Weekly market wrap

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Striking the right balance

Key takeaways:

- Economic data are striking the right balance (not too hot or too cold), helping stocks reach a two-month high and placing the October correction in the rearview mirror.
- Progress on inflation continues, with core CPI falling to its lowest reading in two years. Taken together with the cooling labor market, the Fed can now step to the sidelines and start cutting rates possibly in the second half of next year.
- We see an opportunity for equity-market laggards to catch up and for bonds to recover as the headwind of rising yields gradually subsides. A growth slowdown could trigger volatility, but fundamental drivers support a positive outlook in 2024.

Much like finding the perfect water temperature for a relaxing bath, navigating the incoming economic data in markets requires a delicate balance. Too hot, and there is a risk of economic overheating that pushes inflation higher, triggering a Fed response; too cold, and the markets may freeze as recessionary concerns resurface. So far in November the temperature has been just right, helping stocks reach a two-month high and placing the October correction in the rearview mirror. Ideal conditions don't last forever, but here are three reasons why the fundamental drivers are broadly moving in a direction supporting a positive outlook in 2024.

1. Progress on inflation continues

- After a brief acceleration in late summer, inflation resumed its downward trajectory in October. The headline consumer price index (CPI) was unchanged last month, with the annual rate falling from 3.7% to 3.2%, helped by a sizable drop in gas prices. Oil prices are now down 20% from their September high and will continue to be a drag on next month's data[1]. Core CPI, which excludes food and energy and is a better indicator of the underlying trend, also moved lower, from 4.1% to 4.0%. Though still well above the Fed's target, this was the lowest reading in two years[1].
- A look under the surface reveals some encouraging trends. Prices for goods outright declined in October for the fifth consecutive month, largely driven by falling used car and truck prices. Private wholesale data suggest further declines in used car prices ahead. Outside of autos, the improvement in supply chains and lower transportation costs are consistent with decreasing prices for other goods. Elsewhere, shelter inflation remains the biggest contributor to overall CPI, but th was a notable stepdown in the pace of monthly increases in October. The steep

decline in price increases for newly signed leases should continue to pull housing inflation lower through most of 2024[1].

- In our view, the key takeaway is that inflation is slowing faster than the Fed expects, even as economic growth has stayed stronger than most anticipated. As a result, there is a good chance that policymakers might revise their inflation projections lower when they meet next month. For perspective, the September projections call for the Fed's preferred measure of inflation to end 2023 at 3.7% and 2024 at 2.6%

