Weekly Market Insights

June 17, 2024

U.S. Markets Continue Ahead

Financial Markets

United States equity markets continued their advance this past week. They appeared determined to gain ground, even in the face of a slightly hawkish update from the Federal Reserve. Perhaps even more surprising was the rally seen in the fixed income markets. For the week, the S&P 500 gained 1.58%, the NASDAQ gained 3.24%, while the Dow fell 0.54%. Also of note, investors were seemingly inspired by Apple's generative AI announcement, closing the week up a remarkable 7.92%.

Economics

The International Monetary Fund (IMF) recently published an interesting study about two subjects we have written quite a lot about—the future of the U.S. dollar as the world's reserve currency and global trade subsidies. We continue to believe that the U.S. dollar will maintain its place as the world's reserve currency. While there has been a lot of talk about BRICS,[1] there has been very little movement towards the BRICS basket reserve currency. The dollar faces minimal competition; stability, ample liquidity, and predictability are the primary reasons why. Unsurprisingly, the IMF's conclusion was that there really is no realistic alternative.

The subject of trade subsidies is very interesting. Not long ago, almost all economists would have said that trade subsidies are a detriment to global economic stability. Backed by the idea of comparative advantage, subsidies have always been considered inflationary. That is, subsidies disrupt the economic model where each country produces what it does best and most efficiently. Despite its standing as a fundamental economic theory, comparative advantage has been called into question as of late. One reason is there have been rapid advances in technology, particularly in the areas of production and transportation. Remember, the theory was put forth in the early 1800's. Another reason is the prioritization of supply chain stability and national security over cost efficiency. The debate continues.

Elsewhere, India is entering debatably its most important period since Partition in the mid-1900's. Interestingly, the current problem is a holdover from those events so long ago. For those who need a reminder in history, the Partition of India was when the British Raj dissolved, and the subcontinent was divided into the countries of India and Pakistan. The two nations were separated along religious lines—Hinduism and Islam—with India being Hindu and Pakistan Muslim. Unsurprisingly, religious conflict continues to this day. Fast forward to the recent elections in India, it was thought that Prime Minister Modi's Bharatiya Janata Party would have an overwhelming victory, but this was not to be. This outcome may prove to be divisive, or it could be a great opportunity for India's political and economic advancement. If Prime Minister Modi can learn to rule by coalition and concession, it will go a long way in transforming India into the economic power it has the potential to be.

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[1]BRICS is an intergovernmental organization comprising of Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia, and the United Arab Emirates.

Conclusion
With some exceptions, the global economy remains on a positive trajectory. At the very least, there doesn't seem to be any clouds in the immediate future. However, the political environment is a different story. In Europe, there is a general mood of discontent, with France being the poster child for this movement. Of course, the presidential election is picking up steam domestically, and we are sure to have more to say on this topic in the weeks and months ahead.

Yield Curve Update
Yields declined significantly this past week, driven in large part by encouraging inflation data and a monetary policy update from the Federal Reserve. Relative to the prior week, the 2-year Treasury yield declined 18 basis points, while the 10-year yield declined 21 basis points. The yield curve inversion increased slightly to 48 basis points.

The first catalyst for yields came on Wednesday morning with the May release of the Consumer Price Index (CPI). Both the headline and core measures were reported below expectations and showed that price increases slowed from the previous month. Importantly, disinflation was relatively broad-based with energy and car insurance offering notable sources of *deflation*. Car insurance prices in particular had experienced a prolonged period of significant month-over-month price increases, so the latest month's decline was a welcome sign. Yields plummeted following the CPI release,[2] fueled by hopes that the encouraging inflation data may convince the Fed to soften its "higher for longer" monetary policy stance.

