Weekly market wrap

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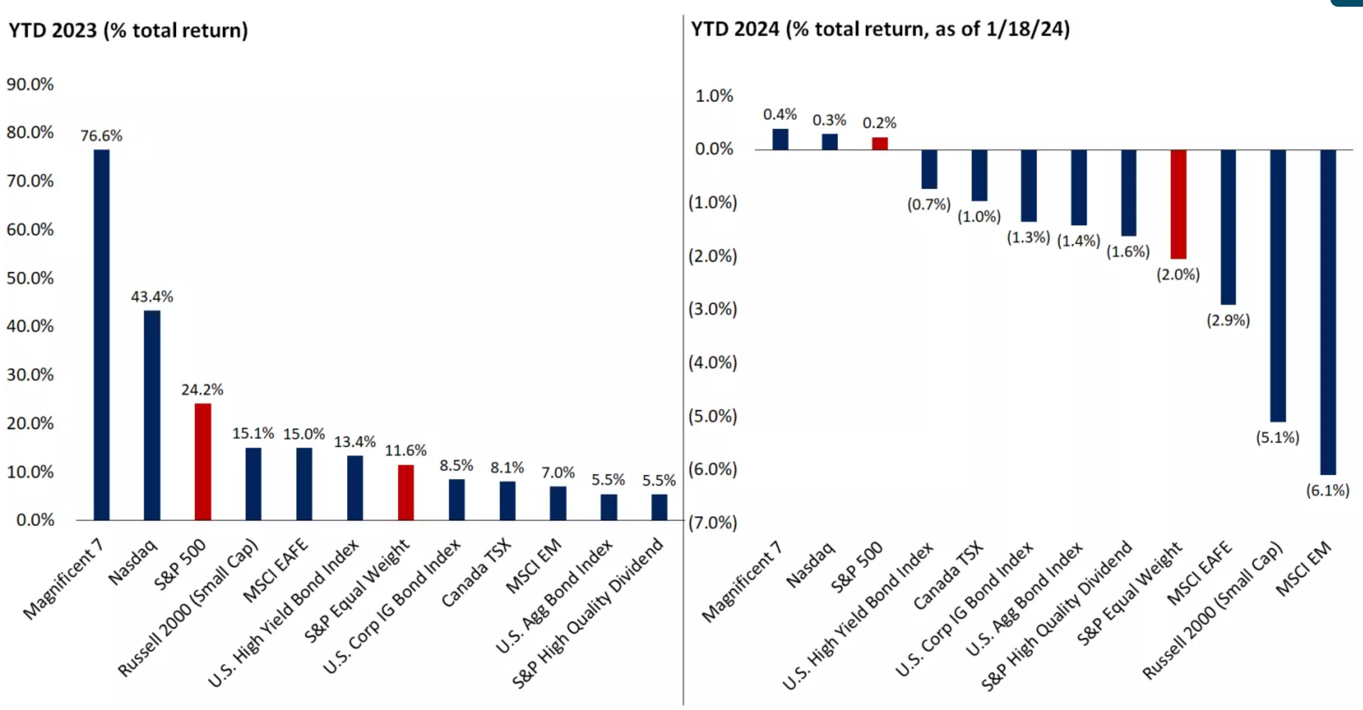
‹ Weekly market wrap

Three datapoints to watch as

markets get through a bumpy January

Despite pushing higher last week, markets in 2024 thus far can best be described as subdued, and perhaps even a bit bumpy. This may not be too much of a surprise after a very strong rally in the last few weeks of 2023, where the S&P 500 rose over 15% from late October through December.[1] Thus, some period of consolidation or even a pullback would be a natural and perhaps even a healthy reset for financial markets. However, with the S&P up modestly, about 0.2% thus far in 2024, even the pullback has been muted and not particularly eye-catching for most investors.

