Market commentary notes

Monthly call notes
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Wealth Management

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Key issues last month and this month:

Just listen to what the Fed says. Part 2 — Last week we had the first Fed Governors' meeting of 2024. Two things stood out to me in Chairman Powell's comments and press release: 1. Powell was pretty clear that the Fed isn't considering reducing the FFR in March. He also implied that the markets were likely overestimating the magnitude of reductions that the Fed is likely to contemplate in 2024. 2. In four different places in his comments he referred to the Fed target as being a 2% inflation rate. That was notable to me in that it was a change from his language of a couple of years ago when he framed the Fed target as 2% on average. The difference being that he seems to have made the goal more rigid. That, in turn, suggests to me that they aren't going to be quick or extreme in reducing rates.

The market still seems to be pricing in 120 bp of reductions this year. My guess is that it will be 50–75 bp and won't start until May or June. We'll probably see a mere 25 bp to start as the Fed tests the water before committing to any more.

The market impact of the reduction is going to depend, as always, on the language that the Fed uses to explain their move. If they frame it as a data-driven response to having achieved their goal, rather than an effort to avoid an impending recession, it could be very positive for the stock market in the second half of the year.

Employment — The markets were surprised by the January jobs report that indicated that the U.S. economy had created 353,000 new jobs that month. That was about double the consensus guestimate. The largest increases were in business, education and health services. Average earnings were up 0.19 per hour, which is around half a percent, but hours were down by a fifth of an hour, which is about half a percent as well. The market didn't react much because the net result of two opposing motivations was "no change." On the one hand, healthy employment expansion implies a growing economy, which should be positive for the stock market. On the other hand, it suggests that the Fed might be that much slower to reduce rates, which means future earnings are less valued today. In the medium term, however, if the economy remains healthy and inflation comes down, permitting the Fed to reduce rates, it should create a very positive backdrop for stocks. [https://www.bls.gov/ces/, Feb. 5, 2024]

Inflation — The 12-month all-item CPI was up +3.4% as of the end of December 2023. All-item, less food and energy, was up 3.9% [https://www.bls.gov/cpi/, Feb. 5, 2024] [https://www.bls.gov/cpi/latest-numbers.htm, Feb. 5, 2024]. The Core (excluding food and energy) Personal Consumption Expenditures Price Index (PCE PI), which the Fed watches, was up 2.9% in December versus a year ago. [https://www.bea.gov/data/personal-consumption-expenditures-price-index-excluding-food-and-energy, Feb. 5, 2024] So, by this measure, inflation is moving in the right direction.

Earnings — With 46% of the S&P companies reporting, the blended earnings growth rate for Q4 S&P 500 EPS currently stands at 1.6%, which matches end of quarter estimates. Blended revenues are up 3.5% for the quarter. You'll notice that sales increased more than profits, which isn't what we normally see over time. I think the reason is that when you have a bout of cost-inflation, as we did, costs rise before revenues, which squeezes profits. We saw that in 2022 into 2023. Then end-pricing catches up, but not completely. In other words, there's a hangover of reduced margins. I think that's what we're seeing and it is likely temporary. Consequently, I expect that we'll continue to see profit growth through 2024. [FactSet, StreetAccount Scorecard, 2 Feb. 2024]

January — Going to plan, sort of — We finished 2023 with a pronounced uptick in all of the major equity indexes both in the U.S. and internationally. January saw the U.S. large cap index rise 1.68%, but small- and mid-cap dipped a little. In fact, the small cap index is just a little better than flat compared to a year ago.

The bond index, strangely, is exactly flat from the start of the year. Commodities are up 4.5%.

Overall, it's an okay start to the year, although I think the bond indexes still reflect an undue degree of optimism where hopes that the Fed will reverse course and start to reduce rates is concerned. The motivation for the Fed to do that seems to decline with each passing week of new data.

