Tuesday, January 16, 2024

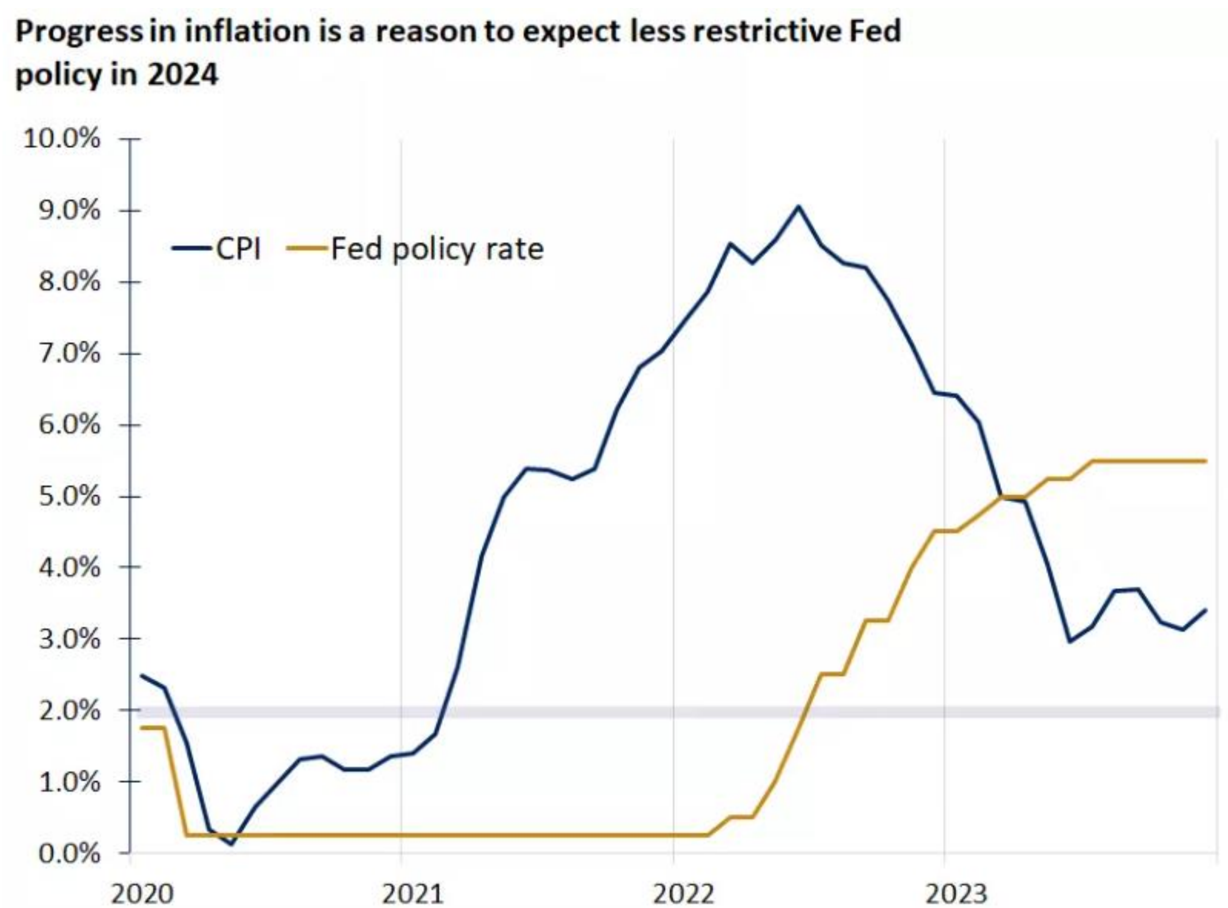
SUMMARY-

I. Stocks rebound after soft start to the year.
II. CPI ticks higher but PPI declines keeping Fed on track to ease.
III. Short-term instruments likely to continue to underperform.
IV. Year ahead looks promising but volatility may be inevitable.