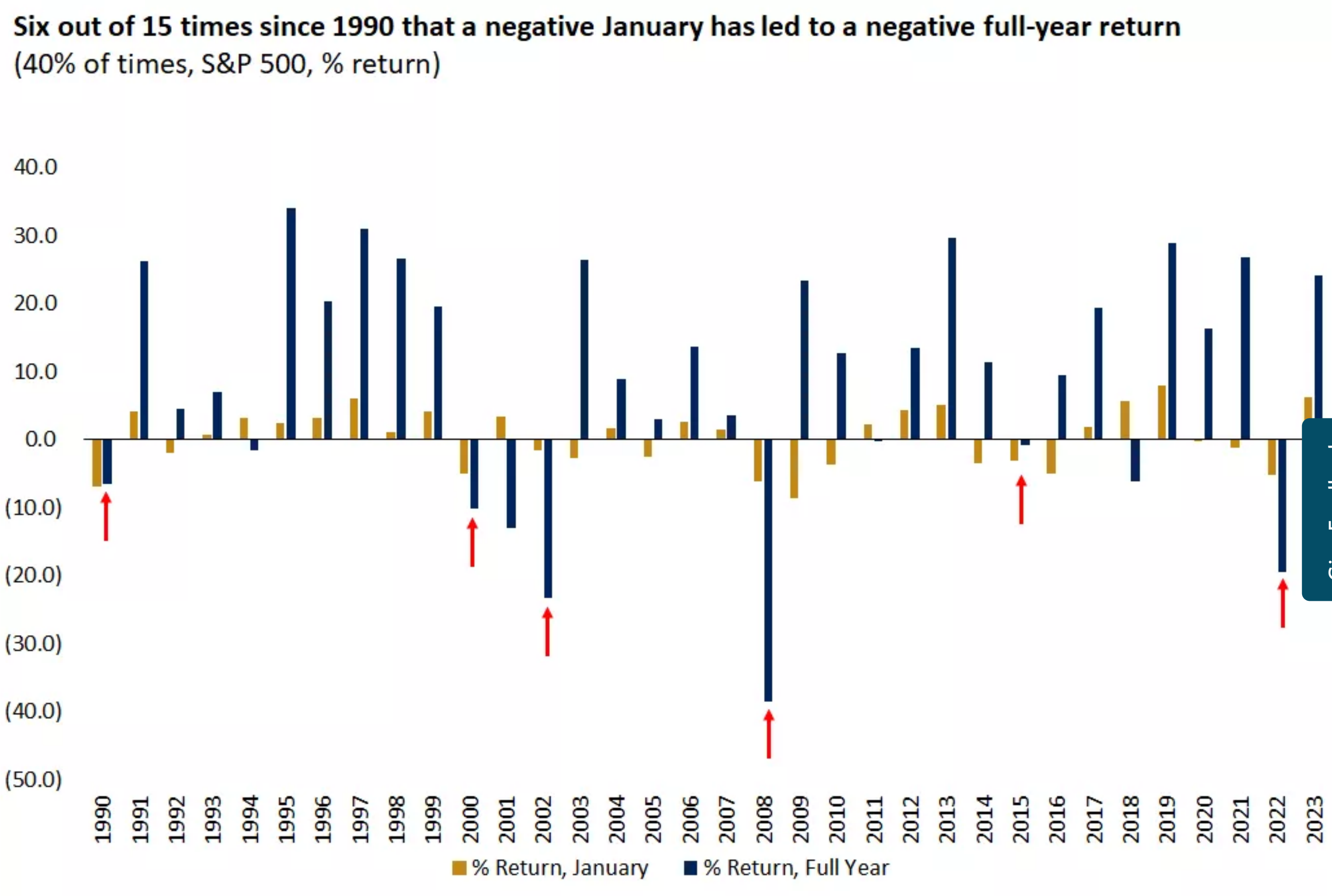
Underneath the surface, there has been a bit more movement. Some areas of the market that had been showing signs of life late in 2023, including small-cap stocks, the broader equal-weight S&P 500, and investment-grade bonds, have now come under some pressure early in 2024. From a sector perspective, technology and communication services remain leaders, but we are also seeing some outperformance from defensive parts of the market, like health care and consumer staples.



Source: Bloomberg. Magnificent 7 represented by Apple, Microsoft, Google, Amazon, Tesla, Nvidia, and Meta

Chart description

One old market adage used to be "as goes January, so goes the year," implying that if markets were negative for the month of January, then there was a higher chance that they would be negative for the full year. Recent history, however, confirms that this is not typically the case. In fact, since 1990, there have been 15 years where S&P 500 returns were negative in January, and of these, only six have gone on to have negative full-year returns (40% of cases). A negative or bumpy January certainly doesn't have to be a precursor to a down year.



