MARKET REVIEW & OUTLOOK

JANUARY 2024

Breaking News:

- February's employment report was a true barnburner reporting 353,000 vs. expectations of 185,000.

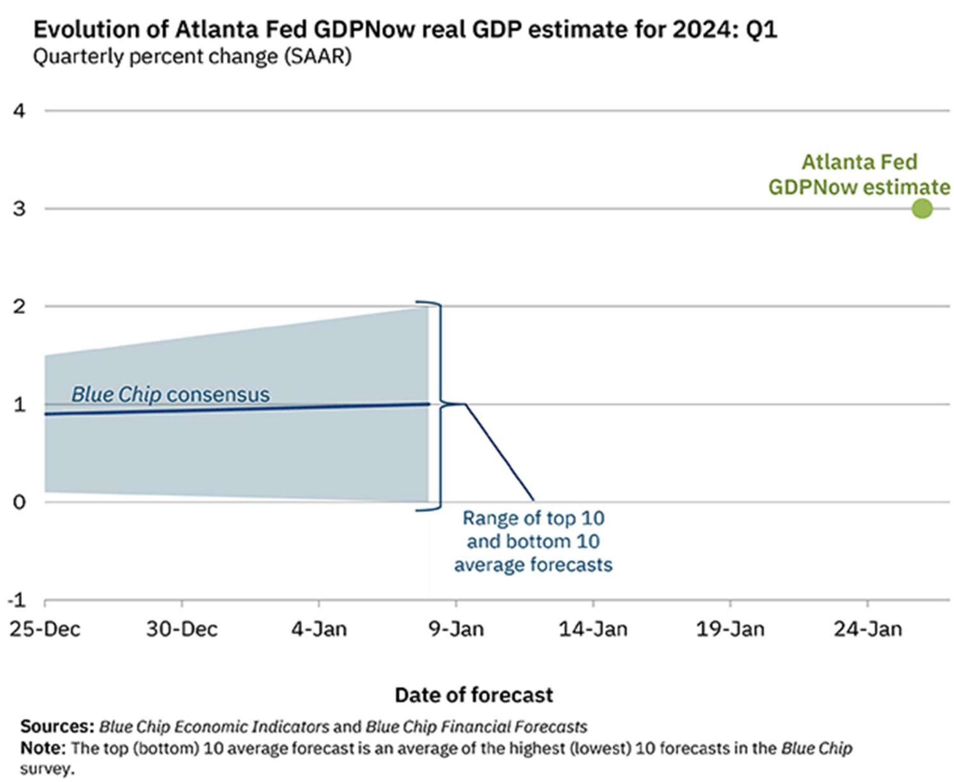
Back to our regularly scheduled programming…

KEY TAKEAWAYS

- The 4th quarter rally stalled through mid-month, but then got a nice bump before the last day, Fed induced, slump.
- The U.S. 10-year Treasury Yields found some stability around the 4% mark.

