Monday February 12, 2024

SUMMARY-

I. Chiefs and mega-cap tech both repeat winners.

II. Lagging sectors still poised for recovery later in the year.

III. Earnings, inflation, and consumer sentiment data on deck.

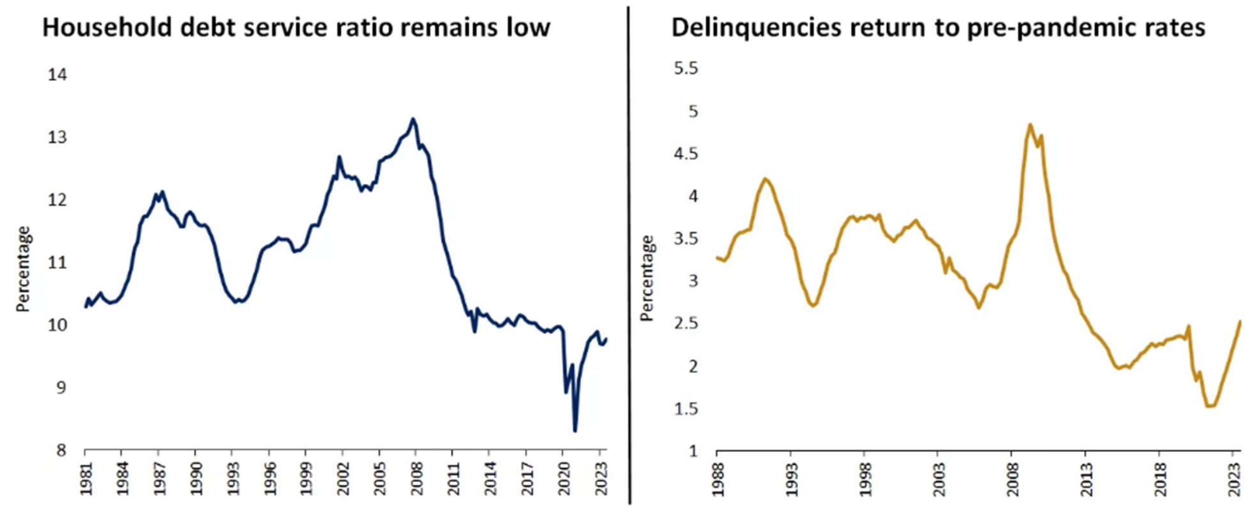
IV. Expecting downside volatility still important during bull markets.

Good morning:

Watching Patrick Mahomes lead the Kansas City Chiefs to another NFL championship may seem like 2023 all over again. In like manner, this year's outperformance by a small number of mega-cap tech companies also seems eerily familiar. Continued excitement surrounding artificial intelligence helped the NASDAQ lead all major averages last week with a gain of 2.3%. The S&P 500 Index added 1.4% and closed above the 5,000 milestone for the first time ever. However, just like the dominance of one team eventually ends, the many under-loved (and undervalued) sectors of the market will eventually also have their time to shine. Value oriented sectors, dividend payers, small caps, and international stocks all fall into this category of lagging areas ready to play catch-up.

However, there are some initial signs that the market's participation may be starting to broaden. The growth-sensitive industrials sector and the ratesensitive 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 based on declining inflation rather than a slump in growth. We believe a rotation from mega-cap tech into cyclical and value-style investments could still materialize later in the year when interest rates start to be cut by the Fed if economic growth remains positive. Much of this growth will again fall to the consumer.

Although household finances remain relatively healthy, consumers have less firepower than a year ago. 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. Mortgage-delinquency rates are now slightly above pre-pandemic levels. And despite the recent job-cut headlines, the January spike appears to be seasonal, with overall layoff announcements remaining lower than a year ago. 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.

