



Tech Stocks: Head Fake or Value Shift?

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The market is experiencing a healthy pullback as rate cut expectations are pushed back. We're on the cusp of the quiet period before the May 1st meeting, and all eyes were on Jay Powell's latest remarks. Despite a seemingly hawkish tone, he emphasized the Federal Reserve's (Fed's) dual mandate and signaled a readiness to adjust rates if the labor market weakens, as long as inflation doesn't worsen. This pragmatic approach is encouraging.

Fed funds futures suggest diminished rate hike expectations, hovering around a single cut this year. I believe we will get more than what's currently priced in. The Personal Consumption Expenditure (PCE) Price Index deflator is on the horizon, and I anticipate it will not be high. We're inching closer to the Fed's target for inflation, and I expect a dip in inflation to a three-year low on the core PCE index this week.

The narrative on the Consumer Price Index (CPI) should also improve, thanks to easing shelter costs and insurance premiums. With the Fed's long-term neutral rate indicated at 2.6%, and current rates more than double that, there's ample room for cuts.

The real economic data showed retail sales as very strong, dispelling any notions of a slowdown which prompted upward gross domestic product (GDP) forecast revisions. Housing starts presented a rare dip in an otherwise steady data stream, including jobless claims maintaining a stable trend. Manufacturing reports hint at a resurgence, also suggesting underlying economic strength.

Geopolitical developments brought some relief, with signs of de-escalation in Middle Eastern tensions and a consequent dip in oil prices.

This week, we look to the PCE deflator, durable goods orders, and the first estimate of Q1 GDP, which I expect to be in the high twos or perhaps over three as a result of the retail sales data. Additionally, an uptick in bank deposits may be reflected in the M2 money supply, data that I am monitoring closely.

On Friday, tech stocks and the Magnificent Seven suffered a severe downturn. The Russell 1000 Value Index rose relative to the Russell 1000 Growth by over 2.5%, the largest one-day change in three and a half years. Does this signal a shift to value, or just a "head fake" as has occurred so often in the past? It's too early to know. Despite the tech downturn, value has still greatly underperformed growth since the COVID-19 pandemic. Notwithstanding, I regard the resulting weakness as a healthy pullback, and expect the market to move to new highs.

But my short-term view, the near-term inflation outlook appears to be under control, with a trend towards moderation and the recent pullback from the high's leading to a healthy correction for the market.

Glossary

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Core CPI excludes food and energy costs.

Fed funds futures: Financial contracts that represent the market opinion of where the daily official federal funds rate will be at the time of the contract expiry. The futures contracts are traded on the Chicago Mercantile Exchange (CME) and are cash settled on the last business day of every month. Fed fund futures can be traded every month as far out as 36 months.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Hawkish: Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

M2 Money supply: Contains all funds deposited in checking accounts as well as funds deposited in savings accounts and certificates of deposit. There are various ways to measure the money supply of an economy. This one is meant to broadly account for the majority of savings and checking accounts held by individuals and businesses across the economic landscape.

Neutral rate: The short-term interest rate that would exist when the economy is at full employment and stable inflation.

Personal Consumption Expenditure (PCE) Price Index: A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The core PCE Price Index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

Russell 1000 Growth Index: A measure of the large-cap growth segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Russell 1000 Value Index: A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Past performance is not indicative of future results. You cannot invest in an index.

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