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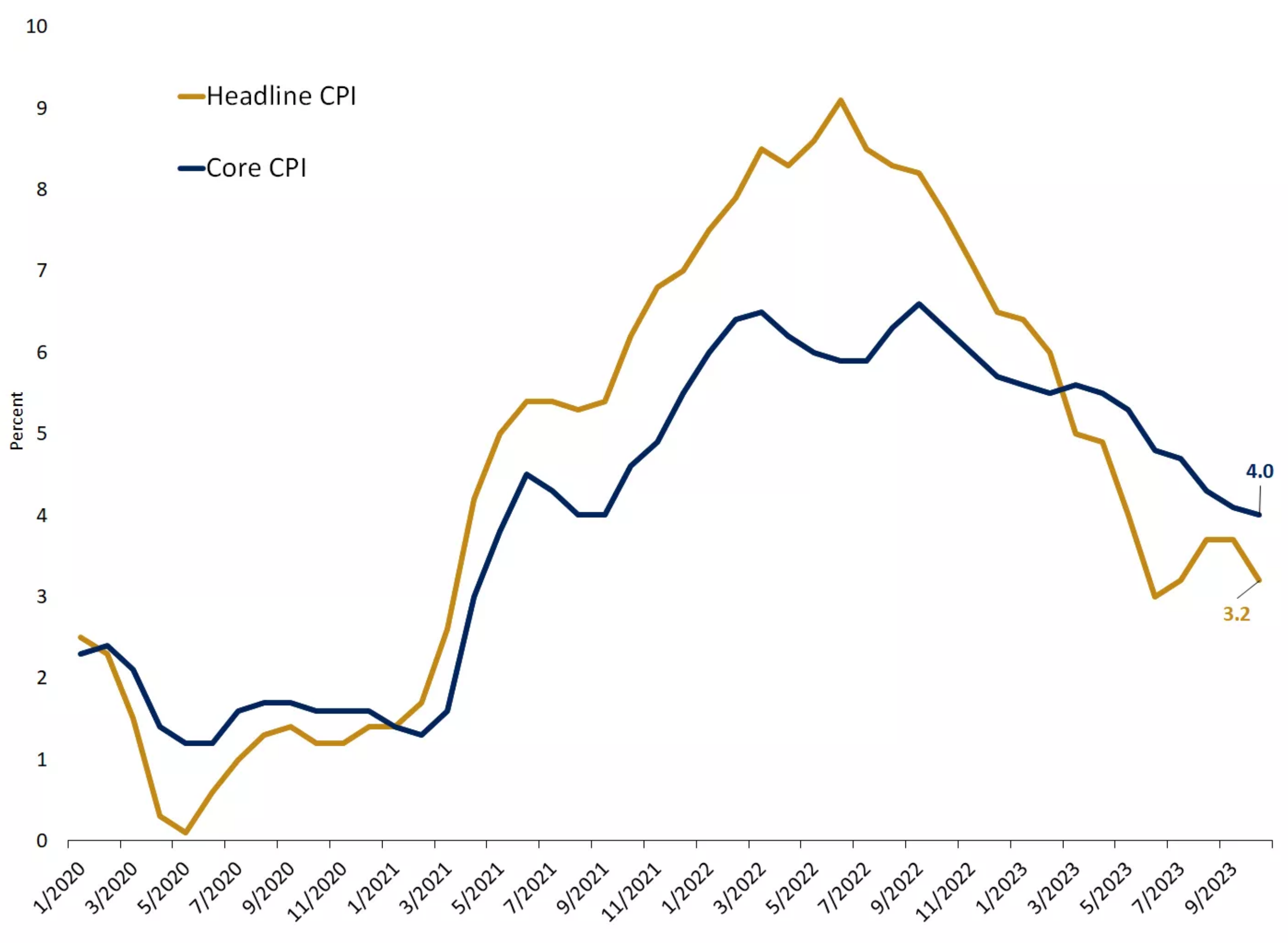
Inflation remains on a downtrend, taking some pressure off the Fed



Source: Bloomberg.

