Capital Market Review

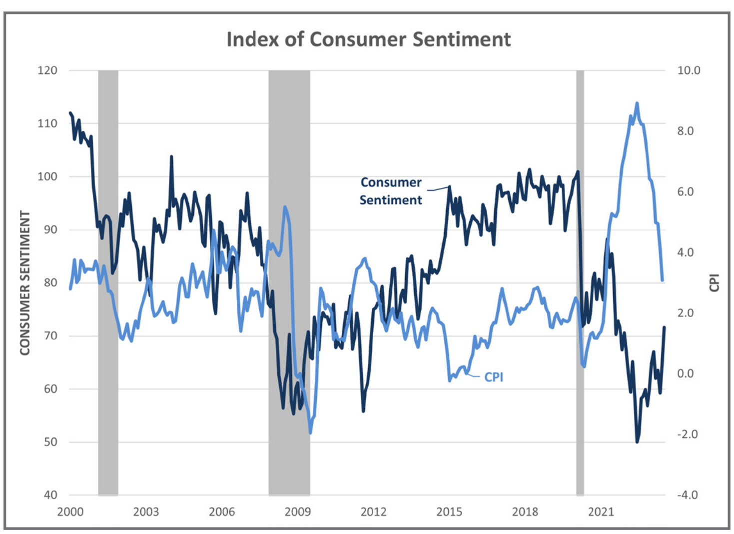
By: Joe Clark, CFA, Allegheny Research Team

The Current Economy: "Is was the best of times, it was the worst of times..."

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair." Charles Dicken's opening in "A Tale of Two Cities" takes most of us back to high school English class and possibly the angst of assigned readings of our teenage years. Years later we can appreciate the opening's relevance in describing the current state of the economy and stock market. Depending on who is delivering the message, the economy either has a great outlook or the U.S. will be experiencing a recession within the coming months.

The U.S. consumer continues pushing us to a "spring of hope" mindset, with inflation leading the optimism. Although still high based on recent history, inflation has fallen from its peak of 9.1% in June 2022 to the current rate of around 3%. While not yet at the Federal Reserve's target of 2%, price increases have slowed compared to one year ago, increasing the hope of avoiding a severe recession.

The University of Michigan's Consumer Sentiment Index has tracked inflation almost perfectly over the past eighteen months. Last year, as inflation continued to rise and recession fears increased, many consumers felt worse about their own and the economy's prospects. Coincidently, the index bottomed in June 2022, the same month inflation peaked at 9.1%. Since then, inflation has slowed, and consumers have become more optimistic each month.



Along with improving inflation, the labor market has remained resilient. Despite recession predictions, the unemployment rate has remained below 4% since the end of 2021, well below the 20-year average of 5.8%. Although there have been headlines surrounding jobless claims increasing, they have increased from extremely low levels to being more comparable to pre-pandemic averages. In an economy led by the consumer, it's hard to have a recession when people are working.

As inflation and the labor market lead optimistic views, there is also the chance of a "season of darkness." Higher interest rates are one of the leading risks to the economy. We have seen higher rates lead to a regional banking crisis and tightening lending standards across the market. Low supply continues to lead to a competitive housing market, but 7% mortgage rates have significantly impacted affordability. And commodity prices have been creeping higher in the background, increasing local gasoline prices by $0.15 over the past month.

Cautiously optimistic can describe many market environments, with this one being no different. Based on last year's comparables and recent commodity prices, inflation may remain flat or even slightly higher than the current rate through the end of the year. The Federal Reserve may continue to raise interest rates or be done and keep rates steady for the next few months. Opposing views are nothing new. There are always positive and negative factors impacting markets, and it's what makes markets efficient. One party has a positive view and wants to buy, and another takes the opposite opinion and sells. Looking past short-term uncertainty and maintaining a long-term view is typically the best strategy to meet investment objectives.

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