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WEEKLY MARKET RECAP | December 27, 2023

Week in Review

Equity Markets:

The S&P 500 finished last week up by 0.77%. This marks the eighth consecutive weekly gain for the index. This is the longest streak for the index since November 2017[1]. The index closed the week only 1.3% from its intraday high of 4,818, nearly two years ago, on January 3, 2022.

As we move into the final trading week of 2023, Large-cap Growth is up 42.53% for the year, experiencing a strong recovery from the slump in 2022. Large-cap value has lagged all year, but a recent run has pushed its year-to-date performance to 10.83%[2]. Market breadth has been concentrated for the majority of the year, but over the last quarter, the markets have had broader participation. Small-caps have been the top performer so far in the fourth quarter. The Russell 2000 is up 14.35%[2].

Third quarter earnings results were much stronger than expected. With 499 S&P 500 companies reported, 82% have beaten earnings estimates. This is a significantly higher beat rate than the long-term average of 66%, and the previous four-quarter average of 74%[3].

Fixed Income Markets:

The bond market saw little changes last week. The 10-year Treasury yield finished the week down 0.01% to 3.9%. The 2-year Treasury yield saw a modest decline of 13 basis points and finished the week at 4.31%. The yield curve steepened last week as shorter maturity bonds were favored. The 2's/10's inversion narrowed by 0.12% and finished the week at -0.41%.

Following the PCE report on Friday, Fed Fund's Futures increased the probability of the Fed cutting rates at the March meeting to 75.6%[4]. The futures market is pricing in 5 to 6 rate cuts next year. This is twice as many as the Federal Reserve has indicated thus far.

Economic:

The inflation environment continues to improve as the Personal Consumption Expenditures Index rose 2.6% year-over-year and fell 0.1% on a monthly basis. Core PCE, which excludes food and energy, rose 0.1% in November and was up 3.2% from a year ago. Policymakers prefer to use this inflation reading because it provides a clearer picture of consumer spending habits, such as trading down in goods. An important data point from the report showed that on a six-month basis, Core PCE was up 1.9% when annualized, which is below the Fed's 2% target. The final estimate for the third quarter GDP saw a slight downward revision to 4.9%. Despite the revision, the US economy remained on strong footing and grew at its fastest pace in two years. The previous estimate was 5.2%. The University of Michigan Consumer Sentiment Index rose to 69.7 in December. This is up from 61.3 in November. Consumers' optimism regarding easing inflation conditions helped push the index higher.

Looking Ahead

Equity Markets:

Earnings have continued to surprise to the upside as companies have remained more resilient than analysts anticipated. Corporations have been able to navigate the challenging environment and, to the surprise of most analysts, they have maintained their healthy margins.

Fourth-quarter earnings season will go into full swing in a couple of weeks with the major banks starting to report. Current expectations are for earnings growth of 5.2%, which is down from the 11% expectation on October 1[3]. Analysts have continued to push their downward revisions further out on the calendar. Going into the new year, we will be paying close attention to revenue growth and corporate profit margins. 2023 has been a year of earning surprises, but revenue growth has been below trend. Thus far, companies have been able to navigate the restrictive environment by cost-cutting and passing on a portion of higher costs to their consumers. If the economic environment deteriorates, we anticipate profit margin compression could be a leading indicator of future earnings weakness.

Valuations are approaching very high levels with the S&P 500 trading at 20.2x forward four-quarter earnings. Investors should be diligent a stick to their strategic allocations at current levels. With rosy valuations and very optimistic sentiment, we could experience heightened volatility in the near term. We believe that a systematic rebalancing program that trims outperforming assets while purchasing underperforming assets can help navigate volatility and provide attractive long-term opportunities to capture skewed risk/return profiles.

Fixed Income Market

The 10-year hit its peak yield of 5% back in October. Since the peak, yields have plummeted, with the 10-year falling 1.10%. A string of favorable inflation and economic reports have been tailwinds for fixed-income investors. Following the rapid descent in yields, we see the potential for upward pressure on rates in the short term. Some of these include the string of treasury auctions over the first few weeks of the year and the very optimistic view of the futures market on the path for rate cuts.

We believe 5 or 6 cuts next year is a reach if we anticipate the economy to remain strong throughout 2024. We do believe the Fed will cut rates because remaining at the current target rate increases the odds of an economic slowdown. We see the 10-year remaining near 4% and having bouts of upward pressure to 4.25%.

Economic:

The final week of the year will be light on economic reports. The S&P/Case-Schiller Home Price Index and the Conference Board's Consumer Confidence Index will be released on Tuesday. Pending home sales from the National Association of Realtors and weekly unemployment claims will close out the week on Thursday.

***** See Important Disclosures on the following page*

Sources:

1)JH Investments, Inc.
https://www.jhinvestments.com/weekly-market-recap#market-moving-news

2) JP Morgan Asset Management
https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/wmr/weekly_market_recap.pdf

3)LSEG I/B/E/S
https://lipperalpha.refinitiv.com/wp-content/uploads/2023/12/TRPR_82221_729.pdf

4) CME Group
https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

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