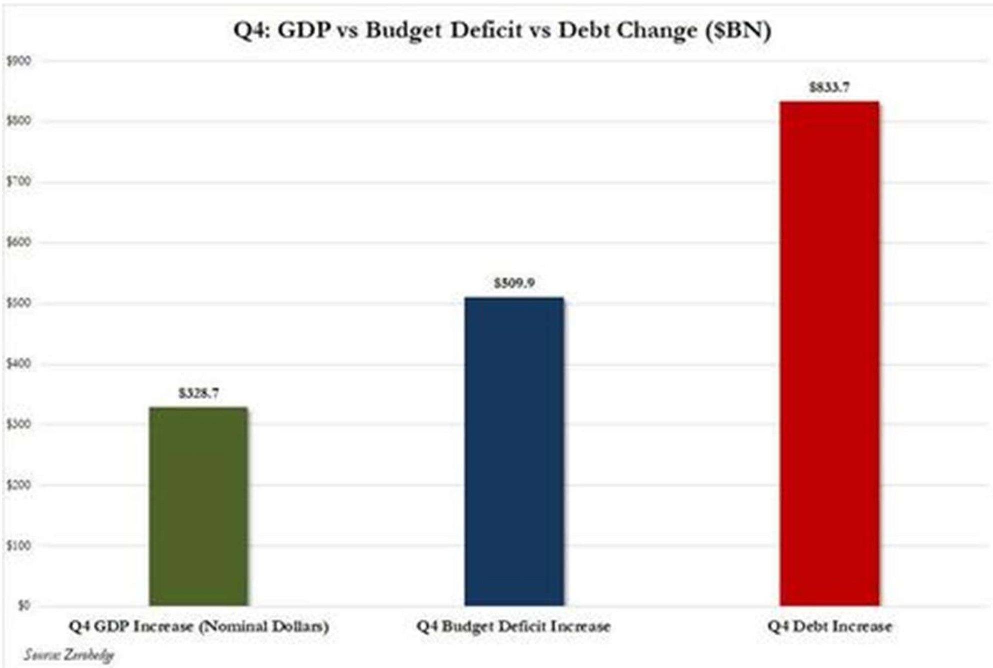
The U.S. Economy

The first look at the 4th quarter, GDP came in much stronger than expected at 3.3%, well above expectations of 2%. The core PCE, the imbedded inflation measure, held steady at 2.0% from the 3rd quarter report. Looking to the 1st quarter estimates for GDP from GDPNow is a robust 3% and the Blue-Chip consensus forecast is right at 1%, as shown in the chart below. Economic activity continues solid, and the PCE deflator has moderated to the sweet spot of "2%" inflation. The data seems reasonable, but the Fed seems unsure of shifting to the markets view of lower sooner, rather than higher for longer.



Source : https://www.frbatlanta.org/cqer/research/gdpnow

How sustainable is all this great GDP growth we are seeing? The chart below illustrates a point we have discussed previously. We are seeing a lot of reported GDP growth, but a look under the hood reveals that a lot of the growth has been generated through deficit spending, which continues to result in issuing more debt. This is generally not viewed as the best way to grow and maintain a healthy economy.



Source: https://www.zerohedge.com/markets/gdp-number-was-great-there-just-one-huge-problem

Stocks and Bonds

The U.S. 10-year Treasury yield bottomed out in late December and had a strong rally into the latter half of the month, but then saw yields drop back to nearly where they started. The Fed heads continued to talk about higher for longer and that March was too early to think about rate cuts. However, the market did not care what they said and continued to price in a rate cut for March. At the last Fed meeting, after leaving rates unchanged, as expected, Fed Head Powell put a little reality into traders' minds when he said without significant weakness in jobs, March is not going to have a rate cut. That comment drove equities down meaningfully on the last day of the month. GDP came in much stronger than expected which doesn't seem to leave the Fed much justification to cut rates imminently. The moderate rise in yields created a mild headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF eased -0.17% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.97%, up modestly from December's close of 3.87%.

The Dow Jones Industrial Average climbed +1.22%, the S&P 500 rose +1.59%, and the small cap iShares Russell 2000 ETF fell -1.49%. The international markets traded similarly with the U.S. small caps. The

MSCI EAFE iShares Core International Developed Markets ETF Index eased -0.76%, and the MSCI Emerging Markets iShares Core ETF Index dropped -4.21%.

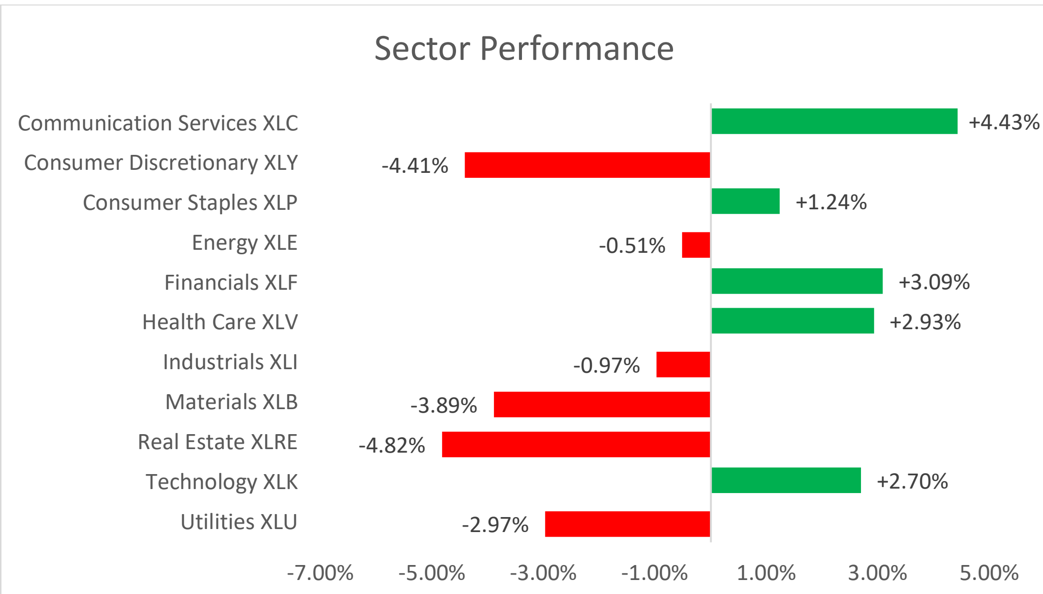
January's performance was evenly split and bifurcated.

