Weekly Commentary with Professor Jeremy J. Siegel

A Slow but Steady Path

Monday, 5/6/2024

The markets rightly experienced a significant relief last week following economic data and commentary from the Federal Reserve (Fed) that eased rate fears heading into the Fed meeting.

Firstly, Chair Jay Powell downplayed the outside risk of a pivot towards rate hikes. He set a tone of patience and emphasized the Fed's current approach of waiting for more definitive signs of inflation trends before making further adjustments, particularly noting the behavior of rental indices which are crucial for assessing inflation but are only adjusted as tenancies change, suggesting a slow but steady path to lower rates.

The Employment Cost Index, which presented a slight uptick, was counterbalanced by encouraging figures from the average hourly earnings report on Friday. Wages increased by only 0.2% month over month, bringing the year-over-year rate down to 3.9%—the lowest since June 2021. This data provided reassurance that wage-driven inflation pressures are moderating. Powell also emphasized, like I do, that productivity growth is a key mitigator for wage gains and only wage gains in excess of productivity is an inflationary concern. While productivity numbers reported for Q1 were disappointing, I think the trend of productivity growth is on an encouraging upturn with strong gross domestic product (GDP) expected in Q2.

There were two small areas of concern in the data last week. The ISM Manufacturing Index reported price increases, indicating that price pressures, while eased in some sectors, remain present in others. This was similarly reflected in the service sector, where on Friday the ISM Services PMI prices continued to rise.

Looking forward, the markets are now again pricing in the possibility of one to two rate cuts later in the year. While many have pushed back the rate cutting cycle to September, I still think it is quite possible for the June meeting to tee up a future rate cut at the July meeting if the inflation data comes in cooler.

Earnings results have been mixed but generally positive, reflecting the resilience of corporate America. Notable tech giants and consumer-oriented companies have surpassed Wall Street expectations. However, there have been outliers like Starbucks who has struggled, particularly in China. Overall, the earnings season supports the markets gains thus far.

In summary, the market rose for good reasons last week. Yields fell as the worst fears for the Fed were not realized. The Fed's current stance of cautious optimism underscores the balancing act of promoting economic growth while preventing inflation, the key theme which is likely to dominate market sentiment in the coming months.

Glossary

Employment Cost Index: A quarterly measure of the change in the cost of labor for employers over time.

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.

ISM Manufacturing Index: A monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms. It is considered to be a key indicator of the state of the U.S. economy.

ISM Services PMI: A monthly economic indicator that measures the performance of non-manufacturing companies in the United States.

Yield: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.