REGIONS ASSET MANAGEMENT

Weekly Market Commentary

MAY 6, 2024

MARKET UPDATES

May 3, 2024: Recorded Leadership Discussion Featuring: Regions Chief Investment Officer and Chief Market Strategist.
May 10, 2024: Join the upcoming live Regions Market Update.

KEY OBSERVATIONS

- The FOMC meeting provided investors in stocks and bonds with something to like. Equity investors cheered the Committee chair's less hawkish message and, if history is any guide, stocks tend to do quite well when the FOMC is 'on pause' as it should be into mid-year. Fixed income investors took comfort in knowing that the Fed's balance sheet will shrink at a more gradual pace starting in June and the fact that the Fed appears to be a willing buyer as the U.S. Treasury issues larger quantities of longer-term bonds starting in 3Q. The 'Fed put' appears to be back which should prevent yields on long-term Treasuries from running away to the upside.
- With the FOMC meeting in the rearview, investors can now turn their attention back to earnings season which has, on balance, been cause for optimism and a constructive outlook on stocks. The S&P 500 remains range bound and stuck between its 50-day and 100-day moving averages, and catalysts to break higher or lower out of that range are difficult to find until Nvidia, a member of the 'Magnificent 7' posts quarterly results on May 22.

WHAT WE'RE WATCHING

- The U.S. Treasury is scheduled to auction off $42B of 10-year bonds on Wednesday. We will be closely watching what percentage of the offering is taken down by indirect bidders, primarily central banks abroad, as well as how much of the issue the dealer community is forced to inventory as a gauge on the current demand environment for long-term bonds.
- China reports import and export data for April on Thursday. Imports are expected to rise 1.2% year over year after falling 1.9% year over year in March. Exports are expected to fall 0.2% year over year, a significant improvement after falling 7.5% year over year in March.
- The University of Michigan Consumer Sentiment index for May is released Friday with a 76.8 reading expected, which would be a modest drop from 77.2 in April. A higher reading would be evidence of improved consumer sentiment and likely lowered inflation expectations as well.

	Price/Yield	Total Return (%)					
	5/3/2024	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	5127.79	0.56	-1.53	7.99	28.23	8.87	13.60
NASDAQ	16156.33	1.44	-0.73	7.85	35.42	6.65	15.59
S&P Mid Cap 400	2929.04	1.19	-2.18	5.80	21.49	3.98	9.87
S&P Small Cap 600	1301.48	1.39	-0.90	-0.71	17.81	0.32	7.33
MSCI World ex US	326.85	0.95	-0.94	6.40	21.05	5.07	9.81
MSCI EM	1061.45	2.03	1.98	4.43	12.42	-4.90	2.13
Bloomberg U.S. Aggregate	5.09	1.17	-0.51	-2.06	-0.66	-3.18	0.11
Bloomberg Corporate	5.52	1.30	-0.41	-1.65	2.27	-2.73	1.19
Bloomberg U.S.High Yield	7.85	1.06	0.51	1.47	10.36	1.81	3.91
Bloomberg EM USD Aggregate	7.28	1.01	-0.23	0.73	6.90	-2.19	0.81
Bloomberg Global Aggregate	3.92	1.29	-0.68	-3.33	-1.58	-5.58	-1.35
Bloomberg Municipal Bond	3.68	0.68	-0.01	-1.02	2.59	-0.92	1.36

Source: Bloomberg (3- and 5-Year Returns Annualized)

	Price/Yield						
	5/3/2024	1 Week Ago	1 Month Ago	12/31/2023	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	5.31	5.32	5.32	5.38	4.81	0.01	2.43
30 Year Mortgage (average rate)	7.38	7.55	7.29	6.99	6.79	3.09	4.09
2 Year Treasury (yield)	4.82	4.99	4.67	4.25	3.80	0.16	2.33
10 Year Treasury (yield)	4.51	4.66	4.35	3.88	3.34	1.60	2.53
30 Year Treasury (yield)	4.66	4.78	4.51	4.03	3.68	2.28	2.92
WTI Crude (closing price)	78.11	83.85	85.43	71.65	68.60	64.49	61.94
Gold (NYM $/oz)	2308.60	2334.80	2294.40	2071.80	2037.00	1791.80	1281.30

Source: Bloomberg (3- and 5-Year Returns Annualized)

WHAT HAPPENED LAST WEEK?

