

WEEKLY CLIENT COMMENTARY | JANUARY 18, 2024

Mitch on the Markets

Portfolio Manager Investing Insights

A Big Global Headwind for Stocks Has Ended

Soaring inflation in 2022, followed by the Federal Reserve’s monetary tightening campaign, is often framed in U.S.-centric terms. Many may see rising prices, rising interest rates, and higher borrowing costs as a uniquely American experience over the past couple of years.

But that’s not the case.

The reality is that rising inflation and central bank tightening were a global phenomenon, which ultimately led to major global central banks raising borrowing costs by 4,105 basis points over the past year and a half or so. Using data from the Council on Foreign Relations (CFR) Global Monetary Policy Tracker, I find that the world hasn’t seen the level of ‘synchronous monetary tightening’ since early 2006.¹

Perhaps the most unique feature of this global monetary tightening event, however, was the pace and magnitude of rate hikes almost across the board. The CFR’s Global Monetary Policy Tracker compiles data from 54 countries around the world, ranking monetary policy as maximally tight (10), neutral (0), or maximally accommodative (-10). From July 2022 to September 2023, the tracker hovered above 8.

Country	Change in Benchmark Policy Rate
United States	+5.5%
New Zealand	+5.5%
UK	+5.25%
Canada	+5%
Euro Zone	+4%
Norway	+4.5%
Australia	+4.35%
Sweden	+4%
Switzerland	+1.75%
Japan	-0.1%

Source: CFR²

ABOUT MITCH ZACKS



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Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

The downside volatility experienced across global equity markets in 2022 was rooted in these rapidly tightening financial conditions. In my view, the recovery that followed in 2023 was equity markets responding to economic resilience, but there were also expectations that the global tightening cycle was nearing its end. That turned out to be right—by December 2023, the CFR monetary policy tracker had fallen to -0.36, and the number of banks cutting rates exceeded the number of banks raising rates for the first time since the pandemic. In other words, by the end of last year, interest rates around the world started falling again.

Long-duration U.S. Treasury bond yields fell late last year, but to date, we have not seen any rate cuts from the Fed. 2024 should deliver a few. The Federal Reserve's preferred inflation gauge, the headline PCE price index, decreased 0.1% in November and was up 2.6% year-over-year. Importantly, the 6-month annualized change of the PCE price index (1.9%) is right on target for the Fed, which I think gives them no choice but to cut. The benchmark Fed funds rate remains in a range of 5.25% to 5.5%, which is about double the long-term "neutral rate" of 2.5% to 3%.

Even if the economy continues to grow, the Fed can cut—as long as inflation does not deliver a negative surprise. In projections released following their December meeting, the Fed indicated rates would end 2024 in a range of 4.5% to 4.75%, which implies three 25 basis point rate cuts in the new year. The market generally expects more than three rate cuts, but forecasts tend to be a moving target.

Globally, the European Central Bank (ECB) and the Bank of England (BoE) both left rates on hold at their latest meeting, and the ECB is widely expected to be one of the first key central banks to cut rates in the new year. Markets are pricing in 140 basis points of cuts. The BoE is still telegraphing "higher-for-longer" to markets, but if the Fed and ECB cut rates, the BoE is almost certain to follow. Same for the Bank of Australia.

Taken together, it's premature in my view to say that 2024 will be a year where all major central banks systematically slashed interest rates together, easing monetary across the globe. But I do think it's fair to say that the global tightening cycle is over, which I think moves the world from 'tightening' to 'neutral,' with the next stop being 'accommodative.'

Bottom Line for Investors

In just the past year, the number of central banks raising rates has declined precipitously, essentially marking the end of the most widespread tightening cycles in decades. This policy reversal does not ensure support for global asset prices going forward, and I'd stop short of calling it a tailwind for stocks in the new year. But it does mark the dissipation of a major headwind, which I think opens the door for strong earnings and growth to propel stocks in 2024.

¹ Reuters. December 14, 2023. <https://www.reuters.com/markets/rates-bonds/major-central-banks-hold-rates-steady-markets-eye-rapid-cuts-2023-12-14/>

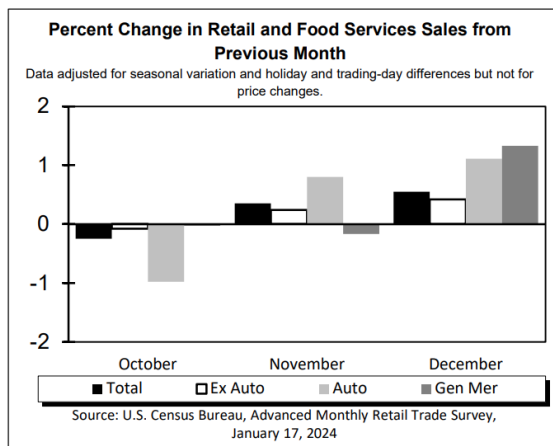
² Council for Foreign Relations. December 2023. <https://www.cfr.org/global/global-monetary-policy-tracker/p37726>

