

WEEKLY COMMENTARY

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Good morning,

What's in this week's Report:

- Two Reasons Markets Have Been So Resilient YTD
- Weekly Market Preview: Focus on the Fed (Will They Hint at Rate Cuts Later in the Year?)
- Weekly Economic Cheat Sheet: More Growth and Inflation Updates
- Why A Spike in Japanese Bond Yields Hit Stocks
- Implications of the Administration's Policies: A Run-Hot Economy (and What Might Come Next)
- What Comes Next from A Policy Standpoint?

Futures are modestly weaker but have rebounded from steep overnight declines, as more political/policy volatility is weighing on futures.

Government shutdown risks spiked over the weekend following another ICE incident, while President Trump separately threatened 100% tariffs on Canada.

Economically, the only report was the German Ifo Business Expectations, which slightly missed estimates.

Today's focus will be on Washington, amid rising government shutdown risks and tariff threats against Canada. Any headlines that make a shutdown seem more likely, or that suggest tariff threats will actually go through, will weigh on markets, while de-escalation on both fronts will help fuel a rebound.

Outside of Washington political volatility, there is one economic report today: Durable Goods (E: 3.1%), and some earnings: STLD (\$1.72), BKR (\$0.67), NUE (\$1.82), but they shouldn't move markets.

Market	Level	Change	% Change
S&P 500 Futures	6,944.25	-1.50	-0.02%
U.S. Dollar (DXY)	97.27	-0.33	-0.34%
Gold	5,107.96	90.96	1.81%
WTI	60.80	-0.27	-0.44%
10 Year	4.212%	-0.028	-0.66%

Stocks

Last Week (Needed Context as We Start a New Week)

Stocks were volatile to start the holiday-shortened week thanks to President Trump's tariff threats against EU allies amid the administration's pursuit of Greenland. The market recovered as Trump dialed back his initially aggressive rhetoric. At the same time, economic data remained strong, but "warm" inflation data capped a rebound into the weekend, leaving the S&P 500 down 0.34% for the week.

U.S. equities gapped sharply lower amid Trump's renewed tariff threats against most EU nations that opposed the U.S.'s quest to take control of Greenland, reigniting familiar trade-war angst. Meanwhile, a sharp rise in global bond yields amid Japanese fiscal worries also weighed on risk assets amid a renewed "sell America" trade, which saw the S&P tumble 2.06% in the session.

Global markets were tentative premarket on Wednesday as traders awaited Trump's speech at the World Economic Forum in Davos. Trump's delivery was calm and cool, focusing on U.S.-EU unity. Critically, the "use of force" was ruled out, sparking an early relief rally. News that the Danish government had "rejected Trump's demands to take over Greenland" sent markets lower. Still, Trump's afternoon announcement on a framework for a future deal on Greenland saw the S&P 500 recover intraday losses to end higher by 1.16%.

The rally continued at the open on Thursday as bullish momentum carried over from Wednesday, but growing uncertainty surrounding the outlook for U.S.-EU relations regarding Greenland limited the advance. At the same time, a strong U.S. GDP report and more signs of a resilient labor market via weekly jobless claims data tamped down dovish Fed hopes. The S&P 500 churned sideways for most of the session before closing up 0.55%.

The sideways churn in stocks that emerged on Thursday persisted on Friday as macroeconomic uncertainty regarding Greenland weighed on small caps. At the same time, big tech outperformed, despite INTC shares plunging ~17% after it delivered disappointing forward guidance. The S&P 500 drifted in a tight trading range to end Friday effectively flat, up an incremental 0.03%.

Two Reasons Why Markets Are Staying So Resilient

The theme of 2026 so far (and admittedly it's very early) is that, seemingly every week, the market must consider some sort of volatile geopolitical, policy, or trade headline. Yet despite these headlines, stocks remain largely stable. That happened last week as markets looked past the European tariff threat and Japanese Government Bond volatility, and it's continuing this week with Trump's 100% tariff threat against Canada.

