

WEEKLY CLIENT COMMENTARY | APRIL 12, 2024

Mitch on the Markets

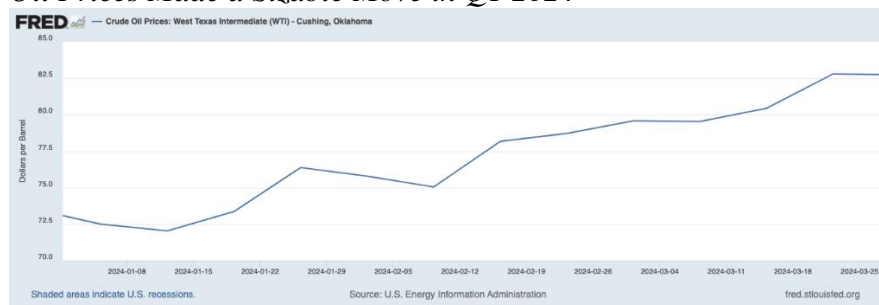
Portfolio Manager Investing Insights

Oil Prices are Rising Fast—Should Investors Be Worried?

Oil prices have been on the move—but not in the direction that favors consumers.

In the first quarter of 2024, the price of a barrel of West Texas Intermediate crude has risen almost 15%, and Brent crude futures – the global benchmark – are up 18%. That puts the global price of a barrel of oil above \$90 as I write, which has already fed into higher gas prices. According to AAA, gas prices are also up 15% this year, with the national average at \$3.57 a gallon.¹

Oil Prices Made a Sizable Move in Q1 2024



Source: Federal Reserve Bank of St. Louis²

There are a few forces driving up prices. On the supply side, the two ongoing wars have caused disruptions. Ukrainian attacks on Russian oil-refining facilities have dented diesel exports, which has prompted refiners elsewhere to increase output (requiring cruder). Traders also fear that escalations in the Middle East could impact production, though we haven't seen major disruptions to date.

The more meaningful hit to supply is actually coming from the U.S. The United States is the world's largest oil producer, and it looks like output could weaken from here. When oil prices went up last year, producers tapped drilled-but-uncompleted wells, which sent production to all-time highs—and also put downward pressure on prices. Lower prices and still-high interest rates have discouraged new investment, which is evident in steeply declining oil rig counts.

On the demand side, a large swath of the global economy looks like it's flipping back into growth mode, which of course puts upward pressure on crude oil and other raw materials. Other factors – like rising demand for jet fuel from robust travel activity, and cargo ship disruptions in the Red Sea that are

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requiring more fuel to sail around the southern tip of Africa – are adding to the demand equation. All told, the International Energy Agency estimates 103 million barrels per day of global oil consumption, which would be a record.

In the near term, I would not be surprised if falling U.S. output and rising global demand place even more upward pressure on crude oil prices. This may also be a reason that the Energy sector outperformed in the first quarter, rising 13.7% in the first three months compared to the S&P 500's 10.6% gain.

So, should investors be concerned if oil prices keep going up in the coming months, perhaps even crossing \$100 a barrel?

Not necessarily. As I've written before, there is not a historically tight correlation between higher oil prices and weak economic growth and/or an underperforming stock market. The chart below demonstrates this point. Pictured is the global price of Brent Crude and West Texas Intermediate oil going back to 2000. I've circled in green a period of about 4 years when oil prices hovered in the \$100 a barrel range, which were also years when the economy grew consistently – albeit modestly – and stocks remained locked in a bull market.

The U.S. economy can withstand higher oil prices



Source: Federal Reserve Bank of St. Louis³

Oil production also is sensitive to price, not global volumes. If the price of a barrel of oil rises above \$100 a barrel, I think we'd see major producers ramp up to take advantage of higher margins. Such an outcome is consistent with what we've seen historically, and new technology allows producers to increase output fairly quickly.

Bottom Line for Investors

Higher oil prices are not without risks. The U.S. economy is at a point in this cycle where inflation needs to remain steady or continue trending downward so that the interest rate outlook and expectations for rate cuts in 2024 remain intact. Since oil is used in the production of everything from plastics, fertilizers, and of course gasoline, higher crude prices can impact the cost of travel, food, and other goods and services that exist downstream. This could pinch consumer spending, delay the Fed's policy loosening plans, and ultimately disappoint markets.

