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US stagflation?

Google searches of the term “stagflation” went up dramatically last week, but I don’t believe we’re seeing stagflation in the US.

Eurozone services?

The recovery in eurozone services appears to have legs, in my opinion, as we are finally seeing better activity in the eurozone’s two largest economies, Germany and France.

Republic First Bank

We saw a small bank failure with the seizure and sale of Republic First Bank, but I don’t see any contagion stemming from this failure.

Stagflation? Sticky inflation? Seven reasons for investors to be positive

Weekly Market Compass | April 30, 2024

The big news last week, given that the world is waiting to see when the US Federal Reserve (Fed) will begin cutting rates, was the US gross domestic product (GDP) report for the first quarter. Not only was growth lower than expected, but inflation was higher than expected. This was followed by the March Personal Consumption Expenditures (PCE) Price Index, showing both headline and core inflation for March were higher than expected. This data calls into question how sticky inflation is going to be - and how long the Fed will have to wait before it cuts rates. As a result, there was a big increase in fear - Google searches of the term “stagflation” went up dramatically, and some even argued that the next Fed action will be a hike, not a cut. In addition, we saw a small bank failure last week with the seizure and sale of Republic First Bank. But despite these concerns, I do see several reasons for investors to be positive.

1. The US is not experiencing stagflation

Stagflation (combining the words “stagnant” and “inflation”) is characterized by slow economic growth, high unemployment, and high inflation. This is not stagflation! The March PCE Price Index is below 3% with year-over-year headline inflation at 2.7% and core PCE inflation at 2.8%.¹ And don’t forget, PCE is the Fed’s preferred measure of inflation.

The US Consumer Price Index (CPI) has been higher, although we can point to idiosyncratic reasons for this, especially lagging components such as automobile insurance (which is reflecting an earlier increase in auto prices) and shelter, which is reflecting an earlier rise in housing costs as higher market prices established by new leases take time to show up in shelter data.

In short, I still believe disinflation has continued although progress has slowed - but that slowdown could be very temporary. There is more data to come between now and the Fed’s upcoming meetings. (It’s also worth noting that while Google searches in the US for “stagflation” have risen significantly, they are still below previous peaks in February 2008 and May 2022.)

2. The eurozone economy appears to be experiencing a solid recovery

Flash Purchasing Managers’ Index (PMI) readings for the eurozone for April indicate the eurozone economy is improving. Eurozone manufacturing PMI weakened a bit, but services PMI reached an 11-month high. And this recovery appears to have legs, in my opinion, as we are finally seeing better activity in the eurozone’s two largest economies, Germany and France, which had shown signs of real weakness for some time.

Additionally, the economy may be poised to get a boost from the start of European Central Bank (ECB) cuts, which still appear very likely to begin in June, which could provide a significant boost to European equities.

3. The UK economy is showing signs of improvement

Despite weaker manufacturing activity, services activity has shown real strength. The flash S&P Global UK Services PMI was far better than expected and is helping to power the overall economy. With disinflationary progress being made in many components, I think the Bank of England is closer to rate cuts than many expect.

4. No contagion expected from last week's bank failure

As stated earlier, we saw a small bank failure last week with the seizure and sale of Republic First Bank. This was the first FDIC-insured bank failure of 2024. As I said back in December, I wouldn't be surprised to see a few isolated bank failures going forward. However, I believe that in assessing situations like this, the key is to determine whether it is contained or contagious. In my view, based on information available, this appears to be an isolated situation with issues that were largely idiosyncratic. I don't see any contagion stemming from this failure.

5. Corporate earnings have been stronger than expected

Markets performed well in the past week despite higher-than-expected PCE inflation and talk about stagflation. Helping stocks is that earnings growth has been stronger than expected - and isn't that what we want driving price gains?

As of Friday, with nearly 50% of S&P 500 companies reporting, we saw 77% register a positive earnings surprise and 60% register a positive revenue surprise.² Earnings growth for the S&P 500 in the first quarter is estimated to be 3.5%, which would be the third consecutive quarter of year-over-year earnings growth.²

And it's not just the US. With 33% of Stoxx Europe 600 companies having reported, 54% have beaten earnings expectations.³ And in Japan, with 14% of Topix companies reporting, 59% have beaten earnings expectations.³ As global growth improves, this should translate into improved earnings growth in coming quarters.

As one multinational consumer company shared on its earnings call, "...the consumer globally, we think is very resilient. And we see it in, as you saw, from our international business performance. And it's basically supported by two facts, very low unemployment or quite low unemployment globally and wages growing at a good pace in a majority of the countries where we participate."⁴

Perhaps we are returning to a more normal world where monetary policy expectations don't have such an outsized impact on assets.

6. European stock buybacks have accelerated

European companies have ramped up their stock buybacks, and now more closely resemble US companies. For example, the Stoxx 600's buyback yield has risen to 1.8%, which is the same as that of the S&P 500.⁵ We are seeing similar behavior in the UK. These companies have significant cash on balance sheets, giving them the potential to further increase buybacks. I believe this should provide material support for European and UK stocks.

