Weekly Market Flash

Equity Investors Plow Through Hot Inflation

March 15, 2024

We always arrive at work on an Inflation Day with a certain amount of uncertainty hovering over us. When the CPI or the PCE report – the two main indicators of US consumer price trends – comes out at 8:30 a.m. it has the potential to sharply shift market sentiment away from whatever direction it was moving in. When the numbers come in hotter than expected, that sentiment can turn sour very quickly. Not so for the hot numbers that came out this week. The Consumer Price Index report for February came out on Tuesday and showed inflation advancing faster than economists had expected. The core CPI number (i.e., excluding the volatile categories of food and energy prices) in particular looked worrisome. The month-on-month increase of 0.4 percent was above estimates and roughly double our own metric for a "good" monthly number being a gain of 0.2 percent or less. That monthly number translates to a year-on-year consumer price gain of 3.8 percent, still stubbornly ahead of the 2.0 percent target the Fed has been trying to engineer with its rate policy.

Supercore is the New Core

So, what could be in store for markets once Tuesday trading got underway? Stocks down and bond yields up? Haha, no, that would be far too rational! Au contraire, stocks had themselves a nice little gain of more than one percent, while the 10-year Treasury did move up a bit but stayed within recent trading ranges without much drama. The dynamic seemed to be more of what we talked about in our commentary last week, with the glass half full crowd winning the day more often than not.

The positive theme investors latched onto on Tuesday was "supercore." This is yet another way of dissecting inflation down to its supposedly least volatile categories, this time by stripping housing costs out of the calculation for services prices. In January this "supercore" number was a very hot 0.87 percent, but in February it slowed to 0.47 percent. Still higher than we would like to see, but what the collective wisdom of the market decided it saw was the trend moving in the right direction. This week saw a record flow of funds into the US equity market -- $56 billion, eclipsing the previous weekly record of $53 billion set in March of 2021.

Flowing Into What?

Where is all that new money going? Well, this week saw a big move into the old theme of tech stocks, with the usual suspects atop the Big Tech pile getting a midweek boost. But there is a decided lack of consensus about overall directional moves these days. Over the past month or so the mega-caps have lost some ground to out of favor sectors. The S&P 500 Equal Weight Index, a measure that takes away the distorting effect of contribution to the index from companies with outsize market capitalizations, has outperformed the benchmark (market cap-weighted) S&P 500 for the past month, reversing a longstanding period of underperformance (for the last twelve months, the equal weight index has lagged the benchmark by some sixteen percent).

That may or may not be indicative of anything sustainable – we have seen plenty of false dawns for value stocks and other overlooked sectors of the market in the recent past. But it's worth paying attention to. While all of this has been going on in the equity market, bond traders have been quietly lowering their (previously outlandish) expectations for Fed rate cuts. All else being equal, higher rates tend to have a more punishing effect on the growthier sections of the stock market. Next week, all eyes will be on the Fed and the March FOMC meeting, which will include an updated set of Summary Economic Projections and thus the latest thinking by the Committee members themselves about where the Fed funds rater is likely to be by year-end. We'll see what they have to say. Lots to process, and no easy answers.

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Additional disclosure: MV Capital Management, Inc. maintains an active equity position in Nvidia, mentioned in this commentary.