# Weekly market wrap

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# Tech saves the day while debate on rates continues

***Key points:***

- *Earnings took center stage last week with the spotlight on the Magnificent 7 stocks. Despite the high bar, companies have so far been able to rise to the occasion, helping the S&P 500 recover half of its April losses.*
- *Economic growth notably slowed in the first quarter, but the headline GDP miss is not as concerning as it first appears. Domestic demand continued to grow at an annualized pace of 2.8%, supported by solid growth in consumption, business investment and housing.*
- *The Fed's preferred measure of inflation confirmed the slow progress on inflation, which means that rates will stay high for longer. However, we think the bar is high for policymakers to resume hiking, and conditions may fall in place for rate cuts to begin possibly in September.*
- *Resilient economic growth, a reacceleration in corporate profits, and the Fed's bias to ease policy support the ongoing bull market. We recommend using periodic pullbacks to trim high cash allocations and redeploy capital into both stocks and bonds as appropriate.*

Between a barrage of earnings, the first-quarter GDP report, and the release of the Fed's preferred measure of inflation, investors had plenty to digest as markets continue to navigate a bumpy start to the second quarter. While new data flooded in, the narrative stayed largely unchanged in our view, and stocks recovered half of the April losses on the back of tech strength. Corporate profits are rising and the economy continues to chug along, though at a slower pace. But inflation pressures persist, driving rates higher. We think this backdrop remains favorable for equities, despite the higher volatility associated with Fed-policy uncertainty. However, it likely delays the rebound in bonds, which we think is still coming later this year. We offer our take on last week's developments, along with portfolio implications.

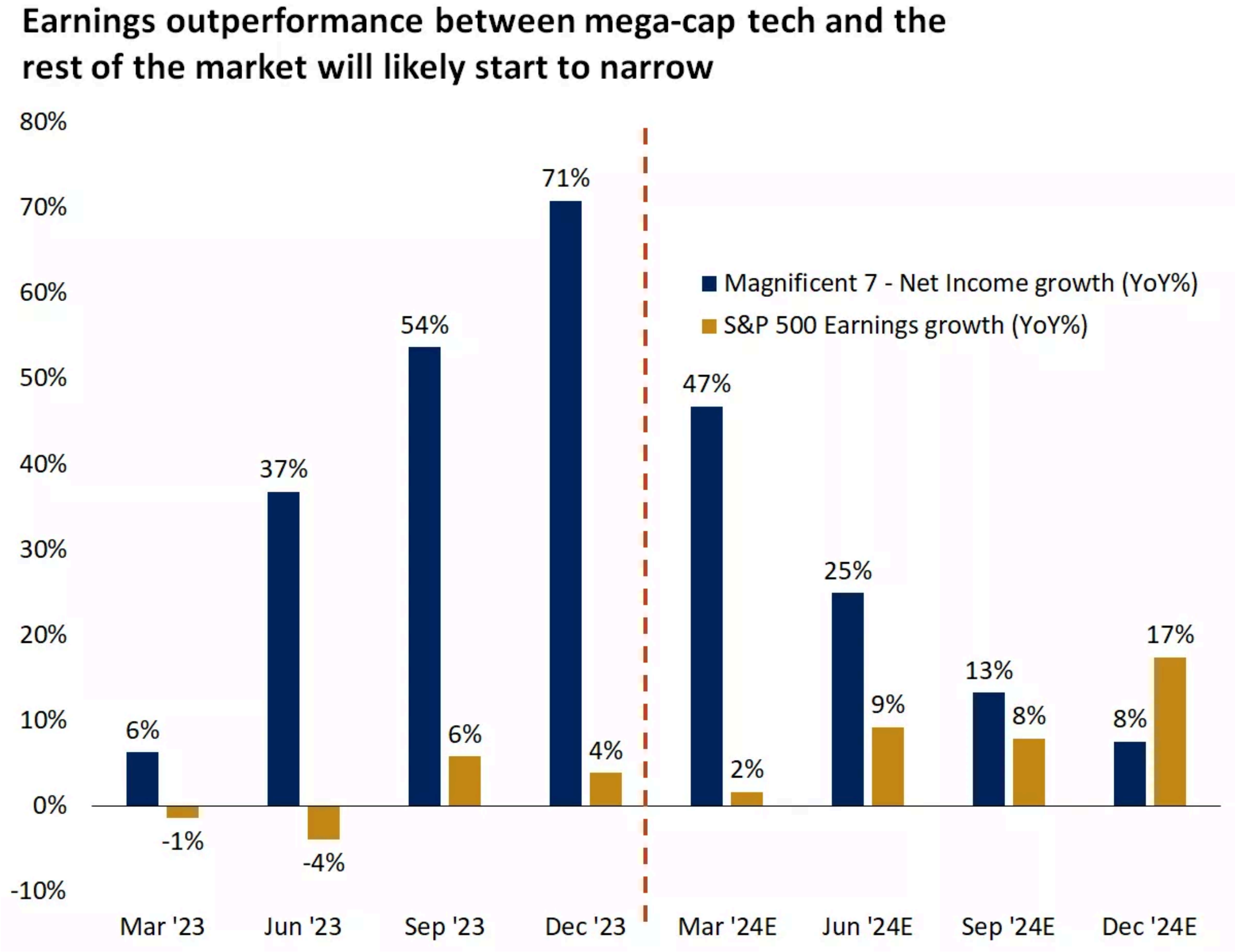
## 1) Magnificent Seven stocks under the microscope as first-quarter earnings roll in