But one question many investors are wondering about through the first four weeks of the year is: Why are markets ignoring all these headlines?

The most straightforward answer is that the core factors that determine stock prices remain healthy, i.e., earnings growth and underlying economic growth. Corporate earnings growth is expected to be more than 10% between 2025 and 2026, and while the start of earnings season has been mixed, that's mostly been due to guidance, and no one is talking about reducing expected 2026 S&P 500 EPS.

Economic growth, meanwhile, is stable. The unemployment rate remains in a low historical range; we're not seeing a spike in jobless claims, and activity across industries is generally "fine." While other forces support stocks (expectations for Fed rate cuts, belief in tariff stability, AI enthusiasm), it's really the two fundamental realities (earnings growth and stable economic growth) that are acting as a buffer against policy chaos. As long as the fundamentals are in place, markets will remain resilient in the face of policy chaos (that headline will still cause short/sharp drops, but the second the policy eases up, markets will rebound).

However, it's essential that investors not fall into the trap of thinking "nothing matters" and that stocks will always rebound. So far, none of these volatile policy headlines has negatively impacted expected earnings growth or overall economic growth; however, neither is impervious. The following two weeks of earnings are the "meat" of earnings season, and while we don't expect disappointing results, the start of the season hasn't been great.

On economic growth, the economy is in solid shape, and it's been "run hot," but that doesn't mean affordability challenges can't cause a slowdown. The reality is that the economy is not far from stalling (expected Q1 GDP growth is only around 1% according to most Wall Street estimates, and all the stimulus efforts have largely been enacted).

Bottom line, expected earnings growth and solid economic growth have insulated the market from these non-stop volatile headlines because none of them have led markets to believe earnings growth could disappoint or economic growth could stall. But neither event is as improbable as the resilient market may lead one to believe. If we suddenly see doubts about earnings or economic growth, then a resilient market will be anything but. We therefore can't get complacent, so we won't.

Economic Data (What You Need to Know in Plain English)

Last Week

Economic data generally reinforced that we're in a Goldilocks economy. However, a delayed inflation report reminded investors that, despite Fed rate cuts, key inflation metrics remain far above their 2.0% target, which could impact the Fed's tone this week at the FOMC meeting (i.e., they push back on further rate cut talks).

The most timely report last week was the weekly jobless claims, which remained very low at 200k. While the monthly unemployment rate has ticked higher and job adds have decreased, our most frequent labor market indicator (jobless claims) is not signaling any material deterioration in the labor market, which is helping reinforce that we're in a Goldilocks economy.

Looking at growth data last week, the final look at Q3 GDP (which, at this point, is very old, as it covers July to October) largely met expectations, as Q3 GDP rose 4.4% saar, while Personal Consumption Expenditures was in line at 3.5%. Both metrics reinforce that economic data was solid in Q3 (though, again, in market terms, that's ancient history and didn't impact markets).

The one number that did get a mild reaction from markets was the November Core PCE Price Index. This is the Fed's preferred measure of inflation, and it was a bit hot on a year-over-year basis, as it rose to 3.0% vs. (E) 2.8%. It's not a shocking jump, and CPI was tame earlier this month, so it's not altering the inflation discussion, but the reality is that 3.0% is not close to 2.0% (the target) and we're going on five years and counting since the Core PCE Price Index did rise 2.0% y/y (again, the Fed's target).

This potentially matters for two reasons. First, it reinforces what I was saying last week about the run-hot economy. Yes, growth is good, but inflation is stubbornly high and not moving decisively towards 2.0%, which is contributing to this affordability issue. Second, that number will get the hawks at the Fed's attention. Given the political pressure on the Fed to cut rates, it's reasonable to expect the Fed may push back on rate-cut expectations at this week's meeting (which would be a mild to moderate negative for stocks).

Bottom line, inflation still matters, and the more "affordability" stays at the top of the news cycle, the more any elevated inflation readings will push back on rate-cut hopes.

