Monday January 8, 2024

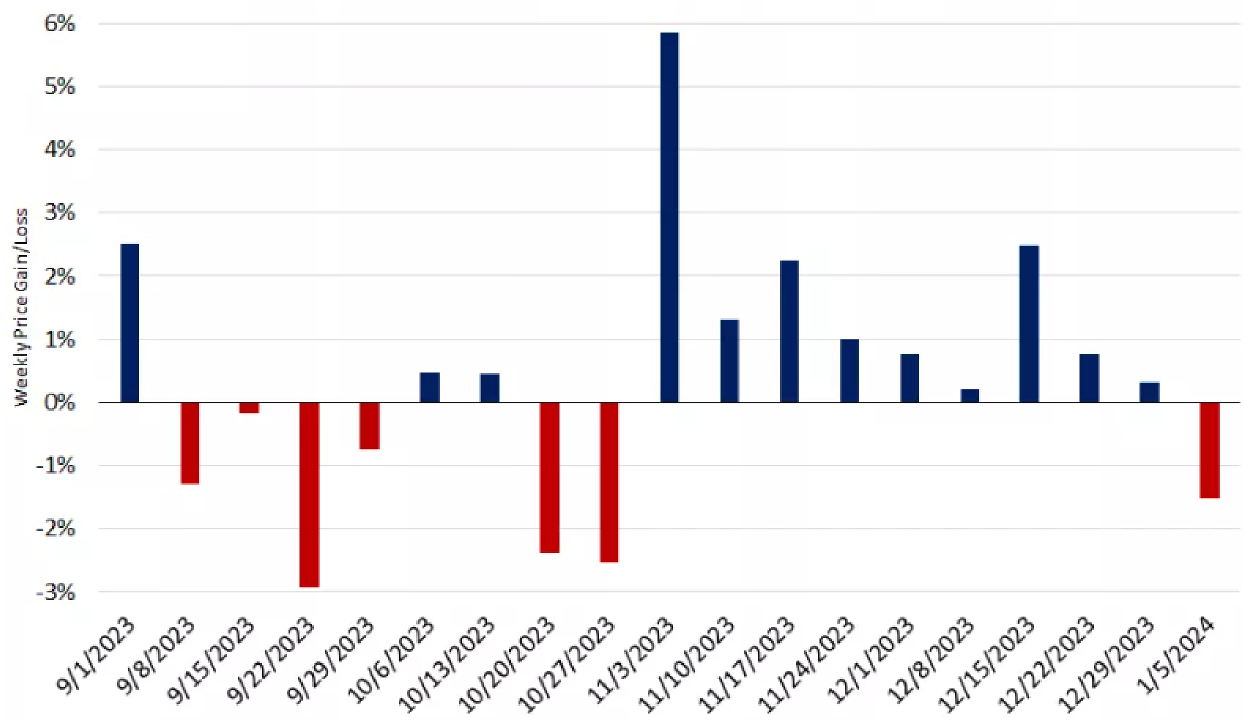
SUMMARY-

I. Stocks retreat after nine-week winning streak.
II. Jobs data ticks up in December, but is expected to soften.
III. Expectations about timing and number of Fed rate cuts vary.
IV. Key inflation reports and start of earnings season this week.

Good morning:

