Week in Review

Equity Markets:

After two years, the S&P 500 set its all-time high on Friday finally breaching the 4,818 level that was seen on January 3. 2022. Last week's rally also pushed the index back in the green for the month after a rough start. The S&P 500 finished the week up 1.54%. The style trend from last year has continued into the new year. The Russell 1000 Growth is up 3.07% year-to-date while its value counterpart is down 0.83%[1]. There also remains a large divergence in returns of smaller capitalization companies. The Russell 2000 has continued to struggle and is down 4.05% this year[1].

10% of the S&P 500 has reported fourth-quarter earnings thus far. 62% of companies have beaten earnings and revenue estimates[2]. The blended earnings growth rate for the fourth quarter sits at negative 1.7%[2]. Moving expectations lower than the -0.1% from the prior week.

Fixed Income Markets:

Yields pushed higher last week as employment numbers came in better than expected. The 10-year Treasury Yield moved up nearly 20 basis points and closed the week at 4.14%. The Fed Fund's Futures Market readjusted expectations for rate cuts this year. The probability of a rate in March moved from 77% down to 46% by Friday[3].

Before the unemployment report, the yield started to steepen as shorter-maturity bonds were favored over the longer term. Mid-week, the 2's/10's spread narrowed to only -0.15%, a 0.38% increase from the levels in mid-December.

Economic:

The preliminary reading on the University of Michigan Consumer Sentiment Index had a strong rebound, rising to 78.8 from December's reading of 69.7. Consumers' inflation expectations and current conditions were major contributors to the rise. Consumers also showed significant strength during the holiday season. Retail sales rose 0.6% month-over-month in December, exceeding the estimate of 0.4%. Existing home sales fell to their lowest annual level since 1995 in 2023[4]. Last year's sales were down 19%.

Looking Ahead

Equity Markets:

It took over two years for the S&P to notch a new all-time high. The rally last week pushed the four-quarter forward P/E on the S&P 500 to 19.7%[5]. Earnings estimates continue to move down as companies have reported profit margin compression so far this quarter. The blended profit margin for the S&P 500 stands at 10.7%, down from the 12.2% reported last quarter[2]. Corporate profit margins remain a key factor that we believe could be a leading indicator for any potential shift in earnings going forward. The market has rallied over the past 12 months and much of that was due to sentiment improvement and margin expansion. We believe fundamentals and valuation will play a key role in a sustained market move.

19.7x forward earnings is an elevated valuation but not one that we consider extreme. This could pose some challenges for the market going forward, and especially if we see earnings weakness. The dispersion in market returns is high and valuation differentials are high as well. As long-term investors we believe that target allocations should be properly diversified to capture rebounds as some of these factors converge. A systematic rebalancing program along with a thoughtfully crafted allocation can help investors navigate challenging times as an asset allocator and also not allow a portfolio to become overexposed to certain sectors and/or styles that could go out-favor very quickly.

Fixed Income Market

The futures market has significantly increased the probability of another pause at the Fed meeting next week. This aligns with our belief that the market was too optimistic on the path of policy rates coming into the new year. We expect to see the futures market continue to dial back its number of anticipated cuts as labor market reports continue to surprise to the upside.

The rapid descent in yields was overdone in our opinion, and we believe the 10-year yield will stay range bound in near the 4% level as long as we continue to see consistent economic reports. Current levels still present attractive yields for fixed-income investors. We believe that investors should focus on high-quality sectors of the bond market given that real returns on bonds remain higher than what was experienced during the last cycle.

Economic:

The economic calendar will garner more attention this week. The headline reports for the week will be the first estimate for Fourth-Quarter GDP on Thursday. Following strong growth in the third quarter, estimates have come down with expectations for 2% growth[6]. To end the week, the market will see the Personal Consumption Expenditures Index (PCE) released. This is the Fed's preferred inflation gauge and will likely have a significant influence on the policy meeting next week. Other reports this week include The Conference Board's Leading Economic Index, New and Pending Home Sales, as well as the weekly unemployment report.

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

Sources:

1)JP Morgan Asset Management
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5) LSEG I/B/E/S
https://lipperalpha.refinitiv.com/wp-content/uploads/2024/01/TRPR_82221_731.pdf .

6) FX Street
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