Monday December 11, 2023

SUMMARY-

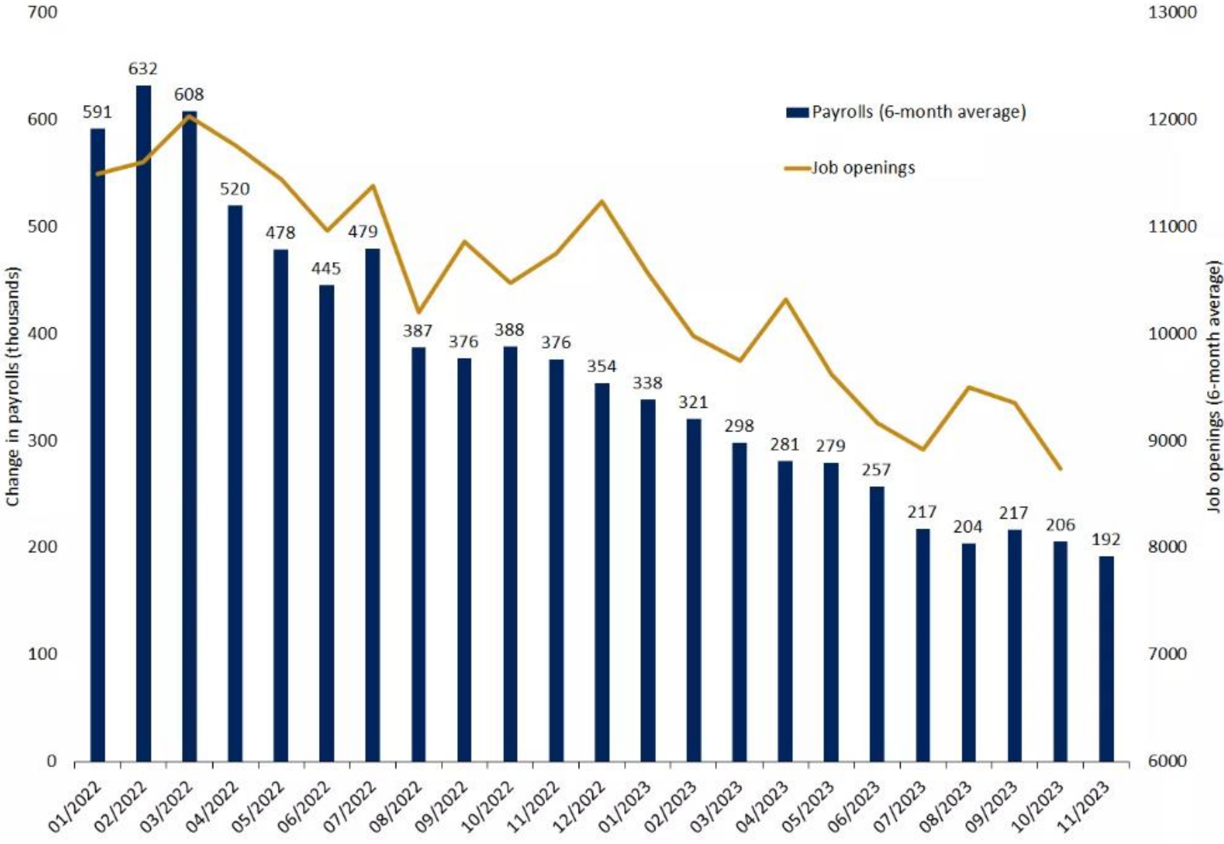
I. Stocks have another good week as inflation data looms.
II. Important CPI report and final Fed meeting of 2024 on deck this week.
III. Expected 2024 rate cuts could help lagging equity sectors.
IV. Portfolio rebalancing into year-end underway to position for 2024.

