MONTHLY UPDATE

CARY STREET PARTNERS

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BY THOMAS O. HERRICK

Chief Investment Officer, Managing Director

Domestic equities largely consolidated and continued to trade within a relatively tight range throughout the month of April. Using the S&P 500 Index as context, the current equity trading range is roughly 3800 on the low end and approximately 4150 on the high end. A near-term challenge for US markets is the lack of breadth. Quite a bit of recent S&P 500 strength can be attributed to mega-cap growth stocks. Year to date, exposure to the growth side of the market has been crucial to performance. This was a key element within our 2023 Market Outlook as this is the portion of the market exposed to long-duration equities, which react positively to a Federal Reserve that is likely to pause its Fed funds rate rise campaign soon. To be clear, this is not the Fed easing as we saw in the beginning of 2020 and running through Q1 2022, but rather, a pause or potential end to the rate rise cycle. There's more on that inflation-induced dynamic below. So far this year, using the Russell large-cap growth and value indexes as proxies, growth is up 14.61% versus value, up 1.53%. This is the complete opposite picture from last year. Those mega-cap names, such as Microsoft, Apple, Amazon, Alphabet (Google), and Meta, are reflected in the large-cap growth numbers. All said, our viewpoint is that this dynamic of mega-cap leadership looks a little tired near term. We recommend keeping a balanced allocation between growth and value.

Yields have extended their downtrend shift, with the benchmark 10-year Treasury currently trading at 3.46%. As a reminder, yields and bond prices move opposite. Lower long-term yields have produced solid bond market returns, especially in the longer-duration Treasury trade that we continue to recommend. Along with decent equity performance, this has produced good returns for the ubiquitous 60/40 stock/bond allocation, *The Princess Bride* just-mostly-dead recommendation in our 2023 Market Outlook. Stocks and bonds are much more highly correlated in a higher inflation dynamic, a more rate-driven market. This was a massive headwind in 2022 and is a tailwind in 2023.

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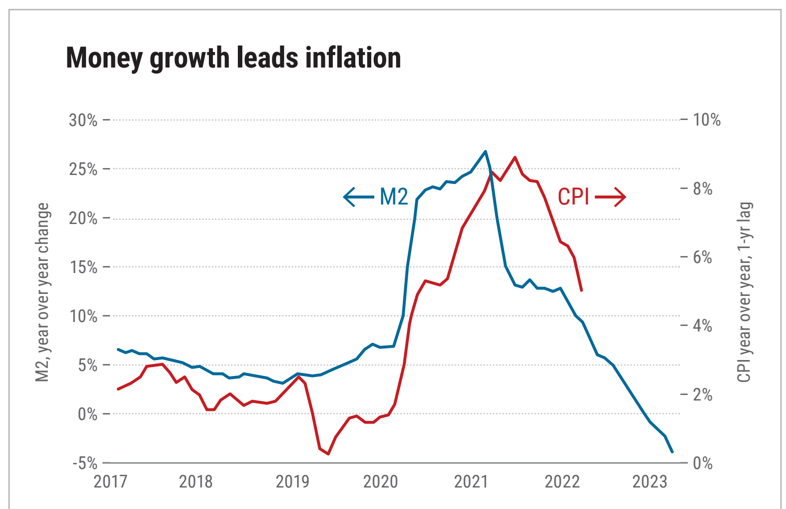
While counter-intuitive to most, the time to extend duration in bonds is when the yield curve is inverted, as it has been for approximately one year. Once the curve inverts, with higher rates at the short end, markets will typically experience a lowering of rates across the curve over the next year or two as those high short-term rates bite into economic growth and inflation. Locking in longer-duration seals in higher yield becomes more valuable as rates decline. The consequent price appreciation in bond prices is most pronounced at the longer end. We see markets as mid-way through this trade and would continue to emphasize Treasuries over corporate credit, which may struggle if the economy slows more than expected. Treasuries also tend to benefit if markets adopt a risk-off attitude as they did during the bank crisis in March.



Source: Federal Reserve, BLS

The most important economic data for markets remains inflation prints, most notably expressed in the monthly CPI report. Inflation has continued to trend lower in April, and we are of the viewpoint that the odds of lower-than-expected inflation are increasing. The leading edge of lower inflation, as it was of higher inflation, is money supply growth. This is not a new data point for us — we referenced money supply as a key driver of inflation in published material all the way back in the spring of 2021. After letting excessive liquidity run far too long into the first quarter of 2022, the Fed induced multi-decade high inflation numbers that peaked in the early fall.

Since March of last year, money supply growth has been tamer. It recently has been negative for the first time since data collection started in 1959. Along with negative money supply growth, we have much tighter credit conditions in the banking system, as evidenced by Federal Reserve loan officer surveys. This was the case even before the March bank crisis but certainly has accelerated since those events. Rent and shelter costs have also plummeted since last fall, and we expect that data will begin to show up in monthly CPI soon. Shelter comprises approximately 40% of CPI.

Negative money supply growth, tighter loan standards, and a falling shelter component are all deflationary and support an outlook of lower inflation. Wage growth, although a little lower recently, is on the other side of the inflation ledger. All add up to a continuation of lower inflation prints. Consequently, the FOMC is likely to pause its rate rise campaign. However, we do not see them pivoting to cutting rates anytime soon, given that an improved inflation dynamic is still far from the 2% target.

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