Important Economic Data This Week

Wednesday's Fed decision is the big event this week, and the key for the decision won't be whether the Fed cuts rates (they almost certainly will not), but instead what the Fed signals on future cuts via forward guidance in the statement and Powell's commentary in the press conference.

From a market standpoint, we know the stakes: Since expected Fed rate cuts are a pillar of the rally, anything that reinforces the view that the Fed will cut rates again in the coming month (right now, Fed Watch points to a June cut) will help support stocks. However, if the Fed signals it may be on an extended pause, and the expected first cut is pushed out further, that will be a modest market negative (if for no other reason than it might ignite more attacks on the Fed from the administration).

Outside the Fed, there's little economic data this week (next week will be busy with the "Big Three" monthly economic reports).

Thursday's jobless claims and today's Durable Goods are the two notable growth reports. Regarding claims, they continue to signal a "no hire/no fire" labor market, which is fine for the broader market because it doesn't imply labor-market deterioration (which points to Goldilocks growth). Regarding Durable Goods, it's the best gauge we have for business investment (which is an important part of overall economic growth). The key here is no big drops that would imply businesses are "pulling back" on spending/investment. Stability remains key for economic data.

Finally, another notable report this week is Tuesday's housing data (the Case-Shiller Home Price Index and the FHFA Home Price Index). The moderation in both of these metrics has been an important factor in keeping inflation largely stable. Investors will want to see further moderation in home price gains (to be clear, we don't want to see outright declines, just small increases below 2.0% to pressure further statistical inflation such as CPI, which could mean sooner-than-expected rate cuts).

The Fed is the focus this week, and whether they reiterate expected cuts is the key question as we begin; however, the data remains important, and anything that points to a continued Goldilocks setup will be positive for stocks.

Special Reports and Editorial

Why A Spike in Japanese Bond Yields Hit Stocks

There are two reasons stocks dropped on Tuesday. The first is due to escalating tensions over Greenland and subsequent tariff threats. The second reason centered on Japan, and specifically a spike in the 10-year Japanese Government Bond yield, which has surged more than 20 basis points over three trading days, a huge move for a normally calm and boring asset.

Starting with why Japanese government bond yields have risen sharply, it's essentially because investors are concerned that Japan's fiscal situation may worsen in the near future. Japan's fiscal situation is, by far, the worst among the major economies, highlighted by its 250% debt-to-GDP ratio, which is double that of the U.S.

Last week, snap elections became likely in Japan, and the potential outcome could be that the Japanese government unleashes more stimulus on the economy. That would 1) make the fiscal situation even worse and 2) potentially increase inflation, both of which are negative for Japanese Government Bonds (and it's why 10-year JGBs have declined sharply).

The reason this hit the entire market last week is that Japanese government bonds are an important and widely held asset across the globe—an asset held for stability and low volatility, and often bought on leverage. So, when we see a massive short-term decline, it causes selling in other liquid assets as funds and investors raise cash.

The bottom line is that Japanese government bonds are an essential global financial element, and when they drop sharply and unexpectedly, it's going to have reverberations across global markets—and that's precisely what happened on Monday.

Looking forward, easing tariff tensions and calm trading in JGBs are needed for this market to stabilize (the former is more important than the latter). Regarding Japan, headlines that imply fiscal restraint from any new government will be an important positive (and the BOJ reiterating looming rate increases will help too).

On tariffs, a de-escalation of threats over Greenland (which likely stems from the president's Davos visit) will reinforce the market's TACO (Trump Always Chickens Out) belief and help calm markets.

Until then, we should expect more volatility, as the market is stretched across valuation metrics and has no cushion to absorb headlines like these.

Implications of the Administration's Policies: A Run-Hot Economy (and What Might Come Next)

Welcome to the "run-hot" economy. A run-hot economy occurs when too much stimulus is poured into the system (either all at once or consistently over a more extended period), and the net result is good economic growth but also higher prices and low "affordability." And that's pretty much where we are now.

