Bull & Bear Bulletin

December 2023

Higher for Longer Transitions into a More Likely to Cut Scenario

Formulating a risk asset strategy going into the new year may need to take less counsel of noisy near term changing circumstances and instead focus on the larger moves in market and economic data which have already occurred. Market prices have recently moved significantly since late October and global economic data around growth and inflation have recently been observed to be slowing across key economic zones throughout the world. This is happening in the wake of 2023 where growth and inflation largely came in "hotter" than expectations, causing the majority of key policymakers to tighten fairly aggressively with the one exception being Japan.

The S&P 500 has returned 14.06% since October 26, after the index hit an intermediate trough this Fall. Price returns in bonds have been similarly large as the yield on the benchmark 10YR U.S. Treasury rate has fallen from 4.99% on October 19 to 4.02% post the December Federal Open Market Committee (FOMC) meeting and rate decision. For both equities and bonds, positive returns of this magnitude are more typical of an entire year as opposed to just six weeks, which is another way of saying an inflection of some significance has possibly occurred.

This is all happening against a backdrop of growth and inflation rates prevalent in the economy, moderating in what for now is a steady and manageable manner. Monetary policies are also now generally considered restrictive and looking to achieve these very results. The general questions outstanding as we head into the new year are as follows: Will the economy continue to grow albeit in a below trend (below 1.8% real GDP) manner and achieve a softer landing next year or will a recession materialize? Secondly, will corporate earnings growth, which has already waded through a negative stretch in late 2022 and into the first half of 2023, remain positive and therefore constructive for the market cycle?

The answer to those questions will likely be determined in time by aggregate wage and employment trends as well as the level of credit which is supplied into the economy for companies and consumers alike. This brings us to the event of the December FOMC press conference where Chair Powell and the FOMC delivered a more dovish message to markets than was expected. Without completely ruling out a rate hike in the future, the message was clearer than before that the bias now is in the direction of rate cuts as we head into 2024. With other key economic zones in Europe and Asia now contracting or struggling to grow at faster rates right now and evidence becoming clearer that the rate of inflation at home is normalizing relatively quickly (see graph), interest rates across the curve remaining at elevated and restrictive levels due to an immovable Fed rate policy could lead to more difficult answers to those questions down the line. Not wanting to make an error in the direction of being overly tight perhaps resulted in noticeably sharper policy intention and pivot.

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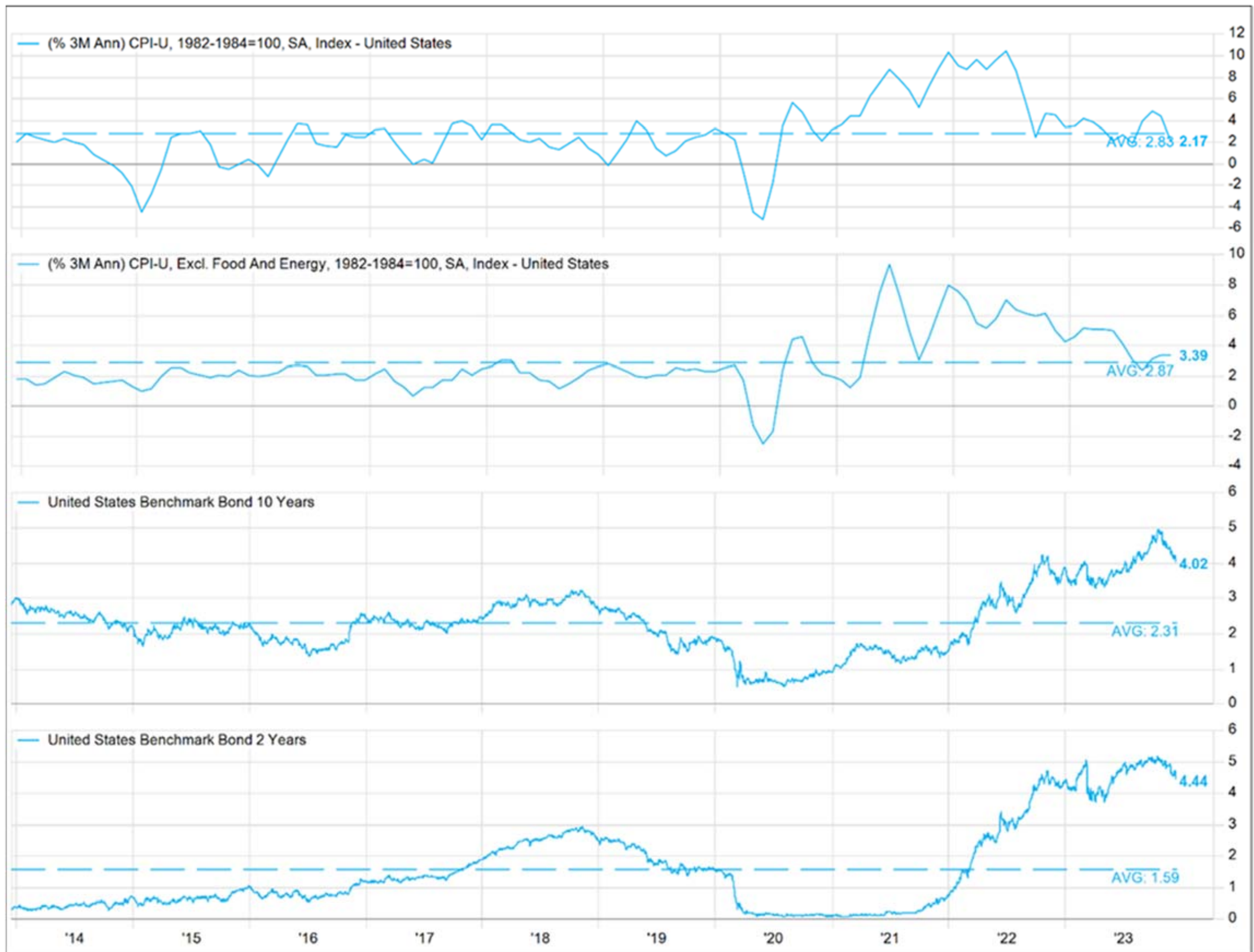

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