Source: Bloomberg. S&P 500 Index

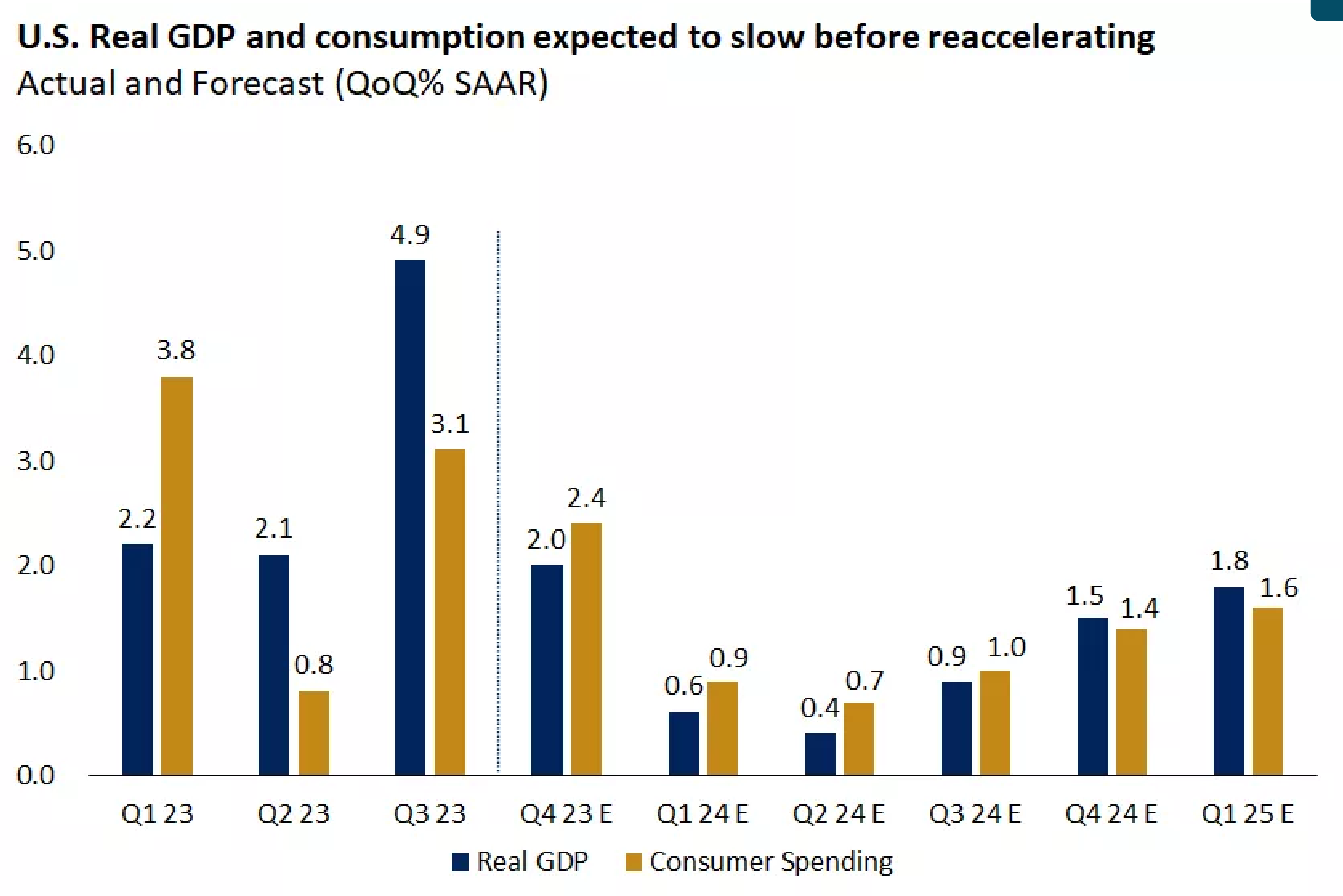
Chart description

Nonetheless, there are several useful datapoints in the final couple weeks of January that can provide insight into key fundamental drivers of the markets and economy. We highlight three of these below:

1. **Fourth-quarter U.S. GDP growth, January 25:** Perhaps one of the keys to the direction of the market in 2024 is what happens to economic growth. Investors will get a first look at U.S. fourth-quarter GDP on January 25, which could offer a clue on the direction of economic growth and consumption coming into the new year. Thus

far expectations are for GDP growth to fall from 4.9% annualized to around 2.0% in the fourth quarter. However, the Atlanta Fed's GDP-Now tracker, a real-time indicator of GDP based on current economic data, indicates that growth in the fourth quarter may have been closer to 2.4%.[2] If U.S. GDP growth does come in around 2.4%, this will be the fifth quarter that economic growth has been above trend growth of 1.5% - 2.0%, despite rapidly rising interest rates and elevated inflation. According to the Fed tracker, consumption also remained healthy last quarter at around 2.0% annualized.[2]

In our view, a resilient consumer has supported stronger economic growth in the U.S. in recent quarters. However, we would expect some rising pressures on the consumer, including lower excess savings and higher credit card debt, to put some downward pressure on GDP growth in the coming quarters. Nonetheless, while we may see GDP growth fall below trend (sub 1.5% annualized), we do not see a recession or contraction on the horizon based on current data. This scenario where growth gradually slows but does not fall into recession, coupled with potentially lower inflation and a Fed rate-cutting cycle, historically has yielded a positive backdrop for financial markets.