In late August, I noted that, in anticipation of the Fed's next rate cut, the NOB spread rose sharply, signaling a run-hot economy. Since then, that's largely where the economy has headed, given solid growth and stubbornly firm inflation readings. And the fact that we are in a run-hot economy is by design (either purposeful or unanticipated).

Since taking power a year ago, almost all of the administration's economic and trade policies have increased the likelihood of a hot economy. Consider:

- The One Big, Beautiful Bill Act (OBBBA) extended and increased tax cuts (which stimulate the economy) and increased Federal spending (which stimulates the economy).
- Deregulation across industries stimulates the economy.
- Enticing foreign investment into the country (think of the litany of foreign countries and companies that have pledged massive investments in the U.S. since last year) stimulates the economy.
- Fannie Mae and Freddie Mac buying \$200 million of mortgages, to push mortgage rates lower, stimulates the economy.
- Pressuring the Fed to lower rates (and the Fed lowering rates 75 bps last year) stimulates the economy.
- Instituting tariffs on virtually all trade partners boosts prices (how much can be debated, but there's no doubt it does boost prices).

The net result of all of these policies is 1) An economy that has very solid growth (which is a good thing) but also one that 2) Has stubbornly high prices (neither CPI nor Core PCE have been at 2% in nearly five years) and 3) Affordability problems, because while the unemployment rate is low and people have rising incomes/asset prices, the cost of everything is so high that the lower-income/no-asset cohort gets squeezed, while the middle class doesn't feel any benefit from rising asset prices or higher wages.

If that sounds familiar, it should, because that's where we are. Broadly speaking, the unfortunate reality is that focusing economic and trade policies exclusively on stimulus and faster growth has negative consequences, including stubborn inflation and affordability issues.

More specifically, the main consequence of the "nothing but stimulus" economic policy is to boost interest rates due to several factors: 1) sustained solid growth, 2) entrenched higher inflation, and 3) rising fiscal concerns due to high government spending and lower taxes. The negative consequence of those rising rates is that they initially exacerbate affordability problems in the economy (happening now) and, over the medium and longer term, can actually slow economic growth, creating stagflation (because prices don't fall immediately).

Coincidentally, we can all see a blatant example of how government policies (or expected government policies) can send rates sharply higher and hit markets, as is happening right now in Japan. As mentioned, Japan is dealing with a less-than-ideal fiscal situation and sustained inflation for the first time in years (if not decades). However, with snap elections looming, investors think the new Japanese government will pour more stimulus into the economy, which will exacerbate fiscal concerns and the inflation situation, and that is why the yield on the 10-year JGB has jumped from 2.18% to 2.38% in three trading days.

To be clear, what's happening in Japan is not a near-term preview of what could happen here in the U.S., as the Japanese economy and demographics are much different/worse than the U.S. So, I am not saying we're about to see a spike in U.S. Treasury yields. But what's happening in Japan is clear proof that unleashing stimulus on the economy over and over can have negative consequences, and the administration should be paying attention to Japan as it considers future policy and tariff threats.

What Comes Next from A Policy Standpoint?

With the Greenland drama hopefully behind markets, focus should return to domestic policy, and if the run-hot economy continues (and there's no reason it shouldn't, at least short term), expect more threats on industries from the administration to address affordability (and we saw that last week in Trump's speech).

Put simply, this attack on specific industries is not totally dissimilar to what Nixon tried in the 1970s with price controls. Administrations, when faced with affordability challenges (usually the unintended result of their policies), will try to implement price controls. Nixon did this broadly, while Trump seems to be targeting specific industries: credit card companies with a rate cap, healthcare companies with insurance rates, defense companies with shareholder activism, and homebuilders. And the longer the affordability narrative has legs in the media, the more these announcements will likely increase.

But here's the problem: Whether price controls are macroeconomic (e.g., Nixon) or industry-specific (Trump is trying through social media threats), the result is always the same—reduced supply. That, in turn, only makes the affordability situation worse because prices may come down, but there's no product available (companies won't produce if there's no profit in it).

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