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Doll's Deliberations

Weekly Investment Commentary

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Summary:
Equities closed higher for the week (S&P 500 +1.4%), despite a large mid-week selloff. Small cap stocks fell for the fifth week in the last six. Magnificent Seven earnings were mixed. Best performers were consumer discretionary (+3.8%) and consumer staples (+2.2%); decliners included energy (-1.0%) and real estate (-0.5%).

Key takeaways:

1. January non-farm payroll growth was a whopping 353,000 and earlier months were revised higher. Disappointments however included a fall in the work week by 0.2 hours and a 0.6% increase in average hourly earnings (4.5% y/y). Unemployment held at 3.7%.

2. Fed Chair Powell suggested strongly that a March rate cut is unlikely. Consensus suggests that May/June is likely to be the month of the first cut.

3. Fed Chair Powell acknowledged that inflation data has been good, but more good data is necessary to conclude that the inflation fight is over. The biggest risk appears to be that inflation stabilizes at a level above the Fed's target.

4. Economic indicators were mixed: Q4 productivity and the January Purchasing Managers Index (PMI) were good, but PMI employment was weak.

5. The Conference Board's Consumer Confidence Index beat estimates and moved up to the highest level in two years.

6. Credit spreads are probably too tight relative to the risk of some economic weakness/slowdown. (Accordingly, we favor treasuries over investment grade and high yield corporate bonds.)

7. Strong profit growth (which is faltering a bit) may be necessary to keep labor market conditions from weakening.

8. Q4 earnings reports have exhibited modest margin pressure as selling price pressure has been falling faster than sticky unit labor costs (despite good productivity results).

9. Company management calls following Q4 earnings have witnessed mentions of recession falling by 80% since the high six quarters ago.

10. A second Trump term would likely lead to far higher tariffs on U.S. imports, with China the biggest target. After immigration, protectionist trade policies would likely be highest priority.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	1.43	2.65
S&P 500	1.41	4.06
NASDAQ	1.13	4.14
RUSSELL 1000	0.31	2.66
RUSSELL 1000 GROWTH	1.99	6.04
RUSSELL 1000 VALUE	0.54	0.95
RUSSELL 2000	-0.19	-2.55

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.64	10.91
CONSUMER DISCRETIONARY	3.76	0.83
CONSUMER STAPLES	2.15	3.31
ENERGY	-0.91	-0.28
FINANCIALS	0.89	3.66
HEALTHCARE	1.98	4.19
INDUSTRIALS	1.90	1.47
INFORMATION TECHNOLOGY	0.78	6.78
MATERIALS	0.76	-2.87
REAL ESTATE	-0.47	-4.30
UTILITIES	0.41	-2.96

Sugar High Continues

Capital market pricing is consistent with an ideal future, comprising a sustained period of healthy economic growth, falling and persistent low inflation, and aggressive central bank rate cuts. Stocks outperforming bonds, the valuation of select U.S. mega-cap stocks, and tight corporate bond spreads are among the signals that global financial conditions are loose and, thus, that current interest rates are not restrictive.

The issue for investors is whether and for how long easy financial conditions can last. The U.S., European, and Chinese economies are all currently performing better than earlier expectations, and there are increasing signs that global trade is improving. While a boom is not on the horizon, even a moderate reversal of last year's trade downturn should help alleviate many investors' concerns about the global economy. An upturn in trade also implies that global manufacturing will firm this year. An improving global economy also brings the risks down the road for capital markets. Easy financial conditions and sturdy global growth imply that investors' expectations of aggressive interest rate cuts by the Fed et al, are misplaced. Indeed, markets have already removed one expected 2024 rate cut in the past month, in large part because of the resilience of the U.S. economy. We believe other expected cuts will reverse later this year subject to swings in U.S. inflation readings. Decent economic growth implies that core inflation will be stickier than investors and central banks are forecasting.

The implication for investment strategy is that a pro-growth orientation is still appropriate in the near term, but the leash on risk will likely need to be reined in as the year progresses. Bonds will be most directly at risk as rate cut expectations eventually are scaled back. Still, the increasingly dovish bias of major central banks suggests that the next upleg in yields is not imminent.

Stocks have powered higher over the past three months on optimism that the economy will remain in expansion mode and the Fed and other central banks will materially cut interest rates this year. Equity performance continues to be dominated by a handful of U.S. mega-cap stocks. These mega-caps are up some 80% since the beginning of 2023 and started off this year in strong form prior to some selective profit-taking last week.

Amidst the optimism embedded in asset prices, the investment climate remains fundamentally challenging. The global economic expansion is mature, profit levels are already high and unemployment rates are historically low. Current late-cycle economic and capital market conditions argue against expecting the seemingly ideal immediate backdrop from persisting for an extended period. Risks include the threat of a wider war in the Middle East and the uncertain policy implications of the U.S. elections in November.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.28	1.26
MSCI ACWI EX U.S.	0.17	-1.33
MSCI EAFE	0.36	-0.20
MSCI EM	-0.30	-4.03

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.60	0.29
BLOOMBERG U.S. CORP HIGH YIELD	0.30	0.23
BLOOMBERG U.S. GOV/ CREDIT	1.58	0.31
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	0.45

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.86	-4.40
COMMODITIES (DJ)	-2.04	-1.50
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.15	-1.09
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.21	2.64

Conclusion:

Equities have near-term tailwinds on the back of the dovish bias of major central banks and the ongoing economic expansion. While U.S. equities have led global gains over the past year and since the October low, the dominance of a few, expensive stocks that are now overbought, exposes investors to high concentration risk.

Data from Bloomberg, as of 2/2/2024.