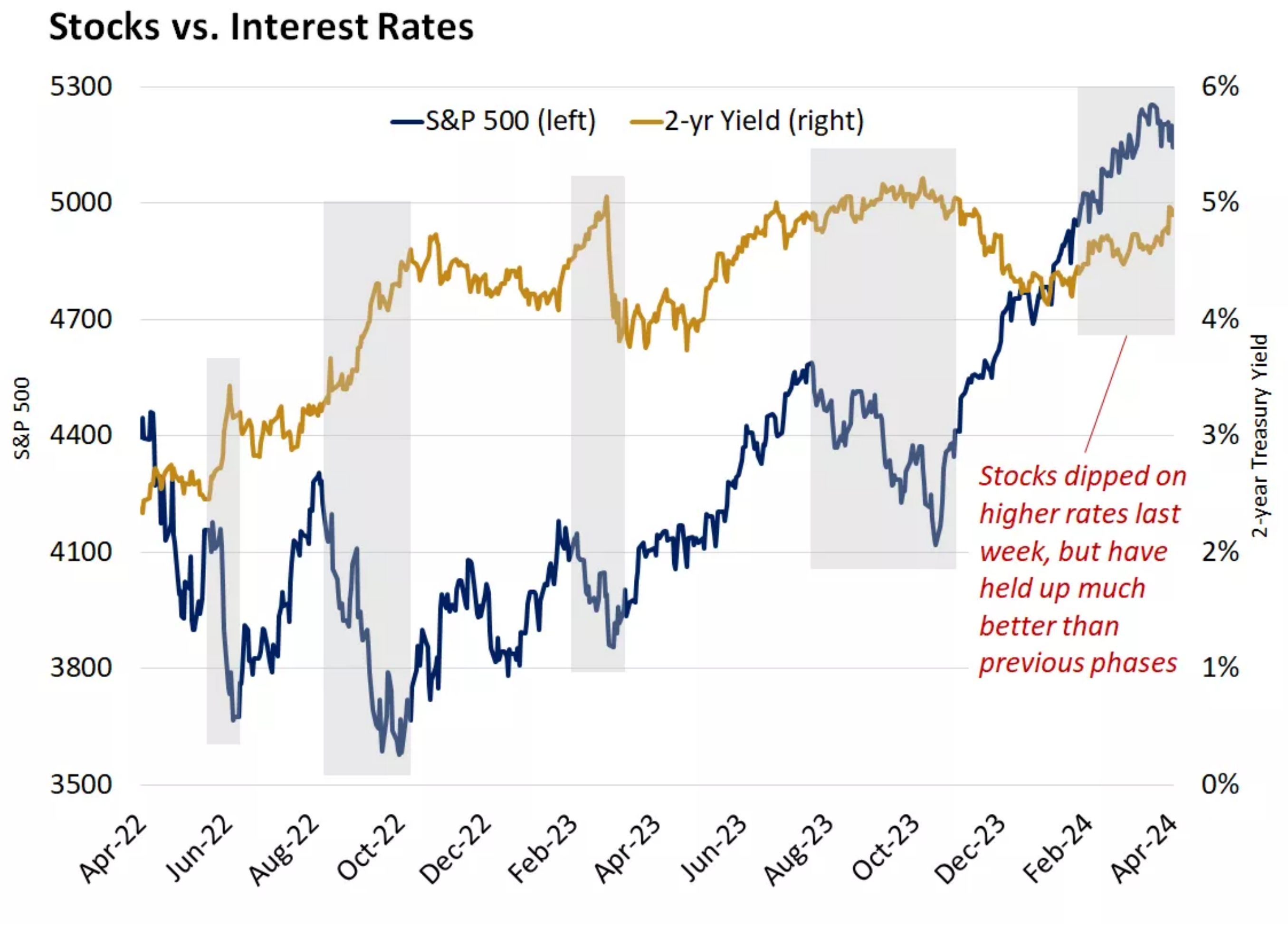

Source: FactSet. S&P 500 Index & U.S. 2-year Treasury yield.

