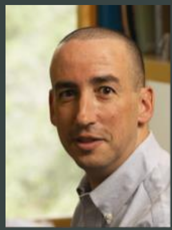

MARKET UPDATE

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Market Update – April 1, 2024

I. Markets

A. Stocks

1. Last week: DJIA +.84%; **S&P 500 +.39%**; Nasdaq -.3%
    a. S&P 500 is up 27% from its Oct. 27, 2023 low
    b. In past five years, 21 declines of 5% and five 10%+ corrections (MarketWatch)
    c. Reddit jumped almost 50% and Astera Labs more than 70% on first day
2. **VIX** closed at 13.01:
    a. Are we ignoring danger?
    b. Is volatility being artificially suppressed by funds selling volatility
    c. Low correlation between single stocks (Barron's)
3. **S&P 500 +10.2% in Q1** with 22 record closes (most in Q1 since 1998)
    a. Since 1950, this has happened 16 times (Q1 of 8%+)
        i. 15 of those years, gained 9.7% more in following three quarters
        ii. 1987 was exception (Barron's)
    b. Gold (+8%), Bitcoin (+66.5%) and WTIC (+16.1%) all higher
4. **Positive themes**: decent Q4 earnings, strong corporate sentiment, optimistic investors, soft-landing hopes, rate cuts, AI, consumer travel demand, infrastructure growth, breadth improvement (Bl.)
    a. **AI challenges**: requires large amounts of water and energy, copyright and content ownership issues, integration of AI (and worker displacement) (FT)
5. **Concerns**: sticky core services inflation, stretched positioning, CRE
    a. Common view is that sentiment is stretched, pullback overdue
        i. S&P 500 ~14% above 200-day moving average
        ii. Earnings expectations for 2024 dropped from 11% to 9%
6. **Russell 2000** +34% since start of 2020 vs. ~74% for S&P 500 (IWM vs. SPY)
    a. Weak balance sheets and low pricing power
    b. 40% of Russell 2000 debt is short-term/floating vs. 9% for S&P 500
    c. Q4 earnings for Russell 2000: -17.6%; 30% are unprofitable (FT)

B. Bonds and Rates

1. In **Q1**, 10-year UST yield rose from 3.88% to **4.20%** despite belief in Fed cutting rates
    a. Higher inflation has led to a belief that rates will be higher in future
    b. Greater supply of bonds in future (WSJ)
2. The **UST market has grown** more than 60% to $27T since 2019
    a. Deficits expected to continue; aging Boomers; rising rates
    b. T-bills now 22.4% of debt outstanding (WSJ)
3. CBO says that **US debt is on an "unprecedented" trajectory**, risking crisis
    a. Paying $1T in interest this year
    b. 2017 tax cuts + pandemic spending. If Trump is reelected and renews tax cuts, it will add another $5T to debt between 2026 and 2035. (FT)
4. In global IG bond index, share of **A-rated increasing** and **BBB decreasing** (Bl.)
5. **Gold** has rallied due to Chinese demand, belief in lower rates, global uncertainty (WSJ)
6. **Big events of past week**: PCE, Baltimore bridge tragedy, Waller said we can wait longer

II. Key News from This Week

A. Inflation – Feb. PCE

1. **Headline** PCE **+2.5%** (Jan. 2.4%); **+.3%** MoM
    a. **Core +2.8%** (Jan. 2.9%); **+.3%** MoM
    b. **Supercore** rose just **.2%** MoM (after a .7% increase in January); **+3.3%** YoY
    c. Cost of **goods** rose .5% MoM after declining four months in a row
        i. Cost of **services** rose .3% (after a .7% increase in January); +3.8% YoY
2. Powell says that the recent data shows that the path to 2% inflation is "**sometimes bumpy**"
    a. US "exceptionalism" amid global weakness means Fed can be patient on rate cuts
3. **Potential obstacles** to further inflation declines:
    a. Gas prices rising again
    b. Shipping disruptions (FT) (WSJ)