Last week was the busiest of the earnings season, with about one-third of the S&P 500 companies reporting earnings, representing 40% of the index's market capitalization. So far results have been encouraging, with about 80% of the companies surprising to the upside and exceeding earnings expectations by 10%[1]. Given their outsized contribution to the index earnings, the spotlight was on the “Magnificent Seven” group of mega-cap tech names.

Profits for the Magnificent Seven are forecast to rise 47% in the first quarter from a year ago, comfortably exceeding the S&P 500’s 2% expected earnings growth[2]. Three of the four companies from the group that reported results last week moved higher (Tesla, Alphabet, Microsoft), with Alphabet being the standout after the company exceeded estimates and announced a dividend for the first time. But shares of Meta dipped, as the company delivered a lighter-than-expected revenue forecast while targeting higher capital spending to support AI.

**Our take:** Because valuations have risen over the past five months, the bar of expectations is high, and companies must deliver the earnings and outlook to support these valuations. The good news is that, altogether, companies have so far been able to rise to the occasion. For the full year, earnings estimates are holding steady, indicating that corporate profits are on track to grow a little over 10%, which would mark a meaningful acceleration from last year[2]. In our view, solid demand will continue to support revenue growth, while profitability might recover as input costs slowly moderate.

The mega-cap tech stocks have experienced a remarkable rally over the last two years, which, unlike the tech bubble, is not built on sand, as it has been driven by strong earnings growth. The opportunity in AI enablement and application appears to still have a lot of growth potential. However, the earnings outperformance and gap with the rest of the market will likely start to narrow in the back half of the year, supporting our view that the rally will broaden to other companies and sectors that have lagged.