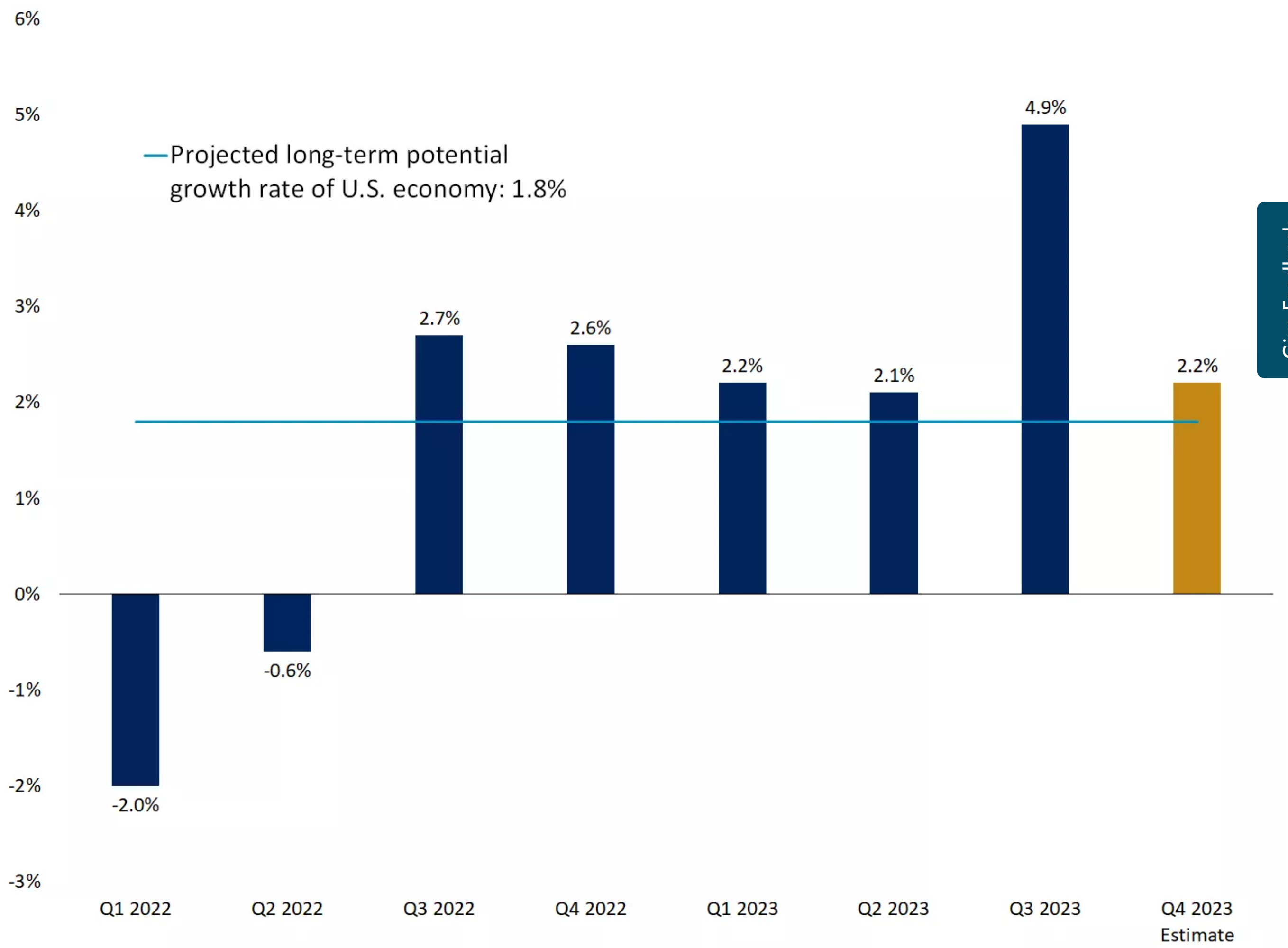
Chart description

2. Growth is gently slowing, with activity still expanding at a solid pace

- The combination of consumer and employment data this month suggest that aft long stretch of above-average growth, we may begin to see some fatigue in household consumption and some cooling in the labor market. Yet that slowdown is only gradual and aids the Fed's effort to lower inflation. The reference of "switching to a slower lane, rather than swerving into the ditch" that we've made before will likely remain relevant for the next couple of quarters.

- Digging a little deeper, last week we saw that October retail sales fell, but less so than expected (-0.1% vs. -0.3%). The modest decline was driven by a drop in gasoline sales, and the more important control-group sales (excludes gasoline, autos, building materials, and food services), which feeds into the GDP calculation, rose 0.2% month-over-month following an upward revised 0.7% gain[1]. The upshot is that while the consumer has been the strongest cylinder in the economic engine, the consumer is gradually slowing because there is a little less dry powder to spend. Nonetheless, consumer activity continues to support overall growth as the year wraps up. After a very strong third quarter, GDP tracking estimates for the fourth quarter are simply normalizing instead of signaling a more worrisome downturn.
- Jobless claims are also in the same bucket of data coming in cooler but not too cold. Initial jobless claims rose to their highest since August, and continuing jobless claims also moved up, hitting their highest in two years. However, both remain about 30% below their historical averages over the past 50 years, which speaks to the solid starting point ahead of a potential deterioration[1]. With demand softening, companies will likely slow hiring to protect profitability. They might proceed carefully with layoffs, however, because overall demand for workers continues to exceed supply, as suggested by the still wide gap between the number of job openings and the number of unemployed.

GDP growth will likely slow in Q4 but remain near the economy's potential



Source: Bloomberg, Atlanta Fed GDPNow Forecast.

