ambwealth

Wealth Advisory Market Update

June 5, 2024

ambwealth

Market Update

Equities:

The market, as measured by the S&P 500, rose by 4.8% for the month of May. The market is now up 10.64% for the year as of month end. This reversed the over 4% decline that occurred in April. The performance was mostly driven by a few names through continued multiple expansion. Economic data continues to deteriorate along with inflation data that is persistently high. During the last FOMC press conference, Chairman Powell stated, he did not see the “stag” or the “flation,” however both are pretty apparent.

Market breadth, the number of companies participating in the rally, continues to be narrow. This is evident when looking at the divergence in returns between the S&P 500 and the S&P 500 Equal Weight Index. For the year, the equal weight measure is up around 3% while the market weighted index is up over 10%. The difference between them is approaching levels not seen since the Great Recession of 2008. A staggering 45% of the S&P 500 are negative for the year. A concentrated market is not a healthy market, especially at current valuations. With this in mind, we continue to emphasize quality, value and companies that can weather a bumpy economic backdrop.

Now that earnings season has concluded, we have the opportunity to assess not only individual companies but also the broader economy. Feedback from retailers has raised some concerns regarding consumer sentiment. Dollar General, a low-cost retailer, reported decreased spending per transaction and spending on discretionary items, suggesting more cautious consumer behavior. Additionally, there has been a noticeable shift in consumer demographics, as evidenced by Walmart's strong earnings driven by higher-end consumers. This indicates that inflation is starting to impact wealthier households, prompting them to be more budget conscious. Higher prices continue to wreak havoc on lower-income households. The past month’s economic data, along with warnings from major retailers, seems to indicate that the consumer is cracking.

Economic Indicators and Monetary Policy

The latest GDP reading was revised lower from 1.6% to 1.3%. The consumer was weaker than previous reports stated and was a major reason for the revision. As we have mentioned over the last year, consumer spending has been assisted by credit, as the savings rate has plunged while revolving credit balances have continued to grow. According to a recent survey by NerdWallet, twenty-five percent of consumers are now utilizing BNPL (buy now pay later) loans, and it has become the 2nd most-used form of credit payment. Many of these loans do not require background checks or an application process and they do not show up in credit reports. With credit card debt at an all-time high, consumers are resorting to riskier forms of credit like this. Forty-four percent of credit cardholders are carrying balances month to month, while the rates of delinquencies have risen to 2011 levels. The personal savings rate has dropped to 3.6%, indicating that the consumer does not have the ability to pay off the record amount of debt they have incurred.

The recent release of the Federal Open Market Committee (FOMC) minutes shed light on the perspectives of FOMC members. In contrast to Fed Chairman Jerome Powell's latest press conference, the minutes revealed a more hawkish mindset. Members expressed concerns about the sluggish progress towards their 2% inflation target and uncertainties regarding the timeline to achieve it. There's also apprehension about the potential repercussions of higher interest rates, particularly on consumers who might resort to riskier forms of financing due to inflationary pressures. Some members even hinted at the possibility of a rate hike if circumstances shift.

Additionally, discussions revolved around the anticipation of a slowdown in economic growth for the current year. On the topic of the quantitative tightening (QT) of the Fed's balance sheet, nearly all members agreed in a need for curtailing the tightening.

Strategy

Given the weakening macroeconomic outlook, persistent inflation, confused Federal Reserve, inflated valuations, and continued market concentration, we feel it is prudent to continue our more defensive approach. Based on historical trends, we prioritize investments with robust market share, pricing resilience, and enduring demand, as they have proven to weather economic slowdowns more effectively. For fixed income portfolios, we continue to extend duration due to rising rates spurred by elevated inflation readings from manufacturing and hawkish rhetoric from the Fed. With spreads remaining tighter compared to previous rate hiking cycles, and given our cautious outlook on the economy, we are focused on seeking high quality credits.
As we navigate this challenging environment, we appreciate your support and the opportunity to collaborate in achieving your financial goals.

Matthew J. Roach, CFA®
Chief Investment Strategist

Mike Servetas
Assistant Portfolio Manager