Weekly Commentary with Professor Jeremy J. Siegel

Navigating Economic Signals with Optimism

Monday, 5/20/2024

While the markets reacted to all the news last week positively, there were both some positives and negatives when looking at the data.

First the positives: the recent Consumer Price Index (CPI) inflation data was quite encouraging, suggesting a moderation in price increases. The details of the CPI report were also encouraging as one of the key elevated inflation metrics remains shelter inflation and I believe the actual shelter inflation trend is lower than the very lagged Bureau of Labor Statistics (BLS) shelter series. Substituting in more real time data shows both core and headline inflation readings about 2%—right on target for the Fed.

However, several real economic indicators have come in below expectations, raising some concerns about the overall health of the economy. This includes softer retail sales, housing starts, and manufacturing output.

GDP forecasts have thus been adjusted downward. While the initial estimates for Q2 gross domestic product (GDP) were overly optimistic, projecting growth in the 4's, we're now seeing revisions bringing expectations down to the low 3's or even upper 2's.

There was also a downward revision of Q1 GDP figures, but it's important to recognize the resilience in corporate earnings despite this softer economy. Companies have generally reported strong results, which is positive that businesses are managing margins well even with more sluggish economic growth figures. We could see a further boost to earnings if the current estimates for Q2 GDP come in on track.

One inflationary risk that caught my attention is the behavior of commodity prices. While oil prices have dropped from their highs, other commodities like copper have experienced big price increases. This is partly due to anticipated demand driven by developments in technologies such as artificial intelligence (AI) and green energy investments, both of which require significant amounts of copper. AI could have some deflationary forces over time but right now the commodity demand is worth watching along with various supply deficits for some critical commodities.

Looking at the technical aspects of the market, there is strong momentum that supports further gains in the short term. However, the fundamentals and particularly this recent softness in real data present a mixed picture. I wouldn't bet against the technical strength winning out in the short run. But it is important to monitor these fundamental economic developments closely, as they will play a crucial role in shaping the market expectations and central bank policies in the coming months.

Glossary

Commodity: A raw material or primary agricultural product that can be bought and sold.

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.

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.

Inflation: Characterized by rising price levels. Core inflation excludes the impact of food and energy. Headline inflation is a measure of the total inflation in an economy, including the prices of food, energy, and other wholesale products that households use daily.