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Market Commentary

Weekly perspective on current market sentiment **April 17, 2024**

[Scott Wren](#)
Senior Global Market Strategist

Last week's S&P 500 Index: -1.6%

Stalled

Key takeaways

- We have been of the view that the decline in inflation, at some point and at some level, was likely to stall.
- We see lower CPI readings in the earlier part of next year followed by higher inflation in the back half of the year.

Stocks and bonds are clearly very sensitive to anticipated levels of inflation and what the Federal Reserve (Fed) might do about it. The yield on the 10-year Treasury note has surged in recent weeks, and the probability of Fed rate cuts keeps edging lower. Last week's Consumer Price Index (CPI) report for March came in a bit "hotter" (higher) than expected (+3.5% year-over-year vs. +3.4%) from a headline perspective and the "core" reading, which excludes the effects of food and energy prices, remains stuck just below 4%.

We have been of the view that the decline in inflation, at some point and at some level, was likely to stall. While much progress has been made from the 40-plus year highs for CPI we saw nearly two years ago at just over 9%, the latest readings remain well above the Fed's long-term average target of 2%. Given the stickiness of inflation in some of the CPI's components like rents (housing), we view the Fed as in no hurry to cut interest rates by any noticeable amount. We have penciled in just two cuts this year and only one additional cut in 2025 as inflationary pressures, overall, remain above the target of our U.S. central bankers. The last thing the Fed wants to do is cut rates too early and find itself having to reverse course at some point down the road if inflation rises.

Our projections call for CPI to notch a 3% increase this year. That is lower than the March reading, but the path is not likely to be in a straight line. We continue to see the economy slowing as we move through the year, which should put downward pressure on the rate of inflation. It will not surprise us if we see some months of sub-3% year-over-year readings later this year. The 3% full-year 2024 result will likely be largely the product of higher levels early in the year that fade in coming quarters.

We see the economy entering 2025 growing at a slower pace with inflation initially lower as well. However, as a modest economic recovery takes place as next year progresses, we see inflationary pressures increasing as well. Once again, the progression of inflation in 2025 is unlikely to be linear but actually the opposite of this year in terms of timing. In other words, we see lower CPI readings in the earlier part of the year followed by higher inflation in the back half of the year. The net outcome in 2025, just like this year, is expected to show a CPI increase of 3%. Again, as inflation remains well above the Fed stated longer-term target, the ability to cut rates significantly is hindered.

Given our expectations, we believe portfolios should continue to lean toward large-cap U.S. equities, the highest-quality equity asset class we cover. Higher rates won't help U.S. small-caps, and we retain our unfavorable rating. And we continue to favor U.S. over international equities.

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