Ropes Wealth Questions to Cut or Not to Cut?

To cut or not to cut is the question for the Fed and for investors as the economic data continues to confound, with inflation running hotter than hoped and the economy showing no signs of a slowdown. This week the Consumer Price Index (CPI) and Producer Price Index (PPI) were both reported. The CPI rose 0.4% in March, a tenth of a percentage point more than expected. Year-over-year, consumer prices rose 3.5%, slightly more than the 3.4% annual increase expected for the largest annual gain since September. Core CPI, excluding food and energy costs, is now running at a 3.8% annual rate of increase. For their part, producer prices are trending at a 2.1% annual rate, up from the 1.6% annual increase in February for the largest annual increase in nearly a year.

These hotter inflation reports further complicate the policy pathway for officials clearly anxious to cut rates. While market participants have been eager to dismiss an earlier backup in price pressures as an anomaly or temporary disruption, three months of acceleration is increasingly more difficult to ignore. Now there is a growing concern the Fed did not raise rates to a sufficiently restrictive level to ensure a return to price stability.

Besides these inflation data points, the March FOMC meeting minutes showed a rising level of concern among Fed officials regarding the upside risk to inflation even before this week's consumer and producer price reports. While most participants agreed rate cuts would likely be warranted at some point this year should the economy evolve as expected, inflation has already proved unruly relative to the Committee's forecasts for a continued disinflationary trend back towards 2%. Additionally, some Fed officials warned that recent increases in inflation *"had been relatively broad-based and therefore should not be discounted as merely statistical aberrations."* While Chair Powell was clear in March that the Committee would not "overreact" to just two months of hotter data, now facing three consecutive months of rising price pressures, the Committee will have an increasingly difficult time ignoring the upside risks to prices. For all these reasons, investors are likewise having a change of heart about falling rates, and bond yields have surged back to higher levels not seen in months.

Only time will tell what the Fed will do, but in the meantime, and in the long-term, it is earnings that should matter most. And we are in luck as the kickoff of the first quarter earnings season begins today, with banks as the first in the lineup. Wall Street projects S&P 500 members will show 3.8% annual growth in earnings per share for the first-quarter reporting period. Notably, profits for the "Magnificent Seven" cohort are on course to rise 38% in the first quarter. If corporate earnings are much stronger than expected overall, what the Fed cuts or doesn't cut may not even matter. For now, markets seem to be lining up to embrace that approach, continuing to put all their eggs in the AI basket as tech companies continue to dominate market returns. However, for those skeptics out there worried about valuations of those companies, consider that the "Magnificent Seven" trade at a significantly lower valuation metric (forward P/E multiple average of 28x) than the top 10 during the dotcom bubble (forward P/E multiple average of 49x) in 2000.

Keep your head up about oil, which continues to gain ground on fears of a Middle East escalation and robust demand outlook against a backdrop of OPEC supply cuts. Rising prices at the pump act like a tax on consumers and have historically been shown to provoke noticeable shifts in consumer spending patterns more than price increases in other categories.

With tax day around the corner, it is a good time to remind you that one of the ways we strive to be your partner is to keep in close touch on taxable gains and income, go the extra mile to choose tax sensitive investments, proactively offset gains with losses when possible, and recommend and implement tax management techniques like in-kind gifts of stock, tax lot level analysis for asset disposition, and providing careful consideration about asset location between taxable and tax-exempt accounts. Market strength in 2023, following the dismal market returns in 2022, has also brought forward some higher taxes as a result of sensible profit taking, and if the market continues to rip higher, that will be the same in 2024. We are focused on executing a prudent modest portfolio rebalancing at these trading levels, and making some moves that may book a tax loss now to store well before year-end. As always and if applicable, we are happy to review outside holdings to support you in your overall portfolio tax management, and to help you consider in-kind gifts of appreciated stock as the markets continue to make new highs.

On that note, I will close with a little tax time humor: *"What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin."* Well said, Mark Twain.

Thank you for your interest in our investment commentary and for your relationship with us. A special shout out to our clients who are running or supporting friends and family in the iconic Boston Marathon on Monday. #BostonStrong always.

If you would like to speak personally with a member of our team at any time, please click **here**.

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