PeoplesBank
WEALTH MANAGEMENT

Quarterly Economic & Market Perspectives

April 2024

"We are on a good path"

--Fed Chair Jerome Powell

Despite ongoing economic growth, falling inflation, and low unemployment rates, Federal Reserve Chair Jerome Powell is not yet ready to declare victory in achieving a "soft landing," a scenario where the economy slows down just enough to curb inflation without triggering a recession.

Speaking in early March, Powell informed the House Financial Services Committee that the central bank aims to support economic conditions that would further reduce inflation while maintaining solid growth and a healthy labor market.

Even with continued strong job growth and persistent high inflation, the Federal Reserve's stance on lowering interest rates later in the year remains unchanged. Powell emphasized the need for more certainty about inflation's downward trajectory before considering rate reductions. He advocated for a cautious approach to rate adjustments due to the continued strength of the economy and labor market.

However, Powell expressed optimism about the current trajectory, stating, "We are on a good path so far to be able to get there."

A cautious approach to rate cuts

At its March 19-20 meeting, the Federal Reserve Open Market Committee opted to maintain the federal funds rate in the 5.25% to 5.5% range, while forecasting three rate cuts in 2024. This decision reflects positive momentum in key economic indicators. The Fed observed, "Recent indicators suggest that economic activity has been expanding at a solid pace, with strong job gains and a persistently low unemployment rate."

Regarding future monetary policy, the Fed reiterated its stance that it will not reduce the target range for the federal funds rate until it is confident that inflation is on a sustainable path back to 2%.

The Fed also made slight adjustments to its economic projections, including:

- An increase in the median real Gross Domestic Product (GDP) growth projections for 2024 through 2026, reflecting a more optimistic outlook on economic growth.
- A slight adjustment in the median unemployment rate forecasts, indicating stability in the job market.

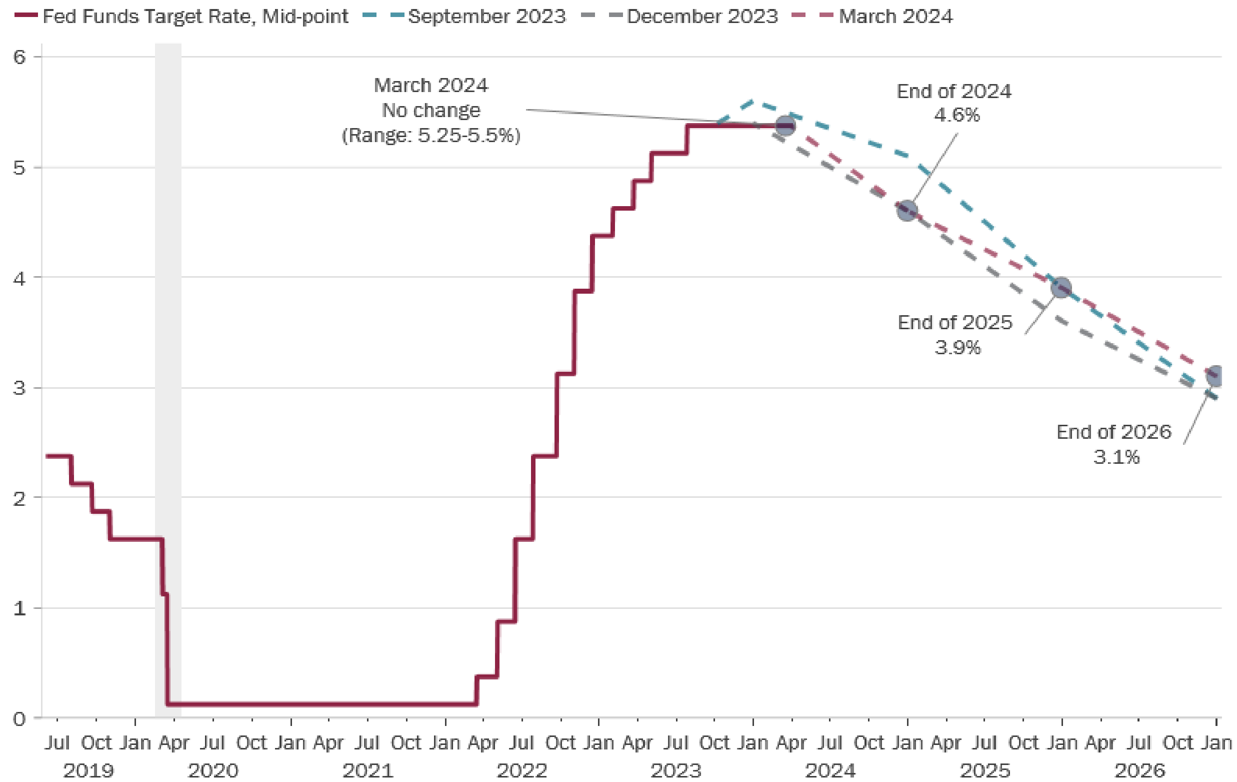
- Updated core Personal Consumption Expenditures (PCE) inflation estimates, showing a gradual approach towards the 2% target.
- Adjustments to the median projections for the federal funds rate, suggesting a more cautious approach to rate cuts, with a slight increase in the long-term neutral rate estimate.