The best performers were…

- Communication Services: +4.43%
- Financials: +3.09%
- Healthcare: +2.93%

The worst performers were…

- Real Estate: -4.82%
- Consumer Discretionary: -4.41%
- Materials: -3.89%



Source: https://www.morningstar.com

Oil Report

The oil market continues trading headlines, the Gaza conflict continues to spread and that drives prices higher, but then headlines about global economic weakness drives prices back down. The markets remain relatively sanguine about the continued escalation of Houthi attacks on ships traveling the Red Sea. The current NYMEX WTI Crude Oil futures settled at $75.85 again posting a gain of almost 6% from the prior month's close of $71.65 a barrel and almost the same price as the end of November. The increase in crude oil led to a similar increase in RBOB gasoline, which finished with a gain of almost 6% vs. December's close. The market doesn't seem to think that delayed shipping, or longer more costly shipping is going to be a problem for long or that attacks will impede the energy complex.

The Rest of the Data

The December ISM Manufacturing Index increased to 47.4 from November's reading of 46.7. The ISM Services Index decreased to 50.6 in December, from November's print of 52.7. The prices paid component for Services remained close to elevated and Manufacturing prices eased off neutral levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence popped to 114.8 in January, which compares to a downwardly revised figure of 108.0 in December. The unemployment rate remained at 3.7%, while the economy added another solid 216,000 jobs in December, besting expectations of 175,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.3% in December, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate increased to +3.4% on a non-seasonally adjusted basis. The CPI ex Food and Energy eased to 3.9% over the last year. Same news, the economic data remains solid, employment reports are good, and inflationary pressures are flattening out, and still higher than the Fed target of 2%. The only sign of real weakness remains in the Manufacturing sector. The market has backed off expectations for a March rate cut and taken out a few cuts for the 2024 total. However, given the robustness of the economic data and initial signs of inflation firming, it seems hard to see rate cuts happening soon without an exogenous event. One potential catalyst is the end of the banking support mechanism that was put in place last March during the Silicon Valley Bank collapse. We will continue to monitor economic activity along with inflation reports.

Summary

The markets generally just seem happy. If economic data is good, the market is happy about the strong economy. If the data is weak, the market is happy that the Fed is about to cut rates. Heads you win, tails I lose. That is all fine and dandy, but the elephant in the room is inflation. Fed Powell has started talking again about the mid-1970's experience when the Fed declared victory over inflation prematurely. In late December it was looking like we potentially were headed for a repeat, but now Powell is signaling that he is still concerned about declaring victory over inflation too soon. The markets generally seem to be content with 4% 10-year U.S. Treasury yields and good economic data, whether we get rate cuts or not. The only potential fly in the ointment is if inflation meaningfully reasserts itself, because strong economic growth or not, the markets would have to concede that all of the rate cuts they have priced in may not come to be.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growth and growing debt, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

Kevin Churchill, CFA®, CFP®
Chief Investment Officer
WaterRock Global Asset
Management

Institutional Asset Management adapted for Private Wealth™

WaterRock Global Asset Management, LLC
Scottsdale, AZ 85260
(808) 896 – 4957