Global stock indexes

Total Index	January %	YTD %	1 yr %	2023 Est PE Trailing/ Projected
S&P 500	1.68	1.68	20.82	23.27/21.76
S&P Mid Cap	-1.42	-1.42	6.70	18.25/16.49
S&P Small Cap	-3.95	-3.95	1.81	26.69/16.44
FTSE All REIT	-4.86	-4.86	-3.75	
MSCI All Country xU.S.	-0.99	-0.99	5.88	
MSCI Emerg Mkt	-4.64	-4.64	-2.94	

Source: Morningstar as of January 31, 2024. Estimated PEs are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 29, 2023. Projected PEs are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	January %	YTD %	1 yr %
Bloom Agg Intermed	0.00	0.00	2.76
ICE BofA U.S. Convertibles	-1.21	-1.21	6.07
S&P GSCI	4.47	4.47	0.10
Bloom U.S. Corp HY	0.00	0.00	9.28

Source: Morningstar as of January 31, 2024

Sector performance — In January, the best performing sectors were: communications services, IT and financials. The bottom three were consumer discretionary (Tesla), materials and real estate. Major companies in the consumer discretionary sector include Amazon, Tesla, Home Depot, Starbucks, McDonalds, Nike. It is impossible to draw firm conclusions from the first month's results, but what this suggests is that rising longer-term rates are generally good for financials and not so good for real estate. There are also some company-specific results mixed in, that we can't generalize from. [https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, Feb. 5, 2024] [https://digital.fidelity.com/prgw/digital/research/sector, Feb. 5, 2024]

Commodities

Commodity and food price changes, current month and YoY.

Total Index	December %	YoY %
Copper	-0.6%	-5.9%
Lumber	-2.7%	-5.5%
Cotton	7.6%	2.0%
Sugar	14.6%	12.5%
Coffee	3.1%	11.1%
Wheat	-0.1%	-21.8%
Corn	-4.8%	-34.5%
Oil	-0.6%	-2.0%
NatGas	-14.5%	-15.6%

Source: https://tradingeconomics.com/commodities, Feb. 3, 2024

Six of these nine major commodities saw prices decline in January. Compared to a year ago, six experienced price declines. For these nine, the average one-year price change was a decline of 6.5%. Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 22 of the 48 saw price declines in January, compared to 29 in December and 20 in September; 33 saw lower prices than a year ago. That suggests to me that price declines are still happening, which should continue to filter through to the consumer end over time. That's good for our inflation numbers and arguably, less good for emerging markets and commodities.

The U.S. economy keeps growing ...

GDP estimates

[https://www.bea.gov/data/gdp/gross-domestic-product, Feb. 3, 2024] [https://www.atlantafed.org/cqer/research/gdpnow, Feb. 5, 2024] The economy continues to surprise with positive growth numbers. The first estimate for GDP real growth in the fourth quarter was +3.3% (annualized), which is much higher than most, me included, estimated.

That, plus the positive corporate earnings numbers and very strong U.S. employment numbers paints a picture of an economy that continues to grow well.

The Atlanta Fed's GDPNow model to estimate 1Q GDP growth is now estimating a 4.2% real growth rate for the quarter we're currently in. We're very early in the quarter, so changes are likely, but that's the current estimate based on one month of data. That also is a positive for the stock market and likely should discourage the view that the Fed will be in a hurry to reduce rates. [https://www.atlantafed.org/cqer/research/gdpnow, Feb. 5, 2024] [https://www.census.gov/econ/indicators/advance_report.pdf, Feb. 5, 2024

Jobs

The January numbers came out last week at +353,000 new payroll jobs. Primary areas of job growth were in health care, government and hospitality/leisure. [https://www.cnbc.com/2024/02/02/heres-where-the-jobs-are-for-january-2024-in-one-chart.html, Feb. 3, 2024]