This cautious stance is due to the persistence of inflation, despite its easing over the past year. The Fed acknowledges that inflation remains above desired levels, with recent higher inflation readings prompting expectations for the first rate cut to be delayed until later in the year.

Despite these challenges, a narrow majority of Federal Reserve officials anticipate three rate cuts this year, encouraged by the ongoing trend of decreasing inflation and supported by robust economic performance.

The Fed still faces the difficult task of balancing the risks: easing too soon could entrench inflation above the target, while acting too slowly risks harming the economy with sustained high rates.

Federal funds rate (actual and projected*)



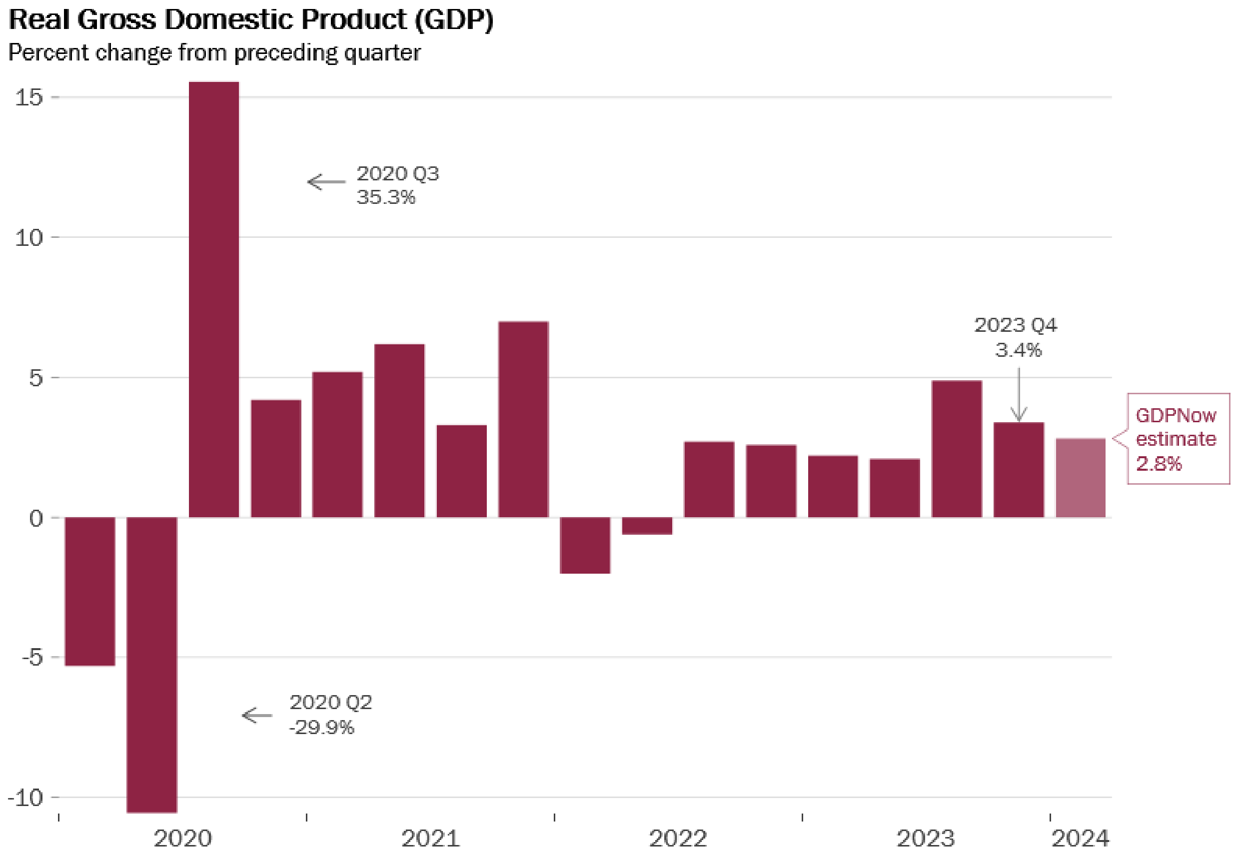
* Based on Federal Open Market Committee (FOMC) participants' Summary Economic Projections (SEP)
Note: The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run.
Source: PeoplesBank, Macrobond, Federal Reserve, Federal Reserve Bank of San Francisco. Shaded areas denote NBER recession dates.

