OBSERVATIONS: *Market momentum returns as S&P grinds higher, record corporate bond issuance, sentiment better.*

- Equities moved higher last week as the S&P 500 hit a new record high on Thursday and ended the week +1.1%, the Nasdaq gained +0.9%, while small caps (Russell 2000) gained +1.8% but remain in a bear market.[1]
- US investment grade corporates have issued over $150 billion so far this year, the highest start to a year since 1990. Nearly two-thirds of the year-to-date issuance has come from the financial sector.[2]
- University of Michigan's consumer sentiment index rose to 78.8 in January, capping a two-month run which saw the figure rise 29.0%—the largest two month gain since 1991. Still, sentiment remains 20% below pre pandemic levels.[1]
- The initial government estimate shows that GDP grew by +3.3% (annualized rate) in Q4. While this figure is lower than Q3's blistering +4.9% figure, it was well above the consensus Q4 estimates for +2.0% growth.[1]
- Durable goods orders were mixed in December. The headline durable goods orders was flat (+0.0% month-over-month, MoM), which was below expectations and below November's +5.5% MoM figure. But excluding the volatile transportation sector (autos and civilian aircraft), orders were up +0.6% MoM, which was better than November's +0.5% figure.[1]
- There were 664k new home sales (annualized rate) in December—that was better than consensus expectations—and better than November's figure, which was revised up to 615k. For the full year, 668k new homes were built in 2023—up +4.2% year-over-year from the number of new homes built in 2022.[1]
- The Fed's preferred gauge of inflation core-PCE (Personal Consumption Expenditure) fell to 2.9% year-over-year in December—this is down from November's 3.2% figure and the first time that core-PCE fell below 3% since March-2021.[1]

EXPECTATIONS: *Waiting for clues from the Fed, ECB keeps rates steady, and earnings off to weak start.*

- The Federal Reserve is set to kick off its first meeting of 2024 next week on Jan 30-31. Expectations are for no changes to monetary policy at this meeting. Markets have priced in five 25bps rate cuts in 2024, with the first cut expected near mid-year. We are still of the view that the first cut is likely to be later and to be part of fewer total cuts as compared to market expectations. More in today's One More Thought.[1]
- The European Central Bank (ECB) held its main policy rate steady at 4% for the third consecutive meeting as it focuses on bringing down Eurozone core inflation down from the current 3.4% reading to its policy target of 2.0%. Markets are currently assigning a 60% chance of a rate cut by the ECB in its April meeting.[3]
- Earnings, thus far, have been on the weaker side with about 25% of the index reporting only 69% have beaten earnings estimates—below the 5-year (77%) and 10-year (74%) averages for earnings beats.[4]

