Summary

Economic data for the week included U.S. GDP for the third quarter being revised downward slightly, but inflation was as well. Durable goods orders gained, while housing data remained mixed.

Equities continued their streak of gains globally, as signs of inflation continued to temper. Bonds were flattish, in keeping with minimal changes in interest rates. Commodities experienced gains in energy and metals.

Economic Notes

(0) The third and final **U.S. GDP** release for Q3 saw the prior estimate of 5.2% downgraded a bit to 4.9%—still extremely strong. The entire revision was the result of personal consumption growth taken down by a half-percent to a rate of 3.1%. Other revisions were largely offsetting, such as better growth in structures (to over 11%), while equipment and intellectual property deteriorated. Real gross domestic income was unchanged at 1.5%. Also, the core PCE price index for the third quarter was revised down from an annualized 2.3% to 2.0%, which is spot on with the Fed's target pace, while the year-over-year measure fell a bit to 3.8%. That quarter contained various hints at the coveted 'soft landing' scenario.

The Atlanta Fed's real-time GDPNow measure continues to show robust Q4 growth expectations, having more than doubled from earlier estimates to 2.3%. By segment, consumer spending remains 1.6% of this total, with additions from government (0.6%) and non-residential fixed investment (0.4%); other segments appear flat to negative. Interestingly, the Blue Chip economist consensus median has remained consistent around an expected 1% growth rate for the quarter, so general expectations remain a bit pessimistic.

(+) **Personal income** for November rose by 0.4%, matching expectations, as gains in wages/salaries, rents, and interest offset a drop in transfer receipts. **Personal spending** rose 0.2%, a tenth better than the prior month, but a tenth lower than forecast, with spending on goods up a half-percent. Accordingly, the personal saving rate ticked up a tenth to 4.1%. The **PCE price index** for inflation fell -0.1% on a headline level, versus expectations of no change, while the core index ex-food and energy rose 0.1% (barely, when rounded upward), despite expectations for a 0.2% rise. Year-over-year, PCE headline and core rose 2.6% and 3.2%, respectively, which showed continued deceleration by several tenths of a percent from October. In that period, a 4% rise in services costs was offset by a minimal decline in goods prices—but -2% in durable goods.

(+) **Durable goods orders** rose 5.4% in November, reversing the decline of October and sharply exceeding the 2.4% median forecast. Core capital goods orders rose 0.8%, beating expectations of 0.1%, while core capital goods shipments fell by -0.1%. That alludes to the headline number being driven by sharp gains in the more volatile commercial aircraft category as well as autos (the latter being strike-related). Other areas seeing gains included electrical equipment, metals, and machinery. Over the past year, total orders were up 10%, but only 2% when the transportation sector is excluded. Nevertheless, this remains positive, albeit still impacted by inflation pushing the numbers up.

(+) **Existing home sales** rose 0.8% in November to a seasonally-adjusted annualized rate of 3.82 mil. units, exceeding the median forecast of -0.3%, and a reversal from the prior five months. This was solely due to single-family rising nearly a percent, as condos/co-ops were unchanged. Regionally, the South saw a gain of 5%, while sales in the West fell by -8%. Year-over-year, existing home sales remain down -7%, driven by declines in homes priced under $750k, while higher-end homes continued to see rising sales. The median sales price of existing homes rose to $387,600, reaccelerating to 4% growth over the last year. The supply of existing homes at 3.5 months' supply is slightly higher than a year ago.

(-) **New home sales** in November fell by -12.2% to a seasonally-adjusted annualized rate of 590k, in contrast to a 1.6% expected rise as the slower winter season began. Sales rose in the Midwest, while the South saw the most dramatic declines. Year-over-year, sales are barely positive, up 1%. The median sales price came in at

$434,700, which is down -6% from last year, but largely due to builders scaling back the square footage of homes to appeal to a broader buyer mix, due to affordability concerns. Inventory conditions improved to 9.2 months' supply, up 16% from a year ago.

(+) **Housing starts** in November rose by 14.8% to a seasonally-adjusted annualized pace of 1.560 mil. units, far better than the -0.9% decline expected. The single-family component rose 18% to lead the way, while the multi-family group rose another 7%, continuing a stretch of strong apartment building. All national regions saw gains, led by the Northeast's 100% rise vs. the prior month. While patterns are not always apparent in single-month data, overall starts are up 9% on a year-over-year basis, single-family starts are up over 40%, while multi-family starts are down -33%. For the latter, conditions seem to be slowing following a stretch of exceptionally strong apartment building activity—in fact, the highest levels in 50 years. **Building permits** fell by -2.5% to a seasonally-adjusted annualized 1.460 mil. pace, a bit further than the -2.2% expected. A -9% drop in multi-family was the primary driver, with single-family permits up a percent, albeit rising for the 10th straight month. In a trend also seen in starts, single-family permits were up 23% over the last 12 months, while multi-family permits fell -20%.

(0/+) The NAHB/Wells Fargo Housing Market Index of **homebuilder sentiment** rose 3 points to 37 in December, generally matching expectations, but remaining well below the level of 50, considered the neutral level of neither pessimism nor optimism. Present conditions were unchanged at 40, while future sales rose to 45, appearing a bit stronger. Mortgage rates falling by over -1% from highs may have helped, although mortgage affordability remains an issue.

