Weekly market wrap

Published Jan. 26, 2024

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‹ Weekly market wrap

The Case for a Soft Landing

Strengthens

Key Takeaways:

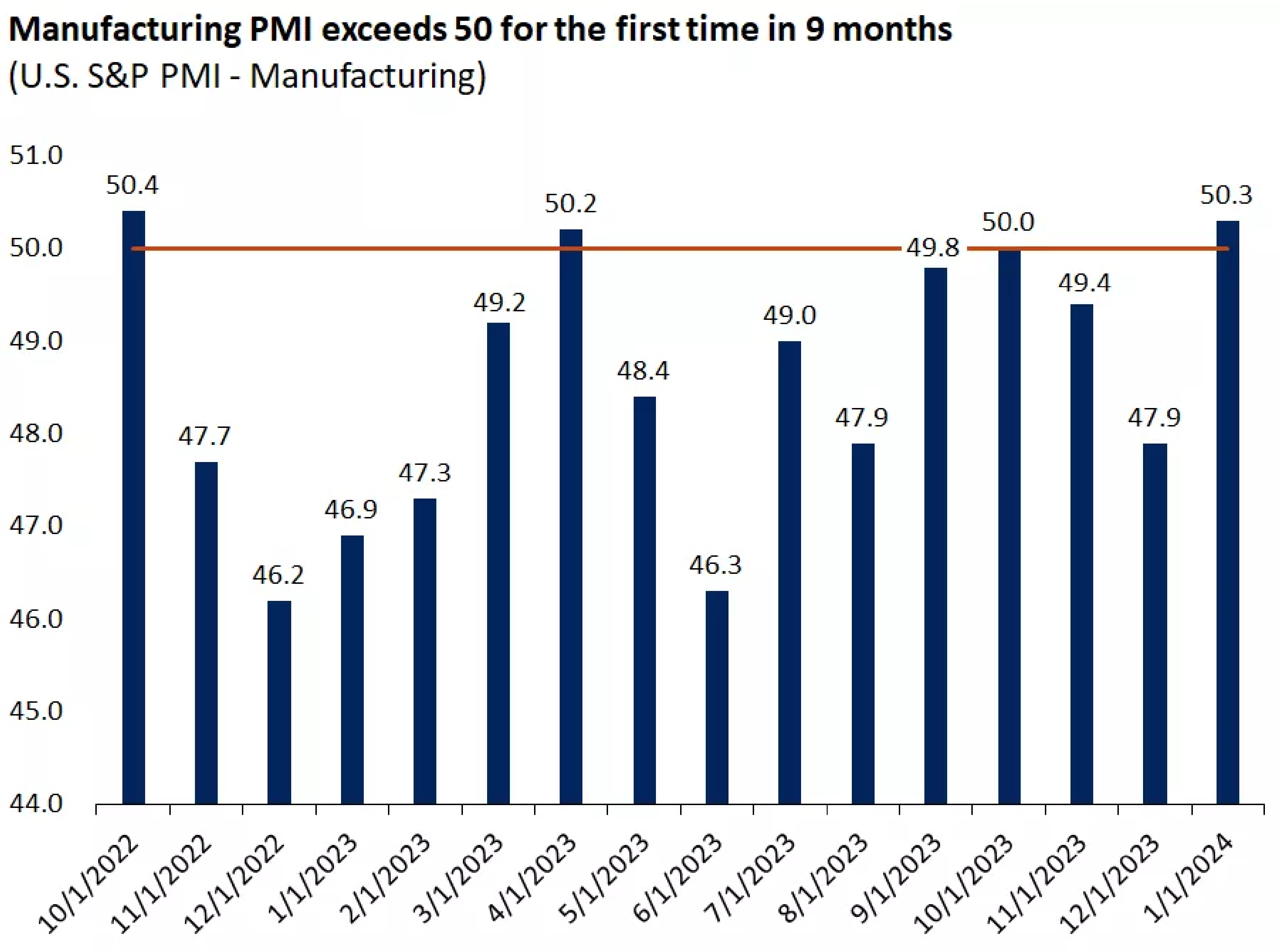
- Over the past week, investors digested two key datapoints that continue to support the case for a soft landing in the U.S.: The S&P PMI data, for both services and manufacturing, were in expansionary territory in January, and fourth-quarter GDP growth exceeded forecasts, coming in at 3.3% annualized, versus expectations of 2.0% growth.
- While these datapoints are backward looking, they support the narrative that the U.S. economy was not softening entering the new year. In fact, the data indicates that economic growth accelerated at the end of last year. Meanwhile, inflation also showed signs of moderation as we entered 2024.
- This "Goldilocks" outcome of better-than-expected growth, coupled with easing inflation, should be supportive of financial markets broadly and put some downward pressure on interest rates. We have seen the S&P 500 push higher thus far in 2024, reaching new all-time highs, while the 2-year Treasury yield, a proxy for the fed funds rate, ticked lower to around 4.35%.

