ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

APRIL 2024

The Rashomon Effect

Same data, different interpretations

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Market Watch

Equity Market Indices[1]	2/29/24 Price	3/31/24 Price	MTD Change	YTD Change
MSCI All Country World	761	784	2.9%	7.8%
S&P 500	5096	5254	3.1%	10.2%
MSCI EAFE	2286	2349	2.8%	5.1%
Russell 2000®[2]	2055	2125	3.4%	4.8%
NASDAQ	16092	16379	1.8%	9.1%
TOPIX	2676	2769	3.5%	17.0%
KOSPI	2642	2747	3.9%	3.4%
Emerging Markets	1021	1043	2.2%	1.9%
Fixed Income				
2-Year U.S. Treasury Note	4.62%	4.62%	0	37
10-Year U.S. Treasury Note	4.25%	4.20%	-5	32
BBG U.S. Agg Corp Spread	0.96%	0.90%	-6	-9
BBG U.S. HY Corp Spread	3.12%	2.99%	-13	-24
Currencies				
Chinese Renminbi (CNY/$)	7.19	7.22	0.5%	1.7%
Brazilian Real (Real)	4.97	5.01	0.9%	3.2%
British Pound ($/GBP)	1.26	1.26	0.0%	0.9%
Euro ($/Euro)	1.08	1.08	0.1%	2.3%
Japanese Yen (Yen/$)	149.98	151.35	0.9%	7.3%
Korean Won (KRW/$)	1331.40	1347.35	1.2%	4.6%
U.S. Dollar Index (DXY)	104.16	104.49	0.3%	3.1%
Commodities				
Gold	2044	2230	9.1%	8.1%
Oil	78.3	83.2	6.3%	16.1%
Natural Gas, Henry Hub	1.86	1.76	-5.2%	-29.9%
Copper (cents/lb)	383	401	4.5%	3.0%
CRB Index	275	290	5.5%	10.0%
Baltic Dry Index	2111	1821	-13.7%	-13.0%

Source: Bloomberg

INTRODUCTION

March was a historic month for central banks. The Bank of Japan (BOJ), the last samurai in this century's controversial negative interest rate saga, officially ended it by delivering its first rate-hike in 17 years that brought its short-term policy rate to a range of 0% to 0.1%. It also discontinued yield curve control (YCC), and large-scale equity purchases. The BOJ's belated policy normalization was countered by a surprise rate cut by the Swiss National Bank (SNB), which became the first major developed market central bank to kick off the easing cycle following the post-COVID inflation episode. The honor of the most consequential "non-move" went to the Federal Reserve, which kept its three-rate-cut guidance for 2024 despite substantially raising its economic growth expectations and nudging up core inflation forecasts. The Fed also indicated that it would start to taper the pace of balance sheet reduction "fairly soon."

The Fed's upsizing of its GDP forecast came on the heels of the non-partisan Congressional Budget Office (CBO) quantifying the big jump in net immigration. The surge in immigration helped explain in part the U.S. economy's surprising resiliency – an increase in population naturally leads to greater consumption. However, the impact on public finances – the cost of accommodations, social services, medical care, etc. – has become a hot-button issue.

Chair Powell's seeming proclivity to restart an easing cycle coupled with more optimistic growth expectations were tonic to the market. Some observers were concerned that instead of taking away the proverbial punchbowl in the face of seemingly bubbly market behavior – e.g., the return of meme coin craze – the Fed spiked the drink with the promise of more liquidity. Perhaps Chair Powell is concerned about the market's limited appetite for the deluge of Treasury debt issuance – there was at least one poor Treasury bond auction in each of the last six months. The troubled commercial real estate market could also be weighing on his mind. However, the Fed's dovish stance runs the risk of hurting its inflation fighting credibility, which could push bond yields much higher and create more instability down the road. It's ironic that some pundits are now using the term "higher for longer" to describe the Fed's tolerance for inflation.

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The Rashomon-esque America

Rashomon, a 1950 film by late Japanese filmmaker Akira Kurosawa, is a masterpiece that put Japanese films on the global cinematic map. The plot unfolds through flashbacks of people involved in a murder and assault – a bandit, the spirit of the murdered samurai, the samurai's wife, and a woodcutter – giving contradictory accounts of what had transpired. Each account reflects the narrator's own motivations and biases, leaving the "truth" tarnished and ambiguous.

The film gave rise to the concept of Rashomon Effect, where a single event is recounted in contradictory manners due to people's biases and self-interests, calling into question the nature of "truth" – it can be subjective and even deceptive.

