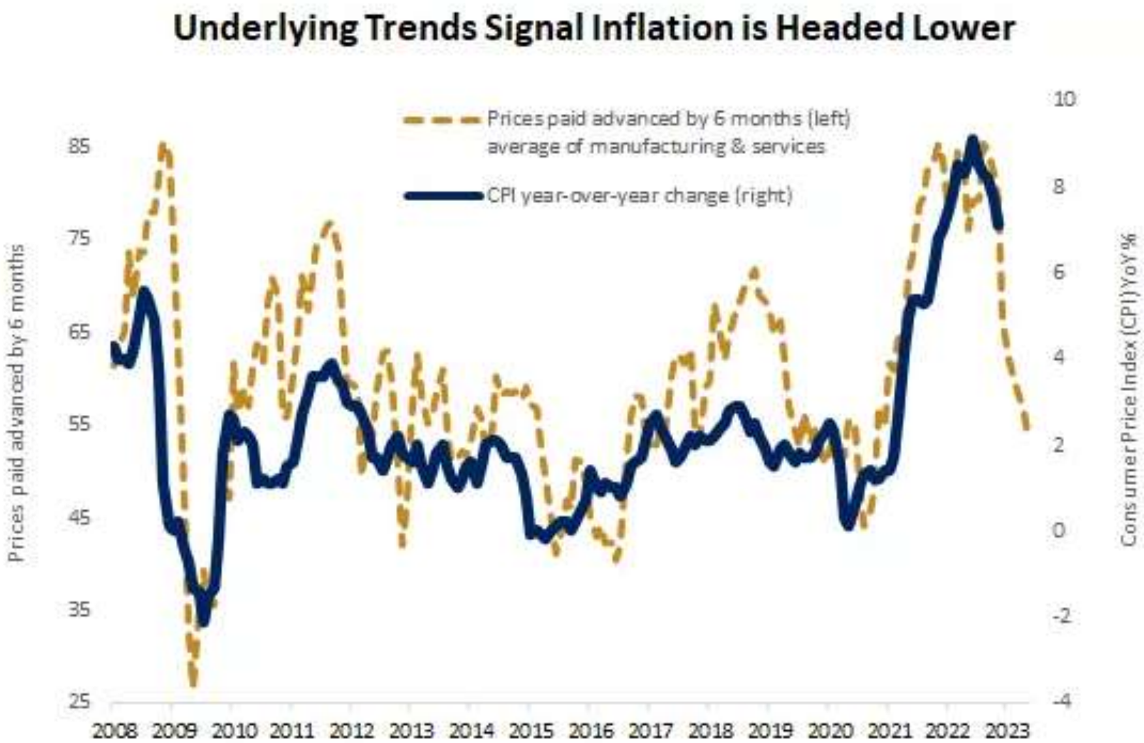
Monday, February 6, 2023

Good morning:

As expected, last week had more than its share of market-moving data points in what was another positive week for the S&P 500 and a particularly strong week for the growth stocks in the NASDAQ. In a shift from more recent value stock leadership, the NASDAQ added 3.3% for the week in spite of a mixed bag of large tech company earnings, while the Dow actually declined 0.2%. Despite being in the heart of earnings season, the Fed announcement and the labor report were perhaps of even more importance.

Since monetary policy reacts with significant lag, it is not surprising that many renowned economists have been critical of the Fed's aggressive stance towards taming inflation. Some were pleased to see their decision to dial down last week's hike to 0.25%, but others believe they have already been too aggressive and will soon have to face the consequences in the form of a recession. For now though, equity investors and traders reacted positively and drove stocks higher on the Fed's decision and accompanying remarks. Since their comments did try to directly target growing optimism, many feel we are now likely nearing the end of this tightening cycle.

However, inflation is still evident in many of our daily purchases. While some prices have pulled back from recent highs, they may never return to their levels of just a few years ago. Declining inflation merely refers to the *rate* at which prices increase, not outright price declines. This chart highlights forward looking inflation indicators pointing to continued softening in inflation pressures. Since the Federal Reserve continues to target a 2% rate of annual inflation, time will tell whether the current declining rates will plateau before reaching their target.



Source: Bloomberg

Friday's labor report had something for both bears and bulls, depending on its interpretation. On one hand, the economy added a whopping 517,000 jobs last month, more than double consensus forecasts. The unemployment rate fell to 3.4%, a level not seen since 1969. The same report revealed that average hourly wage growth declined in January to 4.4% from 4.8% in December. While this may not sound like a positive development, it may be precisely the thing that calms the Fed's concerns that aggressive wage growth pressures inflation.

In just a few months, and particularly since the start of this year, both stocks and bonds have staged an impressive rebound off their multi-year lows. With the Fed still hiking, and earnings outlooks just starting to come down, is such a move higher warranted? Well, that all depends on whether the economic slowdown/contraction is more of the mild or typical variety, or something more severe and protracted. Clearly last week's action suggests many were betting on the former. We remain cautiously optimistic – cautious about the many risks and unknowns that remain in the short run, but optimistic that a new fundamental bull market will materialize after the Fed is done raising rates and inflation is back to more normal levels. The coming months are likely to remain volatile while further potentially conflicting information is released and digested.

As we mentioned last week, 1099s will start to be issued next week in three waves through March 15th. Be sure you have your 1099s for each and every account that issued one before completing your income tax returns. We are here to help you if needed!

Have a great week!

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