*Source: FactSet, Edward Jones.*

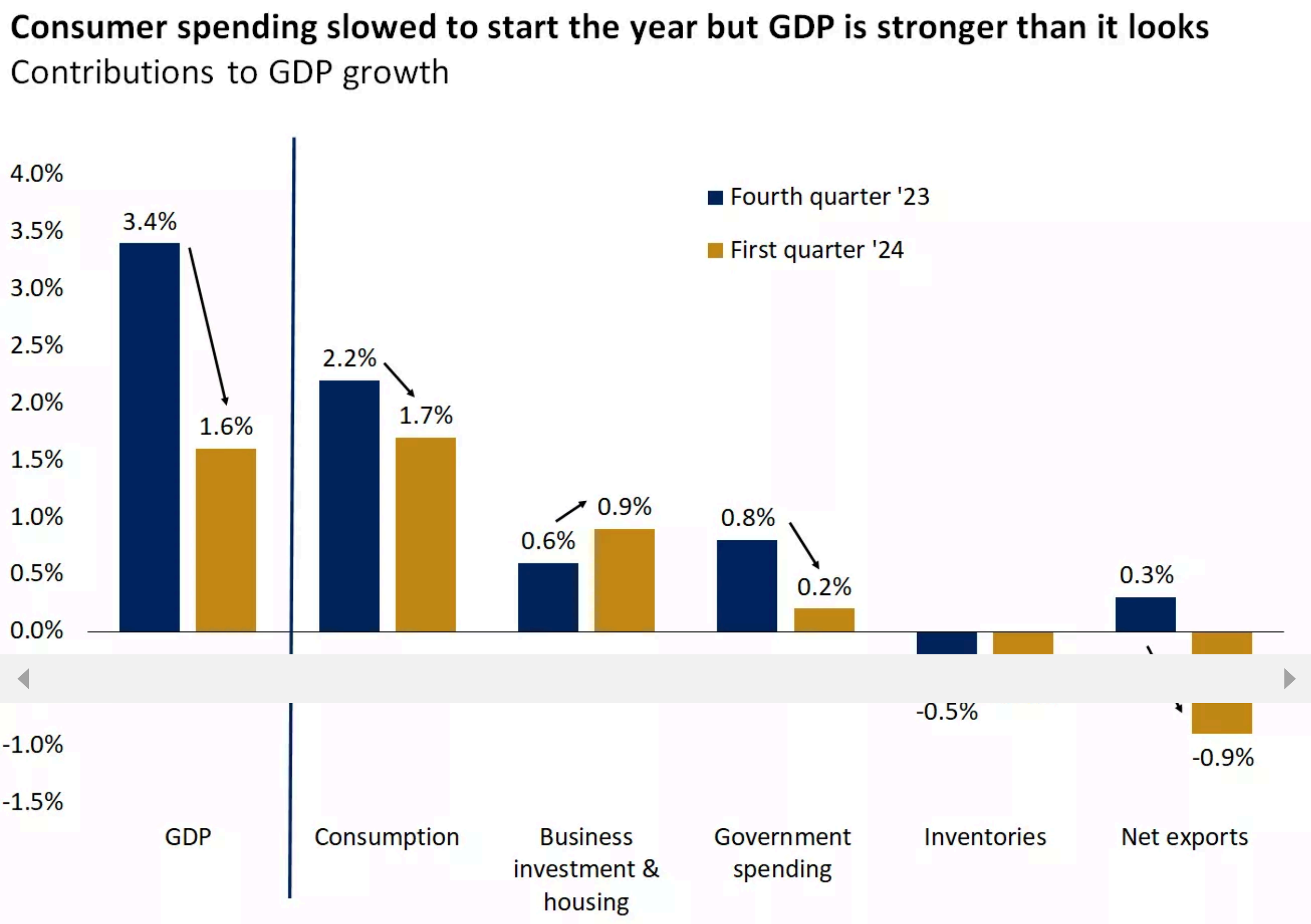
Chart description

## 2) First-quarter GDP slows, but details are better than the headline suggests

U.S. economic growth has been running above its potential of around 2% for the previous six quarters, but that positive streak broke in early 2024. The advance estimate of first-quarter GDP indicated that growth slowed notably to 1.6% from a 3.4% annualized pace, missing consensus expectations[2]. Partly responsible for the downshift was a cooling in personal spending, though consumption contributed a still solid 1.7% to growth. Spending on durable goods fell, with weakness in big-ticket categories possibly signaling some fatigue, as households are feeling the weight of high interest rates. But services consumption grew at its fastest pace in two-and-a-half years, suggesting that the consumer is not yet tapped out[2].