Chart description

3. Falling yields confirm a change in Fed policy

- A key reason why both equity and bond markets have rallied in November is that the easing inflation pressures, together with signs of a cooling labor market, increase confidence that the Fed is likely done hiking rates. After core inflation hit its lowest reading in more than two years, markets were quick to price out a December hike and price in an earlier start to rate cuts. The Fed policy-sensitive 2-year Treasury yield declined below 5.0%, while the growth-sensitive 10-year yield declined below 4.5%[1].
- We think that last month's surge in rates might have marked the peak for this cycle, as the incoming data support an extended Fed pause and potentially the start of rate cuts in the second half of 2024. Policymakers will likely push back against aggressive expectations for Fed easing, so there is a limit to how much and how yields can fall from here. But if price pressures continue to moderate in 2024 as expect, real policy rates (after adjusting for inflation) will become more restrictive,

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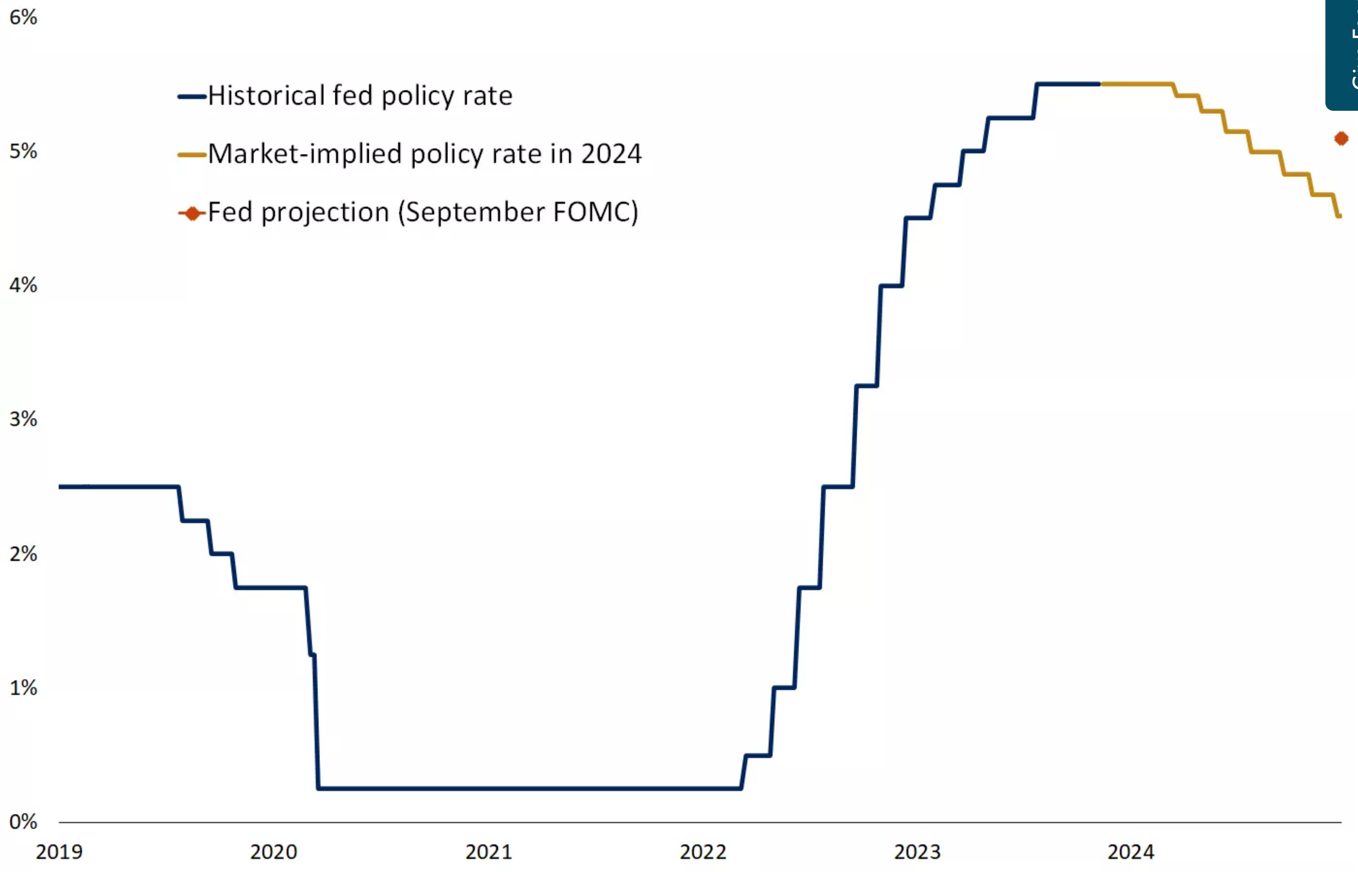
which the Fed will likely try to offset by cutting rates more than the two times it is currently projecting[2].