B. Francis Scott Key Bridge (six workers died)

1. The Port of Baltimore **ranks 20th in the nation based on tons of cargo**
    a. It is the nation's top port for automobiles, light trucks, farm and construction machinery, and imported sugar and gypsum
    b. The port is one of the few on the East Coast that can handle the world's largest vessels and is a significant stop for cruise ships
    c. Handled the equivalent of 265K twenty-foot containers in Q4 vs. 2MM in the NY/NJ port
        i. So how can truck and rail infrastructure in NY/NJ absorb a 10% increase
    d. Some ships are now "trapped" in the Baltimore port
2. **Largest car-handling terminal** in the US – diverting deliveries and exports to other sites
    a. Potential bottlenecks due to increased traffic
    b. Potential shortage of dockside vehicle handlers
    c. Lack of skilled labor and specialist equipment in handling cars at alternative ports
3. Baltimore's popularity among carmakers
    a. Far inland, saving logistics costs
    b. Connected to two direct rail links
4. European carmakers use different ports (FT) (Barron's)

C. Signs of Economic Strength

1. **Real personal income** +.4% in Feb. (.1% estimate)
2. Weekly **initial jobless claims** to lowest since July 2021
3. **Pending home sales** rebounded back in Feb.
4. **Q4 GDP** revised higher (from 3.2% to 3.4%)

III. "The Dual Mandate and the Balance of Risks," Gov. Lisa D. Cook, March 25, 2024

A. Benefits of Maximum Employment
1. Reduces social problems like poverty
2. Means vital resources being used productively; larger, more prosperous economy
3. Promotes business investment, boosting productivity and long-run growth
4. Increases labor force participation, makes employers more willing to recruit and upgrade worker skills

B. Benefits of Price Stability
1. Allows HHs and businesses to make sound economic decisions
2. Reduces uncertainty about future prices and business conditions (supports cap ex)
3. Avoids high inflation which burdens the disadvantaged the most
4. Creates conditions for sustainably strong labor market by avoiding need for forceful tightening to combat inflation

C. Monetary Policy Tradeoffs
1. Mandates often complimentary, especially for demand shocks
2. Supply shocks can create short-run tradeoff
    a. Stimulating employment could push inflation higher
    b. Aggressively fighting inflation may significantly harm employment

D. Inflation Indicators
1. PCE price index – rose on supply chain issues, commodity shocks
    a. Core PCE is better guide to future; rose less, but has fallen less
2. Inflation components
    a. Food and energy drove 2022 inflation, but have slowed
    b. Core goods most impacted by pandemic; has slowed the most
    c. Core services ex-housing hasn't slowed as quickly
        i. Strong demand; prices adjusted less frequently, so still adjusting
    d. Housing services prices boosted by WFH, but new lease data suggests this will continue to fall
3. Inflation expectations – short-run rose, but fallen back; long-run remained anchored

E. Labor Market Indicators
1. Unemployment rate has remained near historic lows
2. LFPR – prime-age participation rebounded, especially for women
    a. Ages 55+ hasn't recovered – health risk and increased wealth
3. Job openings to available workers shows market tightness
    a. Gap has narrowed, but still tight; immigration has helped
4. Labor market churn normalizing
    a. Quits rate has fallen below pre-pandemic pace
    b. Wage growth gap between job-switchers and job-stayers has narrowed
5. Wage growth measures cooling gradually but still elevated
    a. Catching up to prior inflation surge
    b. Whether this is inflationary depends on productivity growth and margins
6. Labor productivity growth has surged but volatile since pandemic
    a. Pandemic-era job switching may have boosted productivity
    b. New business formation could increase innovation
    c. AI could boost productivity, but will take time

