Summary

In the first week of the new year, economic data continued to show a mixed picture. ISM manufacturing continued to contract, but did improve, while ISM services grew, but at a far slower pace. The monthly employment report for December showed gains far stronger than expected.

Equities fell back globally to begin the year, resulting from geopolitical tensions and signs the Fed may not cut rates as dramatically and as quickly as hoped. Bonds lost ground, as yields ticked higher, and foreign bonds were hampered by a stronger dollar. Commodities were mixed, with oil up and metals down.

Economic Notes

(0) The **ISM manufacturing index** ticked up by 0.7 of a point in December to 47.4, just exceeding the 47.1 median forecast—an improvement but remaining in contraction under the 50 neutral level. Of the 18 key industries, only ‘primary metals’ showed expansion during the month. The closely-watched new orders category fell over a point to 47, further into contraction; this segment is often looked at as a leading indicator of activity. However, gains of several points were seen in production, back into expansion, and employment, while it remained in contraction. The prices paid measure fell by nearly -5 points further into contraction, which historically indicates a lack of activity, but more recently reflects easing inflation effects (led by falling crude oil prices). Inventories also fell back, pointing to weaker manufacturing activity overall. This was the 14th straight month of slowing ISM manufacturing activity, the longest stretch in over 20 years; however, there’s been little deterioration further. No doubt future months will provide better clarity on the path this takes.

(-/0) The **ISM non-manufacturing/services index** for December fell by -2.1 points to 50.6, compared to an expected little-changed 52.6. This kept the overall index in expansionary territory, but just barely. New orders fell by nearly -3 points, but stayed firmly in expansion, while employment fell by over -7 points into contraction, with commentary mixed (some having difficulty in finding workers, offset by some layoffs elsewhere). Prices paid fell by about a point, but still remained firmly in expansion, which is related to still-high wage costs. On the brighter side, business activity rose over a point to an even more expansionary 56.6. This report was a bit of a disappointment, showing perhaps some growing weakness in the service sector, which has been the engine of the U.S. economy over the past several years, offsetting manufacturing which has sputtered.

(0) **Construction spending** in November rose 0.4%, just below the 0.6% rise expected, but included several revisions upward for prior months. All growth came from private construction, with residential up a percent, and non-residential up a few tenths; this offset public spending, which declined in both residential (-2%) and non-residential. However, as construction costs rose 1% in the month, the ‘real’ spending result was a net decline.

(0) The **JOLTS** government job openings indicator for November saw a decline of -62k to 8.790 mil., below the 8.821 mil. level expected. The largest gains took place in construction (43k), financial (38k), and ‘other services’ (29k); declines were most dramatic in leisure/hospitality (-97k), government (-35k), and professional/business services (-33k). On the additive side, the job openings rate was unchanged at 5.3%, while the hiring rate fell by -0.2% to 3.5%. In departures, the quits rate fell a tenth to 2.2%, while the layoff rate was unchanged at 1.0%.

(+) **Initial jobless claims** for the Dec. 30 ending week fell by -18k to 202k, below the 216k median forecast. Continuing claims for the Dec. 23 week fell by -31k to 1.855 mil., well below the consensus forecast of 1.881 mil. Claims were largest in the largest states, as would be expected, with little sign of layoffs or labor market changes, although seasonal distortions are likely still present. These remain within the recent range.

(+) The employment situation report for December came in far better than expected, continuing to keep an assumed normalization downward at bay. **Nonfarm payrolls** rose by 216k, surpassing the median forecast of 175k. However, payroll gains for Oct. and Nov. were revised down by -71k in total, offsetting that somewhat (and serving as a reminder of the large standard error for the initial payroll series each month, despite it being watched so closely by markets). For Dec., gains were seen in government (52k, mostly in local), health care (38k), social assistance (21k), and construction (17k). On the other hand, transportation/warehousing jobs fell (-23k), while leisure/hospitality (40k), retail (17k), and professional/business services (13k) saw little change statistically. The boost was seen as due to milder than normal winter weather to some extent, as well as continued demand for skilled workers.

