CLAYTON
WEALTH PARTNERS

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MONTHLY MARKET PERSPECTIVE

Still All About Inflation

By James M. Walden, CFA

DASHBOARD

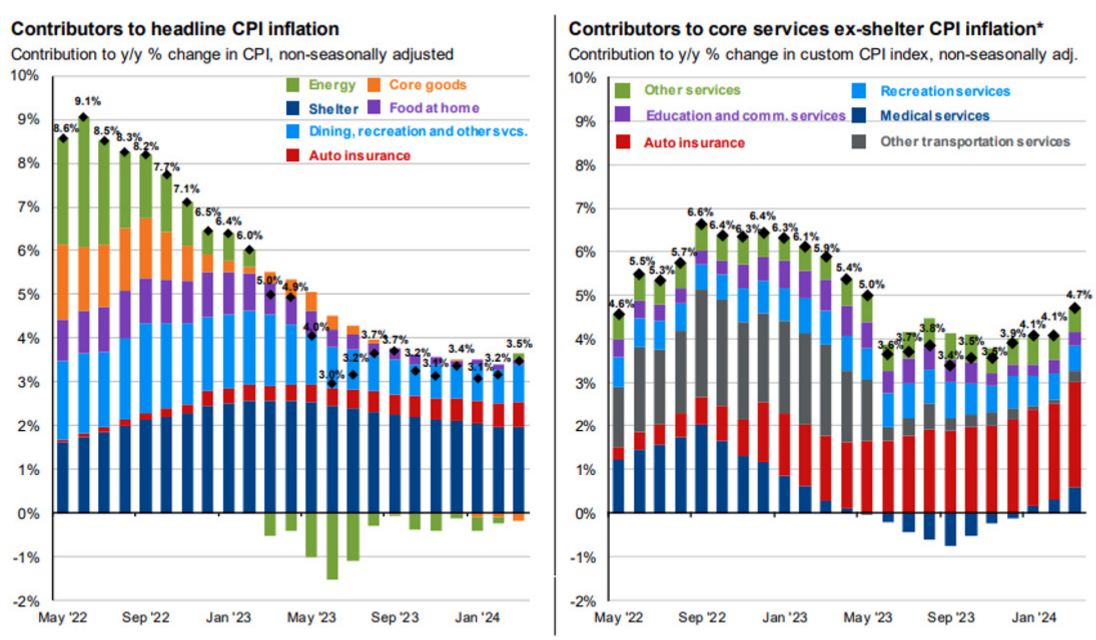
- Business Cycle
- Valuation
- Trend

Two years after the Federal Reserve's first interest-rate hike of the cycle, it's still all about inflation.

Much progress has been made to bring inflation down to the Fed's stated 2% goal. The year-over-year change in the consumer price index (CPI) in March was 3.5%, down from its 9.1% peak in June 2022. However, March's number is an uptick from February's 3.2%, a level around which it had stubbornly remained since October.

Over time, inflation should continue to work its way toward the Fed's goal. Shelter costs, which account for about a third of the CPI calculation, capture new and existing renters and therefore lag real-time rents. Market rents have softened lately, which suggests the large shelter component of CPI should ease in the coming months. Meanwhile, annual increases in the costs of car insurance, which have been another outsized contributor to inflation, should soon become less of a burden. See the left panel of the exhibit for more detail.

Exhibit: Inflation and Its Components



Source: Bureau of Labor Statistics, FactSet, J.P. Morgan Asset Management, Clayton Wealth Partners.

In recognition of the broad improvement in inflation, the Fed recently reaffirmed its projections of three quarter-point cuts to its benchmark interest rate this year. But after the hotter-than-expected March inflation reading, the market lowered its expectations to just two cuts. Fed Chairman Powell indicated that he's in no hurry, preferring to wait for more data to get greater confidence that the improvement in inflation is sustainable. Coupled with projections of just three additional quarter-point cuts in 2025, it seems the Fed wants to proceed with cuts gradually. So, compared to what we've all been used to, interest rates will probably continue to be higher for longer.

Higher interest rates are a mixed bag, depending on one's perspective. The Fed's short-term rate influences the longer-term rates found on Main Street. And it goes without saying that higher rates are unattractive for borrowers. (The average 30-year fixed mortgage rate of almost 7% continues to weigh on housing affordability.) But on the flip side, higher rates are good for savers. With the yield on the 10-year U.S. Treasury about 4.3% as of this writing, investors in high-quality fixed income are being rewarded with income and a source of diversification.

We continue to see relatively more value in high-quality fixed income and high-yielding money markets than we do in stocks, especially after stocks' strong recent run. Meanwhile, the jury is still out on the recession/no-recession debate. Now is not the time to be taking on excess portfolio risk, in our opinion.

Bullish

- The Fed has made good progress in reducing inflation.
- The Fed appears poised to start cutting interest rates in 2024.
- The services sector of the U.S. has remained strong.
- The most attractive yields for fixed income and cash in years.
- Consumer and corporate balance sheets generally remain healthy.

Bearish

- Slowing global economic growth with recession pressures mounting.
- Banks are tightening lending standards.
- Housing affordability remains at a decades-low.
- Leading indicators of unemployment are generally trending down.
- Delinquency rates on consumer loans are rising.
- Russia-Ukraine war, Israel-Hamas conflict, and other geopolitical concerns.
- China is experiencing a growth recession, with deflation fears growing.
- Federal debt and deficits have ballooned.

JAMES WALDEN, CFA
Partner and Chief Investment Officer

As Partner and Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner and management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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716 S. Kansas Ave.
Topeka, KS 66603

832 Pennsylvania St., Suite 1005
Lawrence, KS 66044

785-232-3266 | claytonwealthpartners.com