The U.S. economy enters 2024 from a position of strength

While there was some uncertainty around economic growth as we entered 2024, the data over the last week showed that the U.S. economy has been firing on all cylinders over the past several months. Two key datapoints exemplified this stronger growth:

- **First, the S&P Purchasing Managers Index (PMI) came in higher than expected,** with the manufacturing PMI hitting 50.3 in January, well above expectations of 47.6 and higher than last month's 47.9 reading and reaching its highest reading since October 2022. The manufacturing part of the U.S. economy had been an area negatively impacted by the Fed's rapid rate-raising cycle, with sectors like housing and industrial production coming under pressure over the past 1.5 years. The latest surprise positive reading may be the first indication that the manufacturing economy in the U.S. is now starting to stabilize.

  Meanwhile, the services PMI also continued to strengthen, pointing to ongoing strength in the U.S. services economy. The services PMI came in at 52.9 for January, also in expansionary territory, above expectations of 51.5 and last month's reading of 51.4.[1] Services has been a source of strength in the economy since the pandemic era, as consumers continue to demand services, including in travel, leisure and hospitality sectors.



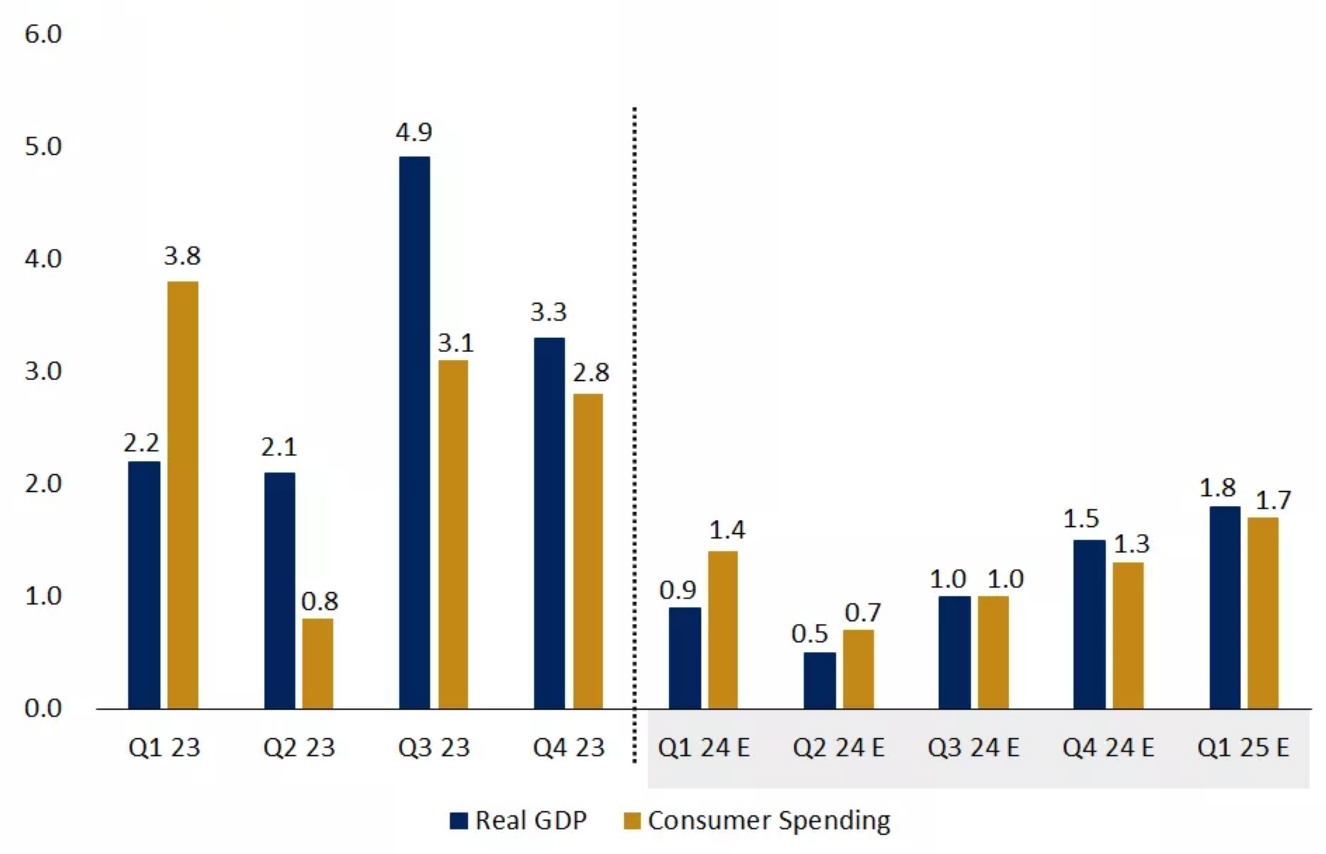
Source: Bloomberg, S&P Global U.S. Manufacturing PMI