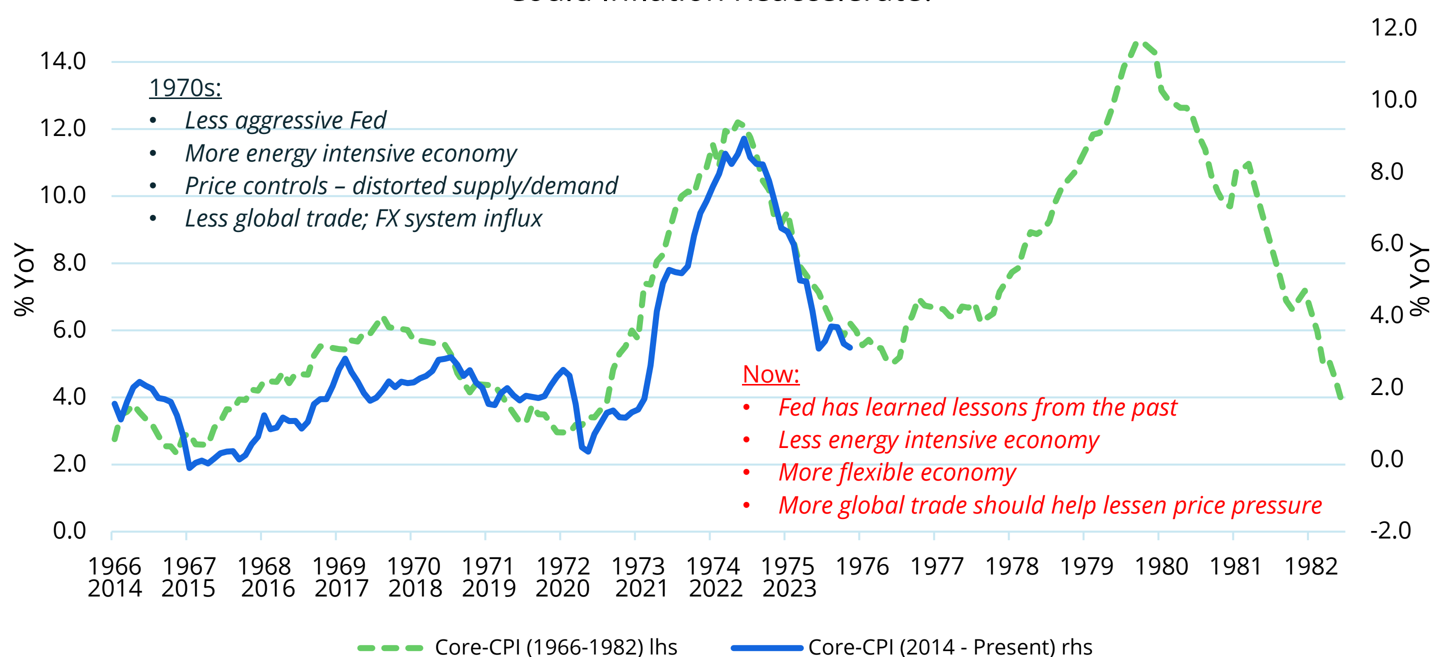
ONE MORE THOUGHT: *The Fed's Worst Fear.*[1]

As we approach another Fed meeting and its subsequent press conference, we are likely to hear additional emphasis by the Fed on the notion that interest rates will remain restrictive for a sufficient length of time to ensure that inflation unambiguously declines towards the Fed's 2% target. This Fed-speak has generally been translated in layman's terms as "higher for longer." Despite the Fed's success in getting inflation to decline from its mid-2022 highs to its current level, it has been careful not to declare victory and signal that near-term rate cuts are around

[1] *Bloomberg LP*
[2] *https://www.ft.com/content/20041cec-a83f-4f41-8cf3-b40d3464c922*
[3] *Bloomberg LP. Eurostat (1/17/2023)*
[4] *FactSet Earnings Insight 1/26/2024*

the corner. The roots of this Fed cautiousness can be found in the 1970s, whereby the Fed having initially raised rates in the early 1970s in the aftermath of the Arab oil embargo and the labor market tightness caused by the Vietnam war draft, began to ease in the mid-1970s only to find that inflation re-accelerated in the back-half of the decade and the Fed was forced to play catch-up for several years well into the early-1980s (Chart of the Week). While the Fed's cautiousness may be frustrating for politicians and market analysts that would like the Fed to get out of the way of the economy and markets, it is likely warranted—at least in part—to ensure the US economy does not re-experience a resurgence of inflation. The Fed has learned several lessons of the 1970s. The 1970s was widely viewed as having a Fed Chairman with a relationship too close to the US President (Fed Chair Arthur Burns (1970-1978) was a personal friend of Richard Nixon. It was also an era marked by an unexpected oil price shock, government decrees to freeze prices—which disincentivized a supply-side response to increase production—and less opportunity to bring in lower-priced imported goods. With lessons learned from the past, today's Fed may be better able to truly bring inflation down towards its 2% target and that the mistakes of the past won't be repeated.

CHART OF THE WEEK



Source: Clearstead, Bloomberg as 12/31/2023

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