Summary

Economic data for the week included the Federal Reserve keeping interest rates unchanged, while alluding to easing policy at a further pace than first expected in 2024. Both producer and consumer inflation showed continued signs of some further deceleration. Industrial production and retail sales showed gains, although trends for the latter remain less robust after correcting for inflation.

U.S. equities gained with optimism of the U.S. Fed hinting at easier policy, while a weaker dollar buoyed foreign stocks higher. Bonds earned positive returns along with a drop in interest rates. Commodities gained on net, led by metals and energy.

Economic Notes

(0/+) The December **FOMC** meeting ended with no change in policy rates, as predicted. The formal statement was also little changed, noting the decline in inflation, while fading economic growth was also acknowledged. However, the 'dot plot' of expectations for Fed funds in the next year alluded to -0.75% in 2024 cuts, in contrast to the -0.25% assumed cut in September (which excited markets). The pace continued to show a gradual pace of rate declines through 2026, including four cuts in 2025, and almost reaching the median longer run expectation of 2.5% in 2026—considered the 'neutral' level.

In the post-meeting press conference, Chair Powell noted that committee discussions of easing were 'just at the beginning,' with a reminder that inflation still remains above target, and they're remaining data-dependent, as usual, in the event that further hikes could be needed. All-in-all, the communication was taken as quite dovish, especially in contrast to the tough inflation-fighting language of meetings not that long ago.

(+) **Retail sales** rose 0.3% in November, surpassing the -0.1% forecasted decline, but included a revision downward of -0.2% for the prior month. Just over half of the 13 categories saw gains. The headline result was affected by a -3% drop in gas station sales, a lesser drop in building materials, while auto sales rose 0.5%. Removing the more volatile components of autos, gasoline, and building materials elevated the core/control measure gain to 0.4%, twice that of expectations. Restaurants/bars rose nearly 2%, while health/personal care gained nearly a percent, likely related to Covid boosters. In the early holiday shopping season, non-store/online sales rose 1%, which offset weaker results for brick-and-mortar stores, with gains in sporting goods and furniture offset by declines in clothing, department stores, misc. stores, and electronics. Over the past year, retail sales are up just over 4%, which is a bit ahead of inflation, but just slightly, resulting in still-minimal 'real' sales growth.

(+) **Industrial production** rose by 0.2% in November, below expectations of a 0.3% gain, but in a sharp reversal of the decline the prior month. The manufacturing production component gained 0.3%, below expectations, led by gains of nearly a percent in business equipment and an 11% rise in auto assemblies as the labor strike ended, while non-auto fell by about a tenth. Mining production rose by 0.3% (which includes energy extraction), while utilities production fell -0.4%, with less extreme weather. Capacity utilization ticked up a tenth to 78.8%. While overall industrial production remains down about a half-percent on a year-over-year basis, one promising trend is the recent growth in high-tech equipment manufacturing. That sector is up 14% over the year, being led by artificial intelligence development and domestic construction of semiconductor facilities driven by the CHIPS Act.

(-) The **Empire Manufacturing Index** fell by a dramatic -23.6 points in December to a contractionary -14.5 level, in contrast to an expected 2.0 reading. Underlying components were weak as well, with new orders and employment falling further into contraction, while shipments deteriorated from expansion to contraction. Prices paid rose slightly, further into expansion. In contrast to all other measures, the 6-months-ahead business conditions index rose 13 points to reverse from a minor contraction back into solid expansion.

(+) The **Producer Price Index** for November came in flat on both a headline and core level, ex-food and energy, despite expectations for a 0.2% rise in core prices. This was due to higher food prices offset by a -1% decline in energy, and a slight decline in retail margins. Year-over-year, headline PPI is up a meager 0.9%, while core decelerated to 2.0%—nearly a two-year low. This included unprocessed goods down over -1% over the year, no change in processed goods prices, while services prices rose 3%.

