Weekly market wrap

Published Feb. 9, 2024

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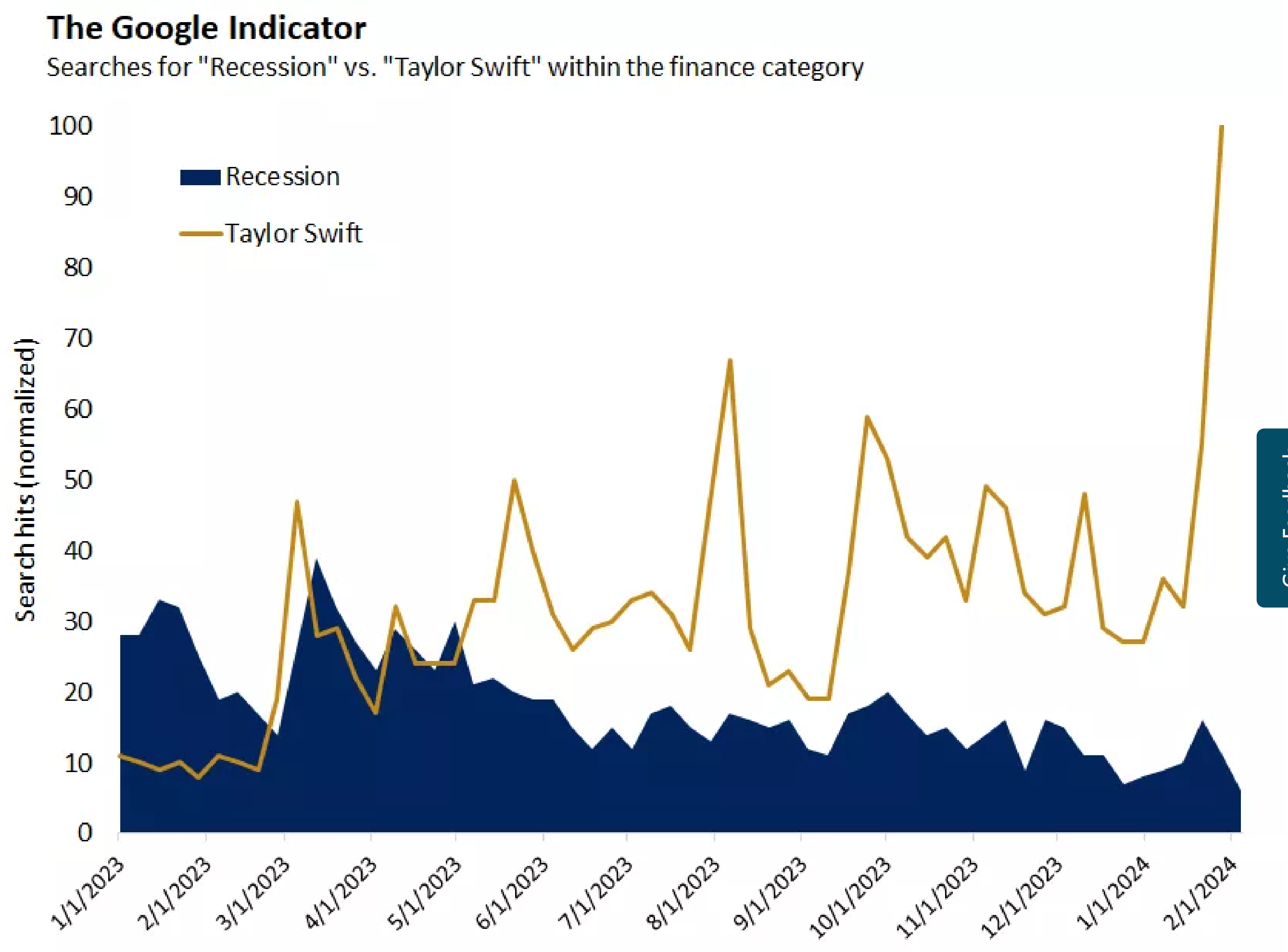
A Swift Surge to 5,000

Key Takeaways:

