Wellington Shields

KEEP SOME POWDER DRY

U.S. stocks rallied in the first quarter of 2024 in anticipation of strong corporate profits and the Federal Reserve cutting interest rates. It is notable that the market's breadth increased, something that was lacking for most of 2023. Towards the end of the quarter, however, some weaknesses developed as several Federal Reserve officials pushed back against the aggressive rate cuts many on Wall Street were predicting.

The U.S. has appeared to be unique versus a more sluggish performance abroad, with several foreign countries entering recession. As a result, numerous global central banks are planning on cutting policy rates in 2024. The U.S. picture, however, appears much stronger. As an example, U.S. non-farm payrolls surged 303,000 month-over-month in March, a notable upside surprise. Average hourly earnings were up by 0.3%. The U.S. labor participation rate rose to 62.7% while the unemployment rate fell to 3.8%. Job growth has been expanding for over three years.

The Federal Reserve faces a core inflation stuck above 2% annually with increasing government deficits, and there have been well-documented historical mistakes of "stopping and going" monetary policy. Notably, the University of Michigan's survey of long-run inflation expectations was 3.0% in early April. In the end, the Fed wants a soft landing, and recent Atlanta Fed data would keep this possibility as wage growth is slowing. While goods inflation is down significantly from COVID-induced supply chain disruptions, services inflation remains more persistent. So, a longer pause (before cutting rates) makes sense at this point.

The weaknesses in equity prices that showed up at the end of the first quarter has continued, and we believe it has further to go. We also have commented in the past about the uniqueness of the election year cycle, wherein stocks tend to bottom around Memorial Day and then rally into year-end. This scenario could be upset by international events---and there are enough uncertainties around to advise holding a near-term higher-than-normal cash position—but the bigger picture is one of stronger corporate profits and eventual falling interest rates.

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