(+) The Conference Board **index of consumer confidence** for December rose by 9.7 points to 110.7, above the median forecast of 104.5. Assessments of present conditions rose by 12 points, while expectations for the future rose 8 points. The labor differential, measuring the ease in finding employment ticked up by a few points, with 40% of respondents noting jobs were 'plentiful,' while only 13% claimed they were 'hard to get.' Anecdotally, the assumed likelihood of recession in the next year fell to a level not seen in the past year and a half, although it still remained at around two-thirds.

(0/+) **Initial jobless claims** for the Dec. 16 ending week rose by 2k to 205k, below the 215k median forecast. Continuing claims for the Dec. 9 week fell by -1k to 1.865 mil., still below the median forecast of 1.880 mil. Minimal changes are not uncommon during the holidays with the possibility of seasonal distortions continuing to play a role.

(-) The Conference Board's Index of **Leading Economic Indicators** in November declined another -0.5%, although this was 'less bad' than the -1.0% decline in October. Stock prices were the only positive contributor of the ten inputs in November, with consumer expectations and ISM new orders faring the most negatively. Over the past six months, the index declined by -3.5%, which is also an improvement on the -4.3% drop over the prior six months from Nov. 2022 to May 2023. November represented the 20th straight negative month for the LEI, which continues to point to high recession risk in months and quarters to come.

Question of the Week

What do we have to look forward to in 2024?

As usual, there is no shortage of talking points, some of which don't change from one year to the next. A few are continuations from 2023, while every new year offers endless chances for surprises. December of each year is filled with specific projections from a variety of firms; the accuracy of such calls is not often measured but tends to not be that great. This is merely a list of issues that could affect market sentiment.

1. Fed and interest rates. In 2023, most of the focus has been on how far and how long the Fed will keep tightening policy in place. Now that we're at an apparent pause, the question now has turned to how

long the pause will last and when the first rate cuts will happen, and, if so, how deep the easing will go. This is obviously hinged on several other factors below. While Chair Powell's press conference was taken dovishly, that the Fed would be open to discussions of cuts, this was taken more seriously by markets, requiring some pullback by several members of the Fed in their speaking circuit—noting that markets may have gotten ahead of themselves by expecting cuts soon. Conditions look to be increasingly well-balanced, which is what the Fed has been aiming for. Regardless of when cuts come, the days of zero-interest rates are likely behind us. That period was in response to an extraordinarily deep economic downturn and financial system distress, while it has been acknowledged that using such low rates to 'bail out' a normal downturn is imprudent and dangerous. Low rates for too long can generate and sustain asset bubbles, which have historically ended badly. A moderate drift lower toward a more balanced rate policy would be the less disruptive and likelier option. Rates staying high for longer could pressure financial conditions, and weigh on growth, while cutting would ease conditions and could be celebrated in both stock and bond markets—assuming the conditions requiring cuts aren't catastrophic.

2. Inflation. This has been a headline concern over the past few years, with mid-2023 finally showing progress back toward normal. In fact, even though levels haven't fallen back completely, some commentators are now describing inflation as 'old news.' Supply disruptions from the pandemic are over, although the shocks from that period coupled with other political trends have pushed many countries to 're-shore' or 'friend-shore' more critical industries. While making inventories more resilient, it could also prove less efficient and raise costs compared to the past few decades when manufacturing in the lowest-cost locations was a top priority. Financial balances (such as M2) which spiked during the pandemic have also retreated, as the Fed winds down its balance sheet. There is a difference between higher prices and inflation, though. Inflation is technically defined as the rate of change in prices—the part that has finally shown deceleration, which is a positive. However, inflation over the past few years resulted in a higher price plateau for a variety of goods, including food, cars, and other items in consumer shopping baskets, as well as services—all of which may have kept consumer sentiment more negative than it might otherwise be.
3. U.S. economic growth vs. recession. Another key question has been resolution of the 'recession' or 'soft landing' debate. Unfortunately, the answer is still yet to be determined. We know from history that recessions are inevitable and unavoidable, as normal parts of the business cycle. The wildcard is the timing (over the last century it's been every 5-6 years in the U.S.). Technically, back-to-back declines of GDP in Q1-2022 (-2.0%) and Q2-2022 (-0.6%) could have been defined as a recession using purely quantitative rules of thumb, but the U.S. NBER dating committee didn't elect to formally classify it that way. Will we finally get a recession in 2024? Or more waiting until 2025 or 2026? The past has shown us that the unforeseen can cause a recession out of nowhere, such as an extreme oil price shock, war, or pandemic.
4. Global economic growth vs. recession. Europe and the U.K. have been on the precipice of recession for months, along with fighting higher inflation, at least until recently. That combination narrowed the room for policy error. Financial market valuations appear to be pricing in the negativity. In Asia, Chinese activity has been hampered since the re-opening from the pandemic with a substantial real estate debt overhang. However, the government appears to be careful in not overstimulating areas it does not want to reward and reinflating speculative excesses. Technology and trade tensions with the U.S. also bring uncertainty, as both sides have generally benefitted from the economic relationship over the last several decades, which could be tricky and expensive to decouple. While emerging markets broadly have provided lackluster results in recent years (again priced in, along with poor sentiment), pent-up demand returning to more normal growth levels could act like a coiled spring.
5. Earnings. Longer-term, this tends to be the primary driver of stock market returns. Earnings reflect a variety of inputs, starting with incoming revenues, which have been related to global economic growth. They also depend on costs, which inflation has affected, in commodity prices until recently and higher employee wages. However, profit margins remain quite high (over 10%, nearly double levels of 20 years ago), partially from the more efficient and less capital-intensive nature of today's market basket, which

