May 3, 2024

MARKET SIGHT LINES

Inflation, the Federal Reserve, and Higher for Longer Trigger Weak April Market Performance

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My team and I publish our work on stifelinsights.com, including our Monthly Market Perspectives, which provides a snapshot of last month's performance and a summary of the related market performance drivers. As our readers know, we're tracking sticky inflation, Federal Reserve (Fed) policy, and the economic and market implications of market interest rates being higher for longer. This has been an important week, with the Fed concluding its latest meeting. So, in this latest Sight|Lines, we review inflation, economic results, the Fed's policy update, and how those forces influenced April market performance.

THE TAKEAWAY: FIRM INFLATION, SOFT GDP, AND A HAWKISH FED COOL THE MARKETS

Inflation remains sticky, GDP disappointed, and the Fed's still hawkish, all leading to weaker markets in April. In summary:

- Three important measures, the consumer price index (CPI), the producer price index (PPI), and the personal consumption expenditures price index (PCE) have remained firm, running above the Fed's 2% target.
- The first estimate of first quarter GDP disappointed, coming in lower than expected.
- The Fed left its hawkish policy unchanged and updated its monetary policy statement.
- Market participants have accepted "higher for longer," losing hope about the number of Fed rate cuts and driving the 10-year Treasury yield higher.
- Equity markets posted negative April returns, giving back some of the first quarter gains.
- Bond markets also posted negative returns, as higher interest rates pushed prices lower.
- We've been watching for a slowdown, and while we don't foresee a recession soon, investors should prepare for a slowing economy and more muted market performance.

IN-DEPTH: INFLATION HAS REMAINED FIRM, FIRST QUARTER GDP DISSAPPOINTED, AND THE FED HAS REMAINED HAWKISH, ALL FORCES COOLING THE MARKETS

Recent inflation reports show inflation remains sticky, while first quarter GDP disappointed and the Fed is maintaining its hawkish policy. These forces led to weaker markets in April. Going deeper:

- The CPI, PPI, and PCE have been running above the Fed's 2% target:
  - The CPI and core CPI averaged 0.38% and 0.37%, respectively, for the three months ended March, compared to 0.17%, the monthly equivalent of the Fed's 2% target.
  - The PPI and core PPI have averaged 0.357% and 0.341% over the same period.
  - Finally, over that period, the PCE and core PCE averaged 0.361% and 0.362%, respectively.
- The first estimate of first quarter GDP disappointed:
  - First quarter GDP has been estimated at 1.6%, well below the consensus view of 2.5%.
- The Fed left its hawkish policy unchanged:
  - The statement was updated to add that "there has been a lack of further progress toward the Committee's 2% inflation objective."
  - Chair Jerome Powell said it will take longer for the Fed to start cutting rates.
- Market participants have accepted "higher for longer":
  - Fed funds futures are signaling one to two cuts in 2024, compared to six as we started the year.
- Equity markets posted negative returns in April:
  - The S&P 500 fell 4.1%, with the VIX Index averaging 20.3 versus 13.7 in the first quarter.
  - The Bloomberg 2000, a small cap index, fell 6.5%.
  - The "Magnificent Seven" outperformed on a relative basis, falling 2.8%, but there was dispersion.
- Bond markets also posted negative returns, as higher interest rates pushed prices lower.
  - The 2-year U.S. Treasury rose 42 basis points (bps) to 5.0%, while the 10-year rose 48 bps to 4.7%, leading to a Bloomberg Aggregate Bond Index return of -2.5%.

CONCLUSION

The Fed remains hawkish to rein in inflation, investors are accepting "higher for longer" interest rates, and markets turned negative in April. We've been watching for a slowdown, and while we don't foresee a recession soon, investors should prepare for a slowing economy and more muted market performance from here.

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