Good morning:

Markets resumed their climb higher last week despite conflicting inflation data. The annual Consumer Price Index (CPI) posted an increase in December to 3.4% from the prior month's 3.1% reading. Core CPI, which excludes food and energy prices, continued to decline from 4.0% to December's rate of 3.9%. While these levels are still well above the Fed's 2.0% target, they remain far below their 2022 peak. In contrast, the Producer Price Index (PPI), which measures prices of goods at the wholesale level, came in below expectations with a decline of 0.1% from last month. Often seen as an indicator of future consumer prices, the lower PPI kept investors on board with the premise that the Fed will begin cutting rates in the not-so-distant future.

The Fed will get two additional months of inflation data before their March FOMC meeting to help them decide when to pull the trigger on their first rate cut. The bond market is currently pricing in a 75% chance of the Fed's first cut coming at the March meeting with two more by June. Since policymakers are in no way bound to follow market expectations, it is entirely possible that the Fed takes a more cautionary approach to easing rates. Perhaps they will continue to take other measures like decreasing or halting the sale of securities from their bloated balance sheet (QT – Quantitative Tightening) as an interim step before actual interest rate cuts commence.

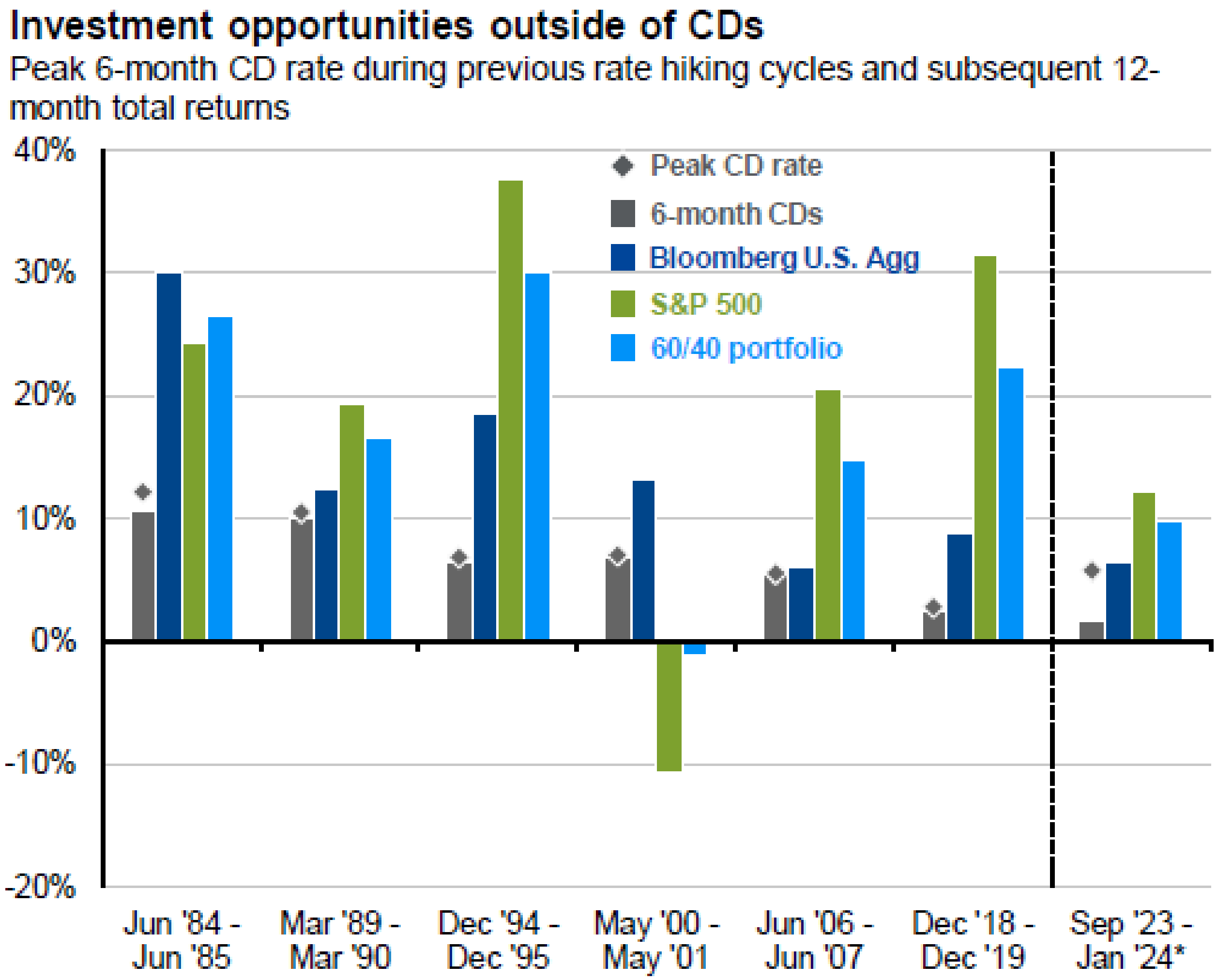


Source: Bloomberg

Led by generally better than expected bank earnings, Q4 earnings season kicked off last week to help stocks post generally solid gains. We start this holiday-shortened trading week with stocks having mostly recovered much of this year's opening week pullback. Eyes will be focused on additional earnings releases, along with several key economic reports. Specifically, Retail Sales, Consumer Sentiment, and Existing Home Sales data this week should add color to the health of our economy and the expected inflation data to come.

Beginning two years ago when the Fed began to aggressively hike rates, yields on short-term savings and investment instruments began to ratchet higher, ultimately reaching levels not seen in over 20 years. As a result, many investors took advantage of these vehicles for both safety and income in an otherwise volatile equity and fixed income market. By the end of last year, money market fund assets ballooned to a record high of nearly $6 trillion. While