The Markets, the Fed, and When Bad News is Good News

By Steven M. RINN, CFP
Principal, Senior Financial Advisor

THE FINANCIAL MARKETS pulled back in April on stronger than expected inflation data. The pullback, or pause, was ever more likely given the near-term market performance from September 2023 through March 2024.

The relationship between market interest rates and stock and bond prices continues to be extremely correlated. Over the last couple of months expectations about interest rate reductions in 2024 have shifted from five cuts to possibly two, in November and December.

Economic data has begun to arrive a bit more mixed than what we saw to start the year. Growth rates look to be slowing and economic numbers are not as strong as they were at the start of 2024. Manufacturing numbers are flirting with "contraction" as indicated by the ISM Manufacturing Index that measures the change in production levels across the U.S. economy from month to month, which declined in April to 49.4. This is important, as a reading below 50 signals contraction. The jobs market grew in April but not as much as expected — 175,000+ jobs versus the expected, 225,000+.

The mixed and weaker data readings for the last week of April have helped boost market prices. We saw the financial markets recover most of their April pullback in the first week of May given the weaker data. This seems counterintuitive, but the weaker economic data is a positive to the markets as it potentially moves us to a more lenient interest rate policy sooner rather than later.

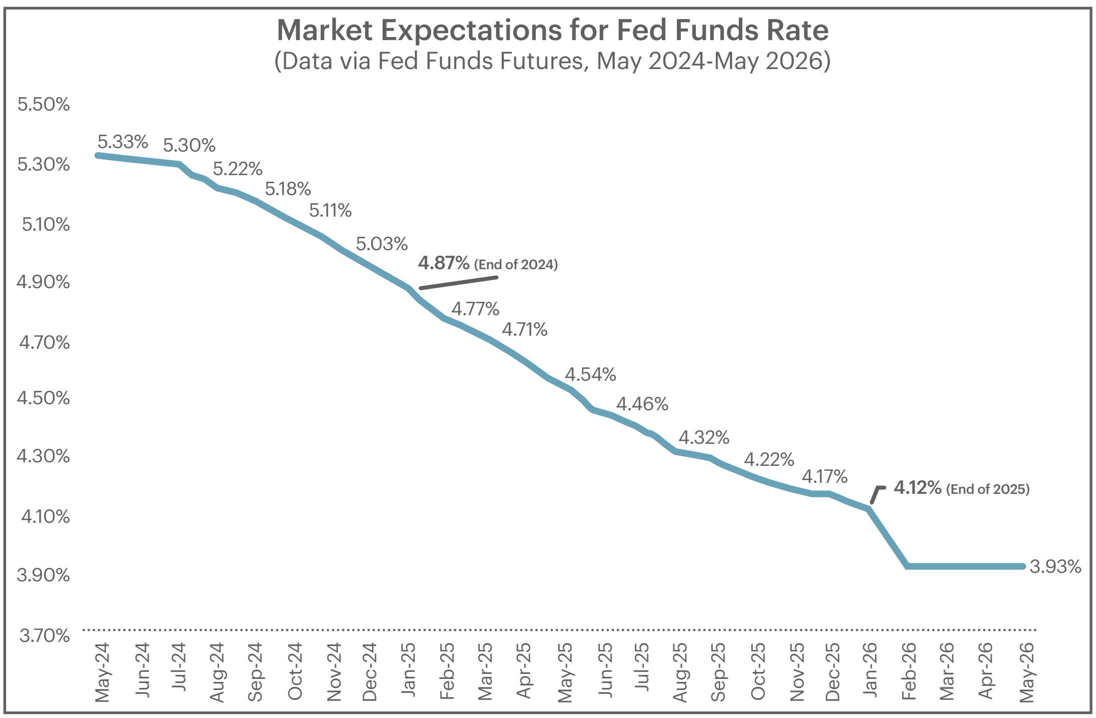
There has been some political pressure on the Federal Reserve and interest rate policy over the last few weeks. Being an election year, the incumbent party is pushing for an interest rate cut before the election, as that would show progress on inflation and likely a benefit — although lagging — to the economy and financial markets. The challengers would prefer no cut in interest rates prior to the election, as they believe the cuts would benefit President Biden and his re-election campaign. Politically speaking, the Fed is in a position to disappoint one or the other.

The Fed has historically steered clear of politics and expressed its intent to act independently of pressure from both sides. On the other hand, its history shows it is not afraid to make major moves in elections years. "... In 10 of the past 17 presidential elections with data available going back to 1955, rates changed by nearly 1 point or more over the year. In 8 of those 17 elections, the Fed was wiling to change rates in the two months beforehand." ("Politics and the Fed Don't Mix," *Barron's* magazine, April 9, 2024)

> Growth rates look to be slowing and economic numbers are not as strong as they were at the start of 2024.

BAD NEWS IS GOOD NEWS?

Why did the S&P 500 rally 1.3 percent and the Nasdaq jump 2.0 percent after the weaker-than-expected payroll report on Friday, May 3? Because sometimes bad economic news is interpreted as good news for stocks, one of the more interesting paradoxes in markets. Why would a slower economy be a good thing? Because of the perception that the Fed will take a more dovish stance, delivering interest rate cuts sooner and at a faster pace. We saw a meaningful shift in Fed Funds Rate expectations after the jobs report, with market participants now pricing in two rate cuts in 2024 (September and December) and two more in the first half of 2025 (March and June).



Source: Bilello, Charlie, Markets, Investing and the Search for Wisdom – The Last Week in Charts (5/6/24), (https://bilello.blog/wp-content/uploads/2024/05/fed-funds-rate-expectations-5-5-1024x666.png)

Investors seemed excited about the prospect of lower rates on May 3, but how long this excitement lasts is anyone's guess. Two rate cuts this year are far from a done deal, and if the Fed feels the need to cut rates despite stubborn inflation, that could indicate a more significant slowdown has commenced, which is another way of saying there's a limit to the "bad news is good news" phenomenon. In such uncertain times, consulting with a trusted financial advisor can help investors navigate these complexities and make informed decisions.

The Fed historically steers clear of politics, but history also shows that it's not afraid to make major moves in election years.

IMPORTANT DISCLOSURES
The information included in this document is for general, informational purposes only. It does not contain any investment advice and does not address any individual facts and circumstances. As such, it cannot be relied on as providing any investment advice. If you would like investment advice regarding your specific facts and circumstances, please contact a qualified financial advisor.

Any investment involves some degree of risk, and different types of investments involve varying degrees of risk, including loss of principal. It should not be assumed that future performance of any specific investment, strategy or allocation (including those recommended by HBKS® Wealth Advisors) will be profitable or equal the corresponding indicated or intended results or performance level(s). Past performance of any security, indices, strategy or allocation may not be indicative of future results.

The historical and current information as to rules, laws, guidelines or benefits contained in this document is a summary of information obtained from or prepared by other sources. It has not been independently verified, but was obtained from sources believed to be reliable. HBKS® Wealth Advisors does not guarantee the accuracy of this information and does not assume liability for any errors in information obtained from or prepared by these other sources.

HBKS® Wealth Advisors is not a legal or accounting firm, and does not render legal, accounting or tax advice. You should contact an attorney or CPA if you wish to receive legal, accounting or tax advice.

Steven Rinn, CFP®

Principal, Senior Financial Advisor, HBKS® Wealth Advisors

Steven Rinn is a principal and senior financial advisor in the HBKS office in Erie, Pa. His expertise extends to comprehensive financial planning, retirement planning, insurance and asset management. He can be reached at (814) 836-5776, or by email at srinn@hbkswealth.com.