These are all real possibilities, in my view, and I think it's possible we see volatility this summer if uncertainty persists—especially given the U.S. presidential election looming in the background. But as I mentioned before, the economy has proven many times over that it can withstand higher oil prices, and I would anticipate that a period of higher prices would only be temporary as it incentivizes more production. Markets will likely anticipate that outcome, too.

¹ Wall Street Journal. April 4, 2024. <https://www.wsj.com/business/energy-oil/oil-is-hitting-its-highest-level-in-monthsjust-in-time-for-summer-driving-season-3370fbf7>

² Fred Economic Data. April 3, 2024. <https://fred.stlouisfed.org/series/DCOILWTICO#>

³ Fred Economic Data. April 4, 2024. <https://fred.stlouisfed.org/series/DCOILBRETEU#>

STEADY INVESTOR WEEK

- **March's inflation report**
- **The high cost of homeownership**
- **The cost of missing tax season**

All Eyes on March's Inflation Report

The Labor Department released March data for the consumer price index (CPI), which sent the stock market into a volatile trading session. It was reported that prices rose 3.5% year-over-year in March, which was slightly higher than economist expectations and marked an acceleration from February's 3.8% print. On a month-over-month basis, the Labor Department reported that prices rose 0.4%, which was 0.1% higher than the street was expecting. March's inflation data sent markets into a flutter of shifting expectations about rate cuts in 2024, which many believe may not occur until September. Narratives in the financial media this week flagged this CPI report as troublesome, mostly because of the notion that rate cuts would be pared back and/or delayed as a result. But as we've written before, the fate of the bull market and economic expansion do not lie solely in the Federal Reserve's hands. Many seem to forget that 2023's better-than-expected economic growth—and the strong market rally that accompanied it—took place while interest rates were still moving higher. The economy has already proven it can withstand higher rates, and we also do not buy into the idea that inflation could head in the wrong direction this year. The consumer price index is known for having an outsized weighting on 'shelter costs,' which make up roughly a third of the index. The Fed's preferred measure of inflation has come in below 3% and will be

released later in the month. We see that gauge trending towards 2% as the year progresses.¹

The High Cost of Homeownership

The National Association of Realtors reports that home-buying affordability is at its lowest level since 1985, when mortgage interest rates were still in the double-digits and had at one point reached 18%. Current mortgage rates are nowhere near those levels, of course, but it's the cost of everything else that has risen dramatically in recent years—home maintenance costs, homeowner's insurance, property taxes, and utilities. According to a home-improvement company called Thumbtack, it costs over \$6,500 a year to maintain a home, up 8.3% from 2022. Homeowner insurance prices have also been surging, as more Americans find themselves living in areas where flood, fire, and other natural disasters are occurring more frequently and with higher intensity. Insurance premiums have risen by about 20% over the last three years, with average annual rates climbing past \$2,300. Property taxes have also been going up. According to real-estate data firm Attom, the average property tax for a single-family home in the U.S. was \$4,062 last year, up over 4% from 2022. All told these non-mortgage costs account for more than half of a homeowner's overall annual costs, and it's been pinching household budgets.²

Tax Day is Right Around the Corner. Missing It Could be Costly

It's everyone's favorite time of year: tax season. 2024 is shaping up to be different from past tax years. The IRS estimates that 19.4 million Americans will request an extension, which is nearly a record high. For context, in 2014 only 12.5 million Americans requested extensions. In some cases, extensions were granted by the IRS

for people living in areas affected by natural disasters. But many Americans simply do not get their taxes done on time or may request more time because of a high tax balance owed. At the very least, Americans should request an extension if they're not able to get their taxes in by the 15th, and it's also wise to make some form of payment in the process. For individuals, failure to file triggers a 5% penalty for unpaid taxes each month, capped at 25% of the total.³

¹ Wall Street Journal. April 10, 2024. <https://www.wsj.com/economy/inflation-march-cpi-report-interest-rate-239b7e5e>

² Wall Street Journal. April 10, 2024. https://www.wsj.com/economy/housing/housing-affordability-taxes-insurance-costs-rise-bca64df1?mod=hp_lead_pos7

³ Wall Street Journal. April 10, 2024. https://www.wsj.com/personal-finance/taxes/tax-day-2024-extensions-refunds-irs-d12ada6d?mod=hp_lista_pos3

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