such investments have a critical role for those needing safety and liquidity, particularly for near-term expenditures, they often underperform other asset classes as time goes on. One often overlooked reality is reinvestment risk. Meaning, if the Fed's next campaign will be one of cutting rates, money market funds and short-term CD rates will surely follow suit and head lower. Despite the rally that closed out 2023, it is not too late to redeploy surplus sidelined cash into either equity or fixed-income areas for superior long-term returns.

Looking back at the last six rate hiking cycles shows that short-term investments like 6-month CDs tend to underperform both stocks and bonds in the year after rates peak. Assuming that rates have already peaked, this trend is on pace to repeat itself. Since CD rates peaked back in September, the S&P 500 has increased 12.1% and the Bloomberg Aggregate Bond Index gained 6.5% respectively while a six-month CD has returned a mere 1.7% over the same period.



Source: JP Morgan Asset Management

Our position remains cautiously optimistic that for a variety of reasons, this year has real potential to be another positive one for both equity and fixed income securities. We are especially encouraged by the outperformance over the past two months of the market's prior lagging areas: value style funds, dividend paying blue-chips, and small cap equities. As these areas continue to revert to their historical mean returns, we see opportunity for investors to capitalize. However, we fully expect this year to also deliver its fair share of volatility and even a normal correction somewhere along the way. Markets rarely go up in a straight line. It is also a presidential election year which, while historically often positive for stocks, is likely to spawn its own dose of anxiety and market-related volatility as we near November. As with most such concerns, we caution against trying to time the market by jumping in and out due to any short-term fear. Instead, we ascribe to sticking to an appropriate longer-term investment strategy based on quality securities and proven fundamentals.

And finally, we will be resending our 2024 client email survey to those households who have yet to respond. Please take a minute to complete it so we can more efficiently schedule this year’s review meetings and events. Thank you for your help with this effort!

Thanks, and have a great week!

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