Stocks:

Earnings, Falling Treasury Yields Drive Gains With Technology Stocks, Small Caps, Emerging Markets Leading The Way.

• **The Beats Roll On As Quarterly Earnings Season Enters The Later Innings:** As of last Friday, 75% of S&P 500 constituents have posted quarterly results, with 79% besting the consensus earnings per share (EPS) estimate, while a less impressive 61% have topped the consensus sales estimate. At the sector level, over 80% of the companies reporting in the communication services, consumer staples, health care, industrials, and information technology sectors have beat on EPS, while less than 70% of the companies reporting in the energy, financial services, and real estate sectors can make the same claim.

• **S&P 500's Trading Range Continues To Hold:** Stocks ran in place into mid-week leading up to the conclusion of the FOMC's meeting on Wednesday but rallied into the weekend after the FOMC struck a dovish tone and Amazon and Apple both beat earnings estimates and rallied sharply. Even after a +2% move for the S&P 500 on Thursday and Friday, the S&P 500 only eked out a 0.5% weekly gain and appears stuck between its 50- and 100-day moving average. A close above 5,130, the index's 50-day moving average, would be noteworthy, and a series of closes above 5,150 could lure rules-based, systematic investors back in, potentially ushering in a quick move back to the year-to-date high. Our bias is to expect a breakout to the upside in the coming weeks, but after last week's move to the upper end of the recent trading range, we could move sideways leading up to Nvidia's earnings release on May 22.

• **Small Caps Rally As Earnings Beats Are Rewarded With Short Interest High, Investors Offsides:** Small cap indices were weak throughout much of last week before buyers stepped in after the dust settled in the wake of the FOMC meeting. A predominantly dovish message out of the FOMC coupled with the weaker April payrolls report forced Treasury yields lower, to the delight of smaller companies that rely on issuing shorter-term debt. The sharp move lower in yields allowed small cap stocks to recover, with the S&P Small Cap 600 index ultimately gaining 1.3% on the week and outperforming large caps in the process. Excessive price swings witnessed over recent weeks within the S&P 600 can at least partially be attributed to rising short interest as sharp reversals on events such as acquisitions or earnings releases can prompt traders to cover positions and push up prices beyond what fundamentals might justify. As a group, investors appear to be under allocated to small cap stocks, and for a segment that thrives on reversals, it may take lower prices still to boost sentiment despite an improving fundamental backdrop. From an earnings perspective, over half of the S&P Small Cap 600 has now reported quarterly results and posted earnings have come in 5.8% above the consensus estimate with revenue roughly in line, but we're hesitant to get too excited until 80-90% of companies report. Falling Treasury yields and some softness in the labor market are most welcome for small caps and could shift from headwinds to tailwinds in short order.

• **"Story" Stocks To Be Found In Unexpected Places:** The S&P 500 utilities sector has quietly been the best performing sector over the past month, and by a wide margin, despite Treasury yields moving higher, a dynamic that would normally weigh on higher yielding, slower growing segments of the market. Relatively attractive yields combined with a secular growth opportunity for the sector driven by increased power generation needs to run data centers in the AI age add to the appeal of a dull, slow growth pocket of the market. We aren't lobbying for investors to increase allocations to utilities, but the performance of the sector of late is a reminder that some of the current themes leading equity markets higher have long tentacles with the potential to positively impact sectors that might otherwise be viewed as afterthoughts.

• **Another Good Week For Emerging Markets:** The MSCI Emerging Markets (EM) index advanced 2%, outpacing domestic equities for the third consecutive week. Chinese equities had a positive impact as the MSCI China index has climbed 11% since the end of March after rising 3.8% last week, and the Hang Seng Index entered bull market territory (peak-to-trough 20%+ gain) despite the holiday shortened week for mainland China markets. Recent data out of Hong Kong has been encouraging with GDP growth of 2.7%, above the consensus estimate, and the first uptick in home prices in 10-months were viewed as green shoots for China's troubled housing market. Better economic readings have boosted the Hong Kong dollar relative to the greenback which could attract global investment dollars when combined with rock-bottom valuations for Chinese stocks relative to many other equity markets. Beyond China, South Korea also drove gains for the broader MSCI EM index as inflation fell more than expected year over year and Brazil contributed as well, driven by improved industrial production and a strengthening Brazilian real, with currency strength turning into a broader trend in emerging market as U.S. yield pressures subside. Country participation within the MSCI EM index was broad, with just 5 of the top 20 countries represented in the index registering negative returns, an encouraging sign of durability in this rally.

