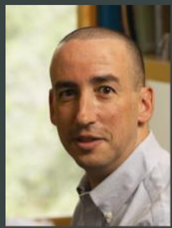

MARKET UPDATE

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Market Update – April 8, 2024

I. Last Week

A. Stocks

1. **Negative** week: DJIA -2.27%; **S&P 500 -.95%**; Nasdaq -.80%; IWM -2.78%
    a. S&P outperforming Nasdaq since early February
    b. US stocks have added $9T in market cap since Oct. 2023
    c. Divergence in big tech stocks could signal rally exhaustion
        i. **Fab 4**: NVDA, META, MSFT, AMZN
            1. Double digit declines in AAPL and TSLA in 2024
                a. GOOGL is in the middle
            2. Earnings growth of other 493 companies will outpace Magnificent Seven by Q4 (WSJ) (Bloomberg) (FT)
2. **Market resilience**
    a. Traders continue to buy the dips
    b. S&P 500 remains above **50-day moving average** (Barron's)
    c. All S&P 500 sectors gained in Q1 (except real estate)
3. **Big stories** from the week:
    a. Possibility of **delayed rate cuts** (~50% chance in June; 2.5 cuts in 2024)
        i. Higher rates (**10-yr** highest since Nov.)
            1. Strong economy
                a. Strong jobs report (discussed later)
            2. Sticky inflation (CPI report next week)
                a. Higher oil prices
                    i. Geopolitical tensions (Syria and Iran accused Israel of a missile strike on an Iranian diplomatic building in Damascus)
    b. **Fed speak** of delaying rate hikes
        i. **Powell**: need greater confidence that we're headed to 2%, but recent data doesn't change the overall picture (Federal Reserve)
        ii. **Kashkari** floated idea of no rate cuts this year
        iii. **Logan** spoke of **higher r*** (real neutral rate)
            1. Growing deficits, strong investment demand, potential productivity boom
            2. 5y5y TIPS real rate ~2%
        iv. Logan also spoke of **immigration** (expanding employment): CBO 4MM more immigrants from 2021 – 2023 than prior estimate; 4.4MM from 2024 – 2026 than estimated (Dallas Fed)
    c. Strong jobs report
        i. Powell said strong job growth in itself is not a reason to be concerned about inflation
    d. **ISM manufacturing** moved into expansion for first time since Sep. 2022
4. **Gold rally**
    a. Expectations of Fed rate cuts, demand from China, ETF flows, geopolitical uncertainty

B. Employment Report

1. Feb. **establishment survey** showed 2.7MM more jobs YoY. **Household survey** was approximately half of that. Difference is likely due to **population growth** estimate in household survey. Estimate is based on Census Bureau estimate of .5% growth. CBO thinks it's actually .9% because of immigration.
    a. Suggests economy can grow more without overheating.
    b. Maybe instead of 100K jobs being our speed limit per month (once we're at full employment), it's really 160K – 200K (WSJ)
2. **March establishment survey**: **+303K jobs** (200K expected); prior two months +22K
    a. **Wage growth +.3% MoM**, **+4.1% YoY** (lowest since June 2021)
    b. Leisure and hospitality and private education and healthcare account for 1.5MM of the 2.9MM jobs gained in past year
3. **March household survey: 3.8% unemployment** (down from 3.9%)
    a. Participation rate rose to 62.7% (first increase since November)
4. Strong job market gives Fed leeway to wait before cutting
5. Strange things we've seen over past year:
    a. Continued job gains despite high rates
    b. Cooling inflation without job losses (WSJ) (Bloomberg)

C. Sticky Inflation

1. Inflation's decline from 2022 highs represents the easy gains. **Last mile** is tougher.
    a. **Core PCE +3.5% annualized in three months** through Feb.
        i. Challenges expectations of steady declines
    b. Central banks expected "bumpy last mile"
2. **Factors contributing to stubborn inflation**
    a. Resilient economic growth (real consumer spending ~5% annualized in Feb.)
    b. Strong job creation and high wage growth (service inflation)
    c. Central banks may be inadvertently adding to inflation pressure
        i. Signaling pivot toward rate cuts pushed down borrowing costs and pushed up asset prices
3. **Factors favoring further inflation decline**
    a. Surge of immigration (keeps lid on wage increases)
    b. Increase in productivity (offsetting high wage growth)
        i. Uncertain whether this will last
    c. China boosting manufacturing capacity and exports amid slumping property market (lowering global goods inflation)
4. **Risks and challenges**
    a. Oil prices have risen recently
    b. If central banks react to stubborn inflation by backing away from rate cuts:
        i. Pressure on heavily indebted governments and employers
        ii. Test of central banks' will to finish last mile
    c. Higher government spending on defense and green energy and geopolitical trade tensions…
        i. May pressure central banks to tolerate higher inflation (WSJ)

II. “How You Might Look at Recent Data,” Richmond Fed Pres. Tom Barkin, April 4th

A. Economic Update

1. **Finished 2023 strong** (contrary to most forecasts)
    a. 12-month PCE inflation came all the way down to 2.6%
    b. GDP 3.4% and unemployment near historic lows
        i. Despite higher interest rates, global conflicts and banking turmoil
2. **Early 2024** has been a little **less encouraging**
    a. PCE inflation has come in higher – first two months annualized: **4.3%**
    b. Consumer spending softer: 1.3% annualized
3. There are arguments to underweight some of recent data (e.g., seasonal adjustments and winter weather), but it raises a question:
    a. Are we seeing a real shift in the economic data or just a bump along the way

