Weekly Market Insights

January 16, 2024

Markets Take a Break

Financial Markets

Financial markets recouped some of their losses after falling the first week of the year. The S&P 500 increased by 1.84%, the Dow Industrials by 0.34% and the tech-laden NASDAQ by 3.09%. It is reasonable to expect investors to step back a bit and see what they have wrought. The market was driven higher by a year-end gift from Jerome Powell and the Federal Reserve. Investors dove into the market when Chairman Powell communicated that the hiking cycle had likely come to an end. Despite Fed officials projecting three rate cuts in 2024, the market currently has over six priced in. Perhaps investors are coming to the realization that their rate cut expectations are somewhat Herculean. It should be a pleasant relief to investors that the Fed feels inflationary pressures have diminished enough to make that significant of an announcement, but, clearly, there are other issues that should perhaps temper but not end investors' enthusiasm.

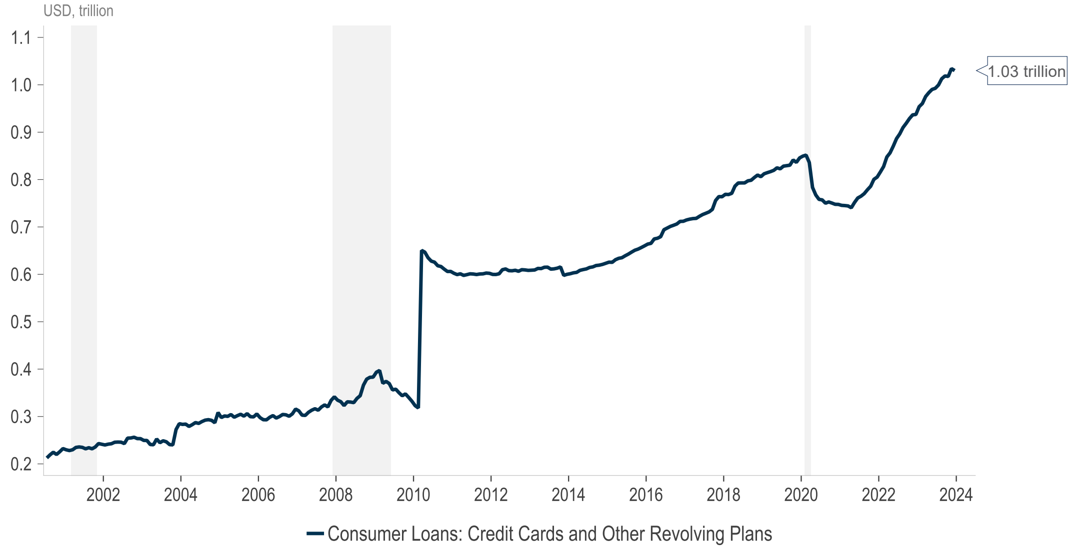
The Economy

We wrote last week about the positives outcomes that may be possible for the U.S. in the intermediate- and long- term, but, of course, these do not exist in a vacuum. There are competing dangers that investors should be aware of, both global and domestic. The wars in Ukraine and, most recently, the Middle East both have the capacity to expand into larger and more widespread engagements. We hesitate to comment as far as the Ukraine-Russia and Israel-Hamas wars are concerned, but it cannot be good for the U.S. or global economies. Beyond the human tragedy, the wars have already disrupted energy markets

The St. Louis Fed recently produced a chart of consumer credit card debt which surpassed a record $1 trillion dollars. This is a worry, but it is mitigated by the fact that personal incomes have grown at a faster rate than outstanding credit card debt. It is an interesting lesson in balance.

