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Investment Institute

# Market Commentary

**Weekly perspective on current market sentiment** **June 12, 2024**

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Last week's S&P 500 Index: +1.3%

## Not as good as it looks. What are the implications?

### Key takeaways

- The underlying labor market is weakening, which directly affects consumer spending and is key to our forward outlook for the economy and markets.
- The Fed is looking for a combination of slower spending along with easing job and wage growth before cutting interest rates.

In what one financially oriented news outlet dubbed "the most ridiculous jobs report in recent history," the May employment report, published last Friday by the Bureau of Labor Statistics, showed that nonfarm payroll jobs increased by 272,000 during the month, which exceeded expectations for a gain of 180,000. The better-than-expected payroll gains pushed the 10-year Treasury yield up by 15 basis points or 0.15%, a big move in one day of trading under just about any circumstance.

But looking closer within the same report, as has been the case each month this year, the number of full-time jobs were lower than in the year-ago period while the number of part-time jobs were higher. In addition, while the portion of the report based on the "Establishment Survey" showed the above-mentioned robust gain, the "Household Survey" portion of the report used to calculate the unemployment rate (which rose to 4%) showed a loss of jobs. And the ADP May payrolls report, which reflects job numbers at the individual company level, has been in a downtrend since June of last year. So, what gives?

In our view, the underlying labor market is weakening, which directly affects consumer spending and is one of the keys to our forward outlook for the economy and financial markets. Consumers at the lower end of the income scale have tapped credit sources and savings to fund spending. At the same time, inflation, particularly as related to the service sector of the U.S. economy, remains sticky and well above the Federal Reserve's (Fed's) longer-term average target (2%). Last week's report highlighted wages that are rising far faster than the Fed believes is needed to help knock price pressures lower. When combined with the Treasury needing to sell large amounts of debt to fund current spending, we expect yields to remain volatile and to finish the year in our target range of 4.25% to 4.75%, and our focus continues to be on investment-grade over high-yield securities.

From an equity standpoint, the S&P 500 Index continues to hover at or near record highs. Market participants appear convinced that inflation and interest rates will trend lower while economic growth supports what we consider to be overly optimistic earnings expectations, particularly next year. Our focus here is also on quality and trimming exposures back to recommended weightings in what we consider to be the overvalued Information Technology and Communication Services sectors. We prefer Industrials, Energy, Materials, and Health Care for placement of those funds.

The Fed is looking for a combination of slower spending along with easing job and wage growth before cutting interest rates. We believe it will have more confidence to do so as the economy slows and inflation cools, probably later this year but timing still to be determined. We continue to pencil in two cuts this year and just one in 2025.

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