B. Different Ways to Look at the Numbers

1. **Soft-landing**
    a. Extraordinary levels of post-pandemic spending have been normalizing
    b. Post-Covid supply chain shortages have been largely resolved
    c. Labor market pressures alleviated by rebound in prime-age labor force participation and recent high levels of immigration
        i. Productivity increases have also helped
            1. Possibly from automation and AI
    d. Most measures of inflation expectations have remained stable
        i. Businesses and consumers see Fed’s actions and targets as credible
    e. 12-month inflation at 2.5% and three-month job gains average 265K
2. **Demand pessimist**
    a. Policy works with a lag
        i. Recent increases in delinquencies
        ii. Challenges in CRE
        iii. Weakness in other interest-sensitive sectors – banking, residential real estate, manufacturing, home improvement
    b. Maybe labor market is nearing a turning point
        i. Nearly ¾ of last year’s job gains came from just three sectors: health care and social assistance, leisure and hospitality, and government
    c. Risk of geopolitical shock
3. **Inflation pessimist**
    a. Continued strong wage growth in a tight labor market
        i. Atlanta Fed Wage Growth Tracker is still at 5% (Feb. 2020 was 3.7%)
    b. Consumers’ continued willingness to spend (healthy personal balance sheets). Savings rate is 3.6% (was 7.7% pre-pandemic)
    c. Macro-forces have turned inflationary
        i. Deglobalization, limited housing supply, demographics, energy transition
4. **Fed pessimist** (most tightening cycles end poorly)
    a. Fed will keep rates high for too long; or
    b. Fed will normalize too quickly and allow inflation to linger

C. Barkin's View

1. **Demand**
    a. Not in a recession today, but all of this **tightening will eventually slow the economy further**
        i. **Corporate interest payments** as a % of corporate revenues and **personal interest payments** as a % of disposable personal income have only now finally gotten back in the range of 2019 levels
            1. Suggests full impact of rates is yet to come
    b. If economy does cool, it **doesn't need to be as painful** as Great Recession
        i. Could have **less dislocation in labor** market
            1. Employers hesitant to lay off workers
        ii. A slowdown **shouldn't catch anyone by surprise** – planning for two years
            1. Already slowed hiring, streamlined costs, managed inventories, and deferred investment
            2. Banks have cut back on marginal credit
2. **Inflation**
    a. Price-setters are increasingly convinced that the era of **significant pricing power is behind them**
        i. High inflation had given them the courage to raise prices
    b. Barkin is looking for **slowing in reported inflation to sustain and broaden**
        i. Before pandemic, 26% of PCE basket had increased >3% YoY
            1. Today, it's 54%
        ii. Much of the inflation drop so far has come from partial reversal of pandemic-era price increases on certain goods
            1. Inflation in both **shelter and services** remains higher than historical levels
    c. Risk is that as price decreases on goods normalize, continued shelter and services inflation will leave overall index higher than 2% target
3. **Fed optimist** (different than believing Fed is infallible)
    a. Optimistic that keeping **rates somewhat restrictive** can bring inflation back to target
    b. If economy does overheat (unexpected), Fed knows how to respond
        i. If economy slows, Fed has enough firepower to support it
    c. It's smart for Fed to **take our time**
        i. Risks to employment and inflation are moving into better balance
        ii. Need greater confidence that inflation is moving sustainably to 2%
            1. No one wants inflation to reemerge
            2. Given a strong labor market, we have time for the clouds to clear before toggling rates down

III. Losing Faith in Education (WSJ)

A. Lost Faith in Idea of "College for All"

1. **36%** of Americans have high confidence in higher ed; was **57%** ten years ago
2. Nearly half of parents prefer not to send child to four-year college after high school
3. **2/3** of high school students think they will be fine without a college degree
4. Percentage of high school graduates that enroll in college: **62%** (2022); 70% (2016)

B. Some of Problems We Face

1. **Cost**
   a. **Real cost** climbed **180%** between 1980 and 2020
      i. State budget cuts, administrative bloat, campus amenities, signaling, Bennett Hypothesis (availability of loans)
   b. Bad results for entrants: 40% don't graduate; 20% chronically underemployed
      i. Only 40% find a job that requires their degree
   c. Diluted signal from degree due to increase in graduates and weaker outcomes
2. **Schools poorly run**
   a. Departments protect turf and fail to adjust to labor market
      i. Undersubscribed humanities classes; waiting lists for classes leading to jobs
   b. Accreditors approve programs that fail to produce financial value for graduates
   c. Broken corporate governance at schools
3. **Problems with teaching**
   a. Failure of schools to teach students critical thinking skills
   b. 1/4 of graduates lack basic numeracy skills; 1/5 lack basic literacy skills (per ETS)
   c. Faculty rewarded for research not teaching
   d. Grade inflation makes it difficult to hold students to high standards
   e. Course instructor surveys result in some faculty appeasing students
   f. Schools treating students as customers purchasing a credential
4. **Problems with students**
   a. Students spend half as much time studying as 1961 – have to work; other options
   b. Increase in cheating due to transactional attitude
5. **Politics**
   a. Politicization of education system by state governors
   b. Political intolerance on campus