Chart description

- **Second, U.S. economic growth continues to surprise to the upside.** Fourth-quarter GDP growth in the U.S. came in at 3.3% annualized, well above expectations of 2.0% growth. This strength was driven by ongoing resilience in consumption, which grew at 2.8%. This is now the sixth quarter of U.S. economic growth coming in over 2.0% -- above potential growth of 1.5% - 2.0% -- despite facing higher interest rates. Remarkably, over the last two quarters we have seen 4.9% and 3.3% growth rates, well above trend.

  While growth has remained resilient over the past year, we would expect some moderation in the quarters ahead. This may be a gradual slowing to trend growth or slightly below-trend growth, driven by softer consumption and perhaps some cooling in the labor market. Nonetheless, we would not expect economic growth to fall into negative territory, and we believe the soft-landing scenario remains intact. In addition, as the year progresses, we could see reacceleration in economic growth, particularly as inflation continues to moderate and the Fed potentially pivots to rate cuts, both supportive for the consumer.

U.S. GDP and consumption expected to slow to below trend, before accelerating later in 2024 (QoQ% annualized)

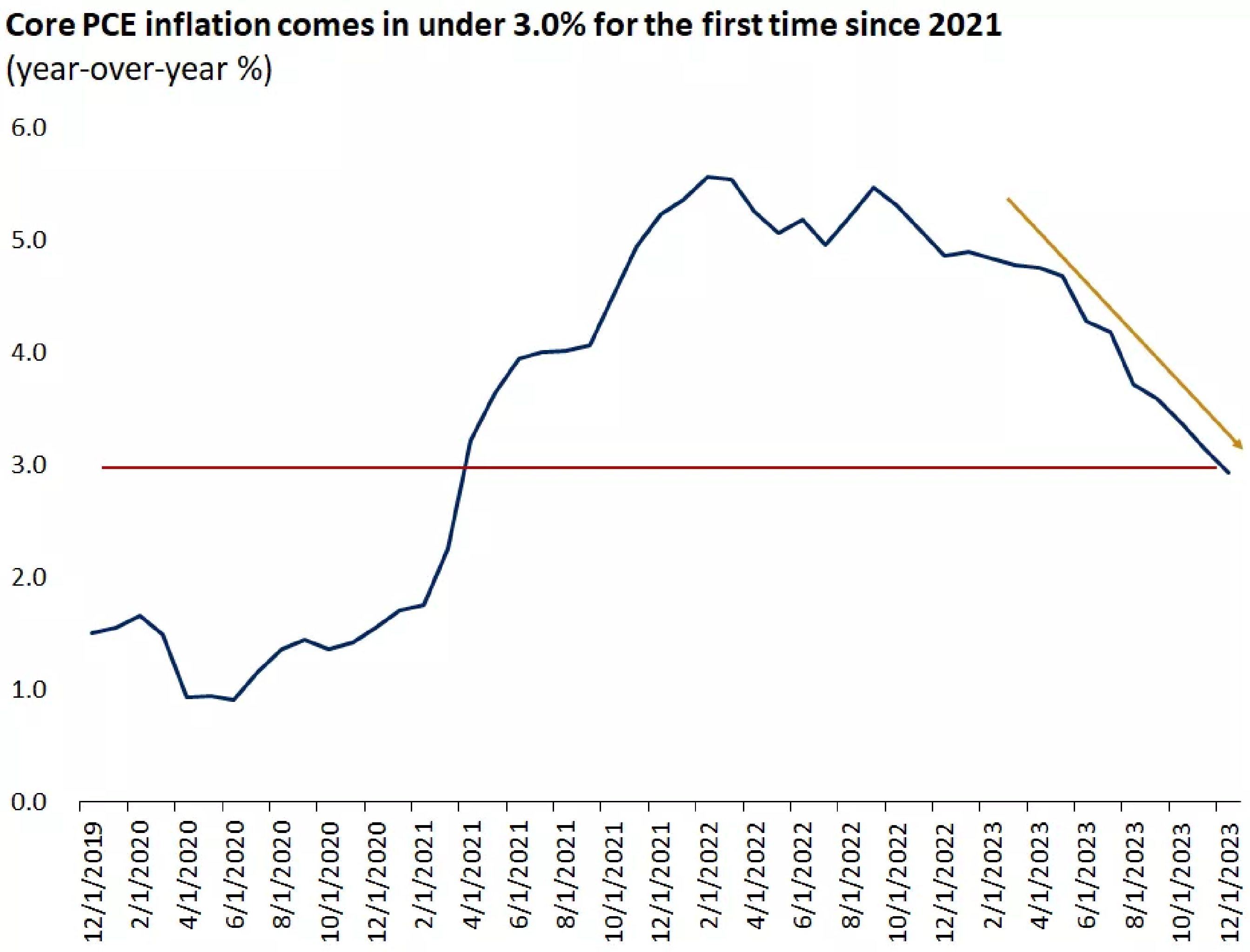


Source: Bloomberg

Chart description

Inflation data supports the "Goldilocks" narrative