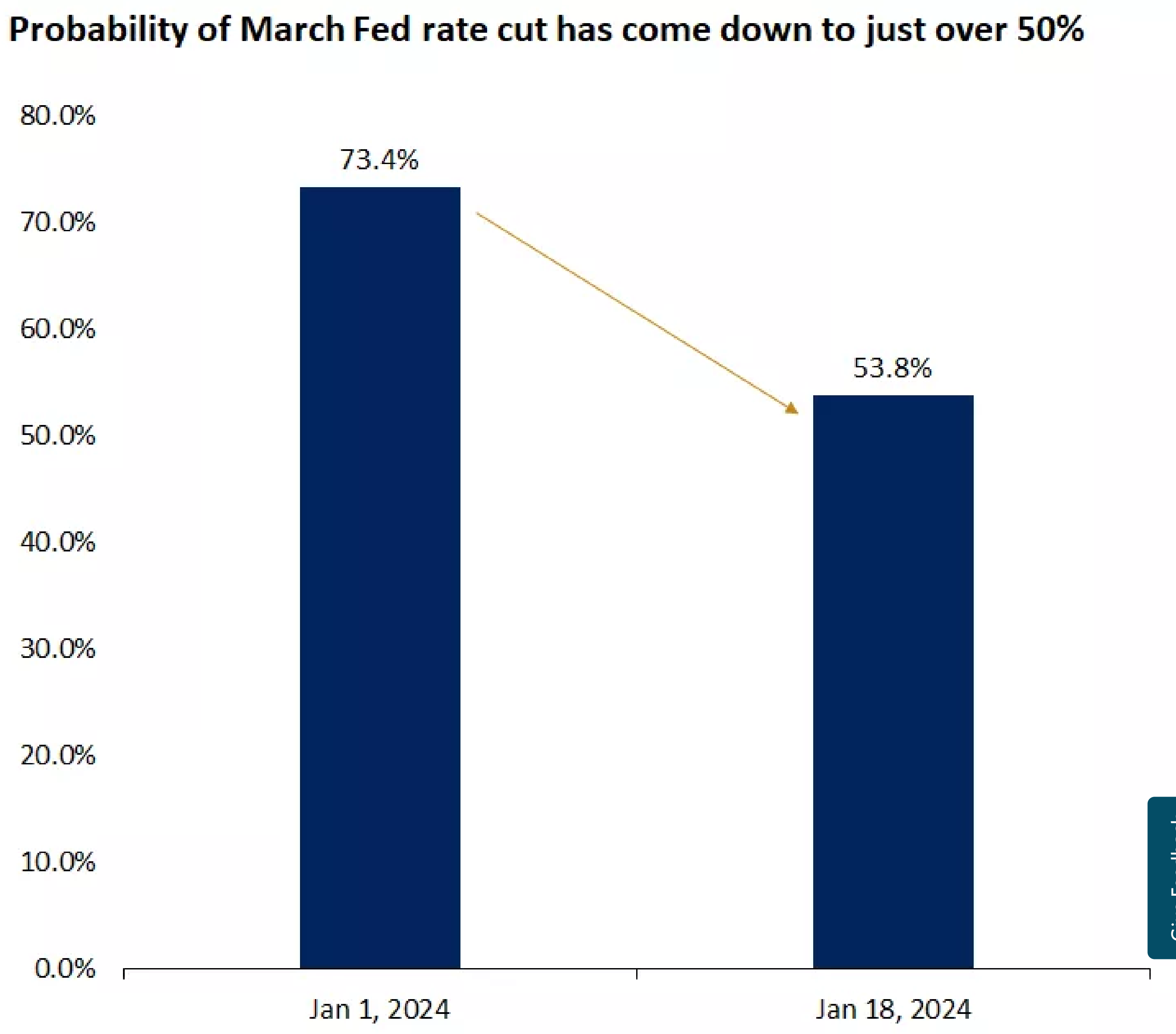
Source: Bloomberg

Chart description

2. **PCE and Core PCE inflation, January 26:** Inflation and the direction of inflation has been a focal point for financial markets and consumers. The inflation data thus far in 2024 has been more mixed. The CPI (consumer price index) inflation figures have surprised to the upside, while the PPI (producer price index) inflation data have surprised to the downside. Perhaps a tiebreaker and next key datapoint for inflation will be PCE (personal consumption expenditure) inflation, which will be released on January 26 and is often considered the Fed's preferred inflation measure. Expectations are for headline PCE inflation for December to remain flat at 2.6% year-over-year, while core PCE inflation is expected to fall from 3.2% to 3.0%.[1] Keep in mind that the Fed had projected at its December meeting that both headline and core PCE inflation would reach 2.4% in 2024. So while the direction of travel has been positive, the Federal Reserve may prefer to see inflation, particularly core inflation, closer to its 2.4% forecast this year before signaling rate cuts.

   In our view, while the last mile to 2.0% inflation may be bumpy, we do see inflation continuing to moderate in the year ahead. We believe a combination of lower shelter and rent inflation (which may show up with a lag in the inflation basket), easing wage gains and services inflation, and commodity prices that remain contained will all contribute to falling inflation. Similar to the Fed, our view is that core inflation falls toward 2.5% in 2024, getting closer to the 2.0% target.

3. **Fed meeting and interest-rate decision, January 31:** And, finally, the Federal Reserve itself, we believe, will continue to remain a key driver for markets and the economy in 2024. The first FOMC interest-rate decision of the year will be released on Wednesday, January 31, followed by a press conference by Fed Chair Jerome Powell. The expectation is for the Fed to keep interest rates on hold at 5.25% - 5.5% at the January meeting, but investors will be listening intently for any clues on whether the Fed is considering an interest-rate cut at the March meeting. Currently, markets are pricing in around six rate cuts in 2024, including the first one at the March 21 meeting – although the probability of this rate cut has declined in recent days as some Fed speakers have pushed back on a March cut. In our view, the Fed will not likely cut rates in March, especially given that core CPI and PCE inflation remain well above the 2.0% target. We do, however, see three or four rate cuts this year, perhaps starting in mid-2024, as inflation likely continues to moderate, and the Fed begins gradually moving rates toward a more neutral level.