- *Consumers have less firepower than a year ago but are not yet tapped out, as household finances and the labor market remain relatively healthy.*
- *While consumer spending will likely slow, the rate-sensitive manufacturing and housing sectors could reaccelerate in the back half of the year.*
- *The window for a hard landing appears to be closing as Fed policy becomes gradually less restrictive. We expect any economic slowdown to be moderate and the bull market to remain intact in 2024.*
- *A rotation from mega-cap tech into cyclical and value-style investments could still materialize later in the year. Mid- and small-caps could play catch-up if the growth and inflation backdrops remain favorable.*
- *We have a neutral view on international equities, as the discounted valuations are partly explained by the slower economic momentum. International diversification still makes sense; we recommend investors stick to their strategic allocation.*

Last week, the S&P 500 crossed the 5,000 milestone, a fresh record high for the index, widely regarded as the primary gauge for U.S. large-cap stocks. While 5,000 is an arbitrary number and simply an attention-grabbing psychological threshold, it is symbolic of the market's strength and resilience in the face of a historically sharp adjustment in interest rates.

It was only about a year ago that worries about a recession were front and center. But since then, there have been more internet searches for "Taylor Swift" within Google trends' finance category than for the term "recession"[1]. This not only speaks to the emergence of Taylor Swift as a cultural phenomenon, but also to the better-than-feared growth backdrop and improvement in inflation. With the economy defying expectations for a slowdown and stocks having rallied about 20% over the past three months, investors are wondering what's next[2]. We provide our views to five common questions:



Source: Google trends, Edward Jones.

Chart description

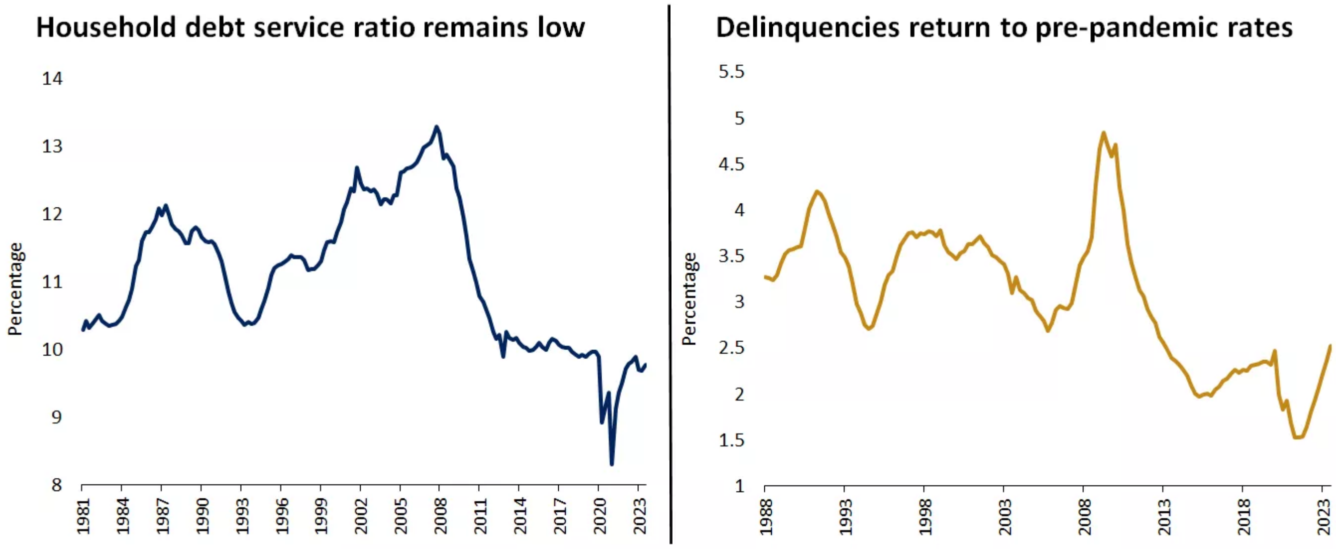
1. Can the consumer continue to carry the load of the economy?

The consumer is the backbone of the U.S. economy, with personal consumption accounting for two-thirds of GDP. Despite high borrowing costs and last year's inflation spike, the consumer has kept spending at a robust pace, helping sustain the expansion. Discretionary spending has been strong. And yes, that includes a 16% jump in performing-arts expenditures during the first three quarters of 2023, likely buoyed by the highly anticipated "Eras" tour[2].

Excess savings during the early pandemic years, a tight labor market, and low mortgage rates locked in by households in 2021 all contributed to last year's strength. But there are some signs of fatigue. Consumer credit slowed notably in December, rising by $1.5 billion compared with $23 billion in November, and card delinquencies are on the rise[2]. Additionally, accumulated savings have mostly been depleted for the low-income cohorts, and layoff announcements have picked up.