In addition to strong economic growth, the data over the past week also supported an ongoing moderation in inflation. In the PMI report, the prices-charged index, a measure of inflationary pressures, eased to its lowest since May 2020, coming in at 51.7 in January.[1] This is also down sharply from its recent peak of 74.6 in April 2022. Perhaps even more notable was that, last week, core PCE (personal consumption expenditures) inflation data, often considered one of the Fed's preferred inflation measures, came in below expectations for the month of December. In fact, core PCE inflation is now 2.9% year-over-year, below last month's 3.2%, and below 3.0% for the first time since 2021. The ongoing moderation in inflation, despite above-trend economic growth, has led to optimism that the Federal Reserve may be able to start cutting policy rates rapidly this year to return to more neutral rates.



Source: Bloomberg

Chart description

All eyes turn to the Fed next week

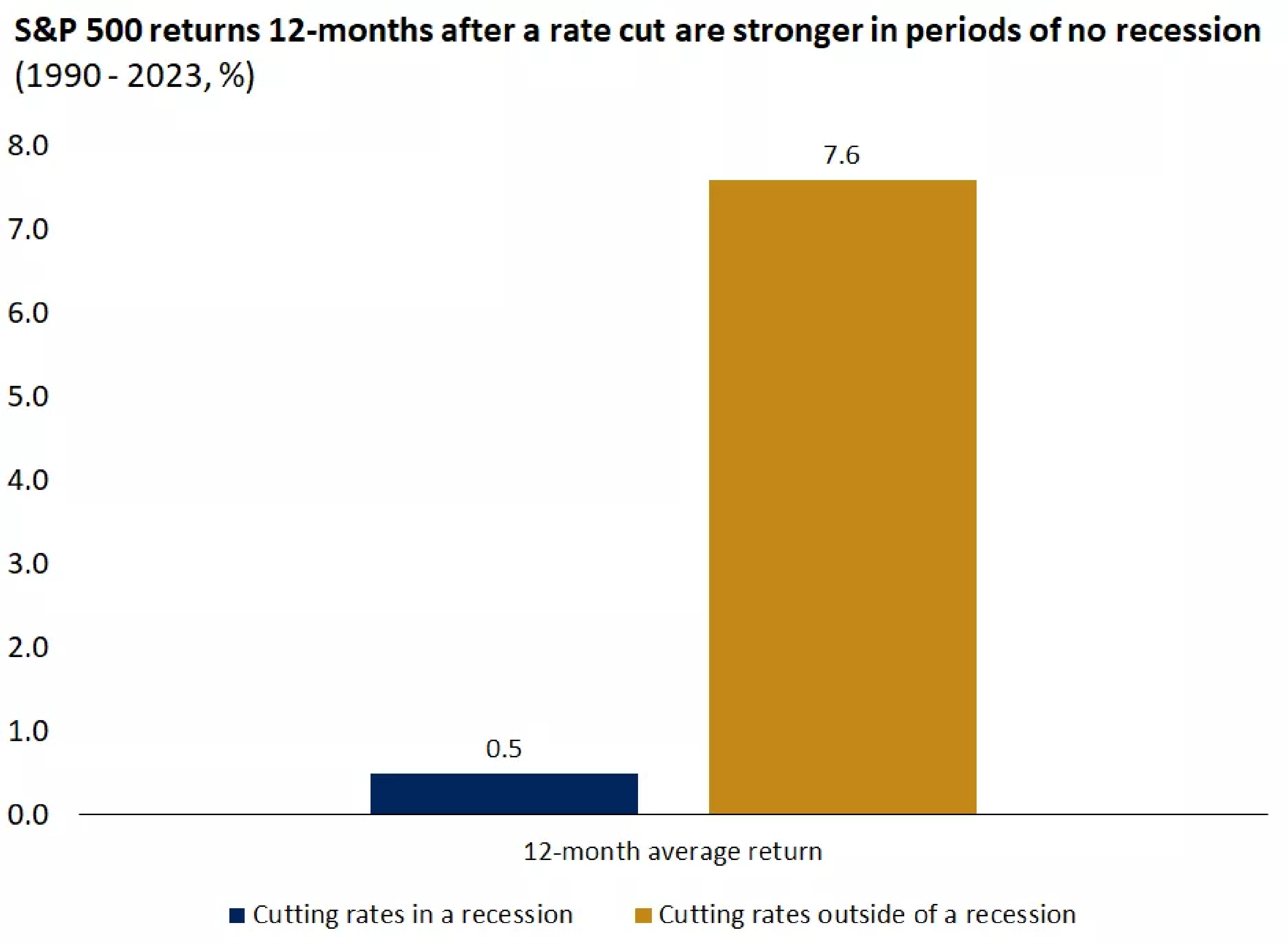
Investor focus will soon shift to the Federal Reserve meeting on January 31, where the Fed is expected to keep interest rates on hold at 5.25% - 5.5%. The better inflation data over the past week certainly highlights less of a need for the fed funds rates to remain in very restrictive territory. While markets are currently pricing in about six Fed rate cuts in 2024, the Fed's own "dot plot" from its December meeting indicates about three rate cuts ahead. However, the market probability of a March rate cut has come down in recent weeks, to around 50%, with rate cuts now expected in the June through December meetings.[2]

