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Week in Review

For the week, through the market close on March 1, 2024, the return for ACWI (iShares MSCI ACWI ETF) was 0.86% and SPY (SPDR S&P 500 ETF) was 1.01%. For the year, ACWI is up 5.81% and SPY is up 7.9%. In the bond markets, the U.S. 10-year Treasury is yielding 4.18%, lower from 4.25% at the end of last week.

This week markets and observers received data surrounding inflation, housing and the state of the manufacturing industry in the U.S. Given the U.S. Federal Reserve's emphasis on gaining more confidence as it relates to the process of disinflation, the most anticipated report was the January release of the Personal Consumption Expenditures (PCE) price index - the Fed's preferred gauge of inflation.

Personal Consumption Expenditures (PCE)

The January PCE data was released this week, and the numbers were slightly higher than consensus expectations on an unrounded basis. For reference, according to the Bureau of Economic Analysis (BEA), the PCE price index is "the value of the goods and services purchased by, or on the behalf of, U.S. residents." Ultimately, this index aims to track prices consumers pay for goods and services in a different manner than the more commonly followed Consumer Price Index (CPI). Because of its methodology, PCE price index is the Federal Reserve's preferred gauge of inflation in the United States.

First, looking at Headline PCE, which includes the volatile prices of food and energy, the index showed that prices rose by 0.34% in January. Consensus expectations were calling for an increase of 0.3% month over month. On a year-over-year basis, the index was higher by 2.40%, which represented a slowdown from the 2.62% annual rate in the prior period.

Stripping out the prices of energy and food, known as Core PCE, this showed an increase of 0.42% in January, up from an increase of 0.14% in last month's report. On a year-over-year basis, the Core PCE price index was higher by 2.85%, which also represents a step down from the prior reading of 2.94%. In fact, this is the lowest year-over-year reading in almost three years. Looking to the drivers of the pickup in sequential monthly inflation, it remains the case that services inflation was strong whereas goods inflation was fairly benign. More specifically, services inflation within the Core PCE index rose by 0.40% in January whereas the likes of nondurable goods exhibited outright deflation, declining for the third consecutive period.

In an attempt to tie all of this together, the main takeaway is that the path to the Fed's 2% average inflation target will be bumpy, but we continue to believe it remains headed in the right direction. While it is true that services inflation remains rather sticky, the annual rate of Core PCE is now roughly half of what it was from the 5.57% rate observed in February of 2022, it is just the case that the path towards 2% may not be a straight line lower. Much like the Fed, we will continue to monitor the incoming growth and inflation data to assess its potential implications on monetary policy. In that spirit, while we would not want to ignore that inflation picked up on a month-over-month basis, it is critical to view things over a longer time horizon and avoid putting too much emphasis on one month's worth of data.

"Confidence" remains key as it relates to gaining more of it from the Fed's perspective that inflation will head durably towards lower, consistent with their price stability goal. With inflationary pressure remaining stable, the reports and comments out of the Federal Reserve will remain a top news story until there is some clarity on the timing of rate cuts.

Housing Market – New Home Sales

According to the National Association of Realtors (NAR), the housing market supports the flows of goods and services to account for nearly 17% of the country's economic activity (GDP). Further, in the NAR's estimation, every home sold creates two jobs. As with all economic analysis, these statistics are an attempt to quantify the importance of housing in the economy. Though, for any observer, or homeowner, it's evident that housing is a key piece to the U.S. economy.

This week a report on the sale of new single-family homes was released from the U.S. Department of Commerce, showing that sales increased by 1.5% in the month of January. This translates to the sale of roughly 661,000 homes at a seasonally adjusted annual rate, missing expectations for an annualized rate of sales closer to 684,000. This marks the second consecutive month of growth in new homes sold, and meaningfully above the summer 2022 lows, when monthly sales were only 543,000 annualized.

Further, on a year-over-year basis, sales of new single-family homes rose by 1.8% through the end of January. This recent pickup in new home sales is likely attributable (at least in part) to the fact that borrowing costs are more favorable today than they were at the end of the last fall. More specifically the 30-year fixed rate mortgage per Freddie Mac peaked just shy of 8% in the fall of last year. More recently this mortgage rate has settled, on average, below 7%. In fact, for most of 2024 the rate on a 30-year fixed mortgage has hovered just above 6.5%. Interest rates, and the direction of rates, play a key factor in homebuyers' decision-making process. Given that this is such an interest-rate sensitive segment of the U.S. economy, elevated mortgage rates serve as a headwind for prospective homebuyers.

Manufacturing PMI

Friday's report from the Institute for Supply Management (ISM) showed that the manufacturing segment of the U.S. economy remained in contractionary territory. The official report showed that the manufacturing PMI declined in February, with a reading of 47.8. Recall that this is a diffusion index, based on answers to surveys across companies within the manufacturing segment of the U.S. economy. A reading above "50" illustrates an expansionary environment, or an increase in activity, while a reading below “50” suggests contraction from the prior period. This month’s reading is down from 49.1 in January and missed expectations for a reading of 49.5.

As mentioned prior, this index, which captures data on many activities throughout the manufacturing sector including new orders, inventory and hiring, has remained below the key metric of “50” since the fall of 2022. Though encouraging, the February data showed that the prices paid component, while still above the 50-mark, edged slightly lower from January’s reading. Next week the Institute for Supply Management will release its services PMI, which has remained firmly above the important reading of “50”.

Have a great weekend,

Baystate Wealth

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