The bulk of the GDP miss came from foreign trade and inventories, both of which are volatile components, with the impact of the latter tending to even out over time. A smaller increase in inventories was a drag for the second quarter in a row, while imports grew much faster than exports, reflecting stronger domestic demand relative to weakness in the global economy and the headwind of a stronger U.S. dollar.

**Our take:** When looking under the surface, the headline GDP miss is not as concerning as it first appears. Domestic demand continued to grow at an annualized pace of 2.8%, supported by solid growth in consumption, business investment and housing[2]. After growing at a rapid pace in the second half of 2023, the economy is gradually slowing, which should help alleviate some of the upward pressures on prices. As household savings accumulated over the past three years are being depleted and the impact of prior rate hikes continues to filter through the economy, our expectation is that growth will settle between 1.5% - 2% in the back half of the year and early 2025, before potentially reaccelerating as the Fed easing cycle kicks in.




*Source: FactSet, Edward Jones.*

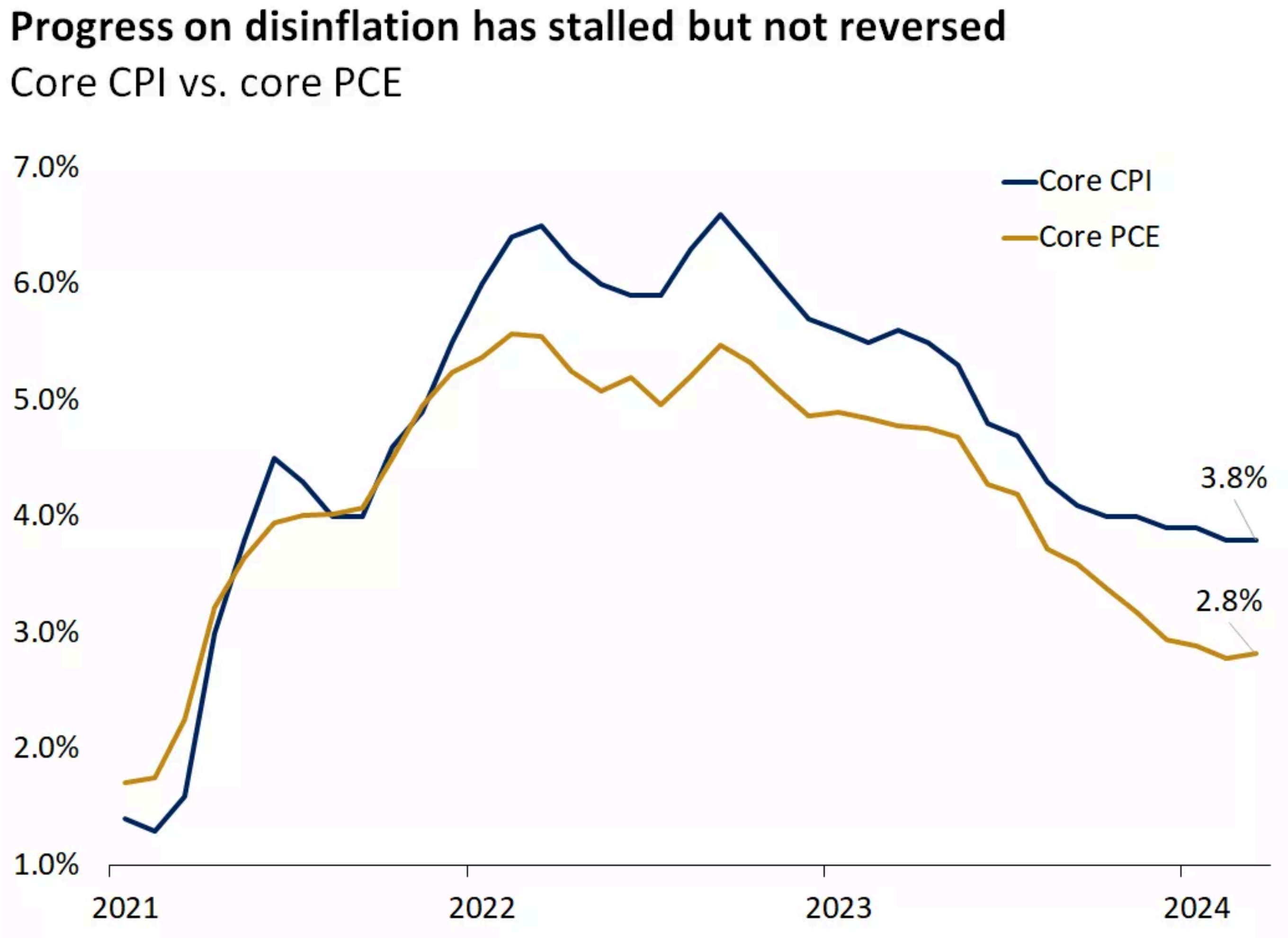
Chart description

# 3) Slow progress on inflation means rates will stay high for longer

The Fed's preferred measure of inflation, the core personal consumption expenditures price index (PCE), was the last key datapoint on prices to be released for the month of March, and it confirmed the message delivered by the consumer price index (CPI) a couple of weeks ago. Progress toward the Fed's 2% target stalled in the first quarter, which, together with a resilient economy, means that policymakers have every reason to be patient with rate cuts.

Core PCE, which strips out the volatile food and energy components, increased 0.3% from the prior month and 2.8% from a year ago, holding steady from February. While elevated, it is still one percentage point lower than the core CPI because of the lower weight in housing (18% share in core PCE vs. the 43% share in CPI)[2]. Nonetheless, the brisk pace of price gains in March does not instill the confidence the Fed was hoping to have by this time, when the last "dot plot" showed three rate cuts for the year.

**Our take:** In light of the recent data, the Fed is likely to reiterate at its meeting this week the recent messaging that it will be appropriate to hold in place the current restrictive policy for longer. But we think the bar is high for the Fed to consider rate hikes again. Our base-case scenario remains that inflation will slow in the months ahead, allowing the Fed to start trimming rates, possibly two times in the back half of the year. After three consecutive upside inflation surprises, investors are now extrapolating the same trend forward, but an eventual softening in rents and a deceleration in wage growth could once again shift the narrative. We expect the "last mile" of inflation to take longer and require some patience, but we see further progress ahead.