Fed will likely push back against easing, but may end up cutting rates in 2024 more than the two times they projected back in September



Source: Bloomberg, September FOMC meeting projections.

Chart description

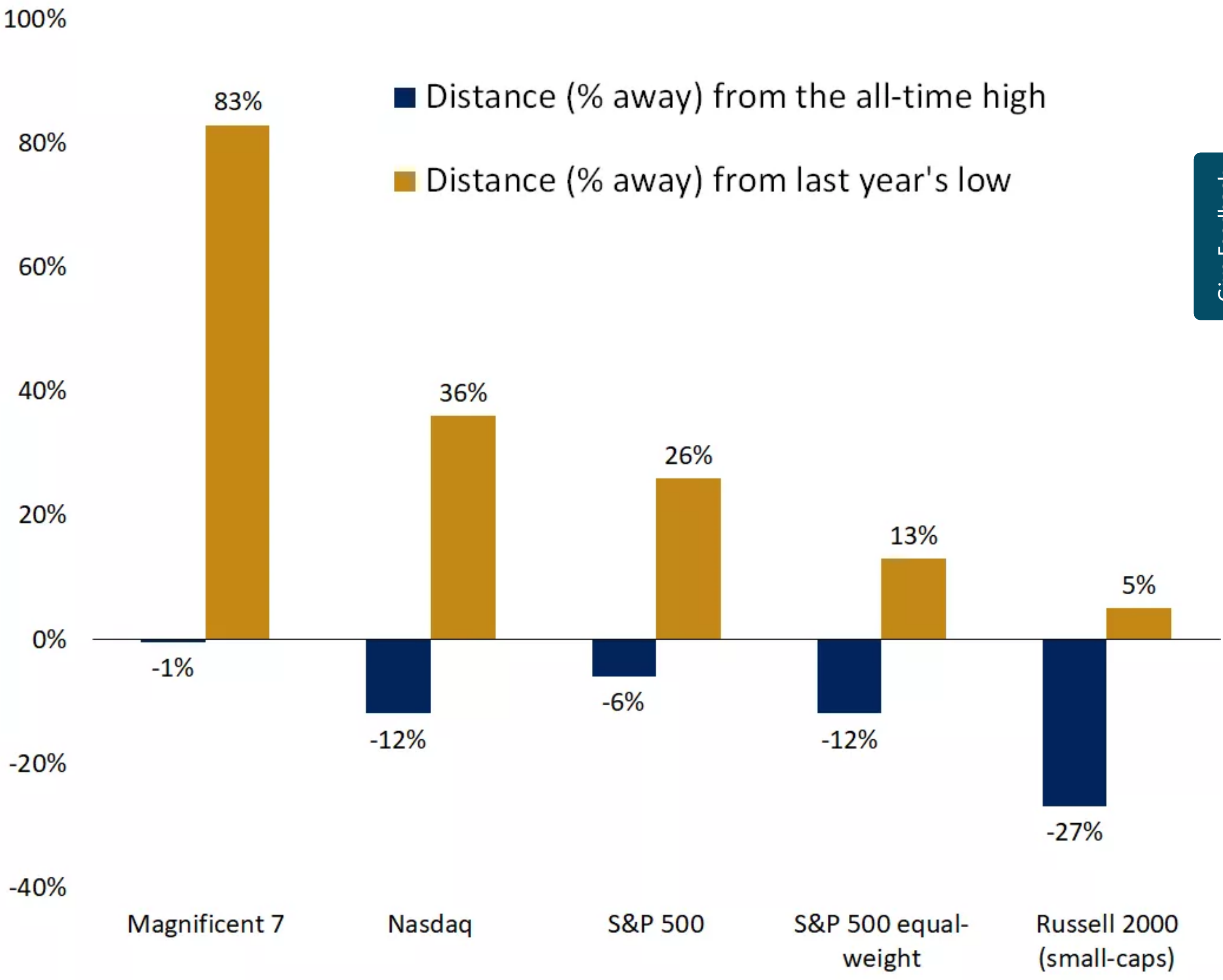
Investment implications - A preview into 2024?