Good morning:

After an extremely strong November for stocks, major equity averages inched a bit higher last week with gains of 1% or less. With only a few weeks left till the end of 2023, markets remain on track for a strong finish. The S&P 500 index is hovering near its highs for the year, and bonds are rebounding nicely after a difficult three-year stretch. The overarching forces supporting portfolio gains this year have been the easing inflation pressures, a resilient economy that has not only avoided a recession but has grown at a surprisingly above-average pace, and enthusiasm around artificial intelligence (AI). Although much of the year's gains has been concentrated in the so-called "Magnificent Seven" large tech stocks, clear signs that market laggards are waking up have appeared.

This week will center around another critical release of inflation data. November CPI figures will be released tomorrow morning, followed by the Fed's reaction to it at their FOMC meeting on Wednesday. This will be the Fed's last scheduled opportunity in 2023 to make any policy adjustments or remarks on

the money supply. The gently cooling labor market report released last week, along with tomorrow's likely declining inflation data (thanks to declining oil prices), should keep the Fed on the sidelines while remaining diligent with their rhetoric.



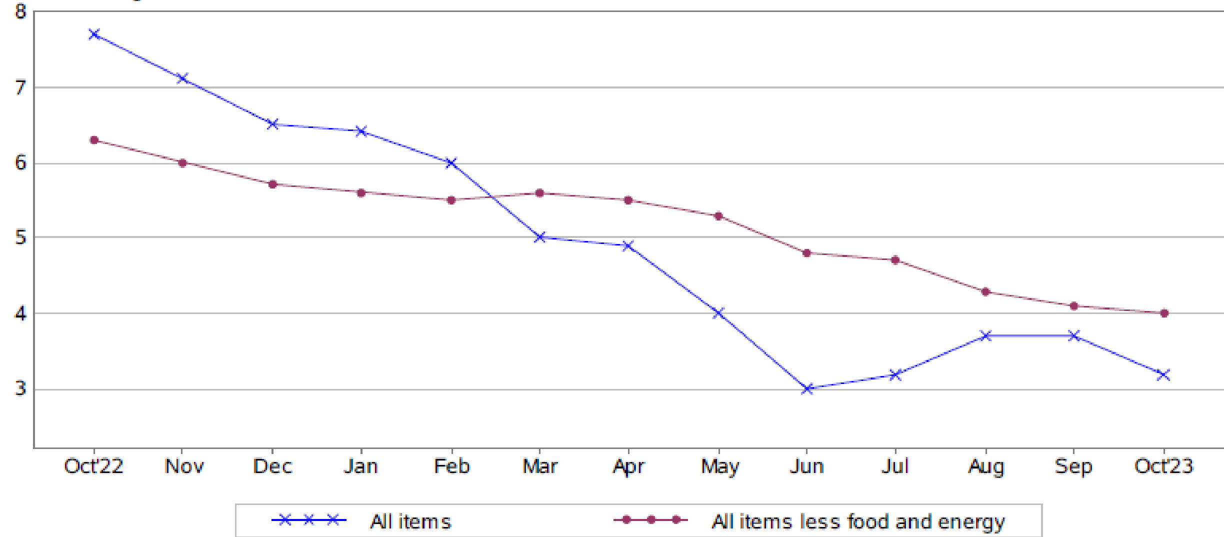
Source: Bloomberg

Early 2023 calls for a hard-landing type of recession have mostly now morphed into either soft-landing or even no-landing as the economy continues to outperform expectations. Driving this optimism is the sharp decline in inflation

from the 9.1% peak in June 2022 to only 3.2% as of October 2023. Although still above the Fed's 2.0% target rate, its downward trajectory has remained intact and likely means the Fed has made its last hike in this cycle. As of now, their dot plot projections of future interest rate decision continue to predict 4-5 rate *cuts* in the back half of 2024.

