May 3, 2024

Market Update: The Good, the Bad, the Fed

Rate Debate Goes On

April was a rough month for the market, with the S&P 500 down over 4%, the worst monthly return since September of 2023. With that said, we are still on track for a strong year and the S&P 500 is actually still up over 20% from its lows last October (meaning we are still in bull market territory). Market weakness for the month was primarily driven by uncertainty around interest rates as inflation appears to be stickier than expected. Interestingly, stocks rebounded toward the end of the month given some good news from corporations.

Let's review some of the latest data:

1. **The Good: Stronger Corporate Earnings –** According to FactSet, with 46% of S&P 500 companies reporting results, 77% have reported a positive earnings surprise and 60% have reported a positive revenue surprise. Companies are showing resilience in the face of high inflation and high interest rates, helping to boost stock prices.
2. **The Bad: Weaker Economic Growth –** Gross Domestic Product (GDP) growth increased at an annualized rate of 1.6% in the first quarter, well below estimates of 2.4%. One of the more impactful contributors to the low print was a slowdown in consumer spending, perhaps a sign that high interest rates are starting to weigh on households.
3. **The Fed: Inflation Sticky –** The Federal Reserve's favorite inflation metric, the Core Personal Consumption Expenditures Price Index (PCE) came in at year-over-year increase of 2.8% for March, above estimates of 2.6%. The Fed is watching for inflation to move closer to their target of 2% before starting to lower interest rates.

The Fed has a tough balancing act to achieve in terms of moderating inflation with higher interest rates, while avoiding a recession. Despite persistent inflation last month, it appears that the economy and consumer spending are cooling down, which may translate into lower inflation going forward. Meanwhile, corporate earnings continue to support stock market strength. We reiterate the view that any more rate hikes are unlikely and we simply need to be patient for the Fed to begin trimming rates.

How Stock Picking Works

A couple weeks ago, I had the pleasure to volunteer at the Junior Achievement Stock Market Challenge in Lincoln, Nebraska. It was a very fun event with over 600 high-school students from 27 schools competing. The rules of the competition were as follows: each team starts with $1M and trades stocks over a 60-minute period, each minute represents a full trading day. News releases are published regularly and can have different impacts on stock prices. The team with the highest net worth at the end of the hour wins.

While this was a theoretical stock trading competition, I couldn't help but notice some real-world similarities:

1. **Headline Chasing** – Every time company news was released, everyone jumped out of their seats! Many teams were buying a given stock, and interestingly just as many were selling that same stock. They were guessing, hoping to get lucky. Company news headlines are designed to get investors' attention, not necessarily to be used as an investment decision making tool. And often times the investment decision is based on the reader's interpretation

of the news. This creates a lot of volatility in prices based on supply and demand dynamics, not based on fundamental health and growth potential of a company.

2. **Performance Chasing** – Many teams simply waited for stock prices to move up after a given news update and proceeded to purchase, hoping to participate in the upward movement. Unfortunately, that often left them with losses as prices reverted back to starting levels, often quickly. Investors tend to buy into companies at peak levels due to fear-of-missing-out on strong historic returns, and forget that stocks move in cycles and may drop in price when they become overvalued.

3. **Slow and Steady Wins the Race** – With over 100 teams competing, the final results were astounding: 3rd Place ended slightly over the starting $1M, while 2nd and 1st were closer to $2M. Thus, two out of a hundred doubled their money (2%), while almost everyone else ended up with less than what they started with! This is the risk with stock picking, particularly in high-frequency. A diversified strategy, including allocations to many stocks across different asset classes, as well as staying invested for the long-term, is often a better approach to reach your long-term investment goals.

Stay diversified, my friends.

Junior Achievement Stock Market Challenge

Source: Kostya Etus

As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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