The Weekly Market Update – 1/16/24: Yields Fall Despite Inflation Uptick

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,783.83	1.84%	0.29%	0.29%	24.60%	4,796.56	0.3%
Dow Jones Industrial Average	37,592.98	0.34%	-0.26%	-0.26%	13.41%	37,715.04	0.3%
NASDAQ Composite	14,972.76	3.09%	-0.26%	-0.26%	43.05%	16,057.44	7.2%
Russell 2000	1,950.96	-0.01%	-3.75%	-3.75%	10.77%	2,442.74	25.2%
MSCI EAFE (USD)	2,226.88	0.87%	-0.42%	-0.42%	14.56%	2,398.71	7.7%
MSCI Emerging Markets (USD)	996.30	-0.58%	-2.68%	-2.68%	4.17%	1,444.93	45.0%
Bloomberg Commodity Index	97.96	-0.68%	-0.70%	-0.70%	-13.16%	237.95	142.9%
Barclays U.S. Aggregate Bond	91.36	0.94%	-0.37%	-0.37%	2.79%	112.07	22.7%

Source: FactSet

Interest rates moved lower to begin 2024 (3-month trend), even as the December consumer price index (CPI) flexed higher from November levels. The 2-year U.S. Treasury yield (which we view as representative of short-term interest rates) traded at 4.19% on 1/12/24, down from 4.40% one week earlier, and compared to 5.20% as recently as 10/17/23. The U.S. 10-year Treasury (which we use as a proxy for long-term interest rates) was 3.99% on 1/12/24, modestly lower for the week (4.04% on 1/5/24) and down from 4.99% in mid-October. In 2023, positive U.S. economic growth was resilient despite higher short-term interest rates from the Federal Reserve Bank (the Fed, sets rate targets using its overnight fed funds interest rate). At the same time, year-over-year (Y/Y) inflation (the CPI measures consumer inflation and is reported monthly by the Bureau of Labor Statistics) was +3.1% in November 2023, compared to +6.4% in January 2023. Moderating inflation paves the way for interest rates to normalize at lower levels and provides data to support a Fed pivot to lower rates (for the first time since 2020) by reducing the fed funds target. December 2023 Y/Y CPI increased +3.4% (higher than November), coming in above the +3.2% FactSet consensus and representing the first monthly uptick in six months. The month-to-month (M/M) CPI increased +0.3%, also above expectations. We have two takeaways from the December report. First, inflation remains above the Fed's +2.0% target. Secondly, continued improvement in 2024 could be less linear than the orderly pattern of 2023. Despite the higher CPI reading to end the year, interest rates moved lower, indicating to us that investors still see a path to lower inflation and Fed rate cuts. While the Fed watched the CPI data, its preferred measure of consumer inflation is the personal consumption expenditures (PCE) price index (PI), an alternative inflation series collected by the Bureau of Economic Analysis. The PCE PI increased just +2.6% in November, and the M/M core PCE PI (excludes food and energy) rose just +0.1% for four of the past five months. In fact, the 6-month average M/M data annualized reflects a core PCE PI of +1.8% in November. In our view, investors have zeroed in on improving M/M inflation data over recent months as pointing to lower fed funds targets in 2024. The December PCE PI report will be on 1/26/24.

The S&P 500 is higher to start 2024, but participation is narrow. After gaining +1.8% last week, the widely followed, large-company S&P 500 equity index increased +0.3% in January (as of 1/12/24), extending the late 2023 rally. However, 7 of the 11 macro sectors (compiled by MSCI's global industry classification standards) were lower to begin 2024 (just two weeks) and the Equal Weight S&P 500 (tracks performance of all S&P 500 companies at the same weight), which reflects performance of the "average" large-company stock, started the year down -1.1%. Among several positive developments in the late 2023 equity market rally was broad participation across sectors and companies. That has stalled in 2024, reflecting uneven returns as we await the ramp of earnings results.

Fourth quarter (4Q23) earnings estimates have slipped in recent weeks, perhaps setting the stage for stronger-than-expected results. As of 1/12/24, S&P 500 4Q23 earnings are estimated (FactSet consensus) to increase just +0.5% Y/Y. Just three months earlier (late October), the consensus estimate was for +4.9% growth. The lower estimate is surprising given recent trends of lower inflation and interest rates, along with solid economic growth expectations. The Federal Reserve Bank of Atlanta's GDPNow model, as of 1/10/24, reflected data showing the U.S. economy was on track to grow +2.2% annualized in 4Q23. Earnings reports will build this week (22 S&P 500 companies scheduled) and could exceed expectations.

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