STEADY INVESTOR WEEK

- **Consumers starting 2024 off strong**
- **The \$8.8 trillion available to equity markets**
- **China's economic growth**

Another Strong Showing from U.S. Consumers

Some economists and analysts were worried that paltry consumer spending data in October was a sign that U.S. consumers were running out of steam heading into the holiday shopping season. They weren't. The Commerce Department reported that U.S. retail sales rose by a seasonally-adjusted 0.6% month-over-month in December, which followed an also strong 0.3% uptick in November. It appears that consumers put a pause on spending in October in anticipation of coming out with greater force in the holiday months (see chart below).¹



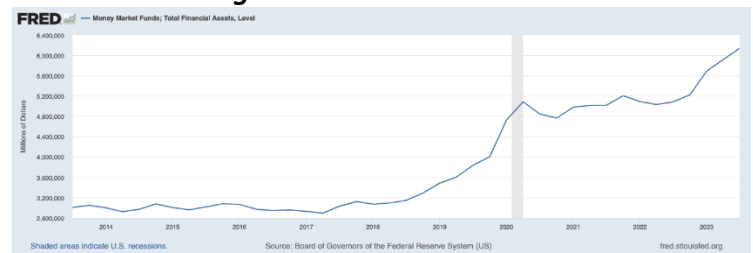
Census²

On a year-over-year basis, retail sales rose 5.6% in December, which was virtually in line with last year's 5.8% December consumer spending data and was about 200 basis points higher than inflation. When consumer spending rises faster than inflation, it's a clear signal that 'real' spending in the economy is rising, a strong growth indicator and a likely sign that the U.S. economy expanded again in the fourth quarter.

The \$8.8 Trillion Available to Rotate into Equity Markets

Rising interest rates in 2023 resulted in short-term downside volatility in equity markets, and also raised borrowing costs for families, businesses, and investment property owners. The other side of higher rates—for savers—was a much better story. Banks offered higher deposit rates in lockstep, and yields on ultralow risk instruments like certificates and money markets shot from basically 0% up to the 5% range. This surge in risk-free yields attractive trillions of new dollars into money-market funds and other cash-like instruments, such that by the end of Q3 2023 there was nearly \$9 trillion parked in cash (see chart below).³

Money Market Funds Attracted Trillions of New Dollars in a Rising Rate Environment



Source: Federal Reserve Bank of St. Louis⁴

So, what happens in an environment when interest rates are expected to come down, considering the Federal Reserve's projections for 75 basis points of rate cuts in 2024? And also considering an economy that's expected to downshift, which could ease pressure on the long end of the yield curve? Investors are hoping that falling rates might encourage some of the ~\$9 trillion in money market funds 'off the sidelines,' rotating into equity markets which have historically outperformed bonds and cash, *especially in the year following rate cuts.*

China's Economic Growth—and Outlook—Continue to Falter

The Chinese economy had a rough 2023. According to the National Bureau of Statistics, China's GDP expanded by 5.2% in the fourth quarter and also by 5.2% for the year, which marks the slowest growth for the world's second-largest economy since 1990 (when excluding the pandemic shutdown). China's ailing property sector has been a key source of the economic drag, but consumer spending has also anchored growth over the past year. The youth unemployment rate remains astonishingly high, over 20% at last print, and has been such a sticking point for the government that they stopped publishing the data altogether. Consumers are increasingly lacking confidence about their economic prospects—and are also feeling negative about sagging property prices—that they've been saving more than spending. It follows that China is experiencing deflationary pressures while the rest of the world grapples with inflation, with consumer prices falling for the third straight month in December. These factors described above are all short-term problems for the Chinese economy, but there's also a glaring issue China is confronting long-term: demographics. Births fell by more than 500,000 last year to just over 9 million, continuing a trend where the number of newborns is in freefall. For the first time since the early 1960s, China's population shrank in 2022, a problem for a

country that's seeking to expand its economic prowess in the future. An aging population, a declining workforce, and strict immigration policies all factor as severe headwinds to economic growth.⁵

¹ Wall Street Journal. January 17, 2024. https://www.wsj.com/economy/consumers/us-retail-sales-report-2024-030eaa0a?mod=djemRTE_h

² Census. January 17, 2024. https://www.census.gov/retail/marts/www/marts_current.pdf

³ Wall Street Journal. January 18, 2024. https://www.wsj.com/finance/investing/the-8-8-trillion-cash-pile-that-has-stock-market-bulls-salivating-0a1b4a8c?mod=djemMoneyBeat_us

⁴ Fred Economic Data. December 7, 2024. <https://fred.stlouisfed.org/series/MMMFFAQ027S#>

⁵ Wall Street Journal. January 17, 2024. https://www.wsj.com/world/china/chinas-growth-slows-to-three-decade-low-excluding-pandemic-93d61487?mod=djemRTE_h

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