Chart description

- We don't think the equity market will fully whistle past the graveyard of later and fewer rate cuts for 2024. As we noted coming into this year, we believe the most likely catalyst for a pause in this rally and the emergence of greater volatility is the potential for adjustments to upcoming Fed policy decisions. So far the reaction has been orderly, but we wouldn't rule out the potential for some lingering temporary weakness as markets continue to digest this new Fed backdrop.
- It should not be lost just how strong and steady the stock market rally has been. Consider the following:
  - The S&P 500 has declined the last two weeks but saw a stretch from November to February in which it was higher in 14 out of 15 consecutive weeks.
  - In the last five months coming into last week, the stock market had experienced only five days in which it declined by 1% or more. And in four of those instances, the market rose by 1% the next day.
  - Despite the weakness in recent days, the S&P 500 is just 2% below its all-high, which is the largest pullback since October of last year. The stock market

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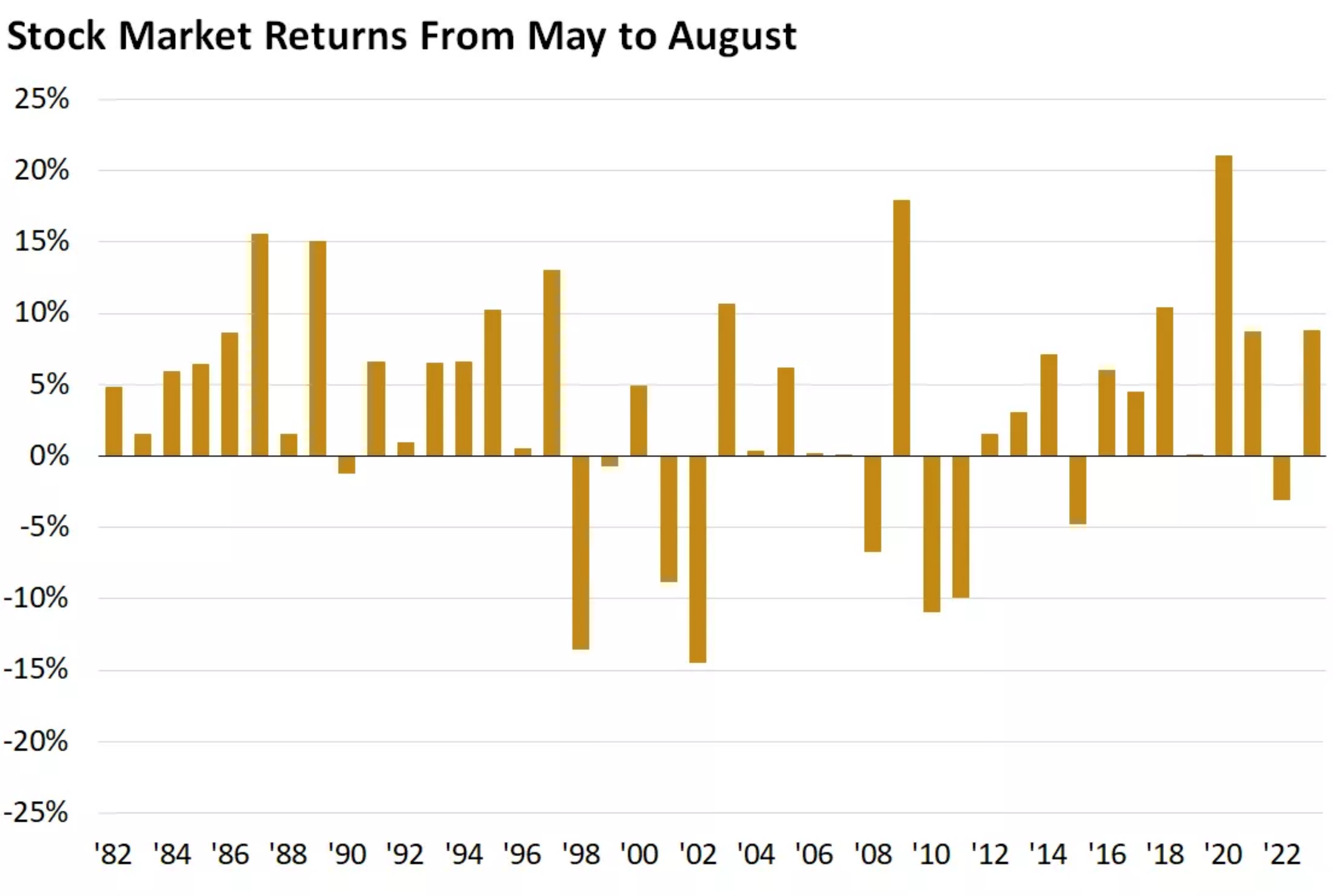
has returned 27% during that stretch.

