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Doll's Deliberations

Weekly Investment Commentary

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Summary:
Equities fell last week (S&P 500 +0.1%), although small stocks were up. The focus last week was on CPI and PPI readings hotter than expected prompting some risk-off action. Best performers were materials (+1.9%) and energy (+2.7%); worst performers were technology (-1.6%) and communication services (-0.1%).

With much to highlight, we decided to expand our key points from 10 to 20 this week and forego the essay.

Key takeaways:

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	0.02	2.76
S&P 500	0.12	5.64
NASDAQ	-1.31	5.18
RUSSELL 1000	0.22	5.47
RUSSELL 1000 GROWTH	-1.21	7.46
RUSSELL 1000 VALUE	0.95	2.05
RUSSELL 2000	2.59	1.81

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.05	11.99
CONSUMER DISCRETIONARY	-0.32	1.99
CONSUMER STAPLES	0.02	1.97
ENERGY	2.70	2.19
FINANCIALS	1.75	5.71
HEALTHCARE	0.77	6.51
INDUSTRIALS	1.51	4.21
INFORMATION TECHNOLOGY	-1.63	8.45
MATERIALS	1.87	-1.03
REAL ESTATE	0.85	-3.24
UTILITIES	1.68	-3.24

1. Headline CPI increased 0.3% m/m and 3.1% y/y, ahead of the 0.2%/2.9% consensus. Core CPI increased 0.4% m/m and 3.9% y/y, also hotter than the 0.3%/3.7% consensus.

2. Meanwhile, the latest Survey of Consumer Expectations from the New York Fed showed the median three-year ahead expected inflation rate at a record low of 2.35%.

3. Retail sales were disappointing in January (-0.8% m/m and revised down a cumulative -0.5% for November/December) signaling a potential downshift in consumer spending.

4. Goods prices are deflating, but services aren't, due to wage pressures. We believe that to have a sustained shift down in inflation, there needs to be a sustained shift up in unemployment. Obviously, that's not yet happened, so inflation could remain sticky.

5. The Conference Board's CEO Confidence measure rose above 50 for the first time in two years. CEOs are more positive on both current economic conditions as well as future expectations.

6. Expectations that the Fed will successfully deliver a soft landing for the U.S. economy remains the dominant narrative. The Atlanta Fed's GDPNow model's latest estimate pointed to 3.4% growth in Q1 (until the retail sales number (see #3 above) dropped it to 1.8%). Continued robust consumer spending is needed to power the economy (since consumption is two-thirds of GDP).

7. The Fed fund futures curve anticipated six Fed cuts in 2024 at the start of the year. That widened to seven times in early January. That is down to 4+ today. Our expectation has been and remains three cuts, most likely starting in June.

8. Ten-year yields went from 3.86% two weeks ago to a peak of 4.28% last week.

9. The earnings of the Magnificent Seven grew by 31% in 2023 while the growth of the remaining 493 stocks in the index was only 2%, perhaps justifying their outperformance. Earnings matter!

10. With two-thirds of the S&P 500 reporting earnings, 75% of companies have reported positive earnings surprises (slightly below the 5-year average of 77%). At 3.8% above estimates, the magnitude of earnings surprises is also below the 5-year average of 8.5%. Sectors that are dominated by "Magnificent Seven" stocks (communication services and information technology) continue to lead the stock market implying that Big Tech (rather than Q4 earnings performance) has been powering the equity rally.

11. 1) EPS surprises haven't been as strong as they initially appear given sizable downward revisions coming into the quarter, 2) overall guidance trends are on track to be the weakest since pre-Covid, although technology remains a standout, 3) healthcare is showing the strongest top-line results relative to consensus, and 4) energy has put up the strongest EPS results relative to expectations.

12. 2023 EPS have ticked higher, but the growth rate of 2024 has suffered slightly with the lack of upward revision to 2024 figures. Growth now sits at about 10% which is down from a peak of 12%. We suspect this growth expectation will continue to slide.

13. Since January 1, the sector with the highest percentage of companies with upward earnings revisions is financials (58%).

14. An indicator of excessive optimism consistent with the stock market melt up is analysts' consensus expected S&P 500 long-term earnings growth over the next five years is 14.7% (more than double the actual long-term rate of earnings growth).

15. Over the past nine months, stock investors have reacted negatively when the U.S. 10-year yield has sustainably risen above 4%. We believe that there's still little fear baked into stock prices, but so far, the high risk, over-valued melt up, has continued.

16. Early last week, Nvidia's market cap surpassed that of the entire China stock market.

17. The top ten holdings in the S&P 500 now make up over 32% of the index, the highest concentration in modern history.

18. While the S&P 500 is forging new highs, under the surface most stocks are not faring as well as the index. In fact, the majority of stocks in the S&P 1500 (52.4% according to Piper Sandler) are down since the Fed started hiking rates in March 2022.

19. In our view, what initially looks like a soft landing will prove to be a temporary state that morphs into a noticeable slowdown, if not a recession, disappointing consensus expectations that the economy will power ahead. The implication is that a deterioration in the economic outlook will create a headwind for earnings estimates, exerting downward pressure on stocks.

20. It took over 200 years for the U.S. to amass its first $10 trillion in debt, nine years to amass its second $10 trillion, and five years to amass its third. The last trillion was tacked on in less than four months.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.39	3.36
MSCI ACWI EX U.S.	0.81	-0.34
MSCI EAFE	0.62	0.19
MSCI EM	1.25	-1.49

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.23	-1.70
BLOOMBERG U.S. CORP HIGH YIELD	-0.21	-0.04
BLOOMBERG U.S. GOV/ CREDIT	-0.25	-1.68
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	0.65

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.05	-4.43
COMMODITIES (DJ)	-0.62	-1.72
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	0.89	1.89
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.40	4.22

Conclusion:

The high-risk, expensive bull market, is attempting to continue. But some signs of economic slowing and sticky inflation reports are threatening. We reiterate our Prediction #6 – "Stocks record a new all-time high early in the year, but then experience a fade."

Data from Bloomberg, as of 2/16/2024.