In our view, the Fed may use the January meeting to acknowledge the progress on both growth and inflation, but still push back somewhat on the aggressive rate cuts priced into the market. We see three to four rate cuts likely in 2024, perhaps starting closer to June, as core inflation continues to moderate. More broadly, we believe that the Fed will prefer to move rates lower gradually to monitor the impact on the economy and ensure inflationary pressures continue to ease. If the Fed were to do six or more rate cuts, this may indicate that the economy has slowed substantially, and if it were to enact two or fewer rate cuts, this could indicate that inflation has reemerged. Thus, we see three to four rate cuts in 2024 as perhaps a balanced approach to moving rates back to neutral over time.

History tells us that markets can do well in a "soft landing" as the Fed pivots to rate cuts

Overall historically, when the Fed begins a rate-cutting cycle and the economy is not in a recession, markets tend to have better performance. Since 1990, the average 12-month return after the first Fed rate cut, in periods of no recession, has been around 7.6%, versus just a 0.5% return in periods of recession. Given the recent strong economic data in the U.S., we see mounting evidence of a soft landing in the economy emerging in 2024, which may bode well for market returns as the Fed pivots to rate cuts.

In our view, some of these positive market returns may have been pulled forward last year, when the S&P 500 climbed 24%.[1] That robust return in part reflected enthusiasm around artificial intelligence (AI) and in part reflected an economy that showed resilience, despite a relentless Fed rate-hiking cycle. Nonetheless, the returns last year were driven by a narrow set of stocks and sectors, and we see returns ahead driven by a broader set of market leadership. While these returns will likely not occur in a straight line, particularly after such a strong year-end rally in 2023, we would use market volatility as an opportunity to position for broader leadership in both equities and investment-grade bonds as the Fed embarks on its rate-cutting cycle. As history has shown us, markets can thrive in an environment of easing inflation and Fed rate cuts, especially when the economy lands smoothly.



Source: Morningstar Direct, Edward Jones. S&P 500 Total Return Index

Chart description

Mona Mahajan
Investment Strategist

Sources: 1. Bloomberg. 2. CME Fed Watch Tool.

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	38,109	0.6%	1.1%
S&P 500 Index	4,891	1.1%	2.5%
NASDAQ	15,455	0.09%	3.0%

INDEX	CLOSE	WEEK	YTD
MSCI EAFE*	2,222.74	2.0%	-0.6%
10-yr Treasury Yield	4.14%	0.0%	0.3%
Oil ($/bbl)	$78.12	6.6%	9.0%
Bonds	$98.07	0.1%	-1.1%

*Source: FactSet, 1/26/2024. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance does not guarantee future results. *Morningstar Direct 1/28/2024.*

The week ahead

Important economic data being released this week includes FOMC meeting and nonfarm payrolls report.

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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