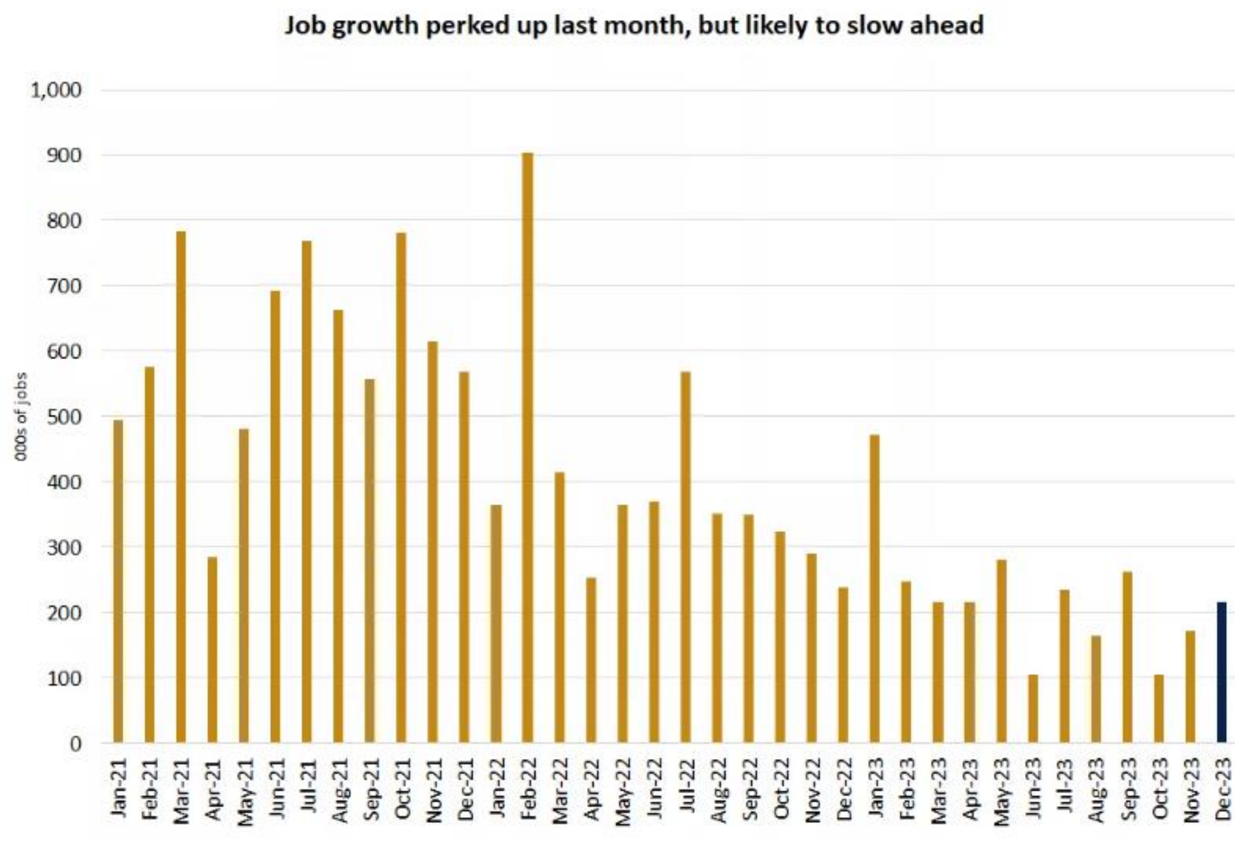
The market's nine-week winning streak that closed out 2023 came to an end last week with both equities and fixed income securities posting modest losses to start the new year. The 10-year Treasury bond yield rose back over 4%. Leading the retreat were some of last year's biggest winners in the NASDAQ that lost 3.2% by Friday's close to the holiday-shortened trading week. The clear rotation into industrials and financials among other laggards was evident with the Dow Jones Industrial Average only declining 0.6%. After such a strong and protracted leg up over the past two months, it should come as no surprise that the market would take a breather; especially now that gains realized by traders won't be taxed until they file their 2024 tax returns.

The stock market's weekly winning streak came to an end at nine



Source: Bloomberg, S&P 500 Index weekly price return.

Despite a bit of profit taking, the underpinnings of last year's closing rally remain intact. Declining inflation and the end of the Fed's tightening cycle while the economy continues to chug along have not suddenly changed. The expected rate cuts later this year are also still a major factor. The strong labor market and resilient consumer that helped us avoid a much-anticipated recession are also both still present. The December jobs report from last week even showed an uptick in new hires but is widely expected to slow as the year unfolds. Wage growth ticked up in December as well but is also expected to moderate later in the year. This will be important to keep inflation heading in the right direction enabling the Fed to lower short-term interest rates.