• **Japanese Equities Rally As Policymakers Finally Have Enough, Step In To Support The Yen:** Japan's Ministry of Finance stepped in to prop up the beaten down Japanese yen on multiple occasions last week, which contributed to a 1.9% weekly gain for Japan's Nikkei 225 index. The trigger for the policy intervention appeared to be the yen falling to 160 to one U.S. dollar, a level that poses significant issues for Japan's economy given the country relies heavily on importing commodities which are priced in U.S. dollars, and a drop in the yen makes those goods more expensive and puts upward pressure on inflation in the process.

Bonds:

Dovish FOMC And Weaker April Payrolls Report Spur A Rally In Treasuries And Investment-Grade Corporate Bonds.

• **FOMC Strikes More Dovish Tone Than Anticipated, Throws Cold Water On The Prospect Of Rate Hikes:** The Federal Open Market Committee (FOMC) concluded its two-day meeting last Wednesday and left the Fed funds target range at 5.25% to 5.50%, unchanged as was widely expected. The FOMC also announced that the pace at which Treasuries would be allowed to run off its balance sheet, otherwise known as quantitative tightening, would be capped at $25B per month starting in June, well below the current pace of $60B per month and modestly below the rumored $30B. The 10-year Treasury yield fell 6 basis points on the day to 4.63% as fixed income investors saw this announcement as a reduction in the amount of bonds the U.S. Treasury will have to float to the public in the 3rd quarter and beyond, thus preventing yields on long-term Treasuries from running away to the upside. Long bonds continued to rally into the weekend on the heels of a weaker than expected April payrolls report and the 10-year Treasury yield ultimately ended the week lower by 16 basis points at 4.51%, a move supportive of stocks and longer duration bonds, specifically, U.S. Treasuries and investment-grade corporates.

• **Employment Cost Index Tells The Same Sticky Story As Recent Inflation Readings:** The Employment Cost Index (ECI) for the 1st quarter was released last Tuesday and is a closely watched measure given the impact that tightness in the labor market and higher wages have on inflation. The ECI rose 1.2% quarter over quarter, above the 0.9% reading in the prior quarter, and year over year the ECI rose 4.2%, in-line with the reading from 4Q23. On balance, the ECI continues to tell a similar story to the inflation data we've seen of late as wage pressures are decreasing at a snail's pace and remain sticky, which will keep upward pressure on inflation as well.

• **Guidance Surrounding Upcoming Treasury Issuance Meets Market Expectations:** The U.S. Treasury's Quarterly Refunding announcement (QRA), which outlines expected borrowing needs, had the potential to spur a rally or selloff in U.S. Treasuries last week but ultimately turned out to be a non-event. The amount of expected Treasury issuance fell largely in-line with estimates at $125B for the May through July timeframe, up slightly from $121B in the 1st quarter. Markets were again comforted by Treasury Secretary Yellen choosing to issue more bills or short-term bonds as opposed to longer-term or coupon bonds. Notably, the FOMC announcing a $25B per month cap on Treasuries running off its balance sheet starting in June implies that the U.S. Treasury now has a 'buyer' for $105B of long-term Treasuries starting in the 3rd quarter. As a result, we would expect the Treasury to step up issuance of long-term bonds at that time, which should keep upward pressure on the long end of the Treasury curve.

• **April Jobs Growth, Average Hourly Earnings Fall Short Of Expectations, Improving September Rate Cuts Odds:** Nonfarm payrolls grew 175k in April, below the consensus estimate of 235k, and prior months were revised lower as well by only a modest 22k. Average hourly earnings rose 0.2% month over month, below the 0.3% estimate, and year over year average hourly earnings grew 3.9%, also below the 4.0% estimate. The unemployment rate ticked higher to 3.9% from 3.8% in March. Market participants became a bit more confident that the first cut to the Fed funds rate would occur in September, with the likelihood of a cut rising from 40% on Thursday to 47% on Friday according to Fed funds futures.

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