Consumer Loans

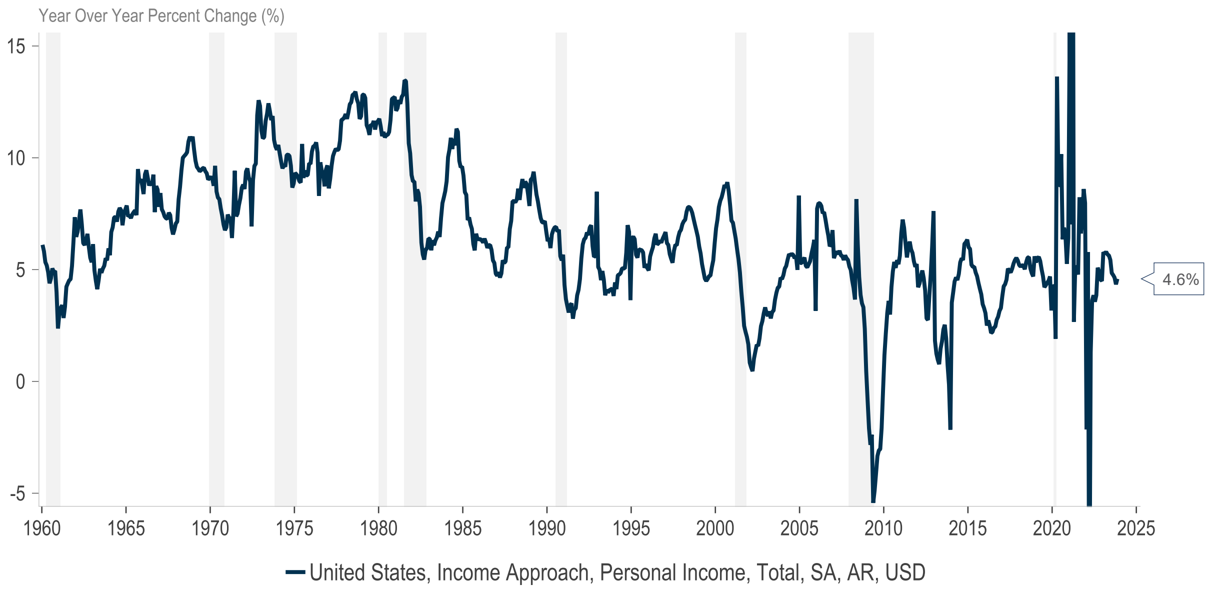
Credit Cards and Other Revolving Plans, All Commercial Banks



Recessions indicated by shaded area
Federal Reserve, Billions of U.S. Dollars, Seasonally Adjusted
Weekly data available from 2000 Q2 to 2024 Q1, last released on Friday, January 12, 2024

Personal Income Growth

Income from All Sources



Recessions indicated by shaded area
U.S. Bureau of Economic Analysis (BEA), Personal Income & Outlays, Seasonally Adjusted Annual Rate
Monthly data available from January 1959 to November 2023, last released on Friday, December 22, 2023
Vertical axis truncated to improve scaling so outlier values may not be visible on chart

Another imbalance is a more serious problem, but further into the future. Americans are undersaving for retirement. We have written about this in the past, and, while it is not something that is an immediate danger, it is looming in the future. This is certainly something that can be fixed, but it won't be if not publicized.

We can't leave the discussion of debt without looking at the debt of the government. Addressing the growing debt problem has become an awful political topic for years. The biggest reason the U.S. debt has expanded so significantly is the stimulus spending that took place during the pandemic. Perfectly reasonable, but how to resolve it? The first thing that most all economists will agree on is to curtail the spending associated with the pandemic. After that, it becomes more politically contentious. The current problem is political. There is a small group in Congress that wants to make drastic cuts in the budget to rapidly draw down the deficit. The danger? A deep recession and a subsequently deeper debt load. Most macroeconomists who study this argue that a better way to address the debt issue is to take a less drastic, longer-term view to budget cuts. Ideally, this method will not cause significant damage to the economy and reduce the debt.

