Summary

Economic data for the week included consumer price inflation coming in a bit stronger than expected, but a slight improvement on a year-over-year basis compared to the prior month. On the other hand, producer price inflation came in a bit weaker than expected.

Equities saw gains in developed markets, while emerging markets declined, led by weakness in China. Bonds fared positively as yields pulled back along with eroding inflation worries. Commodities were mixed for the week, with gold higher and crude oil lower.

Economic Notes

(+) The **Producer Price Index** fell -0.1% in December, contrary to expectations for a 0.1% increase. Core prices, ex-food and energy, were unchanged, compared to the expected 0.2% growth. Final demand goods falling -0.4% was the key culprit, with weaker pricing for both food and energy, while services prices were unchanged for the month. On a year-over-year basis, headline PPI is up a far reduced 1.0%, while core ex-food/energy/trade services rose 2.5%. This includes a drop in goods prices of -1% offset by a 2% rise in services costs. PPI continues to show improvement, showing deflationary effects, especially on the goods side, although heavily influenced by petroleum prices.

(0/-) The **Consumer Price Index** for December rose 0.3% on a seasonally-adjusted basis on both a headline and core level, ex-food and energy. Headline was a tenth higher than expected, while core fell in line. On an unadjusted basis, headline CPI fell -0.1%, while core rose 0.1%. Energy prices overall rose, even though the price of energy commodities, based on crude oil, fell slightly in the month. Other areas of strength were shelter (up 0.5%). used cars (0.5%), medical care services (0.7%), new cars, car insurance, and airline fares.

Year-over-year, headline and core CPI grew at rates of 3.4% and 3.9%, respectively. This represented a rise of 0.3% for headline, while core fell by a tenth from the November pace. While consumer inflation has shown a dramatic deceleration since the highs of summer 2022 (headline 9.1%, core 6.6%), it’s remained stickier than many watchers would have hoped by now. Even the Cleveland Fed’s trimmed mean CPI (removing the 8% highest and 8% lowest results) came in at a better, but sticky 3.9%. Rental inflation has been a big part of this, rising at a 0.5% per month pace, which is faster than the rest of the basket. There is still room for improvement toward the equivalent of the Fed’s core PCE target of 2.0%. Trailing 12-month CPI is the most commonly used measure when inflation is widely quoted in the news, largely out of tradition, but also as longer timeframes tend to smooth out monthly noise. However, this can also tell a different story, particularly if data is fast-changing. In the current case, if we were to instead use the last 6 months of inflation data, and annualize it for consistency, we end up with inflation of 1.1% and 1.9% for headline and core, respectively. Taking this even more recent, using the last 3 months, the headline number turns into annualized -1.3% deflation, and core CPI inflation falls to 1.4%. Falling energy prices obviously play a role in recent results, but the core number provides better news.

(0/+) **Initial jobless claims** for the Jan. 6 ending week fell by -1k to 202k, under the 210k median forecast. Continuing claims for the Dec. 30 week declined by -34k to 1.834 mil., well below the consensus estimate of 1.870 mil. While TX and CA saw a rise in claims, the other results were balanced out among the rest of the U.S. Nothing here points to any escalation in layoff activity or worsening of the labor market.

Market Notes

Period ending 1/12/2024	1 Week %	YTD %
DJIA	0.35	-0.21
S&P 500	1.87	0.34
NASDAQ	3.09	-0.24
Russell 2000	0.00	-3.73
MSCI-EAFE	0.87	-0.40
MSCI-EM	-0.57	-2.65
Bloomberg U.S. Aggregate	0.92	-0.29

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2023	5.40	4.23	3.84	3.88	4.03
1/5/2024	5.47	4.40	4.02	4.05	4.21
1/12/2024	5.45	4.14	3.84	3.96	4.20

U.S. stocks saw gains last week, with inflation results seeing mixed sentiment on the consumer side, while producer prices were a positive sign. Sector results were led by technology and communications up 3-5%, while energy and utilities lagged with negative returns of -2%. Real estate gained slightly along with a drop in interest rates.

Earnings season for Q4 began last week, with the big banks reporting first, as usual. It's expected that some of Q3's earnings strength was pulled forward and will dampen Q4 results. Per FactSet, Q4 S&P 500 year-over-year earnings growth is expected to come in at -0.1%; however, the last several quarters have seen an improvement of several percent as earnings season progressed, with downcast expectations having been exceeded. For Q4, the strongest sectors are expected to be communications, utilities, and consumer discretionary, with earnings growth of 20-40%, with energy and materials lagging, with earnings of -20% to -30%. Revenue is expected to run at about a 3% growth rate, led by 6% gains in real estate, technology, and communications. For the full year 2023, earnings growth is expected to be barely positive at 0.5%, well below average, although hopes for Q1 2024 remain near average (at 6%), and full year 2024 up near 12%. Full year estimates don't provide much clarity about the impact on earnings from recession expectations, though, which could include a positive path throughout the year, or a dip and later recovery, as has been the case in the past. Very early earnings growth estimates for 2025 show an even better rate of 13%. While some watchers view these as a bit optimistic, stock prices have tended to follow earnings over time (short-term sentiment and valuation impact aside), which creates a better story than some are predicting.

Foreign stocks were mixed, ending higher overall led by gains in Japan and Europe to a lesser extent. Japanese stocks have continued to shine under stimulative central bank policy and a weaker yen, boosting trade. Dovish European central bank comments about the worst of inflation being over were coupled with weaker economic data generally, keeping the continent on the cusp of recession. Emerging markets fell back, as China saw further declines in the midst of weak economic activity and outright deflation in several measures. Insofar as the Taiwan elections went over the weekend, the ruling Democratic Progressive Party (DPP) won the presidency—this is the party promoting the country's independent identity and rejecting China's historical claims. China has been lobbying against the candidate over the past week, with this being another wrinkle in keeping tensions elevated. Taiwan is a world leader in semiconductor manufacturing, with this conflict being seen as a potential long-term Achilles heel for the high-flying U.S. technology stock sector, as the one offset to their fundamental financial strength and market dominance.

Bonds saw gains along with falling yields, in keeping with decent inflation results. The 10-year Treasury seems to have found a landing spot at around 4%, balanced by sticky inflation but also downside risks. Investment-grade corporates and high yield outperformed governments, with returns over a percent each, with tightening spreads. Foreign bonds were mixed, with little change in the U.S. dollar, with emerging market dollar bonds gaining with a rally in risk assets generally.

Commodities were little changed as a whole last week, with a percent gain in precious metals offset by declines of roughly the same magnitude in agriculture, energy, and industrial metals. Crude oil fell over a percent last week to $73/barrel, despite seeing an uptick later in the week with reports of U.S. military strikes at Houthi rebels in Yemen, the group recently attacking commercial vessels in the Red Sea. This is in line with typical crude oil behavior with any type of military escalation in the region.

In a financial side note, the SEC finally approved 11 spot bitcoin ETFs for trading, after a decade of debate since the first application was submitted. This closed the loop on the issue and comes after long-standing funds that could invest in bitcoin futures contracts as well as closed-end funds that owned crypto. The controversy had been based on fraud detection capabilities, as well as philosophical questions about how crypto would be regulated—as currencies, commodities, securities, or none of the above. One dissenting SEC commissioner described the decision as “unsound,” summing up the feelings of skeptics concerned about risks in crypto-based products. The SEC commissioner himself described bitcoin as a “speculative, volatile asset that’s also used for illicit activity.” A variety of industry players, including big banks and fund families, have moved in on the action—this should probably be viewed less as an endorsement but rather as a marketing opportunity.

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.