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Commerce Trust Market Brief with Scott Colbert
April 29, 2024

Scott Colbert: Good morning, it's Monday, April 29th, and the markets are open. Recall that the financial markets, particularly the equity markets, were exceptionally positive for the first quarter of the year, led by the S&P 500 (Index), which is up 10.5%. Bond market returns for the first quarter of the year, though, were slightly negative as interest rates were just beginning to nudge up. But April's been very difficult, tough on financial assets, as inflation worries have come back to bear, as well as a slower growth as measured by the gross domestic product (GDP) statistics that just came out last week.

For the month of April, so far, the S&P 500 has given up about 3% of its gains. Small-cap stocks have given up all their gains and are actually slightly negative now on a year-to-date basis. International stocks have given up about half their gains as well. And even with those interest rates rising now, the bond market is fairly negative.

On a year-to-date basis, the winner is still though the S&P 500, so far through April 26th, up 7.4%. Small-cap stocks (as measured by the Russell 2000 Index), (are) slightly negative. International large-cap stocks (as measured by the MSCI EAFE Index) are up 3%. And of course, the bond market, with the two-year Treasury note up about 75 basis points, (and) in line with a 10-year Treasury that has also risen about 0.75%, are negative. The broad-based investment-grade bond market is down 3.2%. Municipals are down about 1.7(%). So, a balanced portfolio, depending upon how much international stock you have or how many municipal bonds you have, is probably up in the range of 2.0–2.5% so far on a year-to-date basis.

So, what's causing all this turmoil in the financial markets? Well, it's primarily just two drivers: Number one would be weaker growth, as measured by the gross domestic product, and number two would be higher inflation statistics, as measured particularly by those personal consumption expenditures reports.

So, let's take a look at the gross domestic product and see if we're really cooling as much as the market thinks. Three quarters ago, we were growing at a 4.9% pace. Two quarters ago, we were growing at a 3.4% pace. And with the recent statistics that came out last week, the gross domestic product for the first quarter this year only grew at a 1.6% pace. This, of course, raises recessionary fears as we watch growth cool. But when we take a look at growth on a year-over-year basis, we see a much smoother rate of change. In fact, GDP on an annualized basis, whether three quarters ago, two quarters ago, or one quarter ago, were all within a 2.9–3.1% very tight range.

So, what do we have, a cooling economy or a relatively steady state economy? Well, we would lean much closer towards the steady state economy. Driving it behind the scenes is simply what? Continued job growth that's averaging about 1.5% incremental jobs per year. Plus, wage and salary growth, that's averaging about 4% per year. That provides about 5.5% more money coming into the economy on a year-over-year basis. You subtract out 2.5 or 3% inflation, and this is how you get this relatively steady 3.0 or 2.5% growth rate going forward. Basically, the compounded employment plus the wage and salary growth leads to an ongoing market expansion with no real signs, near term, of any recession on the horizon.

A further headwind to the markets in April has been sticky inflation. I think we all know that inflation has trended up a little bit as the year has progressed. We would suggest, again, like with the GDP reports, we take a longer-term year-over-year look at it. The CPI (Consumer Price Index), the core CPI, the Personal Consumption Expenditures (price index, or PCE), and the core PCE — the (Federal Reserve's) Fed's favorite measure of inflation — all average about 3.2% at the end of the year. Three months into this year, the trailing 12-month average is still an identical 3.2%. And we believe as the year progresses, you're basically going to get slightly less inflation as we work our way towards the end of the year, particularly because the housing component is beginning to pull inflation down a bit, wage and salary growth continues to cool, and by the end of the year, while we won't have made much progress on inflation, I don't think that it's going to be any worse than it is today.

So, while the markets have had to face some sticky inflation and possibly some cooler growth, there's still other headwinds ahead that we have to work our way through. The Fed has a meeting this week and is likely to provide a very hawkish tone. We've certainly got the election that's going to put a lot of bounce into the markets. And of course, we've got all the geopolitical events going on a day-to-day basis. We'll be back in several weeks to discuss all of those and how they're impacting your portfolios.

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