Source: CME Fed Watch

Chart description

Overall, we continue to see economic growth, inflation and the Fed as the key drivers of financial markets in 2024. We would expect the backdrop for all three of these fundamental factors to improve over the course of the year – with lower inflation, Fed rate cuts, and an economy that is potentially reaccelerating. However, market volatility is more likely in the near term, especially as the Federal Reserve potentially pushes back against March rate cuts, and as interest rates normalize, with a 10-year Treasury yield now back above 4.0%. However, we see volatility early in the year as an opportunity to rebalance, diversify and add quality investments to portfolios – especially for those that may not have fully participated in the rapid market rally at the end of 2023. We believe two themes of broader stock-market leadership and better performance from investment-grade bonds will continue to unfold through 2024. So while a bumpy January and volatile start to the year may not be comfortable, it could also set the stage for better opportunities and smoother sailing for investors in the later months of the year.

Mona Mahajan
Investment Strategist

Sources: 1. FactSet. 2. Federal Reserve Bank of St. Louis.

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	37,864	0.7%	0.5%
S&P 500 Index	4,840	1.2%	1.5%
NASDAQ	15,311	2.3%	2.0%
MSCI EAFE*	2,179.25	-2.1%	-2.5%
10-yr Treasury Yield	4.13%	0.2%	0.2%
Oil ($/bbl)	$73.62	1.3%	2.7%
Bonds	$98.02	-1.1%	-1.3%

*Source: FactSet, 1/19/2024. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance does not guarantee future results. *Morningstar Direct 1/21/2024.*

The week ahead

Important economic data being released this week includes fourth-quarter GDP and PCE inflation.

Review last week's weekly market update.

Mona Mahajan

Mona Mahajan is responsible for developing and communicating the firm's macroeconomic and financial market views. Her background includes equity and fixed income analysis, global investment strategy and portfolio management.

She regularly appears on CNBC and Bloomberg TV, and in The Wall Street Journal and Barron's.

Mona has a master's in business administration from Harvard Business School and bachelor's degrees in finance and computer science from the Wharton School and the School of Engineering at the University of Pennsylvania.

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