U.S. PMI statistics

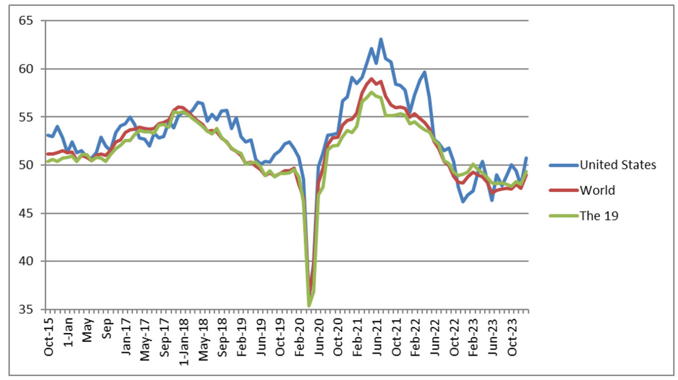
The U.S. Manufacturing PMI for January rose to 50.7. A moderately positive number, but more importantly, the best reading we've had in more than six months. So how do we get such robust GDP growth with PMIs that are barely above 50? The PMI is a "diffusion index" meaning that it merely measures up-down proportions and not the size of the changes. Consequently, if you have many small companies reporting slightly down results and a few big companies reporting significant up results, you'll get a PMI below 50, but it doesn't mean that the economy as a whole is necessarily weak. The U.S. Services PMI—80% of our economy—is well into positive territory at 52.9. [Trading Economics, PMI statistics Feb. 5, 2024] [Trading Economics, https://tradingeconomics.com/country-list/services-pmi, Feb. 5, 2024]

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. In January, numbers improved with 17 of our 38 countries reporting Manufacturing PMIs above 50. That's up from 12 at the end of 2023. China stayed in the modest growth category at 50.8 and the EU rose to 46.6. It was 43.1 in October. Germany is once again, a prime mover, having risen to 45.5. It was in the high 30s four months ago. EU's Services PMI was about stable at 48.4 and Germany at 47.7. Overall, our weighted world index rose significantly to 49, while the index for the 19 major economies rose to 49.4. [https://tradingeconomics.com/country-list/services-pmi, Feb. 5, 2024].

Here's our updated graph of Manufacturing PMIs:



Source: Author's calculations based on published PMI statistics, as of Feb. 5, 2024

Table summary

Region	Manu PMI	Last Month	12 mo. Ago
U.S.	50.7	47.9	46.9
19 majors	49.3	48.0	49.3
38 world	49.0	47.6	48.8
EU	46.6	44.4	48.8
China	50.8	50.8	49.2

Source: Author's calculations based on published PMI statistics, Feb. 5, 2024

Investment strategy

I'd say that I am getting increasingly optimistic for 2024.

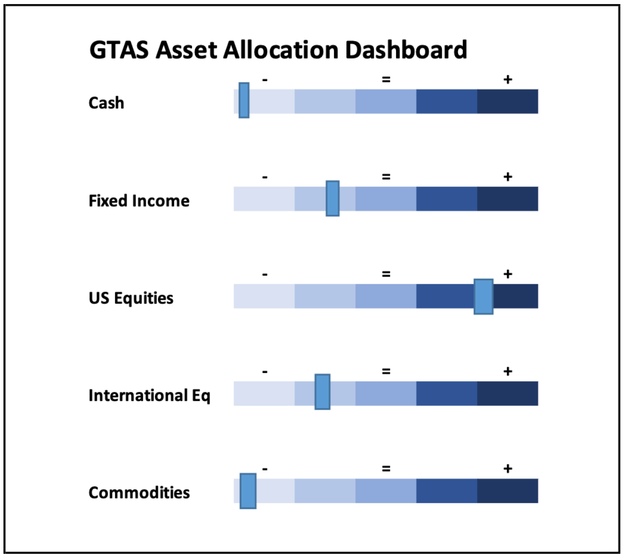
My central case is that 2024 will be okay for equity with U.S. markets up 6–12%. Bonds may return about the yield, so 4.5% or so, less for Treasuries.

It looks like the near-term probabilities of a recession in the U.S. are declining. In Europe as well, it looks like we are seeing the beginnings of a recovery. That should be good for corporate earnings worldwide. I think the U.S. Fed is going to move a little slower than the European central banks to reduce rates, meaning the U.S. dollar will be stronger and international investments a little less attractive than they otherwise would be.

I don't think that's a great environment for gold. Surprisingly, the U.S. is well on its way to being the world's biggest exporter of natural gas—meaning both oil and gas prices ought to stay in a moderate range this year, with volumes increasing.

On the bond side, lower quality bonds will probably offer some decent deals but on the other hand, high quality bonds may make 4–5% which is good by itself.

GTAS Allocation Chart



(+/=/-) represents our group's views over a 6 to 18 month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed – Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY – Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT – FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles – ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade, and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. – MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt – MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

S&P 500 – S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI – S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap – S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap – S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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