In our view, consumers have less firepower than a year ago, suggesting that growth will slow in the quarters ahead. Yet, household finances remain relatively healthy. Debt payment as a percent of disposable income, or what's called the debt-service ratio, is at the low end of its 40-year range[2]. Mortgage-delinquency rates are now slightly above pre-COVID-19 rates, but so far, the rise can be described as a normalization. And despite the recent job-cut headlines, the January spike appears to be seasonal, with overall layoff announcements remaining lower than a year ago[2]. The bottom line is that the consumer is not yet tapped out. Wage gains are supporting incomes and spending, inflation pressures are receding, and assets like real estate and stocks are appreciating, contributing to the rise in consumer confidence.

Give Feedback



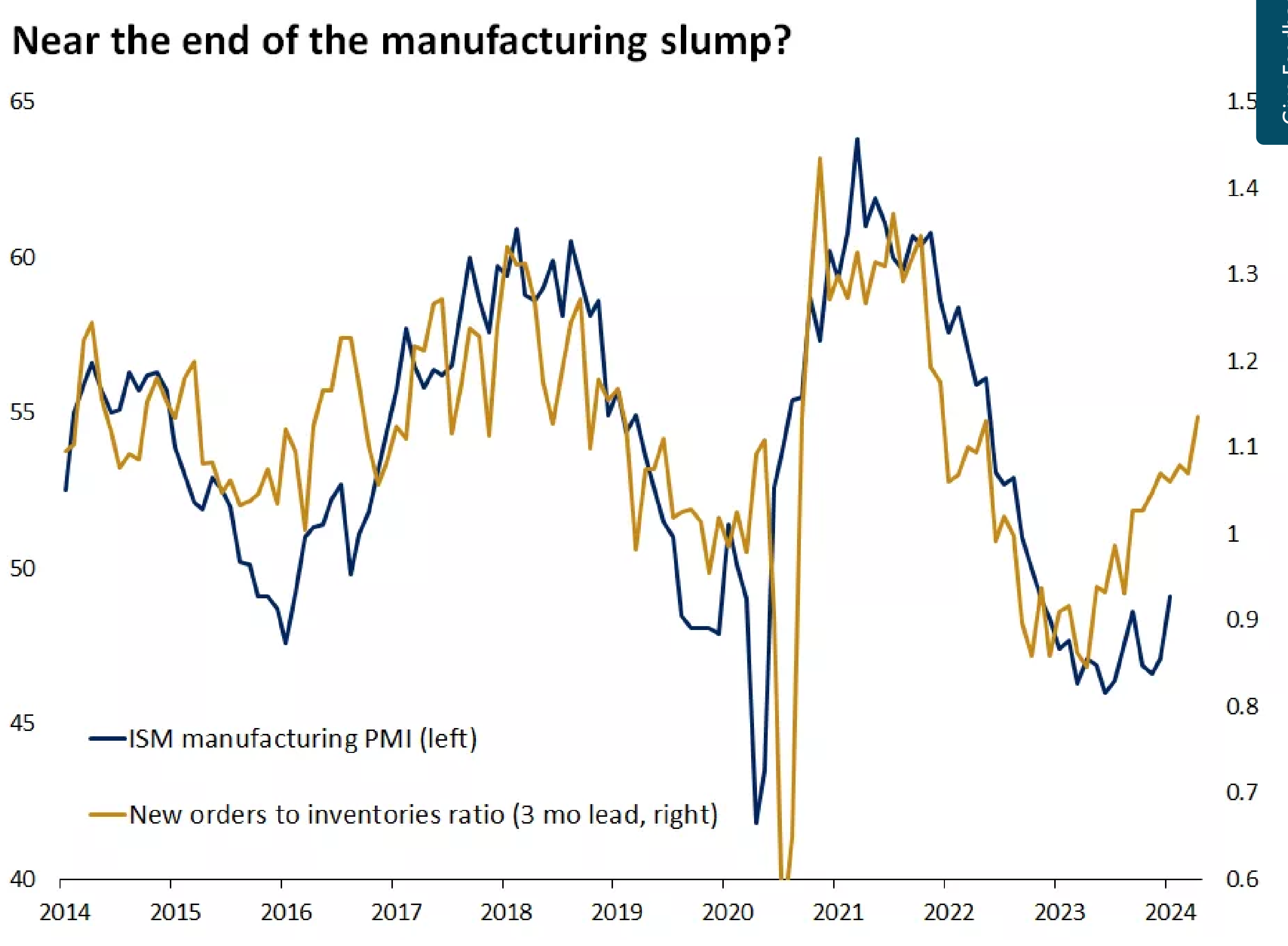
Source: Bloomberg, Edward Jones.

