clearstead

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February 5, 2024

OBSERVATIONS: *Fed resets expectations; small cap stocks slump*

- Markets were mixed last week as the Fed (see Expectations) reset market expectations on US interest rates.[1] The S&P 500 was up +1.4% and the NASDAQ was up +1.1%, but small caps (Russell 2000) fell -0.8% and the yield on a 10-year Treasury fell -11 basis points to 4.0%.[1]
- The Conference Board's consumer confidence index rose to 114.8 in January—this is the highest reading since December-2021 and third straight monthly increase.[1]
- ISM Manufacturing PMI improved in January to 49.1 from December's 47.1—any number below 50 denotes contracting activity. While the ISM manufacturing PMI has remained below 50 for 15 straight months it is now at its highest level since October-2022 just before it broke below 50.[1]
- Jobless claims, while still very low, rose to 224k in the most recent week which was higher than expectations and marked the highest level since the week of November 10, 2023.[1]
- Job openings ticked higher by 101 thousand in December reaching a three-month high of 9.026 million—higher than the consensus expectation of 8.750 million. By this measure, there are over 1.4 open positions for every unemployed person—still well above the pre-pandemic level of 1.2 open positions per unemployed person.[1]
- January's new job figures were a blockbuster. January saw 353k new jobs created, the unemployment rate remain unchanged at 3.7%, labor force participation remain steady, wages increase +4.5% year-over-year, and December's jobs figures revised up 117k to 333k—signaling the US economy created over 300k jobs in back-to-back months.[1]

EXPECTATIONS: *Rates higher for longer; earnings coming slightly sub-par*

- The Fed reset market expectations for the path of rates this year, with Chair Powell flatly stating that a rate cut was unlikely in March and that the Fed would need "greater confidence" based on more evidence (data) the downward trend in inflation toward 2% is "sustainable" before a rate cut was appropriate.[1]
- In a similar fashion to the Fed, the Bank of England also left rates unchanged last week, signaling that no further rate hikes were likely, but demurred about the timing of a potential rate cut citing the need for further evidence that inflation is set to fall "all the way to the 2% (inflation) target."[1]
- Shares of New York Community Bank (NYCB) fell -41.9% last week after the bank reported a fourth quarter loss, took a large provision for credit losses, and cut its dividend by 70%. NYCB acquired significant assets of failed Signature Bank this time last year, and with the bank's total assets pushing above $100 billion it is now subject to higher capital standards. As of now it appears to be more of a one-off scenario than some systemic issue hiding in the shadows—but the larger commercial real estate market remains challenged.[1]
- As of last Friday 46% of the S&P 500 firms have reported and 72% of firms have beaten earning estimates, which is below the 5 and 10-year averages of 77% and 74% respectively, but an improvement the initial weeks of Q4-2023 earnings season. Overall earnings for Q4-2023 are set to be +1.6% year-over-year.[2]

ONE MORE THOUGHT: *Is the impact of higher rates on corporate America overblown?[3]*

As January wraps up, one of the more interesting pieces of data that we noted in a prior note was the volume of investment grade corporate bond issuance. The month set a new record for blue-chip issuance with over $188

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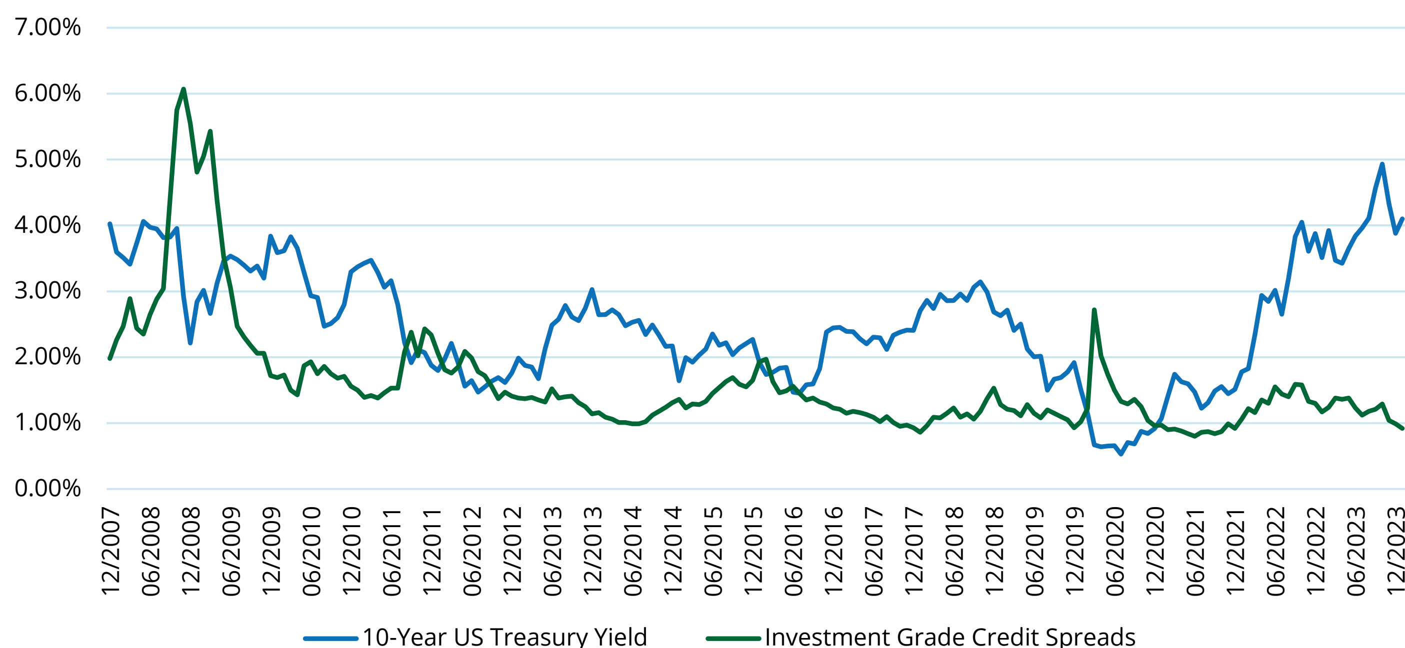
[1] *Bloomberg LP*
[2] *FactSet Earnings Insight 2/2/2024*
[3] *Bloomberg LP, monthly 10-year US Treasury yield data and Bloomberg Aggregate Corporate Spreads*

billion of bonds sold in January alone—a new record to start off a year. While the volume of supply was of note, so too are the credit spreads at which bonds are being priced. Proctor and Gamble for instance issued its new 10-year debt at the tightest 10-year corporate spread on record of 37bps. You read that right; investors needed only a 37bps spread (i.e., additional compensation) over a comparable US Treasury to own the consumer products bond over a ten-year period. The contrast in markets is notable and speaks to the general health of corporate America, against a backdrop where the soothsayers have been warning of higher rates breaking the economy. Remarkably, the 10-year US Treasury yield is higher than 98% of all observations since 2008, yet investment grade credit spreads are tighter than 95% of all observations since 2008. There are undoubtedly pockets of stress in the most leveraged sectors of the economy—for both consumers and corporates—but in terms of the aggregate economy, blue-chip corporates continue to manage their way through this regime of higher rates, and without the specter of recession, investors are reflecting that optimism by investing at lower spreads.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, US Treasury Yield, Bloomberg Aggregate Corporate OAS, monthly as of 1/30/2024

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