

## August news & updates

### Markets Strong in May Despite Late Dip as Investors Eye Rate Cuts

Wall Street rebounded nicely in May from its April slump despite going into rollercoaster mode at the very end of the month. For most of May, the market grew steadily, driven largely once again by the speculative artificial intelligence (AI) boom. All the major indexes hit new record highs, with the Dow Jones Industrial Average topping 40,000 for the first time ever on May 16.<sup>1</sup>

Despite all that, the markets did swoon dramatically in the final few days of May before investors staged a strong last-minute rally.<sup>2</sup> What caused the late dip, and what does it mean for the rest of the summer?

Basically, the cause was investor nervousness ahead of the release of the latest inflation data. As you'll recall, April's market downturn was due partly to news that March inflation had risen slightly over the two previous months. Though inflation is far below the record high levels it was at when the Federal Reserve began raising interest rates as a countermeasure in early 2022, it remains higher than The Fed's target level of 2%. According to the Bureau of Economic Analysis, core inflation rose by just 0.2% in April.<sup>3</sup> That number was right in line with expectations, easing investor fears that inflation would show signs of heating up again. The news was especially welcome given that real economic growth, as measured by the gross domestic product (GDP), fell from 3.4% in the fourth quarter of 2023 to 1.3% in Q1 2024.<sup>4</sup> In other words, the economy is clearly cooling, therefore inflation should be cooling, too, since fundamentally the two go hand in hand.

#### The Interest Rate Issue

The real appeal of the inflation news for investors is that it means the Fed may choose to start lowering short-term interest sooner rather than later. Until last month, most analysts were forecasting The Fed probably wouldn't make a rate cut until late in the year, thanks mainly to stubborn inflation. But with inflation now showing signs of moving closer to the Fed's target goal, coupled with the slowing economy, those forecasts are being revived, and investors are eagerly anticipating the helpful tailwind falling interest rates would provide.

As noted, although the stock market hit new record highs in May and is up by over 11% for the year – as measured by the S&P 500 – much of that growth is still being fueled by the artificial intelligence boom, and specifically the so-called Magnificent 7 tech companies: Alphabet (Google), Apple, Amazon, Meta Platforms, Microsoft, Nvidia, and Tesla. While other companies and sectors are also doing well, the Fed finally lowering rates again would likely bring a bit more parity to the markets since, just as high or rising interest rates depress the value of all assets, falling interest rates generally work to increase values.

That brings us to the bond market, where the inverse relationship between interest rates and bond values is well known. As the stock market rose for most of May, long-term interest rates declined, with the rate on the 10-year government bond falling from 4.68% at the start of the month to 4.47% by May 24. Then came that end-of-month swoon and, as stock prices fell, sell-offs in the bond market pushed the 10-year back up over 4.6%. Then came the good news about inflation and rates headed downward again!

<sup>1</sup> "Dow Tops 40,000 for the First Time," Yahoo Finance, May 16, 2024.

<sup>2</sup> "Market News: Dow Posts Best Day of 2024, S&P 500 Swings Higher After Inflation Report," Investopedia, May 31, 2024

<sup>3</sup> "Tamer Inflation in April Revives Hope for Interest-Rate Cut," [Investopedia.com](https://www.investopedia.com), May 31, 2024

<sup>4</sup> [bea.gov](https://www.bea.gov), May 30, 2024

<sup>5</sup> [MarketWatch.com](https://www.marketwatch.com)



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