Chart description

2. Have the Fed rate hikes made a dent in the economy at all?

While one couldn't tell by looking at consumer spending, the Fed's most aggressive rate-hiking cycle in 40 years has had an impact in slowing economic activity. Housing and manufacturing, two of the most interest-rate-sensitive sectors of the economy, have been under pressure. Housing activity has been subtracting from economic growth for nine straight quarters but turned slightly positive in the last quarter. And the ISM Purchasing Managers Index (PMI), a proxy for manufacturing activity, has been in contraction for 15 consecutive months[2]. Also, the stress with some regional banks and commercial real estate was a vulnerability uncovered after the sharp adjustment in interest rates.

With the Fed now preparing to pivot to rate cuts, the outlook for these sectors is gradually brightening. The average 30-year mortgage rate has dropped about 1.1% from its peak, the NAHB homebuilder sentiment survey has ticked higher, and a shortage of housing supply is helping activity stabilize[2]. On the manufacturing front, orders are now growing faster than inventories, and the ratio between the two, which tends to lead the PMI index by about three months, suggests an acceleration in activity and a return to expansion in the months ahead.



Source: Bloomberg, Edward Jones.

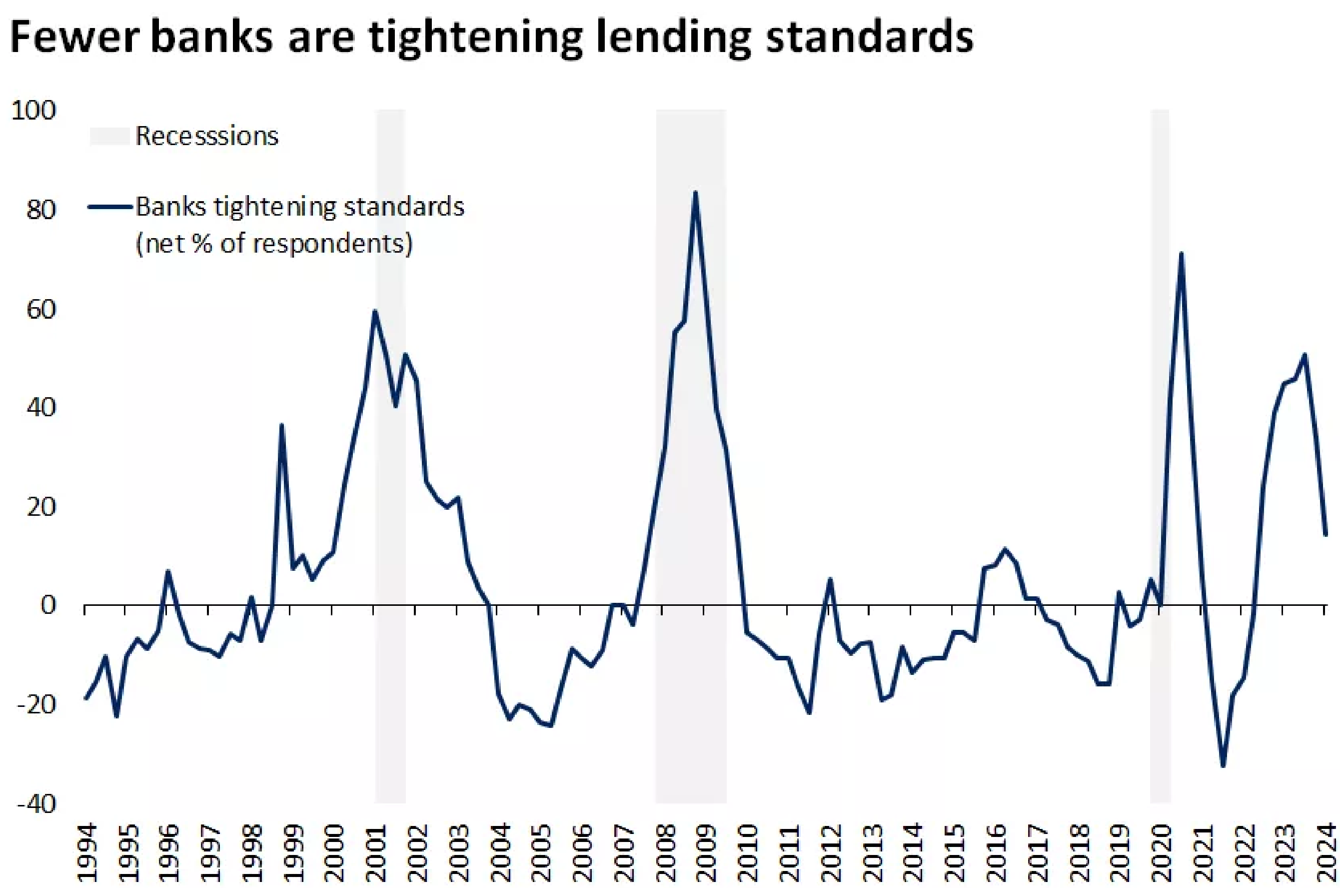
Chart description

Give Feedback

3. Is the recession cancelled?

In our view, the window for a hard landing or a recession appears to be closing as Fed policy becomes gradually less restrictive. That is not to say that a soft landing or no landing is inevitable, but the economy continues to move further away from the worst-case scenarios, in our view. In the latest Senior Loan Officer Opinion Survey (SLOOS) released last week, a lower percentage of banks reported tightening of credit conditions, perhaps suggesting that the bottom in the credit cycle is in the rearview mirror. While consumer spending appears poised to slow, other sectors of the economy could be reaccelerating in the back half of the year, providing an offset.

