

Finding victories in a confusing first quarter for global markets



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A confusing 1Q

Market swings punctuated the first quarter as “central bank speak” proliferated and caused confusion.

Gaining perspective

I put first-quarter global markets into perspective and highlight some “little victories” that may have been easy to overlook.

US disinflation

The core Personal Consumption Expenditures Price Index for March came as a relief — and got a vote of confidence from Federal Reserve Chair Jay Powell.

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I ran into a financial advisor I know after church on Easter Sunday, and I asked him what he and his colleagues are hearing from clients after such an impressive quarter. He said they can’t make sense of what’s happening in markets. That’s not surprising. Market swings punctuated the first quarter as “central bank speak” proliferated and caused confusion. Below, I put first-quarter global markets into perspective and highlight some “little victories” that may have been easy to overlook.

First-quarter market roundup

Equities. The first quarter was a strong one for equities around the world, with few exceptions.¹ Japanese equities were the standout performer, posting double-digit gains. This was followed by the US, with the S&P 500 also gaining more than 10%. European equities also posted solid gains, with UK equity gains more tepid. Emerging market equities also experienced small gains while Chinese equities in particular lost modest ground in the first quarter, adding to oversold conditions.

Fixed income. Fixed income² generally disappointed for the quarter (with the exception of emerging markets bonds). However, global bonds saw better performance for the month of March. The volatility in fixed income was not surprising given some of the large swings experienced by the 10-year US Treasury yield, moving below 4% and above 4.3% over the course of the quarter.³

Alternatives. Alternative asset classes were mixed for the quarter.⁴ Global real estate investment trusts weakened for the quarter, although they had a strong month for March. Commodities, especially energy, had a strong quarter. Industrial metals were relatively flat for the quarter but experienced a significant gain in March. Gold rose during the quarter, as did bitcoin. Major currencies were weaker versus the dollar.

Markets anticipate the start of rate cuts

As mentioned at the outset, we saw market swings along the way, as central bank speak caused confusion. So what happened? In short, this was overall a “risk on” quarter as markets largely overlooked disappointing data and hawkish talk from central bankers, despite some initial negative reactions. Markets are discounting what they anticipate will happen this year – that disinflation in Western developed economies will continue and that their central banks will start cutting rates. Markets are also discounting a soft and brief slowdown for the global economy, followed by a re-acceleration. That’s why I believe we have seen a broadening of markets in recent weeks.

Little victories to start the second quarter

The first quarter of 2024 ended with some small victories:

- **The US is still on the “D train” as disinflation continued in March.**

There were concerns about the US inflation path after some disappointing inflation data recently, so the core Personal Consumption Expenditures (PCE) Price Index for March came as a relief. Core PCE was 2.8% year-over-year, down slightly from 2.9% in February.⁵ This data received a vote of confidence from US Federal Reserve Chair Jay Powell, who said it was “more along the lines of what we want to see.” He continued, “It’s good to see something coming in line with expectations.”⁶ Powell also said he still expected “inflation to come down on a sometimes bumpy path to 2 percent.”⁷

- **The UK and eurozone see more progress on inflation.** Eurozone inflation has also continued to fall and is now within striking distance of the European Central Bank’s 2% target. UK inflation has made even more progress lately — its most recent reading was 3.4% year-over-year for February, its lowest level since 2021 and below expectations.⁸

- **Inflation expectations are becoming better anchored.** As I’ve said, inflation expectations – especially consumer inflation expectations – are important considerations for central banks. And so it was comforting to see the final University of Michigan Survey of Consumers for March. With five-year ahead inflation expectations down to 2.8% and one-year ahead inflation expectations moved down to 2.9%, I think it’s accurate to say that inflation expectations are “well anchored” – an important litmus test for the Fed.⁹ It is a similar story in the UK, where a recent Bank of England survey showed median inflation expectations for the year ahead at 3%, down from 3.3% in the previous survey. Longer-term consumer inflation expectations fell to 3.1%, getting closer to the Bank of England’s target.¹⁰ This was supported by the Citi/Yougov survey, which also showed a drop in consumer inflation expectations for both the short and longer terms.¹¹

All this suggests that rate cuts could begin for some of the major Western developed central banks by the end of the second quarter.

The little victories have continued into the start of the second quarter:

- **A positive economic surprise for China.** We’ve seen a strong market reaction to China’s Caixin Manufacturing Purchasing Managers’ Index (PMI) data released yesterday, which was better than expected. As I’ve said before, I believe Chinese stocks were oversold so any positive surprise could prove to be a strong catalyst to move stocks higher.

- **US manufacturing data is better than expected.** US ISM Manufacturing PMI surprised to the upside, moving into expansion territory for the first time since September 2022. The new orders sub-index was particularly strong, which bodes well for the future.

Now it hasn’t been all sunny:

- The ISM manufacturing PMI data for the US was actually greeted negatively by markets. It is true that the price sub-index also moved higher, but this seems to be largely driven by commodity prices which can be very volatile. And the employment sub-index, while having risen, remains tepid. Nothing in this report changes my view about when the Fed will begin to cut.

- The Bank of Japan (BOJ) Tankan report on Japan's economy was mixed – one area of disappointment was a drop in corporate sentiment. This has purportedly caused some profit taking, but that's to be expected after such strong equity performance in the first quarter. And, perhaps more importantly, the survey showed that companies expect inflation to remain above the BOJ's 2% target for the next five years.¹² There is clearly confidence in the BOJ and the Japanese economy.

