RESEARCH CORNER

December 18, 2023

OBSERVATIONS: *Fed sparks big stock and bond market rally, lots of favorable inflation data, central banks begin to pivot.*

- Equity markets traded up broadly last week; the S&P 500 gained +2.5%—and nearly reached its previous all-time high set-in early January-2022—the NASDAQ gained +2.9% and small caps surged, gaining +5.6%.[1]
- Meanwhile, the yield on the 10-year Treasury Note fell over -30 basis points—the majority of the move after the Fed meeting last week (see One More Thought)—and finished the week yielding 3.91%.[1]
- Core inflation (CPI excluding food and energy) rose +0.3% month-over-month (MoM) in November, in line with expectations. On a year-over-year (YoY) basis core CPI was up +4.0%, also in line with expectations and marks the lowest YoY reading for core CPI since September 2021.[1]
- Meanwhile, US consumer inflation expectations for one year out declined to 3.34%, the lowest expectations since April 2021. Longer-term, 3-Years and 5-Years, expectations were unchanged from the prior month at 3.0% and 2.7%, respectively.[1]
- US producer prices (PPI) continue to show inflation moderating, particularly in the goods (versus services) sectors. The headline PPI index was flat on a MoM basis and showed only a +0.9% YoY gain. Excluding volatile food and energy inputs, the PPI rose by +0.1% MoM and registered a +2.5% YoY gain in November.[1]
- Median rents in the US fell -2.1% YoY last month amidst a jump in supply, the biggest decline in over 3 years. The number of completed apartment buildings jumped by +7.0% YoY pushing rental vacancies to 6.6%.[2]
- Retail sales surprised to the upside in November. Analysts had been expecting a slight drop in retail sales on MoM basis, but retail sales gained +0.3% MoM in November.[1]
- The Bank of England held rates steady last week at 5.25% but warned that the UK had a long "way to go" before achieving their inflation target. Core inflation in the UK is 5.7% YoY and the UK has seen less progress in lowering core-inflation than Europe or the US.[1]
- The European Central Bank also held rates stable last week, but similar to the Fed (see One More Thought) signaled that further rate hikes were unlikely, but refused to commit to eventual rate cuts next year, stating that more work was needed to ensure the declines in inflation experienced this year persisted into 2024.[1]

EXPECTATIONS: *Last Research Corner for 2023, China tries to stabilize its economy.*

- China concluded a series of high-level meetings last week chaired by President Xi that typically set the agenda for next year's economic growth and policy goals. The meeting acknowledged some of the challenges facing the Chinese economy and pledged to strengthen proactive, counter-cyclical fiscal and monetary policies aimed to achieve real (inflation adjusted) growth close to 5% in 2024.[3]
- China vowed to increase its target support for its beleaguered property sector and set about three broad goals—social housing, emergency public facilities, and urban village renovation. Overall, most analysts expect China to increase its federal budget deficit in 2024 to spur growth and work with state-owned banks to make sure lending in the economy is stable and select property developers can continue to build.[3]

ONE MORE THOUGHT: *Federal Reserve lays the groundwork for an eventual pivot in 2024, markets roar.*[1]

As expected, the Federal Reserve remained on pause, a pause that dates back to July 26th when the Fed last raised its policy rate by 25bps to the current target range of 5.25% to 5.50%. In sum, over 2023, the Fed lifted the Fed Fund's rate four times each by 25bps and currently markets expect six rate cuts in 2024. The dot plot (interest rate projections by members of the Federal Reserve) from last week's meeting showed their median expectation for Fed