*Source: Bloomberg, Edward Jones.*

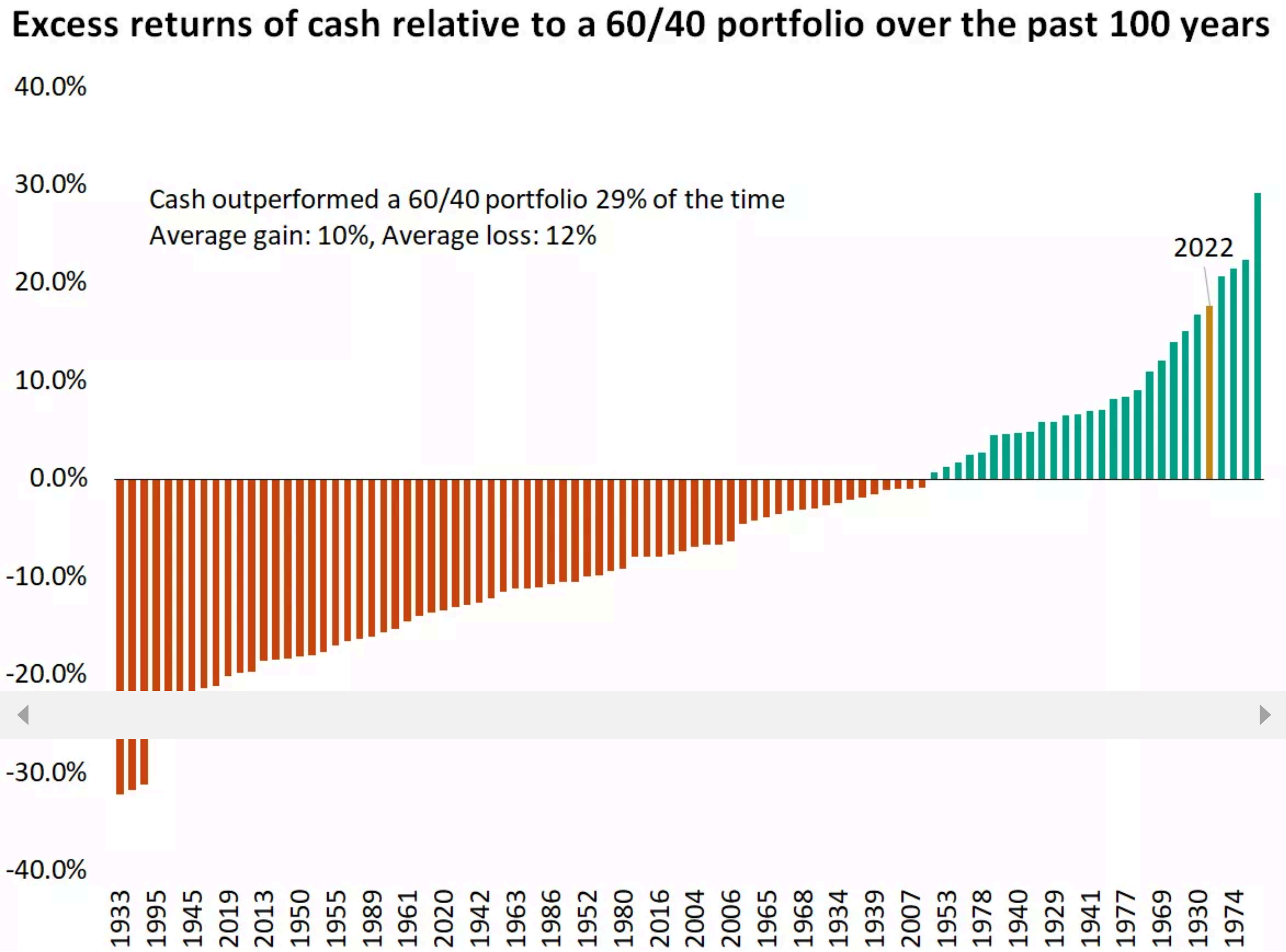
Chart description

## Portfolio implications

We have likely entered a choppier phase of the market, driven by uncertainty around the path of Fed policy. The pendulum has shifted from investors having an optimistic outlook on rate cuts earlier this year to now entertaining the resumption of rate hikes. We maintain our cautiously positive outlook for the year based on resilient economic growth, a reacceleration in corporate profits, and the Fed's bias to ease policy once a string of better inflation readings is established, likely by September. We recommend investors overweight equities relative to bonds as the bull market continues and seek opportunities to diversify equity holdings to segments of the market that have lagged and trade at lower valuations.

The rout in government bonds year-to-date, and more broadly over the last three years, has meant that cash has now outperformed investment-grade bonds over the past 10 years, which is a historical anomaly, reflecting the starting point of record-low yields in the early days of the pandemic and the Fed's aggressive tightening campaign[3]. A sharp rally in bonds is likely not in the cards until the Fed starts cutting rates, but the potential upside is greater than the downside, in our view.

We see an opportunity to start complementing cash with intermediate- and long-term bonds and equities as appropriate with investor's risk tolerance and time horizon. Having an oversized allocation to cash and CDs that currently have attractive rates carries a reinvestment risk, as Fed policy has likely already hit a peak. It also comes with an opportunity cost. Over the past 100 years, cash has outperformed a 60/40 stock/bond portfolio less than 30% of the time, with most of these times coinciding with recessions and bear markets, which are conditions we do not see over the next 12 months[3].