This effect is currently on display in the U.S. presidential election season, which kicked into higher gear in early March with former President Trump becoming the presumptive GOP nominee on Super Tuesday and President Biden going on the offense with his State of the Union Address two nights later.

As usual, the political spin is intense, and interestingly, various surveys have shown that many people's views on the economy have been largely affected by party affiliation. This political lens has rendered some components of the University of Michigan Consumer Sentiment Surveys somewhat less relevant as a gauge on the economy.

How voters process the political spin and their own lived experience will determine the outcomes of this November's elections. Currently, political strategists believe that Democrats are favored to recapture the House while Republicans have a decent shot at winning back the Senate. The presidential election is too close to call and will likely come down to a few battleground states. The upcoming election season will likely be punctuated by surprises, division, and acrimony. Market volatility could pick up materially as we get closer to the election, and elevated policy uncertainty may even prompt some businesses to temporarily halt new spending and hiring initiatives.

Early voting for 2024 primary election continues in Chicago

The Immigration Stimulus

While bread-and-butter issues such as inflation, jobs, and the economy are usually the most important issues to voters, immigration has emerged as a pressing and contentious subject in some recent polls. The surge of migrant arrivals has overwhelmed many municipalities. However, economists and investors have begun to take notice of the impact of surging immigration on the U.S. economy as more data became available.

According to the non-partisan Congressional Budget Office (CBO), net immigration to the U.S. has picked up substantially over the last two years. Net immigration used to average around 900,000 people per year over the decade before the pandemic. However, the CBO's latest estimates of net immigration have increased to 2.7 million in fiscal year 2022 and 3.3 million in fiscal year 2023. The CBO's long-term forecast assumes that the surge in net immigration will last through 2026 – 3.3 million in 2024, 2.6 million in 2025, 1.8 million in 2026 – before settling down to 1.1 million per year over the period of 2027-2054.

The CBO projects the influx of migrants to boost the size of the U.S. economy by a cumulative amount of $7 trillion from 2023 to 2034, adding roughly 0.2% of real growth per annum. I suspect the surge in net immigration in 2023 was more stimulative than a 0.2% addition to real GDP growth. A net increase of 3.3 million immigrants in 2023, assuming it's in the right ballpark, boosted the U.S. population by 1%, and economic growth is essentially tied to changes in population and productivity. While migrants' per capita consumption would not come close to the national average, some municipalities have provided generous aid that benefited select local businesses.

Many businesses, economists, investors, and politicians believe that this surge in immigration will revitalize the U.S. economy by boosting consumption and labor supply as migrants in general are younger than the median age of the U.S. population and many are willing to take on jobs undesired by most Americans. However, polls have shown that most Americans do not embrace such sanguine views as they are more concerned about the economic burden on their communities and security.

The Employment Rashomon

The state of the U.S. job market is another important issue in the presidential race and has been a trump card for the Biden campaign. The latest employment report showed that 275,000 jobs were created in February, easily beating the market's expectation of 200,000. However, a closer examination of recent employment data has revealed some weaknesses.

The Bureau of Labor Statistics (BLS) conducts two monthly surveys to measure employment trends: the Establishment and Household surveys. Over the last three months, the Establishment data tallied a strong gain of 800,000 jobs while the Household survey reported a cumulative loss of 900,000 in the employed population and a decline of 1.8 million in full-time employment. These surveys have created a Rashomon-esque situation – one showed a healthy economic expansion while the other hinted at the start of a technical recession.