Among other encouraging developments, the rise in productivity is helping unit labor costs - what business pay employees to produce one unit of output - rise less than expected. At 2.3%, the rise in labor costs from a year ago suggests that the Fed does not need to see a major slowdown in job creation and rise in unemployment to achieve its inflation objective[2]. The bottom line is that the growth and inflation backdrops remain favorable, but of course that won't preclude periods of volatility and corrections, which are common after strong market rallies like the one we had over the past three months. We expect any economic slowdown to be moderate and the bull market to remain intact this year.



Source: Bloomberg, Edward Jones.

Chart description

4. Will a broadening in market leadership materialize?

Last year a narrow group of mega-cap technology stocks drove most of the S&P 500 gains as enthusiasm around AI grew. One of our calls for this year is that the segments of the market that have been left behind will start to catch up and leadership will broaden. So far in the first six weeks of the year, it's been some of the usual suspects that have led the gains (NVIDIA, Meta and Eli Lilly). Only three of the 11 sectors of the S&P 500 are outperforming the index (communication services, technology and health care), while small- and mid-caps have not been able to make up the lost ground[2].

Even with the status-quo continuing early in the year, there are encouraging signs that more stocks are starting to participate in the rally. The growth-sensitive industrials sector and the rate-sensitive homebuilders are now breaking out to new highs, while financials are only modestly lagging the S&P 500, even with renewed concerns about regional and community banks. We think that a rotation from mega-cap tech into cyclical and value-style investments is still in the cards as the year progresses, especially if the Fed cuts rates for the right reasons (improvement in inflation rather than a slump in growth), as we expect.

Soft landings are not common, but there have been two such episodes following a Fed tightening cycle over the past 60 years, in 1983-1984 and 1994-1995. Leadership was different in the two periods, but in both cases the end of tightening was a catalyst for strong returns across both stocks and bonds, with equities outperforming. Mid-caps saw the largest performance swing before and after the last Fed hike, which makes the asset class interesting this time around given that it has lagged[3].