<u>The Great Fall of China</u>

China, as we have written many times, is facing serious economic and political problems. China has such a long and fascinating history that it is tempting to describe its problems in dynastic terms. But, in this case, it is both easier and more accurate to discuss it in a much shorter time period. We wrote a while ago that, just as Japan was the economic miracle of the 20th century, China began as the

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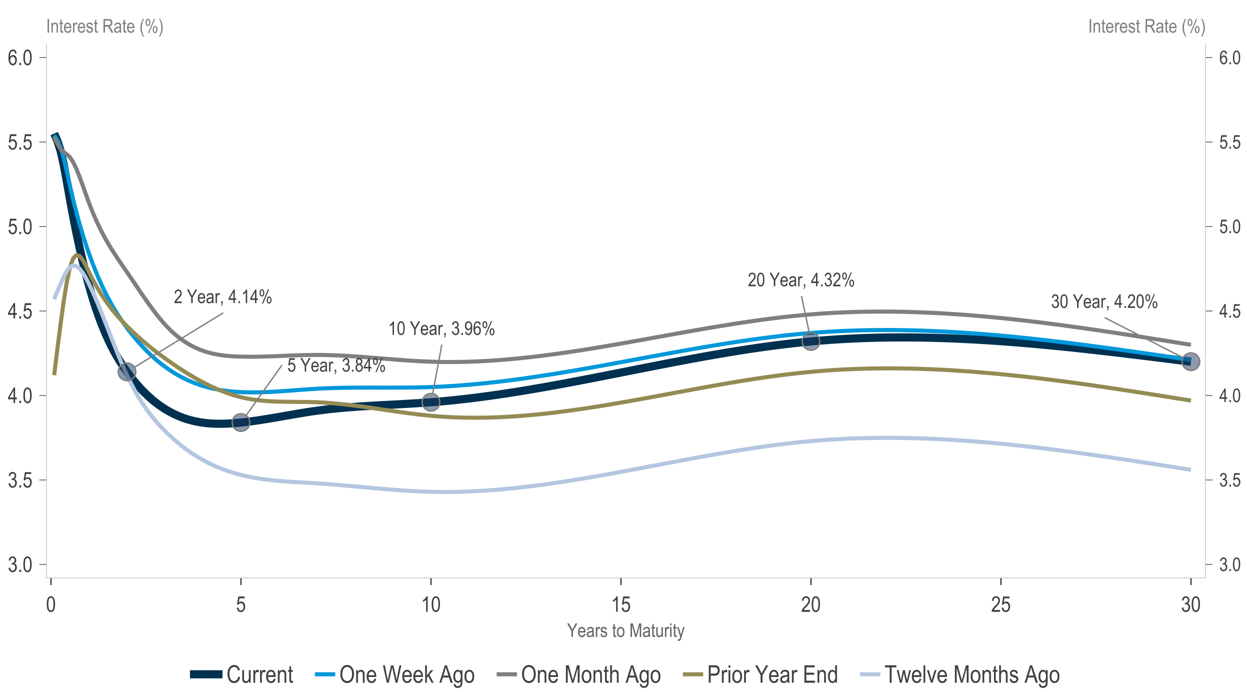
economic miracle of the 21st. They followed similar paths, familiar to many developing countries, and built an export-oriented economy and were less focused on domestic demand. This, along with using government sponsored debt to spur both domestic growth (i.e. real estate) and build political influence abroad (i.e. the Belt and Road initiative), China wound up with an economy less supported by domestic private consumption. One very important difference between Japan and China is political. China, being a dictatorship, particularly under Xi, developed such entrenched interests that made it almost impossible to change. Of course, China has more problems than this, but its political structure makes it very difficult to correct course.

Conclusion

All of the above sounds like a recipe for economic disaster, just as last week sounded like nirvana. Neither is a forecast nor a prediction, but we are just drawing attention to what outcomes could occur. Our long-term view leans positive. The Fed has done a good job, and we don't think they will go off the road at this point. It is impossible to know what will occur in the Middle East, but we don't think any of the Arab nations want this to escalate. Domestically, the most immediate problem is political. We have faith that the House will not allow a default, but mistakes happen, and nothing is a sure bet. In an election year, no one, Republican or Democrat, wants to appear to have caused an economic crisis. As the year moves along, it will be fascinating to see how markets react to the increasingly volatile rhetoric.

Yield Curve

Interest Rates for U.S. Treasury Securities by Maturity Date



U.S. Department of Treasury, Daily Treasury Bill Rates Data
Data as of 1/12/24

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