The economy enters 2024 with strong momentum

The economy has demonstrated resilience in the aftermath of the pandemic. The final reading for U.S. growth in the fourth quarter of 2023 was revised upward to a 3.4% annual pace, surpassing the earlier estimate of 3.2%, adjusted for inflation. This latest GDP number, based on more complete data, reflects improvements in consumer spending and nonresidential fixed investment, which were partially offset by a decrease in private inventory investment. Consumer spending, accounting for about 70% of the U.S. economy, saw an increase revised to 3.3% for the fourth quarter.

This momentum is expected to continue into the early part of the year, with the Atlanta Fed's GDPNow model estimating a robust 2.8% annualized growth rate for the first quarter's GDP, solidly above the Fed's longer-run growth projection of 1.8%.

Despite persistently high interest rates, there are few indications that a recession is on the horizon. Notably, the Conference Board has upgraded its U.S. economic forecast, expecting a slowdown in consumer spending and GDP growth but no recession.



Note: Extreme values in Q2 and Q3 2020 are truncated. GDPNow estimate is as of April 1, 2024
Source: PeoplesBank, Macrobond, BEA, Atlanta Fed.

The job market remains strong, adding 275,000 new jobs in February and outperforming expectations. After holding steady at 3.7% for three months, the unemployment rate rose slightly to 3.9% in February.

The labor force participation rate has been stable at 62.5% since December. Year-over-year wage growth decreased slightly to 4.3%, down from 4.4% in January. However, wage growth for the 12 months ending in February still outpaced inflation, leading to an annual real average hourly earnings increase of 1.1%.

In February, U.S. prices continued to rise, with the Federal Reserve's preferred measure, the PCE index, increasing by 0.3%, just below the economists' forecast of 0.4%. The core rate, which excludes food and energy, also rose by 0.3%. On a year-over-year basis, inflation increased to 2.5% from 2.4%, while core inflation slightly decreased to 2.8% from 2.9%, remaining above the Fed's longer-run target of 2%.

Federal Reserve officials have cautioned that stabilizing the annual inflation rate at 2% would be challenging, and the latest data suggest that the Fed is unlikely to reduce interest rates until June at the earliest as they await more definitive signs of slowing inflation.

Equity market continues to demonstrate resilience

The U.S. stock market showed remarkable resilience in 2023, overcoming challenges such as high inflation, a rapid increase in bond yields, and various crises. This resilience has continued into the first quarter of 2024, with global equities increasing by 8.2%, outperforming bonds and commodities. U.S. equities led the surge with a 10% rise, compared to a 4.7% increase for international equities. Growth stocks outpaced value stocks, with an 11.4% increase versus 9%, respectively. U.S. large-cap stocks gained 10.6%, outperforming U.S. small-cap stocks, which saw a 5.2% increase. The S&P 500 index, a proxy for U.S. large-cap stocks, had its best first quarter since 2019.