(0) The **Consumer Price Index** for November rose 0.1% on a headline level and 0.3% for core, removing the impacts of food and energy. Headline CPI was a tenth higher than expected, while core fell in line with consensus. Energy commodity prices falling back -6% was a major factor for the individual month. Other well-watched items seeing increases included used car prices (by nearly 2%), car insurance (1%), as well as medical care services and shelter/owners' equivalent rent (roughly 0.5% each). On the other hand, apparel prices fell (-1%), as did airline fares and lodging.

On a year-over-year basis, CPI rose 3.1% and 4.0% on a headline and core basis, respectively. Headline was only slightly down from the pace of the prior month, but both are significantly down from the 12-month pace a year ago and continue to show signs of progress. Over the past year, energy prices fell -10%, which helped in this deceleration, while shelter (overall, a third of CPI), rising a half-percent still hampered some of that downward progress. In an alternative view, taking broad CPI and removing food, energy, and shelter, 12-month CPI only rose by 2.1%. Generally, services prices (60% of the index) rose 5% while durable goods fell by nearly -2%, showing the rising dispersion of items within the overall basket.

(0) **Initial jobless claims** for the Dec. 9 ending week fell by -19k to 202k, below the 220k median forecast. Continuing claims for the Dec. 2 week, on the other hand, rose by 20k to 1.876 mil., just under the 1.879 mil. consensus forecast. Seasonal distortions appear to still be playing a role here to some degree, with few state-by-state changes recently.

Market Notes

Period ending 12/15/2023	**1 Week %**	**YTD %**
DJIA	2.93	15.00
S&P 500	2.53	24.89
NASDAQ	2.86	42.70
Russell 2000	5.60	14.42
MSCI-EAFE	2.56	15.90
MSCI-EM	2.69	7.23
Bloomberg U.S. Aggregate	2.16	4.88

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2022	4.42	4.41	3.99	3.88	3.97
12/8/2023	5.44	4.71	4.24	4.23	4.31
12/15/2023	5.44	4.44	3.91	3.91	4.00

U.S. stocks experienced gains for the seventh straight week as investors cheered the Federal Reserve's dot plot, released after the meeting, which alluded to no additional expected rate hikes in addition to four cuts in 2024. This helped reinforce the soft landing case that financial markets had been hoping for, as well as potential for a 'regime shift' from tightening to easing. Producer prices also came in lower than expected, improving the case for inflation generally decelerating.

Nearly all sectors experienced gains last week, led by materials, industrials, financials and consumer discretionary, all up 3-4%, while communications lost a fraction of a percent. Real estate rose nearly 6%, in keeping with the sharp decline in interest rates. Falling rates also powered sentiment for small caps higher, as

they again outperformed large cap stocks. This is due to the perception of an ease in credit conditions, as well as a general 'beta' effect, with smaller firms having a more volatile nature and greater economic sensitivity generally (in both directions).

Foreign stocks gained as well, with hopes for lower interest rates globally, especially with weakness in European and British economic data. Interestingly, both the European Central Bank and Bank of England kept interest rates unchanged, along with the U.S. Fed, but the former mentioned that easing wasn't even discussed at this point, while the latter noted that rates would stay high for an 'extended period.' These hawkish stances were unusual in that both central banks oversee economies that are much nearer to recession than the U.S., but also are more sensitive to inflation outbreaks historically. Even more surprising to markets, the central bank of Norway hiked rates by 0.25%, noting persistent inflation pressures. Emerging markets outperformed developed slightly, led by sharp gains in Mexico and South Africa.

Bonds also fared positively last week, in keeping with lower interest rates. Both investment-grade and high yield gained upwards of 2%, while senior loans rose less than a percent. Foreign bonds outperformed U.S., on an unhedged basis, with falling yields in addition to a sharp drop in the U.S. dollar. The dollar movement appeared to be related to the dovish Fed response, in contrast to the relatively hawkish communications from Europe and the U.K., with relative interest rate levels a driving factor in currency sentiment with all else equal.

Commodities saw gains across the board generally last week, helped by the weaker dollar. Industrial metals rose several percent, as precious metals and energy gained to a lesser degree. Crude oil rose under a percent last week to $72/barrel, with minimal geopolitical news to move the needle other than weaker European demand growth.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.