Seasonal prices: Sell in May and go away?

The market adage "sell in May and go away" may have a ring to it, but it's far more rhyme than reason. The antiquated saying is based on the notion that the stock market is weaker during the summer, but we don't think, nor does the data confirm, that seasonal portfolio overhauls are sensible. That said, with May fast approaching, nearing the one-third mark for 2024, we think historical perspective is informative.

- The summer brings the shift toward travel and leisure, but the market doesn't pack its bags. Over the last four decades, the average return for the stock market from May to August was a respectable 3.4%, hardly a period worth missing. The market was higher in more than three-quarters of those summer periods, with the best May-through-August gains coming in 1987 (+16%), 2009 (+18%) and 2020 (+21%). The worst periods were in 1998 (-14%), 2002 (-14%) and 2010 (-11%).[1]

"Sell in May and go away" more often misses market gains



Source: Bloomberg. S&P 500 total return.

Chart description

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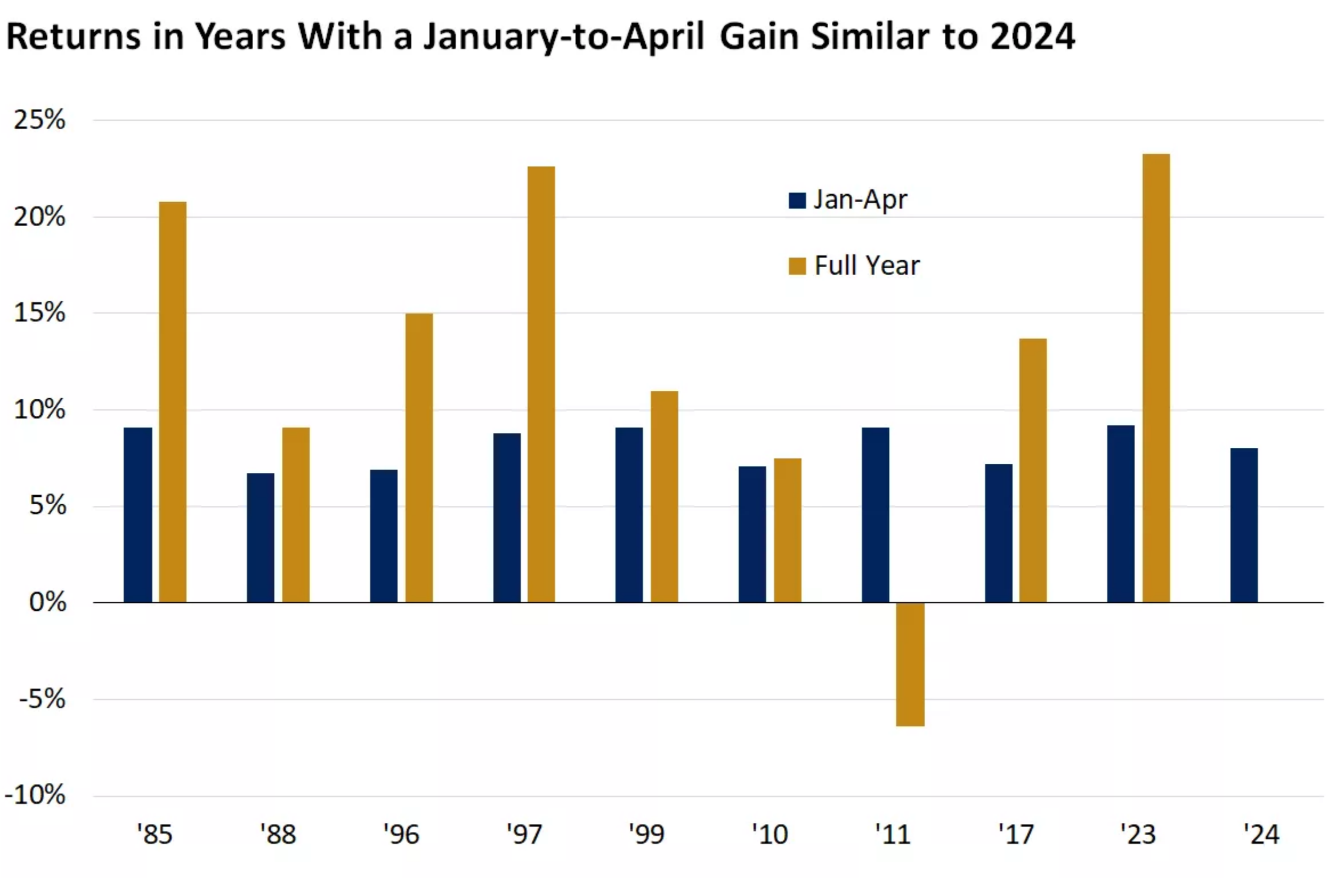
- Historical market experience doesn't support either "sell in May" or "go away." Past summer declines were not simply seasonal declines, but instead were often part of larger phases of market weakness, as was the case in 2022. While we don't think the coast is completely clear, we do believe the bulk of the current bear market is behind us.
- Healthy gains heading into May have historically been a good signal of a positive year for stocks. Since 1982, when the stock market was higher on the year heading into May, it went on to post a full-year gain roughly 90% of the time. In that period, 1987, 2011 and 2015 were the only years in which the market was higher from January to April but finished the year lower.[1] There were nine years in which the year-to-date increase heading into May was in the 6.5%–9.5% range, comparable to 2024's 8% year-to-date gain. In those instances, the stock market went on to post an average full-year increase of 13%.[1]