*Source: Morningstar Direct, Edward Jones*

Chart description

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***Sources: 1. Bloomberg, 2. FactSet, 3. Morningstar Direct, Edward Jones***

## Weekly market stats

| INDEX | CLOSE | WEEK | YTD |
|---|---|---|---|
| Dow Jones Industrial Average | 38,240 | 0.7% | 1.5% |
| S&P 500 Index | 5,100 | 2.7% | 6.9% |
| NASDAQ | 15,928 | 4.2% | 6.1% |
| MSCI EAFE* | 2,266 | 1.3% | 1.3% |
| 10-yr Treasury Yield | 4.67% | 0.1% | 0.8% |
| Oil ($/bbl) | $83.65 | 1.7% | 16.7% |
| Bonds | $95.33 | -0.1% | -3.3% |

*Source: FactSet, 4/26/2024. 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 the FOMC meeting and nonfarm payrolls report.

Review last week's weekly market update.

# Angelo Kourkafas

Angelo Kourkafas is responsible for analyzing market conditions, assessing economic trends and developing portfolio strategies and recommendations that help investors work toward their long-term financial goals.

He is a contributor to Edward Jones Market Insights and has been featured in *The Wall Street Journal, CNBC, FORTUNE magazine, Marketwatch, U.S. News & World Report, The Observer* and the *Financial Post*.

Angelo graduated magna cum laude with a bachelor's degree in business administration from Athens University of Economics and Business in Greece and received an MBA with concentrations in finance and investments from Minnesota State University.

Read Full Bio

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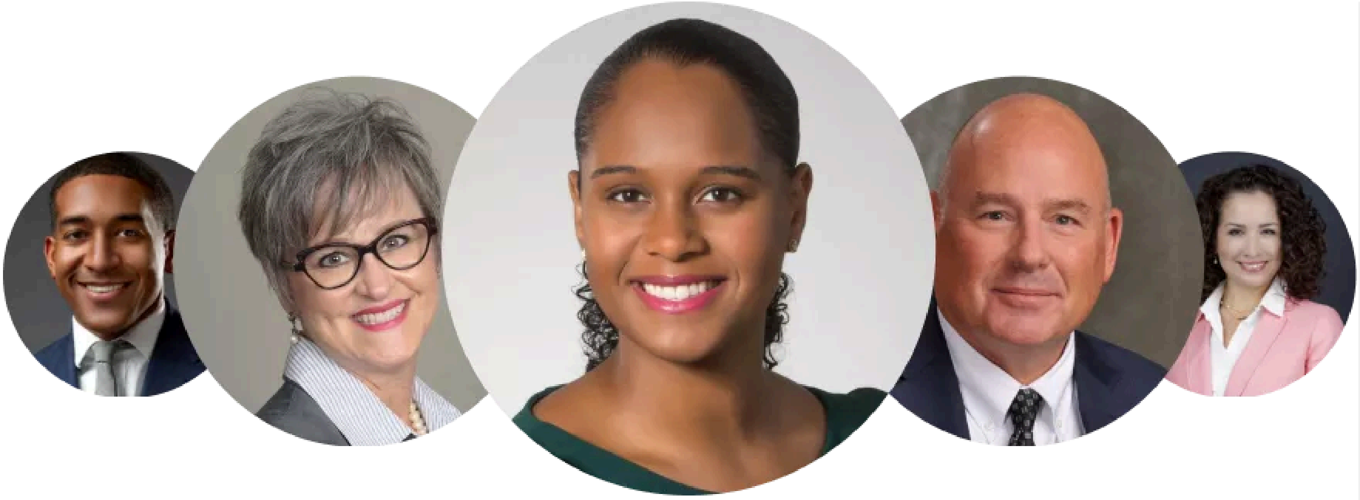

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The Weekly Market Update is published every Friday, after market close.

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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** 38,239.66 ↑ (+153.86)

**S&P 500** 5,099.96 ↑ (+51.54)

**NASDAQ** 15,927.90 ↑ (+316.14)

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