

February 26, 2024

Bumps in the Soft Landing

We have noted that economic growth, employment, and earnings have represented a powerful trifecta of positive stock-market drivers spanning 2023 and extending into early 2024. Equally important have been signs of moderation in two key stock-market impediments, inflation and interest rates, so far in 2024.

January data, however, caused some bumpiness in the market and in the soft-landing thesis. January inflation reports and a leading consumer indicator missed expectations, knocking the stock market off its all-time highs in mid-February and breaking a five-week stretch of higher finishes in the S&P 500.

A single data point or two (or three) does not make a trend. But in a stock market that has been priced for perfection, even modest divots in the runway can interfere with the soft-landing thesis. That scenario has enabled investor greed and FOMO to elbow fear and caution aside as major investment drivers.

Inflation: Not So Fast

The all-items consumer price index (CPI) for January increased 0.3% from the prior month, hotter than the 0.2% consensus forecast. Following revision, CPI all-items for December rose at a 0.2% rate, meaning inflation -- supposedly tamed -- actually rose month-over-month for the first time in over a year.

Core CPI (excluding food and energy) for January rose 0.4% month-over-month, similarly one tick above the 0.3% consensus call and the 0.3% reported for December. The annual change in consumer prices also went the wrong way (upwards). All-items CPI for January 2024 rose 3.1% from January 2023, worse than the 3.0% consensus call though down from the 3.4% annual rate in December 2023. The annual change in January core CPI was 3.9%, level with

the December 2023 reading but above the consensus forecast of 3.7%.

The Fed has been consistent in its goal of getting inflation back to a 2% annual rate. Goods prices have started to respond to the Fed's aggressive rate-hiking policy; prices for goods excluding food were largely unchanged in January. But services prices are proving stickier.

Shelter prices are a particular problem. Shelter prices, meaning rent and rent equivalents, comprise about one-third of total consumer spending measured in the CPI. Shelter costs increased 0.6% month-over-month and accounted for more than two-thirds of the monthly increase. Shelter costs were up 6% year-over-year, or roughly double the annual change in all-items CPI.

The producer price index (PPI) draws less attention than the CPI. Producer prices typically take months to trickle down into consumer prices. In the background, the PPI actually had a better story to tell on inflation throughout 2024. But the January PPI also represented a step back in taming prices, even though there is no shelter component in producer prices.

The all-items PPI rose 0.3% month-over-month in January, much worse than the 0.1% consensus forecast and representing meaningful deterioration from the 0.1% decline in producer prices in December. Excluding food and energy, the consensus was looking for core PPI to rise by 0.1% month-over-month, after declining 0.1% for December. Instead, core PPI jumped 0.5% in January. In terms of annual change, all-items PPI was up 0.9% over the past 12 months, better than the 1.0% forecast; but core PPI rose 2.0%, representing significant acceleration from an annualized 1.7% increase as of December 2023.

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ECONOMIC & MARKET COMMENTARY (CONT.)

Both the CPI data on 2/13/24 and the PPI data a few days later caused the stock rally to falter. More meaningfully, both reports sent interest rates higher across the yield curve. By the end of the trading week, the broad consensus of investors had reassessed their expectations for timing of rate cuts by the Federal Reserve.

Heading into the CPI report, and based on the CME Fed Watch tool, the consensus of investors expected the Fed to begin reducing the fed funds rate by May 2024; and the consensus was looking for a cumulative 100-150 basis points (bps) of rate cuts in 2024, enacted over four to six cuts.

As of 2/20/24, the consensus had significantly reduced expectations for Fed accommodative policy in the current year. Only about one-third of investors now believe the Fed will cut rates in May. And not even one-third of investors expect the fed funds rate by year-end 2024 to be 100 bps lower than it is today.

Argus Fixed Income Strategist Kevin Heal entered 2024 with the belief that the Fed would cut rate three times in 2024, and that those cuts would begin no sooner than the July 2024 FOMC meeting. The market now appears to be coming around to Kevin's more-conservative take on the Fed's planned policy moves.

The Consumer Takes the Month Off

January retail sales surprised to the downside, falling 0.8% month-over-month following a 0.4% gain in December. (Note that these numbers are seasonally adjusted to take out the effects of holiday spending.) The consensus had been looking for January retail sale to decline, but only by 0.1%. On a year-over-year basis, retail spending was just 0.6% higher than in January 2023.

