Summary

Economic data for the week included a minimal revision downward for 4th quarter U.S. GDP growth, strong personal income results and continued decelerating PCE inflation, stronger home prices and new home sales, but weaker durable goods orders and ISM manufacturing data.

Global equities saw gains, led by continued strength in the U.S., with sentiment prompted higher by restrained inflation. Bonds fared well for the same reasons which produced falling yields. Commodities gained as well, led by energy supply considerations.

Economic Notes

(+) The second report of **U.S. GDP** growth for Q4 showed a slight downward revision of -0.1% to a still-robust annualized 3.2%. However, under the hood, upward revisions were seen in personal consumption (by two-tenths to 3.0% growth), capital expenditures, government spending (by 0.9% to 4.2%), and residential investment (by 1.8% to 2.9%), while inventory and net exports were revised down. Inflation measures were also revised up a bit, with headline PCE up two-tenths to an annualized 1.8%, and core PCE up slightly to an annualized rate of 2.1%, although that remains right around the Fed's target level. The GDP deflator was revised up similarly to an annualized 1.6% for Q4, but changed minimally year-over-year at 2.6%.

In looking at the Atlanta Federal Reserve's GDPNow model, Q1-2024 growth expectations decreased by about a precent to a rate of 2.1%. This was similar to the Blue Chip economist survey median expectation of 2.0% (within a band of top high and low estimates of about 1.0% to 2.5%). Underlying the Atlanta Fed's model, personal consumption continues to be the bright spot (contributing 1.5% to the total figure), followed by government spending (adding 0.4%), with other categories showing minimal growth on net. In general, growth continues to run hotter than many economists have expected, causing recession fears to also abate sharply. There are signs of some easing around the edges, with perhaps slower spending on services, but this could be offset by the destocking cycle in manufacturing seeing stabilization. Combined, this has so far provided the rare 'soft landing' environment.

(+) **Personal income** rose 1.0% in January, more than twice the median forecast of 0.4%, with a seasonal gain in wages and also rental income and transfer receipts. **Personal spending** rose 0.2%, on par with expectations. Consequently, the personal saving rate ticked up a tenth to 3.8%. The PCE price index rose 0.3% on a headline level and 0.4% on the core side, removing food and energy. However, core PCE ex-housing rose 0.6%, which appeared to be due to some new year seasonal effects, including higher insurance costs. Year-over-year, the PCE headline and core indexes decelerated to 2.4% and 2.9%, which has provided inflation-watchers with some relief that progress continues to be made.

(0/-) The **ISM Manufacturing Index** for February fell by 1.3 points to 47.8, representing the 16th straight month of contraction, in contrast to an expected small rise to 49.5. The underlying composition was even weaker than the headline, with new orders and production falling back from expansion into contraction, while employment fell further into contraction in the mid-40s. On the positive side, supplier deliveries ticked up to just above neutral, while prices paid moderated by a fraction of a point but remain in expansion at over 52. This report was somewhat negative, as it negated hopes for a continued recovery upward over the past several months, although poor weather likely played a role. At the same time, conditions were not radically worse, but perhaps enough so to help the Fed with a rationale for easing rates. As with goods vs. services, sectors within the manufacturing group are also mixed, with strength seen in tech-related areas, such as semiconductors and artificial intelligence-related data build-out, as well as supply-chain rebuild, while other segments have fared less positively, such as consumer durables.

(-) **Construction spending** for January declined by -0.2%, contrary to the median forecast of a 0.2% rise, although spending for the two prior months was revised up slightly. Public residential spending rose by nearly 2%, offset by a drop in public non-residential, down -1%, with private spending little changed on the month.

(-) **Durable goods orders** fell -6.1% in January, slightly exceeding the -5.0% drop expected by consensus, and the largest drop in about four years. Removing transportation, the decline was trimmed to -0.3%, while core capital goods orders rose by 0.1 for the month. Non-defense aircraft orders pulled down the broader data, being down -60% (although it's a volatile and lumpy series month to month), in addition to a decline in communications equipment. On the brighter side, defense capital goods rose 24% and computers rose 6%. Core capital goods shipments rose 0.8%. On a year-over-year basis, durable goods orders were down -1%, while shipments were up 2%. The past year was driven higher by computers/related products (such as CHIPs Act-driven investment), with aircraft as a headwind. This type of report remains a mixed bag for economic activity, showing a continued rift between various sectors.