The **unemployment rate** held steady at 3.7%, rather than rising by a tenth as was expected, while the U-6 underemployment rate rose a tenth to 7.1%. These were affected by a nearly -700k drop in household employment, offset by a similarly-sized drop in the labor force. **Average hourly earnings** rose by 0.4%, the same pace of the prior month and a tenth better than consensus. Year-over-year, earnings ticked back up a tenth to 4.1%, rather than drop a tenth as was expected. The **average workweek length** fell by a tenth to 34.3, below expectations of no change.

(0) The **FOMC minutes** from the December meeting looked a bit dovish at first glance. The key comment was that members viewed the current Fed funds level as “likely at or near its peak for this tightening cycle.” This was about as definitive as the Fed gets, but they also noted that it would be appropriate to remain at a restrictive level until inflation met their target. This provides some wiggle room should core PCE inflation remain persistently above 2% into next year or rise for unforeseen reasons. Trailing 3-month core PCE readings have been at target-like pace since last summer, which points to an evolution in policy to at least neutral, if not easing to some extent to normalize policy, or further should economic weakening warrant it. Then again, risks of keeping rates too high for too long were also acknowledged, which shows a better balance of risks the Fed has been looking for.

Market Notes

Period ending 1/5/2024	1 Week %	YTD %
DJIA	-0.56	-0.56
S&P 500	-1.50	-1.50
NASDAQ	-3.23	-3.23
Russell 2000	-3.73	-3.73
MSCI-EAFE	-1.26	-1.26
MSCI-EM	-2.09	-2.09
Bloomberg U.S. Aggregate	-1.20	-1.20

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

U.S. stocks began the new year on a sour note, resulting in the first negative week in months. Largely, this was due to rising expectations for rate cuts happening soon perhaps being overdone. Since stocks have moved essentially straight up over the last few weeks, a bit of a pullback wouldn’t be too surprising, which occurred. By Friday, market sentiment pulled back again in response to the stronger-than-expected employment report, which some thought could lower the odds of the Fed cutting rates anytime soon. However, this was offset by an ISM services report coming in at the edge of expansion may have offset that somewhat. Economic data continues to come in showing mixed results, leaving investors without clear direction.

By sector, defensive health care and utilities saw gains of roughly 2%, followed by energy up a percent along with a rebound in oil prices. Laggards included technology and consumer discretionary, down -4% and -3% respectively, with the former led by a downgrade in Apple shares. Real estate also fell back by -2% as interest rates ticked back higher. Earnings season for Q4 this coming week, with fairly tempered expectations (year-over-year growth for the S&P at just over 1%, per FactSet). This appears to be due to some strength having been pulled forward into Q3, where initial expectations for a slight decline in earnings growth ultimately morphed into near-normal actual growth of 5%. Estimates for 2024 are far better, and seem to reflect either a soft landing scenario, or a quick/minor recession and robust recovery.

Foreign stocks in both developed and emerging markets lost ground, similarly to domestic stocks, with declines smallest in the U.K. in dollar terms; Japan gained a percent in yen but fell back when converted back to the stronger dollar. Inflation picking up by a half-percent in Europe didn't help sentiment. As in the U.S., geopolitical concerns appeared to also contribute to the pullback, particularly in emerging markets. This included continued escalation of shipping attacks in the Red Sea—a key route for global commerce—as well as remarks from China in regard to hopes for a reunification with Taiwan. Upcoming elections in Taiwan in about a week are being watched closely, due to opposite philosophical stances on the China relationship—one favors closer Chinese ties, while the other stands on the pro-independence side.

Bonds fell back by about a percent across the board, as yields ticked higher along with the falling rate cut hopes. Senior bank loans outperformed, with flattish results. Foreign bonds fared worse, as the U.S. dollar rose by over a percent.

Commodities were mixed last week, with energy seeing gains while metals and agriculture declined. Crude oil prices rose 3% last week to $74/barrel, on the heels of still-rising Middle East tensions in the Red Sea shipping zone. Oil begins the year within its trading range of the past year and a half—roughly between $65 and $85. There are some assumptions that the U.S. would begin to refill the Strategic Petroleum Reserve at the cheaper end of that range, which could provide a bit of a floor to pricing, offsetting any continued weakness from higher supplies and perceived lack of demand as the global economy slows in 2024.

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.