The U.S. bond market experienced a 0.8% decline, with yields on the 10-year Treasury note rising in the first quarter. U.S. preferred securities had a strong quarter, posting a 5.6% gain, in contrast to the 3.3% loss for long-term U.S. Treasuries. Meanwhile, global commodities experienced a modest increase, buoyed by significant gains in U.S. oil and gold.

The outlook for equities remains positive, bolstered by expectations of Federal Reserve rate cuts, an improving economic forecast, and robust projections for earnings growth. Market breadth is expected to widen, with a broader range of market components beginning to align with the leading indices in 2024. This alignment is supported by steady economic growth and stable interest rates. U.S. small-cap stocks exhibit strong upside potential, attributed to their attractive valuations and a positive economic outlook.

Fixed income markets offer appealing yields despite potential volatility, as investors evaluate the timing and scale of expected Federal Reserve rate cuts. Extending the duration in fixed income portfolios appears advantageous, especially in anticipation of rate reductions. Additionally, cash yields continue to be compelling.

International equity markets present favorable valuations, despite concerns regarding Europe's growth prospects and China's recovery. Emerging Markets are perceived as having relatively attractive valuations, potentially benefiting from more accommodative monetary policies and increased export activities. Japan's equity market is regarded positively, supported by domestic reflation and governance reforms.

Considering the economic and monetary policy context, we favor stocks over bonds for the near term, spanning six to eighteen months. Within the equities sector, we prefer U.S. stocks, particularly small-cap over large-cap, compared to international developed and emerging markets. In fixed income, our focus is on non-core sectors, such as high-yield bonds and preferred securities. Additionally, we have slightly extended the duration in our fixed income allocation to capitalize on potential decreases in yields.

Several risks accompany this outlook, including unexpected shifts in economic indicators, geopolitical tensions, and political events, particularly related to the presidential election. External shocks during this election cycle, such as the post-pandemic recovery, the invasion of Ukraine, and unprecedented interest rate hikes, have led to significant stock market fluctuations. However, historical data dating back to 1930 suggests that equities have generally risen despite such uncertainties.

We remain committed to managing diversified investment strategies that aim to mitigate these risks for our clients and capitalize on longer-term investment opportunities.

S&P 500 4-year presidential election cycle

Source: PeoplesBank, Macrobond, S&P Global

PBWM's STRATEGIC AND TACTICAL ASSET ALLOCATION

	Asset Class	Strategic (%)	Under/Overweight (%)	Tactical (%)
Equity	U.S. large cap stocks	28.8	-1.8	27.0
	U.S. mid and small cap stocks	7.2	5.8	13.0
	Int'l developed market stocks	18.3	-1.3	17.0
	Emerging market stocks	5.8	0.2	6.0
Fixed Income	Core fixed income	38.0	-7.0	31.0
	Non-core fixed income	0.0	4.0	4.0
	Cash & cash equivalents	2.0	0.0	2.0

PeoplesBank Wealth Management's (PBWM's) strategic and tactical asset allocation for its total return moderate growth strategy as of April 2024.

Notes

PeoplesBank Wealth Management's Investment Strategy Committee ("ISC") develops both long-term (strategic) and short-term (tactical) asset allocation recommendations for Wealth Management's investment management and trust accounts. Strategic recommendations are based on how the ISC believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. Tactical recommendations are based on where the ISC sees either increased opportunity or risk over the next one to two years. The ISC is also responsible for selecting and monitoring strategies, managers, and funds implemented within client portfolios. The ISC is comprised of senior members of the Wealth Management team and meets monthly. If you have questions or would like additional information regarding PBWM's investment process, please call or send an email to your relationship or investment officer.

Sources: Atlanta Fed, Bureau of Economic Analysis, Federal Reserve, J.P Morgan Asset Management, Macrobond, MarketWatch, Morningstar, New York Life Investments, Reuters, S&P Global, The Conference Board, and The Wall Street Journal.