Looking ahead

The US jobs report will of course be important this week. I'll be laser-focused on average hourly earnings because I don't think the Fed will care if non-farm payrolls are higher than expected; the Fed's focus is going to be on wage growth because of its direct impact on inflation. Also important this week will be eurozone Consumer Price Index (CPI), and also the Job Openings and Labor Turnover Survey (JOLTS report) to get a sense of whether the US labor market is continuing to ease (it's not necessary for the Fed to begin rate cuts, but it would be helpful to see a reduction in job openings).

Also important this week will be the minutes from the most recent European Central Bank meeting. I will be combing through this account for greater confirmation on when rate cuts may start (the current expectation is for June) and for more illumination on the expected pace of rate cuts.

Dates to watch

| Date | Event | What it tells us |
|-------|--------------------------------|--|
| Apr 2 | Germany CPI | Tracks the path of inflation. |
| | US JOLTS report | Gathers data related to job openings, hires, and separations. |
| Apr 3 | Eurozone CPI | Tracks the path of inflation. |
| | US ISM Non-Manufacturing PMI | Indicates the economic health of the manufacturing and services sectors. |
| Apr 4 | UK PMI | Indicates the economic health of the manufacturing and services sectors. |
| | Eurozone PMI | Indicates the economic health of the manufacturing and services sectors. |
| Apr 5 | US Employment Situation Report | Measures the health of the job market. |
| | Canada Jobs Report | Measures the health of the job market. |

Notes

¹Equity market performance sourced from Bloomberg and MSCI, referencing the MSCI Japan Index, MSCI Europe ex-UK Index, MSCI UK Index, MSCI Emerging Markets Index, MSCI China Index, and S&P 500 Index from Jan. 1, 2024, through March 31, 2024.

²Fixed income market performance sourced from Refinitiv Datastream, referencing the Bank of America Merrill Lynch Global Bond Index, Bloomberg US Aggregate Bond Index, Bloomberg Global Aggregate Credit Index, and Bloomberg Emerging Markets Bond Index from Jan. 1, 2024, through March 31, 2024.

³Source: Bloomberg, as of March 29, 2024

⁴Alternatives market performance sourced from Refinitiv Datastream, referencing the FTSE Global REIT Index, S&P GSCI Commodity Index, S&P GSCI Energy Index, S&P GSCI Industrial Metals Index, S&P GSCI Precious Metals Index, and S&P GSCI Agricultural Goods Index.

⁵Source: US Bureau of Economic Analysis, as of March 29, 2024

⁶Source: Reuters, "New US inflation data 'along the lines' of what Fed wants, Powell says," March 29, 2024

⁷Source: PBS NewsHour, "Powell says the Federal Reserve wants to see 'more good inflation readings' before it can cut rates," March 29, 2024

⁸Source: UK Office for National Statistics, March 20, 2024

⁹Source: University of Michigan Survey of Consumers, March 29, 2024

¹⁰Source: Bank of England/Ipsos Attitudes Survey, March 15, 2024

¹¹Source: Citi/Yougov Survey, March 28, 2024

¹²Source: Tankan Survey, April 1, 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 risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

Businesses in the energy sector may be adversely affected by foreign, federal or state regulations governing energy production, distribution and sale as well as supply-and-demand for energy resources. Short-term volatility in energy prices may cause share price fluctuations.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

Bitcoins are considered a highly speculative investment due to their lack of guaranteed value and limited track record. Because of their digital nature, they pose risk from hackers, malware, fraud, and operational glitches. Bitcoins are not legal tender and are operated by a decentralized authority, unlike government-issued currencies. Bitcoin exchanges and Bitcoin accounts are not backed or insured by any type of federal or government program or bank.

The MSCI Japan Index measures the performance of the large- and mid-cap segments of the Japanese market.

The MSCI Europe ex UK Index is a market-cap weighted index used to measure the performance of non-UK European equities.

The MSCI United Kingdom Index is designed to measure the performance of the large- and mid-cap segments of the UK market.

The MSCI Emerging Markets Index captures large- and mid-cap representation across 26 Emerging Markets (EM) countries.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

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

The Bank of America Merrill Lynch Global Bond Index is a benchmark index for the global bond market.

The Bloomberg US Aggregate Bond Index is an unmanaged index considered representative of the US investment-grade, fixed-rate bond market.

The Bloomberg Global Aggregate Credit Index is an unmanaged index considered representative of the global investment-grade, fixed-rate bond market.

Bloomberg Emerging Markets Bond Index is an emerging markets debt benchmark that includes fixed and floating-rate US dollar-denominated debt issued from sovereign, quasi-sovereign, and corporate EM issuers.

The FTSE Global REIT Index is designed to track the performance of listed real estate companies in both developed and emerging countries worldwide.

The S&P GSCI Commodities Index is a benchmark for investment performance in the commodities market.

The S&P GSCI Energy Index is a benchmark for investment performance in the energy market.

The S&P GSCI Industrial Metals Index is a benchmark for investment performance in the industrial metals market.

The S&P GSCI Precious Metals Index is a benchmark for investment performance in the precious metals market.

The S&P GSCI Agriculture Index is a benchmark for investment performance in the agriculture market.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures. Core PCE excludes food and energy prices while headline PCE includes them.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

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

The Tankan survey is a quarterly assessment of business conditions in Japan from the Central Bank of Japan.

The opinions referenced above are those of the author as of **April 1, 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.