The various adjustments that sometimes soften the headline number did not help much this time. Retail sales excluding vehicles were down 0.6%, worse than a forecast 0.2% increase. And sales excluding vehicles and gasoline were down 0.5%, also worse than a forecast 0.2% increase.

The report had some outliers contributing to weakness, such as a 4% monthly decline in sales at building materials and garden stores. The Fed looks at a "control" group of retail sales, which excludes items such as food service, auto sales, gasoline, and building materials. This measure, which is part of the Commerce Department's calculation of GDP, declined 0.4% month-over-month.

Partly due to weakness in the core retail input, the Atlanta Fed's GDPNow tool forecasts first-quarter 2024 GDP at a 2.9% annualized growth rate. That's good, but it is down from forecast 3.4% growth a week earlier.

Consumers are not supposed to take January off. After months of holiday shopping for others, consumers in January have historically spent for themselves on white goods, spanning everything from sheets to washing machines. The slowdown this year may reflect a one-month pause or something more serious, such as tapped-out credit cards.

Conclusion

The industrial economy added to the bumpy-landing thesis. January industrial production declined 0.1%, hurt by a 0.5% decline in manufacturing output. Capacity utilization continued to slide, falling to 78.5% in January 2024 from 78.7% in December 2023. The industrial economy is considered fully engaged when capacity utilization exceeds its long-term average of 80%.

Earnings, on the other hand, continue to surprise to the upside. With about four-fifths of S&P 500 component companies having reported calendar 4Q23 results as of this writing, Bloomberg now estimates 7.0% annual growth in 4Q23 continuing-operations earnings on a blended basis (including both reported and estimated EPS).

Bloomberg went into 4Q23 reporting season showing a blended forecast EPS decline of 1%-2% for the quarter. Other estimate gatherers (Refinitiv and FactSet) similarly changed their forecasts from slight decline to mid-single-digit growth as the actual numbers rolled in. We have noted that the trend in S&P 500 continuing-operations earnings correlates well with the overall trend in the stock market.

We are not going to make too much of data from a single month, but January did have its share of eyebrow-raisers. If weakening economic data carries into March and into quarter-end, the investing environment may become more challenging.

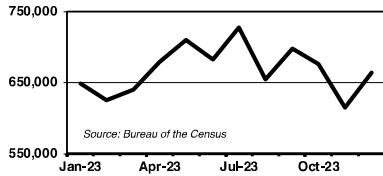
Even after the mid-February setback, stocks remain near all-time highs. Our base case outlook for U.S. markets in 2024 calls for a normal year of S&P 500 returns, in the 8%-12% range. Our year-end target for the S&P 500 is in the 5,200 range.

Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

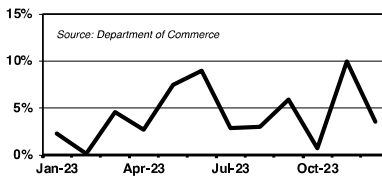
Release: **New Home Sales**

Date: 2/26/2024
 Month: January
 Previous Report: 664000
 Argus Estimate: 670000
 Street Estimate: NA



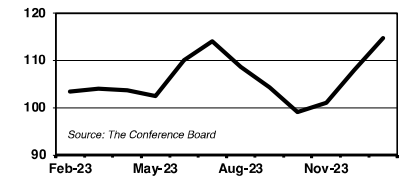
Release: **Durable Goods Orders**

Date: 2/27/2024
 Month: January
 Previous Report: 3.6%
 Argus Estimate: 1.5%
 Street Estimate: NA



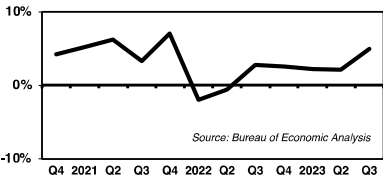
Release: **Consumer Confidence**

Date: 2/27/2024
 Month: February
 Previous Report: 114.8
 Argus Estimate: 114.0
 Street Estimate: NA



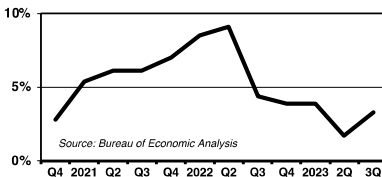
Release: **GDP Annualized QoQ**

Date: 2/28/2024
 Month: 4Q
 Previous Report: 3.3%
 Argus Estimate: 3.3%
 Street Estimate: NA