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, Oct. 2022 - Oct. 2023

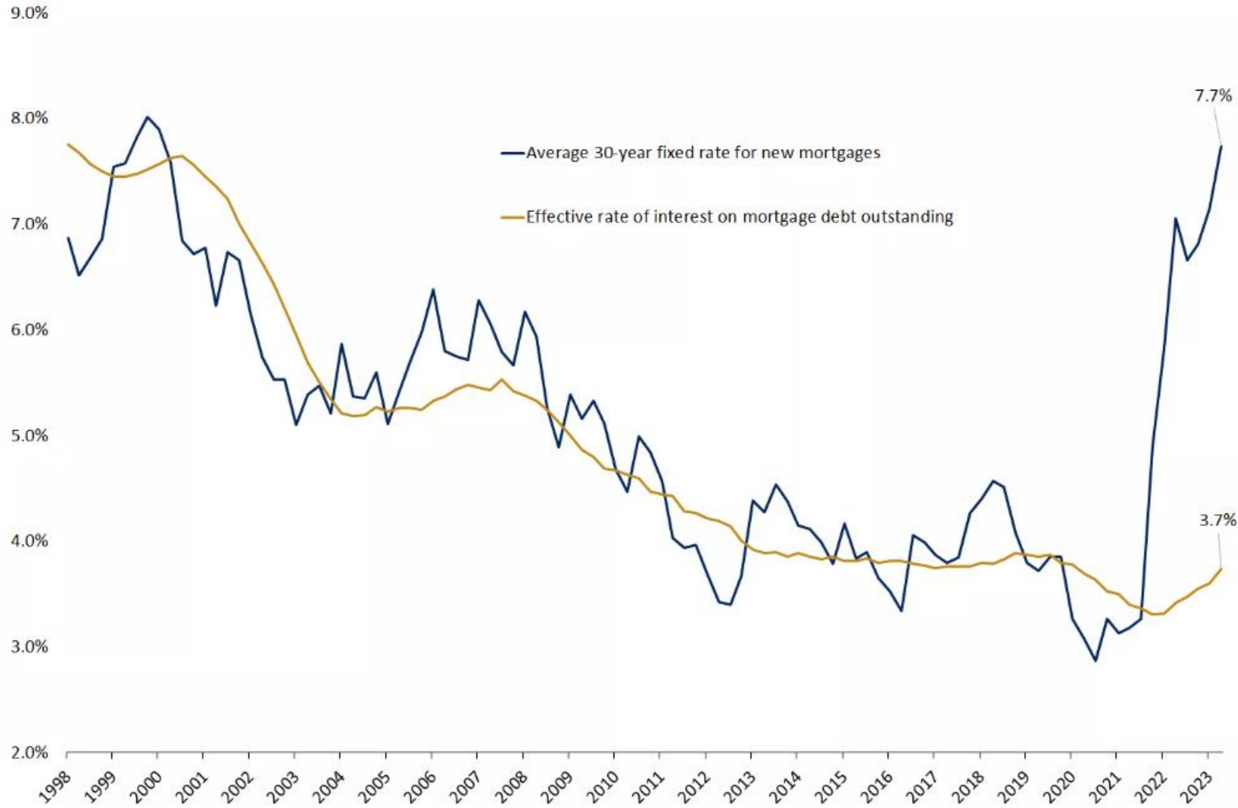
Percent change



Source: U.S. Bureau of Labor Statistics

While these would be cuts of the Federal Funds rates, the target rate at which commercial banks borrow and lend their excess reserves to each other overnight and would surely result in declining money market fund rates, longer term interest rates have already started to fall. Ten-year treasury yields have fallen from the 5% area to 4.25% over the past few weeks. This will likely provide some relief to home buyers since many mortgage rates are keyed off this

rate. Fortunately, most of the existing mortgage debt in the U.S. has a much lower interest rate locked-in from before the recent spike. This has enabled consumers to generally maintain prior spending levels without seeing their mortgage payments balloon.



Source: Bloomberg

With the bond market projecting Fed rate cuts to begin in March, investors are getting more comfortable putting capital at risk in both equities and longer duration fixed-income securities. Upcoming rate cuts also seems to be supporting the subtle shift underway from this year's winners to the laggards. Defensive

sectors, value-style investments, dividend-paying blue chips, and small-caps could all benefit from declining rates as large pools of institutional capital shifts attention in their direction. We have been conducting widespread rebalancing of the various strategies we manage to be well positioned for these 2024 expected moves while maintaining each model's objective and level of diversification to mitigate risk.

Have a great week!

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