contains more tech and communications, and fewer industrials, for example. Per FactSet, expectations for 2024 S&P 500 earnings growth are running around ~12%, which is seen by some observers as too optimistic, but does point to bullish expectations generally.

6. Elections. U.S. Presidential elections tend to flare emotions, but ultimately, political parties or administrations in charge have mattered little to financial market returns. From 1926-2022, per Morningstar and FPS calculations, the third year of a Presidential election cycle (2023 is one) has been the strongest-performing, with average annual returns of 16.7%. The second best is the election year itself, at 10.2%. In the short term, market results can even run the opposite of what is first feared, as 'status quo' in policy has tended to be the norm as opposed to immediate extreme changes, not to mention 'relief rallies' (with election uncertainty simply being over). What markets could react to a bit are changes at the fringes that affect economic growth, global competitiveness/trade, fiscal policy, or tax levels, although such movements haven't been overly persistent historically. Looking globally, nearly one-half of the world's population lives be in countries holding elections in 2024, which contains more potential for unpredictable outcomes, especially in emerging markets.
7. Geopolitics. This is the usual wildcard that could go in any number of directions. The highest odds remain where conflicts are either ongoing or routinely erupt, such as Russia/Ukraine, Israel/Gaza, and now the Red Sea. Naturally, a variety of other tensions are ever-present, involving Iran, China, and others. Aside from military conflict, disruption of commerce or commodity supplies have often been the first assets affected—crude oil is one that has commonly responded first. Now that bonds offer a higher, more historically-normal yield, it would not be surprising to see U.S. treasuries see even more popularity as a safe haven if risks rise. That function has tended to outweigh all other near-term concerns (fiscal situation, etc.) in times of crisis.

Market Notes

Period ending 12/22/2023	**1 Week %**	**YTD %**
DJIA	0.22	15.25
S&P 500	0.77	25.85
NASDAQ	1.22	44.44
Russell 2000	2.47	17.25
MSCI-EAFE	0.84	16.88
MSCI-EM	-0.79	6.39
Bloomberg U.S. Aggregate	0.14	5.02

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
12/15/2023	5.44	4.44	3.91	3.91	4.00
12/22/2023	5.44	4.31	3.87	3.90	4.05

U.S. stocks continued to see gains, for the eighth straight week, with several indexes again approaching all-time highs (for those keeping track). Positive inflation data and dovish talk from members of the Federal Reserve helped sustain the positive mood, notably as one member noted that policy would remain 'tight' even if rates were cut several times in 2024. (Any talk of rate cuts in recent weeks has led to positive market reactions, in further reinforcement that this could be closer than the Fed had previously let on.) Historically, this has been a seasonally strong time of year for equities over the past century, which started this year with traditional weakness in Aug. and Sept., followed by a rally of over 15% in the S&P since Halloween lows.

Communications led all sectors with a gain of over 2%, led by gains in Alphabet and Meta, followed by energy and materials. Utilities brought up the rear, with a small decline of a percent. Real estate earned a small gain

also, with stable inflation and interest rates remaining stable. Small caps again fared positively versus large caps, reflecting another seasonal tendency late in the year.

Foreign stocks saw gains as well, led by the U.K. and Japan, and Europe to a lesser degree. U.K. results were helped specifically by inflation slowing at a faster pace than expected, even though the economy is bordering on recession, as are several other nations in Europe. In emerging markets, Brazil was buoyed by an upgrade in the country's sovereign credit rating, offset by Chinese tech stocks being negatively affected by new government restrictions on online gaming.

Bonds returns were flattish on the week, with little change in underlying yields. The exceptions were high yield and floating rate loans, which saw stronger gains around a half-percent. Foreign bonds fared better, along with a drop in the U.S. dollar.

Commodities gained generally, with declines in agriculture and softs offset by rises in energy, industrial metals, and precious metals. Crude oil prices rose over 2% last week to $73.50/barrel, having spiked by several dollars earlier in the week. This came as BP announced a pause in shipments through the Red Sea (through which one-sixth of world trade and one-fifth of the world's oil traffic moves through), due to Houthi militant attacks from Yemen on shipping traffic. A global naval task force has been formed to help address the problem. Crude oil is an asset commonly first affected by Middle East conflict, although the response has been sporadic and less dramatic than in the past, with more impact on freight rates and shipping insurance costs.

Have a good week and Happy Holidays.

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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.