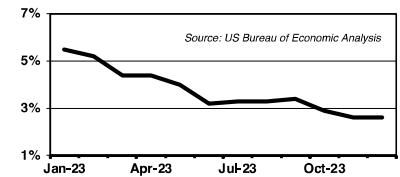
Release: **GDP Price Index**

Date: 2/28/2024
 Month: 4Q
 Previous Report: 1.5%
 Argus Estimate: 1.5%
 Street Estimate: NA



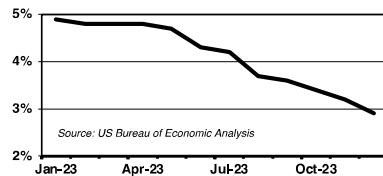
Release: **PCE Deflator**

Date: 2/29/2024
 Month: January
 Previous Report: 2.6%
 Argus Estimate: 2.3%
 Street Estimate: NA



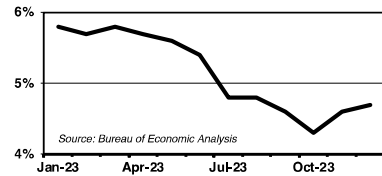
Release: **PCE Core Deflator**

Date: 2/29/2024
 Month: January
 Previous Report: 2.9%
 Argus Estimate: 2.8%
 Street Estimate: NA



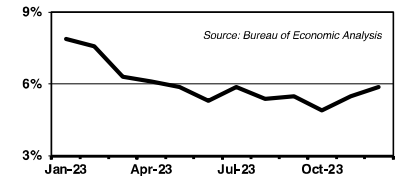
Release: **Personal Income**

Date: 2/29/2024
 Month: January
 Previous Report: 4.7%
 Argus Estimate: 4.8%
 Street Estimate: NA



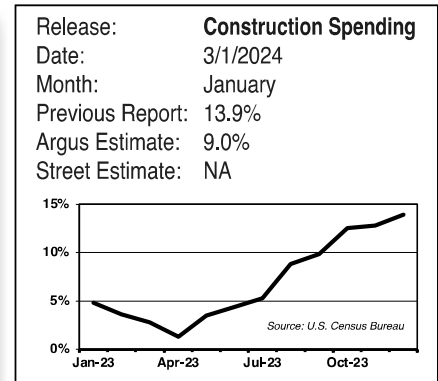
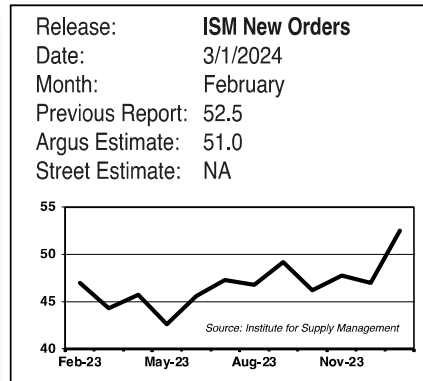
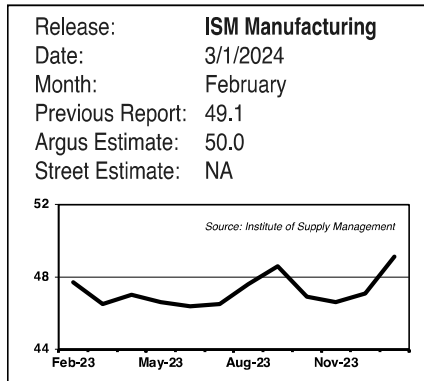
Release: **Personal Spending**

Date: 2/29/2024
 Month: January
 Previous Report: 5.9%
 Argus Estimate: 2.7%
 Street Estimate: NA



Previous Week's Releases and Next Week's Releases on next page.

ECONOMIC TRADING CALENDAR (CONT.)



Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
20-Feb	Leading Index	January	-0.1%	0.3%	NA	NA
22-Feb	Existing Home Sales	January	3.78 Mln.	4.05 Mln.	4.00 Mln.	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
5-Mar	ISM Services Index	February	53.4	NA	NA	NA
	Factory Orders	January	2.3%	NA	NA	NA
6-Mar	Wholesale Inventories	January	-2.7%	NA	NA	NA
7-Mar	Trade Balance	January	-\$62.2 Bil.	NA	NA	NA
8-Mar	Nonfarm Payrolls	February	353 K	NA	NA	NA
	Unemployment Rate	February	3.7%	NA	NA	NA
	Average Weekly Hours	February	34.1	NA	NA	NA
	Average Hourly Earnings	February	4.5%	NA	NA	NA
	Total Vehicle Sales	February	15.00 Mil.	NA	NA	NA

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