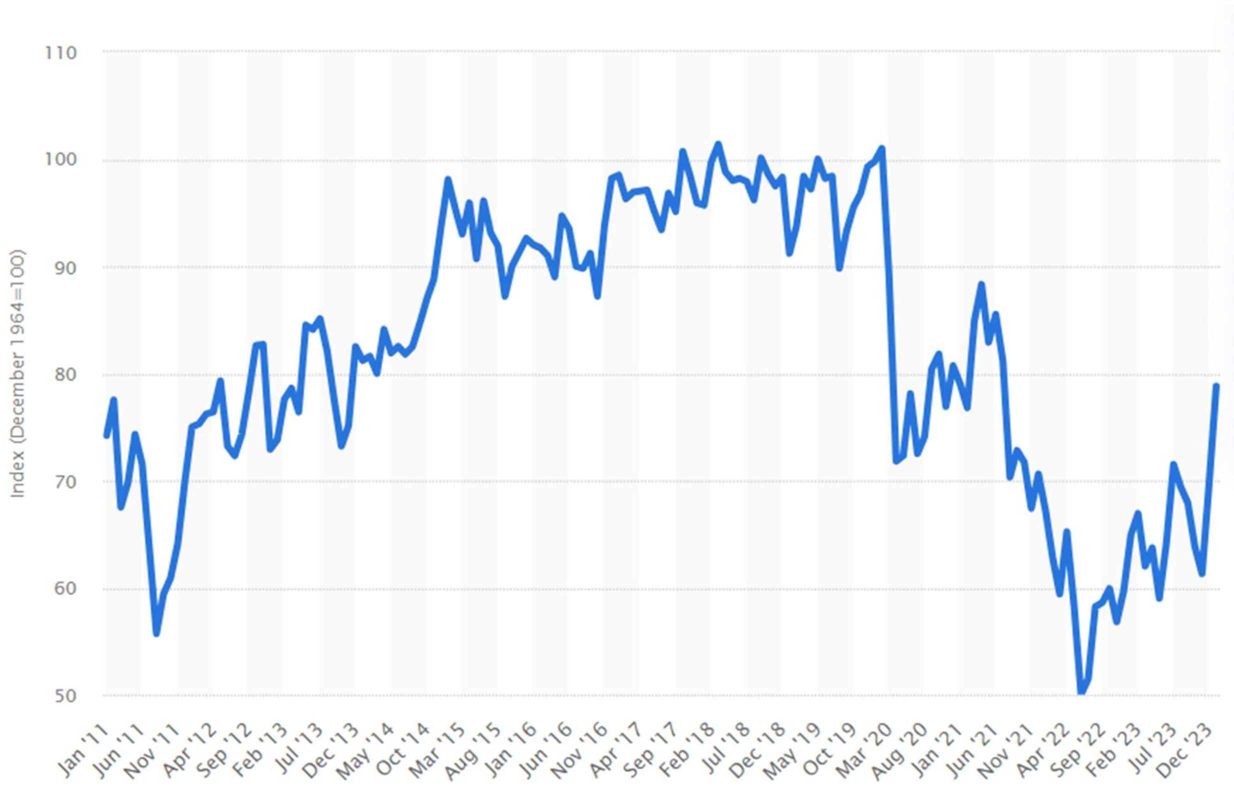


Source: Bloomberg

A broadening consensus seems to be forming around the thesis that our economy continues to move away from the worst-case scenarios that were so widely predicted only a year ago. Aggressive rate hikes had many of the nation's leading economists calling for a hard-landing recession and all the negative consequences that implies. While there could very well be a degree of consumer softening that results in some weaker growth figures later this year, the expected decline in interest rates and the accompanying pick-up in mortgage and housing transactions could spell an economic reacceleration by year end.

In addition to another batch of key earnings reports, this week's market action will likely be focused on several important economic reports. January CPI data will be released Tuesday morning and is expected to show another decline. As a leading inflation indicator, prices paid at the wholesale level will be revealed in Friday's latest Producer Price Index (PPI) report. Consumer sentiment data will also be released on Friday and could further confirm the positive mood that the bull market and declining inflation has helped to created.

United States Consumer Sentiment Index 1/2011 – 1/2024



Source: Statista

Meanwhile, the all-important 10-year U.S. treasury bond yield has settled into a range of 4-4.25% with the curve still noticeably inverted, at least until the Fed starts to reduce short-term rates. The expectation of declining money market yields as the likely way the yield curve normalizes later this year has provided another impetus for some investors to redeploy capital into equities in recent weeks. We see money market funds as perfectly fine for portions of portfolios that may need to be spent in the coming months, especially now that they are paying yields not seen in more than a decade. However, we also foresee their yields declining in lock step with each forthcoming Fed rate cut. For longer-term investment objectives like retirement, high quality equities in a diversified and professionally managed strategy have historically produced superior returns compared to other asset classes and should continue to do so. Investments in equities while achieving these returns have also experienced higher levels of volatility that should be anticipated by investors. Anticipating occasional equity market corrections and even bear market drawdowns should be something every investor should expect to experience with some regularity so as not react abruptly out of fear when they occur.

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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