Returns around the only two soft landing examples over the past 60 years

Performance before and after the Fed's last hike	18 mo before	12 mo before	6 mo before	6 mo after	12 mo after	18 mo after
1983-1984						
U.S. Bonds	7.3%	8.6%	0.7%	14.6%	23.9%	23.6%
U.S. Large-Cap Stocks	7.2%	-3.0%	-5.6%	22.0%	32.3%	30.8%
International Large-cap Stocks	12.2%	3.4%	-8.9%	15.4%	38.4%	48.1%
U.S. Mid-Cap Stocks	2.9%	-12.2%	-10.2%	27.2%	38.7%	34.8%
U.S. Small-Cap Stocks	5.5%	-8.3%	3.9%	15.1%	17.3%	24.1%
1994-1995						
U.S. Bonds	0.6%	-2.5%	0.8%	8.8%	16.8%	10.4%
U.S. High Yield Bonds	3.5%	-1.7%	1.8%	12.3%	19.5%	14.3%
U.S. Large-Cap Stocks	6.2%	0.5%	4.2%	20.5%	39.1%	27.1%
International Large-cap Stocks	5.0%	-4.4%	-5.6%	13.3%	16.1%	11.2%
U.S. Mid-Cap Stocks	4.0%	-2.8%	1.7%	22.4%	35.3%	23.2%
U.S. Small-Cap Stocks	4.6%	-5.7%	2.2%	22.0%	30.7%	20.6%

Source: Morningstar Direct, Edward Jones.

Chart description

Similarly, the bottoming in manufacturing activity after several months of contraction has been positive for risk sentiment and forward equity returns. Small-caps have outperformed large-caps in seven out of past eight manufacturing recoveries by 14.5% on average (1996 was the only exception)[3]. From a sector perspective, cyclical sectors tend to perform well after PMI bottoms. Industrials and discretionary have led early in the recovery, while financials and energy were the best performers once the PMI returned to expansion and moved toward its peak.

Periods of manufacturing contraction and troughs			S&P 500 returns	Small-cap returns	IG Bond returns
Dates of PMI bottom	# of months <50	Lowest reading	From trough to peak	From trough to peak	From trough to peak
May-80	13	29.4	59%	103%	-12%
May-82	19	35.5	28%	42%	19%
May-85	8	47.1	32%	35%	24%
Jan-91	25	39.2	21%	46%	14%
Jan-96	10	45.5	32%	22%	6%
May-01	18	41.3	-19%	-5%	9%
Dec-08	18	34.5	24%	33%	6%
Jan-16	5	47.6	25%	41%	9%
Jun-23	*15*	*46.4*	?	?	?
Average	**14.5**	**40.0**	**25%**	**40%**	**10%**

Source: Morningstar Direct, Edward Jones. Annualized returns.