7. Cash remains on the sidelines

We don't need rate cuts to drive stocks higher - as I've said before, there is excess investor cash on the sidelines that could easily return to capital markets. And the catalyst doesn't have to be imminent rate cuts - it could simply be improved earnings growth or just "dip buying."

Looking ahead: An important week for markets

This week will be an important one for markets - absolutely chock full of data, and with a Fed meeting to boot. We will be getting eurozone CPI, the US Job Openings and Labor Turnover Survey (JOLTS), the US Employment Cost Index, China PMIs, and the US Employment Situation Summary jobs report.

When it comes to the US, I will be most focused on the labor market, especially wage growth. When it comes to the Fed, I wouldn't be surprised to hear hawkish language from Chair Jay Powell given the recent data, but I will not be rattled by it (I'm looking ahead to the data between now and the next two Fed meetings). And we will be getting more earnings reports, which I think will be very helpful in providing macro and industry-specific insights.

I'll be live tweeting the Fed's rate announcement and press conference this Wednesday, May 1. You can follow along @kristinahoopers on X.

Dates to watch

Date	Report	What it tells us
Apr 29	Germany CPI	Tracks the path of inflation.
	Japan Industrial Production	Indicates the economic health of the industrial sector.
	Japan Retail Sales	Measures consumer demand.
	China PMIs (Purchasing Managers' Index)	Indicates the economic health of the manufacturing and services sectors.
Apr 30	Germany GDP	Measures a region's economic activity.
	Bank of England Consumer Credit	Reports outstanding credit extended to individuals.
	Eurozone CPI	Tracks the path of inflation.
	Eurozone GDP	Measures a region's economic activity.
	US Employment Cost Index	Measures the change in total employee compensation each quarter.
	US S&P CoreLogic Case-Shiller Home Price Index	Measures US residential home prices.
	US Conference Board Consumer Confidence	A monthly survey of US consumer attitudes, spending plans, and expectations for inflation, stock prices, and interest rates.
May 1	Canada Manufacturing PMI	Indicates the economic health of the manufacturing sector.
	US ISM Manufacturing PMI	Indicates the economic health of the manufacturing sector.

Date	Report	What it tells us
	US Job Openings and Labor Turnover Survey (JOLTS) Report	Gathers data related to job openings, hires, and separations.
	FOMC Decision and Press Conference	Reveals the latest decision by the US Federal Reserve on the path of interest rates.
May 2	UK Home Price Index	Indicates the health of the housing sector.
May 3	US Jobs Report	Indicates the health of the job market.
	US PMIs	Indicates the economic health of the manufacturing and services sectors.
	Eurozone Unemployment	Indicates the health of the job market.
	Brazil Industrial Production	Indicates the economic health of the industrial sector.

Notes

¹Source: US Bureau of Economic Analysis, April 25, 2024

²Source: FactSet Research Systems, as of April 26, 2024

³Source: JP Morgan, April 26, 2024

⁴Source: Pepsi earnings call transcript, April 24, 2024

⁵Source: Morningstar, April 8, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The PCE (Personal Consumer Expenditure) price index, released each month in the Personal Income and Outlays report, reflects changes in the prices of goods and services purchased by consumers in the United States.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics.

Inflation is the rate at which the general price level for goods and services is increasing.

Headline inflation is a measure of the total inflation within an economy, including commodities such as food and energy prices

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

Stagflation is an economic condition marked by a combination of slow economic growth and rising prices.

Sticky inflation refers to a phenomenon where prices do not adjust quickly to changes in supply and demand, leading to persistent inflation.

A basis point is one hundredth of a percentage point.

The federal funds rate is the rate at which banks lend balances to each other overnight.

Hawkish is to favor relatively higher interest rates if they are needed to keep inflation in check.

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

A flash estimate is a preliminary release of economic data, typically released ahead of the official data release.

Purchasing Managers' Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

Monetary easing is when a central bank lowers rates to stimulate growth in the economy.

The eurozone (also known as the euro area or euroland) is an economic and monetary union of European Union member states that have adopted the euro as their common currency.

The European Central Bank (ECB) is responsible for the monetary policy of the European Union.

Yield is the income return on an investment.

Buyback yield is the ratio between the value of a company's net stock repurchases and its beginning market capitalization.

Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The STOXX® Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region

The Tokyo Stock Price Index (Topix) is a free-float-adjusted market-capitalization-weighted index measuring the performance of large-cap stocks listed on the Tokyo Stock Exchange.

Dip buying, or buying the dip, refers to purchasing an asset following a decline in price.

The US Employment Situation Summary jobs report is a monthly report that estimates the unemployment rate and the monthly change in nonfarm payrolls as well as average earnings and hours worked.

The opinions referenced above are those of the author as of **April 29, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.