Yields reversed course later that afternoon with the conclusion of the Federal Reserve's May meeting. While the Fed held rates steady, as expected, the Committee made a hawkish update to their interest rate forecasts.[3] Specifically, the updated forecast called for just one interest rate cut this year, down from three in March, though the cumulative easing expectations remained unchanged. That is, cuts previously penciled in for 2024 were pushed into 2025 and 2026, but, in total, officials see the Fed Funds rate settling at the same level as they did back in March. In his press conference, Chairman Powell stressed that the Committee is looking to gain further confidence that inflation is moving sustainably down towards their 2% target, and that members are relying on the economic data in the weeks and months ahead for confirmation.

The CPI print was certainly a step in the right direction for Fed officials in gaining that confidence, and Thursday's economic releases only furthered that progress. The headline Producer Price Index (PPI) unexpectedly declined month-over-month, and the core PPI came in cooler than expected. Additionally, initial jobless claims ticked higher, providing another signal that the labor market is continuing to come into better balance. Taken together, this week's economic data fell in line with what the Fed is hoping to see to move forward a September cut, and yields reacted accordingly.

[2]The 2-year and 10-year yields each fell be about 15 basis points following the CPI release.
[3]The Summary of Economic Projections (SEP) offers insights on each participant's assessment of the appropriate path for monetary policy given their respective economic outlooks.

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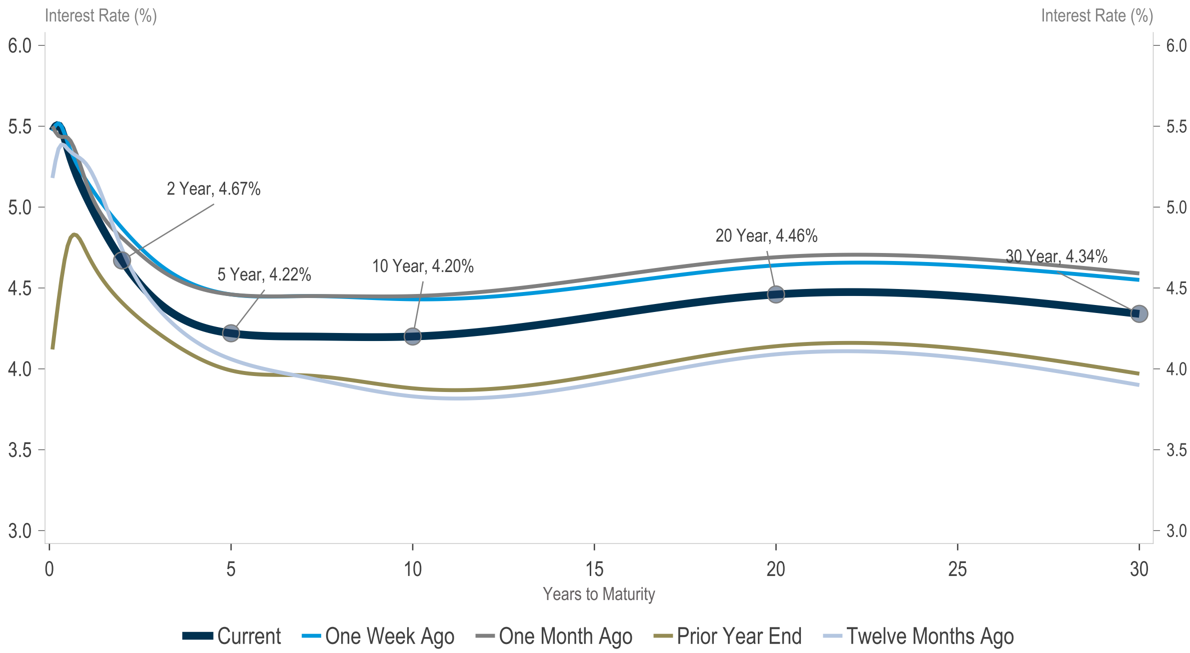
Yield Curve

Interest Rates for U.S. Treasury Securities by Maturity Date



U.S. Department of Treasury, Daily Treasury Bill Rates Data
Data as of 6/14/2024

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