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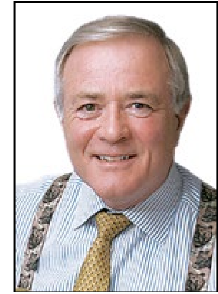
William Rutherford

April bears chase off March bulls; interest rate cuts still paused | Opinion

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The U.S. stock market took a breather in April from its seemingly relentless upward momentum. A technical indicator that signals conditions in the stock market are “overbought” — a term traders use to describe when stocks are trading above fair value — had been flashing for four months. This price momentum indicator moved to overbought in November 2023 and stayed that way through March. The previous record of 60 straight overbought closes was reached in April 1998.

The combination of higher-than-expected inflation rates, below-expectation GDP numbers and the highest levels of interest rates in 23 years raised fears of a slowing U.S. economy — even the possibility of stagflation in coming months — and spooked the market. The S&P 500 was down 4.16 percent in April, bringing its year-to-date return to 5.57 percent, after having posted its best first-quarter performance since 2019. The Nasdaq and Dow dropped 4.4 percent and 5 percent, respectively, for the month.

In April, the U.S. Commerce Department reported that economic growth was much weaker than expected in the first quarter, and prices rose at a faster pace. Gross domestic product (GDP) increased at a 1.6 percent annualized pace, adjusted for seasonality and inflation, according to the Bureau of Economic Analysis. Economists surveyed by Dow Jones had been looking for an increase of 2.4 percent following the 3.4 percent gain in 2023’s fourth quarter and 4.9 percent in its third quarter. First-quarter growth in 2023 was 2.2 percent, so seasonality is a factor in the lower number year to date.

On May 3, the April jobs data — nonfarm payroll increases — came in at 175,000 versus 240,000 expected and followed 300,000 reported in March. The unexpectedly lower number caused yields to fall in anticipation of the possibility of stimulatory rate cuts, and the stock market surged again.

Public-sector employment growth slowed in April, yet public services, health care and social assistance (all transfer-payment jobs as opposed to productivity enhancers) still accounted for over 50 percent of job openings. In Oregon, California and Illinois, these sectors account for more than all net new jobs. That means those states are likely losing jobs in other industries.

This type of job growth is still partly the result of federal pandemic and infrastructure payments.

Service jobs at the low end of the wage scale also grew. Economists postulate that immigration is driving employment growth in services, moderating overall wage-growth numbers and stimulating the economy. Unemployment in April barely ticked up to 3.86 percent from 3.83 percent in March, while the labor participation rate held steady at 62.7 percent. Unemployment has now been below 4 percent for 27 months — the longest stretch since the 1960s.

The healthy jobs market has allowed the Federal Reserve time to focus on its key goal of taming inflation. The Fed's campaign to lower inflation still has a way to go. The Labor Department's Employment Cost Index (ECI) rose by a seasonally adjusted 1.2 percent in the first quarter from the previous three months, and 4.2 percent from a year earlier. The ECI measures the change in the hourly labor cost to employers over time. Higher wages flow through to costs to consumers and businesses, thereby fueling inflation. The core PCE (Personal Consumption Expenditures) price index, the Federal Reserve's preferred cost measure, came in at 2.8 percent — unchanged since March, but higher than the 2.6 percent forecast. These data points suggest that inflation, while much lower than a year ago, is still running hotter than the central bank would prefer. Consumer prices have increased more than Wall Street had expected for three months in a row. The stock market did not take the wage and cost pressure well in April.

The good news is that the Fed, at its policy meeting on May 1, communicated that rates will not change in the first half of the year, so the market is having time to digest the progress on the inflation front. Investors entered the year expecting as many as six rate cuts in 2024; now many doubt there will be any cuts at all. The benchmark federal funds rate remained steady at its highest level in more than two decades. Fed Chairman Jerome Powell seems to want to cut interest rates, but the data does not support this. The funding of the deficit is going to continue to exert upward pressure on market rates. So, real rates may be where they should be.

The U.S. economy by many measures is doing great. About 80 percent of earnings reported for the first quarter were above consensus estimates. There is evidence that the government's statistical system is undercounting employment and income among recent immigrants, meaning recent personal income growth is stronger than the numbers show and that the true savings rate is also higher. Many industries are adding jobs. Along with wage growth, that has encouraged labor market participation.

Earnings season has been a particularly bright spot amid the recent gloom. Looking at reported results for the first quarter, total S&P 500 earnings were up over 5 percent from the same period last year on 3.9 percent higher revenues, which follows the 6.8 percent earnings growth on 3.9 percent higher revenues in the fourth quarter of 2023. Communication services earnings were up 34.4 percent, utilities up 23.9 percent and the technology sector up 22.2 percent for the first quarter, compared to the same period a year prior. The increases for the

technology sector are despite some noteworthy plunges in stock prices for individual companies not meeting analysts' high expectations. Health care and the energy sector earnings dropped notably in the quarter.

This data (combined with consumer spending and jobs numbers) points to a growth outlook, even as the wall of worry grows. Estimates for corporate earnings forward remain steady and will remain so if jobs and employment stay strong, although some multinationals may get impacted by the robust dollar. Inflation is below 3 percent, employment is strong, and bank balances are still above pre-pandemic levels. However, there are some indications that consumers are becoming more selective in their spending. Many voters think the economy is not doing well, which will impact the November election. According to the IMF, the U.S. is set to grow at 2.7 percent this year — double the rate of its G7 peers. The risk is that the Fed lowers rates to stimulate the economy when it doesn't really need to. Fiscal spending, immigration, demand for housing and health care, technological innovation, and a consumer with money to spend are all doing the job. The next Fed and CPI reports providing updated results will be June 11-12.

A popular Wall Street adage, "sell in May and go away," reflects the fact that the six-month period from May through October has historically been a relatively weak stretch for the market. In fact, since 1990, the S&P 500 has averaged only about a 2 percent annual gain from May through October compared to a 7 percent annual gain from November through April. Yet as the world experiences more turmoil, individuals and countries seek the relatively safe haven of the dollar, adding to the demand for U.S. securities.

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