MARKET WRAP MINUTE

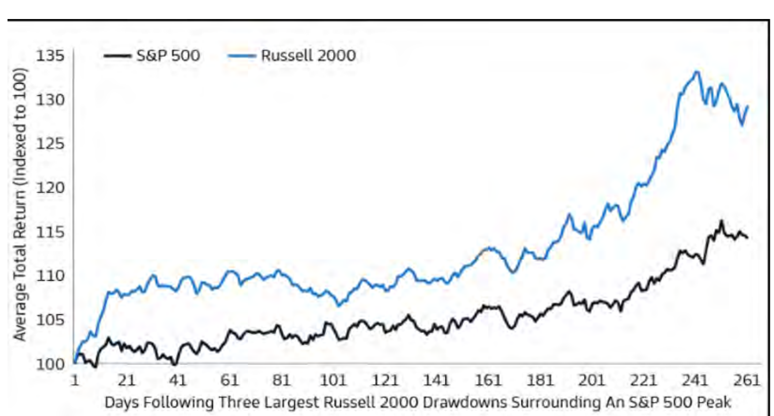
WEEK OF JANUARY 29, 2024

MARKET MENTIONS: Capping Off the 1st Month of 2024

- Over the past week, investors digested two key datapoints that continue to support the case for a soft landing in the U.S.: The S&P PMI data, for both services and manufacturing, were in expansionary territory in January, and fourth-quarter GDP growth exceeded forecasts, coming in at 3.3% annualized, versus expectations of 2.0% growth. While these datapoints are backward looking, they support the narrative that the U.S. economy may not have been softening entering the new year. In fact, the data indicates that economic growth may have accelerated at the end of last year. Meanwhile, inflation also showed signs of moderation as we entered 2024.
- In addition to strong economic growth, the data over the past week also supported an ongoing moderation in inflation. In the PMI report, the prices-charged index, a measure of inflationary pressures, eased to its lowest since May 2020, coming in at 51.7 in January. This is also down sharply from its recent peak of 74.6 in April 2022. Perhaps even more notable was that core PCE (personal consumption expenditures) inflation data, often considered one of the Fed's preferred inflation measures, came in below expectations for the month of December. In fact, core PCE inflation is now 2.9% year-over-year, below last month's 3.2%, and below 3.0% for the first time since 2021. The ongoing moderation in inflation, despite above-trend economic growth, has led to optimism that the Federal Reserve may be able to start cutting policy rates rapidly this year to return to more neutral rates.
- Investor focus will soon shift to the Federal Reserve meeting on January 31, where the Fed is expected to keep interest rates on hold at 5.25% - 5.5%. The better inflation data over the past week certainly highlights less of a need for the fed funds rates to remain in very restrictive territory. While markets are currently pricing in about six Fed rate cuts in 2024, the Fed's own "dot plot" from its December meeting possibily indicates about three rate cuts ahead. However, the market probability of a March rate cut has come down in recent weeks, to around 50%, with rate cuts now expected in the June through December meetings.
- In our view, the Fed may use the January meeting to acknowledge the progress on both growth and inflation, but still push back somewhat on the aggressive rate cuts priced into the market. We see three to four rate cuts likely in 2024, perhaps starting closer to June, as core inflation continues to moderate. More broadly, we believe that the Fed may prefer to move rates lower gradually to monitor the impact on the economy and ensure inflationary pressures continue to ease. If the Fed were to do six or more rate cuts, this may indicate that the economy has slowed substantially, and if it were to enact two or fewer rate cuts, this could indicate that inflation has reemerged. Thus, we see three to four rate cuts in 2024 as perhaps a balanced approach to moving rates back to neutral over time.
- Historically, when the Fed begins a rate-cutting cycle and the economy is not in a recession, markets tend to have better performance. Since 1990, the average 12-month return after the first Fed rate cut, in periods of no recession, has been around 7.6%, versus just a 0.5% return in periods of recession. Given the recent strong economic data in the U.S., we see mounting evidence of a soft landing in the economy emerging in 2024, which may bode well for market returns as the Fed pivots to rate cuts.
- We believe some of these positive market returns may have been pulled forward last year. That robust return in part reflected enthusiasm around artificial intelligence (AI) and in part reflected an economy that showed resilience, despite a relentless Fed rate-hiking cycle. Nonetheless, the returns last year were driven by a narrow set of stocks and sectors, and we see returns ahead driven by a broader set of market leadership. While these returns will likely not occur in a straight line, particularly after such a strong year-end rally in 2023, we could use market volatility as an opportunity to position for broader leadership in both equities and investment-grade bonds as the Fed embarks on its rate-cutting cycle. As history has shown us, markets may thrive in an environment of easing inflation and Fed rate cuts, especially when the economy lands smoothly.

CHART OF THE WEEK

January 19th marked the first time in history that the S&P 500 hit an all-time high while the Russell 2000 was in a bear market. Historically, large Russell 2000 drawdowns surrounding S&P 500 peaks have been a bullish indicator for both small and large caps, with the former outperforming on average. Attractive valuations, a positive economic outlook, and strong upside potential inform our favorable view on small caps in the year ahead.



Source: Bloomberg and Goldman Sachs Asset Management. As of January 26, 2024

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1801 Dove Street
Newport Beach, CA 92660
(800) 388-9700
www.Compak.com

Moe Ansari is the President, Chief Investment Officer, and founder of Compak Asset Management. With over 35 years of investment experience, Moeez evaluates the markets using industry-leading technical and fundamental analysis.

His professional experience includes options trading, portfolio optimization, futures trading, mutual fund selection modeling and financial risk management. He is a nationally sought speaker and has conducted numerous financial seminars since the 1980s.