Market analysis | May 13, 2024

At a glance

Equities shrugged off signs of consumer weakness, inching higher last week as sector performance broadened. Attention turns to inflation data this week, with investors pricing potential Federal Reserve interest rate cuts.

Number of the week

18.8%

The gain of the Communication Services sector so far in 2024 through May 10.

Term of the week

Communication Services sector: This sector includes social media companies, internet search firms, video game makers, telecom providers and streaming media. Companies in this sector include Netflix, Facebook parent Meta, Google parent Alphabet, AT&T and Verizon.

Consumer confidence tumbled in May, posting its biggest decline since mid-2022 in the Michigan Consumer Sentiment Index. Higher gas prices, volatile equity markets and geopolitical uncertainty weighed on consumer opinion. Additionally, consumers' inflation expectations inched higher, challenging the Federal Reserve's confidence in returning inflation to its long-term target rate.

***Robert Haworth**, CFA, Senior Vice President, Senior Investment Strategy Director, U.S. Bank*

Global economy

Quick take: Consumer confidence reflects ongoing inflation and geopolitical concerns despite robust spending. Higher interest rates and tighter lending standards are restricting household borrowing, which should help alleviate inflation pressures.

Our view: The global economy continues to see moderating growth, especially across manufacturing activity, and global inflation continues to decelerate. Despite higher interest rates, the U.S. Bank Economic Team sees conditions consistent with a soft landing in the U.S.

- **Consumer confidence tumbled in May**, posting its biggest decline since mid-2022 in the Michigan Consumer Sentiment Index. Higher gas prices, volatile equity markets and geopolitical uncertainty weighed on consumer opinion. Additionally, consumers' inflation expectations inched higher, challenging the Federal Reserve's (Fed) confidence in returning inflation to its long-term target rate.
- **Consumer credit growth decelerated in March**, with higher interest rates and tighter lending standards continuing to limit household borrowing. Non-mortgage consumer credit outstanding expanded by $6.3 billion annualized month-over-month in March, falling well short of consensus expectations for $15 billion and decelerating from a revised $15.0 billion gain during the previous month. Tighter lending standards are weighing on credit demand. According to the most recent Senior Loan Officer Opinion Survey, banks continued to tighten credit card lending standards in the first quarter, representing a headwind for consumer spending.
- **China's Consumer Price Index rose for a third straight month**, up 0.3% for the 12 months ending in April, led by services, a signal of improving domestic demand. China's central bank indicated a more flexible monetary policy to promote a moderate increase in consumer prices to consolidate the economic recovery. Producer prices fell again, dropping 2.5% in April, led by weaker input costs. The decline has extended since September 2022. Imports rose 8.5% in April, the fastest pace since early 2022, perhaps indicative of rising demand.

Equity markets

Quick take: U.S. equities continue to inch higher on better-than-expected first quarter earnings.

Our view: Inflation, while still persistent, appears to be waning, interest rates are elevated but with downside bias and 2024 earnings projections are stable, all providing valuation support and a basis for stocks to trend higher.

- **Year-to-date performance is becoming more broad-based.** The S&P 500 ended last week up 9.5% for the year, with 10 of 11 sectors positive. Also noteworthy, breadth has improved, with six sectors up 10% or more, led by Communication Services (18.8%) and Utilities (12.3%).
- **Earnings projections for 2024 are inching higher,** providing valuation support. Analysts forecast S&P 500 2024 earnings of approximately $243 per share, according to Bloomberg, FactSet and S&P Cap IQ, reflecting 10% year-over-year growth. At current levels, the index trades at 21.5 times the 2024 estimate, at the high side of its 25-year historical average.
- **First quarter results are trending modestly above expectations.** As of Friday's close, 92% of S&P 500 companies have released first quarter results, with sales and earnings advancing 3.8% and 5.5%, respectively, above expectations of 3.3% for both. We are watching reports from big box retailers Home Depot and Walmart this week, and next week attention will turn to Target and technology bellwethers NVIDIA and Palo Alto Networks.
- **Key takeaways from first quarter releases reflect economic stability, supportive of a risk-on (more aggressive) bias.** Consumers and businesses remain in relatively good shape. Consumer spending trends are mostly stable, with continued emphasis on experiences over goods; lower-income groups appear more cautious and value conscious, evidenced by a pullback in away-from-home dining. Information technology spending by businesses remains robust, particularly on artificial intelligence products and services. "Vendor consolidation" is occurring, with companies continuing to maximize their technology spending. Companies in the Materials and Industrials sector are experiencing inventory de-stocking, and demand remains sluggish. Tight expense control is helping support profit margins and earnings.