Chart description

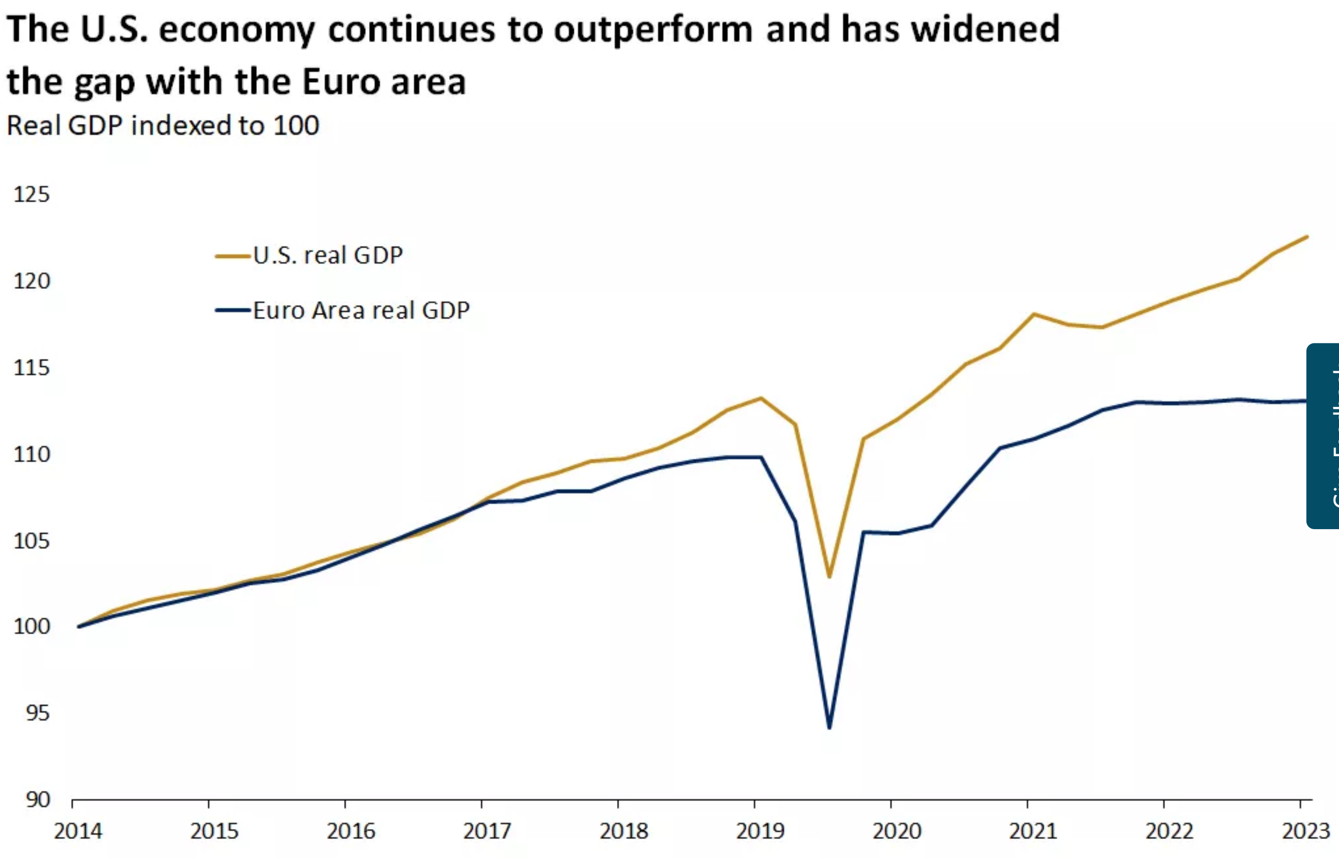
Give Feedback

5. Are international equities a risk, or an opportunity?

We think international diversification still makes sense, and we recommend investors stick to their strategic allocation for now. Certain indexes, like the German DAX and French CAC, are hitting fresh records, while Japan's Nikkei hit a 34-year high. On the flip side, the MSCI China Index is 60% off its 2021 peak amid the country's deepening housing problems. Released last week, the January CPI in China declined at the fastest pace since 2009, and the producer price index remained in deflation for the 16th straight month, highlighting the soft demand backdrop[2].

Overall, international equity markets are deeply discounted relative to U.S. equities and offer more attractive dividend yields. They could also benefit from a potential softening in the U.S. dollar. However, we think that lower valuations are partly justified by the slower economic and earnings growth momentum. In Europe, growth has stagnated, with GDP hovering around zero in the second half of 2023, and China's outlook relies on policymakers' willingness to provide large-scale policy support.

The bottom line is that international equities also have the potential to catch up after a long stretch of underperformance. But that value might only be unlocked when global growth reaccelerates. After all, Ms. Swift's European tour is not starting till the summer...



Source: Bloomberg, Edward Jones.

Chart description

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Investment Strategist

Sources: 1. Google trends, 2. Bloomberg, 3, Morningstar Direct, Edward Jones

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	38,672	0.0%	2.6%
S&P 500 Index	5,027	1.4%	5.4%
NASDAQ	15,991	2.3%	6.5%
MSCI EAFE*	2,225.20	0.1%	-0.5%

INDEX	CLOSE	WEEK	YTD
10-yr Treasury Yield	4.16%	0.1%	0.3%
Oil ($/bbl)	$76.56	5.9%	6.9%
Bonds	$97.62	-0.9%	-1.3%

*Source: FactSet, 2/9/2024. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance does not guarantee future results. *Morningstar Direct 2/11/2024.*

Give Feedback

The week ahead

Important economic data being released this week includes the January CPI inflation reading and retail sales data.

Review last week's weekly market update.

Angelo Kourkafas

Angelo Kourkafas is responsible for analyzing market conditions, assessing economic trends and developing portfolio strategies and recommendations that help investors work toward their long-term financial goals.

He is a contributor to Edward Jones Market Insights and has been featured in *The Wall Street Journal, CNBC, FORTUNE magazine, Marketwatch, U.S. News & World Report, The Observer* and the *Financial Post*.

Angelo graduated magna cum laude with a bachelor's degree in business administration from Athens University of Economics and Business in Greece and received an MBA with concentrations in finance and investments from Minnesota State University.

Read Full Bio

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Market Data

DJIA 38,687.93 ↑ (+16.24)

S&P 500 5,025.69 ↓ (-0.92)

NASDAQ 15,989.93 ↓ (-0.74)

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