

January 2, 2024 – Investment Commentary

2023 ended with an equity rally driven by hopes for rate cuts amid slowing inflation and a resilient economy.

We believe this narrative has driven markets since the beginning of November and appears set to dominate until more US data is released, such as Wednesday's JOLTs (Job opening and labor turnover survey) and manufacturing ISM (Institute for Supply Management) - and the minutes from the Federal Reserve's December meeting.

Since Powell's last meeting, markets moved quickly to price in easing of policy and, as things stand, are looking for 150 basis points of easing this year, with the first 25 basis-point rate cut almost fully priced for March. The dollar is hovering above a five-month low reached at the end of last year, while bond yields in the U.S. and Europe are on the up but remain within striking distance of multi-month lows reached at the end of 2023. As a reminder, the US bond yield fell from 4.7 percent in November to 4.25 percent and the 10 year fell from 4.3 percent to 3.8 percent. This highlights reinvestment risk and IO view thru last year about stepping out of cash into intermediate duration.

Some items we're paying attention to are an extremely bullish sentiment, a low Vix, pending inflation report, geopolitics, domestic politics with a potential government shutdown with a January 19 deadline, and potential headwinds in earnings where multiple expansion was a key driver in 2023. This of course isn't an exhaustive list of factors.

This "earnings recession" finally came to an end in the third quarter (first quarter in 3 consecutive quarters of actual positive year on year eps growth), but the challenge that investors now face is whether companies can manage to satisfy Wall Street's expectations for 12% eps growth in 2024 vs 2023.

When thinking about what could push US long end yields higher, it could be increasing focus on budget deficit which comes with increasing supply and treasury issuance, the risk of another US government debt downgrade, fed QT policy of continuing to shrink the balance sheet, taking a buyer out of the market while foreign demand may fall, and the US government issuing more on the longer end of curve rather than short end bills.

There are a lot of uncertainties that remain, but we believe these are all part of the regular way risks of markets and believe clients should be mindful of what they own and why they own it but not hide in cash, rather risk manage their public and private allocations to meet their long term goals.

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