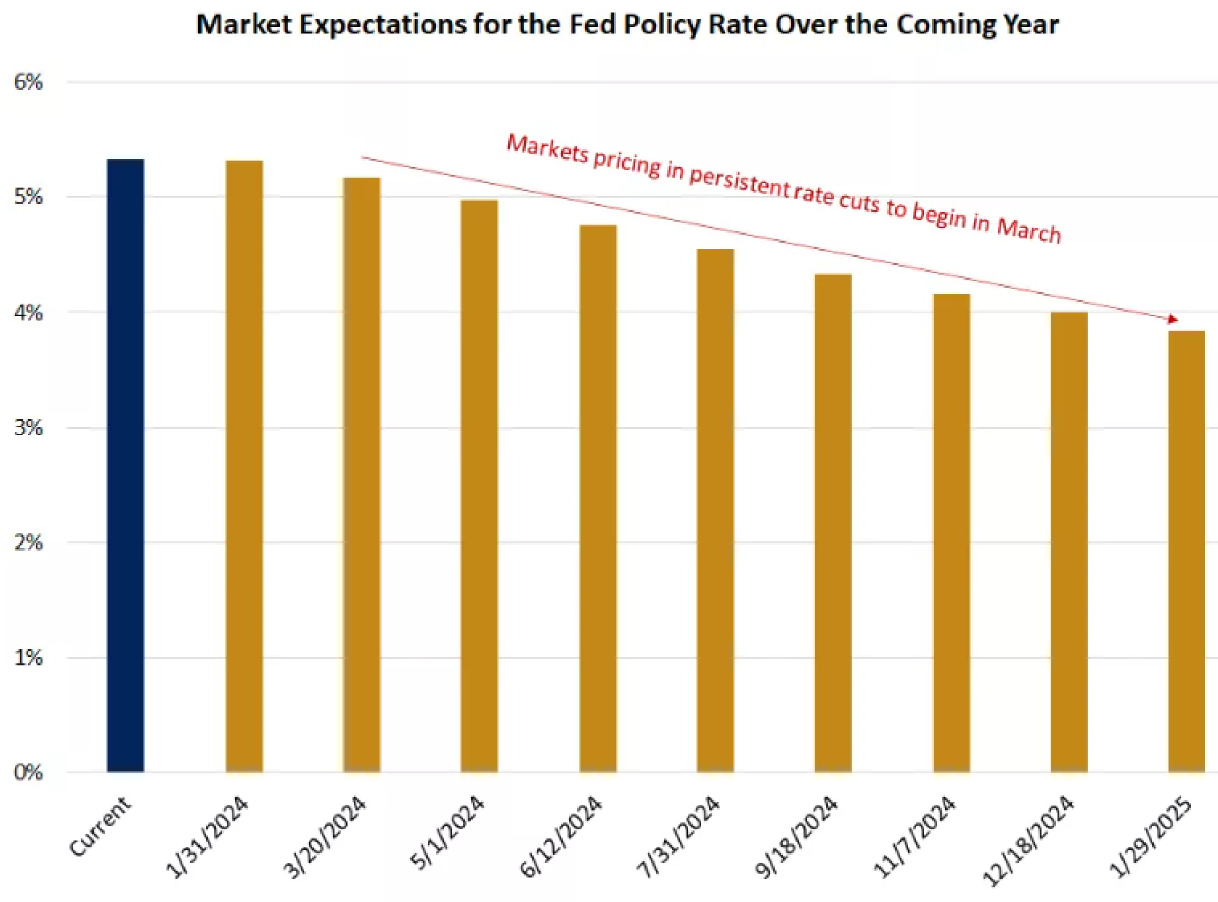
Source: Bloomberg.

Many have already started to predict exactly *when* the Fed will start to lower rates. Some say as early as March while others believe it may not occur until mid-year. Much will depend on the data, particularly inflation and labor statistics. First among this year's key inflation reports the Fed will be watching are this week's CPI and PPI results from December. While each may show a small increase in the monthly reading, an annualized rate that moderates slightly or remains stable would still be seen as productive, and supportive of the Fed's plan to begin easing rates in the near future. Over the past 30+ years, markets usually do well leading up to a Fed rate cutting cycle. However, once cuts begin, results have been more mixed. We see the lack of much of a rebound in the broader market in 2023 to the bear market of 2022 (apart from the Magnificent Seven names) as potential support for further broadening out as the current bull market continues.

	Stock Market Performance:	
Initial Rate Cut	6 months prior	6 months after
Jun-90	3.1%	-6.0%
Jun-95	19.8%	14.4%
Jun-98	17.7%	9.2%
Dec-00	-8.7%	-6.7%
Jun-07	7.0%	-0.6%
Jun-19	18.5%	10.9%

Source: Bloomberg. S&P 500 Index total return.

Bond markets are currently pricing in a steady stream of Fed rate cuts starting with their March FOMC meeting. This could prove to be too optimistic as the Fed will more likely remain cautious about sparking any new waves of inflation by stimulating the economy unintentionally. It is possible that equity traders could become impatient and sell stocks if the Fed fails to start their cuts when expected. We would use any such volatility as a buying opportunity since the rate cuts to come should ultimately be very supportive to economic growth and in turn equity markets.



Source: Bloomberg. Federal Funds rate projections.

Despite the soft start to the year, we remain optimistic that the patience exhibited by most long-term investors to remain invested in well-diversified portfolios over the past few years will continue to be rewarded over time. It is certainly not uncommon for stocks to pause and catch their breath after a strong advance. The forthcoming inflation reports this week, as well as some of the nation’s largest banks kicking off the Q4 earnings season will likely determine whether this week keeps buyers at bay or reignites renewed interest in stocks.

Finally, we will be sending a separate email containing a link to a brief client survey in the coming days. It is designed to help us plan this year’s client communication, events, and review meetings more efficiently. Please take a minute to complete it when it arrives.

Thanks, and have a great week!

Mark and Jeff

Mark S. Loftus, CFP®
Managing Partner & Founder, LPWP
Registered Principal, RJFS
CA Insurance License #0C83705

Jeffrey C. Preusser, CFP®
Senior Partner, LPWP
Registered Principal, RJFS
CA Insurance License #0E01600

O: 630.566.9200 // T: 844.890.8750 // F: 630.566.9292
1901 Butterfield Road, Suite 100, Downers Grove, IL 60515
www.loftus-preusser.com

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