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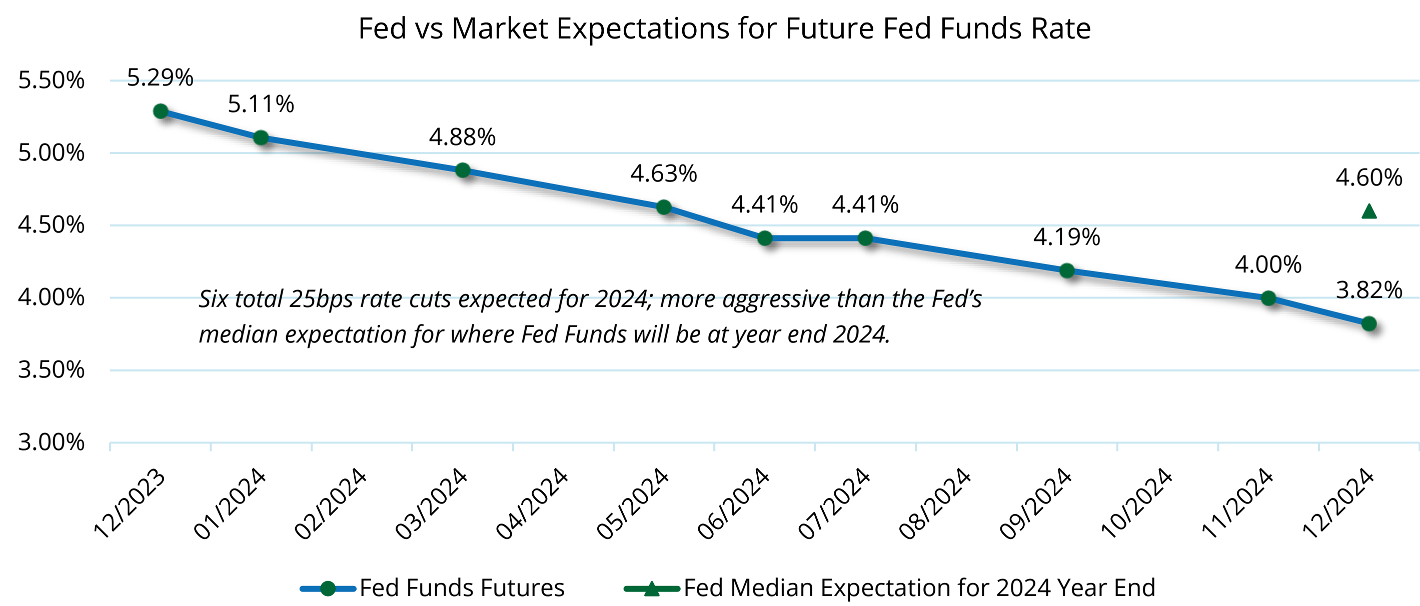
[1] *Bloomberg LP*
[2] *https://www.redfin.com/news/redfin-rental-report-november-2023/*
[3] *Goldman Sachs "China: Central Economic Work Conference maintains pro-growth tone, stressed high-quality growth & policy coordination" 12/13/2023*

Funds is now 4.6% (implying 3 cuts for 2023), the median from September's projection was for 5.1%. The drop in the Fed's new 2024 assumption of a 4.6% Fed Funds narrows a divergence that had built up in markets, in terms of market expectations vs Fed expectations but markets seem too aggressive in the pricing of cuts for next year (Chart of the Week). In the summary of economic projections (SEP), the central bank decreased its expectations for core inflation (PCE, Personal Consumption Expenditures) for the year end 2024 to 2.4% (from September's projection of 2.6%). These assumptions corroborate the market's view of a soft landing, or more likely a slow patch, for the economy in 2024. The path of inflation is likely to be anything but a straight line to the Fed's 2% target and markets may be setting up for disappointment. In the meantime, the S&P 500 broke above resistance and looks likely to test the all-time highs (4,818) set in early January 2022 (otherwise said, the S&P 500 is back to where it was two years ago). Rate cut expectations continue to similarly get priced into bond markets as the 10-Year US Treasury fell below 4.0% last week, helping to continue the recent rally in bond markets—the positive sentiment is likely to support markets through year-end. **As the year comes to an end, we wish you a safe and happy holiday season and we thank you for placing your trust in Clearstead.**

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, Federal Reserve Board, fed funds as of 12/14/2023

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