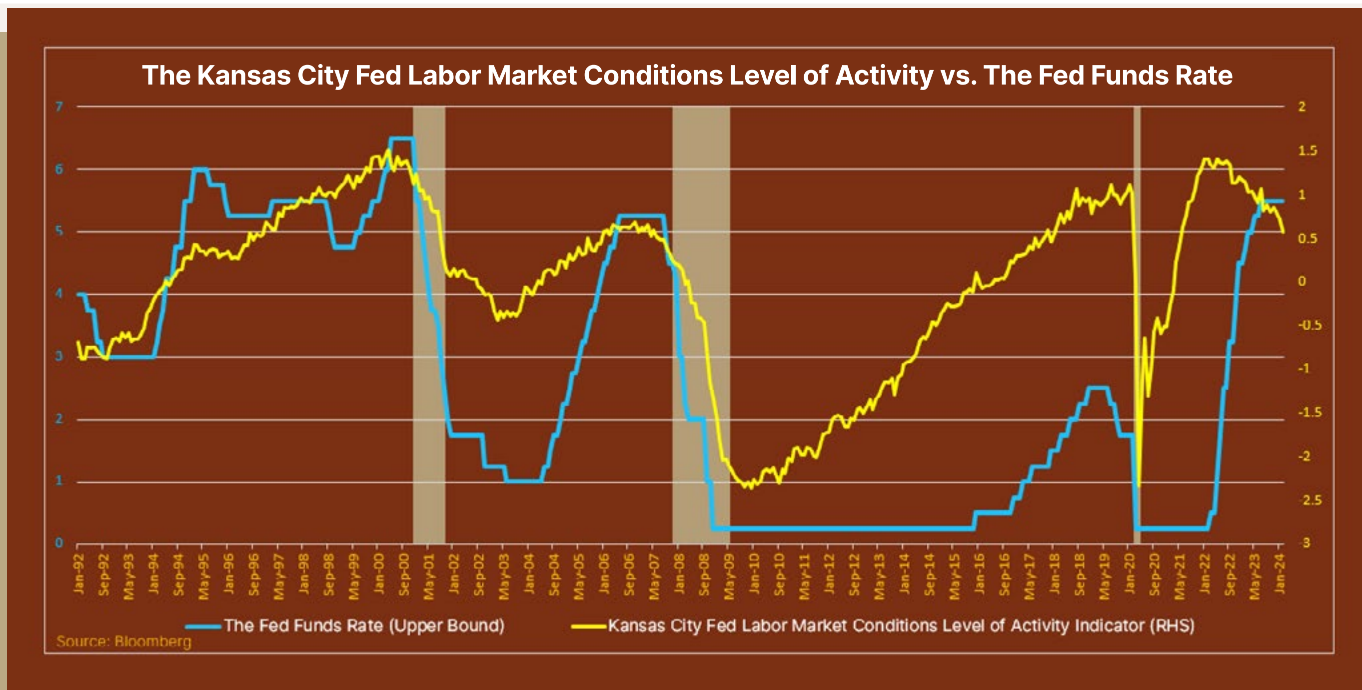
To circumvent the data quality issue, policymakers and investors need to look at a mosaic of information from different sources. The Kansas City Fed has created the Labor Market Conditions Indicators (LMCI) which incorporate 24 labor market variables from a variety of sources. For what it's worth, the level of employment activity measured by the LMCI has shown a steady deterioration since early 2022, similar to the developments preceding the prior recessions in 2001 and 2007. If past is prologue (Chart 1), this indicator would call for the Fed to start cutting the Fed funds rate to avert a looming recession.

The "Higher-for-Longer" Fed

At the conclusion of the March Federal Open Market Committee (FOMC) meeting, the Fed raised its economic and inflation expectations but kept its three-rate-cut guidance and acknowledged that the pace of quantitative tightening (QT) will taper "fairly soon." It appears that the Fed has incorporated the surge in net-immigration into its new forecasts as Chair Powell pointed to "an increase in the supply of workers" and "strong pace of immigration" as two of the growth drivers.

While "Fed watching" is by nature susceptible to the Rashomon Effect, there appears to be a growing consensus among investors that Chair Powell was looking for excuses to stay dovish and may tolerate higher than 2% inflation for longer. How else could Fed watchers rationalize the dovish stance in the face of the Fed's own no landing and higher inflation projections, rapidly easing financial conditions, and bubbly markets? It is also puzzling that, in his last two post-FOMC meeting pressers, Chair Powell has declined to acknowledge that financial conditions have eased significantly as shown in all such indicators, including the Fed's own.

The Fed's surprisingly dovish policy stance and additional fiscal stimulus from Washington, such as the likely resumption of the Employee Retention Tax Credit, could further fuel the powerful rally among risk assets as well as monetary inflation hedges such as precious metals. However, longer-dated Treasury bond yields could climb higher in the absence of softer employment and inflation data. At some point, higher bond yields – probably with the 10-year Treasury yield climbing above 4.4% or 4.5%



– may start to pressure equity valuations like they did in the autumn of 2023. In the meantime, investors will continue to scrutinize every piece of employment and inflation data and judge the strength of all upcoming Treasury bond auctions.

The strong market rally since last November has made it more difficult to find compelling investment opportunities. While momentum investors will continue to ride the artificial intelligence (AI) and GLP-1 (weight loss drugs) waves, others are scrambling to find relative underperformers such as small cap stocks, crude oil, and base metals, to play catch-up. Another laggard is the market's volatility, as the VIX Index has been stuck at multi-year lows. I suspect volatility will increase materially as we get closer to the November election.

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DIN: 1428079438-5056

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