IV. The Fed

A. Ideas about Fed Policy

1. **Ed Yardeni**: The argument to lower rates because inflation is dropping is premised on the idea that consumption and investment decisions are based on real rates.
    a. Lowering rates now risks creating a bubble. (FT)
2. **Torsten Slok (Apollo):** Core CPI is sticky around 3.8% and 3-month (4.2%) and 6-month (3.9%) annualized core CPI are picking back up. Easy financial conditions are supporting consumer spending.
    a. Rates could stay higher as inflation is sticky.
    b. Surge in UST issuance is also a factor on rates (FT)
3. **Powell** said that the Fed is in no rush to cut rates:
    a. Solid economic growth
        i. Allows the Fed to take its time
        ii. US "exceptionalism" in the face of weaker global growth
    b. Strong labor market
    c. Need more clear evidence that inflation is coming down sustainably (Bl.)
4. We don't usually lower rates when inflation is high, labor market is strong, and stock market is booming. (Barron's)
    a. Shipping disruptions and higher fuel costs are obstacles in inflation fight (FT)
5. **Credit spreads are tight for several reasons**:
    a. Fed signaling inflation is no longer a problem
    b. Pension fund demand as they reallocate from stocks
    c. Insurance company demand from surge in annuity sales
    d. Retail buying credit for extra yield (FT)

B. "There's Still No Rush," Gov. Christopher Waller, March 27, 2024

1. Reasons for "**No Rush**" to lower rates
    a. Feb. job gains of 275K, making three-month average 265K
    b. Inflation continues to be hot – core PCE .4% in Jan.
2. **But we do see labor market loosening a bit**
    a. Fewer people quitting than pre-pandemic
    b. Nominal wage growth continues to ease
3. Reasons for **skepticism about high productivity numbers**
    a. Productivity growth is volatile
    b. 2-year average is ~1.25% annually
    c. Multi-year periods of fast growth are unusual
4. Possible **explanations for recent productivity surge**
    a. Large investment projects – this will take years – not a good explanation
    b. Surge in business start-ups – will this continue
    c. Resolution of supply chain issues – temporary boost
    d. Pandemic-driven work and technology changes – a one-off improvement
    e. End of high turnover/repeated new hire training (Federal Reserve)

V. Important Long-Term Issues (Labor Force Growth and Competitiveness)

A. Birth Rates

1. Despite tripling real per capita spending on family-friendly policies between 1980 – 2019, birth rates in developed countries declined from 1.85 to 1.53 per woman.
    a. Child benefits, subsidized childcare, parental leave, etc.
2. Birth rates are not higher in countries with fully subsidized childcare vs. high fees
    a. Decision to have kids is about far more than just money
3. But family-friendly policies have other positive impacts
    a. Make it easier to juggle family and work for those who choose to have kids
    b. Help alleviate child poverty
4. Cultural factors driving down birth rates
    a. Rise of intensive "helicopter parenting"
        i. Realization that your kids need top-quality education (requires huge time and money)
        ii. Huge increase in time mothers spend on child activities (1 hour/day in 1965 has increased to 3-4 hours/day now)
    b. Shifting life priorities for young adults
        i. Having kids seen as less important (US: 61% in 1993 vs. 26% now)
        ii. Biggest competing priorities: personal growth, career, worried over demands of helicopter parenting (childcare costs is 14^{th} on list)
        iii. High overall anxiety levels among young adults correlates with lower intended family size
    c. Declining share of young adult couples
        i. Women's increased financial independence (less need to partner)
5. Recent birth-rate decline driven more by people having no kids (vs. smaller families) (FT)

B. Smartphones and Kids

1. If you wanted to manipulate minds in order to achieve world domination, you'd give kids smartphones
2. While phones can keep kids safe and games can improve problem-solving:
    a. Phones make children sedentary, distracted and depressed
    b. Phones enable predators and bullies
    c. Peer pressure and powerful companies have discouraged parental limits
    d. Schools undermine screen time limits by setting homework online
        i. Many European countries ban phones in schools
3. There has been an exponential rise in teenage mental illness since smartphones became ubiquitous in the early 2010s
4. This is a "collective action" problem – hard for parents to act on their own
5. This should make you think:
    a. China limits under-18s to max two hours per day on smart devices
    b. Chinese TikTok version Douyin is limited to 40 minutes/day for teens
        i. Western TikTok's one-hour teen limit is easily turned off
    c. Some tech executives won't let their kids have phones
6. We worry about Chinese ownership and national security, but we should worry about kids' mental health and learning
    a. In 2022, 1/3 of US teens report using social media "almost constantly" (FT) (FT)