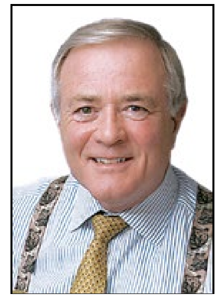
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON


William Rutherford

Bulls return; Fed, European Central Bank face divergent paths

Published Jun 7, 2024

This was not the May to follow the conventional wisdom of "Sell in May and go away." The ongoing news about the power of generative artificial intelligence (AI) to disrupt so many aspects of the work and leisure worlds fueled continuing optimism among traders and investors who had been sitting on the sidelines, hoping for a pullback.

The Dow closed out the month with a monstrous, late-day rally, rising almost 575 points, or 1.5 percent, for its best day of 2024. This move reversed the drop on May 23 of 600 points, or more than 1.5 percent, on the Dow's worst day since March 2023. This decline in 2024 was primarily due to a 7.6 percent drop in Boeing (BA) shares following an announcement of delayed plane deliveries.

Despite the eleventh-hour gains on Friday, fueled by the release of key inflation data that reassuringly met expectations, all three indexes lost ground over the week. The Nasdaq fell 1.1 percent on the week, snapping a five-week streak of gains. The Dow and S&P 500 lost 1 percent and 0.5 percent, respectively. Yet the month remained a good one for all the indexes, with gains of 2.3 percent for the Dow, representing almost all its gains for the year, 4.8 percent for the S&P, and 6.9 percent for the Nasdaq. Year to date as of month end, the Dow was up 2.64 percent, the S&P 10.64 percent, and the Nasdaq 11.48 percent. On May 17, the Dow closed above 40,000 for the first time ever; but it ended the month at 38,686.

Stocks slid from record levels as interest rate worries dominated investor sentiment after blockbuster earnings by Nvidia (NVDA) failed to spur a broader market rally. The gap between Nvidia's 20 percent rise in share price in the three days following its earnings release and the S&P slip was unprecedented. Nvidia's shares topped $1,000 for the first time after the AI bellwether blew past Wall Street's sky-high forecasts for first-quarter earnings. The chip giant also raised its guidance, easing fears that AI demand might be losing steam. Other chipmakers and AI-related stocks rose higher on the coattails of the results. Nvidia's market capitalization was $2.7 trillion at the end of May, a meteoric rise for a company of its size that was valued at $1 trillion a year ago and first surpassed $2 trillion in February. On June 5, it reached $3 trillion.

The month-end rally in all three indexes occurred as core inflation, which excludes energy and food prices, was reported Friday as rising 0.2 percent in April and 2.8 percent over the year.

This report of the Fed's preferred measure of inflation was in line with expectations, easing fears that price increases are reaccelerating and reviving hopes for interest rate cuts this year.

May employment numbers, due for release June 7, after this column was submitted, will have a major impact on this decision. If unemployment creeps above 4 percent, there will be pressure to ease. The rate reported in March was 3.4 percent and the one reported in April was 3.7 percent. U.S. job creation remained solid in May, with an increase in payrolls of 339,000, and revisions to March and April adding 93,000 additional jobs. Over the past three months, monthly job gains have averaged 283,000, a pace that is consistent with a strong labor market supported by robust job creation.

The S&P Global Purchasing Managers Index (PMI) for May came in at 54.4 versus 51.3 the previous month. The flash reading, which came in higher than economists had expected, showed business activity accelerated at the fastest pace in two years, despite the Fed keeping interest rates "higher for longer" to contain price pressures. The first quarter of 2024 saw S&P 500 companies experience their best earnings season in nearly two years, with profits up about 6 percent over the prior year and margins strengthening. All 11 S&P sectors beat expectations, and eight posted profit growth. The next key corporate earnings releases will be in early June.

The U.S. economy remains robust, with annualized real GDP expanding by 2.9 percent in the past four quarters. This contrasts markedly with projected growth for 2024 of 1 percent in the EU and 0.8 percent for the Euro zone, a major U.S. trading partner. Europe has seen its industrial growth hamstrung by higher energy costs and sanctions on exporting to Russia. The European Central Bank has announced a rate cut, which will pressure the U.S. to do likewise so as not to weaken the Euro against the dollar. Most of the payments globally for energy are made in dollars, so a strong dollar is particularly problematic for politicians in western Europe who, since Russia's invasion of Ukraine, are relying much more heavily on U.S. energy imports.

The U.S. Federal Reserve is data dependent, and the data have neither been corresponding to the forecasts nor supporting rate cuts. Since the economy and employment have remained strong, the Fed currently has the luxury of waiting out inflation, while our European partners do not. While it would reassure the equity markets, which tend to rise as rates fall, a cut of 25 basis points would do very little to stimulate investment and jobs creation. Meanwhile, little noticed has been the Fed's announcement in early May of its intention to ease the shrinking of its balance sheet, which has gone from $9 trillion at its peak to $7.3 trillion, by rolling off $25 billion in Treasuries per month compared to over $60 billion per month previously. A smaller Fed balance sheet would remove some of the inflationary pressure of the generous monetary stimulus – some $34 trillion in national debt – still buoying the economy. Despite this early May announcement of easing the easing, they still retired almost $120 billion in Treasuries in May.

As long as the U.S. consumer has a job and continues to spend, and software-based, capital-light businesses, not dependent on high borrowing costs, continue to boost economic growth, the U.S. stock market should be able to ride the relentless waves of monthly jobs, inflation and economic data reports.

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