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MONTHLY MARKET PERSPECTIVE

The Fed Pivot: All Clear for Markets?

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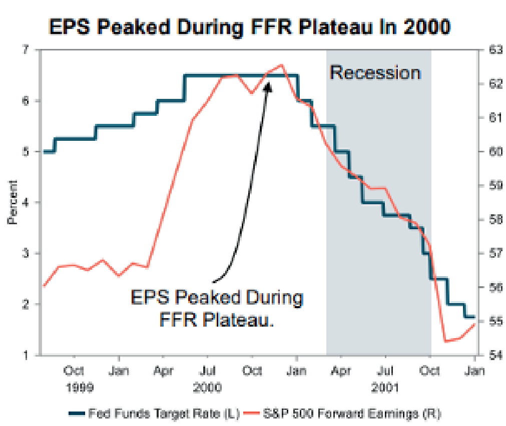
DASHBOARD

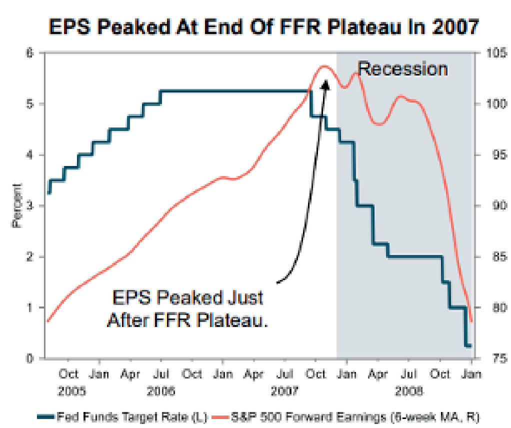
- Business Cycle
- Valuation
- Trend

During the Federal Reserve's December meeting, the central bank forecasted a pivot in its interest-rate strategy. For the first time this cycle, the Fed penciled in rate cuts (three of them) in 2024, making the rate increase in July 2023 likely its last. The Fed has yet to indicate when those cuts will be, and its forecast is at odds with the market's current prediction of six cuts in 2024. Eventually, that difference will be resolved. In the meantime, markets have been content to celebrate the pivot. The S&P 500 surged 12% in the fourth quarter of 2023.

With rate cuts on the horizon and investors feeling more optimistic, does that signal the all-clear for financial markets and the economy? In our opinion, it does not. Practically all the S&P 500's gain in 2023 came from price-multiple expansion (the speculative component of market returns indicating how much investors are willing to pay for a given level of corporate profits, for example). From here, we believe much of the work to advance stocks much further will need to be from earnings growth. As the exhibit demonstrates, earnings can still decline *even with the Fed cutting rates* if the economy is in recession.

Exhibit: Fed Rate Cuts Don't Guarantee Earnings Growth





Source: Federal Reserve Board, Standard & Poor's, Trahan Macro Research, Macrobond, Clayton Wealth Partners.

So, will the U.S. economy enter recession in 2024? That remains the $64,000 question. We remain open to the possibility of a soft landing. But we think the chance of a near-term recession remains elevated because a host of classic precursors and conditions for recession stay in place.

Bullish

- The Fed has made good progress in reducing inflation.
- The services sector of the U.S. has remained strong.
- The most attractive yields for fixed income and cash in years.
- Consumer and corporate balance generally remain healthy.

Bearish

- Slowing global economic growth with recession pressures mounting.
- Banks are tightening lending standards.
- Housing affordability remains at a decades-low.
- Leading indicators of unemployment are generally trending down.
- Delinquency rates on consumer loans are rising.
- Russia-Ukraine war, Israel-Hamas conflict, and other geopolitical concerns.
- China's post-Covid economic rebound has lost momentum, with deflation fears growing.
- Federal debt and deficits have ballooned.

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As Partner and Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner and management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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