(0) The **S&P Case-Shiller** 20-city home price index rose 0.2% in December, meeting expectations. Of the reporting cities, 13 of 20 saw gains in the month, led by Las Vegas, LA, and Miami, all up 0.5-1.0%, while prices in Portland fell by -0.2% on the downside. Year-over-year, the national index rose 6%, continuing a strong run of house price gains broadly.

(0) The **FHFA home price index** rose 0.1% in January, which was a few tenths below expectations. Monthly results were led by the South Atlantic region (MD south to FL), while West North Central (MO north to ND) saw a decline of nearly a percent. Year-over-year, the index rose 6.6%, led by double-digit gains in New England during the period. With a broader and less urban footprint than the Case-Shiller index, this continues to show decent home price growth, especially on a real after-inflation basis, helped by tight inventories and below-average transaction activity.

(+) **New home sales** rose 1.5% in January to a seasonally-adjusted annualized rate of 661k units but lagged the 3.0% increase expected. This was coupled with a revision downward for Dec. of about -13k units. Regionally, the West saw strong sales gains, while the South experienced a sharp decline; the national disparity appeared to be due to weather, which is not uncommon during the winter months. Sales are up 2% from a year ago, while the median sales price has fallen -3% from last year to $420,700, which is down -15% from 2022 peak levels. However, the average sales price (naturally top-heavy) is up 8% from last year to $534,300. Inventory stands at 8.2 months' supply. New home sales continue to run below new housing needs, based on demographic and normal frictional replacement rates, even with some recent easing in financing rates, with affordability remaining a significant issue.

(-) **Pending home sales** fell by -4.9% in January, in a reversal of gains the prior month and in contrast to an expected increase of 1.5%. This brought the year-over-year rate down to -7%. For January, the Northeast and West saw minor gains of 0.5-1.0%, while pending sales in the Midwest and South fell 7-8% each. In typical fashion, this series tends to predict existing home sales a few months out.

(-) The Conference Board **index of consumer confidence** for February fell by -4.2 points to 106.7, well below the 115.0 expected, including a downward revision of -4 points for January. While expectations for the future fell by -2 points, assessments of the present situation fell by -8 points. The labor differential, measuring the ease in finding jobs, fell by -4 points, with jobs 'hard to get' seeing a rise, although still at a very low level (13%). Consumer opinions about a forthcoming recession in the next year rose a bit as well. Generally, consumer sentiment has remained well below the reality of strong economic performance over the past year, as folks seem to be waiting for the other shoe to drop.

(-) **Initial jobless claims** for the Feb. 24 ending week rose by 13k to 215k, just above the 210k median forecast. Continuing claims for the Feb. 17 week rose by 45k to 1.905 mil., above the consensus estimate of 1.875 mil. CA saw a surge in claims, which are likely weather-related, with little pattern elsewhere.

Question of the Week

What is the status of the interest rate pause vs. easing argument?

This has been the question of the year so far, but the answer seems to change by the week. The focus has been on the U.S. Federal Reserve's policy, but the same question is being wrestled with in Europe and the U.K. Each data point for inflation, growth, and jobs, as well as each central banker speech or Q&A session, has been moving the needle in one direction or the other for very sensitive financial markets. It might help to look at the three policy options, focusing on the U.S.

Firstly, raising rates further seems to be off the table, with the last hike in July 2023 and Fed hinting at being done with this cycle, barring any surprise. That hasn't stopped some economists like Larry Summers from assigning another rate hike a small probability (of just 15%), based on the strong January CPI number.

Keeping rates paused, pointing to a later start date for rate cuts, is reliant on inflation remaining stickier and economic growth and employment remaining stronger for longer. The premise is that a strong economy generally doesn't need rate cuts, which, conversely, could potentially just fuel more inflation, and act as an engine for even higher, above-trend growth. This type of over-stimulation could end up in asset price 'bubbles' that create deeper problems down the line. Holding the line on rates allows the 'long and variable lags' of higher rate policy done thus far to continue to hammer away at the economy.

Lastly, the narrative behind rate cuts is based on one of two sub-plots. (1) Insurance cuts would be intended to ease the policy down gently, by a quarter-percent at a time most likely, with the 'tightness' in policy to fight inflation no longer deemed necessary. This would be due to inflation slowing on its own, and likely economic growth also moderating gradually back toward long-term trend (around 2.0% or so). This coincides with the 'soft landing' scenario that seems to be the base case this year, but historically has been so hard to achieve. Or, (2) recession-based cuts would be in response to growth falling off more sharply into recession, requiring dramatic central bank action to boost the economy back to health. Inflation has tended to fall naturally during recessions, along with lower levels of buying demand and excess supply, so it's assumed that part of the mandate would take care of itself. (This is absent an episode of 'stagflation,' which is slow growth coupled with still-high inflation, per the 1970s experience, which makes policy choices more complicated. This has remained a behind-the-scenes potential worry of some economists.) In the recession scenario, rate cuts tend to be quicker (maybe -0.50% at a time, for example) and deeper (e.g., along the lines of 2-3% in total cuts). A higher starting point of over 5% gives the Fed more ammunition for that scenario, a luxury they didn't have a few years ago.

Which of the mainstream scenarios—longer pause, insurance cuts, or recession cuts—takes place remains up in the air. The Fed, ECB, and BOE remain data-dependent as January inflation vs. growth inputs have been mixed and haven't provided the clear-cut guidance a policy maker would hope to have. By default, a wait-and-see approach pushes cuts from Spring 2024 more toward mid-2024 at least.

In an election year especially, politicians tend to favor rate cuts, as they juice the economy and reduce the chances of a recession in the near-term, making voters happier, but to the potential detriment of the economy down the road. One commonly-accepted political maxim is that a recession tends to be one of the worst conditions possible for incumbent officeholders ("It's the economy, stupid."). Though, even if central banks succumbed to these whims, with the election cycle being every two years, the result would be perpetually low rates. This is why central banks in the developed markets tend to be so protective of their independence. Many emerging markets have improved on this front as well, seeing the benefits of stable non-political policy, with occasional hiccups leading to policy errors that can be economically very damaging.

Market Notes

Period ending 3/1/2024	1 Week %	YTD %
DJIA	0.00	4.09
S&P 500	0.99	7.97
NASDAQ	1.76	8.55
Russell 2000	3.00	2.62
MSCI-EAFE	0.72	3.23
MSCI-EM	-0.30	0.27
Bloomberg U.S. Aggregate	0.47	-1.30

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
2/23/2024	5.46	4.67	4.28	4.26	4.37
3/1/2024	5.42	4.54	4.17	4.19	4.33

U.S. stocks continued a trend of gains last week, with small caps outgaining large caps. ‘Growth’ again outperformed ‘value,’ with optimism over artificial intelligence continuing to drive near-term sentiment. By sector, technology and consumer discretionary each gained over 2%, followed by increases in energy and materials. By contrast, defensives health care, utilities, and consumer staples lost ground. Real estate also rose several percent along with falling yields.

A government shutdown was averted last week, with spending bills punted into mid- to late-March. Additionally, the cooler PCE inflation report helped markets breathe a sigh of relief, with weaker ISM manufacturing results boosting hopes for lower rates. Interestingly, as the U.S. stock market hits new highs, a variety of high profile shareholders/founders have been trimming their stakes in their firms—these include Amazon, JPMorgan, Meta, and Walmart. This likely coincides with higher overall U.S. equity valuations but could be due to company-specific idiosyncrasies as well.

Foreign stocks earned gains, led by Japan and Europe, but underperformed U.S. equities, with negative returns from the U.K. and emerging markets. European sentiment was held back a bit by stronger-than-expected inflation and falling economic sentiment.

Bonds gained along with yields falling back last week, along with the PCE inflation and weaker manufacturing data. U.S. Treasuries outperformed investment-grade corporates and high yield, which in turn outgained floating rate bank loans. Corporate spreads widened a bit with the headwind of record-breaking debt issuance levels during the week. Foreign emerging market debt saw gains as well, despite little change in the U.S. dollar.

Commodities rose across the board last week, led by gains in energy and precious metals. Crude oil rose over 4% to $80/barrel, along with markets waiting for an OPEC+ decision about voluntary production cuts this coming week. Natural gas also spiked by 8% with lower inventory results and uncertain upcoming production rates.

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.

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