Strong starts have often carried through to solid full-year gains



Source: Bloomberg, S&P 500 Total Return. 2024 performance through 4/11/2024.

Chart description

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Craig Fehr, CFA
Investment Strategy

Sources: 1. Bloomberg, total return of the S&P 500 Index.

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	37,983	-2.4%	0.8%
S&P 500 Index	5,123	-1.6%	7.4%
NASDAQ	16,175	-0.5%	7.8%
MSCI EAFE*	2,298	-0.9%	2.7%
10-yr Treasury Yield	4.52%	0.1%	0.6%
Oil ($/bbl)	$85.51	-1.6%	19.3%
Bonds	$95.96	-0.7%	-2.6%

*Source: FactSet, 4/12/2024. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance does not guarantee future results. *4-day performance ending on Thursday.*

The week ahead

Important economic releases this week include retail sales data and housing starts.

Review last week's weekly market update.

Craig Fehr

Craig Fehr is a principal and the leader of investment strategy for Edward Jones. Craig is responsible for analyzing and interpreting economic trends and market conditions, alc with constructing investment strategies and asset allocation guidance designed to help investors reach their financial goals.

He has been featured in *Barron's, The Wall Street Journal*, the *Financial Times, SmartMoney* magazine, *MarketWatch*, the *Financial Post*, Yahoo! Finance, Bloomberg News, Reuters, CNBC and Investment Executive TV.

Craig holds a master's degree in finance from Harvard University, an MBA with an emphasis in economics from Saint Louis University and a graduate certificate in economics from Harvard.

Read Full Bio

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Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

Market Data

DJIA 37,983.24 ↓ (-475.84)

S&P 500 5,123.41 (0.00)

NASDAQ 16,175.09 (0.00)

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