- The Fed-friendly data pushed both stocks and bonds higher, extending the November rally. But last week's market moves offered a slightly different flavor from what we've seen for most of the year, with leadership notably broadening.
- Up to this point, most of the equity-market gains have been driven by a small number of stocks, the so-called "Magnificent 7" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, Tesla). Showcasing this point, the S&P 500 is now down only 6% from its all-time high in early 2022, while the equal-weight S&P 500, which assigns the same weight to all the stocks in the index, is down 12%. The Russell 2000, which is the proxy for small-cap stocks, is down 27% from its high

Last week's outperformance from small-caps and the "average" stock potentially offers some insight into what might unfold in 2024[2].

- We see an opportunity for laggards to catch up as the headwind of rising yields subsides. These include bond proxies (like the traditional defensive sectors), small-caps, and value-style investments. A smooth cooling in the economy that allows the Fed to cut rates next year looks increasingly possible. In this scenario, the U.S. dollar could weaken, helping international returns. On the fixed-income side, a peak in rates presents an opportunity to start extending duration, with bond returns likely outperforming cash in 2024.
- As we've articulated in our prior notes, the ingredients for a year-end rally are in place, helped by the right balance of moderating, though still resilient, economic data. However, markets don't move in a straight line, and stocks could pause to digest the recent gains. Looking into 2024, the lagged effects of high interest rates will continue to filter through the economy, driving softer growth, which could trigger periods of volatility. Still, we think that lower rates and modestly rising earnings will help equities build on this year's gains and help the battered bonds rebound.

Market laggards could play catch-up in 2024



Source: Bloomberg, Edward Jones.

Chart description

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Sources: 1. Bloomberg, 2. September FOMC meeting projections

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	34,947	1.9%	5.4%
S&P 500 Index	4,514	2.2%	17.6%

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INDEX	CLOSE	WEEK	YTD
NASDAQ	14,125	2.4%	35.0%
MSCI EAFE*	2,080	3.4%	7.0%
10-yr Treasury Yield	4.43%	-0.2%	0.6%
Oil ($/bbl)	$75.94	-1.6%	-5.4%
Bonds	$95.24	1.4%	0.6%

The week ahead

Important economic data being released this week includes S&P Global Purchasing Manager Index (PMI) data.

Review last week's weekly market update.

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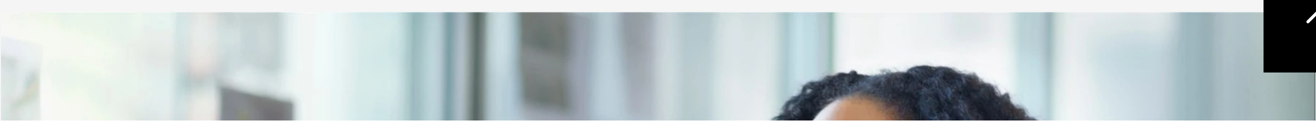
Read Full Bio >



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Market Data

DJIA 34,947.28 ↑ (+1.81)

S&P 500 4,514.02 ↑ (+5.78)

NASDAQ 14,125.48 ↑ (+11.81)

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