Important disclosures provided on page 4

Bond markets

Quick take: Treasury yields held steady last week, with economic data remaining consistent with investor expectations for the Federal Reserve cut rates later this year. Corporate and municipal bond valuations remain somewhat elevated but steady, with riskier and higher yielding bonds outperforming so far this year.

Our view: Elevated bond yields offer reasonable compensation for inflation and Fed policy expectations, but further progress slowing inflation is still needed for the Fed to cut rates later this year. Slightly lower high-quality bond exposure can be used to fund allocations to equities and commodities that benefit from solid growth.

- **Loan officer surveys confirm high interest rates continue to slow credit demand.** The Fed's quarterly Senior Loan Officer Opinion Survey released Monday showed lending standards remain restrictive and loan demand is weak. This implies the Fed's monetary policy settings are gradually cooling economic activity, which should help slow inflation. Wednesday's Consumer Price Index data will provide a useful update on inflation pressures through April. Market interest rates indicate investors expect the Fed to start cutting rates in September or November of this year.
- **Solid fundamentals support elevated corporate and municipal bond valuations.** The extra yields on corporate and municipal bonds over Treasuries remain below historical averages. Lower yield spreads over Treasuries offer less cushion to offset losses when bond issuers default, but corporate and municipal credit fundamentals remain solid. Some weaker issuers have struggled with higher debt servicing costs, but strong earnings growth and expanding economic activity have supported the average issuers' credit health. Corporate and municipal bond issuance has also picked up in recent months, allowing issuers to extend debt maturities. Higher bond supply can pose a headwind to prices, but so far issuance has been met with ample investor demand. We prefer normal exposures to riskier corporate and municipal bonds and modest exposures to unique bond categories like reinsurance and mortgages not backed by the government, which can further boost portfolio income.

Real assets

Quick take: In a week of few catalysts, infrastructure assets and Real Estate posted results in line with the S&P 500. Commodities continued their strength, led by precious metals and agriculture products. All sub-sectors in the commodity market were higher on the week, though overall they were unable to keep pace with the S&P 500.

Our view: Diversified publicly traded real estate trusts remain inexpensive relative to private real estate. Tangible assets with stable cash flows present relative opportunities if currently strong investor sentiment erodes. Commodities can be compelling due to their potential for inflation protection.

- **Real Estate trailed the S&P 500 by 0.1% last week.** Industrial and residential companies posted the strongest returns while data centers and office companies fared the worst. Data centers were the only subsector to post negative results. Publicly traded real estate continues to trade at discounts to private markets (individual properties).
- **Infrastructure stocks beat the broader market by 0.2% last week.** Utilities and toll roads led gains while midstream energy and railroads detracted from performance. Utilities are now outperforming the S&P 500 for the year.
- **Crude oil prices rose a slight 0.3% last week.** Concerns about demand erased much of the early week gains that were based on lower U.S. inventories. Over a longer-term horizon, the crude market appears undersupplied, which should act as a tailwind to prices. However, we acknowledge downside risk to prices if tensions in the Middle East de-escalate or if economic growth disappoints.

This information represents the opinion of U.S. Bank. The views are subject to change at any time based on market or other conditions and are current as of the date indicated on the materials. This is not intended to be a forecast of future events or guarantee of future results. It is not intended to provide specific advice or to be construed as an offering of securities or recommendation to invest. Not for use as a primary basis of investment decisions. Not to be construed to meet the needs of any particular investor. Not a representation or solicitation or an offer to sell/buy any security. Investors should consult with their investment professional for advice concerning their particular situation. The factual information provided has been obtained from sources believed to be reliable but is not guaranteed as to accuracy or completeness. U.S. Bank is not affiliated or associated with any organizations mentioned.

Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning the construction of portfolios and how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes will be suitable for every portfolio. Diversification and asset allocation do not guarantee returns or protect against losses.

Past performance is no guarantee of future results. All performance data, while obtained from sources deemed to be reliable, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for direct investment. The **S&P 500 Index** consists of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general. The **Consumer Price Index** is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is one of the most frequently used statistics for identifying periods of inflation or deflation. The **Michigan Consumer Sentiment Index** is a monthly survey of consumer confidence levels in the United States conducted by the University of Michigan. The survey is based on telephone interviews that gather information on consumer expectations for the economy.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Investment in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issues of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults).