RFG Market Update: February Edition

We hope you're doing well as the new year progresses! Today's message brings us back to focusing on the markets, so please read on and feel free to reach out to your team at RFG to discuss or revisit your own planning needs.

Broad market index and tech stock investors were in command throughout January, even as the month ended with a Federal Reserve (Fed) meeting taming some potentially over-enthusiastic March rate cut bulls.

With the tech and major market index rally continuing its run since November, I thought now would be a good time to inform you of the latest developments set to impact Americans in the month ahead.

Major Stock Indexes

January was good for long-term investors in U.S. stocks, especially in megacap tech with AI exposure. Market bulls were cheering the prospects of a more accommodating Fed in 2024, with the rate decision and Fed statement happening on the last day of the month.

For the month of January, the S&P 500 added 1.59%, the Nasdaq 100 tacked on 1.82%, and the Dow Jones Industrial Average rose by 1.22%.

Mixed/Slowing Inflation Signals

The overall trend for inflation was mixed in January, even as Consumer Price Index (CPI) data came in a bit hot.

CPI: The December Consumer Price Index showed a 0.3% monthly increase in December and a 3.4% increase versus one year ago. Estimates were for a 0.2% monthly gain in December and a 3.2% gain year-over-year. Shelter and services pricing remained sticky.

PPI: For December, the Producer Price Index report came in below expectations, indicating mixed signals on the inflation front.

According to the report, wholesale prices declined by 0.1% month-over-month in December, lower than the expected gain of 0.1% estimated by Dow Jones economists.

PCE: According to the most recent Core Personal Consumption Expenditures (PCE) release, the rate of price increases slowed down as 2023 came to a close.

The Fed's preferred inflation indicator showed that prices were higher by 0.2% month-over-month in December and by 2.9% year-over-year. Dow Jones economists had expected respective increases of 0.2% and 3%.

However, digging a little deeper and looking at the three and six-month averages of Core PCE on an annualized basis, we see it running under 2% (the Fed's Target is 2%).

This data, noted by former Vice Chair of the Federal Reserve Lael Brainard and provided by the Bureau of Economic Analysis, has inflation watchers cheering the current market environment.

Fed Put?

In plain English, a "Fed put" means that the Fed is standing by to change policy if needed, should the equity markets experience declines.

At present, it feels like there are the makings of a Fed put under the market. If storm clouds arise, the market is expecting the Fed to "come to the rescue" with rate cuts in 2024 if needed.

The market was expecting six rate cuts in 2024 before the January Fed meeting, even though the economy has been performing well as of late. This outlook is not the norm. Historically, rate cuts are seen in struggling or downtrodden economies that need stimulation.

The January Fed meeting tempered expectations for a March rate cut, with probabilities declining from 50% to 35.5% on January 31. However, it is still early in this election year.

This idea of a Fed put is a concept, not a guarantee, and seemed to be on the mind of many market participants at the start of February, indicating that the collective market mindset could be that any pullbacks may be short-lived.

Treasury Yields Steady in January

The widely monitored 10-year Treasury note yield was close to unchanged for the month of January, closing the month near 3.966% — about 10 basis points higher than December’s closing level near 3.865%.

January marks two consecutive monthly closes below 4.00% in the 10-year yield.

The steadiness in rates is good news for sidelined prospective mortgage borrowers and great news for long-term investors in U.S. equities.

Fed Rate Decision

The last day of January gave us the first Fed meeting of 2024, as the Fed left interest rates unchanged in line with market expectations.

There were some changes to the Fed’s statement, however, as Federal Reserve Chair Jerome Powell seemed to want to tame the market’s excitement for a March rate cut.

“I don’t think it’s likely that the committee will reach a level of confidence by the time of the March meeting to cut rates," Powell said.

The verbal statement indicating that a March rate cut is not likely poured some water on the fire of potentially overly enthusiastic stock market bulls as the major averages pulled back during and after Powell’s commentary.

Powell did signal rate cuts at some point in 2024, however.

"It will likely be appropriate to begin dialing back policy restraint at some point this year," said Powell.

Consumer & Employment Strong

Consumer health metrics remained strong during January, even as many analysts expect the consumer to “tap out”.

At the same time, labor market data exceeded expectations for December, showing 216,000 jobs created. Government jobs and health-care-related fields led the way.

Starting the month of February, the latest employment report blew away all expectations, showing [353,000 jobs] created in January versus 185,000 estimates by Dow Jones. The labor market continues to surprise to the upside, and the market reaction was an interesting one.

January Labor Data Market Reaction

While the massively better-than-expected January jobs data indicates a stronger economy, it also shows that the economy may still be running hotter than the Fed wants to see. This reinforces the logical probability that a March rate cut could be off the table.

Major U.S. stock indexes didn’t seem to mind, though, as they cheered the data by trading to the upside on the day of. The jobs report was released the morning after positive earnings results from Meta (Facebook), Microsoft, and Amazon. So, perhaps this earnings effect outshined the March rate cut odds everyone seemed to be so fixated upon just a day before.

The probability for a March 25-basis-point cut was all over the place at the end of January and beginning of February, resting at a 20% chance on February 1 after sitting at a 46.2% chance on January 26th, according to the CME FedWatch Tool.

Is the economy still too hot? What do the continuing and massive upside surprises in the job market mean for inflation?